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The Evolution and Adoption of Section 102(b)(7) of the Delaware General Corporation Law

MCNALLY: Well thank you, Gil for consenting to this interview about the history and the developments that led to 102(b)(7). I noticed in thinking about this and going over the history, I actually read a book, a new book out by Robert Reich who was a former secretary of labor. And he pointed out in the 1970's there were a total of 13 hostile takeovers. And by the 1980's there were 150 hostile takeovers in that decade. So it went from one every year to one every month. At that point in time, what were concerns that you were encountering on the part of directors of public companies in 1980's?

SPARKS: [00:01:04] Well, I think as we got into the early eighties obviously all directors were aware of the new takeover environment that we were seeing. And relating it to the topic of what drove 102(b)(7) namely, D&O insurance and potential director liability, I think directors were clearly aware of the rise of hostile takeovers. They were aware there was a fluid and changing legal landscape in terms of what their responsibilities were in that context. And there was also a concern as it related to D&O insurance, really two things. Number one, the magnitude of the potential liability of directors was perceived to have increased dramatically because of the size of the deals that were being done. It's much different talking about a director's failure in one way or another to perform his or her fiduciary duties in the context of building a factory versus the context of selling a company, which included a great larger magnitude of money, if you will. And the second aspect of it was that the traditional protections of directors, and there's really three; there's the business judgment rule, I've already indicated there was flux going on there during this period. The second was indemnification. And the problem there was that indemnification is decided after the fact. [00:02:43] If there were litigation about a takeover, and by the time the case was over and the director was found liable that a completely hostile group of new directors was deciding the indemnification question. That would make anybody who had been opposed to that group nervous about whether or not they would in a straightforward way apply the indemnification standards of acting in good faith and in what they believed to be reasonable in or not opposed to the best interest of the corporation in a straightforward way. In other words, indemnification was riskier in this environment than it had been in the past. So you've got the larger dollar number, you've got the change of control issue, and you've just got this rise of hostile takeovers and fluidity in the legal standards that were applied to directors.

MCNALLY: Was there any concern that because of the nature of these hostile takeovers which promised great returns to stockholders, I guess, or better returns that there would be more stockholder litigation even if the transaction didn't go forward?

SPARKS: At that point in time it was less clear than it is now that you don't really risk great liability in the deals that don't go forward, that your greater risk is in the deals that do go forward. But at that point in time, it's only been the benefit of hindsight that we probably would tell people, look, as long as you basically perform your duties, you're not at great risk for turning down a takeover.

MCNALLY: In preparing for this interview I ran across a 1985 survey by a company called Wyatt which apparently did an annual survey of director and officer insurance. And in that survey in 1985 they say that the D&O market was “in crisis” facing “radical changes”. How did the D&O market for insurance tighten in the early or mid-1980's?

SPARKS: [00:04:48] So if you go through the Wyatt report, and the Wyatt report was available to the corporation law council at the time which was debating what to do about the D&O crisis. If you go through that report you will see that premiums in the period starting about the fourth quarter of 1984 and accelerating into the early part of 1985 were increasing on renewals by a rate of somewhere between fifty and a hundred percent. So premiums were going up dramatically. And coverage, the potential coverage that you could get, was going down. Some primary insurers were going out of the market. Others were decreasing the amount they would write on a primary policy, and a lot of the reinsurers were simply dropping out of the market. So one set of figures that I can remember seeing during that period of time is if you were a high credit and you wanted to build up as much D&O insurance as possible to cover your directors, in the sort of the pre-tightening period of 1983-early '84 period, you probably could accumulate something in the range of 250 million dollars by layering on a primary and a lot of excess insurance. By the time we got to early 1985, that number had decreased dramatically below a hundred million dollars. And there was a particular effect on certain industries. The petrochemical industry, the financial industry, the insurance industry, those are the ones I remember being, in some cases, almost impossible to get insurance because the risk was perceived to be higher. [00:06:36] What caused that was never completely clear to any of us. We were told it was a disruption in the professional liability market emanating from Lloyds of London. I have no idea exactly what it was. What I do know is that the trend started before Smith v. Van Gorkom. So it's sort of a myth that someone perpetrated that 102(b)(7) was a reaction to Smith v. Van Gorkom; probably not right, because all of this began before that as the Wyatt report suggests. But on the other hand, with this increase in hostile takeovers and a perception that there was a possibility or greater possibility of director liability with large numbers than there had been before, it would not

be a bad supposition to say that the insurance market recognized that also and were attempting to shore up, if you will, what had been a relatively sleepy corner of insurance law when they started, since they might actually have to write checks from time to time.

