Analysis of the 1995 Amendments to the Delaware General Corporation Law

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ANALYSIS OF THE 1995 AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW

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INTRODUCTION

The Delaware General Corporation Law was amended in 1995 for the sixth consecutive year. The 137th General Assembly approved changes to thirteen sections of the statute and one entirely new section. The changes reflect a number of technical amendments, some of which reflect the comments of practitioners and some of which were prompted by recent case law. One significant change will enable a Delaware corporation to change, by merger, to a holding company without stockholder approval. Another will specifically permit Delaware corporations to transfer to other jurisdictions without engaging in a reincorporation merger. Section 203, Delaware's Business Combination Statute, has been amended to clarify a number of issues that have arisen in practice since that statute's adoption in 1988.

This article describes the changes effected by the 1995 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

Contents of certificate of incorporation [§ 102].—Section 102 of the General Corporation Law, which establishes the requisite contents of a corporation's certificate

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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, respectively).

of incorporation, was amended to increase the flexibility that corporations have with respect to the choice of a corporate name. Prior to the 1995 amendments, the statute required that any corporation's name include the words " 'association,' 'company,' 'corporation,' 'club,' 'foundation,' 'fund,' 'incorporated,' 'institute,' 'society,' 'union,' 'syndicate,' or 'limited,' " or a similar word or abbreviation in order to indicate the corporation's corporate status. The 1995 amendments eliminated that requirement for corporations with assets totalling more than $10 million, provided that the name does not otherwise appear to be that of a natural person. The $10 million requirement is intended to prevent small and undercapitalized corporations from attempting to use the amendment to pass themselves off as entities with greater resources.

Execution, filing, recording of documents [§ 103].—Section 103 of the General Corporation Law governs the execution, filing and recording of documents with the Secretary of State. Section 103(d) provides that documents so filed may become effective immediately or may provide for a delayed effective time of up to 90 days. The statute was amended in 1995 to provide that if a merger or consolidation is terminated or amended in the interim (if any) between the filing of the merger agreement (or certificate) and the effective time, the filed instrument may be terminated or amended by filing a certificate of termination or amendment. Such a certificate may amend the delayed effective time itself. This new procedure should provide practitioners with greater flexibility by allowing them to file a merger instrument with a delayed effective time prior to a closing, with assurance that if an intervening circumstance requires them to further delay or terminate the merger they will be able to do so.

REGISTERED OFFICE AND REGISTERED AGENT

Resignation of registered agent [§ 136].—Section 136 of the General Corporation Law, which governs resignation by a corporation's registered agent in Delaware, was amended to provide a simpler procedure. Following the amendment, registered agents may give notice of their resignation by mail or delivery rather than by certified or registered mail. The 1995 amendments also eliminate the requirement that an affidavit be attached to the certificate of resignation filed with the Secretary of State.

DIRECTORS AND OFFICERS

Board of directors [§ 141].—Section 141 of the General Corporation Law grants the board of directors power to manage, or direct the management of, the corporation. Section 141(c) authorizes the delegation of certain board powers to committees of the board, but also places specific limitations on the powers which may be delegated. The statute, by its literal terms, had previously prohibited delegations of authority in connection with conventional mergers among corporations, but not in connection with mergers between corporations and other business entities that have become increasingly popular in recent years. The 1995 amendments clarify that directors cannot delegate the authority to adopt an agreement of merger if the transaction in question involves joint stock or other associations, non-stock corporations, limited partnerships, or limited liability companies.

STOCK TRANSFERS

Business combinations with interested stockholders [§ 203].—In 1988, the General Assembly adopted Section 203, Delaware's Business Combination Statute. Because

of Delaware's status as the home of so many important public corporations, consideration of the "antitakeover" provision attracted national attention and debate. In the end, the legislature adopted a moderate provision that has, in the intervening years, served to protect corporations from the abusive tactics which gained notoriety because of their use by corporate raiders in the 1980's. Despite its careful drafting, a number of interpretive questions have arisen in the seven years following the statute's enactment. For the first time since its adoption, the statute has been amended to make technical and clarifying changes.

Amendments to Section 203(a) codify the holding in *Siegman v. Columbia Pictures Entertainment, Inc.*, 576 A.2d 625 (Del. Ch. 1989). Section 203(a) provided that business combinations with interested stockholders will not be subject to the restrictions imposed by the statute if the board of directors approves the transaction or the stockholder prior to the "date" that the stockholder becomes "interested" as defined in the statute. The *Siegman* court found the term "date" should be interpreted as "time" when used in the statute. The 1995 amendments formalize this interpretation. The result in the *Siegman* case, as now incorporated in the statute, has significant practical effect. It is not uncommon for a board of directors to want to approve a share acquisition which makes a stockholder "interested" and a business combination involving that stockholder at the same meeting of the board. The suggestion that these board actions could not be taken *seriatim*, but rather had to be separated by one day, which the use of the word "date" in Section 203(a) previously permitted, posed an unnecessary burden on corporate boards.

