Analysis of the 1996 Amendments to the Delaware General Corporation Law

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ANALYSIS OF THE 1996 AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW

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INTRODUCTION

The Delaware General Corporation Law was amended in 1996 for the seventh consecutive year. The 137th General Assembly approved two bills which made changes in the statute. One bill made several technical changes to the amendments adopted in 1995. The other made changes to sixteen sections of the Delaware General Corporation Law. The great majority of the 1996 changes may also be characterized as technical changes or as fine tuning or clarification of the existing law. Perhaps the most important substantive change relates to expansion of the authority of committees of the board of directors. Other changes should provide added flexibility to Delaware corporations by, for instance, simplifying the procedures for taking corporate action by written consent of stockholders.

This article describes the changes effected by the 1996 amendments and supplements previous reports published by Aspen Law & Business and its predecessor, Prentice Hall Law & Business, describing amendments to the Delaware General Corporation Law.[1]

FORMATION

Execution, filing, recording of documents [§ 103].—Section 103 of the General Corporation Law governs the execution, filing and recording of documents with the

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1 Arsht and Stapleton: Analysis of the New Delaware Corporation Law; Analysis of the 1967 Amendments to the Delaware Corporation Law; Analysis of the 1969 Amendments to the Delaware Corporation Law; Analysis of the 1970 Amendments to the Delaware Corporation Law; Arsht and Black: Analysis of the 1973 Amendments to the Delaware Corporation Law; Analysis of the 1974 Amendments to the Delaware Corporation Law; Analysis of the 1976 Amendments to the Delaware Corporation Law; Black and Sparks: Analysis of the 1981 Amendments to the Delaware Corporation Law; Analysis of the 1983 Amendments to the Delaware Corporation Law; Analysis of the 1984 Amendments to the Delaware Corporation Law; Analysis of the 1985 Amendments to the Delaware Corporation Law; Analysis of the 1986 Amendments to the Delaware Corporation Law; Analysis of the 1987 Amendments to the Delaware Corporation Law; Analysis of the 1988 Amendments to the Delaware General Corporation Law; Analysis of the 1990 Amendments to the Delaware General Corporation Law; Analysis of the 1991 Amendments to the Delaware General Corporation Law; Analysis of the 1992 Amendments to the Delaware General Corporation Law; Analysis of the 1993 Amendments to the Delaware General Corporation Law, Black & Alexander: Analysis of the 1994 Amendments to the Delaware General Corporation Law (Prentice Hall, Inc., 1967, 1969, 1970, 1973, 1974, 1976, 1981, 1983, 1984, 1985, 1986, 1987, 1988, 1990, 1991, 1992 and 1993, Aspen Law & Business, 1994 and 1995, respectively).

Secretary of State. Section 103(d) provides that documents so filed either may become effective immediately or, alternatively, may provide for a delayed effective time of up to 90 days. This delayed effective time provision was amended in 1995, to provide that if a merger or consolidation were terminated or amended to change the future effective time prior to the effective time of the merger with a delayed effective time, the filed instrument could be terminated or amended by filing a certificate of termination or amendment. Building on this change, the 1996 amendments extend the concept to any instrument filed with the Secretary of State that provides for a delayed effective time. In order to so terminate or change the effective time of a previously-filed instrument, the amendment requires the filing of a certificate of termination or amendment, executed in accordance with Section 103, that identifies the instrument to be terminated or amended and that states that the instrument has been terminated or the manner in which it has been amended. The 1996 amendment to Section 103(d) should make practitioners more comfortable in filing any document with the Secretary of State that calls for a delayed effective time. Heretofore, the general utility of the device was circumscribed by concerns that unforeseen delays in approvals by regulatory agencies, or other unanticipated events, could cause embarrassment — or worse — when the clock was ticking against an immutable drop dead date. The elimination of this concern lends added flexibility to the statute. Arguably, even as amended, Section 103(d) does not permit an amendment of the original filing extending the delayed effective time beyond 90 days from the original filing. The second sentence of Section 103(d) provides that a delayed effective time cannot be more than 90 days after a document is filed. But even this limitation should pose no real obstacle since a filing can, in effect, be withdrawn, by terminating the filing and presenting a new document with a new effective time.

