

INSIGHTS

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Proposed Amendments to the Delaware General Corporation Law and Delaware's Limited Liability Company and Partnership Acts

Proposed legislation would amend the Delaware General Corporation Law, the Delaware Limited Liability Company Act, the Delaware Revised Uniform Limited Partnership Act and the Delaware Revised Uniform Partnership Act to clarify, among other things, the treatment of capital stock owned by the corporation, provide a safe harbor procedure for the ratification of void and voidable acts and modify the provisions governing statutory public benefit LLCs and limited partnerships.

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Legislation proposing to amend the Delaware General Corporation Law (DGCL), the Delaware Limited Liability Company Act (LLC Act), the Delaware Revised Uniform Limited Partnership Act (DRULPA) and the Delaware Revised Uniform Partnership Act (DRUPA) was introduced to the

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Delaware General Assembly on April 21, 2021.¹ The following is a brief summary of some of the more significant proposed amendments affecting Delaware corporations, limited liability companies (LLCs), limited partnerships (Limited Partnerships) and general partnerships (General Partnerships), including amendments: (1) clarifying the treatment, for purposes of quorum and voting, of shares of capital stock of a corporation owned, directly or indirectly, by the corporation; (2) providing safe harbor procedures for the ratification of void and voidable acts and transactions of LLCs, Limited Partnerships and General Partners; (3) clarifying the standards governing default information rights of members and partners, as applicable, under the LLC Act, DRULA and DRUPA; (4) confirming the authority under the LLC Act, DRUPA and DRULPA of conflicted persons to delegate managerial authority; (5) modifying the provisions governing statutory public benefit LLCs and statutory public benefit Limited Partnerships; and (6) confirming that General Partners that opt out of separate entity status characteristics as permitted by DRUPA remain governed by DRUPA. If enacted, the amendments will become effective on August 1, 2021.

Amendments to the DGCL

Treatment of Shares of a Corporation's Stock Belonging to the Corporation

Section 160(c) of the DGCL currently provides that

[s]hares of its own capital stock belonging to the corporation or to another corporation, if a majority of the shares entitled to vote in the election of directors of such other corporation is held, directly or indirectly, by the corporation, shall neither be entitled to vote nor be counted for quorum purposes.²

The current statute represents a codification of the common law holding that “the voting of shares directly or indirectly owned by a corporation to perpetuate its management in office violates fundamental principles of proper governance.”³ Although Section 160(c) only expressly references shares of the corporation's own stock belonging to the corporation or another “corporation”—and does not expressly reference other forms of entities that may hold shares of the corporation—the underlying purpose of the statute would be frustrated if it did not apply to non-corporate entities.

Thus, the amendments to the DGCL revise Section 160(c) to clarify that shares of a corporation's capital stock held by any *other entity* (whether a corporation or non-corporate entity) are not entitled to be either voted or counted for quorum purposes if the corporation directly or indirectly holds a majority of such other entity's voting power entitled to vote generally in the election of, or is otherwise entitled to appoint or act as, the governing body of such entity. While the amendment to Section 160(c) provides greater certainty in this limited context, the synopsis to the legislation makes clear that the changes to Section 160(c) should not be construed to create any negative implication with respect to the inclusion or exclusion of non-corporate entities in connection with any other section of the DGCL.⁴

Amendments to the LLC Act, DRULPA and DRUPA

Ratification of Void or Voidable Acts and Transactions

The proposed amendments add a new subsection to each of the LLC Act, DRULPA and DRUPA that provides a safe harbor procedure for (1) the ratification of acts or transactions taken by an LLC, a Limited Partnership or General Partnership that are void or voidable when taken, and (2) waiving failures to comply with any requirements under the limited liability company agreement or the partnership agreement, as applicable, of an LLC, Limited Partnership or General Partnership that make such acts or transactions void or voidable.⁵ The amendments are intended to provide a rule different from the one articulated in *CompoSecure, L.L.C. v. Cardux, LLC*⁶ and *Absalom Absalom Trust v. Saint Gervais LLC*.⁷ The Court in those cases drew a distinction between acts and transactions that are “void” (*i.e.*, those that are *ultra vires* and outside the entity's power),⁸ on the one hand, and “voidable” (*i.e.*, those falling within the entity's power but not properly authorized), on the other, and pronounced that the former are not capable of being ratified while the latter are susceptible to cure by ratification and subject to equitable defenses.⁹

