



PROPOSED AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW

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The Council of the Corporation Law Section of the Delaware State Bar Association has proposed legislation that will amend the General Corporation Law of the State of Delaware (the "DGCL"). If adopted, the legislation will affect a number of provisions of the DGCL, will address a number of different topics, and may change practice in a number of different ways, including with respect to the process by which public company merger transactions are conducted. The merger amendment would add a new Section 251(h) that would allow corporations to opt into a streamlined back-end merger process intended to obviate the need under certain circumstances for a corporation to hold a stockholder meeting, the results of which are a foregone conclusion. The proposed legislation also includes a new Section 204 that authorizes the ratification of certain defective corporate acts and stock issuances and a new Section 205 that confers jurisdiction upon the Delaware Court of Chancery to hear matters related to the new Section 204 as well as other matters relating to the cure of defective or potentially defective corporate acts. In addition, the proposed legislation will permit the formation of specialized public benefit corporations. Directors of a public benefit corporation, or PBC, would be permitted by statute to consider the best interests not only of a corporation's stockholders but also of other persons, entities, communities or interests. Finally, the proposed legislation contains revisions to Sections 114(a), 312(b), and 502(a) designed to address issues identified by the Delaware Secretary of State with respect to so-called "Aged Corporations." A number of conforming revisions are required to other provisions of the DGCL, including Section 262, which governs stockholder appraisal rights.

If ultimately enacted into law, the proposed amendments will take effect on August 1, 2013, except for the new Section 204 and 205 and the changes related thereto, which would become effective on April 1, 2014.

OPT-IN BACK-END MERGER WITHOUT A STOCKHOLDER VOTE (NEW SECTION 251(H) AND CONFORMING REVISIONS TO SECTION 252(E) AND SECTION 262 OF THE DGCL)

Over the past decade, the use of top-up options has become increasingly prevalent. The top-up option is designed to facilitate the closing of a back-end merger in a two-step merger transaction by permitting an acquiror to "top up" the shares received in the tender to the 90% ownership threshold that permits the acquiror to accomplish a short form merger under Section 253 of the DGCL without the time and expense required in order to call a meeting to approve the second-step merger. Top-up options have survived challenge in the Delaware courts and have become a preferred method of structuring public company mergers. However, a corporation's ability to utilize a top-up option remains largely dependent upon the corporation's capitalization structure because of the possibly large number of shares required in order to achieve the 90% ownership threshold. In some cases, a corporation's capitalization structure may make the use of a top-up option untenable, effectively preventing those companies from utilizing the structure.

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The addition of a new Section 251(h) is intended to provide all target corporations with the ability to execute a back-end merger without the need for a stockholder meeting, so long as the parties to the merger agreement comply with the terms of the new statute.² Proposed Section 251(h) specifies that, unless otherwise required by a target's certificate of incorporation, a merger agreement involving a publicly held Delaware corporation (defined as corporations whose stock is listed on a national securities exchange or held of record by more than 2,000 holders) may permit the acquiring company to approve a back-end merger without the need for a stockholder meeting. The definitive merger agreement associated with the transaction must state that the contemplated merger is governed by Section 251(h), and the back-end merger is required to be completed "as soon as practicable" following the consummation of the first-step tender or exchange offer. In addition, Section 251 (h) requires that the buyer initiate and consummate the tender or exchange offer contemplated by the merger agreement for the shares of the target corporation that would be entitled to vote to approve or reject the proposed transaction absent the opt-in election provided under Section 251(h). Third, following the consummation of the tender or exchange offer, buyer must own the percentage of target stock required by the DGCL to adopt the merger agreement, or any higher threshold required by the target's certificate of incorporation. Fourth, in order to avoid an end run around Section 203 of the DGCL, at the time the target's board of directors approves the merger agreement, no other party to the merger agreement may be designated an "interested stockholder" of the target corporation pursuant to Section 203(c) of the DGCL. Finally, the entity making the tender offer is required to merge with or into the target corporation in accordance with the terms of the definitive merger agreement, and must pay the same consideration on the back end merger as offered in the tender offer. In light of the inclusion of the new Section 251(h) in the proposed legislation, conforming revisions were also proposed with respect to Section 252(e) and Section 262 of the DGCL to add relevant references to Section 251(h).

