

**Working Group on Legal Opinions  
DGCL Amendments**

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# Overview

- **Legislation; Status.** The Corporation Law Council of the Delaware State Bar Association prepared a bill to amend the DGCL. Practitioners anticipate that the Bill will be adopted by the General Assembly in June/July and then submitted for approval by the Governor.
- **Summary.** The amendments:
  - Eliminate the date of signature requirement for stockholder consents.
  - Facilitate the use of distributed ledger/block chain technology.
  - Clarify the mechanics for opting out of, or opting into, the Section 203 restrictions on business combinations with interested stockholders.
  - Enact technical improvements to the merger and consolidation statutes.
  - Enact changes to the information required for annual reports filed with the Delaware Secretary of State (which will not be covered today).
- **Related Developments.** We will also discuss recent developments on:
  - Ratifying defective corporate acts under Sections 204 and 205.
  - The mandatory redemption of preferred stock.
  - M&A appraisal actions.

# Stockholder Consents: Overview

- Section 228 permits stockholders to act without a meeting and without prior notice if the holders of the required number of shares take the action by consent.
- The proposed amendments to Section 228 would delete the requirement that a consent bear the date of the stockholder's signature.
- Under current Section 228, the earliest date of signature on a consent starts a 60-day clock for consents to be delivered. That is, a consent is only valid if delivered within 60 days of the earliest dated consent delivered to the corporation.
- The amendments would (i) delete the dating requirement and (ii) provide that the 60-day clock for delivering consents starts on the date that the first consent is delivered to the corporation in the manner required by Section 228.

# Reasons to Eliminate the Date of Signature Requirement

- Practitioners often encounter stockholder consents that are not dated or have a pre-printed “as of” date.
- In *H-M Wexford LLC v. Encorp, Inc.*, the Delaware Court of Chancery stated that, even if facts showed that all consents are delivered within a 60-day period, an undated consent is invalid.
- The Delaware courts have struggled with whether a signature dated “as of” a pre-printed date will satisfy the date of signature requirement.
  - Stockholder signs a consent on a date different from the “as of” date. The consent is likely invalid. *H-M Wexford LLC v. Encorp, Inc.*
  - Sole stockholder signs a consent with a testimonial clause referencing signature “as of” a pre-printed date on the consent. The consent is likely valid if the facts demonstrate the stockholder signed on that date. *Ravenswood Investment Co., L.P. v. Winmill.*
  - Stockholder signs a letter (allegedly intended to serve as a consent) that has no “as of” testimonial clause tying the signature to the date on the first page of the letter. The consent is likely invalid. *Viamericas Corp. v. Microvest I, L.P.* (transcript).

# Rules on Stockholder Consents Post-Amendment

- Amended Section 228 will continue to provide an anti-staleness requirement: consents must be delivered within 60 days of the date of delivery of the first consent.
- The pre-amendment and post-amendment 60-day clock can be sidestepped by soliciting proxies to act by written consent, but the consenting stockholders (including proxy givers) must own the stock as of the record date for the written consent action, per Section 213(b).
- These amendments only apply prospectively, to stockholder consents having a record date on or after August 1, 2017.

# Related Reminders for Stockholder Consents

- Although the rules will change, the courts will likely continue to require strict observance of Section 228.
- Consents should clearly set forth the action being taken, and, when soliciting consents, stockholders should be provided copies of the documents being approved by consent and the attachments referenced in the consent.
  - E.g., if the text of a charter amendment is not provided to a stockholder purportedly consenting to the amendment, then the consent might not be valid. *Carsanaro v. Bloodhound Technologies, Inc.*
- Under Section 228(d), consents may be given by electronic transmission, but the transmission must be printed and delivered in paper form unless the Board has adopted resolutions providing for a different method of delivery.
- Don't forget to send the notice required by Section 228(e) to non-consenting stockholders.
- Check the charter for restrictions or prohibitions on action by consent.
- Check the bylaws for any procedural requirements.

# Amendments for Distributed Ledger / Block Chain

- The proposed amendments would enact a series of changes to the DGCL intended as a first step to facilitate the use of distributed ledger (or block chain) technology.
- Distributed ledger technology includes creating an immutable decentralized shared ledger of transactions across a peer-to-peer network that uses a proof of work chain to validate the data via a consensus algorithm.
- Use of distributed ledger technology may enable issuers to create a more trustworthy record of share transfers (and other actions like voting stock by proxy) through the use of the networks.
  - This technology could enable beneficial owners to hold their stock directly rather than through an intermediary.
  - The use of this type of network has the potential to minimize “back-office” problems: erroneous share transfers, over-issuances, shares voted contrary to owner’s instructions.
- The DGCL amendments facilitate distributed ledger technology by allowing a stock ledger to be maintained on a network and by permitting notice of actions to be given by electronic transmission.

