Analysis of the 2001 Amendments to the Delaware General Corporation Law

Lewis S. Black, Jr., Esq.
and
Frederick H. Alexander, Esq.

Reprinted From
Aspen Law & Business

CORPORATION

ANALYSIS OF THE 2001 AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW

By Lewis S. Black, Jr. and Frederick H. Alexander
Morris, Nichols, Arsht & Tunnell
Wilmington, Delaware

INTRODUCTION

The Delaware General Assembly adopted a number of amendments to the Delaware General Corporation Law effective July 1, 2001. In addition, the General Assembly approved an amendment to the State constitution repealing a provision that restricts the kinds of consideration that a corporation must receive for the issuance of its stock. This constitutional amendment must be approved a second time at a legislative session following the next general election so it cannot become effective, at the earliest, until 2003.

This article describes the changes effected by the 2001 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]

CONSTITUTION

Section 3 of Article IX of the constitution of the State of Delaware provides that "no corporation shall issue stock, except for money paid, labor done or personal property, or real estate or leases thereof actually acquired by such corporation." A parallel provision in Section 152 of the General Corporation Law provides that stock issued by a corporation will be deemed fully paid and nonassessable if the entire amount of the consideration for the stock has been received in the form of cash, services rendered, personal property, real property, leases of real property or a combination thereof. Alternatively,

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 (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, 1995, 1996, 1997, 1998, 1999, and 2000, respectively.)

Section 152 authorizes the sale of stock for such "constitutional consideration" equal to the par value of stock, if the balance of the consideration consists of a binding obligation to pay. These provisions, and similar provisions in other state laws, were originally enacted to protect creditors. With the shift away from such concepts as the preservation of a corporation's capital as a "trust fund" for creditors, and the related concept of par value (surviving in Delaware largely for tax reasons), the provisions have, for the most part, become historical artifacts. Their survival continues to present problems for lawyers called upon to advise on the status of shares issued for such things as future services or for intangibles like contract rights, that may arguably not rise to the level of "personal property." The General Assembly took the first step to repeal Section 3 of Article IX in 2001. It is expected that that process will be completed in 2003 and that the General Corporation Law will be amended to expand the types of consideration for which a corporation may issue fully paid shares.

FORMATION

Contents of certificate of incorporation [§ 102].—Section 102 generally governs the contents of the certificate of incorporation that must be filed with the Secretary of State in order to form a Delaware corporation. Section 102(a)(1) sets forth specific requirements for the name of a Delaware corporation, including requirements relating to the distinctiveness of the name. Prior to 2000, the statutory requirement that names be sufficiently unique as to be distinguishable on the records maintained by the Secretary of State applied only to other corporations and limited partnerships that are organized, or qualified to do business, in Delaware. In 2000 the statute was amended to provide that a corporation's name must be sufficiently unique as to permit it to be distinguishable on the Secretary of State's records from the names of limited liability companies and business trusts that are organized, or qualified to do business, in Delaware. The 2001 amendments add general partnerships to the list.

REGISTERED OFFICE AND REGISTERED AGENT

Change of address or name of registered agent [§ 134].—Sections 131 and 132 of the General Corporation Law require that every Delaware corporation have a registered office and registered agent in the State for the purpose of accepting service of process and certain other documents, such as demands for inspection of corporate records, specified in other sections of the statute. Prior to the 2001 amendments, Section 134 of the statute provided that whenever a registered agent changed its address or its name the registered agent had to file a certificate with the Secretary of State setting forth the new address or new name. This certificate was also required to include the names of all of the corporations represented by the registered agent. Filings made under Section 134 became part of the package of documents that comprise a corporation's certificate of incorporation since they are included in the definition of "certificate of incorporation" set forth in Section 104 of the General Corporation Law. Because there are 182 registered agents in Delaware many of which represent thousands of corporations the so-called "batch filings" generated by the foregoing requirements led to lengthy and complicated documents that served little purpose. The 2001 amendments delete the requirement that certificates filed under Section 134 recording a change of a registered agent's address or name include a recitation of all of the corporations for which it serves as registered agent.

STOCK AND DIVIDENDS

Rights and options respecting stock [§ 157].—Of all the amendments adopted in 2001, the changes to Section 157 of the General Corporation Law, which governs the creation and issuance of rights and options to buy stock, are the most likely to have practical application for public corporations. The use of stock options to provide incentives for corporate employees has ballooned in the last decade (although the use of stock options for compensation purposes has recently come under fire because commentators have focused on the potential dilution posed by large option awards). Structurally, Section 157 has not kept up with the times. Because its terms contemplate close attention at the director level to decisions concerning the grant of stock options, as options are awarded to more and more employees, including even entry level personnel, strict compliance with the statute can consume a disproportionate amount of the time of corporate boards or board committees. Prior to the effectiveness of the 2001 amendments, the ability of directors to delegate (other than to a committee) any of the decisions required to be made in connection with the issuance of options was very limited. The 2001 amendments address the growing use and popularity of stock options by authorizing the board to delegate to one or more officers of the corporation the power to designate the officers and employees who will receive options and to determine the number of options to be granted. The delegation cannot be *carte blanche.* The board of directors must set a ceiling on the total number of options to be issued pursuant to any such delegation. In addition, only the selection of recipients and the number of options they are to receive may be delegated. The board must set the price at which option shares may be purchased, although the amendments make it clear that the board may establish a formula for setting the price rather than the price itself. Finally, it should be noted that the amendments apply only to officers and employees; options to be issued to non-employees, *e.g.,* investors, must still be approved by directors.

