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2014 Proposed Amendments to the General Corporation Law of the State of Delaware

The 2014 proposed amendments to the DGCL would give corporations and their counsel increased flexibility in structuring transactions and in effecting various corporate acts. The proposed legislation would clarify the requirements for accomplishing two-step takeovers without a back-end vote on the merger, provide a means of enabling board and stockholder consents to be delivered in escrow, simplify the process of implementing certain amendments to the certificate of incorporation, relax the filing requirements in respect of voting trusts, and provide corporations a means of dealing with issues that arise when their incorporator has not duly completed the incorporation process and cannot be located to assist with any necessary corrective measures.

By John Mark Zeberkiewicz

Legislation proposing to amend the General Corporation Law of the State of Delaware (DGCL) has been approved by the Corporation Law Section of the Delaware State Bar Association and is expected to be introduced to the General Assembly of the State of Delaware. The proposed amendments, if enacted, would become effective on August 1, 2014, except for the amendments to Section 251(h), which would become effective with respect to merger agreements entered into on or after August 1, 2014.

Section 251(h) Mergers

In 2013, the DGCL was amended to eliminate, subject to certain conditions, the need for a back-end merger vote in a two-step merger involving a front-end tender or exchange offer for shares of a publicly traded Delaware target corporation.[1] Early experience with Section 251(h) demonstrated the statute's utility, with a number of transactions being accomplished pursuant to it within its first year of effectiveness. However, it also gave rise to questions among practitioners regarding certain aspects of its use and application. The 2014 proposed amendments to the DGCL are designed to address those questions.

The 2014 proposed amendments would eliminate the prohibition against the statute's use in circumstances where a party to the merger agreement is an "interested stockholder" as defined in Section 203 of the DGCL. Section 203(c)(5) generally defines "interested stockholder" to mean any person that is the beneficial owner of 15 percent or more of the outstanding voting stock of the corporation, or is an affiliate or associate of

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the corporation and was the owner of 15 percent or more of the outstanding voting stock of the corporation at any time within the three-year period immediately prior to the date on which it is sought to be determined whether such person is an interested stockholder, and the affiliates and associates of such person.[2] By removing the prohibition against the accomplishment of a 251(h) merger with an "interested stockholder," the proposed legislation would, among other things, eliminate any question as to whether an offeror's entry into certain voting agreements or other arrangements with existing stockholders would render the offeror itself an "interested stockholder" and therefore incapable of taking advantage of Section 251(h).

The 2014 proposed amendments also would clarify various timing and other requirements in respect of the back-end merger. Section 251(h) currently provides that, following the consummation of the offer, the offeror must "own" the percentage of stock (and of each class and series thereof) the affirmative vote of which, absent Section 251(h), would be necessary to adopt a merger agreement. The 2014 amendments would provide that, following the consummation of the offer, the stock irrevocably accepted for purchase or exchange and received by the depository prior to the expiration of the offer, plus the stock owned by the consummating corporation, must equal at least the percentage of stock (and of each class or series) the affirmative vote of which, absent Section 251(h), would be required to adopt the merger agreement. The proposed amendments would specify that the term "consummates" (and correlative terms) means the time at which the offeror irrevocably accepts for purchase or exchange stock tendered pursuant to a tender or exchange offer; "depository" means an agent, including a depository, appointed to facilitate consummation of the offer; and "received" means physical receipt of a stock certificate in the case of certificated shares and transfer into the depository's account, or an agent's message being received by the depository, in the case of uncertificated shares. Through these changes, the proposed legislation would provide greater certainty as to which shares may be counted toward the total number of shares needed to accomplish the back-end merger.

Section 251(h) currently requires the offeror to consummate a tender or exchange offer for any and all of the outstanding stock of the target that, absent Section 251(h), would be entitled to vote on the adoption of the merger agreement. The proposed amendments would clarify that such tender may exclude stock that, at the commencement of the offer, is owned by the target corporation, the offeror, persons that directly or indirectly own all of the stock of the offeror, and direct or indirect wholly-owned subsidiaries of the foregoing parties.

The proposed legislation would provide greater certainty as to which shares may be counted toward the total number of shares needed to accomplish the back-end merger.

Section 251(h) currently provides that shares of the target corporation "not to be canceled in the merger" must receive the same consideration paid to holders of shares of the same class or series upon the consummation of the offer. The proposed legislation would modify this requirement to provide that shares that are the "subject of and not irrevocably accepted for purchase or exchange in the offer" must be converted into the same consideration paid for shares of the same class or series irrevocably accepted for purchase or exchange in the offer.

The proposed amendments would clarify that the merger agreement in respect of a transaction

under Section 251(h) may either permit or require the merger to be effected under Section 251(h). Thus, the proposed amendments expressly enable the parties to provide in the merger agreement that the proposed merger under Section 251(h) may be abandoned in favor of a merger accomplished under a different statutory provision. As a related matter, the proposed amendments would clarify that the merger agreement must provide that the back-end merger shall be effected as soon as practicable after the offer *if* the merger is effected under Section 251(h).

