DELAWARE'S LONG-FORM DISSOLUTION STATUTE: AN UNDERUTILIZED ALTERNATIVE

SEPTEMBER 01, 2015

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Introduction

Many companies are "too broke to go bankrupt." As the "ABI Commission to Study the Reform of Chapter 11"[1] notes, "anecdotal evidence suggests that Chapter 11 has become too expensive (particularly for small and medium size enterprises)," and more companies are liquidating without attempting to reorganize under federal bankruptcy laws.[2]Those companies often seek alternatives to Chapter 11. Some of those alternatives are well understood, such as Chapter 7 of the Bankruptcy Code and, in some states, an assignment for benefit of creditors or "ABC."

One alternative that is often overlooked is a "long-form" dissolution under Delaware's General Corporation Law ("DGCL"). The long-form dissolution statute, enacted in 1987, is designed to solve the dilemma of potential personal liability that directors faced under common law and under dissolution statutes in other jurisdictions if they distribute all of the assets of a dissolved corporation and it later turns out that unknown creditors existed.[3] As described in more detail below, this process, which involves proceedings in the renowned Delaware Court of Chancery, addresses this concern while arguably providing the most protection to directors who faithfully carry out the process of any bankruptcy alternative. At the same time, it provides creditors with notice and an opportunity to present their claims.

The Long-Form Dissolution Process

Delaware has two statutory methods by which a corporation can dissolve: the default "short-form" dissolution and the optional "long-form" dissolution. The long-form dissolution process has several key components, including notice to creditors, a bar date, publication notice and a court approval process. The short-form dissolution statute, like the dissolution statutes in most other states, has none of these components.

Notice and Claims Process

The "notice and claims" process is similar to a bar date in a bankruptcy case. It is designed to elicit the filing of claims against the corporation and provides a mechanism for the corporation to respond to and reject disputed claims.[4] The notice of dissolution is mailed to known claimants and holders of contingent contractual claims and must also be published in a Delaware-based newspaper, as well as a newspaper in the corporation's principal place of business and if the corporation has more than $10 million in assets, a national newspaper.[5] The dissolution notice must include, among other things, the bar date, which can be no earlier than 60 days from the date of the notice.[6]

Claims not submitted by the bar date are statutorily barred.[7] While the claims bar does not purport to bar new claims that arise after the bar date, such claims are generally unlikely because the corporation must cease operations upon dissolution.[8] The statute only bars the claims of creditors who have received actual notice of the dissolution.[9] For this reason, we often recommend that a corporation distribute the notice to a broader group of potential claimants than is statutorily required. While this may result in more claims being submitted, it also subjects more claims to being barred, and any frivolous claims may be rejected.[10] Claimants who read the publication notice

will likely be deemed to have actual notice of the dissolution, but mailing the notice directly establishes a presumption of actual notice and avoids evidentiary issues that may arise in relying solely on publication.
The corporation must send the notice to all known claimants, even if the validity of the claim is disputed. Merely giving notice does not revive any claim against the corporation that is otherwise barred or constitute an acknowledgement that a claim is valid.[11] Moreover, the corporation can "reject" claims in whole or in part.[12] The concept of "rejection" is similar to "claims objections" in bankruptcy cases. If a claim is rejected, the claimant must initiate an action, suit or proceeding within 120 days or the claim becomes barred.[13] Unlike after a claims objection in a bankruptcy case, the claimant can institute an action in any court having jurisdiction and need not initiate the action in Delaware.