MCNALLY: I think in the mid-1980's there were other people like doctors, for example, that were having--

SPARKS: Right, it was a professional liability problem. So it was doctors, accountants, lawyers, it wasn't just directors.

MCNALLY: You mentioned, you know, I think the protections the directors had for in cases of accusations of wrongful conduct. How exactly though does D&O insurance fit into that general scheme of protecting directors from unwarranted liabilities.

SPARKS: [00:08:21] So I'd say there are three risks that D&O insurance covers that aren't covered by the traditional mandatory indemnification provisions under Delaware law. One of those is that our indemnification scheme does not permit indemnification for judgements and settlements in derivative suits. So that's one thing that you buy D&O insurance for, because you can cover that subject to whatever contractual exclusions there are in the policy, and there are some. Bankruptcy risk; if your company that is indemnifying you goes bankrupt before you get indemnified, there's obviously nobody to pay you, but the D&O insurance could be there for that purpose. And then I mentioned in my early comment, the risk that for some reason you get denied indemnification, perhaps by a successor board, which was hostile to you at the time of the litigation that gave rise the liability, that is also a possibility for insurance to step in and protect you.

MCNALLY: So the insurance for those reasons provided a vital link in the overall level of protection for directors?

SPARKS: Right, it's one of the legs of what I think you could fairly say was a three legged stool, which would be the business judgement rule, which hopefully would prevent liability in the first place, and then D&O insurance and indemnification.

MCNALLY: Now you have mentioned that the Van Gorkom decision had been decided at that time. That was decided in 1985.

SPARKS: January of '85.

MCNALLY: And Revlon was subsequently decided in 1986, I believe. Now Van Gorkom in particular held directors liable for gross negligence. What was the problem that you

saw in reaching that kind of conclusion after the transaction had already been consummated?

SPARKS: [00:10:29] Well the problem ultimately was that those directors were personally liable for monetary damages for something that the court made it clear was not the product of any duty of loyalty violation, and prior to Van Gorkom there had been literally no director liability cases in Delaware or elsewhere finding monetary liability for pure duty of care violations, with the exception of a few old cases dealing with financial institutions, who were always thought to have a somewhat higher threshold of care required by bank director, if you will. I think looking back we would say that Van Gorkom was probably rightly decided, even though I was on the wrong side of it. Van Gorkom was a Revlon case before Revlon. And if we had laid the Revlon standards up against the conduct of the board in Van Gorkom, they would have not have been satisfied in my view. But what the Van Gorkom case did do was open the eyes, sort of change in the landscape, and it would cause directors greater concern. So while I don't believe Van Gorkom was a cause of the insurance crisis, which we've already discussed, the fact that Van Gorkom was out there coupled with the insurance crisis, certainly created a level of anxiety among directors that hadn't been there before you put the two together, and gave rise to what really drove our concern in looking for a solution. That was if directors decided that they weren't going to put their personal fortunes at stake for a directorship position in a public company because it was just too risky, then we would end up having a slippery slope in which the quality of directors of Delaware corporations would decline. [00:12:47] And this was at the same time that our Supreme Court was making it very clear in cases like Unocal and Revlon, and the cases that came along, but it was already, you could already see the trend in Weinberger v. UOP where the emphasis given to a special committee of outside directors, that the emphasis was switching to having boards that had a majority, indeed a vast majority of independent outside directors. And how are you going to get those people to serve if they came into a corporate board at age 55 or 60, having, basically because they would be prominent people, having made their fortune, and then getting paid what were then very nominal director fees? This was the age of ten thousand, twenty thousand, thirty thousand dollar director fees, not the three hundred thousand, four hundred thousand public company director fees that we see today, if not more. And to say to someone, well you're going to go and sit on the board of this company but by the way it may get taken over, there may be a hostile takeover, the landscape is uncertain in terms of what your responsibilities and liabilities are, and there's this problem where we can't get any more than X in terms of D&O insurance because the market is constrained. I don't know, if somebody had approached me with that, I wasn't fortunate enough to have the kind of money that most directors had, but I would tell you, if I did, I would have certainly thought twice before I said sure, I'll go on that board. And that's what we were concerned about.