DIRECTORS AND OFFICERS

Board of directors [§ 141].—Section 141 of the General Corporation Law gives the board of directors power to manage, or direct the management of, the corporation. Section 141(c) expressly authorizes the delegation of certain board powers to committees of directors, but also places specific limitations on the powers that may be delegated. The 1996 amendments make two important changes to Section 141(c). First, the requirement that committees be appointed only by a majority of the whole board has been eliminated, so that the board can act to appoint a committee by a simple majority of a quorum or whatever other vote is required by the certificate of incorporation or bylaws. Second, and most significantly, the specific enumeration of items that are beyond the power of board committees has been eliminated. As amended, Section 141(c) simply provides that committees may not (1) approve, adopt or recommend to stockholders, any action or matter that expressly requires stockholder action, or (2) adopt, amend or appeal the bylaws of the corporation. Accordingly, all matters beyond basic organic changes, such as mergers or charter amendments, that require stockholder approval, may be placed in the hands of a committee of directors. Perhaps the most significant result of this change will be to permit committees to establish the voting rights of series of stock created pursuant to "blank check" provisions. Also eliminated is the requirement that certain actions that could be delegated to committees, including the declaration of dividends, could be so delegated only if the delegation expressly referred to such action.

Because the changes to Section 141(c) could have the effect of altering the balance of power, particularly in closely-held corporations with carefully negotiated corporate governance provisions, the amendment automatically governs only corporations incorporated on or after July 1, 1996, the effective date of the amendment. However, any corporation incorporated prior to that date may opt into the new provision by resolution adopted by a majority of the whole board.

STOCK AND DIVIDENDS

Repurchases and redemptions of stock [§ 160].—Section 160 authorizes corporations to purchase or redeem their own shares of stock, but generally prohibits any such repurchase that would cause an impairment of the capital of the corporation. This prohibition against repurchases or redemptions out of capital has long been understood to limit a corporation to using its "surplus," as that term is defined in Section 154 of the General Corporation Law, to purchase its own shares. *See In re International Radiator Co.*, 92 A. 255 (Del. Ch. 1914). Section 160 and its predecessors, however, have long provided an exception to this rule preserving corporate capital where the purchase of preferred stock is concerned. Under this exception, redemptions and repurchases may be made even if surplus is not available, so long as the corporation has sufficient statutory capital to be applied to the repurchase. A corporation's capital is generally equivalent to the par value of its issued shares, although directors may assign additional amounts to capital. *See* 8 *Del. C.* § 154. It should be noted that preferred stock can only be purchased out of capital if the test permitting applications of capital under Section 244(b) can be met. That test, though ambiguously stated, appears to require a corporation to have positive net assets (ignoring capital) following an application of capital. That requirement is normally not important in connection with a repurchase or redemption because it is automatically met if the capital impairment test, which requires net assets in excess of capital, is satisfied. *See* D. Drexler, L. Black & A. Sparks, *Delaware Corporation Law and Practice* § 33.02 ("In other words, 'impairment' as described in Section 244 means not merely the existence of a deficit but the existence of a deficit greater than capital."). In the unusual case of a repurchase of stock out of capital, however, where the capital impairment test does not apply, the Section 244(b) test does become significant.

The amendment to Section 160 permits a corporation also to purchase shares of common stock out of capital, but only if no shares of preferred stock are outstanding. It is important for practitioners to note that for modern American corporations, statutory capital is generally nominal, so that, as a practical matter, it is unlikely that many corporations will be able to purchase common stock out of capital when the capital impairment test cannot be met. Thus, while the amendment eliminates an unnecessary limitation on the repurchase of common stock, it will have a practical effect only in a limited number of cases.

