

October 30, 2008

Challenges and Opportunities for Boards of Directors of Maryland Corporations

These are challenging times for boards of directors. In the current economic environment, directors need to remember their overarching responsibility for continuing oversight and informed decision-making. To remind, the Maryland General Corporation Law (“MGCL”) requires each director to act in good faith, with a reasonable belief that his or her action is in the best interests of the corporation and with the care of an ordinarily prudent person in a like position in similar circumstances. While compliance with this standard (which applies to a director’s actions both in the boardroom and as a member of a committee) is aided by a statutory presumption and the authority to rely on management, advisers and experts, the standard applies individually, director by director, and not collectively to the board. Each director should, and advisors should encourage directors to, request and receive whatever information, ask whatever questions and take whatever time the director feels necessary to carry out his or her responsibilities.

With the foregoing in mind, you may wish to consider the following provisions of Maryland law and related points:

Reverse Stock Splits. Many companies’ shares are trading at historic lows, often in single digits. In addition to the general adverse perception of single-digit share prices, we understand that the investment guidelines of many institutions prohibit investing in companies with share prices below ten dollars. Under the MGCL, the board of directors of a publicly-traded Maryland corporation, including a closed-end investment company, may, *without stockholder action*, approve one or more reverse stock splits resulting in a combination of not more than ten shares into one share in any twelve-month period. The MGCL defines a reverse stock split as a combination of the *outstanding* shares of stock of a corporation into a lesser number of shares of stock of the same class. Thus, an additional benefit of a reverse stock split is to increase the number of authorized but unissued shares of stock.

Share Repurchases and Dividends. At current share price levels, many companies are considering repurchasing their shares while other companies are concerned about their ability to continue paying dividends at prior levels. The MGCL prohibits a Maryland corporation from paying dividends, repurchasing its own stock or making other distributions on its shares unless, after giving effect to the distribution, the corporation would be able to pay its debts as they become due in the usual course of business and the corporation’s assets would at least equal its liabilities. In the case of a dividend, these two solvency tests are applied at the time the board authorizes the dividend, so long as it is paid within 120 days after authorization; for a share repurchase, they are applied at the earlier of the time of payment or when the stockholder ceases being a stockholder. We particularly remind that, in determining whether a distribution satisfies the two solvency tests, the MGCL does not limit a board to the corporation’s historical financial statements or accounting principles, or to generally accepted accounting principles, but, rather, specifically permits the board to base its determination on

“[f]inancial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances” or a “fair valuation or other method that is reasonable in the circumstances.” Finally, we continue to recommend that a board obtain reliable information as to the availability of legally sufficient funds for any distribution, including a written certification from the chief financial officer.

Preferred Share Dividends. Some of our clients have considered suspending payment of dividends on their preferred stock. The board’s decision in this regard will be evaluated under the three-part standard of conduct discussed above. Accordingly, each director must consider the best interests of the corporation but is not required to separately consider the best interests of the preferred stockholders.

Charter Amendments. A majority of the entire board of directors of a Maryland corporation may, *without stockholder approval* (unless specifically prohibited by the corporation’s charter), amend the corporation’s charter to (a) change the name of the corporation or (b) change the name or other designation, or the par value, of any class or series of stock of the corporation and the aggregate par value of the corporation’s stock. In addition, if authorized by the corporation’s charter, a majority of the entire board may amend the charter, *without stockholder approval*, to increase or decrease the aggregate number of authorized shares of stock or the number of authorized shares of any class of stock.

Takeover Defenses. We advise our clients to periodically review their defenses against an unsolicited takeover bid. This is particularly important in the current climate of falling stock prices and rising stockholder activism. For more than 30 years, the Maryland legislature has provided strong support for the role of the board of directors in protecting a Maryland corporation against a hostile takeover. Many of the takeover defenses permitted by the MGCL may be adopted by the board *without stockholder approval*.

Hedging Disclosure Bylaw. We are happy to see that more than 120 public companies – many of them our clients – have now adopted some form of the hedging disclosure bylaw provision that we first developed and began recommending to clients over two years ago. In the prevailing economic climate, major investors will continue to hedge and these investors are likely to be particularly active in proposing director nominees and making other proposals. We continue to believe that it is good corporate governance to require these proponents to disclose the extent to which their economic interests are not aligned with unhedged, long positions as well as the extent to which their voting power is not aligned with their economic interest in the company’s stock.

As always, we and our colleagues are available at any time to discuss these or other matters.

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