MCNALLY: Let's talk a little bit about the concept of an exception to the business judgement rule for conduct that constitutes gross negligence. Van Gorkom was a split decision, isn't that correct?

SPARKS: 3-2

MCNALLY: And so the Delaware Supreme Court believed, three of them, that there was gross negligence, and two did not.

SPARKS: Correct

MCNALLY: What was the problem that you saw in people trying to define what constitutes “gross negligence“.

SPARKS: [00:14:58] Well I don't know, even today, I don't exactly know what gross negligence is. It's a lot of negligence. And it was clearly by that time defined as negligence in terms of process. In other words that you were negligent in not fully informing yourself prior to acting. I'm not sure that that fine tuning, while it was in some law review articles by some people like my partner, Sam Arsht and others, in the '70's, it had never really been surfaced in a definitive way by our courts. Now it was. And obviously it's more disconcerting to a director who looks at something and says there are five judges on the Delaware Supreme court, plus a chancellor who decided, so three of them decided one way and three of them decided the other way. So how do I know what gross negligence is other than something that's in the eyes of the beholder? I think that's an uncertainty that sort of layered over this. But I wouldn't over emphasize that. It was just an unsettled time, and it was disturbing in this unsettled time, to see the protections that were afforded historically to directors by D&O insurance being eroded.

MCNALLY: Alright. When Van Gorkham is decided, the insurance crisis hits, what were other people doing in that environment?

SPARKS: [00:16:28] Well other states were beginning to look at what should be done. Many of those were looking at the question on the same track that we were. I was chair of the corporation law council whatever we called it at that point in time. And on the 16th of October I asked that a committee be formed, I think we called it initially the section145 committee to deal with our indemnification provisions. But they were also to take a broad look at what response might be appropriate in this environment. We knew other states were doing things. As time went on, and by the time, this all wrapped up in May and June of the next year, we knew what other states had done. We actually sent a memo out to

the section explaining what other states had done. Just to cover that now, rather than cover that later, what we knew was that Indiana had passed a statute providing that a director was not liable for any action taken as a director or any failure to take any action unless he engaged in willful misconduct or recklessness. That could be viewed as a substantive change. The Delaware Supreme Court had just spoken in the Van Gorkom case, this would have actually been a, depending on how you judged the difference between recklessness and gross negligence, this would have been sort of a slap in the face if we had done something like that to our Supreme Court. And there was no consensus that our Supreme Court opinion was wrong. We discussed the split among the judges, probably a split among the bar about the same of the splitting of the judges. Virginia had passed a statute [00:18:29] which permitted indemnification for amounts paid for judgements or settlements in derivative actions. Well that didn't have anything to do with Van Gorkom. Frankly, it didn't have much to do with the takeover cases, because they're all generally class actions. But that solution, which wouldn't have been a solution at all, really, to the problem that people were really facing, had big policy problems with it. That's a circularity thing. If you think about the public perception of a trial occurring, an appeal occurring, and directors being found liable and told by the court that they were obligated to write a check, just hypothetically, a check for ten million dollars, to the corporation for whatever misdeed they had done, whether it had been a loyalty violation or a care violation or whatever, and then the corporation is permitted the next day, after going through the process, writes a check back to them for the same ten million dollars, that just is an unviable concept. But people were doing strange things. And Missouri had passed a similar statute apparently at the time in May when we recited all these things that was awaiting approval by the governor. And that involved broad power to indemnify directors not engaged in fraudulent conduct, which would sweep away a lot of the fine distinctions over the years that we had developed in our section 145. And there were also legislative solutions being considered in Utah and New York. We knew that in New York in particular, Marty Lipton at Wachtill Lipton was pursuing a cap model. I don't know whatever became of that, because once we acted I didn't much care what the other states had done. So there's that [00:20:22] activity taking place. It didn't really drive our decision to start to look at this process. I don't even think we knew about a lot of this activity back in October when we started to look at this. But as the problem--as the process went on, we became aware of what other states were doing.

