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Amendments to Delaware General Corporation Law

By John Mark Zeberkiewicz and Blake Rohrbacher

Significant amendments to the General Corporation Law of the State of Delaware (DGCL) have been introduced in Delaware's General Assembly this year. The amendments were introduced in two separate bills. One bill, containing the nonstock corporation amendments, was approved by the Delaware General Assembly and was signed by the Governor on May 3, 2010. Those amendments generally become effective on August 1, 2010. The second bill, containing the other amendments, was not yet signed by press time;[1] those amendments generally become effective on August 2, 2010.[2]

Consistent with Delaware's desire to ensure that its corporation laws meet the needs of its constituents, including practitioners, owners, and managers, the 2010 amendments to the DGCL represent further enhancements to Delaware's corporation laws. The centerpiece of the 2010 amendments is a comprehensive revision of the DGCL to rectify existing inconsistencies, problems, and omissions regarding the DGCL's application to nonstock corporations. Among the other notable proposed amendments is new Section 267, which would provide a mechanism for a short-form merger of a subsidiary corporation (or corporations) and a non-corporate parent, such as a limited partnership or a limited liability company.

The Nonstock Corporation Amendments

The focus of the 2010 amendments—probably the largest set of amendments to the DGCL in 40 years—are the amendments regarding nonstock corporations. The nonstock amendments are intended to clarify, fill gaps in, and make consistent the DGCL's application to corporations that are not authorized to issue capital stock, commonly known as nonstock corporations.[3]

As a historical matter, nonstock corporations have not been comprehensively addressed in the DGCL. While most other states have separate statutes for stock and nonstock corporations (or for-profit corporations and non-profit corporations), Delaware has long relied on its general corporation law, which applies to both stock corporations and nonstock corporations, as well as to both for-profit and non-profit corporations.[4]

John Mark Zeberkiewicz and Blake Rohrbacher practice corporate law at Richards, Layton & Finger, P.A., in Wilmington, Delaware. The authors, and other attorneys at Richards, Layton & Finger, were involved in drafting the legislation discussed herein, but the opinions expressed in this article are those of the authors and not necessarily those of Richards, Layton & Finger or its clients.

Under the all-inclusive approach of the DGCL, it sometimes happened that advances in the provisions applicable to nonstock corporations did not always match the advances in the provisions applicable to stock corporations.

Furthermore, the DGCL was occasionally a victim of its own breadth and comprehensive nature. Only 24 sections in the pre-amendment DGCL expressly addressed nonstock corporations. Whether the remaining sections of the DGCL applied to nonstock corporations was sometimes a question. In *Scattered Corp.*, the Delaware Court of Chancery appeared to answer that question in the negative, refusing to find that the "Legislature intended that the term 'stockholder,' as used . . . throughout the DGCL, includes members of nonstock corporations except where otherwise provided," and denying a demand for books and records of a nonstock corporation under 8 *Del. C.* § 220.[5] While Section 220 was amended to fix this particular situation,[6] such section-specific changes intensified the doubt that other provisions of the DGCL containing no express reference to nonstock corporations (but containing express references to stock corporations) applied to nonstock corporations.

The 2010 amendments provide clarity and consistency so that nonstock corporations—whether organized for profit or not for profit—and their advisors will now have appropriate and necessary statutory guidance to arrange their governance regimes and conduct their business and affairs. A guiding principle of the nonstock amendments was to "codify common sense"; that is, the amendments generally clarify that the DGCL operates in the manner in which most practitioners always believed that it operated.

Operation of the Nonstock Amendments

The backbone of the nonstock amendments is new Section 114. It is a "translator" provision setting forth which provisions of the DGCL apply to all nonstock corporations and also, of those provisions, which apply specifically to non-profit nonstock corporations. Although the DGCL contains other provisions dealing specifically with nonstock corporations, most analyses of a statutory issue regarding Delaware nonstock corporations will begin with Section 114.