MEETINGS, ELECTIONS, VOTING AND NOTICE

Consent of stockholders or members in lieu of meeting [§ 228].—Section 228 permits stockholders to take action by written consent in lieu of a meeting if consents are signed by the holders of outstanding stock having not less than the minimum number of votes necessary to authorize the action at a meeting at which all the shares entitled to vote thereon were present and voted. Subsection (d) of Section 228 requires that the corpora-

tion give prompt notice of the taking of such action to stockholders who have not consented in writing. The 1996 amendments clarify that the notice must be given only to those stockholders who would have been entitled to receive notice of a stockholders' meeting at which the action could have been taken. Section 222(b) of the General Corporation Law provides generally that notice of a meeting must be given only to stockholders entitled to vote at the meeting. The amendments also eliminate the requirement that a certificate filed with the Secretary of State implementing an action taken by written consent must state that such notice has been given. That requirement had been something of a trap for the unwary since it necessarily required that the Section 228(d) notice be given before the approved action was actually effected by a filing. Under the statute, as amended, a corporation may file an instrument approved by written consent immediately after sufficient consents for its approval are received, but before having sent notice to those stockholders whose consent was not obtained. The statute retains the requirement, however, that such notice be sent "promptly".

AMENDMENT OF CERTIFICATE OF INCORPORATION

Amendment of certificate of incorporation after receipt of payment for stock [§ 242].—Section 242, which, in general, authorizes a corporation to amend its certificate of incorporation, supplies the statutory mechanic by which a corporation may effect a stock split, either a reverse stock split, *i.e.*, a combination of shares into a smaller number, or a forward stock split, *i.e.* a division of shares into a greater number. The authority to effect stock splits has been located in the penumbra of amendments contemplated by Section 242(a), such as "changes in stock", "exchanges" and "reclassifications". Because the application of Section 242 to stock splits was not clearly stated there was some confusion as to the authorization of stock splits by board action alone, particularly in light of the fact that a forward stock split could, in effect, be accomplished by way of a stock dividend without the stockholder approval required by Section 242 so long as the corporation had surplus sufficient to support the dividend. The 1996 amendments clarify the application of the statute to stock splits by expressly providing that charter amendments implemented pursuant to Section 242 may have the effect of "subdividing or combining the outstanding shares of any class or series of a class of shares into a greater or lesser number of outstanding shares".

Section 242(c) provides that the board resolutions authorizing an amendment to the certificate of incorporation may give the directors authority to abandon the amendment, even following stockholder approval of the amendment. Subsection (c) was amended in 1996 to provide that the power to abandon an amendment may continue, with respect to a certificate of amendment filed with a delayed effective time, until the effective time. This amendment was intended to give directors complete flexibility under the amendments to Section 103(d) described above.

MERGER OR CONSOLIDATION

Merger or consolidation [§§ 251-257, 263, 264].—The merger provisions of the General Corporation Law were amended in 1974 and subsequently to make it clear that the terms of a merger agreement, including the exchange ratio applicable to shares of the constituent corporations, could be made dependent on facts ascertainable outside of the merger agreement so long as the merger agreement "clearly and expressly" sets forth the

manner in which those facts are to operate on the exchange ratio or other merger terms. A similar amendment was made in 1983 to Section 151(a) of the General Corporation Law, which governs the terms of classes and series of stock. The latter amendment confirmed that the rights, preferences and powers of a class or series of stock may similarly be made dependent on facts ascertainable outside the certificate of incorporation. The amendment to Section 151 proved troublesome, as practitioners questioned the scope of the term "facts", with some practitioners arguing that determinations and other actions involving discretion were "judgments", rather than the type of "facts" contemplated by the statute. In order to clarify this ambiguity, Section 151 was amended in 1994 to provide that the term "facts" could include any event, including a determination or action. While this amendment had salutary effects with respect to Section 151, it aggravated a similar ambiguity with respect to Section 251, since questions sometimes arise as to whether merger terms are sufficiently "fact-like". *See Jackson v. Turnbull,* Del. Ch., C.A. No. 13042, Berger, V.C. (February 8, 1994), *aff'd.,* 653 A.2d 306 (Del. 1994).

