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Recent Amendments to Delaware’s LLC and LP Acts Depart from Case Law on Ratification of Void Acts and Delegation by Conflicted Fiduciaries, Among Other Changes

By Norman M. Powell, John J. Paschetto, and Tammy L. Mercer¹

Effective August 1, 2021, the Delaware Limited Liability Company Act (the “DLLCA”) and the Delaware Revised Uniform Limited Partnership Act (the “DRULPA”)² were amended to change rules enunciated by Delaware courts regarding ratification, delegation, and rights to information. In addition, among other changes, the 2021 amendments eliminated a supermajority approval requirement for a statutory public benefit limited liability company or limited partnership to shed its statutory-public-benefit status.³

A New Safe Harbor for Ratification of Void or Voidable Acts

In opinions issued in 2018 and 2019, the Delaware Supreme Court and Court of Chancery, respectively, held that an act could not be ratified where the governing entity agreement provided that the act was “void and of no force or effect whatsoever”⁴ or was “null and void.”⁵ In each case, the limited liability company (“LLC”) agreement at issue provided that certain acts were void if they were not approved as required by the agreement. Applying the “common law rule . . . that void acts are *ultra vires* and generally cannot be ratified,”⁶ the courts held that actions deemed void under the agreements were incapable of ratification.⁷

The 2021 amendments have changed the rule followed in the above cases. A new subsection added to each of DLLCA § 18-106 and DRULPA § 17-106 provides that “[a]ny act or transaction that may be taken by or in respect

of” an LLC or a limited partnership (“LP”) may be ratified, regardless of whether the act was “void or voidable when taken[.]”⁸ Similarly, if “failure to comply with any requirements” of an LLC or LP agreement makes an act or transaction “void or voidable,” that failure can subsequently be waived.

Such ratification or waiver must be effected by the members or managers (in the case of an LLC), partners (in the case of an LP), or other persons “whose approval would be required” at the time of the ratification or waiver under the LLC or LP agreement “(i) for such act or transaction to be validly taken, or (ii) to amend the [LLC or LP] agreement in a manner that would permit such act or transaction to be validly taken[.]” If the act or transaction involved an issuance or assignment of an economic interest in the LLC or LP, then for purposes of the ratification or waiver, that issuance or assignment “shall be deemed” not to have occurred. Importantly, the amendments also make clear that validation of an act or transaction by ratification or waiver under the new provisions will relate back to the time of such act or transaction. The new procedure for ratification provided by the amendments is not exclusive but is instead intended to be a “safe harbor.”⁹

If the ratification or waiver is effected by “the members, managers or other persons whose approval would be required to amend the limited liability company agreement” (in the case of an

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LLC) or by “the partners or other persons whose approval would be required to amend the partnership agreement” (in the case of an LP), and the LLC or LP agreement would require that notice be given of an amendment to validate the void or voidable act or transaction, then notice of the ratification or waiver must be given to the members, managers, partners, or other persons entitled to notice of an amendment, unless such persons participated in the ratification or waiver or otherwise received notice of it.

Any member or manager (in the case of an LLC), any partner (in the case of an LP), “or any person claiming to be substantially and adversely affected” by the ratification or waiver itself (as opposed to the act or transaction that was validated) may apply to the Delaware Court of Chancery for a determination of “the validity and effectiveness” of the ratification or waiver. In such an action, the LLC or LP must be named as a party, but “no other party need be joined” unless the Court of Chancery orders otherwise.

Default Limitation Added to Member and Limited Partner Information Rights

Courts interpreting the General Corporation Law of the State of Delaware (the “DGCL”) have long held that a stockholder validly asserting information rights under DGCL § 220 is entitled to, and only to, corporate information that is “necessary and essential” to accomplish the stockholder’s proper purpose.¹⁰ The Delaware Court of Chancery has held that the “necessary and essential” rule as developed in the corporate context should apply also to assertions of inspection rights against LPs.¹¹ However, when the issue was presented to the Delaware Supreme Court in 2020, the court ruled that unless the governing LP agreement provided otherwise, the “necessary and essential” requirement could be imported only if it was appropriate, under principles of contract law, to imply the requirement in the agreement.¹²

In response to the Supreme Court’s decision,¹³ the 2021 DLLCA and DRULPA amendments have made the “necessary and essential” rule a default limitation on information rights. Specifically, DLLCA § 18-305(g) and DRULPA § 17-305(f) now provide, in part, “If a [member or limited partner] is entitled to obtain information under this chapter or [an LLC or LP] agreement for a purpose reasonably related to the [member’s or limited partner’s] interest as a [member or limited partner] or other stated purpose, the [member’s or limited partner’s] right shall be to obtain such information as is necessary and essential to achieving that purpose.” As noted, the “necessary and essential” limitation applies only by default, and therefore, like other statutory information rights, it may be “expanded or restricted” in an original LLC or LP agreement, or by an amendment adopted in compliance with the remaining provisions of DLLCA § 18-305(g) or DRULPA § 17-305(f).

