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Recent Amendments to Delaware's LLC and LP Acts: Ending Default Rights to Class Votes, Clarifying Delegation of Powers, and Other Changes

By Norman M. Powell and John J. Paschetto

Recent amendments to the Delaware Limited Liability Company Act (the "DLLCA") and the Delaware Revised Uniform Limited Partnership Act (the "DRULPA") have eliminated the default rights that classes of members of limited liability companies, and of limited partners of limited partnerships, formerly had to separate class votes on mergers, conversions, and various other fundamental transactions. These amendments went into effect on August 1, 2015. Nearly all of them, as will be noted below, do not apply to a limited liability company (an "LLC") or a limited partnership (an "LP") whose certificate of formation or certificate of limited partnership (as applicable) was effective before August 1, 2015. Other amendments made as of August 1 this year involve the delegation of management authority and granting of proxies.

Elimination of Default Rights to Class or Group Votes

Before the 2015 amendments, if the members of an LLC or the limited partners of an LP were divided into more than one "class" or "group," the members or limited partners in each class or group were entitled, by default, to a separate class or group vote on such fundamental transactions as mergers, transfers, and conversions. The utility of these default rights had periodically been questioned. Because it was often unclear, in practice, whether the members or limited partners of a given entity fell into multiple classes or groups, a class or group voting right could arguably exist by default where none was originally intended by the parties.

Unlike the General Corporation Law of the State of Delaware—which requires that separate classes (if any) of stock be specified in a corporation's certificate of incorporation (*e.g.*, 8 *Del. C.* § 102(a)(4))—the DLLCA and the DRULPA do not expressly require that classes or groups of members or limited partners be specified in the entity's certificate or operating agreement. *Cf.* 6 *Del. C.* §§ 18-302(a), 17-302(a) (stating that the operating agreement of, respectively, an LLC or an LP "may" provide for classes or groups). Hence, uncertainty could sometimes arise regarding the member or partner approvals required for a transaction even if the operating agreement did not itself create separate classes or groups.

The 2015 amendments have addressed this issue not by restricting parties' ability to create classes or groups, but by removing the default rights of classes or groups to separate votes. Going forward, classes or groups of members or limited partners may be created (or allowed to arise) with the same freedom as before the amendments. But for a class or group to have a right to a separate vote, that right must be set forth in the parties' agreement. It will not normally arise under the DLLCA or the DRULPA if the agreement is silent.

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Accordingly, default class or group voting rights have been removed with respect to a merger (6 *Del. C.* §§ 18-209(b) (LLCs), 17-211(b) (LPs)), transfer to or domestication or continuance in a non-U.S. jurisdiction (§§ 18-213(b), 17-216(b)), conversion to another form of entity or to the same form of entity in another jurisdiction (§§ 18-216(b), 17-219(b)), dissolution upon the approval of members or limited partners (§§ 18-801(a)(3), 17-801(2)), and winding-up by members or limited partners (§§ 18-803(a), 17-803(a)).

In addition, specifically with respect to series LLCs and series LPs, default voting rights for classes or groups among the members or limited partners associated with a series have been removed in connection with dissolution of the series upon the approval of such members or limited partners (6 *Del. C.* §§ 18-215(k)(3), 17-218(k)(3)), and winding-up of the series by such members or limited partners (§§ 18-215(l), 17-218(l)).

All of the foregoing amendments apply only to an LLC or LP whose certificate of formation or certificate of limited partnership became effective on or after August 1, 2015, unless the entity's operating agreement provides otherwise.

Default class or group voting rights have also been eliminated from several provisions of the DRULPA that have no analogue in the DLLCA. These involve the agreement of limited partners to continue an LP after its sole general partner withdraws (6 *Del. C.* § 17-801(3)), revocation of dissolution caused by the absence of general partners or limited partners (§ 17-806(3)), the agreement of limited partners associated with a series to continue the series after the sole general partner associated with the series withdraws (§ 17-218(k)(4)), and the limited-partner approval required for an LP to become a limited liability limited partnership (§ 17-214(a)). All but the last of these four amendments apply only to an LP whose certificate of limited partnership became effective on or after August 1, 2015, unless the partnership agreement provides otherwise.

