Analysis of the 2003 Amendments to the Delaware General Corporation Law

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ANALYSIS OF THE 2003 AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW

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INTRODUCTION

The Delaware General Assembly adopted a number of amendments to the Delaware General Corporation Law effective August 1, 2003. Certain other amendments relating specifically to filings with the Secretary of State became effective in April of 2003. Those amendments responded on an *ad hoc* basis to judicial criticism of the practices of the Secretary of State's Office. Finally, the General Assembly passed an amendment to Section 3114 of Title 10 of the Delaware Code entitled Courts and Judicial Procedure, which expands the jurisdiction of Delaware courts over officers of Delaware corporations. While some of the amendments were merely intended to clarify existing law, a number made substantive changes to the statute. This article describes the changes effected by these amendments and supplements previous reports published by Aspen Publishers and its predecessor, Prentice Hall Law & Business, describing amendments to the Delaware General Corporation Law. [1]

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 and Alexander: Analysis of the 1995 Amendments to the Delaware General Corporation Law; Analysis of the 1996 Amendments to the Delaware General Corporation Law; Analysis of the 1997 Amendments to the Delaware General Corporation Law; Analysis of the 1998 Amendments to the Delaware General Corporation Law; Analysis of the 1999 Amendments to the Delaware General Corporation Law; Analysis of the 2000 Amendments to the Delaware General Corporation Law, Analysis of the 2001 Amendments to the Delaware General Corporation Law, Analysis of the 2002 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 Publishers, 1994, 1995, 1996, 1997, 1998, 1999, 2000, 2001 and 2002, respectively.)

FORMATION

Execution, acknowledgment, filing, recording and effective date of original certificate of incorporation and other instruments [§103].—Section 103 generally addresses the manner in which instruments, such as certificates of incorporation, certificates of merger or certificates of amendment, are to be filed with the Division of Corporations of the Secretary of State's Office. Section 103(c) governs the actual filing mechanics. Prior to 2003, that subsection simply provided that when a document was filed and all fees paid, the Division of Corporations was to certify that the instrument had been filed, and the date and hour of its filing. This cryptic direction was all that governed the timing of filings, which is often critical in closing transactions. According to Section 103(c), the Secretary of State's endorsement of the "filing date" was conclusive of the date and time of filing in the absence of actual fraud. Over the years, certain registered agents and the Division of Corporations developed a practice of giving documents a filing time that differed from the time documents were actually delivered to the Division of Corporations. Although the statute did not address this practice, it allowed Delaware corporations (and their lawyers) to treat these registered agents as extensions of the Division of Corporations, and allow the registered agents in question to absorb much of the processing burden that might otherwise fall on the Division of Corporations. However, because the Division of Corporations did not know when a document was actually delivered to the registered agent, the practice was subject to abuse.

Another timing issue was not addressed by the statute: there was no explicit ability to preserve a filing time when a good faith attempt was made to file a document but the attempt failed due to an emergency. This was a significant issue in the days immediately following September 11, 2001. The issue arose again recently when a heavy snowstorm blanketed Delaware in early 2003. Finally, the statute did not expressly address the filing time of documents that were rejected by the Division of Corporations due to ministerial or clerical mistakes, although the Division generally allowed the corrected document to retain its initial filing time. All of these issues had been generally addressed on an *ad hoc* basis by the Division without formal implementation. This state of affairs might have continued indefinitely had not the issue of a retroactive filing date become a significant issue in a fight for corporate control. *See Liebermann v. Frangiosa*, Del. Ch., C.A. No. 19821-NC (Dec. 4, 2002). In *Liebermann*, in the course of rejecting a back dated filing time that had been given to a document filed by a registered agent, the Court of Chancery sent the Secretary of State's office a clear message to change its policies:

> With advances in technology, the Secretary of State's office is better-positioned than ever to record the actual time of filing with fidelity and accuracy, and doubtless will set in motion revised practices to effect this result, having experienced the chagrin of seeing its current policies generate litigable arguments. *Id.*, at 37 n.49.

