INSIGHTS
The Corporate & Securities Law Advisor

VOLUME 32, NUMBER 4, APRIL 2018

STATE CORNER

2018 Proposed Amendments to the General Corporation Law of the State of Delaware

By John Mark Zeberkiewicz and Stephanie Norman

Legislation proposing to amend the General Corporation Law of the State of Delaware (DGCL) has been released by the Corporate Council of the Corporation Law Section of the Delaware State Bar Association and, if approved by the Corporation Law Section, is expected to be introduced to the Delaware General Assembly.[1] If enacted, the amendments would, among other things: (1) amend Section 262 to apply the "market out" exception to the availability of statutory appraisal rights in connection with an exchange offer followed by a back-end merger consummated without a vote of stockholders pursuant to Section 251(h); (2) clarify and confirm the circumstances in which corporations may use Section 204 to ratify defective corporate acts; (3) allow nonstock corporations to take advantage of Sections 204 and 205, including for the ratification or validation of defective corporate acts; (4) revise Section 102(a)(1) to provide that a corporation's name must be distinguishable from the name of (or name reserved for) a registered series of a limited liability company; and (5) make other technical changes.

If enacted, the amendments to Section 262 (relating to statutory appraisal rights) would be effective only with respect to a merger or consolidation consummated pursuant to an agreement entered into on or after August 1, 2018; the amendments to Section 204 (relating to defective corporate acts) would be effective only with respect to defective corporate acts ratified or to be ratified pursuant to resolutions adopted by a board of directors on or after August 1, 2018; the amendments to Section 102(a)(1) (relating to the requirements of the corporation's name) would be effective August 1, 2019; and all other amendments would be effective August 1, 2018.

John Mark Zeberkiewicz *is a director, and* **Stephanie Norman** *is an associate, of Richards, Layton & Finger, P.A., in Wilmington, DE. The views expressed herein are those of the authors and are not necessarily the views of Richards, Layton & Finger or its clients.*

Appraisal Rights

Application of the "Market Out" Exception to Intermediate-Form Mergers

The proposed amendments would amend Section 262(b) of the DGCL to provide that the "market out" exception to the availability of statutory appraisal rights will apply in connection with an exchange offer followed by a back-end merger consummated without a vote of stockholders pursuant to Section 251(h). As currently drafted, Section 262(b)(3) provides that appraisal rights will be available for any "intermediate-form" merger effected pursuant to Section 251(h) unless the offeror owns all of the stock of the target immediately prior to the merger.[2] Practically speaking, under existing Section 262(b)(3), holders of shares of stock of a target corporation that are listed on a national securities exchange are entitled to appraisal rights in an "intermediate-form" stock-for-stock merger in which they receive only stock listed on a national securities exchange even if they would not be entitled to appraisal rights in a comparable "long-form" merger as a result of the "market out" exception set forth in subsections (b)(1) and (b)(2) of Section 262.

To address the incongruity between long-form and intermediate-form mergers with respect to the availability of appraisal rights in stock-for-stock mergers, the proposed amendments to Section 262(b)(3) provide that, in the case of a merger pursuant to Section 251(h), appraisal rights will not be available for the shares of any class or series of stock of the target corporation that were listed on a national securities exchange or held of record by more than 2,000 holders as of immediately prior to the execution of the merger agreement, so long as such holders are not required to accept for their shares anything except (1) stock of the surviving corporation (or depository receipts in respect thereof), (2) stock of any other corporation (or depository receipts in respect thereof) that at the effective time of the merger will be listed on a national securities exchange or held of record by more than 2,000 holders, (3) cash in lieu of fractional shares or fractional depository receipts in respect of the foregoing, or (4) any combination of the foregoing shares of stock, depository receipts and cash in lieu of fractional shares or fractional depository receipts. Accordingly, if the proposed amendments are enacted, exchange offers followed by a merger under Section 251(h) will receive the same basic treatment as long-form mergers requiring a vote of stockholders with respect to the availability of appraisal rights.

Appraisal Statement

The proposed amendments would effect a technical change to Section 262(e) to clarify what information must be included in the statement required to be furnished by the surviving corporation under that subsection in cases where the merger was effected without a vote of stockholders pursuant to Section 251(h). Section 262(e) currently requires the surviving corporation to provide, upon request and subject to specified conditions, a statement to dissenting stockholders setting forth the aggregate number of shares that were not voted in favor of the merger or consolidation and as to which demands for appraisal have been received, and the aggregate number of holders of such shares.[3] Given that no shares are "voted" for the adoption of an agreement of merger in a transaction under Section 251(h), the proposed amendments to Section 262(e) clarify that where the statement is given in the context of an intermediate-form merger, it must set forth the relevant shares not purchased in the tender or exchange offer for which appraisal rights were demanded, rather than the shares not voted for the merger for which appraisal rights were demanded.

