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Summer 2013

Delaware Transactional & Corporate Law *Update*

Recent Amendments to Delaware's Corporation Law: Two-Step Corporate Takeovers Are Simplified and Public Benefit Corporations Are Permitted, Among Other Changes

by Norman M. Powell and John J. Paschetto

Governor Jack Markell signs Senate Bill 47, enabling the formation of Delaware public benefit corporations, at Young Conaway's Wilmington office on July 17, 2013. Standing L to R: State Representative Rebeccca Walker, State Senator David P. Sokola, Neil Grimmer, CEO of Plum Organics, and Jay Gilbert, co-founder of B Lab.

The Delaware legislature recently adopted what may be the most significant amendments to the state's corporation law since its current "anti-takeover" statute (8 *Del. C.* § 203) was added in 1987. The amendments include (i) a new provision that will make so-called "top-up options" unnecessary in two-step corporate takeovers; (ii) an entire new subchapter enabling the creation of Delaware public benefit corporations; and (iii) two new sections creating procedures by which defective corporate acts, including the unauthorized issuance of stock, can be cured.

Simplifying Two-Step Takeovers

In recent years, the "top-up option" has been accepted as one of the tools available to transactional lawyers in structuring acquisitions of Delaware corporations. When included in a merger agreement, a top-up option typically provides that if the acquirer makes a tender offer for the target corporation's shares, and the number of shares tendered into the offer give the acquirer a controlling stake, the acquirer will then have the option of buying, in exchange for a note, a sufficient number of shares from the target to bring the acquirer's ownership percentage to at least 90%. Following a successful tender offer and exercise of the option, the acquirer will then hold a large enough stake in the target to be able to cash out any remaining target stockholders without a stockholder meeting or stockholder vote, by means of a short-form merger under § 253 of the General Corporation Law of the State of Delaware (the "DGCL").

The use of a top-up option to avoid a stockholder vote in the second step of a traditional two-step, tender-offer-plus-merger takeover has not been viewed unfavorably by the Delaware Court of Chancery, despite invitations to the contrary. *See, e.g., Olson v. ev3, Inc.*, No. 5583-VCL, 2011 Del. Ch. LEXIS 34, at *2-5 (Del. Ch. Feb. 21, 2011). The court thus has impliedly acknowledged that no purpose is served by requiring a stockholder vote before a cash-out merger where the acquirer has just purchased enough shares to control the outcome of the vote.

This reasoning is reflected in new subsection (h) of Delaware's basic merger statute, § 251 of the DGCL. The new provision will enable merger agreements entered into after July 31, 2013, to eliminate the stockholder-vote requirement in a two-step takeover if the target's charter does not provide otherwise, the target's shares are publicly traded (or held of record by more than 2,000 stockholders), and six other requirements are met. First, the parties must expressly provide in their merger agreement that the second-step, cash-out merger will be governed by § 251(h), and that the merger will be effectuated "as soon as practicable" if the acquirer's tender offer is successfully consummated. Second, the tender offer must be for any and all shares of the target's outstanding stock that would otherwise be entitled to vote on the merger. Third, after the tender offer, the acquirer must own at least the number of shares that would otherwise need to be voted for the merger to be approved under the DGCL and the target's charter. This ensures that § 251(h) will not enable an acquirer to avoid a stockholder vote on the cash-out merger unless, as a result of its tender offer, the acquirer owns enough shares to control the outcome of such a vote.

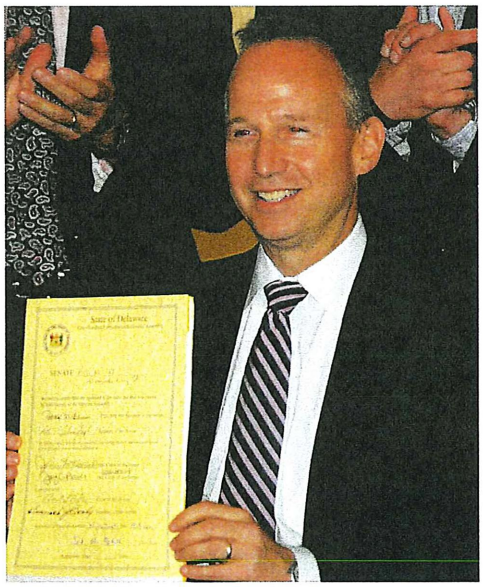
Fourth, at the time the merger agreement is approved by the target's board, no party to the agreement may be an "interested stockholder" of the target under the anti-takeover statute (DGCL § 203).[1] This requirement should prevent parties from using the new § 251(h) procedure as a way of circumventing the default defensive measures built into § 203. The fifth and sixth requirements are that the acquirer actually merge with the target following the tender offer, and that the stockholders who are cashed out in the merger receive the same consideration that was paid to the stockholders who tendered their shares. The amendments do not specify that a certificate of merger filed with the Delaware Secretary of State to effectuate a merger under § 251(h) be different in form from those commonly used under § 251.[2]

