July 23, 2013

2013 Amendments to the Delaware General Corporation Law and LLC Act

The Delaware General Assembly has adopted, and Delaware's governor has signed into law, several important amendments to the State's General Corporation Law (the "DGCL") and Limited Liability Company Act (the "DLLCA"). Of particular interest to corporate and M&A practitioners are the following provisions:

- New DGCL Section 251(h), which eliminates the need for stockholder approval of second-step mergers following tender offers if certain conditions are met, thus eliminating the need for workarounds such as top-up options and dual-track structures;

- New DGCL Sections 204 and 205, which delineate a procedure to ratify defective corporate actions and to vest the Court of Chancery with jurisdiction over disputes regarding such actions;

- New DGCL Sections 361 through 368 (Subchapter XV), which permit the creation of public benefit corporations (*i.e.*, for-profit corporations formed for the benefit of constituencies other than stockholders, such as categories of persons, entities, communities or interests); and

- Amended DLLCA Section 18-1104, which amendments confirm the default rule that fiduciary duties exist in the case of Delaware limited liability companies unless otherwise provided in the LLC agreement.

In addition to the foregoing, other notable changes to the DGCL include: (i) an amendment to Section 152 to confirm a board's authority to establish a formula for determining the consideration that the corporation receives for the stock; and (ii) amendments to Sections 312(b) and 502(a) to discourage the establishment of "shelf" corporations (*i.e.*, those formed without directors or stockholders for the purpose of "aging" the corporation for later use).

These amendments will become effective on August 1, 2013, with the exception of Sections 204 and 205 to the DGCL, which will become effective on April 1, 2014.

DGCL Amendments

"Medium-form" Mergers

In two-step acquisition transactions, it is generally desirable (and often critical for acquisitions involving financing) to complete the second-step and obtain complete ownership immediately after the closing of the first step tender or exchange offer. Yet, the ability to do so depends on certain variables, including whether 90% of each class of shares entitled to vote on the transaction can be acquired in the first-step (so as to take advantage of Delaware's short-form merger procedures) and the presence or absence of the ability to act by written consent. In view of the desirability of completing the second-step as a short-form merger, parties have in recent years typically included "top-up options" in their transaction documents granting an acquirer that has consummated the first-step tender offer an option to purchase from the target the number of additional shares needed to reach the threshold necessary to effect the second-step as a short-form merger. These provisions, however, were sometimes an imperfect fix, *e.g.*, where the target did not have sufficient authorized shares to enable the top-up option to be exercised.

Some acquisition agreements have also used so-called "dual-track" structures involving the simultaneous pursuit of a tender offer and a long form merger to ensure the speediest closing possible in the event the first-step does not result in the acquisition of the level of share ownership necessary to complete a short form merger. This approach entails considerable extra expense and complexity.

New Section 251(h) attempts to address these issues by providing that, where the parties expressly elect to rely on such provision in a two-step merger agreement, no vote of the stockholders of the target corporation is required in connection with that transaction (unless otherwise expressly so stated in the certificate of incorporation) if the following conditions are met:

- The target must be listed on a national securities exchange or held of record by more than 2,000 holders immediately before the execution of the merger agreement.

- The merger agreement, entered into on or after August 1, 2013, must expressly state that it is governed by Section 251(h) and must require the parties to effect the merger as soon as practicable following the consummation of the first-step tender or exchange offer.

- The acquirer must consummate, on the terms provided in the relevant agreement, a tender or exchange offer for any and all of the outstanding shares of stock of the target that would otherwise be entitled to vote on the adoption or rejection of the merger agreement.

- Following consummation of the tender or exchange offer, the acquirer must own at least such percentage of each class and series of the target's stock that, absent Section 251(h), would be required to adopt the merger under the DGCL and the target's certificate of incorporation.

- When the target's board approves the merger agreement, no other party is an "interested stockholder" (as defined in Section 203(c) of the DGCL) of the target.

- The company consummating the tender or exchange offer must merge with or into the target pursuant to the relevant merger agreement.

- The outstanding shares of each class or series of stock of the constituent corporation to be acquired in the merger are acquired for the same consideration paid for shares of such class or series upon consummation of the tender offer.