MCNALLY: Before we get into the various alternatives that I know that you and others considered, perhaps we ought to, because this is supposed to be an interview that helps people understand broader concepts, talk a little bit about the role of the corporation law council. I recognize you are the chairman during that period of time, but tell us what the role is of the corporation law council in the Delaware corporation law context?

SPARKS: So the Delaware Corporation Law Council is a standing group, they're actually elected by members of the section. They're generally are not contested elections--

MCNALLY: Section being? What is the section?

SPARKS: There's a corporation law section of the Delaware state bar association. And then above that there's an executive committee of the bar association and the bar association membership as a whole. The council is in effect the governing body of the section. So while matters may be brought to the section for a vote at some point, the council members are the people who deliberate. It's a standing group, it rotates a couple of people off every year and a couple of new people come on. And it's generally made up of prominent members of the corporate bar. In Delaware, the distinction between the litigation bar and the, I'd say office practice bar is not as--

MCNALLY: Transactional practice.

SPARKS: [00:22:15] Transactional. It's not as bright a line, at least back in these times it wasn't, and it may not still be, as it is in some jurisdictions. And then occasionally we would have a representative such as a general council of a local company or perhaps a law professor in the group. But that's what the council is. And it meets regularly every year to consider changes in what I would call the corporate environment that might require legislative action in the next legislative session, and then proceeds to deliberate, draft, discuss, and ultimately, most years, propose to our legislature one or more amendments to the Delaware General Corporation Law to keep it current.

MCNALLY: I noticed in one of the minutes of the meetings you had, there was a reference to some social legislation that had been proposed in terms of adoption as part of the Delaware corporation law. Did the council have a role in sort of monitoring to make sure Delaware corporation law wasn't used for non-corporation law purposes?

SPARKS: I mean generally, yes. The corporation law council would be alert to proposals that came into the legislature that did not originate with the council, and then they would be particularly alert to those which sought to inject, you call them social issues, but not pure corporate law issues, into our corporation law statutes. We would not view that historically as the appropriate vehicle for that type of activity.

MCNALLY: The example that I'm particularly familiar with is there was an attempt at one point to introduce an amendment to the Delaware General Corporation Law, that would have required every corporation with a certain number of employees, as part of their labor practices, to give six months' notice before terminations. That's obviously not a

corporation law issue, and that was voted down because of the council's opposition to it. That's an example of what I was talking about.

SPARKS: [00:24:28] That would be an example, yeah.

MCNALLY: Now you mentioned the role of Delaware lawyers, but did the council consult with law firms across the country in dealing with various issues that came up?

SPARKS: So the answer to that question is yes. On major matters, this matter and a year later on section 203, once we got something that discussable, if you will, it was--

MCNALLY: Refined for purposes--

SPARKS: Refined for purposes of discussion. Yes, we would reach out, individuals on the council would reach out to their clients and to other interested people, law professors and the like, who might have a view, so we would not be doing this in isolation, but would know what kind of reaction we might get.

MCNALLY: It's just not a Delaware thing, it's a thing that you listen to people all around the country.

SPARKS: We listen to people all around the country, and this was a perfect example. My file, which blessedly still remained after all these years, contains correspondence from a broad variety of people working with the ALI, major corporate groups,(in this case there was a major corporate group headed up by Squibb which had thirty or forty other general councils thinking about this problem), law professors, and other practicing lawyers in other jurisdictions.

MCNALLY: Now I was told to make sure we let people know what certain definitions, abbreviations are. ALI stands for what?

SPARKS: The American Law Institute.

MCNALLY: And what is the American Law Institute?

SPARKS: [00:26:20] So the American Law Institute is an elected group of lawyers, law professors and others interested in the development of the law, and is known for its publication of restatements. And it just happened that at the same time that we were debating this question there was in the works a restatement on the law of corporations that the ALI was working on.

MCNALLY: Alright. Well why don't we turn to the actual development of the statute itself. I know that you mentioned already that a committee had been formed, and I believe it's fair to say that sometime in early March some proposals had gotten to the point where they were going to be generally discussed. Do you recall when that began?

