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# **ANALYSIS OF THE 2007 AMENDMENTS <sup>TO</sup> THE DELAWARE GENERAL CORPORATION LAW**

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## ANALYSIS OF THE 2007 AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW

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### INTRODUCTION

The Delaware General Assembly recently adopted several amendments to the Delaware General Corporation Law (the "DGCL"). The most significant amendments enact changes to the statute entitling stockholders to appraisal rights in mergers, including the adoption of a default interest rate that will apply to appraisal awards and an amendment allowing beneficial owners who hold their stock in street name to commence an appraisal proceeding on their own behalf rather than through the nominee who serves as the stockholder of record. In addition, the General Assembly also amended the Delaware Constitution to empower the Supreme Court of Delaware to answer questions of law certified to it by the United States Securities and Exchange Commission (the "SEC"). Unless otherwise noted, all amendments became effective on August 1, 2007.<sup>1</sup>

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1. This article supplements previous reports published by Aspen Publishers and its predecessor, Prentice Hall Law & Business, describing amendments to the Delaware General Corporation Law. See Arsht and Stapleton: Analysis of the New Delaware Corporation Law; Analysis of the 1967 Amendments to the Delaware Corporation Law; The 1969 Amendments to the Delaware Corporation Law; The 1970 Amendments to the Delaware Corporation Law; Arsht and Black: The 1973 Amendments to the Delaware Corporation Law; The 1974 Amendments to the Delaware Corporation Law; 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 1994 Amendments to the Delaware General Corporation Law; 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; Analysis of the 2003 Amendments to the Delaware General Corporation Law; Alexander and Wolters: Analysis of the 2004 Amendments to the Delaware General Corporation Law; Analysis of the 2005 Amendments to the Delaware General Corporation Law; Wolters and Honaker: Analysis of the 2006 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, 2002, 2003, 2004, 2005 and 2006, respectively).

## DELAWARE CONSTITUTION

**Certification of Questions to the Supreme Court of Delaware.**—Section 11 of Article IV of the Constitution of the State of Delaware was recently amended to expand the jurisdiction of the Supreme Court of Delaware to empower the Court to answer questions of law certified to it by the SEC. Prior to this amendment, the Supreme Court could answer questions of law certified by another Delaware court, the highest appellate court of another state, the Supreme Court of the United States or a United States district or appellate court. Practitioners anticipate that the SEC may wish to certify to the Supreme Court of Delaware questions on the validity of stockholder proposals under Delaware law to determine whether the SEC should pursue an enforcement action against a Delaware corporation that wishes to exclude a proposal from its proxy materials under Rule 14a-8 of the Securities Exchange Act of 1934 on the grounds that the proposal would, if adopted, violate Delaware law.

The extent to which the Supreme Court will use its new jurisdiction to resolve issues of Delaware law will remain an open question until the provision is tested in practice. The Supreme Court may accept or reject a certified question in its discretion, and the Delaware Constitution authorizes the Court to answer certified questions only when it appears to the Court that there are “important and urgent reasons for an immediate determination” of the question. The Rules of the Supreme Court note that the reasons to answer a certified question include addressing a question of “first instance” in Delaware and addressing the constitutionality, construction or application of a Delaware statute which “has not been, but should be” settled by the Court. See Supreme Court of Delaware Rule 41(b).

The amendment to the Constitution became effective on May 3, 2007.

## DIRECTORS AND OFFICERS

**Boards of Directors [§141].**—The 2007 amendments clarify that when a charter confers on a director greater or lesser voting power than other directors, that differential voting power will also apply when the director casts a vote on decisions by a board committee or subcommittee, unless the charter or bylaws provide for a different voting scheme for committees or subcommittees. Prior to this amendment, Section 141(d) already permitted directors and stockholders to confer greater or lesser voting power on one or more directors through a charter provision. The new amendment closes any theoretical gap that might have existed between Section 141(d) and Section 141(c), which authorizes the board to delegate its power to one or more committees and further permits a committee to delegate its power to one or more subcommittees.

## STOCK TRANSFERS

**Business Combinations with Interested Stockholders [§203].**—The 2007 amendments enact a technical change to Section 203, Delaware’s business combination statute. Prior to the 2007 amendments, Section 203(b)(4) specified that Section 203’s restrictions did not apply unless, among other conditions, a class of the company’s voting stock

was listed on a national securities exchange, held of record by more than 2,000 stockholders or “authorized for quotation on The NASDAQ Stock Market.” The 2007 amendments delete the reference to The NASDAQ Stock Market since the relevant trading system formerly operated by the NASDAQ (and now operated by one of its wholly owned subsidiaries) became a “national securities exchange” in 2006; thus, the separate reference to the NASDAQ is no longer necessary since it is covered by the general term “national securities exchange.”

## MEETINGS, ELECTIONS, VOTING AND NOTICE

**Required Vote for Stock Corporations [§216].**—The net effect of an amendment to Section 216(4) clarifies that directors who are elected by a separate vote of one or more classes or series of stock will be elected by a plurality of the votes cast in such election unless the charter or bylaws specify a different vote. The amendment expressly carves out director elections from the default rule for all other stockholder actions adopted by a separate class or series vote, which requires the affirmative vote of a majority of the shares of such stock present in person or represented by proxy at a stockholder meeting at which a quorum is present to approve such actions.

