"2024 DGCL Amendments: Implications & Unanswered Questions"

Tuesday, July 23, 2024

Course Materials

“2024 DGCL Amendments: Implications & Unanswered Questions”

Tuesday, July 23, 2024

2 to 3 p.m. Eastern [archive and transcript to follow]

The 2024 amendments to the Delaware General Corporation Law are intended to address the uncertainty created by recent Delaware Chancery Court decisions calling into question market practices surrounding governance agreements and board approval of merger agreements. However, the debate over the adoption of the amendment suggests that they may have significantly broader implications on the way Delaware corporations are governed, and raise a number of new questions about issues that have long been considered settled.

Join our panelists as they discuss the changes made by the 2024 DGCL amendments, how they may influence corporate governance and dealmaking practices, and some of the unanswered questions that practitioners and the Chancery Court will need to sort through.

- **Steven Haas**, Partner, Hunton Andrews Kurth LLP
- **Julia Lapitskaya**, Partner, Gibson, Dunn & Crutcher LLP
- **Eric Klinger-Wilensky**, Partner, Morris, Nichols, Arsht & Tunnell LLP

Among other topics, this program will cover:

- Overview of the DGCL Market Practice Amendments
- Implications for Governance Agreements
- Implications for Acquisition Agreements
- Fiduciary Duties vs. Contractual Obligations
- Unanswered Questions

“2024 DGCL Amendments: Implications & Unanswered Questions”

Course Outline/Notes

1. Overview of the 2024 DGCL Market Practice Amendments

- Section 122
    - Meant to address the Delaware Chancery Court’s recent decision in *West Palm Beach Firefighters v. Moelis & Company* (Del. Ch.; 2/24) in which Vice Chancellor Laster concluded that the pre-approval and governance rights contained in the agreement ran afoul of Section 141(a) of the DGCL
    - Amendments add new subsection (18) that permits corporations to agree to take actions identified in a stockholders agreement, including to provide veto or consent rights so long as they do not override any requirements for corporate action enumerated in the DGCL or the charter:

> “Every corporation created under this chapter shall have power, whether or not so provided in the certificate of incorporation, to … (18) Notwithstanding § 141(a) of this title, make contracts with one or more current or prospective stockholders (or one or more beneficial owners of stock), in its or their capacity as such, in exchange for such minimum consideration as determined by the board of directors (which may include inducing stockholders or beneficial owners of stock to take, or refrain from taking, one or more actions); provided that no provision of such contract shall be enforceable against the corporation to the extent such contract provision is contrary to the certificate of incorporation or would be contrary to the laws of this State (other than § 115 of this title) if included in the certificate of incorporation. Without limiting the provisions that may be included in any such contracts, the corporation may agree to: (a) restrict or prohibit itself from taking actions specified in the contract, (b) require the approval or consent of one or more persons or bodies before the

corporation may take actions specified in the contract (which persons or bodies may include the board of directors or one or more current or future directors, stockholders or beneficial owners of stock of the corporation), and (c) covenant that the corporation or one or more persons or bodies will take, or refrain from taking, actions specified in the contract (which persons or bodies may include the board of directors or one or more current or future directors, stockholders or beneficial owners of stock of the corporation). Solely for purposes of applying the proviso in the first sentence of this subsection, a restriction, prohibition or covenant in any such contract that relates to any specified action shall not be deemed contrary to the laws of this State or the certificate of incorporation by reason of a provision of this title or the certificate of incorporation that authorizes or empowers the board of directors (or any one or more directors) to take such action. With respect to all contracts made under this paragraph (18), the corporation shall be subject to the remedies available under the law governing the contract, including for any failure to perform or comply with its agreements under such contract."

- Section 147
    - Meant to address the Delaware Chancery Court's recent decision in *Sjunde AP-fonden v. Activision Blizzard, Inc.* (Del. Ch.; 2/24) in which Chancellor McCormick refused to dismiss a plaintiff's claims that the Activision Blizzard board of directors violated DGCL provisions governing board negotiation and board and stockholder approval of merger agreements by approving a late-stage draft of the merger agreement instead of a final execution copy and delegating authority to a board committee to finalize a key term of the merger agreement
    - Amendments add new Section 147, which provides that whenever the DGCL requires board approval of document, it can be approved in substantially final form:

> "Whenever this chapter expressly 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. If the board of directors shall have acted to approve or take other action with respect to an agreement, instrument or document that is required by this chapter to be filed with the Secretary of State or referenced in any certificate so filed, the board of directors may, at any time after providing such approval or taking such other action and prior to the effectiveness of such filing with the Secretary of State, adopt a resolution ratifying the agreement, instrument or document. A ratification under this section shall be deemed to be effective as of the time of the original approval or other action by the board of directors and to satisfy any requirement under this chapter that the board of directors approve or take other action with respect to such agreement, instrument or document in a specific manner or sequence. Ratification under this section shall not be deemed to be the exclusive means of ratifying an agreement, instrument or document approved by the board of directors pursuant to this section, but shall be in addition to any ratification or validation that may be available under §§ 204 and 205 of this title or under the common law."