Section 114 has four operative subsections. Subsection 114(a) generally provides that each provision of the DGCL—unless otherwise provided in subsections 114(b) or 114(c)—applies to nonstock corporations by translating the stock-corporation terms in each applicable provision into nonstock-corporation terms. For example, the term "stockholder" in a given section would be translated into "member," for purposes of applying to a nonstock corporation. Subsection 114(a)(4) accounts for the differences between for-profit and non-profit nonstock corporations by providing that members of non-profit nonstock corporations have memberships, while members of other nonstock corporations hold membership interests, which are personal property.[7]

Subsection 114(b) carves out certain provisions of the DGCL from the operation of subsection 114(a). Specifically, subsection 114(b)(1) lists provisions of the DGCL that already apply to nonstock corporations by their terms and therefore require no translation; subsections 114(b)(2) and 114(b)(3) list sections and subchapters of the DGCL that are not translated by subsection 114(a) to apply to nonstock corporations.[8] Subsection 114(c) carves out specified provisions, in addition to those listed in subsection 114(b), to ensure that the specified provisions do not apply to non-profit nonstock corporations. Finally, subsection 114(d) defines the following terms relating to nonstock corporations: "nonstock corporation," "membership interest," "non-profit nonstock corporation," and "charitable nonstock corporation."

Notable Features of the Nonstock Amendments

While the nonstock amendments primarily are intended to clarify the long-understood

application of certain provisions of the DGCL to nonstock corporations, the amendments also effect some substantive changes to the existing law regarding nonstock corporations. Among those substantive changes are the following:

- Nonstock corporations are expressly required to have members, but subsection 102(a)(4) contains a savings clause to ensure that any nonstock corporation failing to have members is not invalidated for that reason. Subsection 102(a)(4) also allows the conditions of membership to be included in a nonstock corporation's certificate of incorporation or in its bylaws. Furthermore, for those nonstock corporations that fail to set forth their conditions of membership, the members will be deemed to be those who elect the members of the governing body. Under the pre-amendment DGCL, a nonstock corporation must state the conditions of membership in its certificate of incorporation (or provide in the certificate of incorporation that the conditions would be included in the bylaws), but it is unclear whether nonstock corporations are required to have members or what effect the failure to have members would have on a corporation's existence and operations.
- The record date for any meeting of members or other corporate action is deemed to be the date of the meeting or corporate action, unless otherwise provided in the corporation's certificate of incorporation or bylaws or in a resolution of the corporation's governing body.
- Section 253, which generally empowers stock corporations to effect "short form" mergers with or into corporations in which they own more than 90 percent of the stock of each class entitled to vote on a merger, applies when a nonstock corporation having such 90 percent ownership is the parent corporation and the surviving corporation of the merger, with the exception (found in related provisions of the DGCL) that no merger may impair the charitable status of a charitable nonstock corporation.
- Mergers of domestic nonstock corporations are simplified in cases where there are no members of the corporation entitled to vote on the merger other than the members of the governing body themselves. Under the pre-amendment DGCL, these mergers must be authorized first by a majority of a quorum of the governing body and then re-approved by two-thirds of the total number of members of the governing body at a second meeting. Post-amendment, the approval of any such merger may be obtained at a single meeting, by the vote of a majority of the total number of members of the governing body.

Amendments Regarding Stock Corporations

The Delaware legislature is also considering, in a separate bill, amendments to other provisions of the DGCL, regarding stock corporations. These amendments contain a number of enabling and clarifying changes to the DGCL.

Short-Form Mergers with Non-Corporate Entities

Section 253 provides that a parent corporation may merge with a subsidiary if that parent owns at least 90 percent of the outstanding shares of each class of stock entitled to vote on a merger merely by filing a certificate of ownership and merger.[9] The "short-form merger," as it is called, provides a simple procedure for these parent–subsidiary mergers. As discussed above, Section 253 itself was amended by the nonstock corporation amendments to allow a nonstock corporation to take advantage of Section 253 if it is the parent corporation (and the surviving corporation).