A similar amendment to the DRULPA has been made regarding the signatures required on a certificate of cancellation when an LP has been wound up by its limited partners. The certificate must now be signed by the limited partners that own a majority interest in the LP's profits, without (as previously required) signatures by majority owners on a class or group basis. 6 *Del. C.* § 17-204(a)(3).[1] This amendment to the DRULPA applies to all LPs, regardless of when their certificates of limited partnership became effective.

Granting Irrevocable Delegations, Powers of Attorney, and Proxies

The 2015 amendments have changed several provisions of the DLLCA and the DRULPA that deal with the ability to authorize others to act on one's behalf in connection with an LLC or LP. Most significantly, these changes establish that to be irrevocable, a delegation of authority by a member or manager of an LLC, or by a general partner of an LP, must only (i) state that it is irrevocable, (ii) be limited to management authority, and (iii) not be prohibited by the operating agreement. 6 *Del. C.* §§ 18-407, 17-403(c).

Put differently, a delegation of authority is now effectively deemed to be coupled with an interest sufficient to support an irrevocable power if the delegation satisfies the conditions in amended Section 18-407 or 17-403(c). As amended, these sections modify the common-law rule that delegation of a power cannot be irrevocable unless its purpose is to "protect a legal or equitable title" or to secure the performance of obligations owed to the delegatee independently of obliga-

[1] No corresponding amendment was made to the DLLCA because a certificate of cancellation of an LLC must be signed only by an authorized person. 6 *Del. C.* § 18-204(a).

tions that "are incident to a relationship of agency[.]"[2] The reach of the amendments is appropriately limited, however, by the requirement that any such delegation be of a member's, manager's, or general partner's "rights and powers to manage and control the business and affairs" of the LLC or LP. 6 *Del. C.* §§ 18-407, 17-403(c).

Other amendments involving delegation of authority have been made to sections of the DLLCA and the DRULPA that deal generally with powers of attorney. 6 *Del. C.* §§ 18-204(c), 17-204(c). Those sections continue to provide, as they did before the amendments, that a power of attorney concerning an LLC or LP will be irrevocable if it is coupled with an interest sufficient to support an irrevocable power and states that it is irrevocable. The amendments (in addition to removing duplicative language) confirm that Sections 18-204(c) and 17-204(c) apply to proxies as well as powers of attorney. In addition, a new sentence has been added to each section to prevent any inference that its provisions "limit the enforceability of a power of attorney or proxy" when the power of attorney or proxy is contained in an LLC or LP operating agreement.

Other Changes

Provisions of the DLLCA and the DRULPA that relate to obtaining copies of records from the Delaware Secretary of State have been amended to expressly limit the forms in which such records may be provided. 6 *Del. C.* §§ 18-1105(a)(5), 17-1107(a)(5). Such records are now available only as photocopies or "electronic image copies." All other formats, including "bulk data" and databases, are prohibited.[3]

Finally, Section 18-603 of the DLLCA (pertaining to resignation of members) and Section 17-603 of the DRULPA (pertaining to withdrawal of limited partners) have been amended to remove potentially confusing language that has proven to be unnecessary and is not employed in similar contexts elsewhere in either act.

[2] RESTATEMENT (THIRD) OF AGENCY § 3.12(1) (AM. LAW INST. 2006). An application of this rule can be seen in *Gov't Guar. Fund of the Republic of Finland v. Hyatt Corp.*, 95 F.3d 291 (3d Cir. 1996).

Delaware's General Corporation Law Is Amended to Bar Fee-Shifting Provisions in Charters and Bylaws, Permit Selecting Delaware as an Exclusive Forum in Charters and Bylaws, and Clarify Ratification Provisions, Among Other Changes

By Norman M. Powell and John J. Paschetto

The Delaware legislature recently adopted amendments to the state's General Corporation Law (the "DGCL") that should, among other things, resolve several widely debated issues of corporate governance and increase the utility of the ratification procedures that first became effective in April 2014. The amendments took effect on August 1, 2015.

As in prior years, the amendments were accompanied by a legislative synopsis. Particular attention should be given to this year's legislative synopsis because it is unusually extensive, offering valuable explanatory material. It can be found online at http://legis.delaware.gov/LIS/lis148.nsf/vwLegislation/SB+75?Opendocument.

[3] The amendments to Sections 18-1105(a)(5) and 17-1107(a)(5) took effect on June 24, 2015.