    - Also in response to *Activision*, Section 232 was amended to provide that any materials included with a notice to stockholders would be deemed to be part of that notice, and new Section 268 addresses ministerial matters relating to the adoption of a merger agreement

- Section 261

    - Meant to address the Delaware Chancery Court's recent decision in *Crispo v. Musk* (Del. Ch.; 10/22) in which Chancellor McCormick found that approaches to so-called "*ConEd* language" — each of which attempts to give a target the right to seek expectancy damages on behalf of their stockholders — may not be enforceable

- Amendments add new subsection (a)(1) to provide that a target may include a provision that allows it to seek damages against a buyer that has failed to perform its obligations under the merger agreement (including lost premium):

> "(a) Any agreement of merger or consolidation governed by § 251, other than a merger effected pursuant to § 251(g) of this title, § 252, § 254, § 255, § 256, § 257, § 258, § 263 or § 264 of this title may provide: (1) That (i) a party to the agreement that fails to perform its obligations under such agreement in accordance with the terms and conditions of such agreement, or that otherwise fails to comply with the terms and conditions of such agreement, in each case, required to be performed or complied with prior to the time such merger or consolidation becomes effective, or that otherwise fails to consummate, or fails to cause the consummation of, the merger or consolidation (whether prior to a specified date, upon satisfaction or, to the extent permitted by law, waiver of all conditions to such consummation set forth in such agreement, or otherwise) shall be subject, in addition to any other remedies available at law or in equity, to such penalties or consequences as are set forth in the agreement of merger or consolidation (which penalties or consequences may include an obligation to pay to the other party or parties to such agreement an amount representing, or based on the loss of, any premium or other economic entitlement the stockholders of such other party would be entitled to receive pursuant to the terms of such agreement if the merger or consolidation were consummated in accordance with the terms of such agreement) and (ii) if, pursuant to the terms of such agreement, a corporation is entitled to receive payment from another party to an agreement of merger or consolidation of any amount representing such a penalty or consequence (as specified in clause (i) of this paragraph (a)(1)), such corporation shall be entitled to enforce the other party's payment obligation and, upon receipt of any

such payment, shall be entitled to retain the amount of such payment so received."

- Amendments add new subsection (a)(2) to provide that stockholders may appoint a person to act as stockholders' representative through adoption of a merger agreement to enforce their rights in connection with a merger (including to payment of merger consideration or escrow or indemnification arrangements and settlements):

  "(2)(i) For the appointment, at or after the time at which the agreement of merger or consolidation is adopted by the stockholders of a constituent corporation to such merger or consolidation in accordance with the requirements of this subchapter, of one or more persons (which may include the surviving or resulting entity or any officer, manager, representative or agent thereof) as representative of the stockholders of a constituent corporation of this State, including those whose shares of capital stock shall be cancelled, converted or exchanged in the merger or consolidation and for the delegation to such person or persons of the sole and exclusive authority to take action on behalf of such stockholders pursuant to such agreement, including taking such actions as the representative determines to enforce (including by entering into settlements with respect to) the rights of such stockholders under the agreement of merger or consolidation, on the terms and subject to the conditions set forth in the agreement, (ii) that any appointment pursuant to clause (i) of this paragraph (a)(2) shall be irrevocable and binding on all such stockholders from and after the adoption of the agreement of merger or consolidation by the requisite vote of such stockholders pursuant to this subchapter, and (iii) that any provision adopted pursuant to this paragraph (a)(2) may not be amended after the merger or consolidation has become effective or may be amended only with the consent or approval of persons specified in the agreement of merger or consolidation.

> Any provision of the agreement of merger or consolidation adopted pursuant to this subsection (a) may be made dependent upon facts (including, but not limited to, the occurrence of any event, including a determination or action by any person or body, including the corporation) ascertainable outside of such agreement, provided that the manner in which such facts shall operate upon the terms of the agreement is clearly and expressly set forth in the agreement of merger or consolidation."

2. **<u>Implications for Governance Agreements</u>**

    - Criticism of new Section 122(18): Did the *Moelis* decision strike down a common practice of Delaware corporations and the amendments merely restore the status quo?

3. **<u>Implications for Acquisition Agreements</u>**

    - Implications for drafting
    - Implications for board and stockholder approval

4. **<u>Fiduciary Duties vs. Contractual Obligations</u>**

    - Amendment sponsors say, "Fiduciary duties trump contracts always. There is nothing in this legislation that changes that."

5. **<u>Unanswered Questions</u>**

“2024 DGCL Amendments: Implications & Unanswered Questions”

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Proposed Amendments to the Delaware General Corporation Law Would Address Recent Caselaw Regarding Stockholder Agreements and Merger Agreements

Client Alert
03.28.2024

The Council of the Corporation Law Section of the Delaware State Bar Association today released proposed Amendments ("Amendments") to the Delaware General Corporation Law ("DGCL") that, if adopted into law, would address recent caselaw regarding the facial validity of certain stockholder agreements, the ability of parties to a merger agreement to contract for certain pre-closing remedies and for the appointment of a stockholder representative to enforce post-closing remedies, and the process required to approve merger agreements.[1]

The recent cases recognized that the legal requirements identified in the cases were not necessarily in line with market practice. The Amendments are designed to bring existing law in line with such practice. They would do so by giving corporations greater flexibility to order their affairs and giving boards of directors more latitude to delegate to outside counsel the authority to finalize documents after material terms are agreed. The Amendments do not impact the fiduciary duties of directors in approving or causing a corporation to perform contracts, which will continue to be subject to equitable review by the courts on a case-by-case basis.

MOELIS AND STOCKHOLDER AGREEMENTS

The Underlying Case.

In *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.*,[2] the Court of Chancery addressed the facial validity of provisions in an agreement between a corporation and its founding stockholder providing that stockholder consent rights over a broad range of corporate actions, as well as rights

regarding the composition of the corporation's board of directors and board committees. The stockholder agreement was challenged as facially violating Section 141(a) of the DGCL. Section 141(a) provides that, unless otherwise provided in a certificate of incorporation, the business and affairs of a Delaware corporation are managed by or under the direction of a board of directors. The Court analyzed the facial validity of the stockholder agreement through a two-part test. *First*, the Court analyzed whether the contract was an "external commercial agreement" (and thus not subject to Section 141(a) limitations) or instead an "internal affairs document" (and thus subject to those limitations). *Second,* because the Court determined the contract was an "internal affairs document," the Court analyzed whether any of the obligations in the contract violated Section 141(a) as an impermissible infringement on board authority that did not appear in the certificate of incorporation. The Court held that the combination of consent rights in the aggregate, as well as most of the board and committee composition rights, were facially invalid under this rubric. The Court also noted, but did not decide, the potential applicability of its analysis to agreements in other settings, including those settling activist proxy contests.[3]

The Proposed Amendments.