# Amendments for Distributed Ledger / Block Chain

Among the changes:

- Amended Section 224 will allow for the stock ledger and other books and records to be administered “on behalf of the corporation” (such as by a distributed ledger service provider) and on “one or more electronic networks or databases (including one or more distributed electronic networks or databases).”
- Any electronic network or database used to maintain a stock ledger must allow for (i) the stocklist to be prepared as required by Sections 219 and 220, (ii) recording stock transfers as governed by the Delaware UCC, (iii) recording the information required by Sections 156 (balance to be paid by stockholder for partly-paid shares), 159 (share transfers for collateral security), 217(a) (notation for pledgor of stock to vote the same) and 218 (shares subject to a DGCL statutory voting trust).
- A new Section 219(c) will define “stock ledger” as “one or more records administered by or on behalf of the corporation in which the names of all of the corporation’s stockholders of record, the address and number of shares registered in the name of each such stockholder, and all issuances and transfers of stock of the corporation are recorded” in accordance with Section 224.
- Amended Sections 151(f) and 202 will clarify that certain notices that must be given about stock terms and transfer restrictions may be given by electronic transmission.



# Amendments for Distributed Ledger / Block Chain

- The amendments are a first step to facilitate distributed ledger / block chain technology.
- Additional amendments (including to the UCC) may be necessary to further enable this technology.
- For example, there are potential issues with the electronic transfer of certificated shares.
  - Section 8-301(a) of the Delaware UCC requires a purchaser or intermediary to take possession of the certificate representing a certificated share to deliver the share in connection with a transfer.
  - Under Section 158 of the DGCL, a holder of a certificated share is entitled to retain the certificate until the certificate is surrendered (e.g., for transfer).

# Amendments to the Business Combination Statute

- Section 203 imposes restrictions on business combinations between a corporation and interested stockholders (e.g., 15% or more stockholders).
- Section 203 applies to corporations with stock listed on a national securities exchange or with stock held by more than 2,000 record stockholders.
- A corporation may opt out of the Section 203 restrictions by a charter provision or by a stockholder-adopted bylaw.
- Under pre-amendment Section 203, there is some uncertainty about when a charter opt-out is considered adopted.
  - A charter amendment memorializing an opt-out must be filed with the Delaware Secretary of State.
  - The opt-out could be considered adopted either when the stockholders approve the charter provision or the later time when the Delaware Secretary of State filing becomes effective.
- Post-amendment Section 203 clarifies that a charter opt-out is effectively considered adopted when the Delaware Secretary of State filing is effective.
- Amended Section 203 retains the 12-month waiting period and other limits on the effectiveness of an opt-out. Specifically:
  - For a corporation that is listed or widely held (as described above), and for corporations replacing an opt-in provision with an opt-out provision, the corporation will continue to be governed by the Section 203 restrictions until 12 months after the Delaware Secretary of State filing becomes effective.
  - For any corporation adopting an opt-out, the restrictions on business combinations will still apply to any interested stockholder subject to the Section 203 restrictions before the opt-out is considered adopted.

# Amendments to the Business Combination Statute

- The final sentence of Section 203(b) permits a corporation that does not have listed or widely held stock to opt-in to the business combination restrictions by charter provision.
- An opt-in provision does not apply to someone who became an interested stockholder before the provision becomes effective.
- Amended Section 203(b) clarifies that the opt-in provision does not apply to anyone who became an interested stockholder before the effectiveness of the Delaware Secretary of State filing containing the opt-in provision.

# Amendments on Mergers and Consolidations

The amendments will enact a series of technical changes to the statutes on mergers and consolidations (Sections 251-267).

- The amendments will permit mergers of Delaware corporations with joint-stock or other associations, limited liability companies and partnerships formed or organized under the laws of a non-US jurisdiction.
- The amended statutes will use the term “foreign corporation” (as defined in Section 371(a)) to refer consistently to mergers with a corporation organized under the laws of any jurisdiction other than the State of Delaware.
- The amendments will clarify how membership interests in a non-stock corporation may be treated in a merger.
- Each of the statutes on mergers and consolidations involving Delaware corporations and non-Delaware entities will provide that mergers and consolidations are permitted so long as the laws of the applicable non-Delaware jurisdictions do not prohibit the transaction. These amendments would change provisions that permitted mergers and consolidations under Delaware law only if the applicable non-Delaware law “permitted” the transaction.