Delaware Public Benefit Corporations

On August 1, 2013, Delaware became the thirteenth state to permit the formation of benefit corporations under its laws. Benefit corporations are, generally speaking, for-profit corporations that have as one of their purposes the promotion of some social good. The social good to be promoted may be, depending on the jurisdiction, the good of society as a whole pursuant to an enabling statute, a particular social concern specified in the corporation's charter, or both. In managing a benefit corporation, directors are bound to consider the interests of not only the corporation's stockholders but also others who may be affected by the corporation's activities.

B Lab, a Pennsylvania non-profit entity, has been at the forefront in promoting benefit corporations.[3] It has promulgated model benefit-corporation legislation whose organization and language are reflected to varying degrees in the benefit-corporation statutes currently in effect in other states.[4] The provisions adopted in Delaware are on the whole more permissive than the model legislation, leaving it largely up to the parties to decide whether to adopt or reject the governance tools that the statutory provisions make available to a Delaware public benefit corporation (a "DPBC").

The special provisions governing DPBCs are found in new §§ 361-368 of the DGCL (forming new DGCL subchapter XV). DPBCs are subject to all the provisions of the DGCL, except that the provisions of §§ 361-368 will govern when they "impose[] additional or different requirements[.]" 8 *Del. C.* § 361. A DPBC is defined as a Delaware for-profit corporation "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). The DPBC's charter must include within its statement of business purpose (required of all Delaware corporations under DGCL § 102(a)(3)) "one or more specific public benefits to be promoted by the corporation[.]" *Id.* "Public benefit" is defined broadly as "a positive effect (or reduction of negative effects) on one or more categories of persons, entities, communities or interests (other than stockholders in their capacities as stockholders)[.]" 8 *Del. C.* § 362(b).



A DPBC's name must include "public benefit corporation," "P.B.C.," or "PBC." 8 *Del. C.* § 362(c). Its stock certificates and notices of the issuance or transfer of uncertificated stock must note "conspicuously" that the issuer is a DPBC formed under subchapter XV of the DGCL. 8 *Del. C.* § 364. Every notice of a meeting of the DPBC's stockholders must contain a similar statement. 8 *Del. C.* § 366(a).

In terms of governance, the central differences between a DPBC and other for-profit Delaware corporations are found in § 365, which sets forth the duties of DPBC directors and certain limitations on their potential liability. The board of a DPBC must manage its business and affairs "in a manner that balances the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation's conduct, and the specific public benefit or public benefits identified in its certificate of incorporation." 8 *Del. C.* § 365(a). However, a director shall not, by virtue of serving on the board of a DPBC, have a duty to "any person on account of any interest of such person in the public benefit [specified in the charter] or on account of any interest materially affected by the corporation's conduct[.]" 8 *Del. C.* § 365(b). Moreover, while derivative actions may be brought to enforce the directors' duty to balance stockholder and public interests, such an action may be instituted only by stockholders owning at least 2% of the DPBC's outstanding shares or, in the case of a publicly traded DPBC, the lesser of 2% of the outstanding shares and shares with a market value of at least $2 million. 8 *Del. C.* § 367.

Provision has also been made in the new DPBC sections to connect the directors' balancing duty to fiduciary-duty concepts with which practitioners are likely more comfortable. Thus, as regards a decision "implicating the balance requirement[,]" directors will be deemed to have satisfied their fiduciary duties to the DPBC and its stockholders if the decision "is both informed and disinterested and not such that no person of ordinary, sound judgment would approve." 8 *Del. C.* § 365(b). A DPBC may afford still further protection to its directors by providing in its charter that "any disinterested failure to satisfy [§ 365] shall not . . . constitute an act or omission not in good faith, or a breach of the duty of loyalty[,]" for purposes of indemnification or an exculpatory charter provision (as permitted by § 102(b)(7) of the DGCL). 8 *Del. C.* § 365(c).