Authority to Enter Into Contracts. The Amendments add a new subsection (18) to Section 122 of the DGCL to provide that, whether or not set forth in a certificate of incorporation, a corporation has the power to enter into contracts with current or prospective stockholders that contain the consent rights and other provisions addressed in *Moelis*. The Amendments contain a nonexclusive list of provisions that may be included in such contracts, including those that: (i) restrict or prevent the corporation from taking actions specified in the contract, either generally or absent the consent of one or more persons or bodies (including one or more directors or stockholders) and (ii) covenant that the corporation or one or more persons will take or refrain from taking actions specified in the contract (including one or more directors or stockholders). By allowing the contract to restrict corporate action absent the consent of one or more directors, the Amendments would confirm that such contractual consent rights do not violate Section 141(d) of the DGCL, which generally requires that provisions granting directors differential voting powers be contained in the certificate of incorporation.

Contractual Counterparties. New Section 122(18) only addresses agreements with current or prospective stockholders in their capacity as such, and does not address contracts entered into with stockholders or others in different capacities, such as suppliers or creditors. Contracts entered into with parties in such other capacities may nonetheless be entered into under subsection (13) of Section 122, as confirmed in the synopsis to the Amendments.

Consideration Required. The corporation must receive consideration for entering into the contract, and the board of directors is required to determine the minimum amount of such consideration. The Amendments expressly provide that such consideration may include inducing stockholders to take or refrain from taking one or more actions. These actions could include facilitating an initial public offering, and inactions could include not pursuing an activist proxy campaign. By requiring consideration be provided to the corporation, the Amendments would not alter existing caselaw regarding the facial validity of governance arrangements in documents entered into without consideration, such as bylaws or stockholder rights plans.

Fiduciary Duties. The Amendments would not alter the fiduciary duties of directors, or existing standards of review, with respect to a decision to enter into such contracts. Nor would the Amendments alter existing case law setting aside contracts if the contractual counterparty aided and abetted a breach of fiduciary duty in entering into the contract. Finally, the Amendments would not impact the fiduciary duties of directors in considering whether to breach the contract.

Remedies Available Under Contracts. The Amendments provide that the result of a breach of such agreement would be that the corporation is subject to the remedies available under applicable law. Accordingly, even if a contract required action by other persons (such as individual directors), if those persons did not act as contemplated by the contract, the counterparty would have a breach of contract remedy against the corporation only (and not such other persons). If the contract were governed by Delaware law, this could allow a contractual counterparty to seek damages for breach of contract or specific performance. An award of specific performance, however, would remain within the discretion of the Court and might not be available to the extent that such an award would require an order that a board of directors perform an action or that the corporation take an action (such as a merger) requiring stockholder approval in the absence of such approval. Thus, as stated in the synopsis, if an action addressed in a covenant by the corporation requires director or stockholder approval under the DGCL, that approval must still be obtained in order to effect the action pursuant to the DGCL.

Overdelegation Cases Unaffected. The Amendments would also introduce a related amendment to subsection (5) of Section 122 clarifying that any agreement empowering an officer or agent to act on behalf of the corporation would remain subject to existing common law interpreting Section 141(a). Accordingly, the Amendments authorize the creation of a valid contractual obligation and resultant remedy, but do not allow the directors to overdelegate their authority to manage the corporation to others.

Application By Default: The Amendments would also introduce language at the beginning of Section 122 to clarify existing law that a corporation has all of the powers set out in Section 122 unless such powers are expressly limited through a provision of its certificate of incorporation. Accordingly, new

Section 122(18) (along with all other powers in Section 122) will apply to all corporations by default, whether incorporated before or after the Amendments become effective. A corporation will continue to have the ability to limit its powers with respect to any matter specified in Section 122 through a provision in its certificate of incorporation.

Facts Ascertainable. The synopsis to the Amendments provides that such agreements would be facially valid "even if those provisions are not set forth in, or referenced as a fact ascertainable in, the certificate of incorporation." The synopsis further notes that a corporation may limit its corporate power to enter into a stockholder agreement referred to in Section 122(18) "if a limitation is provided for, or referenced as a fact ascertainable in, the certificate of incorporation" as permitted by Section 102. In doing so, the synopsis confirms that a certificate of incorporation may incorporate certain agreements and arrangements by reference into the certificate of incorporation.

CRISPO AND MERGER AGREEMENT REMEDIES

Legal Background.

In a merger, consideration typically is paid to stockholders who are not parties to the merger agreement, as opposed to the target corporation that is a party. In a 2005 opinion addressing a failed transaction, the U.S. Second Circuit Court of Appeals held that, in light of provisions in a merger agreement (i) conferring third-party beneficiary status to the target company stockholders *after* the effective time of the merger and (ii) contemplating liability following a breach for damages "suffered by the party," a target company could not pursue damages for lost stockholder premium arising from pre-closing breaches by the acquiror.[4] The inability of a target company to seek damages based on such lost stockholder premium could make it more difficult for the target to enforce the contract, particularly where a remedy of specific performance is unavailable or made unavailable by the acquiror's breach. Until recently, Delaware courts had not definitively addressed whether Delaware law would follow the Second Circuit approach. Practitioners generally believed, however, that even if Delaware would follow the Second Circuit approach by default, parties could provide the target the ability to seek such damages, either by defining the target's damages to include lost stockholder premium or by allowing the target to pursue such damages as agent on behalf of its stockholders. In *Crispo v. Musk*, the Court of Chancery suggested, in *dicta*, that: (i) Delaware would follow the Second Circuit approach by default and (ii) each of the methods practitioners generally utilized to contract around that approach would be invalid as a matter of law.[5]

Proposed Amendments to the Delaware General Corporation Law Would Address Recent Caselaw Regarding Stockholder Agreements and Merger Agreements

The Proposed Amendments.