SPARKS: Well in the period late February, early March, there were a variety of proposals and concepts that had surfaced. So there was one subcategory that would have been changes to Section 145 itself. Now as it turned out in the end, none of them really got done. There were a couple of tweaks to section 145, but looking back at them now, they were not that substantive. They certainly would not have addressed the problem in any meaningful way. But we didn't know that at the time we were working our way through 145 changes which is the section dealing with indemnification.

MCNALLY: I was going to ask you that, can you explain 145.

SPARKS: Section 145(g) dealt with the subject of D&O insurance. And basically 145(g) then and now says that you can buy D&O insurance to cover things that you can't indemnify for. But there was a trend going on as corporations tried to react to the D&O crisis, of having captive insurance companies. In other words, they would form a subsidiary and get it qualified as an insurance company under state law, and then they would have their subsidiary sell them D&O insurance. Sometimes it was one corporation, one subsidiary, sometimes it might be four or five corporations would get together and they would jointly form a subsidiary and they'd have it write D&O insurance. And there was a discussion and some drafting that went on about whether or not uncertainties about that ought to be eliminated, and make clear that you could do that. Because the question was, if you're writing insurance to insure yourself, is it really insurance, was there really risk passing? So there was that issue that was out there.

MCNALLY: Let's take these proposals one at a time because--

SPARKS: Sure. And there were others. [00:29:18] I mean.

MCNALLY: We will get to those and we will get to the various meetings that happened. I know that in April of 1986 a prominent lawyer sent you a proposal that dealt with a damage cap of a million dollars at that point. What was the reaction, the general idea of damage caps?

SPARKS: Well there was mixed reaction. Obviously there were some who were enthusiastic about it, including, and it was more than one, that sent us a proposal on that.

There were just as many who were concerned about it for various reasons. One reason was that nobody could agree on what the cap ought to be--a million dollars, a hundred thousand dollars, and that obviously would have different impacts depending on how wealthy the director was. There was a problem in terms of what was going on at the same time in the legislature. There was a tort reform activity going on, and the bar association was generally opposed in this tort reform activity to an imposition of caps on liability for tort claims. So there was a concern, and I'm sure this was part of a concern that we later saw of Mr. Crompton, Charlie Crompton who was president of the Bar association. He had one of his sections of here, considering seriously a cap on director liability in certain types of cases. And he's got another section which was lobbying for no caps in the area of tort reform. It didn't lend itself to be a very consistent position.

MCNALLY: Well what about the political problem of, for example, if directors had a cap on their liability and doctors did not?

SPARKS: Well it's a perception problem. Why should these people be favored? I mean that's exactly what we're talking about. A medical malpractice cap for doctors or another form of professional, not having that, and having something for directors on the other hand, in each case dealing with the duty of care, is hard to sell both to the legislature and as a PR matter. [00:31:49] It's a matter of policy. So that was the problem with the cap. There did in this period of time come across the transom from the ALI a proposal that I think ultimately became the structure that we adopted. It came in the form of a communication to both Norm Veasey, Lew Black, and ultimately to me directly, from Marshall Small, who was a prominent lawyer with Morrisson and Foerster in San Francisco who was part of the group at the ALI that was considering how to handle this issue in connection with the broader corporate governance project that I mentioned. They shared with us and I shared with the committee, with the council in early March, a structure that looks a lot like what we ended up with in 102(b)(7). It basically said you can put in a charter amendment that limits the liability of directors, and then it listed a bunch of things sort of like ours that you couldn't limit and left the duty of care unchanged. But it had a feature in it that we ended up not doing, which said that you can't limit liability below what the director's personal benefits were from the company for that year. So you in effect had a 102(b)(7) but you couldn't take it down to zero. [00:33:32] You had to leave some liability for the director, which made it sort of a hybrid cap statute. That was out there on the table by mid-March, and emerged by around the 10th of April, as a more fleshed out, viable concept, which we were then debating against a straight cap. As time went on the changes to section 145 itself receded in importance, and we certainly weren't going to consider things, we summarily rejected things like allowing for settlements and judgements in derivative suits, although there were discussions about whether you want to do something about attorney's fees and the likes in that context.

MCNALLY: You mean about being indemnified?

SPARKS: Indemnified for settlements and judgements. I mean, basically, as time went on, people began to recognize that a more efficient and better way to do this was not through messing around, if you will, within indemnification and insurance provisions of section 145, but tackling it straight on with 102(b)(7).

