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INSIGHT: 2018 Amendments to Delaware’s General Corporation Law and Alternative Entity Statutes



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In its last session, the Delaware legislature passed a number of amendments to the Delaware General Corporation Law (the “**DGCL**”) and the Delaware “alternative entity” statutes—the Delaware Limited Liability Company Act (the “**DLLCA**”), the Delaware Revised Uniform Limited Partnership Act (the “**DRULPA**”), the Delaware Revised Uniform Partnership Act (the “**DRUPA**”) and the Delaware Statutory Trust Act (the “**DSTA**”). Except as noted below, all of the amendments became effective on August 1, 2018.

The amendments to the DGCL effected a number of substantive, technical and clarifying changes, including changes to the provisions governing the ratification of defective corporate acts and changes to the provisions governing the availability of appraisal rights in “medium-form” mergers.

The amendments to the alternative entity statutes include a number of significant substantive changes, the majority of which were made to the DLLCA and, as described below, (i) create a new type of limited liability company series known as registered series, (ii) permit registered series of the same limited liability company to merge or consolidate, (iii) permit a limited liability company to divide statutorily into two or more limited liability companies, (iv) create statutory public benefit limited liability companies, (v) provide jurisdiction to the Court of Chancery, upon a motion by the Attorney General, to cancel the certificate of formation of any limited liability company for misuse or abuse and (vi) confirm the authority to use distributed ledgers, blockchain and other networks of electronic databases for the creation and maintenance of limited liability company records and for certain electronic transmissions. Similar amendments regarding the use of distributed ledgers, blockchain and other networks of databases

were made to the DRULPA and the DSTA. The amendments also include several important changes to the DSTA that, as described below, (i) create default duties for trustees regarding the selection, supervision and actions of officers, employees, managers or delegates acting pursuant to Section 3806(b)(7) or Section 3806(i) of the DSTA, (ii) create default duties for agents and delegates of a trustee acting pursuant to Section 3806(b)(7) or Section 3806(i) of the DSTA, and (iii) provide protection from liability to delegates of a trustee acting pursuant to Section 3806(i) of the DSTA who rely in good faith on certain types of information obtained in performing their duties.

This article will first discuss the amendments to the DGCL and then the amendments to the alternative entity statutes.

Amendments to the DGCL

Distinguishing from a Registered Series of an LLC. [DGCL § 102] Section 102 sets forth requirements for the contents of a certificate of incorporation and requires that the name of any corporation must be distinguishable from names of other entities on the records of the State of Delaware. Section 102(a)(1) has been amended to include a registered series of a limited liability company to the list of entities whose names must be distinguishable from the name of any newly created corporation.

Extension of 204 and 205 to Nonstock Corporations. [DGCL § 114] Section 114 has been amended to permit nonstock corporations to ratify defective corporate acts pursuant to the provisions of Sections 204 and 205.

The 204 Amendments. [DGCL § 204] Section 204, which allows for the ratification of defective corporate acts, has been amended to confirm and clarify certain provisions. Section 204(c)(2) has been added to confirm

that ratification under Section 204 is available in circumstances where no valid stock is outstanding (regardless of the existence of any putative shares). Section 204(d), which requires notice to holders of valid and putative stock as of the time of the defective corporate act in connection with any meeting of stockholders to vote on a ratification, has been amended to permit a corporation to satisfy the notice requirement by providing notice to such holders as of the original record date for the defective corporate act (to the extent applicable). Section 204(g) has been amended so that the notice requirement of Section 204(d) may be satisfied by disclosure in a document publicly filed with the Securities and Exchange Commission if the corporation is a public company.

The amendments to Section 204(h)(1) clarify that any acts that are within a corporation's general powers may be ratified under Section 204 for any failure of authorization. This amendment is intended to confirm that corporate acts that were not authorized in accordance with the requirements of the DGCL are still "within the power of a corporation" for purposes of Section 204(h)(1) (other than acts that involve the exercise of a power expressly prohibited, such as the exercise of banking powers). This amendment is intended to negate the suggestion in *Nguyen v. View, Inc.*, C.A. No. 11138-VCS (Del. Ch. June 6, 2017) that an act authorized in violation of the DGCL is not a "defective corporate act." Rather, such an act (that is within the power of the corporation) is a "defective corporate act" that involves a failure of authorization. These amendments do not limit, eliminate, modify or qualify any power granted to the Court of Chancery under Sections 204 or 205 of the DCGL.

Finally, Section 204(h)(2) was amended to clarify that the failure to authorize or effect an act or transaction in compliance a proxy or consent solicitation disclosure, if and to the extent such failure would render such act or transaction void or voidable, can be ratified pursuant to Section 204. The amendments to Section 204 are effective only with respect to defective corporate acts ratified or to be ratified pursuant to resolutions adopted by a board of directors on or after August 1, 2018.