RATIFICATION OF DEFECTIVE CORPORATE ACTS AND STOCK (NEW SECTION 204 AND VARIOUS CHANGES THROUGHOUT THE DGCL)

The proposed legislation would add new Sections 204 and 205 to the DGCL that will permit Delaware corporations faced with actions that are of doubtful validity to obtain cures for those defects through a self-help safe harbor procedure or through a new procedure that provides the Delaware Court of Chancery with jurisdiction to deal with such issues, as well as to hear and determine the validity of any ratification effected in accordance with the new self-help provisions. The new provisions are intended to bring clarity to an often confusing area of Delaware law regarding which corporate actions are voidable (and, therefore, may be capable of ratification) and which corporate actions are void (and, therefore, may be incapable of ratification). New Sections 204 and 205 of the DGCL are designed to provide corporations and attorneys who are asked to render opinions with respect to the validity of corporate actions with a mechanism to correct actions that have been defectively authorized. If the amendments are adopted by the General Assembly of the State of Delaware and are signed into law, corporations will be permitted to take the steps set forth in new Section 204, or to utilize the judicial proceedings set forth in new Section 205, to validate potentially invalid stock issuances and other corporate actions whose valid authorization may be in question.

² It is important to note that proposed Section 251 (h) has no effect on a target board's fiduciary duties when considering a merger. Thus, a board of directors must determine, as a fiduciary matter, that it is in the best interests of the corporation and its stockholders to utilize the back-end merger construct contemplated by Section 251(h). In making such determination, the board of directors should consider, among other factors, the benefits achieved from a timing and cost standpoint in avoiding the need for a stockholder meeting at which the acquiror will have the votes necessary to approve the merger (and will be contractually obligated to do so). The target's board of directors should also actively consider and evaluate whether the approval threshold required to pursue a back-end merger under Section 251(h) should exceed the minimum required by Section 251 (h).

NEW SECTION 204

Section 204 provides that, if a corporate act is ratified in accordance therewith or validated by the Delaware Court of Chancery in a proceeding in accordance with new Section 205 of the DGCL, then it shall not be void or voidable solely because it was a “defective corporate act.” Section 204 defines “defective corporate act” as (i) any act purportedly taken by or on behalf of the corporation that is, and at the time it was purportedly taken would have been, within the power of the corporation, but was defective due to the failure to authorize such act in compliance with the DGCL, the corporation’s organizational documents, or any plan or agreement governing such act, if and to the extent such failure would render it void or voidable, (ii) an “overissue,” which means the issuance of (a) shares of capital stock of a class or series in excess of the number of shares of such class or series the corporation has the power to issue under Section 161 of the DGCL at the time of such issuance, or (b) shares of any class or series of capital stock that is not then authorized, or (iii) a defective election or appointment of directors.

New Section 204 is intended to overturn the holdings of Delaware cases such as *STAAR Surgical Co. v. Waggoner*, 588 A.2d 1130 (Del. 1991), and *Blades v. Wisehart*, 2010 WL 4638603 (Del. Ch. Nov. 17, 2010), which held that corporate acts or transactions were void as a result of a failure to comply with the applicable provisions of the DGCL or with the corporation’s organizational documents and were incapable of ratification or validation as a matter of equity. In addition, new Section 204 will eliminate any perceived disconnect between Delaware case law and the provisions of the Delaware Uniform Commercial Code (the “Delaware UCC”) that provide a mechanism for curing overissuances of stock. Section 8-202(b) of the Delaware UCC provides that stock held by a bona fide purchaser is valid even if it has been invalidly issued. However, *Noe v. Kropf*, C.A. No. 4050-CC (Del. Ch. Jan. 15, 2009) (Transcript), suggested that the provisions of the Delaware UCC could not validate stock that is invalid under the DGCL. New Section 204 will provide corporations with a clear path to validating “defective corporate acts” to enable them to fix these types of defects in authorization, and it will eliminate any uncertainty with respect to the validity of such acts once they have been ratified in accordance with new Section 204 or approved by the Delaware Court of Chancery in accordance with new Section 205.