Fee-Shifting in Stockholder Litigation

The Delaware Supreme Court held in May 2014 that the bylaws of a Delaware nonstock corporation could provide for fee-shifting when a member unsuccessfully sues the corporation or another member.[4] Following that decision, Delaware practitioners and state legislators began to consider a range of possible amendments to the DGCL that would address fee-shifting in the context of stock corporations. It quickly became apparent, however, that the issues involved were of great interest to a variety of constituencies, several of which urged upon Delaware conflicting approaches. The legislature was therefore not in a position to act on much-anticipated fee-shifting amendments until spring of this year.

The fee-shifting amendments that have now been enacted provide that the certificate of incorporation and the bylaws of a Delaware corporation (other than a nonstock corporation) may not contain "any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim[.]" 8 *Del. C.* §§ 102(f) (charter), 109(b) (bylaws). "Internal corporate claims"—a term that is new to the DGCL—are "claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title [i.e., Title 8] confers jurisdiction upon the Court of Chancery." 8 *Del. C.* § 115.

An amendment to Section 114(b)(2) of the DGCL makes clear that the new anti-fee-shifting provisions do not apply to nonstock corporations. Thus, the Delaware Supreme Court's holding in *ATP Tour* has not been disturbed. In addition, the accompanying legislative synopsis explains that the new anti-fee-shifting provisions are not intended to bar fee-shifting pursuant to a stockholders' agreement.

Selecting Delaware as the Exclusive Forum for Stockholder Litigation

It has become increasingly common for the charters of Delaware corporations to contain provisions making Delaware the exclusive forum for stockholder litigation. These provisions have been held facially valid by the Delaware Court of Chancery and have been enforced by at least one non-Delaware court.[5] The 2015 amendments to the DGCL confirm that such provisions are permissible. In addition, the amendments prohibit the selection of any *other* jurisdiction as the exclusive forum for stockholder claims.

The forum-selection provisions are contained in new Section 115 of the DGCL. Under this section, a corporation's charter or bylaws may require that "internal corporate claims" be brought exclusively "in any or all of the courts in [Delaware]" (subject to "applicable jurisdictional requirements"). The section then states that the charter or bylaws may not *prohibit* the bringing of internal corporate claims "in the courts of [Delaware]." Section 115 also defines the term "internal corporate claims," as discussed above.

The legislative synopsis indicates that Section 115's allowance of exclusive jurisdiction in "any or all" of the courts "*in*" Delaware includes among such courts "the federal court" (i.e., the U.S. District Court for the District of Delaware). By contrast, Section 115's disallowance of prohibiting jurisdiction in the courts "*of* " Delaware would appear to refer specifically to Delaware state courts. Accordingly, Section 115 would seem to bar a charter or bylaw provision requiring that stockholder litigation be brought only in

[4] *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014).

[5] *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013); *Brewerton v. Oplink Commc'ns Inc.* (Cal. Super. Ct. Dec. 12, 2014).

the U.S. District Court in Delaware or only in some subset of the Delaware state courts.

The legislative synopsis further explains that Section 115 is not intended to limit the enforceability of an exclusive non-Delaware forum clause in a stockholders' agreement. In addition, as the synopsis explains, Section 115 is not intended to "limit or expand the jurisdiction of the [Delaware] Court of Chancery or the [Delaware] Superior Court[,]" or to "authorize a provision that purports to foreclose suit in a federal court based on federal jurisdiction[.]"

Substantial Revisions to the Ratification Provisions in Section 204

Among the DGCL amendments adopted in recent years, perhaps the most popular (at least in terms of how often it has been used) was the addition, effective April 1, 2014, of a new self-help procedure by which corporations could validate "defective corporate acts," including the types of defective acts that prior case law had held to be void *ab initio* and thus incapable of ratification. With the 2015 amendments, the relatively new validation procedure—set forth in Section 204 of the DGCL—has been significantly revised to clarify its application and increase its usefulness. The changes to Section 204 are so extensive that a practitioner who became familiar with it in its original form would do well to study the entire statute afresh before employing it.

