Proposed Amendments to the Delaware General Corporation Law

The Corporate Council of the Corporation Law Section of the Delaware State Bar Association (the "Corporate Council") has released proposed legislation[1] to amend certain provisions of the Delaware General Corporation Law ("DGCL") which if enacted would, among other things, (i) amend Section 262 to reduce the number of transactions that would be subject to appraisal claims by extending the "market out exception" to the availability of statutory appraisal rights in exchange offers followed by a merger under Section 251(h), (ii) amend Section 204 to clarify the situations in which that Section may be used to ratify defective corporate acts and (iii) amend Section 114 to allow nonstock corporations to take advantage of Sections 204 and 205. These amendments are the latest round of clean-up precipitated by the rules enacted in 2013 which created Section 251(h) intermediate mergers and procedures for rectifying defective corporate acts.

I. Proposed Amendments to Section 262

Subsections (b)(1) and (b)(2) of Section 262 of the DGCL, as currently drafted, provide a "market out exception" whereby holders of shares of stock of target corporations that are (i) listed on a national securities exchange or (ii) held of record by more than 2,000 holders are not entitled to appraisal rights in connection with a merger or consolidation (with some exceptions), as long as such holders are only required to accept, in exchange for such stock, (a) stock of the surviving corporation (or depository receipts in respect thereof), (b) stock of any other corporation (or depository receipts in respect thereof) that, in either case, at the effective date of the merger or consolidation will be (1) listed on a national securities exchange or (2) held of record by more than 2,000 holders, (c) cash in lieu of fractional shares (or fractional depository receipts) or (d) any combination of (a), (b) and (c).

Section 262(b)(3), however, as currently drafted, provides that holders of shares of stock of a target corporation that are listed on a national securities exchange (or held of record by more than 2,000 holders) immediately prior to the execution of an "intermediate-form" merger pursuant to Section 251(h) (a stock-for-stock exchange followed by a control merger agreement) would be entitled to appraisal rights under Section 262(b)(3), despite the fact that such holders would not be entitled to appraisal rights under Sections (b)(1) and b(2) in the case of a traditional "long-form" merger.

The proposed amendments to Section 262 attempt to reconcile and align these subsections by extending the "market out exception" provided by subsections (b)(1) and (b)(2) of Section 262 to mergers effected pursuant to Section 251(h) by eliminating the carve-out of such "intermediate-form" mergers from Section 262(b)(3). If enacted, these proposed amendments would align the treatment of "intermediate-form" mergers with "long-form" mergers with respect to the availability of appraisal rights.

The proposed amendments also include conforming technical changes to Section 262(e), which clarify what information must be included in the statement by the surviving corporation required to be furnished to requesting holders pursuant to such section. As currently drafted, Section 262(e) requires, upon request of any holder who has complied with the relevant sections of Section 262, a statement from the surviving corporation setting forth the aggregate number of shares not voted in favor of the merger or consolidation, with respect to which demands for appraisal have been received, and the aggregate number of holders of such shares. In the case of an "intermediate-form" merger approved pursuant to Section 251(h), since no shares are "voted" in favor of the merger or consolidation, the proposed amendments clarify that such statement must set forth the aggregate number of shares that were the subject of, but were not tendered into and accepted for purchase or exchange in,

[1] The proposed amendments are available here.

such tender or exchange offer, with respect to which demands for appraisal have been received, and the aggregate number of holders of such shares.

If enacted, the proposed amendments to Section 262 would apply to statutory appraisal rights in connection with mergers or consolidations consummated pursuant to agreements entered into on or after August 1, 2018.

II. Proposed Amendments to Sections 204 and 205

Further to the proposed changes to Section 262 of the DGCL, the Corporate Council has proposed amending Sections 204 and 205 of the DGCL to (i) clarify the circumstances in which corporations may use Section 204 to ratify defective corporate acts and (ii) allow nonstock corporations to take advantage of Sections 204 and 205, including the ratification or validation of defective corporate acts.

(a) Section 204(c)(2)

Section 204 of the DGCL lays out a mechanism by which a board may remedy what would otherwise be a void or voidable corporate act or stock issuance without the need for court involvement. To remedy such an act or issuance, the board may adopt resolutions ratifying such defective corporate act or issuance. In circumstances where a stockholder vote was either required at the time of the defective corporate act or at the time the board adopts the ratifying resolutions, a stockholder vote is also required. As Section 204 is currently drafted, only holders of valid stock may vote to ratify the defective corporate act. The first of the proposed amendments would modify Section 204(c)(2) to confirm that even if there is no valid stock outstanding, whether due to no shares having been issued or because all of the shares are putative stock, a corporation may utilize Section 204.

