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Parsing Controversial Del. General Corporation Law Proposals

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In late March, the Council of the Corporation Law Section of the Delaware State Bar Association proposed amendments to the Delaware General Corporation Law that, if enacted by the Delaware General Assembly, will address issues raised in three recent high-profile Delaware Court of Chancery decisions. The amendments pertain to the validity of stockholder agreements on corporate governance rights (West Palm Beach Firefighters' Pension Fund v. Moelis & Co.), the process required to approve merger agreements (Sjunde AP-Fonden v. Activision Blizzard Inc.), and corporations' ability to contract for "lost-premium damages" in merger agreements (Crispo v. Musk).

The case receiving the most attention is the Feb. 23 opinion in Moelis,[1] currently on appeal to the Delaware Supreme Court, which invalidated a stockholder agreement giving the company's controlling stockholder certain governance rights, holding that such internal governance arrangements violated Section 141(a) of the DGCL as an improper infringement of board authority that did not appear in the charter.

Next, the decision in Activision Blizzard,[2] issued a few days after Moelis, held, among other things regarding the merger agreement approval process, that Section 251(b) of the DGCL requires the board to approve a merger agreement that is either in "final form" or "essentially complete," and that disclosure schedules are not part of the merger agreement for purposes of approval.

The court in Crispo,[3] an October 2023 case, noted that, contrary to practitioners' expectations, Delaware law would follow U.S. Court of Appeals for the Second Circuit precedent in not allowing the target corporation in a proposed merger to recover lost premium damages on behalf of its stockholders if the buyer wrongfully terminated the merger agreement. This decision called into question the validity of lost premium damages provisions in merger agreements.

The proposed amendments, controversial both for their content as well as their timing, represent major changes to the DGCL which, as the amendments' proponents note, would align the governing statutes with general market practice. The "market practice amendments," as some are calling them, were introduced to the Delaware Legislature on May 23 and are awaiting consideration.

Proposed Amendments in Response to Moelis

Proposed Section 122(18): Authorization for Stockholder Agreements

The proposed amendments would add a new Subsection (18) to Section 122 that would expressly grant corporations the power, whether or not set forth in the certificate of incorporation, to enter into stockholder agreements containing certain corporate governance rights. Stockholder agreements are a common vehicle in the marketplace to give a corporation's significant current or prospective stockholders — founders, private equity investors — or beneficial owners contractual rights to participate in or dictate certain corporate decisions.

This proposed amendment is in response to the Court of Chancery's decision in Moelis, which found that a stockholder agreement that gave a founding stockholder control over many of the corporation's basic actions — such as fixing the size of the board, nominating and voting for directors, entering into major transactions, and hiring and firing management — constituted, in the aggregate, impermissible restrictions on the board's authority in violation of DGCL Section 141(a), and therefore those rights must have been included in the certificate of incorporation to be valid.

The court invited a legislative response, noting that similar stockholder agreements are commonplace in the market, and that "[t]he expansive use of stockholder agreements suggests that greater statutory guidance may be beneficial."[4]

In response, the proposed amendments to Section 122(18) specifically authorize a corporation to enter into contracts with one or more of its stockholders or beneficial owners of its stock for minimum consideration, as approved by the corporation's board of directors, including persuading stockholders to take, or not take, particular actions.

The new subsection also provides a nonexclusive list of contract provisions to which a corporation may agree, notwithstanding DGCL Section 141(a):

- "Restrict or prohibit future corporate actions specified in the contract," even if those actions otherwise require approval by the board of directors under the DGCL;
- "Require the approval or consent of one or more persons or bodies (including the board of directors or one or more current or future directors, stockholders or beneficial owners of stock) before the corporation may take actions specified in the contract"; and
- "Covenant that the corporation or one or more persons or bodies (including the board of directors or one or more current or future directors, stockholders or beneficial owners of stock) will take, or refrain from taking, future actions specified in the contract."