## MERGER, CONSOLIDATION OR CONVERSION

**Mergers or Consolidations [§§ 251, 252, 254, 255, 256, 257, 258, 263 & 264].**—The 2007 amendments modify the requirement that an agreement of merger or consolidation to which a Delaware stock or non-stock corporation is a constituent corporation include a certification by the secretary or assistant secretary of the corporation that the agreement either has been approved by the required stockholder or member vote or that a statutory exception applies so that stockholder or member approval is not required. As amended, the DGCL no longer requires such a certification on the agreement if a certificate of merger or consolidation is filed in lieu of the agreement with the Secretary of State of the State of Delaware. Because the certificate of merger or consolidation must include a certification that the agreement was approved in accordance with the applicable statute, there is no need for the additional certification on the agreement. Of course, the DGCL continues to require certification of stockholder or member approval, or certification of an applicable statutory exception (where no such approval is obtained), if the agreement rather than a certificate of merger is filed with the Secretary of State.

A related amendment to Section 258(b) clarifies that a foreign corporation that is a constituent corporation in a merger or consolidation with a Delaware corporation must comply with any certification requirements that apply to the foreign corporation under the laws of its jurisdiction of incorporation.

**Appraisal Rights [§262].**—The 2007 amendments implement several changes to Section 262, the statute that entitles a stockholder to the right to have the fair value of its stock appraised by the Delaware Court of Chancery when the corporation is party to certain mergers or consolidations.

The most significant amendment adds to Section 262 a default interest rate for appraisal awards. Amended Section 262(h) specifies that, unless the Court of Chancery sets a different interest rate in its discretion “for good cause shown,” interest on an appraisal award will accrue and compound quarterly from the effective date of the merger through the date the judgment is paid at “5% over the Federal Reserve discount rate (including any surcharge) as established from time to time during the period between the effective date of the merger and the date of payment of the judgment.” Except for the compounding requirement, the default interest rate is identical to the so-called “legal” rate of interest that serves as the default rule for contracts between lenders and borrowers under Section 2301 of Title 6 of the Delaware Code.

By establishing a default rate of interest, amended Section 262(h) will alleviate the costs associated with attempting to establish an appropriate rate based on the facts of each case. However, amended Section 262(h) continues to afford the Court of Chancery the discretion to award interest at a different rate (or award no interest) for “good cause shown.” The statute does not define “good cause,” but the Synopsis of this amendment notes that examples of “good cause” include “to avoid an inequitable result such as rewarding, or insufficiently compensating for, improper delay of the proceeding or unreasonable or bad faith assertion of valuation claims.”

In another significant change, the 2007 amendments also add a new provision to Section 262(e) that permits a beneficial owner of stock (who owns stock either through a voting trust or through a nominee) to act in its own name to commence an appraisal proceeding and to request a statement setting forth the aggregate number of shares that were not voted in favor of the transaction and for which appraisal has been demanded. Prior to this amendment, an appraisal proceeding could be commenced and the foregoing statement could be requested only by the holder of record of the stock. Before commencing an appraisal action, however, a beneficial owner must continue to act through the holder of record to demand appraisal rights, which is the crucial first step in perfecting appraisal rights.

The 2007 amendments also provide stockholders greater flexibility to withdraw a demand for appraisal. Under Sections 262(e) and (k), a stockholder may unilaterally withdraw a written demand for appraisal and accept the merger consideration at any time on or before the 60th day after the effective date of the merger. Prior to the 2007 amendments, this withdrawal right was curtailed if any stockholder commenced an appraisal proceeding in the Delaware Court of Chancery during that 60-day period. Under the pre-amendment version of the statute, a stockholder’s unilateral withdrawal right terminated once an appraisal proceeding was filed, and thereafter a stockholder could not withdraw its demand for appraisal without Court approval. The 2007 amendments to Sections 262(e) and (k) permit a stockholder to withdraw an appraisal demand during the 60-day period even if an appraisal action has commenced and the Court has not approved such withdrawal, unless the stockholder seeking to withdraw its demand either commenced the appraisal proceeding or joined that proceeding as a named party. The amendment ensures that a stockholder’s withdrawal right will not be affected by another stockholder’s decision to commence an appraisal proceeding.

Consistent with the amendment to Section 203, Section 262(b) has also been amended to delete a reference to the trading system formerly operated by the NASDAQ in light of the new status of such system as a national securities exchange. Broadly, Section 262(b) denies appraisal rights to the stockholders of a corporation merging or consolidating with another corporation if, among other exemptions, both before and after the merger the stock meets certain listing requirements or is held by more than 2,000 holders of record. Prior to the 2007 amendments, the listing requirements included an express reference to stock “designated as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc.” This language has been deleted since the relevant trading system formerly operated by the NASDAQ now qualifies as a “national securities exchange” under Section 262(b).

Finally, Section 262(h) was amended to clarify that the Delaware Court of Chancery cannot determine fair value of stock in an appraisal proceeding on its own initiative and that appraisal proceedings are adversarial proceedings litigated in accordance with the rules of the Court of Chancery. The amendment does not change the substance of Section 262. Rather, the additional language is intended to emphasize that a stockholder seeking appraisal must actively prosecute its appraisal claim and that the Court will not simply appraise the shares absent active litigation of the proceeding by the parties.

The amendments to Section 262 are effective only with respect to mergers and consolidations that were “entered into” after August 1, 2007. With respect to so-called “short-form” mergers between a parent corporation and its subsidiary corporation that are adopted in accordance with Section 253, the 2007 amendments apply only if the board of directors of the parent adopted resolutions after August 1, 2007 to provide for the short-form merger. With respect to all other mergers and consolidations, the 2007 amendments apply to transactions consummated pursuant to agreements of merger or consolidation “entered into” after August 1, 2007. Practitioners should be mindful of whether the amended or pre-amended version of Section 262 applies to a transaction when preparing notices of appraisal, which must include a copy of the applicable version of Section 262.

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