Like B Lab's model legislation, the DPBC provisions include a reporting requirement, although the Delaware requirement calls for biennial, rather than annual, reporting and is narrower in its mandatory disclosures. A DPBC must

provide to its stockholders at least once every two years a statement that includes (i) the "objectives" set by the board to promote the DPBC's public benefit and "the best interests of those materially affected by the corporation's conduct"; (ii) the "standards" adopted by the board to measure the DPBC's "progress in promoting" such public benefit and interests; (iii) "objective factual information based on those standards regarding the corporation's success in meeting the objectives"; and (iv) an "assessment" of the DPBC's success in meeting the objectives. 8 *Del. C.* § 366(b). The DPBC's charter or bylaws may, but need not, require that a "third party standard" or "third party certification" be employed in connection with the DPBC's promotion of its objectives. 8 *Del. C.* § 366(c).

An existing corporation may become a DPBC by merger or by amending its charter. 8 *Del. C.* § 363(a). But if the corporation has received payment for any of its stock, such a merger or amendment must be approved by the holders of 90% of the outstanding shares, including nonvoting shares. *Id.* In addition, any stockholder that does not vote in favor of the merger or amendment will have appraisal rights under § 262 of the DGCL, to which a conforming amendment has been made (adding new paragraph (b)(4)). 8 *Del. C.* § 363(b).

A DPBC may likewise become a standard for-profit corporation by amending its charter or through a merger. 8 *Del. C.* § 363(c). Doing so will require approval by two thirds of the outstanding shares, including nonvoting shares. *Id.*

Curing Defective Corporate Acts

The Delaware Supreme Court's holding in *STAAR Surgical Co. v. Waggoner*, 588 A.2d 1130 (1991), created a challenge for advisers of Delaware corporations. In that case, the court held that stock issued without board authorization was void, not merely voidable. Under settled Delaware jurisprudence, a void corporate act (unlike a merely voidable act) cannot be cured through ratification. Thus, when a corporation has discovered long after the fact that its issuance of outstanding shares was not properly authorized, there has been no clear path toward remedying the problem. The predicament is particularly awkward when shares of doubtful validity have been traded or have affected the outcome of a stockholder vote.

New §§ 204 and 205 of the DGCL will give practitioners two procedures by which a corporation can cleanse the unauthorized issuance of shares and similar unauthorized corporate acts. Section 204 details a cleansing procedure that will not require a court proceeding, while § 205 makes available a proceeding in the Delaware Court of Chancery that may, among other things, achieve the same result. Both sections, along with conforming amendments to other sections of the DGCL, will take effect on April 1, 2014.

New Sections 204 and 205 of the DGCL will give practitioners two procedures by which a corporation can cleanse the unauthorized issuance of shares and similar unauthorized corporate acts.

Sections 204 and 205 pertain to "putative stock" and "defective corporate acts." Putative stock is either stock that was not properly authorized (but would otherwise be valid) or stock whose validity simply cannot be determined by the issuer's board. A defective corporate act is, in essence, an issuance of shares beyond what is authorized in the issuing corporation's charter, an election of directors without due authorization, or any corporate act or transaction that was within the corporation's power but was not authorized or effected in accordance with the DGCL, the corporation's charter and bylaws, and other applicable documents.

According to § 204, no putative stock or defective corporate act "shall be void or voidable solely as a result of a failure of authorization" if it is either "ratified" under § 204 and not challenged in the Court of Chancery within 120 days thereafter, or "validated" by the Court of Chancery under § 205. The ratification procedure of § 204 requires, first, that the board of directors adopt a resolution setting forth certain details of the defective act and that the board "approve[] the ratification" of the act. The resolution must then be submitted to a stockholder vote unless no such vote was required when the defective act was taken, no such vote would be required if the defective act were taken today, and the defective act was not the result of "a failure to comply with § 203 [i.e., the anti-takeover statute]."

The quorum and voting requirements at both the board and stockholder levels are those that would have applied to the defective act at the time the act was taken, unless the currently applicable quorum or voting requirements are greater. No approval is needed, however, from any class or series of shares, or from any person, that was required to give approval but is now no longer outstanding or a stockholder, respectively, or from any director that such a class, series, or person was entitled to elect or nominate. In addition, if the defective act to be ratified is the election of a director, the ratification must be approved by a majority of the shares present at the stockholder meeting and entitled to vote (or such greater proportion as the charter or bylaws may require now or may have required when the defective act was taken). In the case of a defective act resulting from a failure to comply with § 203 of the DGCL, ratification will require the vote specified in § 203, even if such a vote would not have been required otherwise.