The proposed amendment currently has two express limitations on stockholder agreements. Provisions in a stockholder agreement, according to the proposed amendment, will not be enforceable (1) "to the extent such contract provision is contrary to the certificate of incorporation" or (2) if its inclusion in the certificate of incorporation would generally contradict Delaware law, other than DGCL Section 115.

Proposed Subsection (18) also provides that the corporation may be subject to available contract remedies for a breach or attempted breach of the agreement. Moreover, as noted in the synopsis of the proposed amendments, Section 122(18) would not "relieve any directors, officers or stockholders of any fiduciary duties they owe to the corporation or its stockholders," including in determining whether to

cause the corporation to enter into a stockholder agreement, or whether to perform and/or comply with any covenants in a stockholder agreement.

Proposed Amendments in Response to Activision

The following proposed amendments respond to several issues raised by the Court of Chancery's decision in Activision attempting to provide clarity to the process and manner by which boards and stockholders approve merger agreements.

Proposed Section 147: Agreements in "Substantially Final" Form

The first proposed amendment in response to Activision would add a new Section 147, which would allow boards to approve a "substantially final" version of agreements, instruments or documents, such as merger agreements.

In Activision, the court held, as an issue of first impression, that under Section 251(b) of the DGCL, the board must approve a merger agreement that is either in "final form" or "essentially complete." The court noted that it was "undoubtedly true" that, in practice, parties continue to negotiate various key provisions of the merger agreement after the board has already approved the agreement, as it is not practical for a board to wait for every provision and detail to be finalized before approving the agreement. Proposed Section 147 is meant to provide guideposts for these common market practices.

Proposed Section 147 provides that, whenever the DGCL "requires the board of directors to approve or take other action with respect to any agreement, instrument or document, such agreement, instrument or document may be approved by the board of directors in final form or in substantially final form." While the proposed statutory language does not expressly define "substantially final form," the synopsis of the proposed amendment outlines that an agreement will be in substantially final form if all of the "material terms" are otherwise provided "through other information or materials presented to or known by the board" of directors.

Even under this proposal, however, whether a term is "material" will likely be an issue challenged in litigation.

Proposed Section 147 will also permit the board to adopt resolutions ratifying the approval of any agreement, document or instrument. Such ratification would relate "back to the time of the original board approval," and "satisfy any requirement under the [DGCL] relating to the board's authorization." Boards could later ratify an agreement if any questions exist as to whether the agreement is in substantially final form, so long as ratification occurs prior to filing the document with the secretary of state.

Proposed Section 147 gives boards a less cumbersome ratification procedure than that in Section 204, which requires notice to stockholders. However, the amendment makes clear that a board may nonetheless ratify approval of a merger under Sections 204 and 205.

Proposed Section 268: Amended Charter and Disclosure Schedules Not Always Required for an "Essentially Complete" Merger Agreement

Proposed Section 268 gives some guidance as to what comprises an "essentially complete" version of a merger agreement to be approved by the board by providing that (1) the merger agreement does not

have to include a copy of the amended charter of the surviving corporation in deals where stockholders will not receive stock in the surviving corporation, and (2) unless expressly provided in the merger agreement, disclosure schedules are not part of the merger agreement that the board must approve.

In Activision, the court noted that while it is common practice for transactional attorneys to "negotiate and finalize disclosure schedules up until the moment a deal closes, if not beyond,"[5] a board must approve an essentially complete version of the merger agreement, which may not be altered in essential ways following board approval. In the court's view, the merger agreement reviewed by the board did not meet this standard because it was missing the consideration, the disclosure letters, the disclosure schedules, the surviving entity's charter and the dividend provision.

The proposed Section 268(a) provides that in deals where stockholders will not receive stock in the surviving corporation, (1) the merger agreement would not need to include a provision regarding the surviving corporation's certificate of incorporation to be considered in final or substantially final form, (2) any amendment of the surviving corporation's certificate of incorporation may be adopted by the corporation's board of directors or any person acting at the board's direction, and (3) any alteration to the surviving corporation's certificate of incorporation would not constitute an amendment to the merger agreement.

