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2015 Amendments to Delaware's General Corporation Law, LLC Act and DRUPA

Navigating Changes to Fee Shifting, Forum Selection, Stock and Option Issuances, Default LLC and LP Voting Requirements, and More

WEDNESDAY, SEPTEMBER 30, 2015

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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RICHARDS LAYTON & FINGER

Amendments to the General Corporation Law of the State of Delaware: Fee-Shifting and Forum Selection Provisions

September 30, 2015

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Fee Shifting Provisions

Fee-Shifting Provisions – In General

- Fee-shifting provisions impose liability for certain legal fees of the corporation on certain members or stockholders of the corporation who participate in unsuccessful litigation against the corporation.

- A typical stock corporation fee-shifting provision reads as follows:

  "Notwithstanding anything in this Certificate of Incorporation to the contrary, to the fullest extent permitted by law, in the event that (i) any current or prior stockholder or anyone on their behalf (a "Claiming Party") initiates any action, suit or proceeding, whether civil, criminal, administrative or investigative or asserts any claim or counterclaim (each, a "Claim") or joins, offers substantial assistance to or has a direct financial interest in any Claim against the Corporation (including any Claim purportedly filed on behalf of any other stockholder) and/or any director, officer, employee or affiliate thereof (each, a "Company Party"), and (ii) the Claiming Party (or the third party that received substantial assistance from the Claiming Party or in whose Claim the Claiming Party had a direct financial interest) does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought, then each Claiming Party shall be obligated jointly and severally to reimburse the applicable Company Party for all fees, costs and expenses of every kind and description (including, but not limited to, all reasonable attorneys' fees and other litigation expenses) that the applicable Company Party may incur in connection with such Claim."

Fee-Shifting Provisions – The *ATP* Decision

- Fee-shifting provisions garnered wide-spread publicity last year as a result of the Delaware Supreme Court's opinion in *ATP Tours, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014).

- In the *ATP* opinion, the Supreme Court upheld as facially valid a fee-shifting provision contained in the bylaws of a Delaware *nonstock* corporation.

- Although the Supreme Court upheld the fee-shifting provision at issue as facially valid, it stated that the enforceability of such a provision was a factual question. In that connection, the Court held that a fee-shifting bylaw may be enforced only if adopted by the appropriate corporate procedures and for a proper corporate purpose.

- Following the *ATP* decision, many Delaware stock corporations began contemplating the adoption of a fee-shifting provision.

Fee-Shifting Provisions – Response of the Delaware Bar

- In response to the *ATP* decision, the Corporation Law Council of the Delaware State Bar Association recommended legislation to the Delaware General Assembly in late 2014 that would have limited the holding of *ATP* to nonstock corporations and invalidated fee-shifting provisions in stock corporations.

- The proposed legislation was met with unprecedented lobbying from within and outside the State both for and against the proposed legislation.

- The General Assembly responded by approving a non-binding resolution, Senate Joint Resolution 12, which called on the Delaware Bar to "continue its ongoing examination…with an eye toward maintaining balance, efficiency, fairness and predictability" and directed the Delaware Bar to resubmit legislation in the 2015 session.

Fee-Shifting Provisions – Adoption by Stock Corporations

- Following the Delaware Supreme Court's decision in *ATP* and while the Delaware Bar and the General Assembly were considering the issue, a limited number of public *stock* corporations (most of which are thinly-traded and low visibility corporations) adopted a fee-shifting charter or bylaw provision.

- For example, the following public Delaware stock corporation adopted a fee-shifting charter or bylaw provision:

Biolase, Inc.	Cadista Holdings, Inc.	LGL Group, Inc.
Echo Therapeutics	Cogent Communications, Inc.	Cryo-Cell Int'l Inc.
GAMCO Investors	First Aviation Services, Inc.	Lannett Company
Fresh Pet, Inc.	Portfolio Recovery Associates	ATD Corporation
Townsquare Media	Smart & Final Stores, Inc.	Bridgeline Digital
KLX Inc.	Insys Therapeutics, Inc.	GWG Holding, Inc.
Magnolia Holdings	Juno Therapeutics, Inc.	Iradimed Corp.
Barnwell Industries	Hemispherx Biopharma	Riverbed Technology
Frequency Electronics		