Within 90 days of receipt of a contingent contractual claim (such as a claim based on an indemnity provision), the corporation must make an "offer of security" to provide for the claim in case it matures.[14] The offer of security can take many possible forms, including a specific reserve for the claim, an insurance policy to cover the claim, or a general reserve fund to provide for all contingent claimants. Any claimant who fails to reject the corporation's offer of security within 120 days is deemed to have accepted such security as the sole source from which the claim can be satisfied.[15]

Dissolution Proceeding in the Court of Chancery

The in-court phase of a long-form dissolution commences with the corporation filing a petition in the Delaware Court of Chancery to determine the amount and form of security that it must maintain for certain claims.[16] Although the corporation can file a petition at any time after giving notice of its dissolution, many corporations wait until the notice and claims process has been completed to initiate the dissolution proceeding. This is because the Court has the responsibility to independently determine[17] the security that will be "reasonably likely to be sufficient" to provide compensation for suits against the corporation (including suits filed as part of the notice and claims process)[18] and that will be "sufficient" to provide compensation to claimants who reject an offer of security during the notice and claims process.[19] In addition, the Court must also determine the amount and form of security that will be "reasonably likely to be sufficient" for unknown claims or claims that have not yet arisen, but that, based on facts then known to the corporation, are likely to arise within 5 years (or such longer period of time, not to exceed 10 years, as the Court may determine) of the dissolution.[20]Products liability and asbestos exposure claims are examples of future claims that could be considered "likely" to arise in certain situations.

Undisputed dissolution proceedings can often be completed in a matter of weeks. Dissolutions involving extensive contingent, unknown or disputed claims can take considerably longer and may involve full evidentiary discovery, briefing and hearings before the Court of Chancery.[21] For example, in In re RegO Company, the Court of Chancery addressed a petition for approval of a dissolved corporation's plan to provide for future product-liability claims through a trust arrangement.[22] Because the assets of the corporation were not expected to be sufficient to pay all claims in full, the corporation proposed an initial $500,000 cap on each individual claim. Future claimants not paid in full due to the initial cap would later be entitled to payment on a pro rata basis with other claimants from any remaining assets.[23] The representative of the future claimants opposed the plan, arguing that the $500,000 cap impermissibly favored present claimants because the corporation's remaining assets would likely be exhausted long before future claims were likely to arise.[24] The Court agreed and ordered, based on expert testimony and the other evidence presented, that a $300,000 initial cap on each claim was more appropriate because it would preserve the corporation's assets for the future claimants.[25]

Completing the Wind-up and Distributing Remaining Assets

After completing the court proceedings, the corporation must pay any proper claims that have not been rejected, post any security offered to contingent contractual claimants and post any other security ordered by the Court of Chancery.[26] The corporation must also pay or provide for in full any additional claims that are finally determined to be owing by the corporation during the dissolution.[27] Any remaining funds may be distributed to the stockholders.[28]

Directors who complete the long-form dissolution process in accordance with the DGCL cannot be held personally liable to the claimants of the dissolved corporation.[29] Even if the Court of Chancery process results in a larger holdback as security for potential claimants than the board of directors might have desired, there is a substantial benefit to the directors in having that determination made *ex ante* (before the corporation's funds are distributed) rather than *ex post*(after the fact), when personal liability might be the only remedy.[30]

Corporate Existence

Regardless of when the wind-up is completed, the corporation's existence will continue for a minimum of three years after the filing of the certificate of dissolution.[31] During that period, the corporation's existence is limited to winding-up its affairs, which includes prosecuting and defending against suits.[32] At the end of the period, the legal existence of the corporation will cease unless the corporation is a party to an action, suit or proceeding[33] or the Court of Chancery orders that the corporation shall exist for a longer period.[34] At that point, the former officers and directors of the corporation no longer have any authority to act on behalf of the corporation; however, the Court, on application of any creditor, stockholder, director or other person who shows good cause, can appoint a receiver to act for a dissolved corporation.[35] Corporations involved in prolonged litigation or that have substantial long-tail liabilities (such as exposure to future asbestos claims) can petition the Court to continue in existence for longer than the minimum three-year period.[36]

Advantages of the Long-Form Dissolution

The long-form dissolution process has several advantages for directors over the short-form dissolution and other alternatives.