Failed Transactions. The Amendments would add a new subsection (a)(1) to Section 261 of the DGCL to clarify that parties to a merger agreement may contract for penalties or consequences for a breach of the merger agreement that occurs prior to the effective time, or for any other failure to consummate, or cause the consummation, of the merger. Those penalties or consequences may include an obligation to pay damages based on the loss of any premium otherwise payable to stockholders in the merger. The synopsis to the Amendments confirms that such penalties or consequences are enforceable regardless of any otherwise applicable provisions of contract law, such as those addressing liquidated damages and unenforceable penalties. By allowing such penalties or consequences for otherwise failing to consummate, or cause the consummation of, a merger regardless of breach, the Amendments would apply to termination fees payable by the acquiror or its acquisition vehicle in the absence of a breach (such as for failure to obtain regulatory approval of a transaction). The Amendments further provide that the party receiving any such payment may retain it. Accordingly, such payment need not be distributed to stockholders. As noted in the synopsis, the Amendments would not alter the fiduciary duties of directors in determining whether to approve, perform or enforce any such provision. Thus, for example, a determination of a board to approve a contract providing for a termination fee upon a change in recommendation or approval of a superior proposal remains subject to existing fiduciary duty caselaw.

Completed Transactions. In light of, among other things, the discussion in *Crispo* questioning the validity of provisions allowing a corporation to pursue lost stockholder premium damages as agent on behalf of its stockholders, the Amendments would also add a new subsection (a)(2) to Section 261 clarifying that parties to an agreement may provide for the appointment of one or more persons to act as representative of the stockholders. This form of appointment is often included in private company merger agreements to specify the person that may act for stockholders in connection with post-closing purchase price adjustments or indemnification claims. The Amendments would clarify that, through such a provision, the representative may be delegated the sole and exclusive authority to act on behalf of stockholders in enforcing (including by entering into settlements with respect to) the rights of stockholders under the agreement. As the synopsis makes clear, however, the Amendments do not authorize provisions empowering a stockholders' representative to exercise powers beyond those related to the enforcement of the rights of stockholders under the agreement, such as by waiving appraisal rights or rights to bring direct claims for breach of fiduciary duty, or to consent in the name of a stockholder to restrictive covenants (such as a covenant not to compete or a nonsolicitation covenant). The Amendments do not prevent, however, any stockholder from individually granting a stockholders' representative such powers. Under the Amendments, the appointment of the representative is not effective until the agreement is adopted by stockholders, but, when effective, the appointment may be irrevocable and binding on all stockholders. The

Amendments also allow the merger agreement to prohibit the amendment of the terms providing for such appointment, either generally or absent the approval of persons specified in the agreement, after the merger has become effective.

Fact Ascertainable. The Amendments proposed in response to *Crispo* confirm that any of the provisions contemplated by such Amendments may be made dependent upon facts ascertainable outside the merger agreement, so long as the manner in which such facts operate is clearly and expressly set forth in the merger agreement. Such "facts ascertainable" may include the occurrence of any event, including a determination or action by any person or body.

ACTIVISION AND APPROVAL PROCESSES

Legal Background.

The DGCL contemplates the following sequence for approving merger agreements: (i) the board adopts a resolution approving "an agreement of merger," (ii) "the agreement so adopted shall be executed" and (iii) "the agreement . . . shall be submitted to the stockholders" upon due notice of a meeting, which notice "shall contain a copy of the agreement or a brief summary thereof."[6] The DGCL further provides that the agreement must include any amendments to the certificate of incorporation of the surviving corporation to be effected by the merger, or, if there will be no amendments, a statement that the certificate of incorporation of the surviving corporation will be its certificate of incorporation. The DGCL also provides that any such provision will not be amended after stockholder approval of the merger agreement. *Sjunde Ap-Fonden v. Activision Blizzard*[7] addressed a plaintiff's arguments that several of these requirements were not followed in connection with Microsoft's acquisition of Activision. In particular, the plaintiff alleged that the Activision board did not properly approve the merger agreement because: (i) the merger agreement that the board approved was not in "final form" because, among other things, it did not state the amount of consideration or include a provision regarding the dividends the target could pay between signing the agreement and closing the merger; (ii) the package sent to the Activision board did not include the disclosure letter to the merger agreement and accompanying schedules or the surviving corporation certificate of incorporation; and (iii) a committee of the board allegedly negotiated, after board approval of the overall merger agreement, the permitted amount of pre-closing dividends that could be paid by Activision. In addition, the plaintiff alleged that the notice of stockholder meeting did not satisfy statutory requirements because the proxy statement mailed to stockholders did not attach the surviving company charter. Finally, the plaintiff alleged that the parties had improperly effectively amended the merger agreement by agreeing to extend the outside date when regulatory approval appeared unlikely to be obtained by that date.