"Market Out" Exception to Appraisal Rights for 251(h) Mergers. [DGCL § 262] The amendments to Section 262 expand the "market out" exception to appraisal rights to mergers effected pursuant to Section 251(h), the "medium-form" merger provision (which allows for a merger following a tender offer without separate stockholder approval beyond the majority tender). In such mergers, appraisal rights generally will not be available to holders of shares of a target corporation if such shares were listed on a national securities exchange or held of record by more than 2,000 holders immediately prior to the execution of the merger agreement, so long as the holders of such shares are not required to accept anything other than any combination of shares of stock of the surviving corporation, shares of stock of a corporation that is listed on a national securities exchange or held of record by more than 2,000 holders, and cash in lieu of fractional shares of such corporations. The amendments to Section 262(e), a provision that requires notice to holders of shares who have demanded appraisal, clarify that in mergers effected pursuant to 251(h) the surviving corporation must provide notice of the aggregate number of shares

that are not "tendered" for purchase or exchange and for which appraisal has been demanded. The amendments to Section 262 are effective for mergers or consolidations consummated pursuant to an agreement entered into on or after August 1, 2018.

Amending the Revocation or Forfeiture of Charter Provisions. [DGCL § 284] The amendments Section 284 provide that the Attorney General has the exclusive authority to file for the revocation or forfeiture of a charter of a Delaware corporation. Additionally, the amendments allow the Delaware Court of Chancery to appoint a trustee to administer and wind up the affairs of a corporation whose charter has been revoked or forfeited.

Simplifying Certificates of Revival. [DGCL § 313(b)] Section 313, which relates to the revival of exempt corporations, was amended so that the Delaware Secretary of State is no longer required by such provision to issue a certificate stating that the corporation's certificate of incorporation has been revived.

Amendment to Annual Franchise Tax Reports. [DGCL § 502(a)] Section 502, which includes the requirements for the annual franchise tax report, has been amended to provide that corporations exempt from taxation for any cause no longer have to list the specific facts entitling the corporation to exemption when filing their annual franchise tax reports.

Amendments Common to Multiple Alternative Entity Statutes

Distributed Ledgers and Blockchain. [DLLCA §§ 18-104(g); 18-302(d); 18-305(d); and 18-404(d); DRULPA §§ 17-104(g); 17-302(e); 17-305(c); and 17-405(d); DSTA §§ 3801(a); 3806(f)(2); 3806(g)(2); and 3819(d)] The amendments amend numerous provisions of the DLLCA, the DRULPA and the DSTA to provide express statutory authority to use networks of electronic databases, including distributed ledgers and blockchain, to create or maintain records of the entity and for certain electronic transmissions. These amendments confirm that this rapidly advancing technology is available to be used with respect to limited liability companies, limited partnerships and statutory trusts.

Amendments to the DLLCA

Registered Series and Protected Series. [DLLCA §§ 18-101; 18-102(3); 18-103; 18-104; 18-105; 18-203; 18-206; 18-207; 18-208; 18-209(a); 18-215; 18-218; 18-219; 18-220; 18-221; 18-1105(a); 18-1107; 18-1108; 18-1109; and 18-1110] The amendments amend numerous provisions of the DLLCA to create a new type of series known as registered series. Registered series will be addressed in new Section 18-218 of the DLLCA. Section 18-215 of the DLLCA, which currently addresses series, will be amended to provide that series formed under Section 18-215(b) of the DLLCA (either before or after the amendments) will be known as protected series. The provisions relating to registered series are similar to the provisions relating to protected series with several notable exceptions. First, in order to facilitate the use of registered series in secured financing transactions, registered series are designed to qualify as registered organizations under the Uniform Commercial Code. Thus, a certificate of registered series is required to be filed with the Delaware Secretary of State to form a registered series, and the name of a registered series

must begin with the name of the limited liability company and be distinguishable from the names of other Delaware business entities or business entities qualified or registered to do business in Delaware. (In connection with these amendments, Article 9 of the Delaware Uniform Commercial Code is also being amended effective August 1, 2019 to provide that a registered series constitutes a “registered organization”.) Second, one or more registered series of a limited liability company may merge or consolidate with or into one or more other registered series of the same limited liability company. Third, certificates of good standing and certificates of existence with respect to registered series will be issued by the Delaware Secretary of State. Fourth, a protected series of a limited liability company may convert to a registered series of the same limited liability company and a registered series of a limited liability company may convert to a protected series of the same limited liability company. Finally, an annual franchise tax in the amount of \$100 per registered series will be required to be paid, but the aggregate amount of annual franchise tax for all registered series of a limited liability company will be capped at \$5,000 if a limited liability company has more than fifty registered series. Because of the time necessary to implement the creation of registered series, including time needed to prepare for filings with, and the issuance of certificates by, the Delaware Secretary of State, the amendments regarding registered series and protected series will not be effective until August 1, 2019.