First, language added to Section 204 arguably expands the types of "defective corporate acts" that can be validated thereunder. The Section 204 procedure can now be used to directly remedy an incorporator's failure to elect the initial board of directors where the initial board was not named in the certificate of incorporation. In such a situation, the incorporator's lapse, if not remedied by the incorporator or a person authorized to act in his or her place,[6] can result in a chain of defective acts and the absence of any valid board with the power to initiate the Section 204 procedure. The new option of using Section 204 to validate an initial board, combined with the *nunc-pro-tunc* effect of ratification under Section 204, will enable the corporation to establish the authority of the initial board and hence the validity of all acts taken by that board and by the holders of stock issued by that board.

Amended Section 204 also now includes among ratifiable defective acts "any act or transaction taken by or on behalf of the corporation" that is void or voidable because the act or transaction required, but did not receive, approval by the board or an officer. Thus, it is clear that a defective corporate act, to be capable of validation under Section 204, need not be an act that was imperfectly taken by a board or an officer. Rather, it can be any unauthorized act taken by or for the corporation.

Second, changes have been made throughout Section 204 to clarify its application when two or more defective corporate acts are to be validated in a single procedure and to specify the circumstances under which a single certificate of validation may be filed with respect to two or more defective acts for which a filing is needed. The required contents of a certificate of validation are also now addressed at greater length, the contents varying according to the circumstances in which the certificate is filed.

Third, a variety of other changes have been made to the procedural details of Section 204. These changes include the following: (i) giving corporations that employ Section 204 the option of including in notices to stockholders, certificates of validation, and certain other documents the information specified by the statute, in lieu of setting forth verbatim the ratifying resolutions

[6] See Section 108(d) of the DGCL for provisions regarding who may act in place of an unavailable incorporator.

adopted by the board; (ii) confirming that shares that were "putative stock" on the record date for voting to ratify a defective corporate act under Section 204 may not vote or be counted for quorum purposes respecting such ratification; (iii) removing language that limited the effectiveness of validation, insofar as putative stock was involved, to shares of stock identified in the board's ratifying resolutions; (iv) allowing publicly traded corporations to satisfy Section 204's stockholder-notice requirement by means of a public filing under the federal securities laws; and (v) providing that the 120-day period within which a plaintiff must commence an action under Section 205 to challenge a Section 204 validation now starts on the date when the stockholder notice required under Section 204 is given, if the notice is given after the effective time of the validation (otherwise, the validation effective time starts the 120-day period, as under the prior version of Section 204).[7]

Finally, the legislative synopsis explains that the "clarifying and confirmatory amendments to Section 204" (as opposed to amendments that have changed procedural requirements) are not intended to be "inapplicable in determining the proper interpretation of Section 204" as applied to ratifications undertaken before the 2015 amendments went into effect.

Loosening Some Restrictions on Public Benefit Corporations

In several respects, the 2015 amendments have made it easier for a Delaware corporation to become a Delaware public benefit corporation (a "DPBC").[8] The stockholder vote required for a standard Delaware corporation to become a DPBC, which previously was 90% of all outstanding stock, both voting and nonvoting, is now two thirds of the outstanding stock entitled to vote. 8 *Del. C.* § 363(a). Likewise, the stockholder-vote requirement for a corporation moving in the opposite direction—from a DPBC to a non-DPBC—has been amended to be the same (i.e., two thirds of stock entitled to vote). 8 *Del. C.* § 363(c).

The appraisal rights that were already afforded to holders of stock in a standard corporation upon its becoming a DPBC are now subject to a so-called "market-out" exception that is the functional equivalent of the market-out exception set forth in the general appraisal statute, Section 262 of the DGCL. Thus, a holder of stock at the time the corporation became a DPBC will not be entitled to seek appraisal if the stock was listed on a national securities exchange or "held of record by more than 2,000 holders" on the record date for approving the action (i.e., charter amendment or merger) by means of which the corporation became a DPBC. 8 *Del. C.* § 363(b). In the case of a merger, however, the market-out will not apply, and appraisal rights will be available, if (as under Section 262) the stockholders were required to accept in the merger anything in exchange for their shares other than shares in another publicly traded or widely held corporation, with cash consideration only for fractional shares.

The DPBC sections of the DGCL also no longer require that a DPBC include in its name any words or initials indicating that it is a public benefit corporation. 8 *Del. C.* § 362(c). However, if such words or initials are not used, and the DPBC's securities are not registered under the federal securities laws, the DPBC must pro-

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[7] A corresponding amendment regarding the 120-day period has been made to Section 205 of the DGCL.

