

Can It Be Fixed? Further Judicial Guidance Concerning Sections 204 and 205

Contributors

Jenness E. Parker, Counsel

Kaitlin E. Maloney, Associate

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As discussed in an earlier edition of *Insights: The Delaware Edition*, Sections 204 and 205 of the Delaware General Corporation Law (DGCL) provide methods for Delaware corporations to unilaterally ratify defective corporate acts without court involvement (Section 204) or seek relief from the Delaware Court of Chancery to validate a corporate act under certain circumstances (Section 205).¹ Recently, the Court of Chancery issued rulings in three cases addressing the applicability of Sections 204 and 205 to the following defective corporate acts: (i) a stock issuance effected by a corporation even after it was rejected by a majority stockholder; (ii) technical defects related to reverse stock splits perpetuated by allegedly self-interested board members whose consequences manifested years later; and (iii) technical defects related to written consents for stockholder approval of a merger. Each of these cases is examined below.

Nguyen v. View, Inc.

In *Nguyen v. View, Inc.*, the Court of Chancery held, as a matter of first impression, that a corporate act taken after being deliberately rejected by a majority stockholder was not a “defective corporate act” subject to ratification under Section 204.² In 2009, View, Inc. (View, or the Company) asked its stockholders to consent to a round of Series B preferred stock financing. At the time, View’s founder and former CEO Paul Nguyen owned approximately 70 percent of the Company’s common stock. As part of a broader resolution of claims regarding his termination earlier that year, Nguyen signed a settlement agreement that included his consent to the Series B financing, subject to a seven-day revocation period. During the revocation period, Nguyen revoked his consent, but — unbeknownst to Nguyen — View had already closed the Series B financing. The parties arbitrated the issue, where it was determined that Nguyen had properly revoked his consent to the Series B financing, rendering the Series B financing invalid and void.

Nevertheless, View attempted to ratify the financing. In response, Nguyen filed a complaint in the Court of Chancery, arguing that the attempted ratifications were improper. Vice Chancellor Slights agreed with Nguyen. He explained that in order to fall within the “remedial purposes” of Section 204, the ratifications at issue must have been directed at acts that were within the corporation’s power at the time such acts were purportedly taken. To the contrary, at the time View closed the Series B financing, it did not have the power to do so, because Nguyen “deliberately withheld his consent for the transaction — consent that was required for the transaction to be valid as a matter of law.” The court found that Nguyen’s revocation of consent was “more than a mere ‘failure of authorization’ as contemplated by Section 204,” and therefore, View could not use Section 204 to ratify the financing.

Almond v. Glenhill Advisors

In *Almond v. Glenhill Advisors*, the Court of Chancery decided, post-trial, to validate the ratification of defective stock issuances and stock splits impacting the requisite vote for stockholder approval of a merger because the ratifications were not inequitably motivated.³ *Glenhill* is notable for being the first post-trial opinion to validate defective corporate acts under Section 205.

¹ See Jenness E. Parker and Kaitlin E. Maloney, “Sections 204 and 205 of Delaware Corporation Law: Effective Tools to Remedy Defective Corporate Acts,” *Insights: The Delaware Edition*, May 8, 2017. The Delaware legislature made minor amendments to Section 204 to clarify the types of defective corporate acts susceptible to cure by this provision, which became effective on August 1, 2018. See “[Delaware Enacts Amendments to LLC Act and Delaware General Corporation Law](#),” by Allison L. Land and Anne E. Connolly in this edition of *Insights: The Delaware Edition* for further explanation of the Section 204 amendments this year.

² C.A. No. 11138-VCS, 2017 WL 2439074 (Del. Ch. June 6, 2017), *reargument denied*, C.A. No. 11138-VCS, 2017 WL 3169051 (Del. Ch. July 26, 2017).

³ *Almond v. Glenhill Advisors LLC*, C.A. No. 10477-CB, 2018 WL 3954733 (Del. Ch. Aug. 17, 2018).