The concept will be expanded even further—beyond the corporate form—in proposed Section 267.[10] Section 267 will provide a mechanism for a short-form merger of a subsidiary

corporation (or corporations) and a parent non-corporate entity owning at least 90 percent of the outstanding shares of each class of the corporation's stock entitled to vote on a merger. The non-corporate entities entitled to take advantage of Section 267 include general partnerships, limited partnerships, limited liability partnerships, limited liability limited partnerships, limited liability companies, joint-stock associations, and certain unincorporated associations or trusts.[11] Among other things, the amendments to Section 267 will facilitate two-step tender offers with a back-end merger where the acquisition vehicle is organized as a limited liability company. Various sections of the DGCL also are being amended to account for new Section 267.

Clarifying Amendments Regarding Indemnification and Advancement

Section 145 of the DGCL addresses indemnification and advancement of expenses. Two subsections of Section 145 will be amended to clarify a distinction between current officers and directors of a corporation, on one hand, and persons serving at the corporation's request as directors or officers of another corporation, partnership, joint venture, trust, or other enterprise, on the other hand. These various roles are set forth in subsections 145(a) and (b), which both describe a potential indemnitee as a person who "is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of a another corporation, partnership, joint venture, trust or other enterprise."[12]

Section 145(d) requires that a determination that indemnification is proper under subsections 145(a) and (b) be made, for any person "who is a director or officer at the time of such determination," by a majority vote of the non-party directors, by a committee of such directors designated by majority vote of such directors, by independent legal counsel in a written opinion, or by the stockholders. The amendment to subsection 145(d) clarifies that this determination is required only when the potential indemnitee is a director or officer of the corporation at the time of the determination—but not when the potential indemnitee is only serving at the corporation's request as a director or officer of another corporation, partnership, joint venture, trust, or other enterprise. Section 145 does not specify who must make the required determination for a person serving at the corporation's request as a director or officer of another corporation, partnership, joint venture, trust, or other enterprise, but such a determination may be made by the corporation's board of directors or by a committee of the board of directors.

Subsection 145(e) requires current directors and officers (but not former directors or officers) to provide an undertaking to repay any amounts advanced to them if it is ultimately determined that they are not entitled to indemnification. The amendment to subsection 145(e) clarifies that the first sentence of that subsection applies only to the advancement of expenses to present officers and directors of the corporation—but not advancement to a person only serving at the corporation's request as a director or officer of another corporation, partnership, joint venture, trust, or other enterprise. The amendment clarifies further, however, that a corporation may advance expenses (upon such terms and conditions, if any, as the corporation deems appropriate) to persons serving at the request of the corporation as directors, officers, employees, or agents of another corporation, partnership, joint venture, trust, or other enterprise.

SPAC Amendments

The 2010 amendments also are intended to clarify the application of the dissolution procedures under the DGCL to special purpose acquisition companies (SPACs) and other corporations that, by virtue of their certificates of incorporation, expire after a specified term. A SPAC is a public shell company established for the purpose of using the proceeds of its public offering to

identify and consummate an acquisition. Generally, if the SPAC does not identify an acquisition within a specified timeframe, usually 18–24 months, its term expires, and it dissolves automatically by the terms of its certificate of incorporation, at which point the SPAC is required to distribute its assets to its public stockholders. Section 278, which generally provides that a corporation is continued for a term of three years following its expiration or dissolution, will be amended to confirm that DGCL Sections 279 through 282 apply to a corporation that has expired by its own limitation, such as a SPAC that has failed to enter into a letter of intent or agreement with respect to an acquisition. Thus, as a result of the amendments to Section 278, it will be clear that a SPAC (or any other corporation) that has expired by its own terms may take advantage of Delaware's dissolution procedures, including the long- and short-form procedures for liquidating, winding up the corporation's business and affairs, and distributing assets to stockholders, and will be entitled to the protections offered by those procedures.