Section 203(b)(3), which allows corporations to "opt out" of the Business Combination Statute, has been amended to permit corporations that have never been subject to Section 203 to opt out without being subject to the twelve-month waiting period that might otherwise apply. This refinement will allow a privately-held company (which would not normally be subject to the statute) to opt out before an initial public offering of its stock. In addition, a new Section 203(b)(7) has been added to provide that stockholders who become interested prior to the time that a corporation falls within the statute's coverage will not later be subject to the statutory restrictions if the corporation should become covered by the statute. This change protects an interested stockholder in a private corporation that chooses to go public.

As noted above, non-public corporations are not subject to the statute (unless they expressly "opt in" by charter provision). Section 203(b)(4) has been amended to make it clear that the statute applies to any company that is listed on The NASDAQ Stock Market. Practitioners had been concerned that the earlier language could be read literally to apply to the NASDAQ Bulletin Board.

The definition of "business combination" in Section 203(c)(3) was amended to make it clear that the statute may not be evaded by effecting mergers with non-corporate entities. That definition was also amended to make it clear that holding company mergers authorized by new Section 251(g) of the General Corporation Law, *see infra*, are not business combinations for purposes of the statute. In addition, the definitions of "associate," "control" and "voting stock" have been amended, and a new definition of "stock" has been added to the definition section, all in order to address the effects on control of equity interests in non-corporate entities.

Finally, the definition of "interested stockholder" has been amended to expand the so-called "grandfather" exception, which exempts stockholders whose 15% ownership predates the enactment of the statute. The amendment makes it clear that a grandfathered

stockholder who sells down below 15%, but who continues to be an affiliate or associate of the corporation, will not thereby become an interested stockholder as a result of the so-called "look back" provisions found in Section 203(c)(5)(ii).

MEETINGS, ELECTIONS, VOTING AND NOTICE

Inspection of books and records [§ 220].—Section 220 gives stockholders the right to inspect, for a proper purpose, the corporation's stock ledger, a list of its stockholders, and its other books and records. Prior to 1967, such rights could be enforced only by the common law writ of mandamus in Superior Court. In 1967, the precedents concerning inspection were codified and jurisdiction was shifted to the Court of Chancery. However, as drafted, the statute only applied to stock corporations. The 1995 amendments to Section 220 expand the scope of the statute to expressly give parallel rights of inspection to members of membership corporations. The amendment was a response to the decision of the Court of Chancery in *Scattered Corp. v. Chicago Stock Exchange, Inc.*, Del.Ch., C.A. No. 13703 (Dec. 2, 1994). That case refused to extend the statutory right of inspection to membership corporations. Along the same lines, Section 220(d) was also amended to make it clear that the members of a governing body of a non-stock corporation have the same rights as the directors of a stock corporation with respect to inspection of the corporate books and records.

MERGER OR CONSOLIDATION

Merger or consolidation of domestic corporations [§ 251].—Section 251(d) addresses the termination and amendment of agreements of merger; previously, this statute only provided for termination or amendment of a merger agreement prior to the filing of that agreement (or certificate in lieu thereof) with the Secretary of State. The 1995 amendments, in line with the amendment to Section 103(d), *see supra*, recognize that the parties to a merger agreement may wish to amend or terminate the agreement subsequent to filing the instrument, but before the merger becomes effective, assuming that there is a delayed effective time. The amendment accommodates that possibility.

One of the most significant of the 1995 amendments is the addition of a new Section 251(g), which creates a mechanic by which a corporation may change itself into a holding company without a stockholder vote. The management of a publicly-held operating company that wants to adopt a holding company structure has essentially two choices. First, the corporation may transfer the operating assets to a newly-formed subsidiary. This is often impractical for business reasons, since the transfer of assets could have significant affects on the corporation's contracts, notice filings and other matters. Second, the corporation can effect a holding company merger, that is, a merger in which the corporation transforms itself into a holding company by merging with a subsidiary. Prior to the 1995 amendments this alternative required a stockholder vote and, therefore, registration of the shares to be issued in the merger under the Securities Act. By removing the voting requirement, the statute makes such reorganizations more practicable. As discussed below, the statute was carefully drafted so that stockholder rights could not be adversely affected in a holding company merger.

Under new Section 251(g), a corporation may, without a stockholder vote, effect a holding company merger. The merger structure must follow the format generally used in the past to create holding companies by means of a merger. The original corporation,

which will be referred to hereafter as the "operating corporation," must merge with a direct or indirect subsidiary in a merger in which each share of the operating corporation's stock is converted into an identical share of stock of a holding company, which, directly or indirectly, owns all of the capital stock of the subsidiary. When the transaction is completed, the stockholders of the operating corporation will hold shares directly in a holding company and that holding company will own the stock of the surviving operating corporation.