Proposed Section 268(b) states that, unless explicitly stated in the merger agreement, the disclosure schedules — or similar documents that "modify, supplement, qualify, or make exceptions to representations, warranties, covenants or conditions contained in the agreement" — would not be deemed part of the merger agreement for purposes of requiring the board to approve an essentially complete version of the agreement. Instead, disclosure schedules are incorporated by reference into the agreement, rather than part of the agreement itself.

Notably for practitioners, many form merger agreements contain "interpretations" sections providing that certain disclosures and schedules should be deemed part of, and included in any reference to, the agreement. Practitioners may wish to clarify that such provisions do not apply for purposes of the DGCL.

Proposed Section 232(g): Notice to Stockholders

The proposed amendments would add a new Subsection (g) to Section 232, which would broaden the materials that constitute notice to stockholders. The plaintiff in Activision challenged the company's compliance with DGCL Section 251(c), which provides that the merger agreement required by Section 251(b) shall be submitted to the stockholders and that the notice of the stockholder meeting for voting on a merger shall "contain a copy of the agreement or a brief summary thereof."

The defendants argued that they satisfied the notice requirement because the proxy statement attached to the stockholder notice included a summary of the merger agreement. The court, however, rejected this argument and observed that the text of Section 251(c) requires the notice of a stockholder meeting itself to contain the merger agreement or the summary, and that the proxy statement is not the notice — unlike DGCL Sections 228 and 242, which do permit such integration of the proxy in certain instances.

Section 232 deals generally with the manner by which notice may effectively be given to stockholders of a corporation, and permits notice to be provided in writing directly to the applicable stockholder's mailing address or by electronic transmission, in each case to the address on the records of the corporation. Such notice shall be given (1) if mailed, when the notice is deposited in the U.S. mail,

postage prepaid; (2) if delivered by courier service, the earlier of when the notice is received or left at such address; or (3) if given by email, when sent via email unless the stockholder has notified the corporation in writing or by electronic transmission of an objection to receiving notice by email, or such notice is otherwise prohibited by the DGCL from being given by email.

The proposed Subsection (g) provides that if a notice is given by mail or courier service — but not by email —"each document enclosed with the notice or annexed or appended to the notice shall be deemed part of the notice solely for purposes of determining whether notice was duly given" under the DGCL or the corporation's organizational documents.

While Activision does not directly address Section 232, the proposed amendment to Section 232 works hand in hand with the existing Section 251 to provide a more practical approach to the requirement of providing "either a copy of an agreement of merger, or a brief summary thereof."

Going forward, corporate boards can take comfort that the contents of attachments enclosed with a notice provided to stockholders by mail or courier service would be considered in determining whether the requirements of Section 251 had been met.

Proposed Amendments in Response to Crispo v. Musk

Proposed Section 261(a)(1): Seller Can Receive "Lost-Premium" Damages in Broken Deals

The proposed Section 261(a)(1) allows merger agreements to include provisions entitling the merger target to seek damages, including lost premium damages, for the buyer's failure to perform its preclosing obligations or failure to consummate the merger under the terms of the merger agreement. It also statutorily provides that a target company can keep these damages and not distribute them to its stockholders.

In Crispo,[6] a claim arose from Elon Musk's purchase of Twitter, now X, and challenged the validity of a provision in the merger agreement providing for lost stockholder premium damages. The merger agreement also had a customized "no third-party beneficiaries" clause that did not carve out stockholders as third-party beneficiaries for the lost stockholder premium.