As with the legislation originally enacting Section 251(h),[3] the synopsis to the proposed amendments states that the amendments to the subsection do not change the fiduciary duties of directors in connection with any merger accomplished under the subsection or the judicial scrutiny applied to any decision to enter into a merger agreement under the subsection.

Amendments to the subsection do not change the fiduciary duties of directors in connection with any merger.

As noted above, the proposed amendments to Section 251(h), if enacted, would become effective with respect to merger agreements entered into on or after August 1, 2014.

Escrowing Director Consents

Section 141(f) of the DGCL would be amended to clarify that any person, whether or not then a director, may provide, by instruction or otherwise, that a consent to board action will be effective at a future time, including a time determined upon the occurrence of an event, no later than 60 days after the instruction is given or other provision is made, and that the consent will be deemed to have been given at that effective time as long as the person is then a director and did not, prior to the effective time, revoke the consent. The proposed amendment to Section 141(f) was adopted in response to concerns, stemming from *AGR Halifax Fund, Inc. v. Fiscina*,[4] over the validity of consents executed by persons who have not yet become directors at the time they execute board consents.

AGR Halifax involved an action under Section 225 of the DGCL to determine the composition of the board of directors of Certified Diabetic Services, Inc. The petitioners, purporting to hold a majority of Certified's outstanding common stock, claimed that, acting by written consent, they removed the directors then in office, amended Certified's bylaws to reduce the size of the board to two, and elected two new directors.[5] The respondents claimed that the petitioners' consents were invalid, arguing that a prior amendment to Certified's certificate of incorporation eliminated stockholders' power to act by written consent (Consent Amendment).[6] The petitioners alleged, among other things, that the Consent Amendment was void *ab initio* because it had not been adopted in accordance with Section 242 of the DGCL.[7] In particular, they claimed that the board's approval of the amendment was not validly obtained since the respondents had not been validly elected at the time they purported to execute consents approving the amendment.[8] The Court agreed with the petitioners.[9] In reaching its conclusion, the Court found that respondents' argument that the Court's ruling would "'wreak havoc' upon the ability of directors to use the written consent mechanism" lacked force.[10] The Court stated that any conclusion other than the one it reached would require the validation of "actions taken by persons who were not [the corporation's] directors."[11] At the time, the Court found, "[n]o statutory provision or case law compels" it to reach that conclusion.[12]

The concerns flowing from the *Halifax* opinion resulted in acquisition financing transactions

(among other types of transactions) being approved through a series of carefully orchestrated and overly complicated steps. The proposed amendments would help to dispense with the overly complicated sequencing. As a result, acquisition financing transactions may be authorized such that the person or persons who are to become the directors of the surviving corporation may execute consents, to be held in escrow, authorizing the financing and security transactions and related documents. The consents would become effective upon the signing person's or persons' election or appointment to the board of the surviving corporation concurrently with the closing of the transaction. Accordingly, if the 2014 amendments are enacted, transaction planners will be able to arrange for signature pages to be collected from the prospective directors prior to closing without the need to obtain further or additional time-pressured approvals on the date of closing.

The proposed amendments would help to dispense with the overly complicated sequencing.

Escrowing Stockholder Consents

Consistent with the bases for the proposed changes to Section 141(f), Section 228(c) of the DGCL would be amended to clarify that any person executing a stockholder consent may provide, by instruction or otherwise, that the consent will be effective at a future time, including a time determined upon the occurrence of an event, no later than 60 days after the instruction is given or other provision is made and, if evidence of the instruction or provision is given to the corporation, the later effective time will constitute the date of signature. Together with the amendment to Section 141(f), the amendment to Section 228(c) would facilitate a rational sequencing of consents obtained in advance of a transaction's closing.

Amendments to the Certificate of Incorporation

The 2014 proposed amendments would effect two substantive changes to Section 242 of the DGCL, which deals with amendments to the corporation's certificate of incorporation. First, the proposed amendments would eliminate the requirement that the notice of the meeting at which an amendment to the certificate of incorporation is to be voted on contain a copy of the amendment itself or a brief summary of the amendment when the notice constitutes a notice of internet availability of proxy materials under the Securities Exchange Act of 1934. This amendment facilitates Delaware corporations' use of the Securities and Exchange Commission's Notice and Access rule in connection with meetings at which an amendment to the certificate of incorporation is submitted to stockholders. Second, the proposed amendments would authorize a corporation, by action of its board of directors, to amend its certificate of incorporation to change its name[13] or to delete historical references to its incorporator, its initial board of directors or its initial subscribers for shares, or to provisions effecting changes to its stock (e.g., language effecting an earlier stock split), without the need to submit the amendment to a vote of stockholders.[14]

Voting Trusts

Section 218 of the DGCL currently requires that a voting trust agreement, or any amendment thereto, be filed with the corporation's registered office in the State of Delaware.[15] The 2014 proposed amendments to Section 218 would provide that a voting trust agreement, or any amendment thereto, may be delivered to the corporation's principal place of business instead of its registered office.

