CLEARY GOTTLIEB Alert Memo

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Action by Written Consent: A New Focus for Shareholder Activism

Shareholder proposals advocating that corporations provide shareholders with the right to act by written consent in lieu of a meeting reappeared on ballots this proxy season after a hiatus of several years and have won average shareholder support of over 54%. While these proposals are nonbinding and the number of companies with such proposals on the ballot in 2010 is relatively small – a total of 16 companies, according to RiskMetrics – the level of shareholder support is striking and will likely encourage proponents to advance proposals at more companies next year.

Today, only approximately 28% of the Fortune 500 and 31% of public companies[1] permit shareholders to act by less than unanimous written consent, but, over time, shareholder activism can change common practice. The recent marked decrease in companies with classified boards or shareholder rights plans and the increase in companies with majority-voting standards are notable examples. All public companies, whether or not they received a written consent proposal this proxy season, should understand the issues involved and prepare for the possibility of future proposals.

Under Delaware law, shareholder action may be taken by written consent in lieu of a meeting unless the certificate of incorporation either expressly prohibits action by consent or effectively prohibits it by requiring that such action be taken only by unanimous consent.[2] Written consent proposals seek to have the board propose a charter amendment to permit action by written consent. Action by written consent may be used to accomplish, among other acts, the wholesale amendment of bylaws and, absent specific impediments in the certificate of incorporation, removal of directors without cause and filling of board vacancies, all without waiting for an annual or special meeting. As a result, except in limited instances such as where the charter prevents the removal of directors without cause, the right to act by written consent may be used to replace up to the entire board of directors. Among other things, the ability to gain control of the board can undermine takeover defenses, such as a shareholder rights plan, and thereby potentially prevent the board from using a rights plan or other defensive mechanism to explore alternative ways of realizing value for shareholders. The vulnerabilities that arise from the existence of the right to act by written consent, even if not actually exploited, arguably give hostile bidders and insurgent shareholders leverage whenever they are negotiating with incumbent boards.

Moreover, in some cases, approval of these actions could occur by written consent with little or no advance notice to the company or the market – and before the board has a meaningful opportunity to communicate its views regarding the proposed shareholder action. Absent procedural safeguards in the charter or bylaws, the incumbent board may be assured of prior notice that consents to approve shareholder action are being sought only if either:

- The insurgent is soliciting consents from more than 10 shareholders, in which case federal securities laws require that the insurgent file a consent solicitation statement on Schedule 14A; or

- The insurgent itself beneficially owns at least 5% of the company's voting power and complies with its obligation to promptly amend its Schedule 13D to disclose that it is soliciting consents.

At a company with a concentrated shareholder base and organizational documents that include no procedural safeguards, an opening may exist for shareholders to approve actions by consent that would result in a change of control at the board level, all without advance notice to the board or other shareholders of the intention to solicit consents from up to 10 shareholders.[3]

Against this background, how should boards react if a written consent proposal is approved or if otherwise pressured to adopt changes to their charters to permit shareholder action by written consent? The first step should be proactive shareholder outreach to articulate the potential negative consequences of extending this right. If shareholders already have the right to call special meetings, then the company may be able to make the case that the ability to act by written consent is unnecessary. If, however, the popularity of written consent proposals or other shareholder pressure leads a company to contemplate amending its charter to provide for this right, the board should consider including in the proposed charter amendment requirements to assure that any written consents under that provision are accompanied by a full and fair opportunity for the board to communicate its position and for all shareholders to consider the merits of the proposed action.

Delaware law permits a charter amendment to include parameters on the ability of shareholders to act by consent. Shareholders are unlikely to view some parameters – *e.g.*, a special supermajority voting standard applicable only to actions by consent – as responsive to their demand for the right to act by consent. However, there are good arguments for why shareholders – even activist shareholders – should support a charter amendment authorizing action by consent that also includes procedures to assure that the board and all shareholders receive sufficient advance notice and information before action by consent may be taken. For example, the charter could provide that action by written consent would only be permitted if solicitations were obtained through a consent solicitation statement made available to all shareholders and would not be deemed adopted unless valid consents were delivered and not withdrawn as of a reasonable date after the first notice to the board of the

intention to solicit consents. Such a provision would be designed to give both the shareholder proponent and the board a reasonable amount of time to communicate with all shareholders about the merits of their positions, including time needed to prepare consent solicitation statements.

If a board wants to implement meaningful advance notice requirements of this type, then those requirements should be included in the charter amendment that provides for action by consent. Under Delaware case law, there are significant limits on a board's ability to implement similar limitations through a bylaw provision.[4] Moreover, approval of a subsequent charter amendment that provides only for procedures that limit the right to act by consent may be much harder to achieve than one that combines a new right to act by consent with procedural safeguards.

Careful preparation thus will be essential to enable boards and managements to respond thoughtfully and proactively to shareholder activism seeking the right to act by written consent.

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[1] Based on information provided by SharkRepellent.net.

[2] The corporate law of some other U.S. states is similar to that of Delaware, while other states do not permit non-unanimous action by written consent or require that a company's governing documents affirmatively permit such action.

[3] The SEC's proxy rules may be read to require the distribution to shareholders of an information statement on Schedule 14C relating to the action by consent at least 20 calendar days prior to its effectiveness (even when the filing of a consent solicitation statement on Schedule 14A is not required), although there is some question about whether this requirement applies when consents were not sought by the company. In any event, while such a requirement may delay the implementation of the action that has been approved by consent, it would not delay the effective date of the approval itself. Under Delaware law, the approval of an action by written consent is effective as soon as holders of the requisite percentage of shares, as of the applicable record date, have submitted consents.

[4] In Delaware, generally the only procedural limitations on action by consent that a board may adopt without shareholder approval are bylaws that establish a process for setting the record date for all actions by consent, and these bylaws will, at best, give the board only 20 calendar days before the approval by consent becomes a *fait accompli*.

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