2025| VOL. 42 | NO. 1

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A publication of the Corporate Counsel Section of the New York State Bar Association

The (Market-Practice) Empire Strikes Back: 2024 Amendments to the Delaware General Corporation Law

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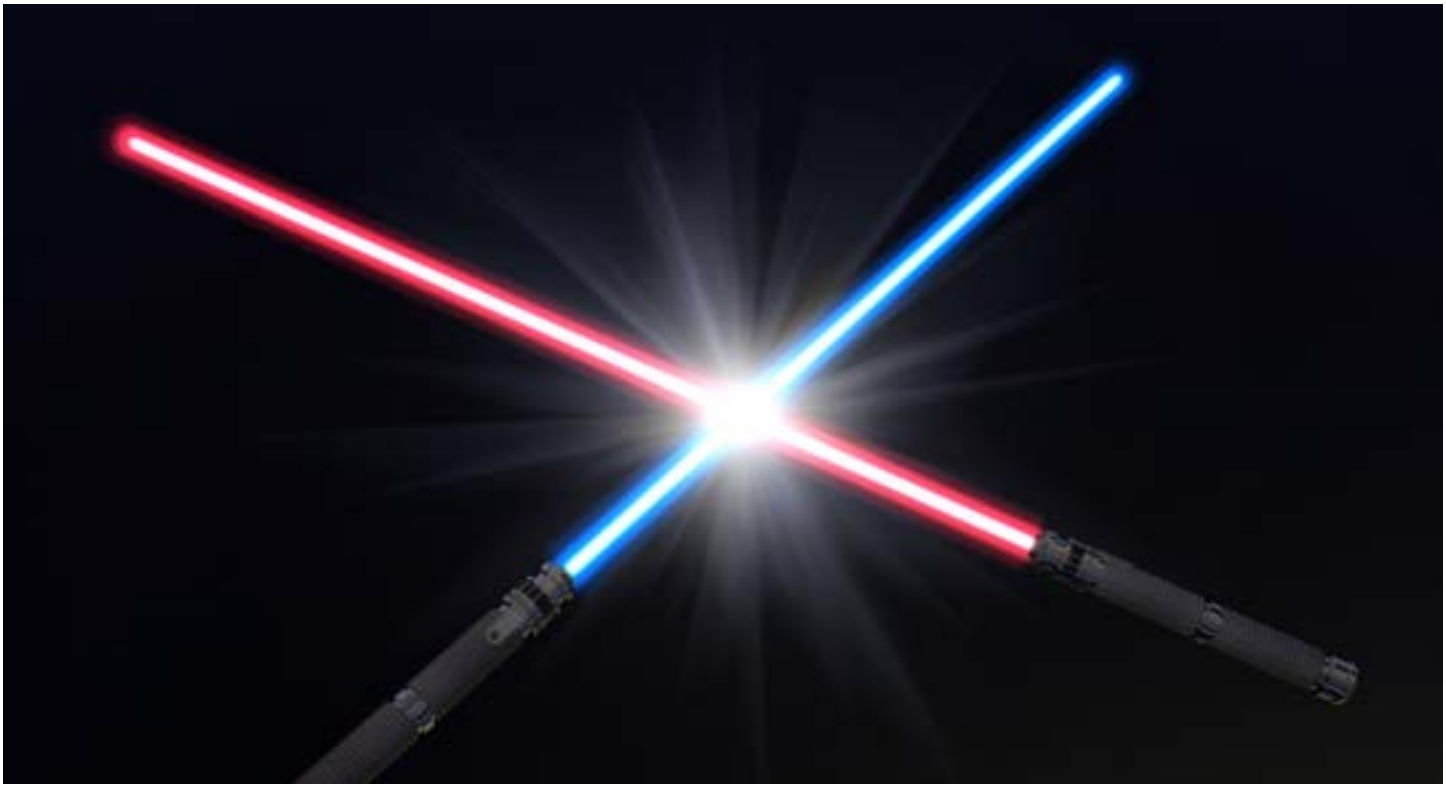

Delaware enjoys a well-deserved reputation for trying to ensure its corporate laws are responsive to the needs of the broader business community. Consistent with that reputation, Delaware enacted several significant amendments to the Delaware General Corporation Law (DGCL) in 2024. Notably, these changes were made in direct response to rulings by the Delaware Court of Chancery that called the validity of several common market practices into question. Through these amendments, the Delaware legislature essentially overruled the Court of Chancery's decisions, and in doing so confirmed the validity of various existing market practices.