With respect to the allegations regarding board approval, the Court held that, at minimum, the merger agreement approved by a board of directors must be "an essentially complete" version of the merger agreement, and that plaintiff's allegations regarding omissions from the merger agreement approved by the board and accompanying board package, as well as delegation to a committee to finalize the permitted amount of pre-closing dividends, survived a motion to dismiss under an "essentially complete standard." With respect to the allegations regarding the stockholder notice, the Court held that, even though the proxy statement accompanying the notice contained a summary of the merger agreement, the text of the notice itself did not refer to that summary and instead referred to the enclosed copy of the merger agreement, and that the enclosed copy was not complete because it omitted the surviving company charter. As a result, the Court held that the plaintiff adequately alleged the merger was not duly authorized in accordance with the DGCL and that its shares were unlawfully converted. Finally, with respect to the allegation that the parties had improperly effectively amended the merger agreement by agreeing to extend the outside date, the Court dismissed plaintiff's claims because plaintiff's allegations focused on speculation of an extension, rather than a letter agreement entered into on the outside date that (i) waived until a later date the parties' rights to terminate the merger agreement for failure to consummate the merger by the contractual outside date, (ii) increased the reverse termination fee payable for failure to obtain regulatory approval and (iii) waived the negative covenant on paying dividends to permit Activision to pay an additional $0.99 dividend pre-closing.

The Proposed Amendments.

The Amendments would address issues raised in *Activision* regarding the process of board and stockholder approval of a merger agreement.

Board Approval of Merger Agreement. The Amendments would add a new Section 147 to the DGCL providing that, whenever the DGCL requires a board to approve or take other action with respect to any agreement, instrument or document, that agreement, instrument or document may be in either final form or substantially final form.[8] The synopsis to the Amendments clarifies that "other action" includes declaring advisable and recommending any such agreement, instrument or document. Although new Section 147 does not define "substantially final form," that synopsis contemplates that an agreement will be in substantially final form if all of the material terms are set forth therein or determinable through other information or materials presented to or known by the board of directors. Although helpful, there still may be questions regarding whether a term is "material."[9] To provide flexibility if questions exist as to whether an agreement is in substantially final form when approved, new Section 147 will also provide the ability to adopt a resolution ratifying any approval or other action with respect to an agreement (such as a merger agreement) that is required to be filed with the Secretary of State or referenced in any certificate so filed (such as a certificate of merger),

so long as such ratification occurs prior to such filing, and provides that such ratification will be deemed effective as of the time of original approval or other action, including for purposes of satisfying any DGCL requirement that the board of directors and stockholders approve or take other action with respect to such agreement, instrument or document in a specific manner or sequence. This ratification is an alternative to ratification contemplated by Section 204 of the DGCL, and thus does not require notice to stockholders that otherwise would be required under Section 204.

In addition, and recognizing that the provisions in the DGCL addressing the surviving corporation charter practically only effect corporations whose stockholders will receive stock in the surviving corporation, the Amendments would add a new Section 268(a) to the DGCL, which will address actions required to be taken regarding the surviving corporation charter by a constituent corporation whose stockholders do not receive stock in the surviving corporation (such as the target in a cash out merger). With respect to such constituent corporations, clause (i) of that subsection provides that the merger agreement approved by the board need not include any provision regarding the certificate of incorporation of the surviving corporation in order for the agreement to be considered in final form or substantially final form. Although the surviving corporation charter still must be adopted on behalf of such a constituent corporation, clause (ii) of that subsection states that such adoption may be by the board of directors of such constituent corporation or any person acting at its direction or, if the shares or equity interests of any other constituent entity to the merger are to be converted into all of the shares of capital stock of the surviving corporation, by the board of directors or governing body of such other constituent entity or other person acting at its direction. Finally, clause (iii) of that subsection provides that, with respect to a constituent corporation whose shareholders do not receive stock in the surviving corporation, no alteration or change of the surviving corporation charter shall be deemed to constitute an amendment to the merger agreement. As a result, the surviving corporation charter may be amended without implicating, with respect to such a constituent corporation, the prohibition in Section 251(d) on amendments to the surviving company charter after stockholder approval of the merger agreement.[10] Notwithstanding this additional statutory flexibility, a target corporation may seek to include certain covenants regarding the post-closing certificate of incorporation of the surviving corporation in the merger agreement; for example, those relating to exculpation, indemnification and advancement of expenses of directors, officers and others.

Finally, the Amendments would add a new Section 268(b) to the DGCL providing that, unless otherwise expressly provided by the relevant agreement, disclosure letters and schedules with respect to representations, warranties, covenants, or conditions contained in the agreement are not deemed part of the agreement for purposes of the DGCL. As stated in the synopsis, new Section 268 (b) reflects the fact that such disclosure schedules often operate as "facts ascertainable" by reference into the agreement, but are not themselves part of the agreement. Accordingly, they may

be negotiated and prepared by officers and agents at the direction of the board without the need, as a statutory matter, for formal approval by the board. Although not deemed part of the agreement for purposes of the DGCL, new Section 268(b) makes clear that the disclosure letters and schedules will have the effects provided for in the agreement.

Notice of Stockholder Meetings. The Amendments would add a new subsection (g) to Section 232 of the DGCL providing that any document enclosed with, or annexed or appended to, a notice will be deemed part of the notice solely for purposes of determining whether notice was duly given under the DGCL and the corporation's certificate of incorporation and bylaws. As stated in the synopsis, because such documents are deemed part of the notice solely for purposes of technical compliance with the DGCL and governing documents, the information contained in such documents is not intended to be deemed "per se" material to stockholders. In addition, as noted above, new Section 268(b) of the DGCL would provide that, unless otherwise expressly provided by the relevant agreement, disclosure letters and schedules with respect to representations, warranties, covenants, or conditions contained in the agreement are not deemed part of the agreement for purposes of the DGCL. Accordingly, such disclosure documents need not be included in the notice of stockholder meeting. The synopsis to the Amendments makes clear that they do not affect the equitable disclosure obligations of the directors.