Incorporator Unavailability

The 2014 proposed amendments would accomplish two changes to address issues that

arise when a corporation's incorporator has become unavailable before completing his, her or its statutory functions. Section 103(a)(1) of the DGCL currently provides that if the incorporator is unavailable by reason of death, incapacity, unknown address or refusal or neglect to act, a person for whom or on whose behalf the incorporator was acting may, subject to certain conditions, execute any such certificate with the same effect as if it were executed by the incorporator.[16] The proposed amendments to Section 103(a)(1) would eliminate any limitation arising from the reason for the incorporator's unavailability. In addition, the proposed amendments would add a new Section 108(d) that renders the concepts embodied in Section 103(a)(1) applicable to instruments in addition to certificates filed with the Delaware Secretary of State. Thus, new Section 108(d) would provide that if an incorporator is not available to act, any person for whom or on whose behalf the incorporator was acting may, subject to certain conditions, take any action that the incorporator would have been entitled to take under Section 107 or 108 of the DGCL.

Conclusion

The 2014 amendments to the DGCL will provide corporations and their counsel greater flexibility in structuring transactions, and they demonstrate Delaware's commitment to maintaining a corporate law that meets the needs and demands of modern business.

Notes

1. 79 Del. Laws ch. 72 (2013). For a summary of the 2013 amendments to the DGCL, see William J. Haubert, John Mark Zeberkiewicz & Brigitte V. Fresco, *Significant Proposed Amendments to the General Corporation Law of the State of Delaware*, INSIGHTS, June 2013.

2. *See* 8 *Del. C.* § 203(c)(5).

3. The synopsis to the legislation enacting Section 251(h) stated: "The subsection does not change the fiduciary duties of directors in connection with such mergers or the level of judicial scrutiny that will apply to the decision to enter into such a merger agreement, each of which will be determined based on the common law of fiduciary duty, including the duty of loyalty." *See* H.B. 127, 147th Gen. Assem. (Del. 2013). The synopsis to the 2014 proposed amendments includes nearly identical language.

4. 743 A.2d 1188 (Del. Ch. 1999). The issue became more prominent following the decision of the Court in *U.S. Bank National Association v. Verizon Communications Inc.*, C.A. No. 3:10-CV-1842-G (N.D. Tex. Aug. 8, 2012), which relied upon the holding in *AGR Halifax*, discussed below.

5. *Id.* at 1189.

6. *Id.* Through a fairly involved series of consents at the board and stockholder levels, the respondents had attempted to remove directors, reduce the size of the board, elect themselves to the board, and amend the certificate of incorporation. *Id.* at 1190. Of particular relevance to this discussion, the board consent approving the Consent Amendment was executed on May 20, 1999, but the stockholder consent reducing the size of the board and electing the directors signing the board consent to office was not delivered and did not become effective until May 24, 1999. *Id.*

7. *Id.* at 1191–92.

8. *Id.* at 1193.

9. *Id.* at 1194.

10. In rejecting respondents' arguments, the Court stated: "A good way to understand the flaw in the respondents' position is to assume that three persons who are seeking election as directors—but who have not yet been elected—hold a meeting. Purporting to act as the board, those persons adopt a resolution proposing an amendment to the corporation's charter and providing that the resolutions will become effective if and when those three persons are elected as directors. Surely no one would seriously contend that that resolution—a nullity from the outset—would suddenly become legally valid and effective if (and when) its adopters are elected as directors one week later. Why, then, should the result be any different where those same persons act by a written consent that contemplates that their acts will become effective if and when the consent is delivered to the corporation? In either case, persons who are not directors are attempting to make decisions for the corporation at a time that they have neither the statutory power under § 141(a) to do so, nor the weight of fiduciary responsibility which accompanies that power." *Id.* at 1194–95.

11. *Id.* at 1195.

12. *Id.*

13. The DGCL currently permits Delaware corporations to effect a name change without obtaining a stockholder vote by complying with the short-form merger provisions set forth in Section 253. *See* 8 *Del. C.* § 253. The 2014 amendments would dispense with the need to follow those procedures if the corporation desires to change its name without a stockholder vote.

14. These proposed amendments to Section 242 are consistent with existing Section 245(c) of the DGCL, which provides: "A restated

certificate of incorporation may omit (a) such provisions of the original certificate of incorporation which named the incorporator or incorporators, the initial board of directors and the original subscribers for shares, and (b) such provisions contained in any amendment to the certificate of incorporation as were necessary to effect a change, exchange, reclassification, subdivision, combination or cancellation of stock, if such change, exchange, reclassification, subdivision, combination or cancellation has become effective" and which specifies that "[a]ny such omissions shall not be deemed a further amendment." 8 *Del. C.* § 245.

15. 8 *Del. C.* § 218.

16. *Id.* § 103(a)(1).