



Officer Exculpation Under Delaware Law—Encouraging Results in Year One

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Effective August 1, 2022, Section 102(b)(7) of the Delaware General Corporation Law (the “DGCL”) was amended to permit Delaware corporations to exculpate certain senior officers, to provide them with protection from liability for monetary damages that is similar to the protection that has been available for directors under the DGCL for nearly 40 years. To provide for officer exculpation, however, a Delaware corporation must amend its certificate of incorporation, which requires stockholder approval. Heading into the 2023 proxy season, it was unclear how many Delaware corporations would seek to take advantage of this new officer exculpation provision and, if so, whether their stockholders and the proxy advisory firms would support proposed amendments to certificates of incorporation to effect this change. With many annual meetings completed, initial results have been very encouraging. To date, over 260 publicly traded Delaware corporations have proposed amendments to their certificates of incorporation to provide for officer exculpation, and have submitted such proposed amendments to their stockholders for approval at their 2023 annual meeting. With nearly half of those annual meetings completed, the vast majority of such proposals have received stockholder approval, often by an overwhelming majority of the votes cast.

Background

Section 102(b)(7) of the DGCL was amended less than a year ago to authorize exculpation of certain senior officers of Delaware corporations from personal liability for monetary damages in connection with breaches of their fiduciary duty of care (the “Officer Exculpation Amendment”). This was viewed by many as a welcome and necessary change, putting such senior corporate officers on similar footing with directors, who have long been afforded protection from personal liability,¹ although the officer exculpation provisions are more limited than the protection available to directors.² In recent years, the frequency with which officers of public

¹ Since its original adoption in 1986, Section 102(b)(7) of the DGCL has authorized exculpation of directors of Delaware corporations from personal liability for monetary damages in connection with breaches of their fiduciary duty of care.

² For more information on the Officer Exculpation Amendment, see <https://corpgov.law.harvard.edu/2022/12/20/exculpation-of-personal-liability-expanded-to-include-certain-corporate-officers/>.

corporations have been targets of stockholder lawsuits has increased significantly, emphasizing the need to provide them with protection from personal liability.

In order to take advantage of the protection from personal liability afforded to senior officers by the Officer Exculpation Amendment, Delaware corporations must “opt-in” by including an officer exculpation clause in their certificate of incorporation, which, for existing corporations, means that they must adopt an amendment to their certificate of incorporation. Subject to limited exceptions, Section 242(b) of the DGCL requires stockholder approval of amendments to an existing corporation’s certificate of incorporation, upon the affirmative vote of a majority of outstanding stock entitled to vote on the proposed amendment (unless a greater number of votes, or approval by holders of any separate class or series of stock, is required to adopt such amendment to the corporation’s certificate of incorporation pursuant to the terms thereof or the DGCL).

Results from the 2023 Proxy Season

Since adoption of the Officer Exculpation Amendment, many Delaware corporations have sought to take advantage of these changes by proposing that stockholders adopt amendments to their certificates of incorporation to provide for exculpation to their corporate officers. Despite early signals from proxy advisors that corporations might need to provide a compelling reason for adoption of such amendments in order to garner institutional investor support, the proposals submitted to a stockholder vote to date have largely passed and the market has generally been receptive. In the limited number of situations where stockholders failed to adopt a proposed officer exculpation amendment, it appears that the failures may have been due to complexities in the voting process rather than stockholder opposition.

Of the more than 260 proposals for officer exculpation amendments submitted for stockholder approval by publicly traded Delaware corporations at their 2023 annual meetings, approximately 130 have gone to a vote to date. Of the published voting results, approximately 85% have passed, with an average approval rating of 71%. Bearing in mind that the DGCL generally requires a “majority of outstanding shares” to vote in favor of amending a certificate of incorporation (absent a higher voting standard, or a separate class or series voting requirement, in a corporation’s certificate of incorporation), average results are higher when looking solely at the votes cast—with an average of 89% of the shares present and voting on these proposals casting an affirmative vote.

Thus far, only 16 of the more than 260 proposals to adopt officer exculpation amendments have not passed. In all but 7 of these situations, the certificate of incorporation required supermajority approval to adopt such an amendment, which was not achieved. Of the 7 situations not requiring supermajority approval, the proposal generally appeared to fail due to insufficient stockholder participation at the meeting (including as a result of broker non-votes), making it difficult to achieve approval by a majority of outstanding shares entitled to vote, since, on average, only 56% shares were voted at those meetings.