Extension of Outside Date. The Amendments do not address the potential, suggested by the Court in Activision, that side letters by which the parties agree not to exercise their termination rights for a period of time following the outside date, are effectively an amendment to the merger agreement. Under Section 251(d) of the DGCL, any such amendment would be invalid if it occurs after stockholder approval and "adversely affects" the stockholders. Given that the DGCL already provides, however, that any term of a merger agreement "may be made dependent upon facts ascertainable outside of such agreement," the parties could mitigate this issue by defining the outside date to include a specified date "or such other date as may be agreed to by the parties from time to time."

EFFECTIVENESS OF AMENDMENTS.

The Amendments would apply to all contracts made by a corporation, all agreements, instruments or documents approved by the board of directors and all agreements of merger entered into by a corporation, whether or not made, approved or entered into before the effective date of the Amendments. Accordingly, to the extent existing agreements may facially be invalid for reasons set forth in *Moelis*, the Amendments would eliminate that potential facial invalidity to the extent the agreement complies with proposed Section 122(18). The Amendments would not, however, affect the outcome of any litigation completed or pending prior to the effective time of the Amendments; with respect to such litigation, the law predating the Amendments would apply.

Given that the Amendments would apply to contracts whether or not approved before the effective date of the Amendments, any corporation currently party to a contract that may be facially invalid under *Moelis* should discuss with outside counsel what, if any, action should be taken while the Amendments are under consideration by the General Assembly. Because the Amendments would not affect the outcome of any litigation pending prior to the effective time of the Amendments, consideration may be given to the potential for a stockholder lawsuit challenging the facial validity of the relevant agreement prior to the Amendments becoming effective (assuming they are adopted into law). We believe, however, a facial validity challenge brought between the announcement of the Amendments and any potential adoption of the Amendments would ultimately confer no corporate benefit because, if adopted, the Amendments would automatically render the agreement no longer facially invalid.

ENDNOTES

[1] The Amendments will be submitted for approval by the Corporation Law Section and presented to the Executive Committee of the Delaware State Bar Association before they are presented to the Delaware General Assembly for its consideration.

[2] 2024 WL 747180 (Del. Ch. Feb. 23, 2024).

[3] The Court has subsequently applied a Moelis-type analysis in expediting litigation challenging provisions of an agreement settling an activist campaign. See *Taylor v. L3 Harris Tech's, Inc.*, C.A. No. 2024-0205-JTL (Mar. 13, 2024); *Miller v. Bartolo*, C.A. No. 2024-0176-JTL (Mar. 8, 2024).

[4] *Con. Edison, Inc. v. N.E. Utilities*, 426 F.3d 524 (2d Cir. 2005).

[5] 2023 WL 7154477 (Del. Ch. Oct. 31, 2023). Although the Court left open the possibility that stockholders could be permitted under the contract to seek such damages pre-closing, acquirors are generally unwilling to provide stockholders that right.

[6] 8 *Del.* C. § 251.

[7] C.A. No. 2022-1001-KSJM (Del. Ch. Feb. 29, 2024) (corrected Mar. 19, 2024).

[8] New Section 147 thus applies to documents beyond merger agreements, such as charter amendments. The timing exigencies at issue in Activision, however, are most likely to arise in connection with approval of a merger agreement and for ease the remainder of this discussion focuses on merger agreements.

[9] For example, an exception to a covenant regarding payment of dividends pre-closing may or may not be material, particularly in a case like Activision, where required regulatory approvals would result in a lengthy time between sign and close.

[10] In a cash out merger structured as a reverse triangular merger, because the stock of the acquisition vehicle that merges with the target will be converted into surviving company stock, this additional flexibility will not apply with respect to approvals by that entity. Because however, the terms of a merger agreement may be made dependent on facts ascertainable outside of the merger agreement, it will continue to suffice to state that the certificate of incorporation of the surviving corporation will be amended to be in the form of the certificate of incorporation of the acquisition vehicle as it exists immediately prior to the merger (subject to any changes with respect to corporate name, registered agent and incorporation).

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March 29, 2024

Proposed 2024 DGCL Amendments: "Chancery Court Cleanup in Aisle 3!"

The Chancery Court's recent decisions in *Crispo*, *Moelis*, and *Activision Blizzard* have caused a lot of angst in the M&A community. Yesterday, the Delaware Bar took steps to calm the storm by recommending proposed amendments to the DGCL designed to address the uncertainty created by these decisions. Here's an excerpt from this Richards Layton memo summarizing some of the proposed changes:

> – Section 122, which enumerates express powers that a corporation may exercise, is being amended in response to the Delaware Court of Chancery's opinion in *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.*, — A.3d —, 2024 WL 747180 (Del. Ch. Feb. 23, 2024), to provide that a corporation may enter into governance agreements with stockholders and beneficial owners where the corporation agrees, among other things, to restrict itself from taking action under circumstances specified in the contract, require contractually specified approvals before taking corporation action, and covenant that it or one or more persons or bodies (which persons or bodies may include the board or one or more current or future directors, stockholders or beneficial owners of stock) will take, or refrain from taking, contractually specified actions.
>
> – New Section 147 is being added in light of the Delaware Court of Chancery's opinion in *Sjunde AP-Fonden v. Activision Blizzard, Inc.*, 2024 WL 863290 (Del. Ch. Feb. 29, 2024), to provide that, where the DGCL requires the board of directors to approve an agreement, document or other instrument, the board may approve the document in final form or substantially final form. The new section will also provide that, where the board has previously taken action to approve an agreement, document or other instrument that is required to be filed with the Delaware Secretary of State (or required to be referenced in a certificate so filed (*e.g.*, a certificate of merger or certificate of amendment)), the board may ratify the agreement, document or other instrument before the instrument effecting the act becomes effective.
>
> – New Section 261(a)(1) is being added in light of *Crispo v. Musk*, 304 A.3d 567 (Del. Ch. 2023), to provide, among other things, that a target company may include in a merger agreement a provision that allows the target to seek damages, including damages attributable to the stockholders' loss of a premium, against a buyer that has failed to perform its obligations under the merger agreement, including any failure to cause the merger to be consummated.
>
> – New Section 261(a)(2) is being added to provide that stockholders may, through the adoption of a merger agreement, appoint a person to act as stockholders' representative to enforce the rights of stockholders in connection with a merger, including rights to payment of merger consideration or in respect of escrow or indemnification arrangements and settlements.