Fee-Shifting Provisions – Litigation Filed

- The adoption of fee-shifting provisions resulted in the filing of several lawsuits in the Delaware Court of Chancery. None of these cases, however, resolved the issue of the validity of a fee-shifting provision in the governing documents of a stock corporation.
  - *Pignatelli v. Biolase Inc.*, C.A. No. 9920 – VCN (filed July 21, 2014) - involved a suit by a stockholder seeking a court order that his slate be included in the proxy statement of Biolase Inc. The complaint also included a claim relating to the adoption of a fee-shifting provision by Biolase. After plaintiff's motion to expedite with regard to plaintiff's slate of directors was denied, plaintiff voluntarily dismissed the claims without consideration by the Court of the fee-shifting provision at issue.
  - *Kastis v. Carter*, C.A. No. 8657-CB (filed June 18, 2013) – an existing stockholder suit was amended seeking to invalidate a fee-shifting bylaw that was adopted by Hemispherx Biopharma after the original suit was filed and which purported to apply retroactively to the lawsuit. Hemispherx agreed not to apply the bylaw to the litigation, and the validity of the bylaw was not addressed by the Court.
  - *Strougo v. Hollander*, C.A. No. 9770-CB (filed June 16, 2014) – involved a stockholder suit filed as a result of the adoption of a fee-shifting bylaw by First Aviation, four days after the board approved a reverse stock split that squeezed out the minority stockholders. Without ruling on the overall validity of the fee-shifting provision, the Court found that the provision did not apply to the stockholder litigation at issue because it was adopted after the stockholders were squeezed out in the reverse stock split and a bylaw cannot regulate the conduct of a corporation's former stockholders.

Fee-Shifting Provisions – Proxy Advisory Firms Weigh In

- Following the adoption of fee-shifting provisions by several public stock corporations, Institutional Shareholder Services ("ISS") and Glass, Lewis & Co., LLC ("Glass Lewis") took negative positions regarding the adoption of such provisions.
  - ISS recommends that stockholders vote against a proposal to adopt a fee-shifting bylaw and generally recommends a vote against the election of the board of directors if the corporation's bylaws are amended to include a fee-shifting provision without stockholder approval thereof.
  - Similarly, Glass Lewis "strongly opposes" the adoption of fee-shifting bylaws and recommends that stockholders vote against the election of all of the members of the nominating and governance committee where a board of directors adopts a fee-shifting bylaw without stockholder approval thereof.

Fee-Shifting Provisions – The 2015 Legislation

- Earlier this year, in accordance with the Senate Joint Resolution 12, the Delaware Bar approved proposed amendments to Sections 102 and 109 of the General Corporation Law of the State of Delaware to invalidate fee-shifting provisions in the certificate of incorporation or the bylaws of a Delaware *stock* corporation.

- The amendments were approved by Delaware's General Assembly, were signed by Delaware's governor and became effective on August 1st.

- The amendments are not intended to:
  - disturb the Supreme Court's ruling in *ATP* with regard to nonstock corporations; or
  - prevent the application of a fee-shifting provision pursuant to a stockholders agreement or other writing signed by the stockholder against whom the provision is to be enforced.

Fee-Shifting Provisions – The Amendments to the DGCL

- A new section (f) was added Section 102 of the DGCL which provides as follows:
  - "(f) The certificate of incorporation may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim, as defined in § 115 of this title."
- A new sentence was added to Paragraph (b) of Section 109 of the DGCL which provides as follows:
  - "The bylaws may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim, as defined in § 115 of this title."
- Section 115 of the DGCL defines "internal corporate claims" as "claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery."

Forum Selection Provisions

Forum Selection Provisions – In General

- Forum selection provisions permit corporations to manage the risk of intra-corporate litigation against the corporation and its directors in multiple forums by requiring stockholders to bring such actions in one specified jurisdiction (typically the corporation's state of incorporation).

- In 2013, the Delaware Court of Chancery upheld the facial validity of the challenged forum selection bylaw provisions adopted by the boards of directors of Chevron Corporation and FedEx Corporation in *Boilermakers Local 154 Retirement Fund v. Chevron Corporation*, 73 A.3d 934 (Del. Ch. 2013).

- The Court of Chancery observed that the challenged forum selection bylaw provisions "are not intended to regulate *what* suits may be brought against the corporations, only *where* internal governance suits may be brought."

- While the Court of Chancery found that forum selection provisions are facially valid, a stockholder could still bring a claim against the directors of a corporation for breach of fiduciary duty in connection with the adoption of such a provision.