Ratification and Validation of Defective Corporate Acts

The proposed amendments would effect several changes to Section 204 of the DGCL, which deals with the ratification of defective corporate acts, primarily to confirm the circumstances in which it is available for use.

First, the proposed amendments to Section 204(c)(2) would confirm that Section 204 may be used

in circumstances in which there is no valid stock outstanding, even if the ratification of the underlying defective corporate act would otherwise require stockholder approval under Section 204(c). As originally drafted, and as further clarified in amendments that became effective in 2015, Section 204 specifies that whenever a vote of stockholders is required to ratify a defective corporate act, only the valid stock (which is generally defined as stock that has been issued in accordance with the DGCL) is entitled to vote on the ratification of a defective corporate act.[4] The proposed changes are intended to confirm that where there are no shares of valid stock outstanding, either because no shares (valid or putative) have been issued or because all of the shares are putative stock, a corporation may take advantage of Section 204, even if a vote of stockholders otherwise would be required to approve the ratification.

Second, the proposed amendments to Section 204(d) would specify the holders to whom notice of a ratification of a defective corporate act must be given. Currently, under Section 204(d), where a vote of stockholders is required to approve the ratification of a defective corporate act, notice of the meeting at which the proposed ratification will be considered must be given to the holders of valid stock and putative stock, whether voting or non-voting, as of the record date for notice of the meeting as well as the holders of valid stock and putative stock, whether voting or non-voting, as of the time of the defective corporate act. The corporation need not provide such notice to holders of valid stock or putative stock at the time of the defective corporate act if their identities or addresses cannot be determined from the records of the corporation.

In many cases, the time of the defective corporate act differs from the original record date that was fixed for purposes of determining the stockholders entitled to vote or provide consent on the authorization of the original act, or the record date fixed for another purpose in relation to the defective corporate act. For example, where a reverse stock split is the defective corporate act to be ratified, the time of the defective corporate act would be the date on which the reclassification of the outstanding shares pursuant to a certificate of amendment to the certificate of incorporation becomes effective. The stockholders' authorization of such amendment, however, in many cases will have been given at a meeting held weeks in advance of such effective time by stockholders of record as of a date preceding the date of the meeting.

Experience has shown that many corporations, particularly public corporations, are far more likely to have a list of stockholders as of a particular record date than they are to have a list of stockholders as of the time of a defective corporate act where such act did not occur on the record date for determining stockholders entitled to vote on the authorization of the defective corporate act. Accordingly, the changes to Section 204(d) provide that in cases where a vote of stockholders is being sought for the ratification of a defective corporate act at a meeting of stockholders, the notice that is required to be given to holders of valid stock and putative stock as of the time of the defective corporate act may be given, in circumstances where the defective corporate act required the establishment of a record date for voting, consent or for another purpose, to the holders of valid stock and putative stock as of the record date established for determining stockholders entitled to vote on or provide consent with respect to the authorization of the defective corporate act or the stockholders as of the record date fixed for such other purpose. Section 204(g) also is being amended to provide that public companies may give such notice through disclosure in a document publicly filed with the Securities and Exchange Commission pursuant to Sections 13, 14 or 15(d) of the Securities Exchange Act of 1934.

Third, the proposed amendments to Section 204(h)(1) would clarify and confirm that any act or transaction within a corporation's power under subchapter II of the DGCL may be subject to ratification under Section 204. Subchapter II of the DGCL is broadly enabling, empowering Delaware corporations to engage in all categories and classes of activities, with very few exceptions.[5] As originally drafted, Section 204 was designed to enable Delaware corporations to ratify any act or transaction

taken by or on behalf of the corporation so long as the act was one involving a power not specifically denied to corporations generally under the DGCL, such as engaging in a banking business or conferring honorary degrees.[6]

In *Nguyen v. View, Inc.*, the Court of Chancery arguably adopted a different reading of the statute.[7] Specifically, the Court indicated that because an arbitrator had ruled that a stockholder whose vote was required to approve an amendment to the certificate of incorporation specifically had revoked his prior consent, the subsequent ratification of the amendment had to "be viewed in light of that operative reality."[8] The Court held that the corporation, in proceeding with a financing transaction that relied for its effectiveness on the stockholders' approval of the amendment, "did so notwithstanding that the majority common stockholder had deliberately withheld his consent for the transaction—consent that was required for the transaction to be valid as a matter of law." Therefore, the Court found, "at the time the defective corporate acts . . . the [corporation at issue] did not have the power to take these acts. . . ."[9]

The proposed amendments to Section 204(h)(1) would overturn any implication from the *View* opinion that an act or transaction may not be within the power of a corporation solely on the basis that it was not approved in accordance with the provisions of the DGCL or the corporation's certificate of incorporation or bylaws. Indeed, defective corporate acts require ratification because originally they were not so approved. The amendments attempt to clarify that the failure to approve an act in accordance with the DGCL or the certificate of incorporation or bylaws may not, of itself, serve as a basis for excluding the act from the scope of the statute.

