Recent Amendments to the DGCL Affect Appraisal Rights, Mergers and the Chancery Court's Jurisdiction

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On June 16, 2016, House Bill 317 was signed into law by Delaware Governor Jack Markell providing significant changes to the Delaware General Corporation Law (DGCL). The new amendments clarify the requirements relating to so-called "intermediate-form" mergers under Section 251(h) of the DGCL, modify certain provisions of Section 262 of the DGCL governing appraisal rights, and expand the jurisdiction of the Delaware Court of Chancery under Section 111 of the DGCL. The amendments will generally become effective on August 1, 2016.

APPRAISAL RIGHTS – SECTION 262

One of the primary goals of the changes with respect to appraisal rights is to respond to the growing rise in the practice of hedge funds and others acquiring shares in merging companies solely for the purpose of initiating the appraisal rights process. The amendment is intended to prevent stockholders from seeking appraisal in "nuisance" cases where the number or value of shares is minimal and the purpose of the proceeding is solely or primarily to obtain a settlement from the corporation. In such situations, a corporation is more likely to make a settlement payment to avoid the litigation costs and distractions caused by the appraisal proceeding.

To implement these changes, the amendments to Section 262(g) of the DGCL establish a de minimis exception to the general rule that permits stockholders of a corporation to exercise appraisal rights in certain merger transactions. Under this new framework, the Court of Chancery must now dismiss an appraisal proceeding as to all stockholders otherwise entitled to appraisal rights, unless (1) the total number of shares entitled to appraisal exceeds 1% of the outstanding shares of the class or series eligible for appraisal; (2) the value of the consideration provided in the transaction for the total number of shares entitled to appraisal exceeds $1M; or (3) the merger is a short-form merger approved under Section 253 or 267 of the DGCL. Importantly, the de minimis exception only applies to companies that are listed on a national securities exchange prior to the merger.

In addition, the newly adopted amendments to Section 262(h) of the DGCL permit a surviving corporation in a merger to pay stockholders (that are entitled to an appraisal payment) prior to the entry of a judgment regarding fair value in an appraisal proceeding. This is a potentially significant change since prior to the amendments, Section 262(h) provided that unless the Court of Chancery determines otherwise for good cause shown, interest on the amount that is determined to be the "fair value" of appraisal shares accrues from the date of the merger through the date of payment of judgment, at a rate of 5% over the Federal Reserve discount rate, compounded quarterly. Although companies were previously permitted to propose various arrangements with appraisal petitioners, there was not a mechanism to force appraisal petitioners to accept such a payment.

Similar to the changes to Section 262(g), this amendment to Section 262(h) is intended to address the rise in appraisal actions over the past five years for the purpose of "appraisal arbitrage," where stockholders buy up shares with appraisal rights after a merger is announced solely for the purpose of seeking an appraisal award, including a significant interest component. Although it is not entirely clear whether the statutory interest provisions have played a role in increasing these actions, various studies and commenters on the subject do believe that it has been a factor. As a result, this change provides surviving corporations the ability to limit the accrual of statutory interest on appraisal awards by making early payments to stockholders seeking appraisal rights at any time before the entry of judgment in the appraisal proceeding. After making any such payments, interest would only accrue upon the sum of (i) the difference, if any, between the amount previously paid and the fair value of the shares as determined in the appraisal proceeding, and (2) any interest accrued at the time of payment, unless paid at such time.

MERGERS – SECTION 251(H)

Section 251(h) of the DGCL was adopted in 2013 to eliminate the stockholder approval requirements on certain back-end mergers following a tender offer or exchange offer. The statutory framework provides that unless expressly required by the certificate of incorporation (and so long as certain other requirements are met), a vote of the target's stockholders is not required if such shares are listed on a national securities exchange or held by more than 2,000 holders immediately prior to the execution of the merger agreement. The new amendments to Section 251(h) expand the availability of this structure to certain buyers and target entities and clarify certain items in the following manner:

- permits a target corporation to take advantage of Section 251(h) if any class or series of stock is listed on a national securities exchange or held of record by more than 2,000 holders (i.e., not all classes or series need to be listed or held);
- for purposes of determining whether the offeror has acquired, in accordance with the statute, enough of the target corporation's stock to adopt the merger agreement, it may include certain shares held by any person that owns, directly or indirectly, all of the outstanding stock of the offeror or that is a direct or indirect wholly owned subsidiary of such person or of the offeror (an "offeror affiliate") and "rollover stock" that is transferred, contributed or delivered to the offeror or an offeror affiliate in exchange for equity interests in the offeror or any offeror affiliate;
- clarifies, for purposes of determining whether minimum tender conditions have been satisfied, that certificated shares are deemed received when physically received together with an executed transmittal letter and uncertificated shares are deemed received if (1) held by a clearing corporation as nominee, when transferred into the depository's account by means of an agent's message; (2) if not held by a clearing corporation, on physical receipt of an executed letter of transmittal by the depository; (3) in both cases above, as long as the shares have not been reduced or eliminated as a result of a sale of the shares before the closing.

JURISDICTION – SECTION 111

Section 111 of the DGCL provides that the Delaware Court of Chancery has jurisdiction over any civil action to interpret, apply, enforce or determine the validity of any provision of certain documents enumerated in the statute. The new amendments expand the Delaware Court of Chancery's jurisdiction over certain matters. Specifically, the amendment expands Section 111 to include any instrument, document or agreement (1) to which a corporation and one or more holders of its stock are parties, and pursuant to which any such holder or holders sell or offer to sell any of such stock or

(2) by which a corporation agrees to sell, lease or exchange any of its property or assets, and which by its terms provides that one or more holders of its stock approve of or consent to such sale, lease or exchange.

ADDITIONAL CHANGES

In addition to the above, the 2016 amendments to the DGCL also include certain other technical changes. Section 158 of the DGCL was amended to reflect changes in practice. In recognition of the fact that corporations may use differing titles with respect to officers and that some historical titles like "treasurer" are no longer commonly used (e.g. a corporation may have a CEO and not a President or a CFO and not a Treasurer), Section 158 will now provide that any two officers of the corporation who are authorized to do so may execute stock certificates.

Section 141 of the DGCL, relating to committees of the Board of Directors, was amended to specify default quorum and voting requirements of committees and subcommittees. Under the 2016 amendments, the default rule is that a majority of directors serving on a committee or subcommittee constitutes a quorum of such committee unless modified in the corporation's certificate of incorporation, bylaws or by resolution. However, in no event may a quorum be set at less than one-third of the directors serving on such committee. Similarly, the amendments clarify that the vote of a majority of the members of a committee or subcommittee present at a meeting at which a quorum is present shall be the act of the committee, unless modified in the corporation's certificate of incorporation, bylaws, or by resolution requiring a greater number.

Finally, Sections 311 and 312 of the DGCL were amended to clarify procedures relating to revoking dissolution and restoring or reviving a certificate of incorporation. Specifically, Section 311 of the DGCL was amended to provide a procedure to restore a corporation's certificate of incorporation in the event that the certificate provides for a time limit for the corporation's existence that has passed. In the event the corporation restores its certificate of incorporation, the corporation must then file all annual franchise tax reports and pay all franchise taxes that it would have had to file or pay had the corporation's certificate of incorporation not expired. In addition, Section 312 of the DGCL was revised to clarify that it applies to situations where the corporation's certificate of incorporation has been forfeited or becomes void. Accordingly, Section 312 was revised to only use the term "revival" (instead of renewal, extension and restoration) to reflect the process for reviving a corporation after its certificate has become forfeited or void. Importantly, the 2016 amendments provide that a majority of the Board of Directors then in office may authorize the revival of the corporation's certificate of incorporation by filing a certificate of revival.

If you have questions about how these changes may affect your business or would like additional information, please contact Marc Casarino (casarinom@whiteandwilliams.com; 302.467.4520), Lori Smith (smithl@whiteandwilliams.com; 212.714.3075), Michael Psathas (psathasm@whiteandwilliams.com; 212.868.4833) or another member of our Corporate and Securities Group.