Ratification of a defective corporate act or an overissuance under new Section 204 will require (i) approval by the board of directors, and (ii) approval by the stockholders if a vote of stockholders would have been required either at the time the prior act occurred or at the time of the ratification. If stockholder approval is required, notice must be given to (i) all current holders of the corporation’s valid stock and “putative stock,” whether voting or non-voting, and (ii) the holders of valid stock and “putative stock,” whether voting or non-voting, as of the date of the defective corporate act to be ratified, unless such holders cannot be determined from the corporation’s records after reasonable inquiry. “Putative stock” is defined to include the shares of any class or series of capital stock of the corporation as well as shares issued upon the exercise of options, rights, warrants, or other securities convertible into shares that were created or issued pursuant to a defective corporate act that, were it not for the invalid authorization, would constitute valid stock, or that cannot be determined by the board of directors to be valid stock. In order to avoid a possible end-run around Section 203, if the invalidity of the authorization has been caused by the failure to comply with the provisions of Section 203, then stockholder approval, by the vote required by Section 203(a)(3), is required to ratify the defective corporate act regardless of whether such vote would otherwise be required (for example, because an interested stockholder has been such for three years prior to the ratification vote).

Once the applicable board and stockholder approvals are obtained, if the act would have required a filing under Section 103 of the DGCL, the corporation must file with the Delaware Secretary of State a new document that will be called a certificate of validation. The certificate of validation will provide a clear record that the corporation has engaged in a ratification process under Section 204. In addition, the corporation must provide notice of any ratification effected by the board of directors without stockholder approval to (i) all current holders of valid and putative stock, whether voting or non-voting, and (ii) all holders of valid stock and putative stock, whether voting or non-voting, as of the date of the defective corporate act to be ratified unless such holders cannot be determined from corporate records after reasonable inquiry.

A defective corporate act that is ratified in accordance with Section 204 will be fully effective, and the effectiveness of the ratification will relate back to the date the act was originally taken, unless the board of directors provides otherwise in the resolution ratifying the act or the Delaware Court of Chancery otherwise determines for good cause shown in a proceeding challenging the ratification brought in accordance with new Section 205. As more fully described below, any action under Section 205 seeking to invalidate a ratified act or seeking to impose conditions or qualifications on its validity must be commenced within 120 days of the date that notice of the ratification is provided to the stockholders (in the case of a ratification not requiring stockholder vote) or the date of the stockholders' meeting to vote upon the ratification if any. The doctrine of laches may still apply and may independently bar an application for relief under new Section 205.

It is important to note that the procedures set forth in new Sections 204 and 205 are not intended to preempt or restrict other traditionally valid means of ratifying any corporate act, including defective corporate acts, that would otherwise be voidable but not void. Accordingly, there is no obligation to follow the procedures set forth in Section 204 to ratify voidable actions. The general doctrine of ratification, as discussed in Delaware cases such as *Klig v. Deloitte LLP*, 36 A.3d 785 (Del. Ch. 2011) and *Kalageorgi v. Victor Kamkin, Inc.*, 750 A.2d 531 (Del. Ch. 1999), *aff'd*, 748 A.2d 913 (Del. 2000) (unpublished table decision), still exists. Additionally, the doctrine of stockholder ratification discussed in *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009) – that a fully informed vote of stockholders to approve director action that does not legally require stockholder approval to become effective – is still an effective method of ratification. The amendments do not modify any fiduciary duties that would apply to the decision to ratify a defective corporate act or an overissuance, which will remain subject to traditional equitable review. The amendments are intended as a remedy for the technical validity of the acts.

NEW SECTION 205

New Section 205 confers jurisdiction on the Delaware Court of Chancery to hear and determine the validity of any ratification effected pursuant to Section 204, the validity of any corporate act and any stock not ratified effectively pursuant to Section 204 (for example, by the failure to receive the required vote of stockholders), and to modify or waive any of the procedures set forth in Section 204. Section 205 also confers jurisdiction on the Delaware Court of Chancery to hear and determine the validity of any defective corporate act that a board of directors has decided not to ratify under the procedures provided in Section 204 (for example, if a board of directors chooses to rely on “classic” ratification or because there may be a series of defective acts that would be difficult to address under Section 204). This section expressly confers jurisdiction upon the Delaware Court of Chancery to address cases such as *In re Native American Energy Group, Inc.*, 2011 WL 1900142 (Del. Ch. May 19, 2011), in which the Court held it did not have jurisdiction to address the issuance by a public company of void shares.

Under Section 205, the Delaware Court of Chancery will be empowered to, among other things: (i) declare that a ratification in accordance with Section 204 is not effective or will only be effective at a specified time or upon conditions established by the Court; (ii) validate any defective corporate act or putative stock; (iii) require measures to remedy or avoid harm to any person substantially and adversely affected by a ratification; (iv) order the Delaware Secretary of State to accept an instrument for filing with an effective time specified by the Court; and (v) order that a meeting of holders of valid stock or putative stock be held. Section 205 permits the following persons or entities to apply to the Court of Chancery for relief: (i) a corporation; (ii) any successor entity to the corporation; (iii) any member of the board of directors; (iv) any record or beneficial holder of valid stock or putative stock; (v) any record or beneficial holder of valid or putative stock as of the time of a defective corporate act ratified pursuant to Section 204; or (vi) any other person claiming to be substantially and adversely affected by a ratification pursuant to Section 204.