The proposed amendments to Section 204(h)(1), however, would not disturb the Court's power to decline to validate a defective corporate act under Section 205 on the basis that the failure of authorization that rendered such act void or voidable involved a deliberate withholding of any consent or approval required under the DGCL, the certificate of incorporation or bylaws. Notably, Section 205 of the DGCL provides the Court broad power, upon application of various parties, to validate or decline to validate (or grant other relief) in respect of acts that have been ratified in accordance with Section 204 as well as acts that have not been ratified.[10] In resolving matters brought under Section 205, the Court is expressly directed to consider, among other things,

> [w]hether the defective corporate act was originally approved or effectuated with the belief that the approval or effectuation was in compliance with the provisions of [the DGCL], the certificate of incorporation or the bylaws of the corporation.[11]

Finally, the proposed amendments to Section 204(h)(2) would clarify that the failure of an act or transaction to be approved in compliance with the disclosure set forth in any proxy or consent solicitation statement may constitute a failure of authorization. The amendment to Section 204(h)(2) would confirm that any act that is alleged to be defective due to deficiencies in the disclosure documents pursuant to which the vote or consent of stockholders was sought may be cured through ratification pursuant to Section 204. By way of example, the amendments make clear that a corporation may use Section 204 to ratify an amendment to the certificate of incorporation that is alleged to be defective due to a misstatement in the proxy statement regarding the vote required for its adoption.

Application of Sections 204 and 205 to Nonstock Corporations

The proposed amendments also would revise Section 114 of the DGCL to enable nonstock corporations to take advantage of Sections 204 and 205. In 2010, Section 114 was added to the DGCL to apply (or preclude the application of) other sections of the DGCL to nonstock corporations by translation.[12] As noted above, in 2014, Sections 204 and 205 were added to the DGCL. Those sections originally were designed primarily to cure defects in capital stock.[13]

As a result, and because nonstock corporations are inherently more structurally flexible than their stock corporation counterparts (thus allowing greater opportunity for "self-help" fixes to defective acts), Section 114 initially excluded the application of Sections 204 and 205 to nonstock corporations. Experience has shown, however, that Sections 204 and 205 have wide-ranging applications and could offer nonstock corporations a means of fixing otherwise intractable problems. Although Section 114 will not operate to translate every term in Sections 204 and 205 with literal precision, consistent with ordinary principles of statutory construction, the as-translated statutes should be construed in such a way as to give effect to the underlying intent of enabling nonstock corporations to take advantage of the procedures for ratifying or validating defective corporate acts.[14]

Corporate Name

The proposed amendments also would revise Section 102(a)(1) to provide that a corporation's name, as included in its certificate of incorporation, must be such as to distinguish it upon the records of the Division of Corporations in the Delaware Department of State from any name reserved for or name of any registered series of a limited liability company. Currently, Section 102(a)(1) requires a corporation to include its name in its certificate of incorporation and, with limited exceptions, specifies that the name must be such as to distinguish it upon the records of the office of the Division from the names that are reserved on such records and from the names on such records of each other corporation, partnership, limited partnership, limited liability company, or statutory trust organized or registered as a domestic or foreign corporation, partnership, limited partnership, limited liability company, or statutory trust under Delaware law. The revisions to Section 102(a)(1) adding registered series of limited liability companies to the list of entities from which a corporation's name must be distinguished are being proposed in connection with proposed amendments to the Delaware Limited Liability Company Act providing for the establishment of registered series of a Delaware limited liability company, which series would be formed through the filing of a certificate of registered series with the Delaware Secretary of State.

Forfeiture of Charter

The proposed amendments would clarify that the Attorney General of the State of Delaware has the exclusive authority to seek the revocation of a charter pursuant to Section 284 of the DGCL, and that the Court of Chancery may appoint a trustee to wind-up the affairs of a corporation whose charter has been revoked. The proposed amendments thereby would clarify the procedures applicable in situations in which a corporation's charter is revoked due to a clear abuse of its privileges and franchises, such as grievous criminal violations perpetrated by or in the name of the corporation.

Exempt Corporations

Finally, the proposed amendments would effect a technical change to Section 313(b) of the DGCL to reflect the Delaware Secretary of State's current practice regarding the filing of certificates of revival for exempt corporations. Corresponding amendments are proposed to be made to Section 502 of Title 8 of the Delaware Code to reflect the Secretary of State's practice regarding exempt corporations' filing of annual reports.