(b) Section 204(d) and 204(g)

Under Section 204(d), where a vote of stockholders is required to approve the ratification of a corporate act, notice of the meeting at which the proposed ratification will be considered is required to be given to all holders of valid stock and putative stock, whether voting or non-voting, as of both (a) the record date for notice of meeting and (b) the time of the defective corporate act. The latter requirement has proven difficult for many corporations as they are far less likely to have a list of stockholders as of the date of a defective corporate act (that did not occur on a record date) than as of a particular record date.

The proposed amendment to Section 204(d) seeks to remedy this problem by providing that "[t]he notice shall … be given to the holders of record of valid stock and putative stock, whether voting or nonvoting, as of the time of the defective corporate act (or, in the case of any defective corporate act that involved the establishment of a record date for notice of or voting at any meeting of stockholders, for action by written consent of stockholders in lieu of a meeting, or for any other purpose, the record date for notice of or voting at such meeting, the record date for action by written consent, or the record date for such other action, as the case may be)…." The Corporate Council has also proposed an amendment to Section 204(g) allowing public companies to give such notice through disclosure in a publically filed document with the Securities and Exchange Commission pursuant to Sections 13, 14 or 15(d) of the Securities Exchange Act of 1934.

(c) Section 204(h)

Section 204(h) of the DGCL defines "defective corporate act" as "…an overissue, an election or appointment of directors that is void or voidable due to a failure of authorization, or any act or transaction purportedly taken by or on behalf of the corporation that is, and at the time such act or transaction was

purportedly taken would have been, within the power of a corporation under subchapter II of this chapter, but is void or voidable due to a failure of authorization…." The proposed amendment to Section 204(h) would revise the definition of "defective corporate act" by clarifying that the failure to approve an act in accordance with the DGCL or the certificate of incorporation or bylaws may not, of itself, serve as a basis for excluding the act from the scope of the statute.

Nguyen v. View, Inc., C.A. No. 11138-VCS (Del. Ch. June 6, 2017), identified the need for this amendment. In that case, the Court implied that an act or transaction may not be within the power of a corporation based solely on the fact that it was not approved in accordance with the provisions of the DGCL or the corporation's certificate of incorporation or bylaws. While the proposed amendments seek to clarify that the failure to approve an act in accordance with the DGCL or the certificate of incorporation or bylaws may not, of itself, serve as a basis for excluding the act from the scope of the statute, the Court still has the power under Section 205 of the DGCL, upon application of various parties, to validate or decline to validate acts that have been ratified in accordance with Section 204, as well as acts that have not been ratified. The proposed amendments also leave intact the Court's power under Section 205 to consider "[w]hether the defective corporate act was originally approved or effectuated with the belief that the approval or effectuation was in compliance with … [the DGCL], the certificate of incorporation or the bylaws of the corporation."

Section 204(h)(2) provides the definition for "failure of authorization." The proposed amendment to Section 204(h)(2) seeks to add that failure to authorize or effect an act or transaction in compliance with the disclosure set forth in any proxy or consent solicitation statement may constitute a failure of authorization.

(d) Application of Section 204 and 205 for nonstock corporations

The proposed amendments would enable nonstock corporations to also take advantage of Sections 204 and 205 by revising Section 114. Section 114 was added in 2010 to apply (or preclude the application of) other numerous sections of the DGCL to nonstock corporations. The proposed amendment would specifically carve out Section 204 and 205 from the list of enumerated sections, allowing both Sections to be applied to nonstock corporations.

III. Conclusion

If approved by the Corporate Council, the proposed amendments will be introduced to the Delaware General Assembly and, if approved, would take effect on August 1, 2018. In the future, the Corporate Council is likely to continue to propose further adjustments of this type to the DGCL as conflicts and unintended consequences of the 2013 rules are revealed in practice and judicial interpretations.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Helene Banks at 212.701.3439 or hbanks@cahill.com; Bradley J. Bondi at 202.862.8910 or bbondi@cahill.com; Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Geoffrey E. Liebmann at 212.701.3313 or gliebmann@cahill.com; Kaitlyn Pasco at 212.701.3859 or kpasco@cahill.com; or Joseph Rosati at 212.701.3438 or jrosati@cahill.com.

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