The bulk of new Section 251(g) is given over to provisions designed to protect the rights of stockholders in light of the fact that their approval will no longer be required to effect a merger which establishes a holding company structure. First, the charter and by-laws of the new holding company must be identical to the charter and by-laws of the old operating corporation (except for certain changes that otherwise could be effected at any time without stockholder approval). In addition, the certificate of incorporation of the surviving operating corporation must also be identical to the certificate of incorporation of the old operating corporation, except that the number of classes and shares of capital stock may be reduced. Moreover, the certificate of incorporation of the surviving operating corporation must provide that any act or transaction involving the surviving operating corporation that requires the approval of stockholders, under either the General Corporation Law or the charter of the surviving operating corporation, must be approved by the stockholders of the holding company by the same vote. This last odd-sounding requirement is designed to foreclose the use of a holding company merger to circumvent statutory or other requirements for stockholder approval of asset sales or other transactions.

In addition, the directors of the holding company must be the same as the directors of the old operating corporation and stockholders must not incur gain or loss for federal income tax purposes because of the merger. Finally, the statute provides that the holding company merger will not change the status of the entity under Section 203, the Business Combination Statute.

Appraisal rights [§ 262].—The 1995 amendments provide that mergers effected pursuant to the new holding company statute, *see supra,* will not trigger appraisal rights. Technical changes in the language added in 1995 are anticipated. While the legislative intent was to deny appraisal rights in mergers effected under Section 251(g), as written, the statute would not have this affect in certain cases.

SALE OF ASSETS, DISSOLUTION AND WINDING UP

Payment of franchise taxes [§ 277].—This section, which previously required that corporations pay any franchise tax due prior to dissolving, has been amended to clarify that the same requirement applies to corporations merging out of existence. This amendment merely codifies the current practice of the Division of Corporations.

FOREIGN CORPORATIONS

Withdrawal of foreign corporations from State [§ 381].—The 1995 amendment to Section 381 of the General Corporation Law conforms that section, which governs the withdrawal of foreign corporations' qualifications to do business in Delaware, to Section 103 of the statute, which governs the execution of other documents filed with the Secretary of State. Section 103 was amended in 1994 to simplify the execution requirements.

DOMESTICATION AND TRANSFER OF CORPORATION

Transfer and continuance of domestic corporations [§ 390].—Since 1984, Section 388 of the General Corporation Law has provided that non-U.S. corporations may "domesticate" into Delaware; that is, a juridical entity created in a non-U.S. jurisdiction may transfer its domicile into Delaware without merging into a new Delaware corporation. Prior to 1984, the only way to "move" jurisdictions was by means of a reincorporation merger. In such a merger, the non-U.S. entity would merge into a newly-formed Delaware corporation. While this accomplished the transfer of domicile, it could be disadvantageous from a business point of view because it involved the creation of a new entity.

While Section 388 provided a simple mechanism for non-U.S. corporations to domesticate into Delaware there was no reciprocal procedure permitting a Delaware corporation to leave Delaware and domesticate in a non-U.S. jurisdiction. New Section 390 closes the loop by creating a parallel process for transfers *out* of Delaware. Under Section 390, a Delaware corporation may transfer its domicile to any non-U.S. jurisdiction that permits such domestication or continuation. In order to protect minority stockholders, Section 390 requires unanimous stockholder approval, including the vote of shares which are not otherwise entitled to vote. It was felt that this requirement was consistent with the needs of Delaware's corporate citizens and, in any case, would not in practice present a burden because the problems that the statute addresses generally involve wholly-owned subsidiaries of multinational corporations or corporations having closely held stock.

The procedure is very simple, requiring the adoption of a board resolution, stockholder approval and the filing of a short certificate of transfer. The certificate must provide that the corporation may be served with process in Delaware for the enforcement of any obligation arising while it was a Delaware corporation and appointing the Secretary of State as agent to accept service of process. Upon compliance with the provisions of Section 390(b) and payment of the prescribed fee, the Secretary of State will certify that the corporation has ceased to exist as a Delaware corporation. That certificate serves as *prima facie* evidence of the corporation's transfer out of Delaware. The transfer does not affect in any way the obligations or liabilities of the corporation incurred prior to the transfer, nor does it affect the law that is applicable to such matters.

MISCELLANEOUS PROVISIONS

Taxes and fees payable to the Secretary of State upon filing certificates or other paper [§ 391].—This section was amended to provide that the filing of a certificate of transfer must be accompanied by a fee of $1,000.

Review and refund; jurisdiction and power of the Secretary of State; appeal [§ 505].—Section 505(c), addressing refunds of franchise tax payments, has been amended to provide that any refund due to a corporation that is merged into another Delaware corporation will be credited to the surviving corporation.

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