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Are Your Bylaws Ready for E-Proxy?

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Since 1995, the SEC has permitted electronic delivery of proxy materials provided that the stockholder has affirmatively consented in advance to electronic delivery. Following the SEC's interpretative guidance on this topic, many companies have attempted to solicit from their stockholders affirmative consents to electronic delivery. Common reasons include saving printing and mailing costs, reducing the environmental impact of paper delivery, and demonstrating technology savvy. The requirement for advance affirmative consent has however inherently limited the benefits which can be derived from electronic delivery.

In January 2007, the SEC adopted new rules to permit Internet delivery of proxy materials without advance affirmative consent. In July 2007, the SEC adopted further rules which combined the voluntary provisions of the January 2007 rules with a mandatory Internet availability requirement. The new rules, commonly referred to as the "e-proxy rules," apply to issuers, and to intermediaries who furnish proxy materials to beneficial owners of shares held in street name. The mandatory portion of the e-proxy rules became effective January 1, 2008 for large accelerated filers (other than registered investment companies), and will become effective January 1, 2009 for other issuers. Large accelerated filers, as well as other companies that wish to take advantage of the e-proxy rules this year, should make certain that the procedures they choose are in accordance with their bylaws. Our experience suggests that most companies will find that their bylaws do not affirmatively restrict their e-proxy choices, but many will nonetheless find that their bylaws can be improved to comport better with their actual corporate communication practices.

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E-Proxy Framework

The e-proxy rules are structured via what the SEC calls a "notice and access model." The notice and access model allows companies a choice between two delivery methods:

Full Set Delivery—providing stockholders with a full set of paper copies of the proxy materials, posting the same on the issuer's web site, and including a Notice of Internet Availability of Proxy Materials with the paper copies.

Notice Only—posting proxy materials on the issuer's web site, and mailing only a Notice of Internet Availability of Proxy Materials. Under the notice only method, paper copies are not delivered unless a stockholder affirmatively requests paper copies.

Companies need not choose one method exclusively, and may use full set delivery for some stockholders, and notice only for others. Companies may also continue to use the SEC's existing guidance concerning delivery of proxy materials by electronic delivery with advance affirmative consent.

The e-proxy rules also facilitate electronic voting by permitting the notice to specify an electronic voting platform.[1]

E-Proxy and Bylaws

The good news for most issuers is that complying with the mandatory portions of the e-proxy rules will not likely require changes to the bylaws. Most bylaws govern the manner of delivery of notices of stockholder meetings, and not the manner of delivery of proxy materials. Since both methods of notice and access compliance involve mailing a notice to stockholders, compliance with the notice provisions set forth in the bylaws will generally be satisfied in the same fashion as it has in the past.[2]

Even if a company decides to use e-proxy implementation to take advantage of the ability to secure advance affirmative consent for electronic only delivery, amendment of the bylaws is probably not required. In July 2000, amendments to the Delaware General Corporation Law (DGCL) facilitating electronic communications became effective.[3] These were commonly referred to as the "Technology Amendments." The Technology Amendments allowed for electronic delivery of notices of stockholder meetings and any other notices required by the DGCL, a corporation's certificate of incorporation or its bylaws, provided the stockholder has consented to such delivery. Section 232 of the DGCL states that notice of a stockholder meeting is effective if given by a form of electronic transmission consented to by the stockholder to whom the notice is given. This is similar to the SEC's interpretive position on advance affirmative consent.[4]

The e-proxy rules also support (but do not require) use of electronic means of executing proxies. Section 212 of the DGCL, as amended by the Technology Amendments, permits a proxy to be given by telegram, cablegram or other form of electronic transmission provided that such transmission either sets forth or is submitted with information from which it can be determined that the proxy was authorized by the stockholder. Accordingly, electronic means of executing proxies may not require any amendment to a corporation's bylaws.

The situation may be different for an annual report to stockholders. The DGCL does not require the delivery of an annual report to stockholders, and accordingly there are no provisions in the DGCL expressly authorizing delivery of such report by electronic transmission. Although there is no statutory requirement, many public companies do have bylaws that require delivery of an annual report to stockholders. These provisions were often included due to requirements imposed by the major stock exchanges for delivery of annual reports to stockholders. Both the NYSE and Nasdaq have recently amended their rules to permit annual report delivery to be satisfied through Internet posting.[5] However, bylaw provisions corresponding to the old rules may still survive, and may require mailing of the annual report. Amendment of such a provision may be necessary in order to take advantage of the notice only method of delivery of proxy materials.[6]

