POTTER ANDERSON & CORROON

DELAWARE TRUST BUILDING

P. O. BOX 951

WILMINGTON, DELAWARE 19899

(302) 658-6771

TELECOPIER (302) 658-1192

CABLE: WARDGRAY

BLAINE T. PHILLIPS
JOSEPH H. GEOGHEGAN
RICHARD L. McMAHON
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DONALD J. WOLFE, JR.
GREGORY A. INSKIP
DAVID B. STRATTON
DAVID J. BALDWIN

ROBERT P. BARNETT
COUNSEL

DAVID F. ANDERSON
WILLIAM POOLE
JOHN P. SINCLAIR
HUGH CORROON
OF COUNSEL

FREDERICK H. ALTERGOTT
JOHN E. JAMES
W. HARDING DRANE, JR.
MARY E. URANN
W. LAIRD STABLER, III
RICHARD L. HORWITZ
WILLIAM J. MARSDEN, JR.
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KENT A. JORDAN
KATHLEEN T. FUREY
LAURIE A. SELBER

April 28, 1986

Those minutes are ok

BY HAND

A. Gilchrist Sparks, III, Esquire
Morris, Nichols, Arsht & Tunnell
12th & Market Streets
P. O. Box 1347
Wilmington, DE 19899

Re: Council of Corporation Law Section

Dear Gil:

Enclosed are my draft Minutes of the April 23, 1986 Council meeting for your review and comment.

Please let me know when you wish me to notice the next Council meeting. At that time I can circulate the Minutes, subject to any changes you wish to make, for approval at the meeting.

With best regards.

Sincerely yours,

David B. Brown

DBB/jf

Enclosure

DBB:4/28/86

MINUTES OF MEETING OF COUNCIL OF CORPORATION LAW SECTION OF DELAWARE STATE BAR ASSOCIATION

APRIL 23, 1986

A meeting of the Council of the Corporation Law Section was held on April 23, 1986 at 9:00 A.M. in the offices of Morris, Nichols, Arsht & Tunnell. Council members present were: A. Gilchrist Sparks, III (Chairman), Edward M. McNally (Vice Chairman), Lewis S. Black, David B. Brown, Donald A. Bussard, Michael D. Goldman, Stephen P. Lamb, Joseph A. Rosenthal, and John H. Small. Also in attendance was Edward P. Welch.

Mr. Sparks stated that he and Mr. Balotti had met with Bar President Crompton. Although Mr. Crompton was not necessarily persuaded to support the Council's legislative proposal on D&O liability and indemnification, Mr. Sparks reported, he has an open mind on the matter and has agreed to work with us. Mr. Bussard also reported that Representative Hebner had assured him and Mr. Veasey that he (Mr. Hebner) would help facilitate passage of D&O legislation this term.

The first item of business considered was the proposed amendments to §145 that had been circulated prior to the meeting by Mr. Small with his memorandum dated April 22, 1986. Mr. Goldman asked if the effect of the §145(e)

amendment was to relieve the board from its duty to make a determination under §145(d) as to any indemnification under §145(a) or §145(b). Mr. Sparks responded that there was no such intent. It was agreed that the matter should be clarified in the commentary to §145(e) rather than in the text of the amendment.

Mr. Sparks noted that we would need, in addition to a synopsis of each amendment, several pages of preamble describing, in layman's language, the need for D&O legislation. The preamble should include mention, he added, that the D&O crisis, by encouraging the defection of directors, threatens to stifle entrepreneurial activity.

Next the Council considered the revised draft of the proposed amendment to §102(b) which draft had been circulated prior to the meeting with Mr. Welch's memorandum dated April 22, 1986. Much of the discussion focused on whether the amendment should apply to officers as well as directors and whether a corporation should be able to eliminate or limit liability for "reckless" conduct. As to the first issue, arguments were presented on both sides of the issue. Mr. Black expressed concern that we might be perceived as doing too little if officers are not given the same protection as directors and noted that the corporate officials who decide where to incorporate are almost invariably officers. He added that directors and officers are generally treated similarly for purposes of liability,

as indeed they are in §145, and that we should not be quick to draw a distinction between them in our proposed amendment to §102. Mr. Rosenthal expressed disagreement, stating that no justification exists for exculpating bank officers from their grossly negligent acts that may cost the bank millions of dollars. Because jurisdiction cannot be obtained over officers as opposed to directors under §3114, it was suggested that officers have no pressing need for protection from liability for gross negligence in the Delaware courts. It was pointed out, however, that §3114 might be changed at some point in the future to extend to officers, at which point Mr. Sparks noted that Mr. Gross should be urged to report in the Fall on his subcommittee's study of §3114. There was also discussion without any definitive conclusion as to whether an officer/director subjected to jurisdiction by virtue of §3114 could be found liable for acts he committed qua officer.