MEETINGS, ELECTIONS, VOTING AND NOTICE

Voting rights of members of nonstock corporations; quorum; proxies [§ 215].—Section 215 of the General Corporation Law governs the voting rights of members of nonstock corporations. It provides that certain sections of the statute, specifically sections 211-214 and 216, dealing with meetings of stockholders of stock corporations, do not apply to nonstock corporations. The 2001 amendments make a carve out within this statutory carve out for the provisions of Section 211 (subsection (a)) and Section 212 (subsections (c) and (d)) in order to make available to nonstock corporations changes made previously to the General Corporation Law. These changes permit meetings to be held by means of remote communication and expand the means by which proxies may be granted to include electronic transmission. In addition, a new subsection (e) has been added to Section 215 authorizing any requirement for written ballots to be satisfied by a ballot submitted by electronic transmission if authorized by the governing body of the nonstock corporation.

Consent of stockholders or members in lieu of meeting [§ 228]. —Section 228 of the General Corporation Law authorizes stockholders and members of corporations to act by written consent in lieu of meetings, unless the certificate of incorporation has eliminated the right to so act. In 2000 a new subsection (d) was added to Section 228, to make it clear that stockholder consent may be given by electronic transmission or the delivery of copies of facsimiles of consents. However, the new subsection omitted any

reference to consents submitted by members. This omission was cured by the 2001 amendments.

Notice by form of electronic transmission [§ 232].—The 2001 amendments change the formal title of Section 232 to "Notice by electronic transmission."

Voting trusts and other voting agreements [§ 218].—Section 218 of the General Corporation Law permits stockholders to create voting trusts by transferring shares of stock to a voting trustee who holds the shares pursuant to the terms of a written agreement that provides how the shares will be voted. Prior to the 2001 amendments, Section 218 referred to the deposit of shares subject to the voting trust with a "person or persons or a corporation or corporations authorized to act as trustee." Recognizing that entities other than corporations may be authorized to act as trustees, the 2001 amendments change references to "corporations" in Section 218 to "entities."

AMENDMENT OF CERTIFICATE OF INCORPORATION; CHANGES IN CAPITAL AND CAPITAL STOCK

Restated certificate of incorporation [§ 245].—Section 245(c) of the General Corporation Law permits a corporation to omit from a restated certificate of incorporation provisions contained in a previously filed certificate of amendment in order to effect a change, exchange, reclassification or cancellation of stock that has been completed. The 2001 amendments add the words "subdivision and combination" to this litany in order to conform Section 245(c) with Section 242(a), which was amended in 1996 to clarify that charter amendments implemented under Section 242(a) may effect stock splits or reverse stock splits, *i.e.*, may have the effect of "subdividing or combining the outstanding shares" into a greater or lesser number of shares.

MERGER, CONSOLIDATION OR CONVERSION

Merger or consolidation of domestic corporations [§ 251].—Section 251(g) of the General Corporation Law was added to the statute in 1995. It exempts from the voting requirements for mergers found in Section 251 so-called "holding company mergers," *i.e.*, mergers designed to change an operating company into a holding company. Holding company mergers may be effected without stockholder approval so long as the conditions specified in Section 251(g) are met. Those conditions are intended to assure that the merger will not involve changes in the substantive rights of stockholders that should require a stockholder vote to accomplish. The 2001 amendments expand Section 251(g) to permit holding company mergers involving limited liability companies. Thus, a corporation can use Section 251(g) to convert to a holding company structure in which the operating entity is a wholly-owned limited liability company. This structure will provide additional flexibility, and, in particular, will enable holding company mergers to go forward without unwanted tax effects. In order to protect the rights of stockholders, the conditions referred to above will now include provisions requiring, *inter alia*, that the business and affairs of a surviving entity that is not a corporation be managed by or under the direction of a governing body consisting of individuals who are subject to the same fiduciary duties applicable to directors of a corporation.

Appraisal rights [§ 262].—Section 262(d)(2) of the General Corporation Law requires that notice be sent to stockholders who are entitled to appraisal rights in connection with a merger approved by written consent pursuant to Section 228 or by action of the board of directors of a parent corporation pursuant to Section 253 advising those

stockholders of approval of the merger and of the availability of appraisal rights. This notice may be sent either before the merger or within ten days after the effective date of the merger. Prior to the 2001 amendments the language of the first sentence of Section 262(d)(2) was confusing. It could be read to provide for a post-merger notice sent by a constituent corporation that did not survive the merger. The 2001 amendments restructure the first sentence of Section 262(d)(2) to make it clear that notice sent after the effective date of the merger is to be sent by the surviving corporation.

