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2007 Delaware Business Entity Statutory Amendments

In July 2007 Delaware Governor Ruth Ann Minner signed into law amendments to the Delaware General Corporation Law and alternative entity statutes. The statutes are reviewed and amended annually, reflecting the sustained effort of Delaware lawmakers to respond to the evolving needs of businesses. Some of the amendments are technical. Others make substantive changes that will be of importance to practitioners, directors and stockholders. We summarize below the more important substantive changes.

The Delaware Constitution was also amended recently to enable the United States Securities and Exchange Commission (“SEC”) to certify questions of law to the Delaware Supreme Court. The Delaware Supreme Court’s expanded jurisdiction to hear such certified questions creates an important tool for the SEC to eliminate guesswork or speculation on how the Delaware Supreme Court might rule on important issues of corporate governance. The Delaware judiciary welcomed the opportunity to respond to the SEC’s expressed interest in seeking advice on corporate issues. The SEC likewise hailed the innovative approach and its “new ability to obtain definitive answers to important questions of Delaware law.”

I. DELAWARE GENERAL CORPORATION LAW AMENDMENTS.

The 2007 Delaware General Corporation Law (“DGCL”) amendments include changes to the appraisal statute that provide a presumptive interest rate and allow beneficial owners of shares to petition for appraisal in their own name. Other changes include clarifications

respecting voting in director elections and elimination of the requirement that a merger or consolidation agreement include a secretary's certification that the agreement was adopted by the requisite stockholder vote. Finally, several sections were amended to conform to the recent restructuring of Nasdaq's securities markets. The amendments are generally effective August 1, 2007. The amendments to Section 262, the appraisal statute, are applicable only with respect to agreements entered into after August 1, 2007.

A. Appraisal Statute.

The Section 262 amendments are effective with respect to transactions consummated pursuant to agreements entered into after August 1, 2007 (or, with respect to short-form mergers under Section 253, resolutions of the board adopted after August 1, 2007). Thus, Section 262 in its pre-amended form continues to apply to transactions entered into on or before August 1, 2007, even if the notice of appraisal rights is not delivered, or stockholder approval is not obtained, until after that date. Importantly, because notice of appraisal rights (typically combined with a proxy statement) must contain a verbatim copy of Section 262, corporations and practitioners should pay close attention to the date of the merger agreement to determine which version of Section 262 governs appraisal rights and must be distributed to stockholders.

1. Rights of Beneficial Owners.

A beneficial owner of stock held in "street name" may now petition for appraisal in his own name and also request a statement of shares subject to appraisal demands. The record holder, however, still must deliver the actual appraisal demand to the corporation. Before this amendment, only the record owner could petition appraisal. This amendment may be of considerable importance in light of the Court of Chancery's holding in In re: Appraisal of Transkaryotic Therapies, Inc., 2007 WL 1378345 (Del. Ch.).

In Transkaryotic, the court held that a beneficial owner who purchased stock after the record date but before the merger vote may, through the record holder, demand appraisal, so long as the number of shares for which appraisal is sought is no greater than the aggregate number of shares the record holder either voted against the merger or did not vote in connection to the merger. The court reasoned that the relationship between the beneficial owner and record holder was irrelevant to the record holder's right to demand appraisal. Now that beneficial owners may pursue appraisal in their own name, investors can capitalize more easily on arbitrage opportunities created in the marketplace by merger transactions involving Delaware corporations which trigger appraisal rights under Section 262.

2. Presumptive Interest Rate.

Section 262(h) now provides a presumptive interest rate on appraisal awards unless good cause is shown. The Court of Chancery has been burdened with extensive litigation over the appropriate interest rate in appraisal cases. The presumptive interest rate will simplify appraisal proceedings and provide predictability, absent unusual circumstances, on interest rate issues. The rate accrues at 5% over the Federal Reserve discount rate and is compounded quarterly. The award of interest is from the effective date of the merger through the date of payment of judgment.

3. Withdraw of Appraisal Demand.

Sections 262(k) and (e) were amended to clarify that a stockholder who has demanded appraisal may withdraw that demand within 60 days after the effective date of the merger. The right to withdraw applies even if a petition for appraisal has been filed with the Court of Chancery, so long as the withdrawing stockholder did not file the petition or join as a named party.

4. The “Market-out” Exception.

The “market-out” exception in Section 262(b) was amended by deleting the reference to shares that are “designated as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc.” Because securities markets administered by Nasdaq were reorganized recently and designated by the SEC as “national securities exchanges,” the separate reference to the NASD interdealer quotation system is no longer needed.