# Ratification of Defective Acts: *View, Inc.*

- Last week the Delaware Court of Chancery issued an opinion in *Nguyen v. View, Inc.*
- At issue was the attempted ratification of charter amendments and other corporate actions to create and issue several rounds of preferred stock.
- The validity of the preferred stock rounds were called into question because an early round, effected in 2009, required a class vote of common stockholders.
  - A founding common stockholder, who owned a majority of the common stock, at first consented to the corporate actions but later revoked his consent. The corporation proceeded with the financing notwithstanding the revocation.
  - An arbitrator upheld the revocation of consent.
- The corporation relied on Section 204 to ratify the prior corporate acts. To obtain the common stockholder vote for the ratification, holders of valid preferred stock converted shares into common stock to ensure approval of the ratification.
- The Court held that the acts in question could not be ratified because, at the time of the initial vote in 2009, the common stockholders “expressly” and “deliberately” rejected the actions.

# Redemption of Preferred Stock: *ODN Holding Corporation*

- In *Hsu Living Trust v. ODN Holding Corp.*, the Delaware Court of Chancery recently revisited the requirements for redeeming preferred stock and addressed fiduciary duty claims in connection with a sale of assets to satisfy a redemption obligation.
- The corporation was a tech company with four business lines and started out with an aggressive growth strategy.
- Oak Hill bought preferred stock in 2008 in exchange for \$150 million.
  - The preferred had a mandatory put feature, allowing Oak Hill to require redemption of its stock starting in 2013.
  - Preferred stock terms permitted redemption only out of funds legally available.
  - Preferred stock terms provided that, if the corporation lacked sufficient cash to satisfy the redemption obligation:

“The Company shall take all reasonable actions (as determined by the [Board]) in good faith and consistent with its fiduciary duties to generate. . . sufficient legally available funds ... including by way of incurrence of indebtedness, issuance of equity, sale of assets, effecting a [merger] ... or otherwise.”
- Oak Hill acquired a majority of the common stock in 2009 and was alleged to be the corporation’s controlling stockholder thereafter.
- After taking control, Oak Hill allegedly caused the Board to sell most of the corporation’s assets, to collect cash to satisfy the future redemption obligation. The corporation sold three of its four business lines and sold a significant part of the remaining business line. The sales resulted in a 90-plus% reduction in revenue.
  - Some assets were sold for a fraction of what the corporation paid for the assets a few years earlier.
  - Top managers were given compensation agreements providing bonuses if the corporation redeemed \$75 million in value of the preferred stock.
  - A majority of the board was allegedly conflicted: a minority of the board was affiliated with Oak Hill, and certain other directors were either company management or had softer ties with Oak Hill.

# Redemption of Preferred Stock: *ODN Holding Corporation*

- The Court first held that the corporation had sufficient funds legally available to redeem the preferred stock.
- Summarizing earlier cases, the Court noted that, to redeem the preferred stock:
  - the corporation needed sufficient surplus, as required by Section 160 (i.e., net assets minus statutory capital equaled a sum greater than or equal to the cash used for redemption); and
  - the corporation had to satisfy common law requirements that, following the redemption, the corporation would be able to pay its debts as they became due and the corporation would be able to continue as a going concern (i.e., be left with “sufficient resources to operate for the foreseeable future”).
- The Court rejected an argument that, for purposes of the surplus test, the redemption amount owed to the preferred stock should be counted as a liability.
- The Court held that, for purposes of determining whether there were funds legally available for redemption, the corporation could sell off business lines, so long as the remaining business line remained a viable going concern.

*“The Complaint also does not support a reasonable inference that the redemptions left the Company without sufficient resources to operate for the foreseeable future. ... The Complaint describes an entity that was a shadow of its former self, with one partial line of business where it used to have four. The Company generated less revenue; it also had fewer employees and a smaller operational footprint. Given the Company's reduced state, the Complaint does not support a reasonable inference that the Company could not continue to operate. Whether Oak Hill and the individual defendants acted loyally by stockpiling cash, selling off businesses, and using the proceeds to make redemptions is an issue that will be evaluated in equity, not at law.”*

# Redemption of Preferred Stock: *ODN Holding Corporation*

- The Court held that the plaintiff pleaded claims, surviving a motion to dismiss, that the corporation's directors and controlling stockholder might have breached duties to the common stockholders by selling assets to satisfy the redemption obligation.
- The directors owed a duty to advance the best interests of the "stockholders in the aggregate in their capacity as residual claimants, which means the undifferentiated equity as a collective."
- Although the directors were constrained by the corporation's redemption obligation, the directors still owed a duty to evaluate the corporation's alternatives within that constraint.