Notice of a stockholder meeting to vote on ratification under § 204 must be given to each current record stockholder, including holders of putative stock and nonvoting stock. The notice must also be given to anyone who was a record holder, including a holder of putative stock or nonvoting stock, at the time of the defective act. Importantly, however, § 204 does not require that notice be

given to "holders whose identities or addresses cannot be determined from the records of the corporation." The lengths to which the corporation must go to locate former stockholders are thus reasonably circumscribed. If no stockholder meeting is required for ratification, then a similar notice must be provided promptly after the board ratifies the defective act.

If the defective act is one that would have required the filing of a certificate with the Delaware Secretary of State, then, regardless of whether such a certificate was previously filed, a "certificate of validation" must be filed containing certain information specified in § 204. The fee to be charged by the Secretary of State for such a filing has been set at $2,500, in addition to any amount that may otherwise be due if the certificate of validation causes the corporation's number of authorized shares to be increased. 8 *Del. C.* § 391(a).

The notice required under § 204 shall state that any challenge to the ratification must be commenced within 120 days after the later of (a) the effectiveness of an associated certificate of validation, and (b) the stockholders' ratifying vote or, where no stockholder vote is needed, the giving of post-ratification notice. Proper notice will be crucial because, after the 120-day period, no claim may be brought asserting that the ratified stock or act is void by reason of the subject failure of authorization, except for a claim asserting that § 204 itself was not complied with or a claim brought by a person who was required to be given notice under § 204 and "to whom such notice was not given."

Section 205 gives the Delaware Court of Chancery exclusive jurisdiction to determine the validity of ratification under § 204, along with jurisdiction to determine the validity of any corporate act, transaction, stock, or rights to acquire stock. Application for such a determination may be made by the corporation or any successor entity, any director, any record or beneficial owner of valid or putative stock either currently or at the time of a defective act ratified under § 204, and any person "claiming to be substantially and adversely affected" by ratification under § 204. The Court of Chancery is given broad authority by § 205 to validate defective acts or putative stock, to review § 204 ratifications, and to take other remedial measures in connection with defective corporate acts. Service of process in an action under § 205 needs to be made only on the corporation's registered agent in Delaware, but the court may require that notice be provided to others if the corporation itself is the applicant.

The potential attractiveness of the new procedures under §§ 204 and 205 is enhanced by a provision that a "failure of ratification" under those sections will not "create a presumption that any such [underlying] act or transaction is or was a defective corporate act or that such stock is void or voidable." In addition, when a defective corporate act or putative-stock issuance has been duly ratified under § 204 and not successfully challenged under § 205, the cleansing effect of the ratification will relate back to the time when the defective act was taken or the putative stock was issued. The *nunc pro tunc* effect of ratification should make the new procedures a welcome means of untangling the knot of interrelated problems that can arise when unauthorized stock has been in the market for some time and has been bought, sold, and voted as if valid.

Other Amendments to the DGCL

The above amendments, significant as they may turn out to be, are not the only noteworthy changes made to the DGCL in the latest legislative session. Section 152—the source of the requirement that consideration to be paid for newly issued stock be determined by the issuing corporation's board of directors—has been amended to make clear that boards are permitted to "determine the amount of such consideration by approving a formula by which the amount of consideration is determined." 8 *Del. C.* § 152. In addition, an important change affecting non-Delaware corporations doing business in Delaware has been made to the provisions regarding the deemed appointment of the Delaware Secretary of State as an agent to receive service of process. 8 *Del. C.* § 382(a). Newly added language states that any foreign corporation that consents in writing to the jurisdiction of any state or federal court in Delaware shall be deemed to have thereby appointed the Secretary of State as its agent for service of process if the agreement or other document containing the consent to jurisdiction does not specify how process may be served on the corporation. *Id.*

Changes have also been made to certain provisions of the Delaware Code relating to the corporation franchise tax. Under 8 *Del. C.* § 502(a) as amended, the annual franchise tax report that Delaware corporations are required to file with the Secretary of State may no longer be signed by a corporation's incorporator, with the exception of the corporation's "initial report" and a report filed in connection with the dissolution of a corporation before the issuance of shares (under DGCL § 274). The primary purpose of this amendment is to deter the formation of so-called "shelf" corporations, i.e., corporations formed with the intention that they will have no stockholders or directors for several years.

