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PROPOSED AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW WOULD ADDRESS RECENT CASELAW REGARDING STOCKHOLDER AGREEMENTS AND MERGER AGREEMENTS

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

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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).

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

[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).

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]

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

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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.

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:

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[6] 8 *Del. C.* § 251.

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

(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

[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

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

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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.

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

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[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 incorporator).

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.