MCNALLY: Well let's just circle back to something you mentioned a moment ago, which was the use of captive insurance companies. Why was that not ultimately thought to be a way to deal with the D&O crisis?

SPARKS: Well I can tell you my concerns with it. I thought it was a disguised unlimited indemnification statute. In other words, if you got a captive insurer and then that entity writes the policy, there's no real risk passing because, just like indemnification, if there was found to be a valid claim, the corporation would end up paying it, whether directly or indirectly through its subsidiaries. So you did not have the market concept of risk passing which then in effect dictates what kinds of exclusions there are, what kind of premiums get paid, what kind of extensions there are. So it ran the risk of being just an end run around our finely tuned indemnification statute.

MCNALLY: Did you have any concerns about how the decision to actually cover a loss would be made by a captive insurance company, who presumably had directors appointed by the very people who were seeking indemnification?

SPARKS: Well that was one of the problems. That's why it was sort of like the way you would make a decision in an indemnification context, there would be theoretically, contractual provisions. I mean, somebody would have an insurance form and policy, but all of those permit a degree of interpretation. And when the same people are doing the interpreting as would be done in the indemnification context, it was pretty easy to see how... it wasn't real insurance. I mean it got back to the point where it wasn't real insurance. And while you can legislate and say well ok it is now real insurance, the fact that it wasn’t risk passing and the fact that those contractual terms were being dictated by the very people who were the purported beneficiaries of it makes it pretty clear that it would not be good policy.

MCNALLY: Alright, so you had in early 1986 a series of different proposals. Let's try to go through how specifically 102(b)(7) evolved? I know that you had mentioned, I think that in April or so there was a draft around April 11 of a potential statute. Do you recall that and how that came about?

SPARKS: Yeah, so just to go back so we get the chronology exactly right. [00:37:40] On March 11th I sent around to the committee the work that the ALI people had done. It was confidential and I asked that it not be shared with anybody else because we had been asked by the ALI to keep it as close to our vests as possible. When we got to the meeting on April the 11th, Norm Veasey had drafted a scaled down version of the ALI proposal, and at the end of the meeting submitted that for consideration.

MCNALLY: Who was Norman Veasey?

SPARKS: So Norm Veasey was a prominent corporate lawyer who later became chief justice of our supreme court. But at that point he was a prominent corporate lawyer at Richards, Leyton, and Finger.

MCNALLY: Sorry I interrupted you but you were going to talk, he submitted--

SPARKS: He submitted, I guess I would call it a one page standalone version of something that you would now recognize as being an early version of what became of 102(b)(7). John Johnston at Lew Black's request in our office had also right around the same time done something similar. And as we went forward into the April period, by April 17th, I think it was pretty clear. I think it's April 17th...

MCNALLY: Yeah, there's a set of minutes in April 17th, 1986, that specifically do focus on that. For example, I know in the minutes, it says that after other discussions of other things, Mr. Sparks then circulated the proposal Mr. Veasey had made at the prior meeting titled Possible Amendments to 8 Delaware Code 102(b).

SPARKS: Right. And so we then started to debate that along with the other things that we had been debating. [00:39:51] And as time went on, and pretty quickly by the next meeting, it became our primary focus.

MCNALLY: Well before we get into that meeting, before we go past that meeting, I notice that at the end of the minutes people express their various views. There was the one outlier who we won't even mention, and then there's this statement that Mr. Sparks would try to meet with Mr. Crompton if possible to discuss the proposed amendment. Mr. Charlie Crompton at that point was the president of the bar association, is that right?

SPARKS: He was president of the bar association.

MCNALLY: Why'd you have to meet with him then?

SPARKS: Well I think he began to get uncomfortable. And by this time we didn't have anything we had decided on. But I think that the proposals that were out there which included a cap and which we would have put in the legislation in 146 or perhaps a variant that we were working on in 102(b)(7) all involved this cap idea. And I've already explained to you that he had broader concerns than just our work, and his initial reaction was negative. And I was asked to talk to him about it and explain where I thought we were headed.

MCNALLY: And that's what you did.

SPARKS: And that's what I did.

