Analysis of the 2002 Amendments to the Delaware General Corporation Law

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CORPORATION

ANALYSIS OF THE 2002 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 July 1, 2002. The amendments are, for the most part, by way of clarification, ministerial or designed to smooth corporate practice. Corporate secretaries and others responsible for mailings to stockholders will be particularly interested in amendments permitting "householding" of notices to stockholders intended to segue with rules adopted by the SEC permitting householding. This article describes the changes effected by the 2002 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, acknowledgment, filing, recording and effective date of original certificate of incorporation and other instruments [§103].—Section 103(c)(6) of the General

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 (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, 2000 and 2001 respectively.)

Corporation Law requires the Secretary of State to enter information from documents filed in the Secretary of State's office, including certificates of incorporation, in the records maintained by that office. The 2002 amendments add the words "as a public record" following the requirement that that information be "permanently maintained." This change is intended to match the definition of "registered organization" under revised Article 9 of the Uniform Commercial Code. That definition provides, in part, that a registered organization, a term that includes corporations, is an organization organized under state law as to which the state must "maintain a public record" showing the organization to have been organized. Under revised Article 9 the general rule is that the law of the debtor's location (the state under whose law a registered organization is organized) governs perfection of most security interests that are perfected by filing.

DIRECTORS AND OFFICERS

Board of directors [§141].—The question sometimes arises whether corporations or other entities may serve as directors. The 2002 amendments to the General Corporation Law amend Section 141(b) in order to confirm that members of the board of directors must be natural persons.

STOCK AND DIVIDENDS

Stock certificates [§158].—The 2002 amendments to the General Corporation Law add a sentence to Section 158 stating that Delaware corporations do not have power to issue bearer shares. Some foreign jurisdictions permit corporations to issue stock certificates in bearer form. This has never been permitted in Delaware. The amendment to Section 158 is confirmatory only.

STOCK TRANSFERS

Business combinations with interested stockholders [§203].—Section 203 of the General Corporation Law imposes a three-year moratorium on business combinations between corporations and any "interested stockholder" (generally a person owning 15% or more of the corporation's voting stock and that person's affiliates and associates) unless certain exceptions are available. One such exception applies where the interested stockholder would own at least 85% of the corporation's outstanding voting stock upon consummation of the transaction that resulted in its becoming an interested stockholder. Excluded from the calculation of the corporation's outstanding stock are shares owned by persons who are directors and also officers and shares owned by employee stock plans whose participants do not have the right to decide whether shares subject to the plan will be tendered in response to a tender offer. Prior to the 2002 amendments, the language in Section 203(a)(2) introducing this exclusion began "excluding for purposes of determining the number of shares outstanding . . ." The 2002 amendments replace the words "number of shares" with "voting stock." In addition the amendments add after "outstanding" the parenthetical "(but not the outstanding voting stock owned by the interested stockholder)".

The latter change is intended to make it clear that while voting stock owned by director/officers and certain employee stock plans is not included in the total amount of voting stock outstanding to calculate the 85% exception, that stock is included in determining the amount of voting stock owned by the interested stockholder. The former change has an interesting and somewhat tortured history. It was prompted by the decision of the Court of Chancery in *In re Digex Inc. Shareholders Litigation,* Del. Ch. 789 A.2d 1176 (2000) where the Court confronted, but found not ripe for adjudication, the question whether the term "voting stock" in Section 203(a)(2) refers to voting power of stock or simply to stock having the right to vote. The defendants, who owned—or following a proposed merger

would own—a 94.2% voting interest in Digex but only a 52% economic interest, claimed that the calculation whether an interested stockholder had 85% of the "voting stock" must look to the voting power of stock. They based their argument on Section 212(a) of the General Corporation Law, which states that where a certificate of incorporation provides for more or less than one vote per share for any of a corporation's authorized shares, "every reference in this chapter to a majority or other proportion of stock shall refer to such majority or other proportion of the votes of such stock." The plaintiffs took the position that calculation looked solely to the number of shares owned.