If the parties forgo a stockholder vote under the terms of Section 251(h), and file the merger agreement with the Delaware Secretary of State in lieu of filing a certificate of merger, the secretary or assistant secretary of the surviving corporation must certify on the merger agreement that the merger agreement was adopted under Section 251(h) and the conditions of Section 251(h) were satisfied.

There is no change to the circumstances in which appraisal rights are available as a result of the adoption of Section 251(h).

Ratification of Defective Corporate Acts

New Sections 204 and 205 set forth procedures to ratify "defective corporate acts" and to vest the Court of Chancery with jurisdiction over disputes regarding such actions. Under current Delaware case law, certain defective corporate acts are "void," whereas others are "voidable." The distinction between "void" and "voidable" corporate acts has long been a concern of practitioners because acts that are merely "voidable" may be ratified, while those that are "void" may not. The void/voidable distinction has not always been clear in practice, and Delaware courts have reached rigid holdings in some cases, for example, finding that stock issued in violation of the DGCL or the corporation's organizational documents was indeed void—and incapable of ratification—and not merely voidable. These cases have led courts to invalidate defective corporate acts, even if such invalidation was (arguably) inequitable.

Under new Sections 204 and 205, the term "defective corporate act" covers all corporate acts (including elections or appointments of directors) that are within the power granted to a corporation under the DGCL, but that are otherwise "defective" based upon a "failure of authorization" due to non-compliance with the DGCL, the corporation's organizational documents or any plan or other agreement to which the company is a party and where the failure to comply with such provisions, documents or instruments would render such act void or voidable. Under Sections 204 and 205, no defective corporate act would be void or voidable "solely as a result of a failure of authorization," if ratified in accordance with Section 204 or validated by the Court of Chancery in a proceeding brought under Section 205. Notably, the statute expressly states that ratification under Section 204 or validation under Section 205 is not the exclusive means of ratifying or validating a defective corporate act. Defective corporate acts that were capable of ratification under common law can still be ratified by obtaining after-the-fact approval from the board or the stockholders, as applicable. Failure to use Section 204 or 205 will not affect the validity of any proper common law ratification or create a presumption that any corporate act was defective and voided or voidable.

Section 204

Section 204 provides that the corporation's board of directors must adopt a resolution relating to the defective act and that such a resolution must include, among other items, details such as: (i) the time of the act; (ii) the nature of the failure of the authorization; and (iii) that the board of directors approves the ratification of the defective corporate act. The resolutions may also provide that at any time before the validation effective time, the board may abandon its resolution, even if such resolutions have already been approved by the stockholders. The board resolutions must then be submitted to the stockholders for adoption unless (i) no other provision of the DGCL, the certificate of incorporation, the bylaws, or another agreement to which the corporation is a party requires stockholder approval for the defective act to be ratified; and (ii) the defective corporate act did not result from a failure to comply with Section 203 of the DGCL (Delaware's anti-takeover statute), in which case a vote would instead be required under Section 203(a)(3). The stockholder quorum and voting requirements applicable to the adoption of such resolution by the stockholders shall be the quorum and voting requirements applicable at the time of such adoption for the type of defective corporate act to be ratified, subject to certain exceptions set forth in Section 204.

Section 204 also sets forth the stockholder notice requirements. Importantly, notice must be given to stockholders of record as of the time of adoption of the resolution, as well as stockholders of record as of the time of the defective act (to the extent their identities can be determined from the corporate records).

If the corporation follows the procedures set forth in Section 204, unless otherwise determined in an action brought under Section 205 (as explained below): (i) each defective act so ratified would no longer be deemed void or voidable effective retroactively to the time of the original defective corporate act; and (ii) each share of putative stock issued pursuant to a ratified defective corporate act would no longer be deemed void or voidable and would be deemed to be an identical share of outstanding stock as of the time it was purportedly issued.

Section 205

Section 205 grants the Court of Chancery jurisdiction to: (i) determine the validity and effectiveness of any defective corporate act ratified, or any ratification done, pursuant to Section 204; (ii) determine the validity and effectiveness of any defective corporate act not ratified or not ratified effectively under Section 204; (iii) determine the validity of any corporate act or transaction and any stock rights or options to acquire stock; and (iv) modify or waive any procedures set forth in Section 204. These claims may be brought by the corporation (or its successor entity), a director, any record or beneficial owner of valid or putative stock (including those holding stock at the time of the defective corporate act) or any other person claiming to be substantially and adversely affected by a ratification under Section 204. Such claimant must assert the claim within 120 days from the validation effective time. The foregoing time limitation does not apply to claims asserting that ratification did not comply with Section 204 or to any person that was entitled to receive notice of the ratification but did not receive such notice.