Merger or consolidation of domestic corporation and limited partnership [§ 263].—Section 263 of the General Corporation Law authorizing mergers between corporations and limited partnerships dates to 1988. The 2001 amendments expand the provisions of Section 263 to authorize mergers between corporations and all partnerships "whether general (including a limited liability partnership) or limited (including a limited liability limited partnership)." In order to protect stockholders against the potential loss of limited liability that a merger of a corporation into a partnership could engender, the amendments add a sentence to Section 263(c) providing that if the surviving entity in such a merger is a partnership, each stockholder of a merging corporation who will become a general partner must approve the agreement of merger.

Conversion of other entities to a domestic corporation [§ 265].—In 1999 Sections 265 and 266 were added to the General Corporation Law to introduce the concept of conversion—as an alternative to mergers—by which an "other entity," defined in Section 265 as a limited liability company, a limited partnership or business trust, can change its form of organization to a corporation and *vice versa*. Importantly, in a conversion, the original entity survives in a new form thereby avoiding certain contract and regulatory issues that can arise in a merger where the resulting entity succeeds to all of the rights and obligations of the constituent entities by operation of law, but, technically, is not a continuation of a constituent.

Like the amendments to Section 263 of the General Corporation Law described above, the 2001 amendments to Section 265 expand the application of that provision to all partnerships "whether general (including a limited liability partnership) or limited (including a limited liability limited partnership)."

Conversion of a domestic corporation to other entities [§ 266].—In a change paralleling the amendments to Section 265 described above, Section 266 was also expanded in 2001 to permit a corporation to convert to a general partnership (including a limited liability partnership), a limited liability company, a business trust or a limited partnership (including a limited liability limited partnership). Because the conversion of a corporation to another entity under Section 266 requires the unanimous vote of the holders of all of the stock of the corporation, whether voting or nonvoting, no amendment to the statute was required to address the possibility that a stockholder might, without consent, become a general partner.

RENEWAL, REVIVAL, EXTENSION AND RESTORATION OF CERTIFICATE OF INCORPORATION OR CHARTER

Revocation of voluntary dissolution [§ 311].—Section 311 of the General Corporation Law permits a corporation that has dissolved pursuant to Section 275, during the three-year period following its dissolution, to revoke the dissolution, but only if the revocation is approved by directors and stockholders. Prior to the 2001 amendments, it was unclear who constituted "stockholders" for purposes of approving such a revoca-

tion. By adding a new definitional paragraph (1) to Section 311(a) the 2001 amendments clarify that for purposes of such approval, "stockholders" means those stockholders who were stockholders of record on the date the dissolution became effective.

Renewal, revival, extension and restoration of certificate of incorporation [§ 312].—Under Section 312 of the General Corporation Law certificates of incorporation which have become void by operation of law for nonpayment of taxes or because of failure to appoint a successor to a resigning registered agent may be revived, as may the certificate of incorporation of a corporation with a limited duration that has reached its expiry. Charters of corporations with a limited term that has not yet expired may be renewed. Section 312 is also expressly made available to those corporations whose certificates of incorporation have been renewed but, through failure to comply strictly with the provisions of the General Corporation Law, the validity of that prior renewal has been brought into question. Prior to the 2001 amendments, Section 312(i) provided that after a certificate of incorporation has been renewed or revived (except where a special meeting of stockholders has been held in accordance with the provisions of Section 312(h) to elect directors so as to permit the appointment of officers to effect the renewal or revival) the officers who signed a certificate of renewal or revival "shall, jointly, forthwith call a special meeting of the stockholders" for the purpose of electing a "full board of directors." This provision seemed unnecessary—not to mention embarrassing—for corporations with fully functioning boards of directors whose charters had been permitted to lapse for nonpayment or underpayment of franchise taxes or through inadvertence. The 2001 amendments replace the language in Section 312(i) mandating the call of a special meeting of stockholders with a reference to Section 211(c) of the General Corporation Law, providing that following a renewal or revival Section 211(c) shall "govern." Section 211(c) provides that upon the application of a stockholder or director the Court of Chancery may summarily order the holding of a meeting of stockholders if no annual meeting has been held for 13 months since the corporation's last annual meeting or within 30 days after the date designated for the annual meeting. The amendments to Section 312(i) provide further that the 30-day and 13-month periods to which Section 211(c) refers include the "period of time the corporation was in dissolution." In addition, new Section 312(i) provides that a special meeting of stockholders held in accordance with Section 312(h) to facilitate a renewal or revival is deemed an annual meeting for purposes of Section 211(c).

For more information about **Corporation,** write: Customer Service Department, Aspen Law & Business, A Division of Aspen Publishers, Inc., 7201 McKinney Circle, Frederick, MD 21704; or call toll free 1-800-901-9074.

If you want additional copies of the article, please contact the authors.