B. Disparate Director Voting Power.

In 2006, Section 141(d) was amended to authorize certificate provisions granting super-voting power to specified directors, unrelated to whether the director was elected by a specified class or series. Section 141(d) has now been amended to clarify that directors with super-voting power enjoy the same voting rights at the committee level, unless the certificate or bylaws otherwise provide.

C. Closely Held Exception of Section 203.

Section 203(b)(4)(ii) was amended to eliminate the reference to shares “authorized for quotation on The NASDAQ Stock Market.” As discussed above, this amendment recognizes the reorganization of Nasdaq’s securities markets.

D. Clarification of Plurality Vote to Elect Directors.

The default rules for plurality voting under Section 216(d) were amended to clarify that the default “plurality” vote requirement for director elections applies to election of directors by one or more classes or series of stock that are entitled to elect directors separately. Prior to this amendment, Section 216(d) could have been interpreted as requiring a majority vote of a class or series to elect directors.

E. Elimination of Approval of Merger Certification.

The DGCL merger statutes (Sections 251-264) have been amended to eliminate the requirement that a merger or consolidation agreement include a certification by the secretary (or assistant secretary) that the agreement was adopted by the requisite stockholder vote (or otherwise approved in accordance with Section 251) if a certificate of merger or consolidation is filed with the Delaware Secretary of State in lieu of filing the agreement. Certification still will be required, however, when the merger or consolidation agreement itself is filed.

II. ALTERNATIVE ENTITY STATUTES.

The 2007 amendments to the Delaware Revised Uniform Partnership Act (“DRUPA”), the Delaware Revised Uniform Limited Partnership Act (“DRULPA”), and the Delaware Limited Liability Company Act (“Delaware LLC Act”) include changes that permit contractual prohibitions on fundamental transactions, and particularly for DRULPA and the Delaware LLC Act, provide for “series” of assets, and clarify certain requirements for partnership and LLC agreements. As with the amendments to the DGCL, these amendments are effective August 1, 2007.

A. Enforceability of Restriction on Fundamental Transactions.

RUPA, DRULPA and the Delaware LLC Act were amended to permit the governing instrument of the entity to provide that the entity shall not have the power to merge, consolidate, convert to another entity, or transfer or domesticate to another jurisdiction. This amendment clarifies that contractual prohibitions on such actions (as opposed to high vote requirements and restrictive covenants) are enforceable.

B. Series of Assets.

Under amended Section 17-218 of DRULPA and Section 18-215 of the Delaware LLC Act, a “series” with separate assets and liabilities from other series or the entity as a whole may

now be established as a series of assets, in addition to series of interests, partners, or members. The amendments clarify the record keeping requirements and provide a safe harbor for satisfying the separate accounting requirements. Assets are deemed to be associated with the series separately from the other assets of the limited partnership or LLC so long as records are maintained that reasonably identify the series assets by specific listing, category, type, or formula. The amendments also clarify that the assets of a series may be held in the name of such series, in the name of the limited partnership or LLC, or through a nominee or otherwise. Finally, the amendments provide that a series may carry on any lawful business (except banking), and may in its own name enter into contracts, hold title to assets, grant liens and security interests, and sue and be sued.

C. “Implied” Partnership Agreements and LLC Agreements.

The definitions for a “partnership agreement” provided in Section 17-101(12) of DRULPA and a “limited liability company agreement” provided in Section 18-101(7) of the Delaware LLC Act were amended to include implied agreements created by the conduct of the parties.

D. Effective Date of Limited Partnership and Limited Liability Company Agreements.

Section 17-201 was amended by adding a new paragraph (d). This amendment provides that a partnership agreement is required by DRULPA, but may be entered into “before, after or at the time of the filing of a certificate of limited partnership.” The effective date of such an agreement may be effective as of the formation of the limited partnership, or at such other time provided in “or reflected by the partnership agreement.” That the effective date of the partnership agreement may be “reflected” conforms this Section to amended Section 17-101(12), which allows for implied partnership agreements. Section 18-201(d) already permitted LLC agreements to be entered into “before, after or at the time of the filing of the certificate of

formation” and that the agreement may be effective as of the formation of the LLC or such time provided for in the agreement. This section was amended to also provide that an LLC agreement is required under the Delaware LLC Act and that the effective date of such an agreement may be “reflected by” the LLC agreement.

E. Bearer Shares Prohibited.

RUPA, DRULPA and the Delaware LLC Act were amended to provide expressly that partnerships, limited partnerships and limited liability companies shall not have the power to issue interests in “bearer form.” This provision cannot be modified in the governing instrument of the entity.