Division of a Limited Liability Company. [DLLCA §§ 18-203(a); 18-206; 18-209(a); 18-217; and 18-1105(a)] New Section 18-217 of the DLLCA authorizes a limited liability company to divide into two or more newly formed limited liability companies, with the dividing limited liability company either continuing its existence or terminating as part of the division. A division of a limited liability company is effected by (i) the adoption of a plan of division setting forth the terms and conditions of the division including, among others, the allocation of assets, property, rights, series, debts, liabilities and duties of the dividing limited liability company among the resulting limited liability companies and, if it survives, the dividing limited liability company, and (ii) the filing with the Delaware Secretary of State of a certificate of division and a certificate of formation for each newly formed limited liability company. A plan of division will be given effect to divide the assets and liabilities of a limited liability company among the resulting limited liability companies and, if it survives, the dividing limited liability company so long as the plan of division does not constitute a fraudulent conveyance under applicable law. With respect to any limited liability company formed prior to August 1, 2018 that is party to any written contract, indenture or other agreement entered into prior to August 1, 2018 that by its terms restricts, conditions or prohibits such limited liability company from (x) consummating a merger or consolidation with or into another party or (y) transferring assets, such restriction will be deemed to apply to a division as if it were a merger or consolidation or asset transfer.

Statutory Public Benefit Limited Liability Companies. [DLLCA Subchapter XII] New subchapter XII of the DLLCA authorizes the creation of statutory public benefit limited liability companies, which are similar to public benefit corporations organized under subchapter

XV of the DGCL. Subchapter XII of the DLLCA is intended to provide a simple and efficient “opt-in” procedure for forming a public benefit limited liability company. As with a public benefit corporation, a statutory public benefit limited liability company must be intended to produce a public benefit and to operate in a responsible and sustainable manner. New subchapter XII of the DLLCA does not limit the formation or operation of a limited liability company formed or operated for a public benefit (including a limited liability company designated as a public benefit limited liability company) that is not a statutory public benefit limited liability company.

Powers to Cancel a Certificate of Formation for Abuse or Misuse. [DLLCA §§ 18-112; and 18-203(a)] Under new Section 18-112 of the DLLCA, upon motion by the Attorney General, the Court of Chancery may cancel the certificate of formation of any limited liability company for abuse or misuse of its limited liability company powers, privileges or existence. The Court of Chancery may appoint a trustee or receiver to administer such limited liability company’s winding up.

Amendments to DSTA

Duties and Liabilities of Trustee Regarding Officers, Employees, Managers and Delegates. [DSTA §§ 3806(b)(7); and 3806(m)] The amendments add new subsection (m) to Section 3806 of the DSTA to provide default rules for a trustee’s duties and liabilities regarding the selection, supervision and actions of officers, employees, managers or delegates acting pursuant to Section 3806(b)(7) or Section 3806(i) of the DSTA. The default rule provides that, subject to the governing instrument, a trustee has no duties or liabilities with respect to the selection, supervision, or actions of, or to exercise or perform the rights, powers or duties of, an officer, employee, manager or delegate when such appointment, election, engagement or delegation is made, or is required to be made, pursuant to a provision of the governing instrument or another agreement contemplated therein. Additionally, when a trustee makes an irrevocable delegation under Section 3806(i) of the DSTA pursuant to the trustee’s discretionary authority, again subject to the governing instrument, the trustee must exercise the standard of care of a trustee required under the governing instrument or the DSTA in making, and establishing the scope and terms of, such selection or delegation, but is not otherwise responsible for the delegate’s activities. In all other cases, the trustee must exercise the standard of care of a trustee required under the governing instrument or the DSTA in making, and establishing the scope and terms of, such selection or delegation and monitoring such officer, agent or delegate. In connection with the new default rules enumerated in new subsection (m) of Section 3806 of the DSTA, Section 3806(b)(7) of the DSTA was amended to remove the current default rule providing that a trustee shall choose and supervise the officers, managers, employees or other agents or independent contractors of the trust.

Duties and Liabilities of Agents and Delegates. [DSTA § 3806(n)] The amendments add new subsection (n) to Section 3806 of the DSTA, which provides that an officer, employee, manager or delegate acting pursuant to Sections 3806(b)(7) or 3806(i) of the DSTA shall comply with the scope and terms of the appoint-

ment, election, engagement or delegation including any standard of care and standard for liability for failure to adhere to such standard of care set forth therein, but if neither the governing instrument of the statutory trust nor the terms of such appointment, election, engagement or delegation address these issues, such officer, employee, manager or delegate shall exercise its rights, powers and duties subject to the standard of care required of a trustee under the governing instrument or the DSTA and be liable for the failure to do so.

Good Faith Reliance. [DSTA § 3806(k)] The amendments amend Section 3806(k) of the DSTA to provide delegates of a trustee under Section 3806(i) of the DSTA full protection from liability when they rely in good faith on the records, information, opinions, reports, or statements obtained in performing their duties, which is the same standard that applies to a trustee or beneficial owner or an officer, employee or manager acting pursuant to Section 3806(b)(7) of the DSTA.

Personal Liability Protection. [DSTA § 3803(c)] The amendments amend Section 3803(c) of the DSTA to provide that any person to whom a trustee has delegated its rights, powers or duties to manage and control the business and affairs of the statutory trust under Section 3806(i) of the DSTA has protection from personal liability to the same extent, as an officer, employee or manager acting pursuant to Section 3806(b)(7) of the DSTA. In addition, Section 3803(c) of the DSTA has been amended to add trustees to the list of persons to whom, as a default rule, the protection from liability provided by that section does not apply.

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