Given the broad statutory power afforded to LLCs, Limited Partnerships, and General Partnerships,¹⁰ an act or transaction taken or effected by the entity without the receipt of an approval required under its governing instrument will often fall within the entity's broad power such that the failure of compliance or authorization would not render the act or transaction void.¹¹ In *CompoSecure*, however, the Delaware Supreme Court, examining a provision of an LLC's limited liability company agreement providing that any “Restricted Activity,” if taken by the LLC without the requisite authorization therefor under the agreement, shall be “void and of no force or effect whatsoever,” held that any Restricted Activity taken in violation of the provision would be “void and incapable of being ratified.”¹² Following

that precedent, the Delaware Court of Chancery, in *Absalom Absalom Trust*, noted that a transaction deemed “null and void” by the express terms of the LLC’s limited liability company agreement is incapable of being ratified.¹³

The proposed amendments allow the ratification of acts or transactions that are void or voidable when taken (or the waiver of the failure to comply with any requirements of the limited liability company agreement or the partnership agreement, as applicable, making such act or transaction void or voidable) by the persons whose approval would otherwise be required under such agreement at the time of such ratification or waiver (1) for such act or transaction to be validly taken or (2) to amend such agreement in a manner to permit such act or transaction to be validly taken. If an amendment to a limited liability company agreement or partnership agreement to permit an otherwise void or voidable act to be validly taken requires notice to any persons under the terms of such agreement, and the ratification or waiver of such act or transaction is effectuated by the persons whose approval would be required to amend such agreement, notice of the ratification or waiver must be given following such ratification or waiver to such persons who would have been entitled to notice of the amendment and who have not otherwise received notice of, or participated in, such ratification or waiver.

Under the proposed amendments, any act or transaction ratified (or the waiver of the failure to comply with any requirements of such agreement) is given retroactive effect and deemed validly taken as of the time of such act or transaction. The proposed amendments expressly provide that the applicable new subsection being added to each of the LLC Act, DRULPA and DRUPA should not be construed to limit the ratification or waiver of void or voidable acts or transactions by other means permitted by law. Accordingly, the proposed amendments are not intended to preclude or restrict any other valid means of ratification or waiver or to impair the effectiveness of valid ratifications and waivers effected prior to the adoption of the proposed amendments.

The proposed amendments additionally provide a procedure whereby the entity, a member, a manager or a partner, as applicable, and any person claiming to be substantially and adversely affected by a ratification or waiver (excluding any harm that would have resulted had the act or transaction been valid when taken) may petition the Delaware Court of Chancery for a determination with respect to the validity and effectiveness of any such ratification or waiver effected pursuant to the new subsections of the LLC Act, DRULPA, or DRUPA, as applicable.

Application of “Necessary and Essential” Test to Information Rights

In any action in which a stockholder of a Delaware corporation is seeking to inspect books and records under Section 220 of the DGCL,¹⁴ the Delaware courts have long held that the stockholder’s right to inspection is limited to information that is “necessary and essential” to the stockholder’s stated purpose for conducting the inspection.¹⁵ In *Murfey v. WHC Ventures, LLC*,¹⁶ the Delaware Supreme Court declined to apply an analogous standard to a limited partner’s request to inspect certain books and records of a Limited Partnership under a contractual books and records provision contained in the applicable partnership agreement, holding that limited partners are not limited to inspecting books and records that are “necessary and essential” to the articulated purpose for conducting inspection where the partnership agreement does not expressly condition the contractual inspection right upon satisfying the “necessary and essential” standard.¹⁷

The proposed amendments to the LLC Act, DRULPA and DRUPA provide that a member or partner, as applicable, who is entitled to obtain information for a stated purpose (whether under the LLC Act, DRULPA or DRUPA, as applicable, or a limited liability company agreement or partnership agreement, as applicable) may obtain such information as is “necessary and essential” to achieving that purpose, unless such right has been expanded or restricted in the limited liability company agreement or partnership agreement, as applicable.¹⁸ To

the extent current law does not apply the “necessary and essential” test to a member’s or partner’s (1) statutory rights to obtain information for a purpose reasonably related to such person’s interest, or (2) contractual rights to obtain information for a stated purpose, the proposed amendments are intended to change current law.

