

ANDREW B. KIRKPATRICK, JR.
RICHARD L. SUTTON
DAVID A. DREXLER
JOHANNES R. KRAHMER
O. FRANCIS BIONDI
LEWIS S. BLACK, JR.
WALTER L. PEPPERMAN, II
PAUL P. WELSH
WILLIAM O. LAMOTTE, III
DOUGLAS E. WHITNEY
WILLIAM H. SUDELL, JR.
MARTIN P. TULLY
THOMAS REED HUNT, JR.
A. GILCHRIST SPARKS, III
RICHARD D. ALLEN
DAVID LEY HAMILTON
LAWRENCE A. HAMERMESH
JOHN F. JOHNSTON
WALTER C. TUTHILL
DONALD F. PARSONS, JR.
JACK B. BLUMENFELD
DONALD NELSON ISKEN
DAVID A. JENKINS
DONALD E. REID
MARGUERITE A. CONAN
DENISON H. HATCH, JR.
JEFFREY S. WELCH
THOMAS C. GRIMM
KENNETH J. NACHBAR
BEVERLY J. WIK
KATHERINE S. GARGES
ANDREW M. JOHNSTON
MARY B. GRAHAM
MICHAEL HOUGHTON
EDMOND D. JOHNSON
KEVIN J. GARM
ANDREW G. KERBER
MATTHEW B. LEHR
PALMER L. WHISENANT

MORRIS, NICHOLS, ARSHT & TUNNELL

TWELFTH AND MARKET STREETS

P. O. Box 1347

WILMINGTON, DELAWARE 19899

TELEPHONE (302) 658-9200

TELECOPY (302) 658-3989

May 16, 1986

HUGH M. MORRIS
1878-1966
ALEXANDER L. NICHOLS
1906-1985
JAMES M. TUNNELL, JR.
1910-1986


S. SAMUEL ARSHT
W. GLASGOW REYNOLDS
OF COUNSEL

DOVER OFFICE
GEORGE F. GARDNER III
RESIDENT PARTNER
SUITE 109—BARRATT BUILDING
821 SILVER LAKE BOULEVARD
P. O. BOX 1003
DOVER, DELAWARE 19903
(302) 674-5900

GEORGETOWN OFFICE
RANDY J. HOLLAND
RESIDENT PARTNER
MICHAEL J. RICH
8 WEST MARKET STREET
P. O. BOX 231
GEORGETOWN, DELAWARE 19947
(302) 856-6366

MEMORANDUM

TO: R. Franklin Balotti Edward B. Maxwell, 2nd
Lewis S. Black, Jr. Edward M. McNally
Donald A. Bussard Joseph A. Rosenthal
Michael D. Goldman John H. Small
Stephen P. Lamb David B. Brown

FROM: A. Gilchrist Sparks, III 

RE: 1986 Legislation

Enclosed for your files is a copy of the materials which I have arranged to forward to Ned Davis for distribution to various members of the legislature. It includes the original memorandum approved by the Council designed to explain the legislation, as well as the bill itself. Please note the changes at pages 2 and 4 of the bill from the last copy you were given to reflect the fact that we are deleting from subsection (e) of Section 145 the words "as authorized by the board of directors" as well as the words "in the specific case." The making of this change was approved by all eight of the Council members who I was able to reach yesterday and today.

/lrg
Encs.

SPONSOR: _____

HOUSE OF REPRESENTATIVES

_____ GENERAL ASSEMBLY

HOUSE BILL NO. _____

AN ACT TO AMEND TITLE 8 OF THE DELAWARE CODE RELATING TO THE DELAWARE GENERAL CORPORATION LAW.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF DELAWARE (TWO-THIRDS OF ALL MEMBERS ELECTED TO EACH HOUSE THEREOF CONCURRING HEREIN):

Section 1. Amend subsection (b)(6) of Section 102, Title 8, Delaware Code, by deleting the period at the end of the subsection and substituting therefor a semicolon.

Section 2. Amend subsection (b) of Section 102, Title 8, Delaware Code, by adding a new subsection (7) to read as follows:

(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 a 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 when 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.