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[1] At the risk of gross oversimplification, an "interested stockholder" of a corporation is defined in DGCL § 203 as any person that, directly or indirectly, owns or has the power to vote at least 15% of the outstanding voting shares of the corporation. 8 *Del. C.* § 203(c)(5).

[2] The § 251(h) procedure is also available in mergers of Delaware and non-Delaware corporations, pursuant to an accompanying amendment to § 252 of the DGCL.

[3] Briana Cummings, Note, *Benefit Corporations: How to Enforce a Mandate to Promote the Public Interest*, 112 COLUM. L. REV. 578, 594 n.111 (2012).

[4] A copy of the model legislation, with commentary, can be downloaded at http://benefitcorp.net/for-attorneys/model-legislation.

Delaware Statutorily Confirms That Default Fiduciary Duties Apply to LLCs, Among Other Amendments to Its LLC and LP Acts

by Norman M. Powell and John J. Paschetto

Recently adopted amendments to the Delaware Limited Liability Company Act (the "DLLCA"), effective August 1, 2013, make clear that the managers and possibly members of a Delaware limited liability company may owe fiduciary duties unless the company's operating agreement provides otherwise. The amendments also confirm that the provisions of the DLLCA are not inapplicable solely on the grounds that an LLC has only one member rather than multiple members. In addition, amendments to the DLLCA and the Delaware Revised Uniform Limited Partnership Act (the "DRULPA") expressly provide that interests in an LLC or LP may remain outstanding through a conversion, domestication, and certain other transactions.

Default Fiduciary Duties Apply to LLCs

During the past few years, courts and practitioners have been increasingly focused on the question whether managers or members of a Delaware LLC can have fiduciary duties if the LLC's operating agreement is silent on the subject. The Delaware Court of Chancery, for example, has held that default fiduciary duties do apply to LLC managers. *Feeley v. NHAOCG, LLC*, 62 A.2d 649, 663 (Del. Ch. 2012). The state's Supreme Court, however, has observed (without ruling) that "reasonable minds could differ" on the issue and has invited a legislative solution. *Gatz Props., LLC v. Auriga Capital Corp.*, 59 A.3d 1206, 1219 (Del. 2012).

Accordingly, an express reference to fiduciary duties has been added to § 18-1104 of the DLLCA. Whereas the section previously stated that "the rules of law and equity, including the law merchant, shall govern" in any case not provided for in the DLLCA, it now provides that "the rules of law and equity, including the rules of law and equity relating to fiduciary duties and the law merchant, shall govern." 6 *Del. C.* § 18-1104 (emphasis added). The precise scope of such duties remains to be developed on a case-by-case basis, just as the law of fiduciary duties has developed in the corporate context. The *Feeley* opinion cited above provides an example of the Court of Chancery's application of fiduciary duties in the context of an LLC. It should be remembered, as well, that parties remain free to restrict or eliminate fiduciary duties in an LLC agreement, pursuant to 6 *Del. C.* § 18-1101.

Single-Member LLCs

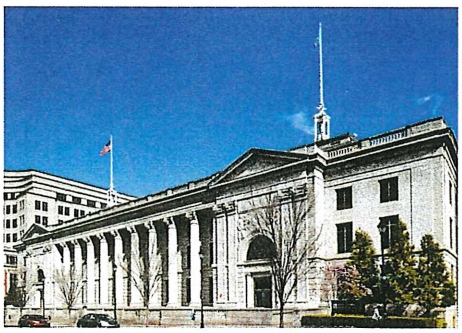
Two amendments have been made to the DLLCA to make clear that its provisions should not fail to be applied on the grounds that an LLC has only one member rather than multiple members. A general statement of this principle has been added as new subsection (j) of 6 *Del. C.* § 18-1101: "The provisions of this chapter shall apply whether a limited liability company has 1 member or more than 1 member."

The specific application of this principle in the case of a charging order against a limited liability company interest has also been made through an amendment to 6 *Del. C.* § 18-703(d). That subsection now provides, in relevant part, that "attachment, garnishment, foreclosure or other legal or equitable remedies are not available to the judgment creditor, whether the limited liability company has 1 member or more than 1 member." Thus, to the extent that a court might be inclined to read the DLLCA as permitting a judgment creditor to step into a debtor's shoes when the debtor is the only member of an LLC—on the theory that a single-member LLC does not implicate the "pick one's partner" policy—these amendments should make such an interpretation unavailable.