Confirmation of Broad Authority to Delegate Managerial Authority

Each of the LLC Act, DRULPA and DRUPA contains a similar default provision addressing the broad right of members, managers and partners, as the case may be, to delegate managerial authority.¹⁹ Despite such broad grant of authority, in *Wenske v. Bluebell Creameries, Inc.*,²⁰ the Delaware Court of Chancery held that a conflicted person was legally disabled from delegating authority over the subject matter as to which such person was conflicted.²¹ The proposed amendments to the LLC Act, DRULPA and DRUPA seek to create a rule that is different from the one applied by the *Wenske* Court.

To that end, the proposed amendments expand the broad grant of power to delegate managerial authority in the LLC Act, DRULPA and DRUPA by providing that a member or manager of an LLC, a general partner of a Limited Partnership and a partner of a General Partnership may delegate any of its rights, powers or duties, including any core governance functions, to manage and control the business and affairs of such entity regardless of whether such person has a conflict of interest with respect to the rights, powers or duties being delegated, and that the person to whom such rights, powers or duties are delegated shall not be deemed to be conflicted solely by reason of a conflict of interest of the delegating party.²² The proposed amendments to each of the LLC Act, DRULPA and DRUPA also make clear that any delegation may be made to a committee of one or more persons.

Statutory Public Benefit Entities

In a development that may be of significant interest to social entrepreneurs, the LLC Act and

DRULPA were recently amended to enable LLCs and Limited Partnerships to elect to be a statutory public benefit LLC or statutory public benefit Limited Partnership (each, a Statutory Public Benefit Entity).²³ In general, a Statutory Public Benefit Entity is a for-profit LLC or Limited Partnership that is intended to produce a public benefit and to operate in a responsible and sustainable manner. To that end, a Statutory Public Benefit Entity is required to be operated in a manner that balances the pecuniary interests of the members or partners, as applicable, of such Statutory Public Benefit Entity, the best interests of those materially affected by such Statutory Public Benefit Entity’s conduct, and such Statutory Public Benefit Entity’s stated public benefit. Each Statutory Public Benefit Entity is currently required in its certificate of formation or certificate of limited partnership, as applicable, to (1) identify itself as a Statutory Public Benefit Entity, and (2) set forth one or more specific public benefits to be promoted by such Statutory Public Benefit Entity. The term “public benefit” is statutorily defined broadly as

a positive effect (or reduction of negative effects) on one or more categories of persons, entities, communities or interests (other than members or partners, as applicable, in such capacities) including, but not limited to, effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature.²⁴

The proposed amendments provide that a Statutory Public Benefit Entity also must identify its specific public benefit and its existence as a Statutory Public Benefit Entity in its limited liability company agreement or partnership agreement, as applicable. The proposed amendments further provide that the public benefit listed in the limited liability company agreement or partnership agreement will control as among the members, managers and partners, as applicable, and other persons bound by such agreement, in the event there is an inconsistency between

the applicable agreement and certificate, and that a provision in the applicable agreement or certificate will not be effective to the extent it is inconsistent with the applicable provisions of the LLC Act or the DRULPA.

Additionally, the proposed amendments obligate the managers, members or general partners, as applicable, of a Statutory Public Benefit Entity to promptly amend such Statutory Public Benefit Entity's certificate of formation or certificate of limited partnership, as applicable, if such person becomes aware that a specific public benefit to be promoted is inaccurately set forth in such certificate.

The proposed amendments also allow an existing LLC or Limited Partnership to become a Statutory Public Benefit Entity either by (1) complying with the applicable requirements specified in its limited liability company agreement or partnership agreement, as applicable, or (2) amending its certificate of formation or certificate of limited partnership, as applicable, and its limited liability company agreement or partnership agreement, as applicable, to comply with the statutory requirements.