[8] A "public benefit corporation" is a "for-profit corporation organized under and subject to the requirements of [the DGCL] that is intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner." 8 *Del. C.* § 362(a). Provisions permitting the formation of public benefit corporations were first added to the DGCL in 2013.

vide notice that it is a public benefit corporation to any person to whom it issues shares or sells treasury shares, before such issuance or sale.

Other Changes to the DGCL

In 2013, the DGCL was amended to confirm that a board of directors may satisfy its obligation to determine the consideration for which stock will be issued by approving a formula rather than a specific price. 8 *Del. C.* § 152. The 2015 amendments have further revised Section 152 to make it easier for a board to delegate ministerial tasks associated with the issuance of stock. It is now clear that the board may in one action authorize the issuance of stock in multiple transactions, in various amounts, and at various times, and may delegate (to an officer, for example) the authority to decide the sizes and times of such issuances. The board's resolution must only specify the maximum number of shares that may be issued thereunder, the period within which the shares may be issued, and the minimum consideration (or a formula that will determine the minimum consideration). The amendments also confirm that the formula may be made dependent on "facts ascertainable outside the formula[.]"

Likewise, the DGCL provisions regarding grants of stock options have been similarly amended to confirm that a formula for determining the option exercise price (use of which was already permitted) may be made dependent on facts outside the formula. 8 *Del. C.* § 157(b).

The amendments have added a new standard under which the Delaware Secretary of State may permit a corporation to use a name that does not "distinguish" the corporation from all other entities registered, and names reserved, with the Secretary of State. Before the amendments, a non-distinguishing name could be used only with the written consent of the entity already using the name or of any person who may have reserved the name. Now, even if such consent has not been given, the state may nonetheless permit the non-distinguishing name to be used if the corporation seeking to use it shows "to the satisfaction of the Secretary of State" that the corporation previously made "substantial" use of the name, that the corporation made "reasonable efforts" to obtain the consent of the other entity or the person holding the name reservation, and that permitting the non-distinguishing name "is in the interest of the State[.]" 8 *Del. C.* § 102(a)(1). Importantly, however, the amendments also provide that the state's grant of permission to use the name will not "prejudic[e] any rights" of the other entity or the person holding the name reservation.

The DGCL section regarding restated certificates of incorporation has been amended to make the required contents of such certificates (in § 245(c)) consistent with provisions in Section 242 governing when stockholder approval of charter amendments is and is not required. Finally, Section 391(c) of the DGCL has been amended in the same respects that Section 18-1105(a)(5) of the Delaware Limited Liability Company Act and Section 17-1107(a)(5) of the Delaware Revised Uniform Limited Partnership Act have been amended, as discussed above on page 3.[9]

No Changes to the Appraisal Statute

In spring of this year, the Delaware State Bar Association's Section of Corporation Law considered proposing amendments designed to limit "appraisal arbitrage" using stock of Delaware corporations. In appraisal arbitrage, stock is purchased by the arbitrageur after the public announcement of a merger in which (if the merger is consummated) stockholders of the corporation may have appraisal rights under Section 262 of the DGCL. The arbitrageur anticipates that an appraisal action will be pursued under Section 262, and that an ultimate award of the stock's appraised value, together with interest at the statutory rate, will result in a net gain. This

[9] The amendment to Section 391(c) of the DGCL took effect on June 24, 2015.

practice has raised concerns because it is believed to increase the costs borne by courts and corporate defendants while not serving the policy goals that underlie Section 262—primarily, to provide a source of relief to stockholders who oppose a merger and believe that the merger price does not reflect the corporation's value were it to continue as a stand-alone enterprise.

The amendments would have made two significant changes to Section 262. An appraisal action involving publicly traded shares would be subject to mandatory dismissal unless (i) the total number of shares for which appraisal rights were perfected exceeded one percent of the total outstanding immediately before the merger, (ii) the merger consideration that would have been paid in respect of the appraisal shares exceeded $1 million, or (iii) the merger was a "short-form" merger under DGCL Section 253 or 267. In addition, the corporation defending the appraisal action would have an avenue for mitigating its interest-rate risk: if the corporation paid, in advance of judgment, some amount to the holders of appraisal shares, the statutory interest would accrue only on the difference, if any, between that pre-paid amount and the principal amount of the judgment.

These proposals generated substantial comment and ultimately were not included among the amendments enacted in 2015.

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