*"The Complaint asserts that the Board acted disloyally by selling businesses to raise cash to satisfy a future redemption obligation **before there was any contractual obligation to redeem the Preferred Stock.** The Complaint contends that if the Board had retained those businesses, they would have generated greater long-term value for the benefit of the undifferentiated equity."*

- The Court also specifically noted that the redemption provisions contemplated that the Board's duty to sell assets and otherwise make funds available for redemption was subject to the Board's fiduciary duties:

*"After the Redemption Right ripened, if the Board had sold businesses to raise funds to redeem the Preferred Stock in a manner that compromised the Company's ability to generate long-term value for the benefit of the undifferentiated equity, then the Redemption Provisions themselves recognize that a plaintiff could assert a claim for breach of fiduciary duty. A comparable legal framework applies to actions that the Board took before the Redemption Right ripened."*



# Redemption of Preferred Stock: *ODN Holding Corporation*

- The Court held that the plaintiff pleaded sufficient facts to call into question the independence of a majority of the directors and sufficiently alleged that Oak Hill used its power as a controlling stockholder to cause the corporation to take action to benefit Oak Hill at the expense of the other stockholders. Accordingly, the Court might ultimately apply the entire fairness test to the Board's actions.

*“The Redemption Provisions did not require that the Company effectively liquidate itself. That [the outside directors] repeatedly took steps to benefit Oak Hill as if it were a secured creditor supports a reasonable inference that they acted to maximize the value of Oak Hill’s Redemption Right rather than the long-term value of the Company for the benefit of the undifferentiated equity.”*

- In assessing the fairness of the Board's decisions to sell assets to satisfy the redemption obligation, the Court specifically noted that Oak Hill's preferred stock did not carry a cumulative dividend after the redemption right matured. If there were a continuing cumulative dividend, “the common stock may be functionally worthless, because the company can never realistically generate a sufficient return to pay off the preferred stockholders and yield value for the common.”

# Appraisal Litigation Developments

Recent opinions from the Court of Chancery have been divided on whether deal price is indicative of fair value in appraisal proceedings:

- *In re Appraisal of Dell, Inc.*: Relied on discounted cash flow analysis where, among other things, deal structured as an MBO and company only performed a limited pre-signing market check.
- *In re Appraisal of DFC Global Corp.*: Declined to rely exclusively on deal price where company's performance was "in a trough" due to acute regulatory uncertainty.
- *Dunmire v. Farmers & Merchants Bancorp of W. Pa., Inc.*: Relied on discounted net income analysis where, among other things, one family controlled both buyer and seller and there was no sales process.
- *Merion Capital L.P. v. Lender Processing Servs., Inc.*: Deferred to deal price where sales process involved a reasonable number of "heterogeneous" bidders to create meaningful competition .
- *In re Appraisal of PetSmart, Inc.*: Deferred to deal price where there was a "robust" sales process and management's projections were unreliable.
- *In re Appraisal of SWS Group, Inc.*: Relied on discounted cash flow analysis where there was a "problematic [sale] process" and buyer had partial veto right over other transactions, but because of synergies arising from merger, fair value award was less than the deal price.

# Appraisal of Preferred Stock

- In a decision issued last week, *In re Appraisal of GoodCents Holdings, Inc.*, the Delaware Court of Chancery discussed the interplay between preferred stock terms and what holders of preferred stock and common stock are entitled to in an appraisal.
- GoodCents entered into a merger transaction that provided the preferred stockholders all of the merger proceeds and cancelled the common stock for no consideration.
- The merger consideration was less than the liquidation preference of the preferred stock.
- A former common stockholder brought an appraisal action under Section 262, arguing that, for purposes of the appraisal, the holders of common stock and preferred stock should be treated pro rata, with the preferred stock entitled to consideration on an as-converted-to-common basis.
- The preferred stock terms provided:
  - “Without the affirmative vote of the holders of a majority of the Series 1 Cumulative Convertible Preferred Stock, [GoodCents] shall not ... effect any merger or consolidation ... unless the agreement or plan of merger ... shall provide that the consideration payable to the stockholders of [GoodCents]... shall be distributed to the holders of capital stock of [GoodCents] in accordance with [the waterfall provisions specifying (among other things) that, in a liquidation or dissolution, the preferred stock was entitled to receive the greater of (i) its original issue price plus accrued dividends and (ii) an amount distributed on an as-converted-to-common-stock basis].”
- The Court interpreted this provision as granting the preferred stockholders a voting right “but not a right to the Liquidation Preference” in the case of a merger and held that the former common stockholders seeking appraisal were entitled to their proportionate share of the fair value of GoodCents considering the preferred stock on an as-converted basis.
- The Court relied on a 1997 decision from the Delaware Court of Chancery, *In the Matter of Appraisal of Ford Holdings, Inc. Preferred Stock*. In *Ford Holdings*, the Court was asked to determine whether the language at issue effectively capped the amount of merger consideration that the preferred stockholders were entitled to in the appraisal proceeding.