General Partnerships that Opt Out of Separate Entity Status Characteristics Remain Governed by DRUPA

The general default rules under DRUPA provide that (1) a General Partnership is a separate legal entity distinct from its partners, (2) property acquired by a General Partnership is property of the General Partnership and not of the partners individually, and (3) a partner is not a co-owner of partnership property and has no interest in specific partnership property, unless, in each case, the partnership agreement and a statement of partnership existence or statement of qualification modify these default rules.²⁵ The proposed amendments to DRUPA confirm that, unless the partnership agreement of such General Partnership provides otherwise, a General Partnership that has a partnership agreement and a statement of partnership existence or statement of qualification modifying one or more of such default rules (*e.g.*, the rule that a General

Partnership is a separate legal entity) continues to be governed by all other provisions of DRUPA, including provisions relating to the dissolution of the General Partnership.²⁶

Conclusion

The proposed amendments reflect Delaware's continuing commitment to maintaining statutes governing its corporations, limited liability companies, limited partnerships and general partnerships that effectively serve the business needs of the national and international business communities.

Notes

1. See S.B. 113, 151st Gen. Assem. (Del. 2021) (amendments to the DGCL), S.B. 114, 151st Gen. Assem. (Del. 2021) (amendments to the LLC Act), S.B. 115, 151st Gen. Assem. (Del. 2021) (amendments to DRUPA), and S.B. 116, 151st Gen. Assem. (Del. 2021) (amendments to DRULPA).
2. 8 *Del. C.* § 160(c).
3. 1 David A. Drexler et al., *Delaware Corporation Law and Practice* § 19.03 (2020).
4. S.B. 113, 151st Gen. Assem. (Del. 2021).
5. The new sections of the LLC Act, DRULPA and DRUPA appear in 6 *Del. C.* § 106(e), 6 *Del. C.* § 17-106(e), and 6 *Del. C.* § 15-202(g), respectively.
6. *CompoSecure, L.L.C. v. Cardux, LLC*, 206 A.3d 807 (Del. 2018).
7. *Absalom Absalom Trust v. Saint Gervais LLC*, 2019 WL 2655787 (Del. Ch. June 27, 2019).
8. See *CompoSecure*, 206 A.2d at 816.
9. *Absalom Absalom Trust*, 2019 WL 2655787, at *3 (stating that “[e]quitable defenses can validate voidable acts but not void acts” and articulating “[t]he common law rule [] that void acts are *ultra vires* and generally cannot be ratified, but voidable acts” falling within the entity's power, “though not properly authorized, and are subject to equitable defenses.” *Id.*
10. See, *e.g.*, *CompoSecure*, 206 A.2d at 817, n.36 (“The LLC Act grants broad authority to Delaware LLCs, which have ‘such powers and privileges as are necessary or convenient to the conduct, promotion or attainment of the business, purposes or activities of the limited liability company.’

6 Del. C. § 18-106(b). The powers ‘necessary or convenient to’ the business of an LLC include the ability to enter into contracts. Section 18-107 of the LLC Act grants LLCs the power to enter into interested transactions.”