Delegation by a Conflicted Principal Will Not Cause the Delegatee to Be Conflicted

It is well settled that when a stockholder of a Delaware corporation has properly initiated a derivative suit, the corporation’s board may nevertheless seek to have the suit dismissed on the grounds that dismissal would serve the best interests of the corporation.¹⁴ The board retains this power even if a majority of the directors are conflicted regarding the suit.¹⁵ Under those circumstances, to satisfy the court that it may defer to the board’s determination, the board must delegate the decision whether to seek dismissal to a committee of disinterested and independent directors.¹⁶

At first glance, it may appear that such a procedure should be equally effective where a derivative suit has been brought by a limited partner of a Delaware LP, and the LP’s sole general partner is a corporation. In other words, one might expect that even when the general partner is conflicted regarding the derivative suit, the general partner could seek dismissal if an independent

committee formed by the general partner determined that the suit was not in the LP's best interests.

The Delaware Court of Chancery recently held, however, that such an approach was not effective in the case of an LP with a single, conflicted general partner that was itself a corporation.¹⁷ In that situation, the court held, the corporate general partner could not avoid the conflict by having the demand considered by a committee of independent decision makers.¹⁸ The court's reasoning was that where the general partner itself, as opposed to just members of the general partner's board, is conflicted, the conflict cannot be avoided by the general partner's delegation of the dismissal decision to an independent body. As the court noted, under principles of agency, any conflict on the part of the general partner necessarily made its delegates conflicted as well.¹⁹

The DLLCA and DRULPA have been amended to eliminate this issue. As amended, DLLCA § 18-407 and DRULPA § 17-403(c) now provide that a member's or manager's (in the case of an LLC) or a general partner's (in the case of an LP) default power to delegate rights, powers, and duties to other persons may be exercised "irrespective of whether the [member, manager, or general partner] has a conflict of interest with respect to the matter as to which its rights, powers or duties are being delegated[.]" Moreover, "the person or persons to whom any such rights, powers or duties are being delegated shall not be deemed conflicted solely by reason of the conflict of interest of the [member, manager, or general partner]." Accordingly, a conflicted corporate general partner of an LP (or manager or managing member of an LLC) should now be able to validly consider and seek dismissal of a derivative action by means of an independent-committee mechanism similar to that developed under Delaware corporate law.

Amendments Affecting Statutory Public Benefit LLCs and LPs

A statutory public benefit LLC ("SPB-LLC") or statutory public benefit LP ("SPB-LP") is a for-profit LLC or LP "that is intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner."²⁰ Provisions enabling the formation of SPB-LLCs were first added to the DLLCA in 2018, and the following year, similar provisions were added to the DRULPA. The 2021 amendments have revised those provisions in several respects.

First, the public benefits promoted by an SPB-LLC or SPB-LP must now be set forth not only in its certificate of formation or certificate of limited partnership (as was the case formerly), but also in its operating agreement.²¹ In the event of an inconsistency between the operating agreement's and the certificate's statement of the public benefits, the agreement will control as regards members, managers, partners, and "other persons who are party to or otherwise bound by" the operating agreement. In addition, any inaccuracy in the certificate's description of the public benefits must be promptly corrected by a manager, member (in the absence of a manager), or general partner, as the case may be, that becomes aware of the inaccuracy.

Second, provisions that formerly required supermajority approval for an SPB-LLC or SPB-LP to cease to have SPB status have been removed from the DLLCA and DRULPA.²² It therefore now appears that actions effecting an exit from SPB status (such as mergers, divisions, or operating-agreement amendments) will be governed by the applicable non-SPB sections of the DLLCA or DRULPA.