In response to the *Liebermann* opinion, the General Assembly amended Section 103(c) in April, 2003 in a number of ways. First, paragraph (3) was amended to provide expressly that the Secretary of State will record the time of delivery of

instruments and that this time will be treated as the filing time, subject to certain exceptions. The ministerial exceptions are set out in a new paragraph (4). Exceptions for states of emergency are set out in new subsection (i).

First, paragraph (4) permits the Secretary of State to establish procedures for permitting a delayed filing time; that is, the filer may request that an instrument be treated as filed sometime *after* its actual delivery. Second, paragraph (4) provides that if the Secretary of State refuses to file some instrument because of an error (if, for example, the name of the corporation is spelled incorrectly, or if, as sometimes happens, the filing contains blanks that have not been filled in) the document may be held in suspension for up to five business days, during which time the corporation may deliver a replacement instrument in proper form. In such a case, the instrument will retain its original filing time; however, during the period of suspension, the Secretary of State will not issue a certificate of good standing for the company. Finally, paragraph (4), together with new paragraph (7), permits those registered agents that have authority to enter information into the Delaware Corporation Information System (a database of corporate information) to enter such information with respect to a filing and to establish the time of the information being so entered as the time of filing as long as the actual instrument is delivered to the Secretary of State on the same date within four hours after such information is entered.

To address emergencies, new subsection (i) allows documents that cannot be successfully delivered to the Secretary of State for filing because of an "extraordinary condition" to retain the filing time of the attempted delivery if the document is actually delivered within two days after the extraordinary condition ceases, and the document is delivered together with an affidavit attesting to the earlier attempted delivery or, alternatively, the Secretary of State provides a written waiver of the affidavit requirement. The statute defines two types of extraordinary conditions. First, there are emergencies such as attacks, invasions, disasters, catastrophes or similar emergencies that take place in the United States or other locations in which the Secretary of State conducts business that cause an attempted delivery to be unsuccessful. Thus, if there is a natural disaster where a closing is scheduled that prevents the participants from having a closing document filed with the Secretary of State, the parties may nevertheless be able to preserve their attempted filing time. The second type of extraordinary condition involves the Division itself and includes malfunctions or outages of electrical or telephone service or other conditions causing the Secretary of State's Office not to be open for the purpose of accepting filings, or if, as a result of the condition, the filing cannot be effected without "extraordinary effort."

The foregoing changes in the protocols for filing documents with the Secretary of State provide practical benefits. They assure Delaware corporations that closings involving filing of documents will take place at the desired time regardless of unforeseen events that are not the fault of the parties, while at the same time preserving the integrity of the records of the Secretary of State. It should be remembered that, in addition to the new provisions, the statute continues to permit documents to be filed with delayed effective times so that the instrument itself can provide that it becomes effective up to 90 days after the filing time.

8 *Del. C.* §103(d). In addition, the certificate of correction process is available to correct any defective instrument, without losing its original filing time. 8 *Del. C.* §103(f).

One other change was contained in the bill amending Section 103. Section 391 of the General Corporation Law was amended to adopt a procedure to permit a new, one-hour category of expedited filings. Previously, the fastest service available was a guaranteed two-hour turnaround.

Interpretation and enforcement of the certificate of incorporation and bylaws [§111].—Section 111 of the General Corporation Law previously granted subject matter jurisdiction to the Delaware Court of Chancery with respect to any action to "interpret, apply or enforce the provisions of the certificate of incorporation or the bylaws of the corporation." Although the Court of Chancery is the chief venue in which actions involving Delaware corporations are brought, subject matter jurisdiction is available only if there is a specific provision granting the court jurisdiction or if the matter otherwise lies within the court's equitable jurisdiction. As a result, from time to time, corporation law issues may not be amenable to resolution in the Chancery Court. Because the availability of the Court of Chancery is one of the chief benefits of being a Delaware corporation, Section 111 was significantly expanded by the 2003 amendments in an effort to insure that almost any matter involving corporation law can be brought in the Court of Chancery. As revised, Section 111 goes well beyond covering actions involving charters and bylaws, and provides that actions involving documents concerning the sale of stock, restrictions on transfer, proxy relationships, voting trusts, mergers, conversions, domestications, and instruments required by any provision of the General Corporation Law, as well as any action to interpret, apply or enforce any provision of the statute, may be brought in Court of Chancery.