11. See *CompoSecure*, 206 A.3d at 817 (observing that, “[o]rdinarily,” a contract entered into by an LLC without the required approval under its LLC Agreement “would be voidable”); see also *In re Oxbow Carbon LLC Unitholder Litig.*, 2018 WL 818760, at *48 (Del. Ch. Feb. 12, 2018) (“There is no dispute that Oxbow had the power as an entity to issue units and admit new members. Oxbow could have issued units to the Small Holders and admitted them as members, if the parties had adhered to the procedures specified in the LLC Agreement. Consequently, assuming for the sake of analysis that the parties failed to follow the requisite procedures, the issuance of units to the Small Holders and their admission as members would be voidable, not void.”), *aff’d in part, rev’d in part on other grounds sub nom. Oxbow Carbon & Minerals Hldgs., Inc. v. Crestview-Oxbow Acq., LLC*, 202 A.3d 482 (Del. 2019).
12. See *CompoSecure*, 206 A.3d at 817.
13. *Absalom Absalom Trust*, 2019 WL 2655787, at *3.
14. 8 Del. C. § 220.
15. See, e.g., *Wal-Mart Stores, Inc. v. Indiana Elec. Workers Pension Trust Fund IBEW*, 95 A.3d 1264, at 1271 (Del. 2014).
16. *Murfey v. WHC Ventures, LLC*, 236 A.3d 337 (Del. 2020).
17. *Id.*, at 352 (Del. 2020) (“Since the Partnership Agreements do not expressly condition the limited partner’s inspection rights on satisfying a ‘necessary and essential’ condition, and given the obvious importance of tax return and partnership capital contribution information to the Partnerships’ investors, as evidenced by the agreements, we are not persuaded that such a condition should be implied. Further, the Partnerships should not be able to cull from the tax returns only that information which they deem ‘necessary and essential’ to the Plaintiffs’ valuation purpose when they have not set forth any standards that pertain to such inspection requests.”).
18. The proposed amendments appear in Section 18-305(g) of the LLC Act, 6 Del. C. § 18-305(g), Section 17-305(f) of DRULPA, 6 Del. C. § 17-305(f), and Section 15-403(f) of DRUPA, 6 Del. C. § 15-403(f).
19. The current provisions relating to delegation of authority appear in Section 18-407 of the LLC Act, 6 Del. C. § 18-407, Section 17-403 of DRULPA, 6 Del. C. § 17-403, and Section 15-401 of DRUPA, 6 Del. C. § 15-401.
20. *Wenske v. Bluebell Creameries, Inc.*, 214 A.3d 958 (Del. Ch. 2019).
21. *Id.* at 962. *Wenske* involved a derivative action arising from alleged failures by Blue Bell Creameries, Inc. (Blue Bell GP), the sole general partner of the nominal defendant Blue Bell Creameries, L.P. (Blue Bell), to operate Blue Bell in compliance with the governing standards set forth in Blue Bell’s limited partnership agreement. The defendants moved to dismiss the claims, contending, among other things, that the plaintiffs had failed to demonstrate that demand was futile as required by Chancery Court Rule 23.1. The Court denied the defendants’ motion to dismiss claims against Blue Bell GP, concluding that the plaintiffs had adequately pled demand futility. Blue Bell GP subsequently established a committee of its board of directors that, in turn, formed a special litigation committee to manage and control Blue Bell’s claims against Blue Bell GP. That special litigation committee then moved to stay the derivative action so that it could proceed with its investigation and make a determination. While noting that such motions are often granted, the Court found that the particular request was not proper in light of the Court’s previous determination that Blue Bell GP had a “disabling conflict” for pre-suit demand purposes. *Id.* at 961. The Court stated: “As a matter of agency law, a principal who delegates authority to an agent will be deemed to maintain control over that agent’s conduct, regardless of whether the principal actually exercises control. Any conflict that disables the principal disables the agent. Because [Blue Bell GP], as principal, is not fit to decide how to manage the [Blue Bell’s] claims against the Defendants (including the claims against [Blue Bell GP] itself), its purported special litigation committee, as agent, is likewise disabled.” *Id.* at 962. The Court accordingly denied the motion to stay, which, it found, had “been brought by a special litigation committee with no authority to bring it.” *Id.*
22. The proposed amendments appear in Section 18-407 of the LLC Act, 6 Del. C. § 18-407, Section 17-403(c) of DRULPA, 6 Del. C. § 17-403(c), and Section 15-401(l) of DRUPA, 6 Del. C. § 15-401(l).

23. The provisions governing statutory public benefit LLCs are currently set forth in subchapter XII of the LLC Act, 6 *Del. C.* §§ 18-1201 – 18-1208, and those governing statutory public benefit limited partnerships are currently set forth in subchapter XII of DRULPA, 6 *Del. C.* §§ 17-1201 – 17-1208.
24. See 6 *Del. C.* § 18-1202(b) (LLC Act) and 6 *Del. C.* § 17-1202(b) (DRULPA).
25. See 6 *Del. C.* §§ 15-103, 15-201, 15-203 & 15-501.
26. The amendments appear in Section 15-103(c) of DRUPA, 6 *Del. C.* § 15-103(c).

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