Following the acquisition of Design Within Reach (DWR) by Herman Miller, Inc. through a short-form merger, Herman Miller stockholders contended that the acquisition was never properly consummated due to a series of technical mistakes. These included that (i) DWR failed to properly issue shares of common stock upon the conversion of certain shares, (ii) which caused a reverse stock split prior to its acquisition by Herman Miller to fail, and (iii) those technical mistakes meant that Herman Miller owned less than the requisite 90 percent of DWR stock to effectuate a short-form merger.

In response, DWR's board used Section 204 to ratify the stock issuance and stock split, and the corporation requested validation from the Court of Chancery under Section 205. Stockholders that objected to the validation request made allegations of self-dealing in connection with that request, and Chancellor Andre G. Bouchard⁴ ordered a trial. After trial, Chancellor Bouchard validated the ratifications because, among other things, there was "no inequitable motivation" underlying the defective acts or the board's subsequent ratification of them, and the corporation promptly took corrective action to fix them.⁵

Chancellor Bouchard also rejected the plaintiffs' argument that the ratification was ineffective because too much time had passed between the board's failure to amend the certificate of incorporation in 2010 and the stock conversions in 2013. Chancellor Bouchard explained that "Section 205 does not contain a temporal limitation on the court's power to validate defective corporate acts, nor would such a limitation make sense where, as here, the effect of a defective corporate act may not manifest itself until years into the future."

⁴ *Almond v. Glenhill Advisors LLC*, C.A. No. 10477-CB (Del. Ch. Jan. 31, 2017) (TRANSCRIPT).

⁵ The plaintiffs also brought breach of fiduciary duty claims against the director defendants alleging that one or more of them engaged in self-dealing in connection with the merger. The court held that because it validated the defective corporate acts, those claims "necessarily failed."

Cirillo Family Trust v. Moezinia

In *Moezinia*, the court validated deficiencies in written consents approving the merger between DAVA Pharmaceuticals, Inc. (DAVA) and an affiliate of Endo Pharmaceuticals, Inc., holding that "[t]he failure to properly date [written consents] is the epitome of a technical shortcoming that the Delaware General Assembly sought to address when it promulgated Section 205."⁶

Following the board's approval of the merger, DAVA obtained written consents approving the merger from its nine largest stockholders collectively holding over 95 percent of shares. However, seven of the nine written consents were undated or contained a typewritten date added by DAVA's counsel after they were submitted. Because the written consents were not dated when signed, they were considered *per se* invalid under Section 228(c) of the DGCL, and the merger thus technically failed to be approved by a majority of stockholders. Like in *Glenhill*, a stockholder asserted, among other things, that the board engaged in self-dealing, which the court rejected. DAVA and its board sought validation of the written consents under Section 205.

Rejecting plaintiffs' arguments, Chancellor Bouchard validated the written consents and stockholder approval of the merger because the failure to properly date the written consents is exactly the type of technical mistake that the Delaware legislature sought to address when it enacted Section 205. The court also noted that Section 228 was amended in 2017 to eliminate the requirement that written consents bear the date of signature of the consenting stockholder, "suggest[ing] that this requirement was technical in nature and a superfluous condition to the use of written consents."

⁶ *Cirillo Family Trust v. Moezinia*, C.A. No. 10116-CB, 2018 WL 3388398 (Del. Ch. July 11, 2018).

Key Takeaways

Sections 204 and 205 remain effective mechanisms for Delaware corporations to unilaterally fix issues and obtain validation of defective corporate acts from the Court of Chancery. The recent cases discussed in this article underscore several important developments concerning Sections 204 and 205:

- The *View* opinion suggests that Section 204 may not be used to ratify corporate acts deliberately rejected by a majority of stockholders because they are not within the corporation's power.
- In circumstances similar to *Glenhill* and *Moezinia*, corporations and their counsel may consider utilizing Section 205 to facilitate the correction of technical corporate mistakes to avoid potentially disruptive consequences or resolve fiduciary challenges.
- As Chancellor Bouchard explained in *Moezinia*, Section 205 does not contain a specified time limit for a corporation to seek judicial validation of a ratified corporate act, particularly when the effect of such an act may not manifest itself until years into the future.
- When facing potential fall-out from a defective corporate act, consultation with counsel knowledgeable about Sections 204 and 205 may be beneficial to implementing a strategy to effectively remedy the problem.