Validity of Stockholder Agreements

In *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.*,[1] a stockholder challenged the validity of numerous provisions in a stockholder agreement between a company and its founder, who was also chairman and CEO. The stockholder alleged that the provisions, which included giving the founder consent rights over "eighteen different categories of actions" and board and board committee composition, impermissibly interfered with the board's ability to manage the "business and affairs" of the corporation as required by DGCL 141(a). The Court of Chancery agreed, holding numerous provisions of the agreement were facially invalid under Delaware law because they interfered with the board's ability to exercise its business judgment in certain governance matters yet were not included in the company's charter.

Notably, stockholder agreements such as the one at issue in *Moelis* are not uncommon. The Court of Chancery's decision thus generated a fair amount of uncertainty as to whether, and to what extent, numerous existing stockholder agreements remained enforceable.

In response, the Delaware legislature amended the DGCL to add paragraph 18 to Section 122. Section 122 addresses powers that a corporation can exercise. New Section 122(18) explicitly permits corporations and current or prospective stockholders to enter into governance agreements, provided the corporation receives consideration for the agreement that the board deems sufficient.[2] Section 122(18) identifies a non-exclusive list of the subjects those agreements may address. For example, under Section 122(18), a corporation may agree to "restrict or prohibit itself from taking actions specified in the contract," obtain consent or approval before taking future action, and take or not take (or cause persons or corporate bodies such as the board to take or not to take) actions specified in the contract.

Section 122(18) also places restrictions on what any such agreement may address. The terms of the agreement cannot conflict either with the corporation's charter or Delaware law (other than DGCL Section 115).[3] The new statute also only authorizes the agreement to provide for remedies against the corporation; it does not itself authorize remedies against the board or individual directors, nor does it authorize directors to personally bind themselves via such an agreement.

Validity of Board Approvals of Agreements

In *Sjunde AP-fonden v. Activision Blizzard, Inc.*,[4] a stockholder challenged the Activision board's process for approving Microsoft's acquisition of the company. Among other things, the stockholder challenged the fact that the Activision board approved a draft merger agreement that did not include the final consideration amount and Activision's name as the target, the surviving company's charter, or the agreement's disclosure schedules. The stockholder also challenged the fact that stockholder notice relating to the merger did not itself include a summary of the merger agreement and that the proxy used to solicit approval for the deal that accompanied the notice included an incomplete copy of the merger agreement because it failed to attach the disclosure schedules or the surviving company's charter. According to the stockholder, these failures violated multiple aspects of DGCL 251, which requires directors to approve "the agreement of merger."

The Court of Chancery agreed. The Court held the stockholders' allegations stated a reasonably conceivable claim that the Activision board had failed to comply with DGCL 251. However, the Activision board's actions were hardly unique. To the contrary, everything the Activision board did was arguably consistent with longstanding market practice. So siding with existing practice, the Delaware legislature enacted multiple amendments to the DGCL to address the *Activision* holding.

First, a new Section 147 was added to the DGCL, which addresses board approval of any "agreement, instrument, or document." Section 147 authorizes boards to approve documents in "final form or substantially final form." Under the new statute, a document is "substantially final" if all its material terms are either set out in the document or known to the board through other materials presented to it. Section 147 also gives boards the opportunity to ratify a previously approved agreement or instrument required to be filed with the Delaware Secretary of State to the extent it was not in at least "substantially final" form when approved, so long as ratification occurs before the filing occurs. While Section 147 gives boards more latitude in terms of approval, it does not address the form in which documents must be delivered to stockholders when stockholder approval is required.