Mr. Sparks spoke against extending §102(b)(7) to protect officers, stating that our object from the outset was to encourage outside directors to continue serving. He expressed concern that extending the protection to officers might be widely criticized. Mr. Sparks also pointed out that preserving liability for acts of gross negligence by officers would promote the salutary policy of encouraging officers to bring matters to the board.

It was then agreed that new §102(b)(7) should extend only to directors and not to officers.

As to whether "reckless" conduct should be expressly included in the proviso to §102(b)(7), there was extensive debate on whether any meaningful distinction existed between "recklessness" and "gross negligence." Mr. Sparks remarked that after studying the research one of his associates had done on the issue, he had concluded that no real difference existed between the two terms. He cited the Third Circuit's discussion in the Healey case [616 F.2d at 649] as support for this conclusion. Mr. Rosenthal contended that tort law did recognize a distinction between the two terms. He suggested use of an ALI formulation that precludes a limitation on liability for "conscious disregard or indifference to the director's duties to the corporation [that was reckless under the circumstances]." There was wide opposition expressed to the bracketed portion of the formulation but considerable discussion ensued on the wisdom of using the remainder of the formulation. It was finally agreed that the remainder of the ALI formulation should not be used but that acts not in good faith should constitute one of the exceptions in the proviso to §102(b)(7). There was discussion as to whether the term "bad faith" was equivalent to and should be used in lieu of the term "not in good faith." It was decided that the latter term should be used since it is used in §145. Mr. Sparks stated that

the courts would have to decide whether the formulation adopted included or excluded any conduct short of intentional acts.

There followed an extended discussion of proposed §102(b)(7)(i) with debate over whether a director who served on both boards in a cash-out merger should be permitted to avoid liability by abstaining or whether he should be required at least in some circumstances to affirmatively oppose the merger. It was finally agreed to state §102(b)(7)(i) in terms of excluding duty of loyalty cases rather than undertaking to describe all circumstances where duty of loyalty is implicated.

It was also pointed out that director duties under §174 (unlawful dividends and redemptions) should be one of the exceptions in the proviso to §102(b)(7). It was agreed that instances where a director derived an improper personal benefit should be expressly excepted out as well. It was noted that a director's receipt of pro rata benefits as a shareholder would not be improper under this formulation.

Finally, it was agreed that new §102(b)(7) should become effective immediately upon enactment but that the amendment should provide that a charter provision embracing §102(b)(7) may not limit or eliminate liability as to acts or omissions occurring before the charter provision became effective.

The text of proposed §102(b)(7) as approved at the meeting is attached and made a part of these minutes.

John Small agreed that he and his subcommittee would draft the §102(b) and §145 as approved together with synopses and the preamble suggested by Mr. Sparks at the outset of the meeting.

During the meeting the issue was raised again as to whether there was a need to act immediately to propose D&O legislation. It was pointed out that a growing number of states have adopted or are considering remedial legislation for directors and officers, and Mr. Sparks mentioned that the general counsels of Squibb and DuPont had both contacted him in the past week on the subject. He noted that if we do not act now to introduce legislation in the current session, we will not be able to introduce a bill until January, 1987 which in his view will be too late. It was also pointed out that if the Council does not act there is high risk that other groups will submit legislation reflecting a more extreme response than we think advisable and that it will be politically difficult for us to oppose such legislation. Many industry groups, Mr. Sparks stated, might well favor a complete abolition of derivative suits, but it is up to our organization to provide responsible leadership in formulating a rational legislative response to the D&O crisis.

Following approval of the minutes of the meeting of April 17, 1986, the meeting was adjourned at 12:30 P.M.

David B. Brown
Secretary

[§102(b)(7)]

(7) A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of such director (i) for any breach of the director's duty of loyalty to the corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under section 174 of this title, or (iv) for any transaction from which the director derived an improper personal benefit. No such provision shall eliminate or limit the liability of a director for any act or omission occurring prior to the date upon which such provision becomes effective. All references in this subsection to a director shall also be deemed to refer to a member of the governing body of a corporation which is not authorized to issue capital stock.