Other proposed amendments would address additional concerns raised by these decisions. In response to *Activision*, Section 232 of the DGCL would be amended to provide that any materials

included with a notice to stockholders would be deemed to be part of that notice, and a new Section 268 would be added to address ministerial matters relating to the adoption of a merger agreement.

– **John Jenkins**

Posted by John Jenkins
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May 13, 2024

Proposed 2024 DGCL Amendments: Revisions Pare Back Moelis Fix

In March, the Delaware Bar proposed DGCL amendments designed to addresses the issues created by the Chancery Court's *Crispo*, *Moelis*, and *Activision Blizzard* decisions. However, some of the proposed changes, particularly a proposed amendment to Section 122 of the DGCL, attracted a lot of criticism. That amendment would have overruled *Moelis* by permitting a Delaware corporation to enter into governance agreements with stockholders that would restrict it from taking action, require specific approvals before it takes action, and require the board, stockholders and others to take, or refrain from taking, contractually specified actions.

Critics of the proposed revision pointed out that it would undo some pretty fundamental propositions of Delaware law:

> On its face, the Amendment seemingly authorizes corporations to enter *any* contract changing *any* aspect of corporate governance. But that cannot be its intended effect. Do the Amendments intend, for example, to empower a corporation to promise its directors that it will never sue them, even for an intentional tort or bad faith act? Do the Amendments intend to empower a board to cede 100 percent of its decisionmaking power to a single person? The answers to these questions cannot be yes.
>
> The Amendments would also conflict with other parts of the statute. DGCL 141(b) provides that only natural persons can serve on a board, but the Amendments would enable a corporation to contractually cede one or more seats to an outside entity. Is this an intended consequence? If so, then far more is at stake than the agreement rejected in *Moelis*.

In response, the Delaware Bar tweaked the language of the proposed amendments to Section 122. In a recent blog, Prof. Ann Lipton summarized the effect of the revisions:

> The new amendments are a little different, in that they do not permit contracts that would confer governance powers *beyond* what could be included in the charter, or would be contrary to Delaware law. In other words, if there are certain core powers that must remain with the board and can't be visited in someone else via the charter, then, these amendments to the amendments would not allow those powers to be transferred via stockholder contracts. The new language provides:
>
> > no provision of such contract shall be enforceable against the corporation to the extent such contract provision is contrary to the certificate of incorporation or would be contrary to the laws of this State … if included in the certificate of incorporation.
>
> But also, in determining what these "core" board powers are, courts can't rely on the fact that the power is one that is statutorily conferred on the board. As the amendments put it, "a restriction, prohibition or covenant in any such contract that relates to any specified action shall not be deemed contrary to the laws of this State or the certificate of incorporation by reason of a

> provision of this title or the certificate of incorporation that authorizes or empowers the board of directors (or any one or more directors) to take such action."

So anyway, that's where we are now. When I was at Tulane's Corporate Law Institute a few months ago, the Delaware justices in attendance indirectly addressed the ongoing "let's get out of here and move to Nevada or Texas!" kerfuffle. The justices strongly defended Delaware's judiciary, but I came away feeling that this whole controversy has caused some real alarm. The lightning speed with which the Delaware Bar responded to these decisions and the scope of the changes it proposed – and now this rapid backpedaling – has kind of left me with the same feeling.

– **John Jenkins**

Posted by John Jenkins
Permalink: https://www.deallawyers.com/blog/2024/05/proposed-2024-dgcl-amendments-revisions-pare-back-moelis-fix.html

June 21, 2024

Delaware Legislature Passes Moelis Fix

Last night, the Delaware Legislature passed the controversial 2024 amendments to the DGCL and sent the legislation to Gov. John Carney for signature. Whatever the legislation's merits may be, it would make sweeping changes to Delaware's statutory corporate governance structure and create a number of thorny issues for the Chancery Court to work through. One respected commenter warned that the legislation could also backfire on the state. Here's an excerpt from a *Delaware Business Times* article on the Legislature's action:

> Charles Elson, who founded the University of Delaware's Weinberg Center for Corporate Governance and has served on several board of directors and advised many others, testified a third time before legislators that he thought SB 313 would threaten Delaware's dominance in corporate litigation matters.
>
> "This kind of revision hasn't taken place since the 1980s, and that took two years of back and forth and compromise. This has taken two months, and I don't believe there's significant enough debate or attempts to compromise," he said. "Decisions on corporate law should not be a ballgame, because it's our bread and butter … It constitutes 67% of our revenues, and it's the reason we don't have a sales tax."

Supporters of the legislation include former Chancellor William Chandler, who expressed his faith in the Delaware Corporate Law Council, which drafted the legislation. According to the *Business Times* article, he warned legislators that if the amendments didn't pass, "[t]he headlines will read that two judges and a lot of law professors succeeded in convincing [legislators] to vote down changes to corporate law that would have preserved the continuity and stability that we have known."

Former Chancellor Chandler also called out Chancellor McCormick and Vice Chancellor Laster for their public participation in the debate over the legislation. Here's another excerpt from the *Business Times* article:

> "As chancellor, I was taught that judges need to stay in their lane and need to be applying the law [legislators] give them," Chandler said. "Judges don't need to intrude upon the process of law, because if they do they become the makers as well as the appliers."