The statute does not provide the Court of Chancery with exclusive jurisdiction over these matters so that they could, in some cases, be maintained in Delaware's Superior Court, where, unlike the Court of Chancery, there is the possibility of a jury trial, and where punitive damages are available. Accordingly, the drafters of agreements may wish to include a forum selection provision designating the Court of Chancery in order to take advantage of Section 211's expanded coverage.

DIRECTORS AND OFFICERS

Board of directors [§141].—Subsection (c) of Section 141 authorizes the boards of directors of Delaware corporations to appoint committees of directors which committees may, with certain exceptions, exercise the powers of the board. The 2003 amendments add a new paragraph (3) to subsection (c), expressly providing that those committees have the power to, in turn, create subcommittees to which any of the authority of the committee may be delegated. This provision, which clarifies the power to delegate to subcommittees, was adopted to make it clear that Delaware corporations could, consistent with recent changes to the listing requirements applicable to corporations with publicly traded securities, provide in the charters of certain board committees that those committees may create subcommittees and assign duties to them.

Agreements to submit matters to a vote of stockholders [§146].—The General Corporation Law requires that certain matters, such as charter amendments, mergers, sales of substantially all assets and dissolution, be submitted

to stockholders for approval. In addition, stock exchange listing requirements mandate that certain matters be submitted for stockholder approval even in the absence of a state law requirement, and stockholder approval may be necessary to secure certain benefits that are available under securities and tax laws or regulations. New Section 146 provides that a board of directors can commit a corporation to submit a matter for stockholder approval even if the board of directors subsequently determines to recommend against the matter. This broadens the application of a concept that heretofore (at least since 1998) applied only to mergers.

In the 1985 Delaware Supreme Court decision, *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), the Supreme Court held that, with respect to mergers, a board could *not* submit a merger for stockholder approval if it had withdrawn its recommendation following the initial board approval of the merger. In 1998, the General Assembly adopted an amendment to Section 251(c) to change this rule so that a board of directors could commit the corporation to submit a merger for stockholder approval even if the board of directors changed its recommendation. Section 146 extends this rule to all matters submitted for stockholder approval.

The adoption of Section 146 does not necessarily mean that directors will be able to promise in all cases to submit a matter to a stockholder vote even if the directors have changed their minds. The directors' fiduciary duties may limit their ability to commit to such an action. *See, e.g., OmniCare, Inc. v. NCS Healthcare, Inc.*, Del. Supr., No. 605, 2002 (Del. Apr. 4, 2003) (where stockholders holding a majority of voting power irrevocably agreed to approve a merger agreement, board could not irrevocably commit to submit merger for stockholder approval).

MEETINGS, ELECTIONS, VOTING AND NOTICE

Inspection of books and records [§220].—Section 220 of the General Corporation Law allows stockholders to inspect the corporation's stocklist, and to inspect a corporation's other books and records, in either case for a proper purpose, *i.e.*, a purpose reasonably related to such person's interest as a stockholder. Where the stockholder seeks information beyond a stocklist, the statute puts the burden of demonstrating a proper purpose on the stockholder. In addition to providing stockholders with the right to examine books and records, subsection (d) of Section 220 provides that directors also have the right to examine the stocklist and other books and records.

Because it provides stockholders and directors with an important tool with which to monitor the management of their corporation, the drafters of the 2003 amendments believed that it would be appropriate to reexamine the section in light of recent highly publicized events calling into question the quality of corporate governance. As a result, several changes were made. First, inspection rights were extended to include beneficial owners of stock who do not own shares of record. Given the reality that for purposes of convenience many stockholders hold their shares in "street name," it was thought that requiring stockholders to obtain actual record ownership in order to seek to inspect corporate books and records imposed an unnecessary burden. Second, the requirement that a demand be under oath was defined to include any statement affirmed to be true under penalties of perjury, thereby eliminating the need to submit a demand for inspection with a notary's seal or attestation.