Section 3. Amend subsection (b) of Section 145, Title 8, Delaware Code, by deleting the phrase "for negligence or misconduct in the performance of his duty."

Section 4. Amend the first sentence of subsection (e) of Section 145, Title 8, Delaware Code, by (a) deleting the phrase "as authorized by the board of directors in the specific case," (b) deleting the word "unless" after the word "amount" and substituting therefor the word "if" and (c) by adding the word "not" after the phrase "determined that he is."

Section 5. Amend subsection (f) of Section 145, Title 8, Delaware Code, by (a) adding to the first sentence thereof the words "and advancement of expenses" after the phrase "the indemnification", (b) adding to that sentence the phrase ", or granted pursuant to, the other subsections of" after the words "provided by", (c) adding to that sentence the phrase "or advancement of expenses" after the phrase "seeking indemnification", (d) deleting the comma after the word "office" and substituting therefor a period, and (e) deleting from that sentence the phrase "and shall continue as to a person who has ceased to be a director, officer, employee or agent, and shall inure to the benefit of the heirs, executors and administrators of such a person."

Section 6. Amend Section 145, Title 8, Delaware Code, by adding a new subsection (j) to read as follows:

The indemnification and advancement of expenses provided by, or granted pursuant to, this section shall, unless otherwise provided when authorized or ratified, continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to

the benefit of the heirs, executors and administrators of such a person.

Section 7. This Act shall become effective on _____.

SYNOPSIS

Section 102(b)(7) and the amendments to Section 145 represent a legislative response to recent changes in the market for directors' liability insurance. Such insurance has become a relatively standard condition of employment for directors. Recent changes in that market, including the unavailability of the traditional policies (and, in many cases, the unavailability of any type of policy from the traditional insurance carriers) have threatened the quality and stability of the governance of Delaware corporations because directors have become unwilling, in many instances, to serve without the protection which such insurance provides and, in other instances, may be deterred by the unavailability of insurance from making entrepreneurial decisions. The amendments are intended to allow Delaware corporations to provide substitute protection, in various forms, to their directors and to limit director liability under certain circumstances.

Commentary on Section 102(b)(7)

This provision enables a corporation in its original certificate of incorporation or an amendment thereto validly approved by stockholders to eliminate or limit personal liability of members of its board of directors or governing body for violations of a director's fiduciary duty of care. However, the amendment makes clear that no such provision shall eliminate or limit the liability of a director for breaching his duty of loyalty, failing to act in good faith, engaging in intentional misconduct or knowingly violating a law, paying a dividend or approving a stock repurchase which was illegal under 8 Del. C. §174, or obtaining an improper personal benefit. This provision would have no effect on the availability of equitable remedies, such as an injunction or rescission, for breach of fiduciary duty.

Commentary on Section 145(b)

Paragraph (b) has been amended to conform the standard for indemnification under the statute with the recent holdings of the Delaware Supreme Court. No substantive change in the law is intended.

Commentary on Section 145(e)

The first amendment to Section 145(e) deletes the previous requirement for authorization of advancement of

litigation expenses, "as authorized by the board of directors in the specific case" so as to permit general authorization of advancement of expenses including a mandatory certificate of incorporation or by-law provision to that effect. The second amendment to Section 145(e) changes the undertaking required for the advancement of expenses to directors and officers so as not to create an obligation to repay unless a specific determination is made that the director or officer is not entitled to be indemnified as authorized in Section 145. Nothing in these changes to subsection (e) relieves the board of directors from its affirmative duty to see that the determination required by subsection (d) is made for any indemnification under subsections (a) and (b).

Commentary on Section 145(f)

The addition of the phrase "and advancement of expenses" is intended to make clear that the "other rights" provided for in Section 145(f) may include rights to have expenses advanced on terms other than those provided in Section 145(e). The phrase "and shall continue as to a person who has ceased to be a director, officer, employee or agent" has been relocated to a new subsection (j).

Commentary on Section 145(j)

New subsection 145(j) has been added to set forth the provision from Section 145(f) referred to above. No substantive change in the law is intended.