Second, a new Section 268 was also added to the DGCL, which among other things addresses charter amendments for surviving entities in statutory mergers and merger agreement disclosure schedules. As to the former, Section 268 provides that in mergers where stockholders do not receive stock in the surviving corporation as part of the consideration (like in *Activision*), a merger agreement no longer must include a provision regarding the charter of the surviving corporation in order to be approved by the board of directors.[5] As to the latter, Section 268 specifies that disclosure schedules and comparable documents that alter or modify representations, warranties or covenants are not considered part of a merger agreement, and thus need not be approved by a board unless the agreement itself specifies otherwise.

Finally, DGCL 232 was amended to add a new Section (g), which clarifies that documents enclosed, annexed, or appended to stockholder notices are deemed part of the notice, even if they are not described in the notice itself.

Validity of Merger Agreement Damages Provisions

In *Crispo v. Musk*,[6] the Court of Chancery addressed the question of whether a non-breaching party to a merger agreement can recover "lost premium" damages from a counterparty that refuses to close the transaction. Before *Crispo*, merger agreements regularly contained provisions allowing the non-breaching party to recover various types of damages from the non-closing counter-party, including the lost premium stockholders would have received in the deal. But in *Crispo*, the Court of Chancery suggested that such clauses could not be enforced by the non-breaching party itself and potentially constituted unlawful penalty provisions. According to the Court, because stockholders – and not the target company – receive the merger consideration (and the benefit of any premiums that consideration reflects), only the stockholders and not the target company could have a claim for losing out on the deal premium.

In response to *Crispo*, the Delaware legislature added Section 261(a)(1) to the DGCL. Section 261(a)(1) expressly permits parties to a merger agreement to set "penalties or consequences" for pre-closing breaches or a failure to close, including damages for any lost deal premium. The section also clarifies that the party to the agreement itself (and not necessarily the stockholders) is entitled to enforce such provisions and to keep any payments received thereunder, even if such payments would have ordinarily gone to stockholders if the transaction had closed.[7]

Key Takeaways

Given the developments noted above, in-house counsel should pay attention to two key takeaways.

Facially Valid Does Not Mean Valid *Per Se*

It is important to keep in mind that while the changes to the law discussed above make certain practices technically permissible, it does not immunize those practices from scrutiny. Even when engaging in a legally permitted practice, directors, officers, and controlling stockholders must still ensure their actions are consistent with their fiduciary duties and other applicable equitable principles that govern their conduct. For example, just because the DGCL now expressly permits certain governance agreements between a stockholder and a corporation, that does not mean the stockholder and the corporation are free to agree to any terms they wish, or reach agreement through any process they desire, irrespective of any fiduciary or other duties owed to the corporation.

Legislative Changes Do Not Completely Resolve Matters

While the recent DGCL amendments remove some uncertainty, at the end of the day they are new laws, the exact application and interpretation of which remains to be seen. It is unlikely that the new laws will eliminate stockholder challenges to governance agreements and corporate approvals, particularly as corporations inevitably explore the bounds of what the new statutes permit. Further developments in this area are imminent. Counsel should closely monitor market and judicial reaction to how these new laws are implemented in practice.

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Endnotes

1. 311 A.3d 809 (Del. Ch. 2024).
2. The section also permits corporations to opt out of the ability to enter into such agreements in the corporation's charter.
3. The carve-out of DGCL Section 1105 permits governance agreements to include a non-Delaware exclusive forum selection clause to resolve disputes relating to the agreement.
4. 2024 WL 863290 (Del. Ch. Feb. 29, 2024).
5. As another way of describing the real-world implications of the new provision, the legislative synopsis states that, "[a]mong other things, this amendment will provide flexibility to a buyer in a typical 'reverse triangular merger' to adopt the terms of the [survivor's charter] that, following the effectiveness of the merger, will be wholly owned and controlled by the buyer."
6. 304 A.3d 567 (Del. Ch. 2023).
7. Although not a response to *Crispo*, the Delaware legislature also added Section 261(a)(2) to the DGCL, which, consistent with longstanding market practice, broadly permits merger agreement parties to appoint a stockholder representative as the party exclusively empowered to enforce certain stockholder rights under the merger agreement.