Advantages Over Short-Form Dissolution

The long-form dissolution statute was designed to address concerns that many directors had with the short-form dissolution process stemming from the lack of notice given to a corporation's creditors. Without such notice, it is extremely difficult for directors to ensure that creditors have not been overlooked prior to distributing funds to known creditors and stockholders. Once all of the corporation's remaining funds have been distributed, a creditor's only recourse is to seek recovery from the stockholders or the directors who authorized the distribution. Seeking recovery from diffuse stockholders will often prove costly and impractical, so the dissolved corporation's directors are likely to find themselves the focus of a jilted creditor's ire. Although the DGCL limits the personal liability of directors to a dissolved corporation's creditors even in the short-form process, the Court of Chancery has acknowledged that "compliance with [the short-form dissolution's] standard . . . will, in principle at least, always be litigable. Thus, reliance upon the mechanism of Section 281(b) may present a risky situation for corporate directors regardless of their good faith and due care."[37] Because directors are faced with the potential for personal liability (or at least litigation costs) in a short-form dissolution, they have an incentive to hold excess funds in reserve rather than make distributions to stockholders.

The long-form dissolution process alleviates many of these concerns. Directors have more information regarding the nature and extent of the corporation's potential liabilities due to the notice and bar date mechanics, and the power to reject frivolous claims, which will be barred unless the creditor is willing to expend the time and resources necessary to litigate the claim. More importantly, whether the directors' plan of security is sufficient is the *sine que non* of the Chancery Court proceeding, so the Court will make an *ex ante* ruling. So long as the corporation complies with the Court's ruling, there is no basis for claims against the directors.

Advantages Over Other Alternatives

While a Chapter 11 plan after a claims bar date process provides many of the same benefits as a long-form dissolution, the costs are exponentially higher. A Chapter 7 case is less expensive than a Chapter 11 process, but does not leave the corporation and its board of directors in charge of its liquidation, frequently results in litigation, including against vendors, directors and officers, and requires additional tasks of the corporation's officers that are not part of a dissolution process, such as preparation of statements and schedules. And even with all of those burdens, neither a Chapter 11 nor a Chapter 7 case provides statutory protections to the board of directors akin to those set forth in the long-form dissolution statute.

An ABC is often a desirable solution and is far less expensive than bankruptcy. However, the protections afforded to the board of directors or an assignee under an ABC at most derive from common law and are untested, whereas they are clear and statutory for long-form dissolutions. In addition, ABC regimes vary widely from state to state; in some states they are the subject of lengthy statutes that resemble the bankruptcy code, whereas others are wholly common law. The long-form dissolution statute is clear, succinct, and its requirements solely relate to the problems at hand without adding additional hurdles and requirements.

When the Long-form Dissolution Statute Cannot Be Used

A long-form dissolution is not for every company. First, it only applies to Delaware corporations; there is no similar statute for limited liability companies or limited partnerships, and most states do not have a similar statute in their corporate code.[38] Second, dissolution requires stockholder approval, which can be difficult for a public company to obtain.[39]Third, dissolved corporations cannot continue to operate; their continued existence is solely to wind-up the corporation's affairs.[40] Thus, if the corporation still has significant operations, the corporation may need to seek a sale of its operating assets before engaging in a long-form dissolution.

In other situations, the long-form dissolution option can be overkill. For example, a corporation that already has been through bankruptcy, or that ceased operations a decade ago and is unlikely to have unknown creditors, likely should utilize a simpler, less expensive alternative, such as a short-form dissolution, in most instances.

Conclusion

The long-form dissolution statute is an attractive, but often overlooked, alternative for winding-up the affairs of a Delaware corporation. It avoids the expense and complexity of bankruptcy and addresses many of the shortcomings of a short-form dissolution, while providing superior protections to directors who comply with the process. The regime is a viable and attractive alternative and should be considered by any board of directors that is evaluating a corporation's options for ceasing operation.