Even where the Technology Amendments clearly permit a form of electronic transmission, there may be interpretive concerns with use of an electronic access method permitted by the e-proxy rules, where the bylaws expressly require a physical means of delivery. While bylaws may be found void where they unreasonably limit a right given in the DGCL, a bylaw that places reasonable restrictions on a broader statutory right may be upheld. A company which chooses to take advantage of any of the voluntary flexibility permitted by e-proxy rules would be well-advised to make certain that its bylaws do not expressly prohibit the actions contemplated, or expressly require actions that are not performed in reliance on e-proxy flexibility. In such circumstances, it is not clear that the Technology Amendments will protect the validity of the corporate action. Inconsistencies may make it difficult to obtain an unqualified legal opinion as to the validity of certain corporate actions. Bylaws may generally be amended by board action, so correction of inconsistencies is not difficult.[7]

Moreover, the bylaws can be a useful roadmap for planning and conducting stockholder meetings. When they are kept current with statutory updates, the corporate secretary's office may use them to plan for the proxy season and stockholder meetings without the need to reference separately the DGCL. Planning is more difficult and cumbersome,

and procedural errors become more likely, when the bylaws are missing some of the requirements of the DGCL, are inconsistent with the DGCL, have provisions located under seemingly inapplicable section headings, or otherwise do not reflect the actual means by which a corporation is governing itself.

We therefore believe the SEC's adoption of the e-proxy rules presents a good opportunity for companies to review all of their corporate governance communication practices, and ensure (1) such practices conform to all applicable laws and rules; and (2) that the bylaws conform to such practices. For example, many companies provide notices of board meetings by e-mail (which is permissible under the DGCL), but we frequently find that the enumerated means of giving notice stated in older bylaws do not include e-mail.

Examples of areas that may be reviewed, updated and improved in a communications review of bylaws include the following:

- All of the DGCL provisions relating to notices of stockholder meetings of stockholders can be relocated to a single section.
- Provisions governing the electronic availability of stockholder lists may be provided, including express protection of the privacy of e-mail addresses.
- Express language permitting a stockholder meeting without physical location may be added.
- Express language permitting participation in stockholder meetings by remote communication may be added.
- Express rules permitting ballot (as opposed to proxy) voting by electronic transmission may be added.

Various provisions stating the means of permissible communications, which may currently be internally inconsistent or not in full accordance with the definition of "electronic transmission" contained in the DGCL, can be harmonized and expanded to permit electronic communications in areas such as notices of board meetings, waivers of notice of or consent to board meetings, written consents in lieu of board meetings, notices of resignation by a director, and notices of resignation by an officer.

Conclusion

For most companies, e-proxy rules will not mandate an amendment to the bylaws. However, the e-proxy rules present an opportunity to take a fresh look at processes of corporate communications with stockholders and other corporate constituencies. It is not uncommon to find that bylaws, particularly older bylaws, no longer conform to the manner in which the company conducts itself or wishes to conduct itself. In the best case, the lack of conformity is an issue only of optics. In the worst case, it may call into question the validity of certain corporate actions, leading to unnecessary difficulty obtaining legal opinions, or even litigation challenging corporate decisions. For these reasons, we recommend companies take the opportunity to review their bylaws with fresh eyes during the 2008 "e-proxy" season.

Notes

1. The issuer must establish and indicate in the notice a method of executing proxies. Permissible methods include an Internet voting platform, a toll-free telephone number, or a printable or downloadable proxy card from the issuer's web site. If a telephone number is used, the number itself cannot be included on the notice card.

2. The e-proxy rules limit the content of the Notice of Internet Availability of Proxy Materials, but expressly permit information required to be included in a notice of a stockholders meeting under state law.

3. This article discusses only Delaware corporations. Many other state corporation codes have been updated to reflect electronic means of communications, and many of the areas of inquiry discussed in this article will also apply to bylaws of corporations organized in other jurisdictions. Of course, the laws of the particular state of incorporation need to be reviewed in accordance with any review of the bylaws.

4. The SEC's interpretative releases permitting electronic delivery upon advance affirmative consent require evidence of actual delivery of a document. Such evidence is not required under Section 232 of the DGCL.

5. The NYSE and Nasdaq rules require a company that will rely on Internet posting to issue a press release stating that its annual report is available on the company's website and including its website address. Consistent with the e-proxy rules, an NYSE or Nasdaq listed issuer must provide a hard copy free of charge upon request.

6. California corporations, as well as foreign corporations whose principal executive offices are located

in California, or which regularly hold board meetings in California, may not be able to use the notice only method under current California law. California Corporations Code § 1501 requires such companies to delivery an annual report, and the permissible means of electronic delivery require advance consent as a precondition. Until Section 1501 is amended to conform to the e-proxy notice and access model, a corporation subject to Section 1501 should plan to use full set delivery for stockholders of record, and may also need to use full set delivery for street name holders.

7. A Form 8-K is required within four business days of any amendment to the bylaws. *See* Item 5.03.

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