More substantively, the books and records subject to inspection were expanded to include the records of certain subsidiaries. Prior case law had limited the extent of the inspection right available under Section 220 to books and records of the corporation in question. Given the holding company structure of many corporations, this imposed a serious limitation on the efficacy of Section 220 inspections. However, the new right to inspect the books and records of subsidiaries is by no means open-ended. Records may be reviewed if the corporation has actual possession and control of the records. In addition, as amended, the statute permits inspection if the corporation could obtain the records through the exercise of control over the subsidiary, but only if that inspection would not constitute the breach of an agreement between the corporation or the subsidiary and a third party (*e.g.*, a confidentiality agreement) and only if the subsidiary would not have the right under applicable law to deny the corporation access to the books and records. The legislative commentary accompanying the statute specifically provides that the extension of the inspection right to subsidiary documents is not intended to affect existing legal doctrine respecting the distinct nature of separate corporate entities.

Finally, the right of directors to inspect corporate books was enhanced by placing on the corporation the burden of proving that a director's purpose for seeking to inspect books and records is improper if it chooses to make that claim.

Contested election of directors; proceedings to determine validity [§225].—Section 225 of the General Corporation Law authorizes any stockholder or director or any officer whose title to office is contested to apply to the Court of Chancery to determine the validity of an election of any director or officer and the right of any person to hold office. In such proceedings, service of copies of the application upon the registered agent of the corporation is deemed to be service on the corporation and any person whose title to office is contested as well as any person claiming the office. Accordingly, decisions rendered in Section 225 proceedings have the effect of binding all contestants to office and represent an important avenue for achieving corporate finality. Prior to the 2003 amendments, the wording of the statute could have suggested that certain disputes over whether a director was in office were not covered by Section 225. The 2003 amendments add the words "appointment, removal or resignation" to the litany of matters that can be decided in a Section 225 action in order to insure that the proceeding is available in all cases where an office is contested.

MERGER, CONSOLIDATION OR CONVERSION

Merger or consolidation [§§251-257, 263 and 264].—The language in Section 251(c) authorizing directors to commit to presenting a merger for stockholder approval even if they change their recommendation was deleted because new Section 146, described above, now addresses this question. In addition, all of the provisions of the General Corporation Law addressing mergers were amended to recognize expressly that shares of a constituent corporation in a merger may be cancelled for no consideration. Previously, the provisions of the statute had referred only to the conversion or exchange of shares for consideration.

Conversion of a domestic corporation to other entities [§266].—Section 266 of the General Corporation Law permits a corporation to file a certificate of conversion pursuant to which the entity is converted into a different form while continuing its

existence. The 2003 amendments clarify that in order to properly effect a conversion, the documents covering the formation of the type of entity into which the corporation is converting must also be filed in accordance with the provisions of the statute governing that entity's formation.

Courts and judicial procedure [10 *Del. C.* §3114].—Prior to 1977, the Delaware courts could exercise personal jurisdiction over non-resident officers and directors of Delaware corporations through Delaware's sequestration statute. That year, however, the United States Supreme Court, in the landmark case *Schaffer v. Heitner*, 433 U.S. 186 (1977), struck down such exercises of jurisdiction as violations of due process. The Court suggested, however, that a consent statute might supply the minimum contacts necessary to exercise personal jurisdiction over such individuals for breaches of duty. In response, the Delaware General Assembly adopted Section 3114 of Title 10 of the Delaware Code, providing that by accepting the office of director of a Delaware corporation, an individual is deemed to have consented to service of process in any action claiming a violation of his or her duty as a director. The consent statute extended only to directors, and not officers. The drafters of the 2003 amendments, again in response to failures in corporate governance that received widespread publicity in recent years, considered whether such a consent mechanism should also apply to senior officers of corporations, since some of the more highly publicized cases appear to have involved officers and not directors. In response to this circumstance, the 2003 amendments extend the concept of deemed consent to certain senior officers namely, the "president, chief executive officer, chief operating officer, chief financial officer, chief legal officer, controller, treasurer or chief accounting officer as well as any person identified in a public company's filings with the SEC as one of the most highly compensated executive officers." In addition, the consent statute applies to any officer who, by written agreement with the corporation, has consented to be identified as being subject to the consent statute. The amendment to Section 3114 becomes effective on January 1, 2004.

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