Conclusion

The 2018 amendments to the DGCL make several important changes, continuing Delaware's commitment to updating its corporate law annually to address issues affecting corporations and practitioners.

Notes

1. The proposed legislation has not been introduced to the Delaware General Assembly at the time of writing. A copy of the proposed legislation is *available at http://www.rlf.com/files/15699_Proposed%20Amendments%20to%20the%20General%20Coporation%20Law%20of%20the%20State%20of%20Delaware.pdf.*

2. *See* 8 Del. C. § 262(b) (2017). Section 262(b) currently provides, in relevant part, that "[a]ppraisal rights shall be available for the shares of any class or series of stock of a constituent corporation in a merger or consolidation to be effected pursuant to § 251 (other than . . . , subject to paragraph (b)(3) of this section, § 251(h) of this title)." Section 262(b)(1), in its current form, then provides the "market out" exception denying appraisal rights to holders of shares listed on a national securities exchange or held of record by more than 2,000 holders, while Section 262(b)(2) then restores appraisal rights for such holders if they are required to receive anything other than the types of consideration specified therein. *Id*. Paragraphs (1) and (2) of Section 262(b) are currently not applicable to intermediate form mergers effected under Section 251(h). Id. Those mergers are dealt with under paragraph (3) of Section 262(b), which provides, in relevant part, that if "all of the stock of a subsidiary Delaware corporation party to a merger effected under § 251(h) . . . is not owned by the parent immediately prior to the merger, appraisal rights shall be available for the shares of the subsidiary Delaware corporation." *Id*.
3. 8 Del. C. § 262(e) (2017).
4. *See* C. Stephen Bigler & John Mark Zeberkiewicz, *Restoring Equity: Delaware's Legislative Cure for Defects in Stock Issuances and Other Corporate Acts*, 69 Bus. Law. 393 (2014) (hereinafter "Restoring Equity"). In describing the manner in which a hypothetical defective corporate act would be ratified under Section 204 as originally adopted, the authors noted that the resolutions of the board of directors ratifying the act "would be submitted only to the holders of [specified] shares, since they constitute the only shares of valid stock." *Id*. at 427. The authors further noted that the shares of putative stock in their hypothetical "would not be included in that vote." *Id*. In 2015, Section 204 was amended to clarify that, where a defective corporate act requires stockholder approval under Section 204, only the valid stock is counted for quorum and voting purposes. The synopsis to the legislation effecting such clarifying change stated: "Section 204(d) has been amended to clarify that the only stockholders entitled to vote on the ratification of a defective corporate act, or to be counted for purposes of a quorum for such vote, are the holders of record of valid stock as of the record date for determining stockholders entitled to vote thereon. It does so by confirming that shares of putative stock will not be counted for purposes of determining the stockholders entitled to vote or to be counted for purposes of a quorum in any vote on the ratification of any defective corporate act." S.B. 75, 149th Gen. Assem. (Del. 2015).
5. Subchapter II of the DGCL consists of Sections 121 through 127. 8 Del. C. §§ 121–127. Sections 121 through 123 are broadly enabling empowering statutes, *see id*. §§ 121–123, and Section 124 deals with "ultra vires" acts, *id*. § 124. Sections 125 through 127 are the provisions that primarily impose restrictions on a corporation's power. *Id*. §§ 125–127. Section 125 restricts a corporation's power to confer academic or honorary degrees, subject to certain conditions, *id*. § 125; Section 126 specifically prohibits corporations from engaging in a banking business, *id*. § 126; and Section 127 requires a private foundation that does not opt out of that section in its certificate of incorporation to act or refrain from acting in specified ways, *id*. § 127.
6. *See generally* Bigler & Zeberkiewicz, *Restoring Equity*, at 402–03.
7. 2017 WL 2439074 (Del. Ch. June 6, 2017).
8. *Id*. at *9.
9. *Id*.
10. *See* 8 Del. C. § 205(a) & (b).
11. *Id*. § 205(d)(1).
12. 77 Del. Laws ch. 253 (2010).
13. *See generally* Bigler & Zeberkiewicz, *Restoring Equity*.
14. *See* John Mark Zeberkiewicz & Blake Rohrbacher, *A New Day for Nonstock Corporations: The 2010 Amendments to Delaware's General Corporation Law*, 66 Bus. Law. 271, 282 (2010) (noting, in reference to the operation of the "translator" provision, that "[p]ractitioners should be aware . . . [that] each of the four translator guides in subsections 114(a)(1)–(4) uses the terms "references" and "deemed to refer to," which were intended to show that the nonstock translations are concept-based, not merely word-based" and that, accordingly, "some translations may not be verbatim and may require some rewording."