Section 205 provides a list of factors the Delaware Court of Chancery may, but is not required to, consider. Such factors include: (i) whether the defective corporate act was originally approved with the belief that such approval was in compliance with the DGCL and the corporation's organizational documents; (ii) whether the

corporation and the board of directors have treated the defective corporate act as a valid act and whether any person has acted in reliance on the public record that such act was valid; (iii) whether any person will be or was harmed by the ratification, excluding any harm that would have resulted if the act had been valid when approved; and (iv) whether any person would be harmed by the failure to ratify the act.

Section 205 provides that any person to whom notice of ratification was given pursuant to Section 204 may bring a claim challenging such ratification within 120 days from the effective time of the validation of defective corporate act or putative stock. After such time, the ratified act or putative stock may not be invalidated or subjected to conditions in an action under Section 205. This statute of limitations does not apply to persons to whom notice was not provided as required by Section 204 or to challenges to the compliance by the corporation with Section 204 itself.

PUBLIC BENEFIT CORPORATIONS (NEW SUBCHAPTER XV AND VARIOUS CHANGES THROUGHOUT THE DGCL)

If adopted, the proposed legislation would create a new subchapter XV of the DGCL specifying the formation, management, and notice requirements for the establishment of a public benefit corporation (a “Public Benefit Corporation” or a “PBC”). While a Public Benefit Corporation is formed in a manner similar to other Delaware corporations, proposed Sections 361 and 362 of the new subchapter provide additional formation mechanics specific to PBCs. Specifically, in light of the expectation that a PBC will produce a public benefit and operate in a “responsible and sustainable manner,” Section 362(a) states that the certificate of incorporation of a PBC must (i) identify within its statement of business or purpose in accordance with DGCL Section 102(a)(3) one or more specific public benefits to be promoted by the corporation, and (ii) state within the heading of the certificate of incorporation that it is a public benefit corporation.³ Section 362(c) further provides that the name of a public benefit corporation must contain the words “public benefit corporation,” the abbreviation “P.B.C.” or the designation “PBC.” To ensure that stockholders of a PBC are aware of the corporation’s status under the DGCL, Section 364 requires any stock certificate issued by a Public Benefit Corporation, as well as any notice provided to stockholders pursuant to Section 151(f), to note “conspicuously” that the corporation is a PBC. Section 366(a) further requires that a Public Benefit Corporation include in every notice of a stockholder meeting a statement affirming that the corporation is a PBC formed pursuant to Subchapter XV of the DGCL.

With respect to the fiduciary duties of the board of directors of a Public Benefit Corporation, proposed Section 365(a) specifies that, in managing the PBC, directors are required to engage in a three-part balancing test weighing (i) the financial interests of the corporation’s stockholders, (ii) the best interests of parties materially affected by the corporation’s conduct, and (iii) the public benefit or benefits specified in the PBC’s certificate of incorporation. To address concerns about the exposure to liability of directors who engage in this balancing, the new statute provides that a director is deemed to satisfy his or her fiduciary duties to the stockholders and to the PBC if the board’s decision is informed and disinterested. In addition, the certificate of incorporation of a Public Benefit Corporation may include a provision stating that any disinterested failure to satisfy the tripartite balancing test outlined in Section 365(a) will not, with respect to Section 102(b)(7) or Section 145 of the DGCL, be viewed either as a breach of a director’s fiduciary duty of loyalty or as an act taken in bad faith.

Although the directors of a PBC are required to balance the interests of various constituencies, Section 365(b) and (c) limits the parties eligible to bring derivative claims to enforce a Public Benefit Corporation’s benefit provisions to the PBC’s stockholders. In addition, given the unique nature of a PBC, proposed Section 368 provides that, in order to have standing to bring a derivative suit, a stockholder must own, individually or collectively as of the date the suit is filed, at least two percent of the corporation’s outstanding shares or, if the

³ Section 362(b) defines the term “public benefit” 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 capacity as stockholders) including, but not limited to, effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific, or technological nature.”