As plaintiffs' lawyer Joel Fleming pointed out on Twitter, that's a lesson that the former Chancellor apparently neglected to pass on to his immediate successor. It's also a message that many other members of the Delaware judiciary who, over the years, have written articles, given speeches and provided other extra-judicial commentary to influence the course of Delaware law, apparently never received.

– **John Jenkins**

Posted by John Jenkins
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June 28, 2024

Delaware Amendments: The Return of the Dead Hand Pill?

If you've been paying attention to the debate over the 2024 Delaware DGCL amendments, one thing that seems pretty clear is that a lot of stuff we all thought was settled long ago is once again up for grabs. Take "dead hand" poison pills, for example. These pills contained provisions that only permitted them to be redeemed by "continuing directors" and the Chancery Court invalidated them in *Carmody v. Toll Bros.*, 723 A.2d 1180 (Del. Ch. 1998), on the basis that the adoption of such a provision involved both a violation of Section 141 of the DGCL and a breach of the directors' fiduciary duties. In a recent M&A Law Prof Blog post, Prof. Brian Quinn says that the Delaware Legislature may have resurrected the dead hand pill:

> In *Toll Brothers*, VC Jacobs – on a motion to dismiss – held that since the Rights that were the fulcrum for the dead hand pill could not be redeemed pursuant to the terms of the Rights Agreement by any board other than the directors who had initially adopted the pill (or at least by the directors who were continuing from the original board following a successful proxy contest) that the Rights Agreement ran afoul of § 141(a) and (d) was therefore invalid.
>
> OK, so fast forward to 2024. Now that § 122(18) has passed and § 141(a) no longer sits atop the statutory hill, one can imagine writing an amendment to the Shareholder Rights Agreement that designates a shareholder or shareholders (who happen to be current directors) as responsible for pulling the pill. The board covenants not to redeem the pill under the Rights Agreement unless the director/shareholder agrees. So, even if the director (or directors) are replaced in a proxy contest, their dead hands will still float around the boardroom preventing the new board from pulling the pill in a manner that the new board believes is consistent with its fiduciary duties.

I don't know that this issue is quite as cut and dried as this blog suggests. As noted above, Vice Chancellor Jacobs also held that in adopting the dead hand provisions, the directors breached their fiduciary duties, and fiduciary duty claims are something that the advocates of the amendments contend are unaffected by them. Still, if you're defending a dead hand provision, you'd rather try to argue your way through *Unocal* than confront a statutory brick wall.

– **John Jenkins**

Posted by John Jenkins
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July 9, 2024

Delaware Amendments: Is There a Remedy for a Breach of a Section 122(18) Contract?

The list of unanswered questions about Delaware's statutory *Moelis* fix – new Section 122(18) of the DGCL – isn't getting any shorter. A recent post on the Harvard Governance Blog by Stanford Law School lecturer Jim An says that parties to the kind of governance agreements enabled by Section 122(18) may find themselves unable to obtain specific performance – and perhaps unable to obtain monetary damages as well.

The blog lays out a hypothetical under which a party has a contractual right to veto the appointment of a new CEO, but the company appoints that CEO over the party's objections. The blog notes that this an equitable remedy like specific performance to compel the CEO's removal would be the preferred remedy in this situation, but this excerpt suggests that might not work:

> A problem arises, however, if the remedy of specific performance is put up against the legislative purpose of § 122(18). As a reminder, § 122(18)'s sponsors repeatedly represented to Delaware's legislators that, at least in the § 122(18) context, "fiduciary duties trump contracts, always."
>
> To elaborate on the above CEO-veto example, suppose that the directors of the corporation have made a good-faith determination that Candidate A is the best choice for CEO, and that it would violate their fiduciary duties to allow the side-letter counterparty to veto that choice. Accordingly, the directors cause the corporation to breach the terms of the side letter and appoint Candidate A anyway, as the directors must to fulfill their fiduciary duties.
>
> If, however, a court subsequently enforces the veto right at the behest of the counterparty, it will have rendered the clear intent of § 122(18)'s drafters and proponents a nullity—the contract would have trumped the board's fiduciary duties, and no "efficient breach" would be possible in any meaningful way. The only way for a court to give meaning to the purpose of § 122(18) is to hold that specific performance is unavailable for § 122(18)-enabled contracts where a corporation can show that it breached the contract as a result of its directors' fiduciary obligations under the relevant standard of review (which would be the deferential business judgment rule in most cases). Moreover, if a board intentionally avoids such a breach to escape, say, public harassment from the counterparty, the board may be engaging in self-dealing conduct and exposing itself to a fiduciary duty suit from other shareholders subject to enhanced scrutiny.

The blog goes on to say that an alternative like a liquidated damages provision with teeth might also preclude a board from engaging in an efficient breach, and in the absence of such a provision, economic damages may be very difficult to prove – thus leaving the party with a contract right that's essentially illusory.

I do think the Chancery Court is going to spend an inordinate amount of time over the next several years sorting out the fiduciary duties v. contract rights thicket created by these amendments, but I guess I'm as skeptical about this addition to the parade of horribles supposedly associated with this statute as I am about the suggestion that dead hand pills are now undead. It seems to me that the

unfortunate phrase “fiduciary duties always trump contracts” is being used as a straw man here, and I doubt that the Chancery Court is going to see these issues in black and white terms.

> Fortunately, you don’t have to rely on my half-baked thoughts on the DGCL amendments, because we’ve assembled a panel of experts for our upcoming webcast – “2024 DGCL Amendments: Implications & Unanswered Questions” – to help you navigate Section 122(18) and the other recent changes to the DGCL.

– **John Jenkins**

Posted by John Jenkins
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