Proxy advisory firms have been mixed in their support of proposals to adopt officer exculpation amendments. In cases where proxy advisory firms did not support the amendments, however, their voting recommendations appeared to have little effect on the ultimate results. Early in the 2023 proxy season, both Institutional Shareholder Services (“ISS”) and Glass Lewis indicated they would evaluate officer exculpation proposals on a “case-by-case” basis, but viewed them as

generally acceptable, with both firms recommending stockholders vote “for” such proposals. However, shortly after the first few officer exculpation amendments were proposed, Glass Lewis changed its stance to generally recommend “against” officer exculpation amendments, explaining that it would “generally recommend a vote against...unless compelling rationale for the adoption is provided by the board, and the provisions are reasonable.” It remains to be seen what Glass Lewis views as a “compelling rationale” and “reasonable” provisions, despite the number of officer exculpation proposals that have been submitted for stockholder approval and passed thus far. Nevertheless, Glass Lewis’ policy does not appear to have had a meaningful impact on votes overall, with the market and stockholders being overwhelmingly receptive to officer exculpation amendment proposals.

Conversely, ISS has not changed its original view and has generally recommended stockholders vote “for” a proposal to adopt officer exculpation (absent other factors, such as the impact of the proposal on stockholder rights when it was “bundled” with other proposals that affected such rights—warranting stricter scrutiny from ISS).

Institutional investors generally have not yet weighed in with their views of officer exculpation in their 2023 proxy voting and policy guidelines, but the high level of support reflecting in the voting results of annual meetings that have been held thus far suggests there is general institutional support for officer exculpation proposals.

Litigation

While stockholders have generally supported officer exculpation amendments, these issues are not entirely without controversy. At least three lawsuits have been initiated by stockholders against corporations seeking to adopt officer exculpation amendments. In each case, the issues related primarily to multi-class share structures involving controlling stockholders where the public stockholders alleged they were deprived of their rights.

In the first two cases, the corporations each had at least one class of voting stock and one class of non-voting stock outstanding, and amended their certificates of incorporation with approval of the voting class of shares only. The non-voting stockholders filed separate lawsuits alleging that the amendments were void because they violated the separate class voting requirement of Section 242(b)(2) of the DGCL, which provides that if a corporation has more than one class of stock outstanding and a proposed amendment to the certificate of incorporation would “alter or change the powers, preferences, or special rights” of a class of stock so as to affect them adversely, then such amendment also must be adopted by a majority of outstanding stock of that class.

In a consolidated bench ruling, the Court of Chancery rejected such arguments and dismissed both actions. The Court of Chancery held that a separate class vote of the non-voting stock was not required because the proposed officer exculpation amendments did not affect any “power, preference, or special right” of such class expressly set forth in the certificate of

incorporation. Thus, only the approval by a majority of the outstanding voting stock was required to adopt the officer exculpation amendments.³

The stockholders in the above-mentioned two actions filed a notice of appeal with the Delaware Supreme Court following the Court of Chancery's ruling. As of the date of this article, a decision from the Delaware Supreme Court on the appeal has not been issued.

Next Steps

Following the adoption of the Officer Exculpation Amendment, many Delaware corporations were keen to take advantage of the new rules, but adopted a "wait and see" approach in the first year following the amendment to the DGCL. Investors have demonstrated a general receptiveness towards officer exculpation amendments in the 2023 proxy season. This, coupled with favorable decisions by the Delaware Court of Chancery in the challenges described above, should encourage even more corporations to seek stockholder approval to adopt officer exculpation going forward.

As with any matters of this nature, a corporation seeking to amend its certificate of incorporation to include officer exculpation should consult legal advisors to discuss the detailed provisions and limitations of the Officer Exculpation Amendment, as well as the procedural requirements and the applicable board and stockholder approvals required to adopt an officer exculpation clause, in light of the specific provisions of its certificate of incorporation. Corporations should consider their stockholder base, and any views previously expressed by any significant stockholders, and may also want to consider hiring a proxy solicitor to facilitate solicitation of votes, particularly for corporations with a large retail stockholder base.

³ Similarly, in a third case, the corporation had a dual class voting structure with one class having super voting rights of 10 to 1, and the amendments were adopted without a vote from the ordinary voting class. As of the date of this article, a motion to dismiss the third action is pending before the Delaware Court of Chancery.