Other Changes

Both the DLLCA and the DRULPA have been amended in multiple places to confirm that interests in an LLC or LP "may remain outstanding[,]" as an alternative to being canceled or exchanged for cash, property, rights, or securities, where the subject entity is the surviving entity in a merger or undergoes a domestication, transfer, continuance, or conversion. 6 *Del. C.* §§ 17-211(b) (merger), 17-215(j) (domestication of non-U.S. entity as a Delaware LP), 17-216(f) (transfer or domestication and continuance of Delaware LP to or in a non-U.S. jurisdiction), 17-217(i) (conversion of other entity to a Delaware LP), 17-219(d) (conversion of Delaware LP to other entity), 18-209(b) (merger), 18-212(j) (domestication of non-U.S. entity as a Delaware LLC), 18-213(f) (transfer or domestication and continuance of Delaware LLC to or in a non-U.S. jurisdiction), 18-214(i) (conversion of other entity to Delaware LLC), 18-216(d) (conversion of Delaware LLC to other entity).

The charging-order provisions of the DRULPA have been amended to make clear that "attachment, garnishment, foreclosure or other legal or equitable remedies are not available to the judgment creditor." 6 *Del. C.* § 17-703(d). Lastly, amendments have been made to two sections of the DRULPA to clarify how the provisions of the Delaware Revised Uniform Partnership Act relating to limited liability partnerships should be applied to limited liability limited partnerships. 6 *Del. C.* §§ 17-104(d), 17-104(i)(4), 17-214. These amendments are not intended to change the substance of the applicable law.



Nonuniform Provisions in the "2010" Amendments to Delaware UCC Article 9

by Norman M. Powell

The revised version of Article 9 ("Revised Article 9") of the Uniform Commercial Code, as promulgated in 1998 by the Uniform Law Commission ("ULC") and The American Law Institute ("ALI"), has been enacted in all fifty states, the District of Columbia, and the U.S. Virgin Islands, and generally took effect on July 1, 2001. From 2008 to 2010, a committee (the "Review Committee") convened by the ULC and the ALI considered certain issues, ultimately recommending amendments to the official text of, and official comments to, Revised Article 9 (the "2010 Amendments"), intended to take effect on July 1, 2013. While most are unremarkable and simply clarify existing text, some are noteworthy. They have been widely considered by numerous authors.[1] Several address issues seemingly anticipated by nonuniform text in Revised Article 9 as enacted in Delaware prior to the 2010 Amendments ("Delaware Article 9"). This article briefly discusses the nonuniform provisions in the 2010 Amendments as recently enacted in Delaware, effective July 1, 2013 (the "Delaware 2010 Amendments").

Public Records of Registered Organizations

Section 9-102(a)(68) presents the new defined term "public organic record", bringing specificity to the question of just what public record should be consulted to determine a registered organization's name. The new term generally means the document filed with or issued by the relevant state or the United States to form or organize a registered organization. In a modest nonuniformity, the Delaware 2010 Amendments recognize that relevant filings relating to Delaware registered organizations can include not only initially filed records, amendments thereto, and restatements thereof, but also related corrective filings.

Locations of Registered Organizations Formed Under Federal Law

Section 9-307 of Revised Article 9 provides the rules for determining a debtor's location, and thus the place in which one must generally file for a financing statement to be effective.[2] Its subsection (f) addresses the location of registered organizations organized under federal law. Subparagraph (f)(2) previously provided that when an organization's location is designated in accordance with federal law, such location constitutes the organization's location for filing purposes. Alas, in the parlance of many federal laws (e.g., the National Bank Act), what's designated is actually denominated a "main office" or "home office," not a location. In its initial enactment of Revised Article 9, Delaware added nonuniform language to the effect that designating a main office or home office constitutes designation of a location. New language in the 2010 Amendments removes any doubt that such designations are, in fact, designations of a location for filing purposes. But inasmuch as the language to such effect in the 2010 Amendments differs from the nonuniform language in Delaware Article 9, for avoidance of any uncertainty Delaware both carries forward its original nonuniformity and adopts the new uniform text.