Forum Selection Provisions – Increase in Adoption

- Following the Court of Chancery's decision in *Boilermakers*, the number of corporations that included a forum selection provision in their governing documents increased significantly. For example:
  - approximately 583 public corporations have adopted forum selection provisions.
  - approximately 118 of the S&P 500 companies have adopted forum selection provisions.
- In addition, following the decision in *Boilermakers*, courts in other jurisdictions appear to have recognized the enforceability of a forum selection provision that selected Delaware as the forum.
  - These jurisdictions include, but are not limited to, Alabama, California, Florida, Illinois, New York and Texas.
- Although the trend towards enforcement of forum selection bylaw provisions increases the likelihood that they will continue to be upheld, it does not ensure that such provisions will be upheld in all non-Delaware courts.

Forum Selection Provisions – Sample Provision

- Although forum selection provisions can be included in either the certificate of incorporation or the bylaws, they are most commonly implemented by amendment to the bylaws adopted by the corporation's board of directors.

- A typical forum selection provision reads as follows:

"Unless the Corporation consents in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall, to the fullest extent permitted by law, be the sole and exclusive forum for (1) any derivative action or proceeding brought on behalf of the Corporation, (2) any action asserting a claim of breach of a fiduciary duty owed by any director, officer, other employee or stockholder of the Corporation to the Corporation or the Corporation's stockholders, (3) any action asserting a claim arising pursuant to any provision of the [General Corporation Law of the State of Delaware] or as to which the [General Corporation Law of the State of Delaware] confers jurisdiction on the Court of Chancery of the State of Delaware, or (4) any action asserting a claim governed by the internal affairs doctrine. Any person or entity purchasing or otherwise acquiring or holding any interest in shares of capital stock of the Corporation shall be deemed to have notice of and consented to the provisions of this section."

Forum Selection Provisions – Proxy Advisory Firms Weigh In

- In its 2015 U.S. Proxy Voting Summary Guidelines, ISS stated that its recommendation on how stockholders should vote on a proposal to adopt a forum selection provision would be made on a case-by-case basis taking into account factors such as the corporation's rationale for adopting the provision, disclosure by the corporation of past harm from multi-forum litigation, the breadth of application of the bylaw and governance features.

- Thereafter, the ISS Guidelines were updated to adopt a stand-alone policy on unilaterally adopted bylaw amendments, including forum selection bylaw provisions. ISS stated that it would generally vote against or withhold from directors individually, committee members or the entire board (except new nominees) if the board amends the bylaws unilaterally in a manner that "materially diminishes" stockholder rights or that could "adversely impact" stockholders, taking into account various factors.

- In a subsequent publication titled "2015 Benchmark U.S. Proxy Voting Policies: Frequently Asked Questions on Selected Topics", ISS clarified that a board's unilateral adoption of a forum selection bylaw would be considered on a case-by-case basis, but generally would not be considered "materially adverse" to stockholders under its stand-alone policy.

Forum Selection Provisions – Proxy Advisory Firms Weigh In

- Glass Lewis has taken a more negative view of forum selection provisions, and it recommends that stockholders vote against any proposal to adopt a forum selection provision unless the corporation:
  - provides a “compelling argument” on why the provision would benefit stockholders,
  - provides evidence of “abuse of legal process” in non-favored jurisdictions,
  - narrowly tailors the provision and has a strong record of good corporate governance practices.
- In addition, Glass Lewis will recommend against the election of the chair of the nominating and governance committee where a board of directors adopted a forum selection bylaw provision during the year prior to the election.

Forum Selection Provisions – The Amendments to the DGCL

- Consistent with recent court decisions within and outside of Delaware that have upheld the validity of forum selection provisions selecting Delaware as the forum, the General Corporation Law was recently amended to add a new Section 115 which confirms that a forum selection provision selecting Delaware as the forum may be included in a corporation's certificate of incorporation or bylaws.
- New Section 115 provides as follows:
  - "The certificate of incorporation or the bylaws may require, consistent with applicable jurisdictional requirements, that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State, and no provision of the certificate of incorporation or the bylaws may prohibit bringing such claims in the courts of this State. "Internal corporate claims" means claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery."
- The proposed amendment does not expressly authorize or prohibit provisions that select a forum other than Delaware as an *additional* forum in which an internal corporate claim may be brought, but it would invalidate any provision selecting courts outside of Delaware as the *exclusive* forum for internal corporate claims.

Saul Ewing LLP

2015 Amendments to the General Corporation Law of the State of Delaware

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STOCK AND OPTION ISSUANCES SECTIONS 152 AND 157

Saul Ewing LLP

Section 152 – Stock Issuance

- Amendment provides that the resolution authorizing the issuance of stock may provide that such stock may be issued in one or more transactions, in such numbers, and at such times as determined by the resolution.

- Such determination may be by any person or body (including the corporation) as set forth in the resolution.