Finally, the DLLCA and DRULPA now specify how an existing LLC or LP can become an SPB-LLC or SPB-LP. If the entity "is not formed" as an SPB-LLC or SPB-LP, it can become one "in the manner specified in its [LLC or LP] agreement or by amending its [LLC or LP] agreement and certificate of [formation or limited partner-

ship] to comply with the requirements of’ the SPB subchapter of the DLLCA or DRULPA.²³

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² The DLLCA is Chapter 18 (§§ 18-101 to 18-1208), and the DRULPA is Chapter 17 (§§ 17-101 to 17-1208), of Title 6 of the Delaware Code.

³ Del. S.B. 114, 151st Gen. Assem. (2021) (LLCs); Del. S.B. 116, 151st Gen. Assem. (2021) (LPs).

⁴ *CompoSecure, L.L.C. v. CardUX, LLC*, 206 A.3d 807, 810 (Del. 2018).

⁵ *Absalom Absalom Trust v. Saint Gervais LLC, C.A.* No. 2018-0452-TMR, 2019 WL 2655787, at *3 (Del. Ch. June 27, 2019).

⁶ *CompoSecure*, 206 A.3d at 816; *see also Absalom*, 2019 WL 2655787, at *3.

⁷ *CompoSecure*, 206 A.3d at 817; *Absalom*, 2019 WL 2655787, at *3-4.

⁸ 6 Del. C. § 18-106(e) (LLCs), § 17-106(e) (LPs).

⁹ Del. S.B. 114 syn. § 1, 151st Gen. Assem. (2021) (LLCs); Del. S.B. 116 syn. § 1, 151st Gen. Assem. (2021) (LPs).

¹⁰ *E.g., Saito v. McKesson HBOC, Inc.*, 806 A.2d 113, 116 (Del. 2002).

¹¹ *E.g., Madison Ave. Inv. P’rs, LLC v. Am. First Real Estate Inv. P’rs, L.P.*, 806 A.2d 165, 176 (Del. Ch. 2002).

¹² *Murfey v. WHC Ventures, LLC*, 236 A.3d 337, 346-47 (Del. 2020).

¹³ *See* Del. S.B. 116 syn. § 3, 151st Gen. Assem. (2021) (LPs).

¹⁴ *Zapata Corp. v. Maldonado*, 430 A.2d 779, 787-88 (Del. 1981).

¹⁵ *Id.* at 785-86.

¹⁶ *Id.* at 788-89.

¹⁷ *Wenske v. Blue Bell Creameries, Inc.*, 214 A.3d 958 (Del. Ch. 2019).

¹⁸ In *Wenske*, an independent board committee delegated to an ad hoc committee of **non**-directors, as permitted by the LP agreement. *Id.* at 962.

¹⁹ *Id.* at 966-67.

²⁰ 6 Del. C. § 18-1202(a) (LLCs), § 17-1202(a) (LPs).

²¹ 6 Del. C. § 18-1202(a) (LLCs), § 17-1202(a) (LPs).

²² 6 Del. C. § 18-1203 (LLCs), § 17-1203 (LPs).

²³ 6 Del. C. § 18-1201 (LLCs), § 17-1201 (LPs).

DGCL Amendment Expressly Bars Voting of Shares Held by an Alternative Entity Controlled by the Issuing Corporation

By John J. Paschetto

The Delaware legislature recently amended the provision of the General Corporation Law of the State of Delaware (the “DGCL”)¹ that addresses the voting of shares under the control of the corporation that issued them. Before the amendment, § 160(c) of the DGCL provided that shares could not be voted or counted for quorum purposes if the shares were held by the issuing corporation (i.e., they were treasury shares) or were held by “another corporation” when the issuing corporation held, directly or indirectly, a majority of the shares entitled to vote in the election of the other corporation’s board. Thus, under a strict reading of pre-amendment § 160(c), shares could be voted and counted for quorum purposes if they were held, not by a “corporation” controlled by the issuer, but by a controlled limited liability company, limited partnership, or other type of entity that was not a corporation.

This apparent loophole has been closed by the 2021 amendment, which took effect on August 1. The prohibition in § 160(c) now extends not only to shares held by the issuing corporation or by a corporation whose board it has the power to elect, but also to shares held by “any other entity, if a majority of the voting power of such other entity is held, directly or indirectly,” by the issuing corporation, or “if such other entity is otherwise controlled, directly or indirectly,” by the issuing corporation.² Amended § 160(c) continues to make clear that it does not limit the right of any corporation to vote shares, including its own shares, that are held in a fiduciary capacity.

¹ The DGCL is Chapter 1 (§§ 101-398) of Title 8 of the Delaware Code.

² Del. S.B. 113, 151st Gen. Assem. (2021).

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