Other Amendments

The proposed 2010 amendments also contain a number of more targeted provisions, including the following:

- Subsections 242(b) and 251(c) (dealing with amendments to the certificate of incorporation and mergers, respectively) will be amended to clarify—without defining or limiting any duty of disclosure owed by the directors in regard to the transaction—that the decision to include either a copy or a summary of a proposed amendment to the certificate of incorporation, or agreement of merger or consolidation, respectively, need not be approved by a specific act of the board of directors.
- A number of the provisions regarding mergers will be amended to clarify that, in a merger, the certificate of incorporation of the surviving corporation may be amended and restated in its entirety. Currently, as a statutory matter, a restated certificate of incorporation only may be filed in a merger if the surviving corporation has previously restated its certificate of incorporation.
- Section 274 and subsection 275(d), which deal with the dissolution of stock corporations before and after the issuance of stock, respectively, will be amended to require that a certificate of dissolution filed thereunder must set forth the date of filing of the corporation's original certificate of incorporation with the Secretary of State.
- Subsection 132(b), which sets forth various requirements imposed on registered agents of Delaware corporations, will be amended to clarify that it applies to registered agents for both domestic corporations and foreign corporations.
- Subsection 371(b)(1), which relates to the procedures for qualification of a foreign corporation to do business in Delaware, will be amended to require that the required certificate evidencing the corporation's existence in the foreign jurisdiction must be as of a date not earlier than 6 months before the filing date. Subsection 371(b)(2) will be amended to expand the types of entities that may serve as registered agents for foreign corporations qualified to do business in Delaware—such entities will include the foreign corporation itself or other foreign or domestic entities, including corporations, partnerships, limited liability companies, and statutory trusts.
- Various provisions of the DGCL will be amended to modernize the procedure for service of process on the Secretary of State, including allowing for service of process on the Secretary of State by means of electronic transmission (but only as prescribed by the Secretary of State) and enabling the Secretary of State, in proper circumstances, to provide notice of service by letter sent by a mail or courier service that includes a record of mailing or deposit with the courier and a signed receipt of delivery.

Conclusion

The proposed 2010 amendments generally are intended to assist corporations and their advisors by clarifying and streamlining certain provisions and procedures, including SPAC dissolutions and service of process on the Secretary of State. The 2010 nonstock amendments represent a full-scale review and revision of the DGCL, with the goal of providing Delaware's charitable, non-profit, and for-profit nonstock corporations with a clear and solid statutory foundation. Practitioners should pay particular attention to the clarifying amendments and should be generally aware of new Section 114 and its application to nonstock corporations.

NOTES

1. At press time, the Delaware House of Representatives had passed H.B. 375.

2. The effective date of the bill implementing the nonstock corporation amendments is August 1, 2010, while the effective date of the bill implementing the remaining amendments is August 2, 2010. The bills' dates of effectiveness are staggered by a day to address a minor overlap, since each bill amends one particular subsection (8 *Del. C.* § 253(a)).

3. With only a minor exception, the nonstock amendments were not intended to affect the DGCL with respect to stock corporations, either directly or by negative implication. The minor exception involves an expansion of the definition of "exempt corporation" to include certain categories of stock corporations, as well as nonstock corporations. Exempt corporations are not subject to Delaware's annual franchise tax.

4. Typically, Delaware's non-profit corporations are organized as nonstock corporations. The nonstock amendments expressly provide for non-profit nonstock corporations.

5. *Scattered Corp. v. Chi. Stock Exch., Inc.,* 671 A.2d 874, 877 (Del. Ch. 1994).

6. *See* 70 Del. Laws ch. 79, §§ 11–12 (1995).

7. Under the 2010 nonstock amendments, 8 *Del. C.* § 159 (by translation under subsection 114(a)) provides that membership interests in for-profit nonstock corporations are personal property. Because subsection 114(c) provides that Section 159 does not apply to non-profit nonstock corporations, memberships in non-profit nonstock corporations are not personal property.

8. It should be noted that some of the sections listed in subsection 114(b)(2), although they are not translated by subsection 114(a), may nonetheless be made applicable to nonstock corporations by other provisions in the DGCL, such as post-amendment Sections 215(a), 255(e)–(f), and 276.

9. 8 *Del. C.* § 253(a).

10. Notably, Section 267 will not apply to nonstock corporations.

11. Delaware's alternative-entity statutes are also proposed to be amended to conform to Section 267.

12. 8 *Del. C.* § 145(a)–(b).

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