Saul Ewing LLP

Section 152 – Stock Issuance

- The resolution must fix:
  - a maximum number of shares that may be issued;
  - a time period during which such shares may be issued; and
  - a minimum amount of consideration for which the shares may be issued.

Section 152 – Stock Issuance

- To determine the consideration for which shares may be issued, a board has the option of either:
  - setting a minimum amount of consideration; *or*
  - approving a formula by which the amount of consideration is determined.
- The formula may include or be made dependent upon extrinsic facts (e.g. market price), provided that the manner in which such facts operate on the formula is clearly and expressly set forth in the formula or in the resolution approving the formula.

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Section 157 – Rights / Options

- Amendments to Section 157 provide that the formula used for determining the price at which rights or options may be issued may include or be made dependent on extrinsic facts, provided that the manner in which such facts operate on the formula is clearly and expressly set forth in the formula or in the resolution approving the formula.

RATIFICATION OF DEFECTIVE CORPORATE ACTS AND STOCK SECTION 204

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Section 204(b) – Incorporator

- Section 204(b)(2) addresses the situation where the initial board of directors was not named in the original certificate of incorporation and has not been constituted by the incorporator.
- Persons who have been acting as *de facto* directors may adopt resolutions ratifying the election of those persons who have been acting on behalf of the corporation as the board.
- This Section is not intended to prevent a corporation from correcting its certificate of incorporation pursuant to Section 103(f).

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Section 204 – Board Ratification

- Section 204(b)(1) makes clear that the board may ratify multiple defective corporate acts in a single set of resolutions.
- Section 204(c) provides that each defective corporate act—rather than the board's ratifying resolution—that requires or required a vote of stockholders must be submitted to stockholders for their approval.
- Quorum and voting requirements for the stockholder ratification are those that would otherwise have been applicable for such defective corporate action (on a case-by-case basis).

Section 204 – Board Ratification

- A board is not prevented from:
  - Cross-conditioning its own ratification of a defective corporate act on the approval of one or more other defective corporate acts; or
  - Conditioning its ratification of any defective corporate act on the approval by stockholders of one or more other defective corporate acts, (whether or not such vote is required by Section 204(c)).

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Section 204 – Stockholder Ratification

- Section 204(d) makes clear that the only stockholders entitled to vote on the ratification of a defective corporate act, or be counted for purposes of a quorum for such vote, are the holders of valid stock.

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Section 204 – Certificate of Validation

- Section 204(e) has been amended to clarify the requirements in respect of certificates of validation, with the goal of providing greater uniformity.
- Section 204(e) no longer requires that a certificate of validation include a copy of the board's ratifying resolutions.
- Instead, the certificate of validation must set forth specified information regarding the defective corporate act and the related failure of authorization.

Section 204 – Notice

- Where a notice sent pursuant to Section 204(g) is included in a notice sent pursuant to Section 228(e), the notice must be sent to the parties entitled to receive the notice under both Section 204(g) and Section 228(e).

- No such notice need be provided to any holder of valid shares that acted by written consent in lieu of a meeting to approve the ratification of a defective corporate act or to any holder of putative shares who otherwise consented thereto in writing.

- Publicly-traded corporations may give this Section 204(g) notice by making public filing with the SEC.

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Section 204 – Effective Time

- The term "validation effective time" previously meant the later of the time (x) the resolution was adopted by (or notice given to) the stockholders (as applicable) or (y) the effective time of a certificate of validation.

- Section 204(h)(6) amends that definition to permit the board to fix a future validation effective time for any defective corporate act that does not need to be submitted to the stockholders or require the filing of a certificate of validation.

- Section 204(h)(6) confirms that where stockholder approval is need, the "validation effective time" occurs at the time of stockholder approval – regardless of whether the stockholders are acting (x) at a meeting or (y) by written consent.

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Section 205 – Challenges to Ratification

- Provides that stockholders will have 120 days from the later of:
  - the validation effective date; *or*
  - the date of notice

  to challenge the ratification of a defective corporate action.

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Section 204 – Common Law

- Section 204(i) provides that Section 204 is not the exclusive means of ratifying corporate acts, recognizing that certain "voidable" acts may be susceptible to cure by ratification under common law.

- The amendment clarifies that the scope of the subsection encompasses actions ratified under the common law "pre-incorporation doctrine."

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PUBLIC BENEFIT CORPORATIONS SECTION 363

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Section 362 – PBC Names

- PBCs are no longer required to include the words "public benefit corporation" or an abbreviated designation in their name.
- If the PBC's name does not contain such language, then it must provide notice that it is a PBC prior to issuing its shares.
- Such notice is not required if the issuance is pursuant to a public offering.

