Is it time for a checkup of your corporate bylaws and articles of incorporation?

By Roger M. Marks, Jr.

Your directors and officers have two primary sources of personal asset protection: (1) D&O insurance and (2) indemnification and advancement of legal expenses from the company they serve. The two go hand in hand. But while your risk management department probably reviews your D&O insurance program on an annual basis, you may not have critically reviewed your bylaws or indemnity agreements in years. If this is the case, you may be surprised to learn only after the claim arrives that your D&O insurance program may not dovetail with your corporate indemnity and advancement obligations. Or worse yet, your board may not be entitled to take advantage of new or evolving protections potentially available under the law.

If you have not recently had an outside legal review of these provisions, it would be a good idea to enlist the aid of your legal department or use outside counsel. In any event, you will first want to retrieve your articles of incorporation and determine whether your company has an exculpation provision (eliminating director liability for certain breaches of fiduciary duty). Most companies have included such provisions where the governing law allows.

Next, review your current corporate bylaws and, specifically, the scope of indemnification and advancement obligation. Do they mandate indemnification to the fullest extent allowed under the controlling law?

Or, is the decision whether to indemnify or defend a director or officer against allegations of misconduct left to the discretion of the board in control at the time of the claim? The level of protection can vary greatly from one company to the next.

Some companies will mandate very broad protection for certain directors and officers and not other employees. Other companies may prefer permissive indemnification for all parties, with some being concerned that broad advancement provisions could require the company to fund the defense of guilty parties, to the detriment of the company and its shareholders. And, in the case of certain highly regulated industries, providing indemnification or a defense against certain claims by state and federal regulators may be legally prohibited.

Because your D&O insurance program serves as a backstop to your corporate indemnity and advancement, it is good idea to review the two in tandem on a regular basis. For example, your D&O policy may preclude coverage for certain individuals or matters even though, under broader bylaw provisions, the company still has an indemnity obligation. Or, conversely, your bylaw provisions may narrow the scope of advancement in other contexts like criminal matters, only to see coverage for those

same individuals deplete the insurance proceeds otherwise available to innocent board members and adversely affect your claims history with insurers.

Finally, a few companies are now starting to look at whether bylaw provisions can be modified to protect against, or at least strongly dissuade, meritless shareholder litigation. These companies are asking cutting edge questions like whether recent trends upholding mandatory arbitration provisions and class action waivers can be applied in the corporate shareholder litigation context; or whether companies can contractually shift the litigation costs to a losing shareholder (or one who obtains only part of the relief requested).

There has been much recent attention paid to these so-called "fee shifting provisions" in the wake of the Delaware Supreme Court's decision in the *ATP Tour, et al. v. Deutscher Tennis Bund, et al.* case rendered this past May
(see *Shareholders, Disarmed by a Delaware Court, New York Times*, Oct. 25, 2014, http://www.nytimes.com/2014/10/26/business/shareholders-disarmed-by-a-delaware-court.html?ref=business&_r=0)

The ATP Tour decision concerns the enforceability of a fee-shifting by-law enacted by directors of a Delaware, non-stock corporation requiring plaintiffs who are "owners" to pay "… all fees, costs and expenses of every kind and description …" if they "[do] not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought…"

In its ruling, the Delaware Supreme Court upheld the facial validity of the law, finding the directors were authorized by Delaware law to enact the bylaw, and the intent to deter litigation is a proper corporate purpose for such bylaw.

While the case involved a non-stock corporation, the decision was viewed as applying more broadly to stock corporations. There has been much commentary pro and con by corporate practitioners, legal scholars, legislators and organizations representing corporate and shareholder interests about the court's decision.

The ongoing examination of this issue by the Delaware Bar Association, at the direction of the Delaware State legislature, is being watched closely and is anticipated to give rise to legislative action in 2015.

It is possible the action could be more inclusive than simply the fee-shifting issue and could involve legislative pronouncements on issues such as forum selection clauses (upheld already by Delaware courts) and mandatory arbitration provisions. As mentioned in the attached article, it also remains unclear whether the SEC will seek to weigh-in on these issues. Some commentators and even members of Congress have criticized the SEC for its silence.

If you do not now have an opinion on how your bylaws do or should respond to these issues, it may be time to ask more questions.

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