The 1996 amendments resolve this ambiguity with respect to mergers and conform the merger statutes to Section 151(a). It is important to note that the amendments are not intended in any way to alter the fiduciary duties of directors approving a merger agreement or making determinations, or taking any other action that constitutes a fact within the merger agreement.

Section 253, which governs mergers of corporations with 90 percent or more owned subsidiaries, was also conformed to the other merger statutes. Section 253 does not require a merger agreement, but rather permits a board of directors of a parent corporation, by resolution, to authorize a merger with or into its subsidiary. Prior to the 1996 amendments, Section 253 did not contain language contemplating reference to facts ascertainable outside such resolutions. The 1996 amendments conform Section 253(a) to the other merger statutes in this regard.

Section 253(a) was also amended in order to protect against short-form mergers that might be used to circumvent the protections established under Section 251(g), a provision adopted in 1995 that authorizes corporations to engage in holding company reorganizations without stockholder approval. Following the adoption of Section 251(g), it was recognized that certain charter provisions required by that section to be adopted by operating companies created in such reorganizations might be circumvented through a short-form merger. The amendment is intended to prevent this.

Section 251 and the other merger provisions permit merging corporations to file a certificate of merger, which is generally a simple one or two-page document, in lieu of filing the entire merger agreement with the Secretary of State. However, in order to ensure that the actual agreement of merger is available to stockholders of the constituent corporations, Section 251 and the other merger provisions formerly required that the certificate state that the executed agreement of merger or consolidation would be on file at the principal place of business of the surviving corporation. The 1996 amendments permit the executed agreement to be filed in any office of the surviving corporation or entity, whether or not its principal place of business.

Appraisal rights [§ 262].—Section 262 provides appraisal rights to stockholders in certain mergers. Subsection (d) of that section establishes a procedure for giving notice to stockholders as to the availablility of appraisal rights. Paragraph 2 of Section 262(d), which addresses the notice of appraisal rights to be given in short-form mergers or mergers approved by written consent, was significantly revised by the 1996 amendments. Most importantly, the amendment provides a mechanism for sending separate notices

with respect to the approval of the merger and its effective date. Previously, the statute provided for one notice with respect to both approval and the effective date. By providing for separate notices, the statute will permit corporations to initiate the 20-day period for appraisal demands as soon as a merger is approved, when the effective date is not known at the time notice of approval is sent. In addition, the amendment establishes a method of fixing a record date for determining the stockholders entitled to receive such notice. The amendments also provide that the notices given prior to the effective date are to be given by the appropriate constituent corporation, rather than the surviving corporation, as previously provided. Finally, the amendments eliminate the requirement that notices be sent by certified or registered mail, return receipt requested.

Section 262(b) was amended to make it clear that holding company mergers effective pursuant to Section 251(g), which may be effected without stockholder approval, do not trigger appraisal rights.

SALE OF ASSETS, DISSOLUTION AND WINDING UP

Dissolution of joint venture [§ 273].—Section 273 of the General Corporation Law provides a special dissolution mechanic for corporations having two stockholders, each of whom owns 50 percent of the stock. While the provision may aid in solving certain deadlock situations, some joint venturers may not want to be subject to Section 273 and its procedures. In the past, application of the statute was avoided by subterfuges such as issuing one nominal share of stock to a third party in order to avoid meeting the statutory definition of joint venture. The 1996 amendments permit a more straightforward opt-out from the statute, either in the certificate of incorporation of the corporation or in a written agreement between the stockholders.

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