PBC has shares listed on a national securities exchange, the lesser of such percentage of shares or at least two million dollars in market value of stock.

To permit stockholders to monitor the compliance by the board of directors of a Public Benefit Corporation with the terms specified in its certificate of incorporation, proposed Section 366(b) requires a PBC to furnish to stockholders at least biennially a statement outlining the corporation's promotion of (i) the public benefit or benefits specified in the certificate of incorporation and (ii) the best interests of the parties materially affected by the PBC's conduct. Section 366(b) also requires the biennial statement to contain (i) the objectives established by the board of directors to achieve the public benefit, (ii) standards the board has adopted in order to measure the corporation's progress in promoting the relevant public benefit specified, (iii) "objective factual information" based on such standards regarding the corporation's efforts to achieve the public benefit specified, and (iv) an assessment of the corporation's success in meeting its objectives and promoting the relevant public benefit. Importantly, the certificate of incorporation or bylaws of a Public Benefit Corporation may require the corporation to provide the statement contemplated by Section 366(b) more frequently than biennially, to make the statement public and/or to secure periodic third party certification addressing the corporation's promotion of the public benefit identified in the certificate of incorporation and/or the best interests of those materially affected by the corporation's conduct.

Finally, the new Subchapter XV addresses the stockholder vote required to alter the status of a non-PBC corporation or for an existing Public Benefit Corporation to assume non-PBC status. Recognizing the unique attributes of a PBC, Section 363(a) requires a vote of ninety percent (90%) of the outstanding shares of each class of stock (whether voting or non-voting) to (i) amend the corporation's certificate of incorporation in a manner that causes the corporation to become a PBC, or (ii) merge with another entity if, as a result of the merger, the shares of the corporation would be converted into or exchanged for shares in a Public Benefit Corporation. Importantly, Section 363(b) provides that any stockholder of an existing Delaware corporation who fails to vote in favor of an amendment to the certificate of incorporation or to a merger pursuant to which the stockholder would hold shares of a PBC is entitled to seek an appraisal of the fair value of its shares in accordance with Section 262 of the DGCL, thus permitting such holders to cash out of the new PBC. In addition, Section 363(c) requires a two-thirds vote of the outstanding shares of each class of stock (whether voting or non-voting) of a Public Benefit Corporation to (i) amend the certificate of incorporation in a manner that causes the corporation to lose its status as a PBC, or (ii) merge with another entity if, as a result of the merger, the shares of the corporation would be converted into or exchanged for shares of a corporation that is not a Public Benefit Corporation.

In light of the proposed addition of the new Subchapter XV, Section 262 of the DGCL was revised to reflect that appraisal rights are available to stockholders who comply with the relevant statutory requirements in accordance with Section 362(b). Conforming amendments have also been proposed to Sections 114(b)(2), 114(b)(3) and 114(c)(3) of the DGCL, which discuss nonstock corporations, and certain DGCL chapters were re-designated and appropriate cross-references in the DGCL were revised.

AMENDMENTS TO ADDRESS "AGED CORPORATIONS" (SECTIONS 114(A), 312(B) AND 502(A))

The proposed legislation would revise three sections of the DGCL to deter the practice of forming "shelf" corporations that have no stockholders or directors and take no substantive action with respect to the management of the corporation for the sole purpose of creating an "aged corporation" that will eventually be acquired or revived several years in the future. Specifically, Section 502 of the DGCL as amended states that the annual report of a corporation, other than its initial report, must be signed by a director or officer, and states that the renewal or revival of a Delaware corporation must be approved by the corporation's board of directors or by its stockholders. In addition, Section 312(b), as amended, clarifies that the requirement for a certificate of renewal or revival to be filed with the authorization of a corporation's board of directors as specified in Section 312(d) represents a statutory condition under the DGCL.

ADDITIONAL AMENDMENTS

The proposed legislative package also contains additional changes of a “clean-up” or clarification nature. Chief among these is a change to Section 152 that expressly permits the board of directors of a Delaware corporation to determine the amount of consideration by using a formula. This will facilitate pricing of securities issuances “at the market.” In addition, proposed amendments to Section 114, the so-called “translator” provision for nonstock corporations, contain conforming changes to reflect the changes to Sections 312 (a) and 502, as well as the proposed addition of Subchapter XV. A number of the merger-related provisions were also amended to eliminate reference to the “force the vote” provisions of Section 251 that have been removed following the adoption of Section 146.

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