Section 205 expressly enumerates various actions that the Court of Chancery may take with regard to its authority granted under Section 205 (including the broad ability to "make such other orders regarding such matters as it deems proper under the circumstances"), and certain considerations that it may take into account in making its determination (including "any other factors or considerations that the Court deems just or equitable").

Public Benefit Corporations

New Subchapter XV to the DGCL authorizes the creation of public benefit corporations. A public benefit corporation is a for-profit entity whose certificate of incorporation identifies specific public benefits that the corporation will promote. A public benefit is broadly defined as a "positive effect (or reduction of negative effects) on one or more categories of persons, entities, communities or interests." To achieve the dual mandate of operating a for-profit entity while promoting a public benefit, the new subchapter requires the board of directors to "balance the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation's conduct, and the specific public benefit or public benefits identified in [the corporation's] certificate of incorporation" when it manages the corporation's business and affairs.

As a mechanism to hold the board of directors accountable, Subchapter XV allows the stockholders of the corporation to bring a derivative suit asserting that the board is not fulfilling the public benefit mandate if the stockholders, individually or collectively, own 2% of the corporation's outstanding shares, or if the corporation is listed on a national securities exchange, the lesser of 2% of the corporation's outstanding shares, or shares having at least $2 million in market value.

Additionally, Subchapter XV limits the ability to amend the certificate of incorporation of the corporation, and the ability of the corporation to effect a merger, if the corporation would abandon its public benefit mandate as a result of such merger. In those situations, Subchapter XV requires the approval of 66 2/3% of the stockholders of each class of outstanding stock of the corporation.

Other Amendments

Section 152

Section 152 (which relates to the authorization and issuance of capital stock) is amended to clarify that a board of directors may fulfill its duty to determine the price(s) at which stock is issued by approving a formula for the determination of stock price. For example, such a formula could provide that the stock price is set with reference to the market price of the stock over a period of time.

Sections 312(b) and 502(a)

Amendments to Section 312(b) and Section 502(a) of the DGCL are designed to discourage the establishment of "shelf" corporations (i.e., those formed without directors or stockholders for the purpose of "aging" the corporation for later use) by confirming the limited role of an incorporator. Section 312(b) now clarifies that only directors or stockholders may authorize a renewal or revival of a corporation that has ceased to be in good standing. Section 502(a) is amended to prohibit an incorporator from signing any annual franchise tax reports (other than the corporation's initial report) and require a corporation to list at least one director on its franchise tax reports, unless the report is filed in connection with the corporation's dissolution.

DLLCA Amendments

Section 18-1104 of the DLLCA is amended to confirm the default rule that fiduciary duties govern the internal affairs of limited liability companies unless otherwise provided in the LLC's operating agreement. The Court of Chancery had taken the position that fiduciary duties exist by default where the operating agreement is silent, but the Delaware Supreme Court had not definitively ruled on this issue. *Compare Feeley* v. *NHAOCG, LLC*, 2012 WL 6840577 (Del. Ch. Nov. 28, 2012) *with Gatz Properties, LLC* v. *Auriga Capital Corp.*, 2012 WL 5425227 (Del. Nov. 7, 2012). Although the amendment resolves that debate, any disclaimer of fiduciary duties in an LLC's operating agreement should be express and clear for the avoidance of doubt. In particular, the operating agreement should address the existence and scope of such duties as may be applied to members as well as managers of such entities.

* * *

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Ariel J. Deckelbaum 212-373-3546 ajdeckelbaum@paulweiss.com	Justin G. Hamill 212-373-3189 jhamill@paulweiss.com	Stephen P. Lamb 302-655-4411 slamb@paulweiss.com
Jeffrey D. Marell 212-373-3105 jmarell@paulweiss.com	Frances F. Mi 212-373-3185 fmi@paulweiss.com	

Cara M. Grisin and Justin A. Shuler contributed to this client alert.