Proposed DGCL Amendments Would Expressly Authorize Stockholders' Agreements and Align DGCL Provisions With Current M&A Practices

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On March 28, 2024, the Council of the Corporation Law Section of the Delaware State Bar Association (DSBA) approved proposed amendments to the Delaware General Corporation Law (DGCL) in order to align the DGCL's provisions with current market practices following several recent Court of Chancery decisions.

The proposed amendments must be approved by the DSBA's Corporation Law Section and Executive Committee at meetings expected to be held in April, and then submitted to Delaware's General Assembly for its consideration. If adopted by the General Assembly and signed into law by the governor, the amendments would become effective August 1, 2024, except to the extent described below.

Statutory Authorization for Stockholders' Agreements (§122(18))

Stockholders' agreements are a mechanism often used to provide a corporation's significant stockholders — including its founders, private equity firms, and other sponsors — or beneficial owners of its stock with certain contractual rights, including the right to participate in decision-making with respect to the corporation, for so long as they continue to own specified amounts of the corporation's stock.

The Court of Chancery recently examined such an agreement in In *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.*, 2024 WL 747180 (Del. Ch. Feb. 23, 2024), and held that provisions of a stockholder agreement granting the corporation's founder certain approval rights were unenforceable because they constituted an impermissible delegation of the board's managerial authority in contravention of DGCL Section 141(a).

The court also invalidated provisions of the agreement that fixed the size of the board, granted the founder board and board committee designation rights and required directors to take actions, including nominating the founder's designees, recommending to stockholders that they vote in favor of the election of such designees and filling any vacancies on the board with the founder's designees.

The *Moelis* decision has prompted significant debate among practitioners about the validity of the myriad of existing agreements granting similar rights to stockholders, and could result in a wave of litigation challenging such arrangements. The Court of Chancery noted in *Moelis* that "greater statutory guidance may be beneficial" in light of the "expansive" use of such agreements between corporations and their stockholders.

The proposed amendments to DGCL Section 122 would add a new Section 122(18) that expressly authorizes a corporation to enter into agreements with current or prospective stockholders and beneficial owners of its stock for such minimum consideration as is approved by the board of directors (including inducing stockholders or beneficial owners to take, or refrain from taking, specified actions).

If enacted, Section 122(18) would provide greater certainty to corporations, stockholders, practitioners and other market participants in negotiating and entering into stockholders' agreements, that include provisions relating to the management of the corporation's business and affairs.

Proposed Section 122(18) sets forth a non-exclusive list of provisions that may be included in a stockholders' agreement, by which a corporation may agree to:

- Restrict or prohibit itself from taking actions specified in the contract.

- Require the approval or consent of one or more persons or bodies (including the board of directors, or any current or future directors, stockholders or beneficial owners of stock) before the corporation may take specified actions.
- Covenant that the corporation or one or more persons or bodies (including the board of directors or any current or future directors, stockholders or beneficial owners of stock) will take, or refrain from taking, actions specified in the contract.

Notably, proposed Section 122(18) provides that the corporation will be subject to remedies available under the law governing the stockholders' agreement for any failure to perform or comply with any of the corporation's agreements in the stockholders' agreement, such as those listed above, including for any failure of the corporation or its board, or any current or future directors, to take, or refrain from taking, actions specified in the agreement.

Section 122(18), however, would not authorize any stockholders' agreement that imposes remedies against current or former directors if they take, or fail to take, any action required by the stockholders' agreement; nor would it authorize any such agreement that purports to bind the board or individual directors, in their capacities as such, as parties to the agreement.

Moreover, as noted in the synopsis to the proposed amendments, Section 122(18) would not relieve any directors, officers or stockholders of any fiduciary duties owed to the corporation or its stockholders, including in determining whether to cause the corporation to enter into a stockholders' agreement, or whether to perform and/or comply with any covenants in a stockholders' agreement.

Section 122(18) is not intended to impact certain other principles articulated in existing case law, nor does it affect the case law empowering a court to grant equitable relief in respect of a contract, such as when a contract is set aside because the counterparties have aided and abetted a breach of fiduciary duty or based on director actions under an enhanced form of scrutiny.

The proposed amendments also clarify that a corporation may take any of the actions specified in Section 122 regardless of whether they are set forth in the certificate of incorporation. This amendment clarifies existing law, other than with respect to new Section 122(18).

Board Approval of Agreements, Instruments and Documents in 'Substantially Final' Form (§§147, 262 and 268)

In *Sjunde AP-Fonden v. Activision Blizzard, Inc.*, C.A. No. 2022-1001-KSJM (Del. Ch. Feb. 9, 2024), the Court of Chancery addressed whether a board properly approved a merger agreement under Section 251(b) where the board did not approve the final, execution version of that agreement. The court held, as a matter of first impression, that Section 251(b) requires a board of directors to approve either a final merger agreement or an "essentially complete version of the merger agreement." The court, however, did not elaborate on the requirements under the "essentially complete" standard, leaving that for future court determinations.

The *Activision* decision also addressed a challenge to the corporation's compliance with the requirement of Section 251(c) to provide stockholders with notice of the merger. The court held that (i) the summary of the merger agreement in the proxy statement is not sufficient to satisfy such requirement because the "Proxy Statement is not the notice" and (ii) the copy of the merger agreement attached as an annex to the Proxy Statement was insufficient, because, at a minimum, it omitted an essential document appended thereto, i.e., the surviving corporation's certificate of incorporation. The court noted that the General Assembly could adopt amendments to the DGCL to address how the proxy statement relates to the notice of merger.