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Section 363 – Voting Standards

- The amendments also relax the voting standards required to approve charter amendments or transactions in which a corporation that is not a PBC becomes a PBC or its stockholders become stockholders of a PBC (or vice-versa).
  - As amended, Section 363 provides that such actions require two-thirds (2/3) of the outstanding shares entitled to vote.
  - The previous voting standard had required the approval of 90% of the outstanding shares of each class of stock, *whether voting or nonvoting*.

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Section 363 – Appraisal Rights

- The amendments also provide a "market out" exception to the appraisal rights provided in Section 363(b) in connection with a corporation becoming a public benefit corporation.
- Similar to the market out exception to appraisal rights under Section 262(b).

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2015 AMENDMENTS:

Delaware Limited Liability Company Act and the Delaware Revised Uniform Limited Partnership Act

September 30, 2015

Overview

- Elimination of certain default "class" or group voting requirements
- Clarify that irrevocable power-of-attorney provisions also apply to irrevocable proxies
- Provide for the irrevocable delegation of rights and powers

Default Requirement for Class & Group Votes

- LLC ACT

– § 18-209(b), § 18-213(b), § 18-215(k), § 18-215(l), § 18-216(b), § 18-801(a) and § 18-803(a) were amended to delete default requirements for class and/or group votes for mergers and consolidations, transfers or continuances, termination and winding up of series, conversions and the dissolution and winding up of a limited liability company.

Default Requirement for Class & Group Votes

- LP ACT

  – § 17-204(a)(3), § 17-211(b), § 17-214(a), § 17-216(b), § 17-218(k), § 17-218(l), § 17-219(b), § 17-801, § 17-803(a) and § 17-806 were amended to delete default requirements for class and/or group voting for certificates of cancellation, mergers and consolidations, conversions to a limited liability limited partnership, transfers or continuances, termination and winding up of series, conversions, the dissolution and winding up of a limited partnership and the revocation of dissolution.

Default Requirement for Class & Group Votes

- NOTE: Prospective: default voting requirements as in effect on July 31, 2015, will continue to apply to entities formed (by the filing of an original certificate of formation or limited partnership, as the case may be, on or before July 31, 2015). LLC or LP Agreement can override prospective limitation with an express provision in the LLC or LP Agreement.

Enforceability of Proxy

•LLC ACT

- § 18-204(c) was amended to confirm that the provisions of that section relating to a power of attorney also apply to a proxy.

Enforceability of Proxy

- LP ACT

- § 17-204(c) was amended to confirm that the provisions of that section relating to a power of attorney also apply to a proxy.

Irrevocable Delegation of Rights and Powers

- LLC ACT

– § 18-407 was amended to clarify that unless otherwise provided in a limited liability company agreement, a delegation of rights and powers is irrevocable if it states that it is irrevocable.

Irrevocable Delegation of Rights and Powers

- LP ACT

– § 17-403(c) was amended to clarify that unless otherwise provided in a limited partnership agreement, a delegation of rights and powers is irrevocable if it states that it is irrevocable.

Miscellaneous Other

- LLC ACT

–§ 18-603 was amended to delete certain surplus language and has no substantive effect.

–§ 18-1105(a)(5) was amended to provide that in exchange for the fees described the Secretary of State may issue public records in the form of photocopies or electronic image copies and need not provide public records in any other form.

Miscellaneous Other

- LP ACT

– § 17-603 was amended to delete certain surplus language and has no substantive effect.

– § 17-1107(a)(5) was amended to provide that in exchange for the fees described the Secretary of State may issue public records in the form of photocopies or electronic image copies and need not provide public records in any other form.

General Partnerships

Delaware Revised Uniform Partnership Act
(6 Del C.§ 17-1101 et seq.)

General Partnerships

- DRUPA

– § 15-123 was amended to confirm that the provisions of that section relating to a power of attorney also apply to a proxy.

– § 15-202(f), § 15-401(m), § 15-407(d), § 15-407(e), § 15-807(h) and § 15-902(b) were amended to delete surplus language and do not change the effect of those sections (per § 15-103 of the Act, a partnership agreement can otherwise provide).

– § 15-401(l) was amended to confirm that unless otherwise provided in a partnership agreement, a delegation of rights and powers is irrevocable if it states that it is irrevocable.

General Partnerships

- DRUPA

– § 15-1207(a)(5) was amended to provide that in exchange for the fees described the Secretary of State may issue public records in the form of photocopies or electronic image copies and need not provide public records in any other form.

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