MCNULTY: And then after that what happened next? I mean, I know there is another set of minutes in April 28th, I think before April 28th?

SPARKS: We had a meeting on April the 23rd. And Mr. Frank Balotti and I had met with Charlie Crompton. And we had at least gotten to a point, as the minutes recite, probably as accurately as I can remember that "Although Mr. Crompton was not necessarily persuaded to support the council's legislative proposal and deal of liability and indemnification, he has an open mind on the matter and has agreed to work with us." And then we had some assurance that we would have some legislative cooperation. And then we talked about some of the proposals, some of the things that needed to be done. And then we considered a revised draft of 102(b), which had been circulating prior to the meeting.

MCNALLY: Let's pause for a moment and make people understand why this focused on section 102. What is the role of 102?

SPARKS: [00:42:28] So 102 is one of the things that you're permitted to have, a listing of the things you're permitted to have in your certificate of incorporation. So when we're talking about 102(b)(7), we're talking about a piece of legislation that says you may put in this, I'll call it director protection provision, if you want to, in your charter. So as our thinking emerged in all of this, we basically came to the conclusion, we were saying to corporations, look, if you are concerned about this D&O problem, we will give you the option, by shareholder vote, of putting this proposal into place, of putting a limitation on director liability for essentially duty of care violations into place. You don't have to, if you believe that holding a hammer over director's heads of monetary liability is a more important than attracting good directors, you can make that decision and not propose this to your stockholders, or your stockholders can make that decision and not vote for it. But

we're going to give you this option. So putting it in 102 was the way of giving corporations that type of option.

MCNALLY: In other words, you weren't forcing people.

SPARKS: We weren't forcing people to do this. We did have a meaningful debate by the time we were getting to April 17th about whether or not to include officers.

MCNALLY: Now I know on the April 23rd meeting there was a very specific discussion of questioning whether or not--

SPARKS: Yeah, April 23rd. So whether we ought to have officers. And if we want to move chronologically, maybe we ought to talk a little bit about that now.

MCNALLY: Ok

SPARKS: And it's interesting because I still get questions in real time about why not include officers?

MCNALLY: What was the thinking about that?

SPARKS: So the thinking about it, and it's all recited in the minutes. The minutes are very good about these policy issues in terms of looking at them. There were some, one of my partners, Mr. Black, apparently expressed concern that we might be perceived as doing too little if officers were not given the same protection as directors, and noted that they were generally treated equally. Joe Rosenthal disagreed, stating there's no justification exists for exculpating bank officers for their grossly negligent acts that may cost banks millions of dollars. Others noted that because jurisdiction could not be obtained under 3114, it wasn't really, over officers at that time.

MCNALLY: 3114 is the statute that permits long arm of service on the board of directors?

SPARKS: Right. I believe that statute has subsequently, much later, been amended, but at that point in time it didn't give you a long arm jurisdiction over officers, so it wasn't customary to see officers named in these lawsuits. And some found that to be a reason why not to extend it to officers, because it wasn't necessary. And then I expressed my view, which I continue to hold today, and which is written down here pretty well. I was against extending it to officers since the object of our exercise from the beginning had been to make sure we can attract qualified outside directors to continue to serve as directors of Delaware corporations. And we simply didn't need to do that with respect to

officers who were well paid and nobody had ever heard of a situation where an officer had declined to become an officer because he didn't have D&O insurance. The officers weren't the ones who were complaining. And our theory, our purpose in all of this was to encourage people to serve and you didn't need to do that with officers. [00:47:00] The other issue that I thought was important was that by not extending it to officers you would cause officers bring sticky problems to the attention of the board so they can be dealt with on that level. So I'm talking two levels: I thought then, and I continue to think now, that it would have been a mistake to extend it to officers. And also, a concept at least I had, was let's do what we need to do to solve the problem and no more. And ultimately it was agreed because of that conversation, that back and forth, where you can see there were views expressed in both directions, it was agreed not to include officers.

MCNALLY: Well I know at some point there was an amendment to the statute that dealt with activity that was perceived to be not in good faith. And I believe that there's a set of minutes on April 28th or so, where Joe Rosenthal suggested not in good faith as a term to be used in the statute. Who was Mr. Rosenthal?

SPARKS: [00:48:14 audio cuts out]