The proposd amendments would align the DGCL with market practices with respect to these matters, and provide guidance to merger parties and their counsel, as described below:

- The proposed amendments would add a new Section 147 providing that, whenever a board of directors is expressly required by the DGCL to approve or take other action with respect to an agreement, instrument or document (such as making an advisability determination or recommendation to stockholders), the board may approve, or take other action with respect to, an agreement, instrument or document in final form or "substantially final" form.
  - The "substantially final" standard in proposed Section 147 would enable a board of directors to approve or take other action with respect to an agreement, instrument or document if, at the time of such approval or other action, all of its "material terms" are either set forth in the agreement, instrument or document or are determinable through other information or materials presented to or known by the board.
- Proposed Section 147 also provides that, if the board approves or takes other action with respect to any agreement, instrument or document that is required to be filed with the Secretary of State or referenced in any certificate so filed, then, at any time prior to such filing, the board of directors may adopt resolutions ratifying such agreement, instrument or document, and such ratification is deemed to be effective as of the time of the board's original approval or other action, and is deemed to satisfy any requirement under the DGCL relating to the board's approval or other action with respect to such agreement, instrument or document or the specific manner or sequence of any such approval or other action.

  - Ratification under proposed Section 147 is available as an option to provide greater certainty in situations where there may be a question as to whether an agreement, document or instrument approved by the board in substantially final form was in fact substantially final. No such ratification is required, however, for the valid authorization of any such agreement, document or instrument.
  - Proposed Section 147 is not intended to, and does not, exclude any equitable remedies, or alter the fiduciary duties of directors in connection with approving, taking other action with respect to, or ratifying any agreement, instrument or document.
- The proposed amendments would add a new Section 268, which, among other things, provides that a disclosure letter or disclosure schedules or any similar documents or instruments delivered in connection with an agreement of merger or consolidation will not, unless otherwise expressly provided in the agreement of merger or consolidation, be deemed part of the merger agreement for any purposes of the DGCL, but have the effects provided in the agreement (such as qualifying representations and warranties).
- New Section 268 also would permit a merger agreement to exclude provisions relating to the certificate of incorporation of any constituent corporation if all of the shares of its stock will be converted or exchanged in the merger (other than for shares of stock of the surviving corporation).
- Section 232(g) also would be amended to provide that any notice given by a corporation to its stockholders by mail or courier service is deemed to include any document enclosed with, or appended or annexed to, that notice (including a proxy statement), and all information in any such document is incorporated in the notice.

Lost Premium and Other Penalties and Consequences of Terminating a Merger Agreement (§261)

In *Crispo v. Musk*, C.A. No 2022-0666-KSJM (Del. Ch. Nov. 4, 2023), the Court of Chancery addressed an issue of first impression regarding the validity of "lost-premium damages" provisions, which require the buyer to pay the target the amount of premium the target's stockholders would have received in the merger, if the buyer wrongfully terminates the merger agreement, The court noted that "[a] target company has no right or expectation to receive merger consideration, including the premium," and, as a result, "has no entitlement to lost-premium damages in the event of a busted deal."

The court also noted that, although sometimes merger agreements authorize targets to act on behalf of its stockholders to recover lost premium damages, "this approach rested on shaky ground … because there is no legal basis for allowing one contracting party to unilaterally and irrevocably appoint itself as an agent for a non-party."

The proposed amendments include a new Section 261(a) providing that an agreement or merger or consolidation may include any of the following provisions:

- A party to such agreement that fails to perform or comply with the agreement's terms and conditions, or fails to consummate the merger or consolidation (whether by a specific date, upon satisfaction or waiver of conditions or otherwise) shall be subject to such penalties or consequences set forth in the agreement, which may include an obligation to pay an amount based on the loss of any premium or other economic entitlements the stockholders of the other party would be entitled to receive if the merger became effective.
- If a corporation is entitled under such agreement to receive payment of any such penalty or other amounts from another party, the corporation may enforce the other party's payment obligation itself, and shall be entitled to retain the amount of any payment it receives.
- One or more persons may be appointed as representatives of the stockholders of any constituent corporation, including stockholders whose shares will be cancelled, converted or exchanged in the merger or consolidation, and such persons may be delegated the exclusive authority to enforce the rights of such stockholders, including rights to receive payments and under an escrow or indemnification arrangement, and enter into settlements with respect thereto.
  - Any such appointment of a stockholders' representative may be made effective as of, or at any time following, adoption of the merger agreement by such stockholders, and thereafter shall be binding on all stockholders of such constituent corporation.

Effective Dates of Proposed Amendments

As noted above, if enacted by the General Assembly and signed into law by the governor, the proposed amendments will be become effective on August 1, 2024, and shall apply to all contracts made by a corporation (including all stockholders' agreements), all agreements, instruments or documents approved by a board of directors, and all agreements of merger or consolidation entered into by a corporation, in each case, regardless of whether or not they are made, approved or entered into on or before August 1, 2024.

However, the amendments will not apply to or affect any civil action or proceeding completed or pending on or before August 1, 2024. The law in effect prior to the amendments will apply to such actions and proceedings.