The Court found the question a close one. First, the Court pointed out that Section 203 contains its own definition of "voting stock" at Section 203(c)(8). There, voting stock is defined as stock "entitled to vote generally in the election of directors." The Court went on to say that the language of Section 203(a)(2) appeared to lend support to the plaintiffs' argument. The Court found it significant that in making the 85% voting stock calculation called for in Section 203(a)(2) one must determine the "number of shares" outstanding rather than the number of "votes." The Court explained:

> In calculating whether an interested stockholder has reached the 85% threshold, § 203(a)(2) directs the Court to divide a number representing the interest held by the interested shareholder by the number of shares outstanding. The number representing the interest of the interested shareholder must therefore also be expressed in terms of the number of shares, not votes, controlled if this calculation is to make any sense. If, instead, the statute intended for us to divide the number of votes held in shares owned by the interested shareholder by the outstanding number of votes (that is, to calculate the "voting power" of the interested shareholder), the statute would properly direct us to exclude certain shares for the purposes of calculating the outstanding number of votes. The statute therefore seems to place the emphasis in the term "voting stock" on the term "stock" and not the term "voting."

789 A.2d at 1199.

The 2002 amendments to the General Corporation Law answer the question left unanswered in *Digex* by adding to the definition of "voting stock" in Section 203(c)(8) a sentence stating that every reference in Section 203 to a percentage of voting stock refers to the percentage of votes of the stock. Hence, the legislature has come down on the side of the argument that proportions of voting stock refer to voting power of stock. The 2002 change to Section 203(a)(2) replacing the reference to "number of shares" with "voting stock" is designed to fix the ambiguity highlighted by the Court in *Digex* that supported the contrary argument.

In addition, Section 203(c)(5) was amended in 2002 to fix an inaccurate cross reference. The reference in Section 203(c)(5) to "paragraph 8 of this subsection," the definition of "voting stock," should be a reference to paragraph 9, the definition of "owner."

MEETINGS, ELECTIONS, VOTING AND NOTICE

Voting rights of stockholders; proxies; limitations [§212].—As discussed above, Section 212(a) of the General Corporation Law provides that where shares of a corporation are entitled to more or less than one vote per share every reference in the statute to a majority or other proportion of stock is meant to refer to that proportion of the votes of the stock. Because some provisions of the General Corporation Law refer to voting or other matters by "shares" rather than stock, for example Section 253 permits short form mergers where a parent corporation owns at least 90% of a subsidiary's outstanding shares, and in

order to cure globally the ambiguity encountered in *In re Digex Shareholders Litigation,* Del. Ch. 789 A.2d 1176 (2000), as described above, Section 212(a) was amended in 2002 to encompass every reference in the statute to "stock, voting stock or shares."

Vacancies and newly created directorships [§223].—Section 223(c) of the General Corporation Law provides that where vacancies or newly created directorships are filled at a time when the directors in office constitute less than a majority of the whole board, the Court of Chancery may order an election to fill the vacancies or to replace directors chosen by the existing board. The statute provides for a summary proceeding leading to such an election. Prior to the 2002 amendments to the General Corporation Law that proceeding could be invoked upon application by any stockholder or stockholders holding at least ten percent of the "total number of the shares" having the right to vote for directors. Consistent with the amendment to Section 212(a) of the General Corporation Law and to cure any ambiguity of the type found to exist in Section 203(a)(2) in *In re Digex Shareholders Litigation,* Del. Ch. 789 A.2d 1176 (2000), as described above, the words "total number of the shares" in Section 223(c) were replaced by "voting stock" in the 2002 amendments.

Notice to stockholders sharing an address [§233].—Section 233 is a wholly new section added to the General Corporation Law in 2002. As its title indicates it permits corporations to give a single written notice of meetings of stockholders and other matters to stockholders who share the same address if those stockholders consent to receiving only one notice. Section 233 is intended to interface with rules adopted by the Securities and Exchange Commission in 2000 permitting "householding." The SEC rules permit corporations to send a single proxy statement to consenting stockholders where there is more than one holder of record with a similar name at the same address. Since most corporations include the notice of a meeting required by state law with the proxy statement, the form of which is governed by SEC rules, the new "householding" rules needed action on both state and federal fronts to be fully effective.

New Section 233(b) deems consent to householding to be given by any stockholder who does not object in writing to receiving a single notice within 60 days of having been given written notice of the corporation's intention to household. However, once given—expressly or by implication—a consent to householding may be revoked at any time by written notice to the corporation.