Individual Debtors' Names

The issue that presented the greatest challenge to the Review Committee was that of individual debtor names. Under Revised Article 9, when the debtor was an individual, a financing statement was sufficient only if it provided the "name of the debtor." While Revised Article 9 provided guidance for determining and rendering a debtor's name "sufficiently," such guidance was less than helpful in the case of individual debtors, for whom use of their "individual" names is required.[3] The simplicity of requiring the "name of the debtor," while appealing, presupposes that one can determine a debtor's name with greater certainty and ease than experience suggests one actually can. The Review Committee found no panacea, and instead offered in the 2010 Amendments two alternative approaches.

Alternative A – the "only if" approach – requires use of the name that appears on the debtor's driver's license or other specified document (e.g., an identification card issued by his or her state of residence) or, if the debtor has no such document, the debtor's surname and first personal name. Alternative B – the "safe harbor" approach – retains the current "name of the debtor" approach, but also provides a "safe harbor" for using either of the names designated by statute (viz., the surname and first personal name, or the name appearing on the debtor's driver's license or state-issued identification card). Each has its limitations and shortcomings. The Delaware Division of Motor Vehicles utilizes only uppercase letters, truncates surnames at forty characters, lists first and middle names (without distinction between them) in a second field truncated at forty characters, omits all commas, renders "junior" and "senior" as "JR" and "SR," renders roman numerals as arabic (Thurston Howell, III, had he lived in Delaware, would have been issued a driver's license identifying him as THURSTON HOWELL 3RD), and uses only the twenty-six letters of the English alphabet and arabic numerals modified as shown in the preceding parenthetical. Hyphens are used only in the surname field; no "foreign" letters or characters whatsoever are used. Of course, these conventions could change at any time, whether with or without coordination between the Division of Motor Vehicles and the Office of the Secretary of State.

Delaware was the first state to act on the challenge presented by individual debtors' names. Prior to the enactment of Delaware Article 9, it was recognized that determining an individual debtor's name could prove problematic. Noting that financing statements are generally indexed and searched by debtor's name, the issue arises as follows. Subsection 9-506(c) provides in effect that if a search under the debtor's correct name would disclose a filing that fails to properly provide the debtor's name, such filing would not be "seriously misleading" for that reason, and thus could be effective despite the misrendering of the name. A corollary of this rule, of course, is that such a financing statement, if not so found, is "seriously misleading" and ineffective. In its enactment of Revised Article 9, Delaware exempted filings naming individual debtors from Section 9-506's search logic test by inclusion of nonuniform text (i.e.,

"[e]xcept in the case of individual debtors . . ."). [4] This approach has worked well for Delaware, and is continued through the Delaware 2010 Amendments, though with the addition of Alternative B. Thus, the Delaware 2010 Amendments offer safe harbors for filings providing either the surname and first personal name of an individual debtor, or such individual debtor's name as it appears on an unexpired driver's license or state-issued identification card.

Conversion of Debtor Entities

Many have puzzled over Section 9-512 (Amendment of Financing Statement), and its requirements where a debtor undergoes a "conversion" to a different form of business entity under applicable state law. Many states permit "conversion" of one organization into another, but state laws differ (and some are simply unclear) as to whether the organization resulting from the conversion is the same legal person as the organization prior to conversion, or is a new legal person. That is, it is sometimes unclear whether the debtor is the same organization, albeit with a different name (and perhaps a different type of organization and jurisdiction of organization), or is a different organization entirely. Revised Article 9 defers to the law governing conversion for a determination as to whether the resulting organization is the same legal person as the original debtor, and the 2010 Amendments make no change in that approach. New Official Comment 5 is intended to clarify and emphasize this deference. It explicitly provides that when such organizations are one and the same, an amendment reflecting the name (and any other) change should be filed, whereas when such organizations are separate and distinct, an amendment adding the resulting entity as a new debtor should be filed. Helpfully, the Official Comment offers that in the face of uncertainty, one would do well to follow both courses of action. Owing to the ubiquity of Delaware entities, in the interest of greater salience and clarity the Delaware 2010 Amendments include nonuniform text to such effect at Section 9-512(f).