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[1] Reprinted in Am. Bankr. Instit. L. Rev., Vol. 23, No. 1 (Winter 2015).
[2] Id. at 12-13.
[3] See In re RegO Co., 623 A.2d 92, 96 (Del. Ch. 1992); Heaney v. Riddle, 23 A.2d 456 (Pa. 1942) (holding directors personally liable under Pennsylvania statute for failing to provide for a contingent liability in dissolution).
[4] See 8 Del. C. § 280.
[5] 8 Del. C. § 280(a)(1), (b)(1).
[6] 8 Del. C. § 280(a)(1).
[7] 8 Del. C. § 280(a)(2). Claims in active litigation do not need to be submitted in response to the dissolution notice, and therefore are not barred if no claim is filed. See 8 Del. C. § 280(a)(1), (2).
[8] However, the corporation is required to provide security for future claims that are likely to arise in the future. See 8 Del. C. § 280(c)(3).
[9] 8 Del. C. § 280(a)(2).
[10] See 8 Del. C. § 280(a)(2)-(4).
[11] 8 Del. C. § 280(d).
[12] 8 Del. C. § 280(a)(3).
[13] 8 Del. C. § 280(a)(3), (4).
[14] 8 Del. C. § 280(b)(2).
[15] Id.
[16] 8 Del. C. § 280(c).
[17] RegO, 623 A.2d at 109 ("[The Court] stands as the statutorily designated arbiter of the security arrangement that is appropriate.").
[18] 8 Del. C. § 280(c)(1).
[19] 8 Del. C. § 280(c)(2). Although there are no Delaware cases addressing the significance (if any) of the distinction between the Court of Chancery's obligation to determine the security that is "sufficient" to compensate for contingent contractual claims and the security that is "reasonably sufficient" to compensate for all other claims, the statute arguably requires the Court to take a more protective, creditor-friendly approach when determining the amount of security required for contingent contractual claims.
[20] 8 Del. C. § 280(c)(3). The Court of Chancery may appoint a guardian ad litem to represent the interests of any unknown claimants in the dissolution proceeding. Id.
[21] See, e.g., Gans v. MDR Liquidating Corp., 1990 WL 2851 (Del. Ch. Jan. 10, 1990) (the first in a series of five opinions that address disputes over the amount and form of security for the payment of various creditors).
[22] 623 A.2d at 100-02.
[23] Id. The Court noted that a corporation that cannot provide for all of its claimants in full is not prevented from dissolving under the long-form method so long as it dedicates all of its remaining assets to satisfying its creditors. Id. at 102-03.
[24] Id. at 105. The Court of Chancery noted that the Delaware statute does not contain a general statute of limitations period for bringing claims against a dissolved corporation. Id.; see also Krafft-Murphy, 82 A.3d at 705 ("Nothing in § 278 operates as a statute of limitation that would bar claims or extinguish a dissolved corporation's liability to third parties.")
[25] RegO, 623 A.2d at 109-10.
[26] 8 Del. C. § 281(a).
[27] Id.
[28] Id.

[29] See 8 Del. C. § 281(c).
[30] See Jack B. Jacobs, “Delaware Receivers and Trustees: Unsung Ministers of Corporate Last Rites,” 7 Del. J. Corp. L. 251, 254-55 (1982) (discussing the advantages of a court-supervised dissolution).
[31] 8 Del. C. § 278.
[32] Id.
[33] Suits brought against or initiated by the corporation during the three-year wind-up period will not abate by reason of the dissolution and the corporation’s existence as a “body corporate” will be automatically continued beyond the three-year period solely for purposes of resolving the suit. Id.
[34] Id.
[35] 8 Del. C. § 279; see also Krafft-Murphy, 82 A.3d at 703-04 (noting that a receiver can be appointed “at any time” for specified purposes); id. at 710 (concluding that a receiver would need to be appointed to defend against lawsuits initiated more than three years after the corporation’s dissolution because the corporation had ceased to exists as a “body corporate” for purposes of any suit not initiated prior to the expiration of the three-year period).
[36] See 8 Del. C. § 278.
[37] RegO, 623 A.2d at 97.
[38] Other entities can, of course, be converted into corporations which then can utilize the long-form dissolution statute. See 8 Del. C. § 265. Similarly, entities in other jurisdictions can convert to a Delaware corporation. Id.
[39] 8 Del. C. § 275.
[40] 8 Del. C. § 278.