Section 233 applies to all Delaware corporations and not just to corporations having securities registered under the Securities Exchange Act of 1934. It also applies to notices given pursuant to provisions of a corporation's certificate of incorporation or bylaws as well as to notices given pursuant to provisions of the General Corporation Law. However, certain kinds of notice to stockholders required by the General Corporation Law are specifically excluded from householding treatment by Section 233(d). That subsection provides that the provisions of Section 233 do not apply to the following sections of the statute: Section 164 (notice of sale of shares of stockholder who failed to pay an installment or call on stock not fully paid); Section 296 (notice of disputed claims relating to insolvent corporations); Section 311 (notice of meeting of stockholders to revoke dissolution of corporation); Section 312 (notice of meeting of stockholders of corporation whose certificate of incorporation has been renewed or revived); and Section 324 (notice when stock has been attached as required for sales upon execution process).

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

Revocation of voluntary dissolution [§311].—Section 311 of the General Corporation Law provides that a corporation that has voluntarily dissolved may revoke that dissolution at any time within three years after it dissolved pursuant to Section 275 of the statute or such longer period as the Court of Chancery may have allowed pursuant to Section 278. The revocation of dissolution must be approved at a special meeting by the vote of a majority of the stock of the corporation that was outstanding and entitled to vote at the time of its dissolution.

The 2002 amendments to the General Corporation Law add a new subsection (c) to Section 311 (relettering the existing subsections (c) and (d) as (d) and (e)) providing that directors may be elected at the special meeting of stockholders called to vote on the revocation of dissolution, in which event that meeting is deemed to be the annual meeting of stockholders of the corporation for purposes of Section 211(c) of the statute. Section 211(c) provides for a court-ordered meeting at which directors will be elected if there has been a failure to hold an annual meeting (or take action by written consent) within 30 days of the time designated for the meeting or 13 months since the last election or the corporation's organization.

In addition, new Section 311(c) provides that after a revocation of dissolution has become effective, the period of time that the corporation was in dissolution is included in calculating the 30 day and 13 month time periods specified in Section 211(c) that trigger the right of any stockholder or director to commence a summary proceeding in the Court of Chancery seeking an order requiring that a meeting of stockholders be held. That provision is consistent with a similar provision added last year to Section 312(i) of the General Corporation Law relating to the renewal or revival of corporate charters that have become void or have been forfeited for non-payment of franchise taxes or other reasons, or have expired by their own terms.

Renewal, revival, extension and restoration of certificate of incorporation [§312].—The 2002 amendments to the General Corporation Law replace the words "corporation was in dissolution" in Section 312(i) describing a period of time when a corporation's charter was not in effect with the words "certificate of incorporation of the corporation was forfeited pursuant to § 136(b) of this title, or was inoperative or void, or after its expiration by limitation." The new language more accurately reflects the circumstances covered in Section 312 that can give rise to a corporation's effort to procure an extension, restoration, revival or renewal of its certificate of incorporation in accordance with that section.

MISCELLANEOUS PROVISIONS

Corporations using "trust" in name, advertisements and otherwise, restrictions; violations and penalties; exceptions [§395].—Prior to the 2002 amendments to the General Corporation Law, Section 395(c) prohibited "any person, firm, association of persons, or corporation" not supervised by the State Bank Commissioner or regulated under the Bank Holding Company Act or Savings and Loan Holding Company Act from advertising itself as a trust company, transacting business as a trust company or using the word "trust" in its name. The 2002 amendments limit the application of Section 395(c) to corporations. This change not only makes subsection (c) consistent with the other subsections of Section 395 but also consistent with the provisions of the General Corporation Law generally

insofar as those provisions are intended to regulate the affairs of corporations and, only incidentally, if at all, the affairs of non-incorporated persons and other entities.

CORPORATION FRANCHISE TAX

Filing and publication of proclamation [§512].—Section 511 of the General Corporation Law provides for the annual issuance by the Governor of a proclamation listing the names of the corporations whose charters have been repealed for failure to pay franchise taxes. The previous version of Section 512 of the statute provided for the filing of this proclamation with the Secretary of State and its publication "in at least 1, and not more than 3," newspapers published in Delaware. The 2002 amendments to the General Corporation Law completely rewrite Section 512. The requirement that the gubernatorial proclamation be filed with the Secretary of State is retained. The publication requirement is modernized and rendered with greater precision. As amended, Section 512 requires that on or before October 31 of each year, the Governor's proclamation shall be published "on the Internet or on a similar medium" for a period of one week and the website or other address where the proclamation can be accessed must be advertised in at least one newspaper of general circulation in Delaware.

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