Grounds on Which a Filing May Be Rejected

Section 9-516 (What Constitutes Filing; Effectiveness of Filing) provides an exclusive list of grounds upon which a filing office may rightfully reject a record. In an effort to assist searchers in eliminating from concern filings that appear to relate to the debtors with which they are concerned but which, in fact, relate to other, identically or similarly named debtors, Revised Article 9 provided that a financing statement can be rejected if it fails to state the debtor's type of organization, jurisdiction of organization, and organizational identification number (or an indication that it has none). [5] Of course, such information has little relevance except as applied to registered organizations, as to which filings are generally to be made in their jurisdiction of formation. And jurisdictions generally preclude the duplicative use of registered organization names and confusingly or deceptively similar names. The consequence is that the burden of providing such information was adjudged greater than any resulting benefit. The 2010 Amendments eliminate any requirement for these three data. Interestingly, Delaware Article 9 never required inclusion of organizational identification numbers – Delaware declined to adopt subsection 9-516(b)(5)(C)(iii). Thus, Delaware is no longer nonuniform in this regard.

The nonuniformities between the "2010" amendments to UCC Article 9 and amended Delaware Article 9 are few and modest, coordinate with other applicable state law, or carry forward existing nonuniformities.

Additional Nonuniform Provisions

Delaware Article 9 contains certain nonuniform provisions intended to coordinate with other provisions of Delaware law. These include text in Section 9-516(c) relating to records filed in the office of the recorder of deeds in the several counties. Title 9, Chapter 96 of the Delaware Code requires that certain information appear on documents filed in such offices (e.g., real estate tax parcel number and identity of document preparer). While the 2010 Amendments do not bear directly on these nonuniform provisions, their text has been revisited in the Delaware 2010 Amendments to make certain nonsubstantive, conforming changes.

Delaware Article 9 contains certain nonuniform provisions intended to bring greater clarity and certainty to filings involving trusts and trustees as debtors. These provisions, which speak in terms of the debtor being a trust or trustee, have been amended to conform to the general nomenclature of the 2010 Amendments, and now speak in terms of the collateral being held in a trust.

Section 9-521 (Uniform Form of Written Financing Statement and Amendment) mandates that a filing office that accepts written records must accept them on specified "safe harbor" forms (it is free to accept them on other forms, as well). The 2010 Amendments include revisions to such forms, reflecting the substantive changes effected by the 2010 Amendments. The Delaware 2010 Amendments include such revised forms, as well as conforming revisions to certain alternative forms suitable for filing with the Delaware Secretary of State.

Generally, there's a five-year transition period before "old" filings made in conformity with Revised Article 9 must be amended or otherwise revised to conform to the 2010 Amendments. Recognizing the risk, burden, and potential for errors posed by the transition from former Article 9 (i.e., Article 9 as in effect prior to July 1, 2001) to Revised Article 9, Delaware Article 9 includes a nonuniform (and no longer relevant) subsection § 9-703(c) providing special transition rules for

financing statements filed under former Article 9 with respect to trusts and trustees as debtors. This nonuniform provision, and the accompanying nonuniform text in subsection 9-705(f), effectively provided that certain Delaware filings made under former Article 9 and identifying the debtor in the manner customary under former Article 9 (e.g., ABC Trust Company, not in its individual capacity, but solely as Owner Trustee) could be continued under Delaware Article 9 without the necessity of complying with the debtor naming convention mandated by Delaware Article 9. This special rule is carried forward by the Delaware 2010 Amendments. As before, it applies only to continuations, and not to amendments. When such a Delaware filing made under Revised Article 9 is first amended in any respect, it also must concurrently be amended to comply with then-current requirements for identifying the debtor.

Thus, Delaware's nonuniformities are few and modest, coordinate with other applicable state law, or carry forward existing nonuniformities.

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[1] *See, e.g.*, Norman M. Powell, *The Proposed 2010 Revisions to UCC Article 9*, in the summer 2010 issue of the *Update*, which can be found online at http://www.youngconaway.com/files/Publication/ab0eaf52-2a36-4316-8479-73090beb3660/Presentation/PublicationAttachment/6a2cbfd5-616f-4424-986c-98a40189bfcc/DEUpdateSummer2010.pdf.

[2] The general rule is subject to exceptions, e.g., for fixture filings and for security interests in timber to be cut and as-extracted collateral. *See* U.C.C. § 9-301, cmt. 5.

[3] U.C.C. § 9-503(a)(4)(A).

[4] 6 *Del. C.* § 9-506(b).

[5] U.C.C. § 9-516(b)(5)(C).

About the Update:

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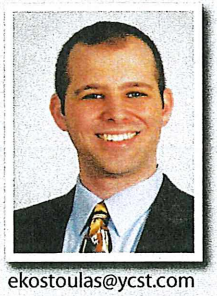

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