**PROPOSED AMENDMENTS TO SECTIONS 102 AND 145
OF THE DELAWARE GENERAL CORPORATION LAW**

In the past year it has become increasingly difficult for businesses incorporated in Delaware and elsewhere to obtain adequate directors and officers liability insurance. To the extent such insurance is available, the scope and amount of coverage is decreasing and the cost is rising dramatically.* Many corporations engaged in industries such as finance, high technology, utilities, real estate, petrochemicals and steel cannot find coverage for their boards at any price.** Loss of insurance has also been followed by director resignations, including resignations by outside directors who do not hold positions of employment with the corporation.***

The existing provisions of Delaware law regarding indemnification of directors and officers do not provide an adequate substitute for insurance. For example, a Delaware corporation may not indemnify directors or officers for

* See generally, Director Insurance Drying Up, Wall St. J., March 7, 1986, at D1; Liability Insurance Is Difficult To Find Now For Directors, Wall St. J., July 10, 1985, at 1; Insurers Beginning To Refuse Coverage On Directors, Officers In Takeover Cases, Wall St. J., January 20, 1986, at 3; Business Struggles To Adapt As Insurance Crisis Spreads, Wall St. J., January 21, 1986, at 31.

** Ailing D&O Insurance Market Looks For Cure, The Business Lawyer Update, March/April 1986 at 1.

*** Business Struggles To Adapt As Insurance Crisis Spreads, supra, at 31; Director Insurance Drying Up, supra.

judgments or amounts paid in settlement of stockholder derivative suits, even in cases where there are no allegations of fraud, bad faith or self-dealing. As a result, there is good reason for concern over the ability of Delaware corporations to continue to attract qualified persons to serve as directors.

There is also a growing effort in a number of states to develop a legislative solution. Indiana recently passed a statute providing that a director is not liable for any action taken as a director, or any failure to take any action unless he engaged in willful misconduct or recklessness. Virginia has passed a statute which appears to permit indemnification under certain circumstances for amounts paid for judgments or settlements in derivative actions. The Missouri legislature has passed a similar statute (which is awaiting approval by the governor) granting corporations broad power to indemnify directors for conduct not involving knowingly fraudulent, deliberately dishonest or willful misconduct. Other legislative solutions are being considered in Utah and New York.

The Council of the Corporation Law Section of the Delaware State Bar Association has carefully considered this issue in recent months and believes that there is an immediate need for legislation in Delaware designed to address this issue and maintain Delaware's leadership in providing responsible solutions to evolving business problems. The

Council also believes that the proposed amendments represent a balanced and proper response to this problem.

Proposed Section 102(b)(7)

The proposed amendment to Section 102(b)(7) is intended to permit stockholders, as the owners of a corporation, to decide for themselves whether or not a limitation on director liability for breach of the fiduciary duty of care in managing the business and affairs of the corporation is necessary in order to enhance the corporation's ability to attract and retain qualified directors and is appropriate for the particular corporation involved. Such a limitation would be analogous to principles of trust law which contemplate that beneficiaries may agree to limit the liability of trustees. See 1 Restatement of Trust 2d §222 (1959).

The proposed amendment would permit a corporation, in its original certificate of incorporation or an amendment validly approved by the stockholders, to adopt a provision eliminating or limiting personal liability of board members for violation of the duty of care, provided that no such provision would be effective to eliminate or reduce liability if the director also breached his duty of loyalty, failed to act in good faith, engaged in intentional misconduct or a knowing violation of law, paid a dividend or approved a stock repurchase which was illegal under 8 Del. C. §174, or obtained an improper personal benefit. The proposed amendment to Section 102 would not affect the ability of

stockholders to obtain injunctive or other equitable relief from the courts with respect to a transaction which is the product of a duty of care violation.

Proposed Amendments to Section 145

The proposed amendments would also change certain provisions of the existing director indemnification statute, 8 Del. C. §145. The purpose of these proposed changes is to conform that section to a recent decision of the Delaware Supreme Court regarding the duty of care standard applicable to directors and to clarify the procedures relating to the advancement of litigation expenses.