The court left the general interpretation of such provisions unclear, but ultimately decided that in transactions where (1) there is a provision in a merger agreement conferring third-party beneficiary status to the target company's stockholders after the effective time of the merger, and (2) there is a claim contemplating liability following a preclosing breach for damages by the acquirer, a target company cannot pursue damages for lost stockholder premiums arising therefrom. The court recognized the efficiency of allowing the target corporation to recover the stockholders' lost premium, but indicated that a corporation could not appoint itself as the stockholders' agent for that purpose.

In practice, this outcome decreases the overall protection available to a target company's stockholders by disincentivizing buyers from allowing provisions that name the target company's stockholders as third-party beneficiaries or include a lost damages premium as a potential measure of damages. The proposed amendment will have the effect of clarifying the validity of provisions like those discussed in Crispo, and seeks to correct the decrease in stockholder protection that resulted from the application of the Crispo court's holding.

The previous Section 261 merely contemplated the effect of a merger on ongoing or pending litigation,

but did not statutorily address lost profit damages or the third-party beneficiary concerns. This proposed amendment effectively eliminates the common law requirement to contractually designate the stockholders as third-party beneficiaries or appoint the target company as an agent on behalf of the stockholders for the purpose of seeking lost premium damages and choosing not to distribute proceeds directly to the stockholders.

Proposed Section 261(a)(2): Appoint Stockholder Representatives to Litigate Post-Closing Claims

The proposed Section 261(a)(2) allows parties to a merger agreement to appoint one or more persons to act as the stockholders' representative to enforce the stockholders' post-closing rights, including purchase price adjustments or indemnification claims. Under the proposed Section 261(a)(2), the stockholders' representative could enforce the stockholders' rights under the merger agreement, but they could not consent to restrictive covenants, waive appraisal rights or assert any direct claim for breach of fiduciary duty in the name of any stockholder without express authorization by such stockholder.

Section 261(a)(2) expressly confirms by statute that the merger agreement may include provisions appointing a stockholders' representative to enforce the rights of stockholders in connection with the merger, which was previously governed by common law and not addressed in the existing DGCL Section 261.

Timing of Amendments

If enacted by the General Assembly before the regular legislative session ends on June 30, the amendments will become effective on Aug. 1, and will apply to all agreements made by a corporation or approved by the board of directors whether or not made or approved before Aug. 1. However, the amendments will not apply to any litigation that was completed or pending before Aug. 1. For those cases, the preamendments law would apply.

These "market practice amendments" are controversial not only for their substance and their arguable effect on the DGCL, corporations, and stockholders going forward, but also for the speed with which the amendments were drafted, proposed and submitted to the Legislature. The amendments were drafted and proposed by the Delaware State Bar Association within weeks of the issuance of the Moelis and Activision opinions — and while both cases are still being litigated — which is unusually fast.

Critics of this timetable have argued that this rushed pace is in response to a perceived crisis, runs contrary to Delaware's normal legislative process, and has foreclosed, or at least short-circuited, the fulsome debate and revision by both the Legislature and the DSBA that should necessarily accompany such consequential changes to the DGCL.

Other commentators, however, are advocating for enacting these amendments as quickly as possible in order to provide the legislative guidance required to restore clarity and certainty for Delaware corporations and their executives, employees, investors, and advisers who now face unpredictability after the recent Chancery decisions.

No matter when and in what form these amendments are enacted, they will represent significant changes to the DGCL that will be hotly debated — and litigated — for the foreseeable future.

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[1] West Palm Beach Firefighters' Pension Fund v. Moelis & Co., 2024 WL 747180 (Del. Ch. Feb. 23, 2024).

[2] Sjunde AP-Fonden v. Activision Blizzard Inc., 2024 WL 863290 (Del. Ch. Feb. 29, 2024).

[3] Crispo v. Musk, 304 A.3d 567 (Del. Ch. 2023)

[4] Moelis & Co., 2024 WL 747180 at *39 n.272.

[5] Activision Blizzard Inc., 2024 WL 863290 at *6.

[6] 304 A.3d 567 (Del. Ch. 2023).