
Delaware Corporate Statute Amended to Override Much of Recent Chancery Court Decision Invalidating Certain Stockholder Agreement Corporate Governance Provisions

The Delaware legislature has passed and Governor John Carney has signed into law amendments to the Delaware General Corporation Law (the “DGCL”) intended to override significant portions of the Delaware Court of Chancery’s recent decision in *West Palm Beach Firefighters’ Pension Fund, et al. v. Moelis & Company*, No. 2023-0309-JTL (Del. Ch. Feb. 23, 2024). In that decision, Vice Chancellor J. Travis Laster held that certain provisions of a stockholders agreement granting the principal stockholder rights to consent over a broad range of matters and to control various aspects of board composition were facially invalid on the basis that they violate Section 141(a) of the DGCL, which requires that a Delaware corporation be managed by its board of directors except as provided by statute or in the corporation’s certificate of incorporation. The DGCL amendments will become effective on August 1, 2024. The amendments are available [here](#), and the *Moelis* decision is available [here](#).

The *Moelis* Decision

Prior to the 2014 initial public offering of Moelis & Company (the “Company”), the Company, its founder and principal stockholder (the “Founder”), and the other pre-IPO stockholders entered into a stockholders agreement (the “Stockholders Agreement”). So long as the Founder maintained at least one-third of his ownership in company shares immediately after the IPO and at least 5% of the company stock and certain other conditions were met the Stockholders Agreement granted the Founder the following rights:

- The board could not authorize a range of actions without prior approval of the Founder (the “Pre-Approval Requirements”); and
- The Founder had the right to designate a majority of the board and certain other rights relating to composition of the board of directors and committees of the board (“Board Composition Provisions”).

In 2023, shareholders sued, arguing that the Stockholders Agreement improperly impinged on the rights and powers of the Company’s board of directors, thereby violating Section 141(a) of DGCL.

Section 141(a) of the DGCL provides that “the business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.”

In reviewing the rights granted under the Stockholders Agreement, the court remarked that the Pre-Approval Requirements covered “virtually everything the Board can do.” It also found the Board Composition Provisions guaranteed that the Founder’s designees would control the board, even if the Founder held less than a majority of the outstanding voting power of the company’s stock.

Following an extensive discussion and analysis of case law, the court in *Moelis* applied a two-prong test to each of the challenged provisions to determine whether the provision violated Section 141(a): first, whether the provision is part of an internal governance arrangement (as opposed to an external commercial agreement), and second, whether the provision improperly restricts the board’s powers under Section 141(a). As Vice Chancellor Laster noted in a subsequent similar case, “Governance arrangements that do not appear in the charter and deprive boards of a significant portion of their authority contravene Section 141(a).”¹

The court held that the Pre-Approval Requirements and certain Board Composition Provisions were invalid under Section 141(a) because they were part of an internal governance arrangement and improperly impinged on the board’s rights and powers. The Board Composition Provisions that were invalidated and those that were not invalidated are listed in the table below:

Invalidated	Not Invalidated
<ul style="list-style-type: none"> control over the maximum size of the board 	<ul style="list-style-type: none"> the right to designate a majority of the directors
<ul style="list-style-type: none"> the right to have the board recommend that the Company’s stockholders vote for the Founder’s designees 	<ul style="list-style-type: none"> the right to have the Founder’s designees nominated by the board
<ul style="list-style-type: none"> the right to have any vacancy in a board seat occupied by a Founder designee filled with another Founder designee 	<ul style="list-style-type: none"> the right to have the company use reasonable efforts to have the Founder’s designees elected
<ul style="list-style-type: none"> the right to have any committee of the board include a number of Founder designees proportionate to the number of such designees on the board 	

The court noted that the Founder could have achieved most of what he wanted by putting the challenged provisions in the Company’s certificate of incorporation, or even in a certificate of designations for preferred stock (which would not require stockholder approval as long as the certificate of incorporation included a “blank check” preferred stock provision²), instead of the Stockholders Agreement. The court also invited the legislature to enact clarifying provisions regarding stockholders agreements by noting in the opinion that “additional statutory guidance” would be welcome (although, after the proposed amendments were published, Vice Chancellor Laster expressed concerns about the push for quick amendments in response to the ruling).

¹ *Seavitt, et al. v. N-able, Inc.*, No. 2023-0326-JTL (Del. Ch. July 25, 2024).

² A “blank check” preferred stock provision authorizes the company to issue new classes of preferred stock with such terms as may be determined by the board of directors.

Note that the ruling applied only to corporations, not to limited liability companies or limited partnerships.

The Amendments to the DGCL

Almost immediately after the decision, the Delaware State Bar Association took up Vice Chancellor Laster's invitation and circulated proposed amendments to the DGCL to address the *Moelis* decision (and certain other recent Delaware cases). The amendments, which have now been enacted, address *Moelis* in particular by expressly including the power to enter into "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 a new Section 122(18) of the DGCL. To illustrate this point, the new language in Section 122(18) includes a non-exclusive list of provisions to which a corporation can agree in such contracts, namely:

- restrictions or prohibitions on the corporation from taking actions specified in the contract,
- requirements that the approval or consent of one or more persons or bodies (which may include the board or a stockholder, among others) specified in the contract be obtained before taking specified actions, or
- covenants that the corporation or one or more specified persons or bodies will take, or refrain from taking, specified actions.

By authorizing corporations to enter into such contracts that contain restrictions on corporate actions without the consent of the board of directors, the statutory updates affirm that such contractual restrictions are not prohibited by Section 141(a) of the DGCL.

Section 122(18) specifies that the corporation must receive consideration for entering into such contracts, which may include inducing stockholders "to take or refrain from taking one or more actions" and that the minimum amount of the consideration is to be determined by the board of directors.

Section 122(18) also states that, by entering into a contract authorized by Section 122(18), a corporation will be subject to all the remedies available under the law governing the contract in the event of a breach. Accordingly, as the synopsis accompanying the amendments further elaborates, Section 122(18) does not authorize contracts that impose remedies against individual directors for taking or failing or take any action required by the contract or that purport to bind the individual directors (or the board of directors as a whole). The synopsis also clarifies that Section 122(18) was solely intended to address the authorization of contracts and does not relieve the fiduciary duties of officers, directors or stockholders owed to the corporation or its stockholders, including with respect to the decision to enter into such contracts and whether to comply with the provisions of such contracts.

Conclusion

The amendments discussed above will become effective on August 1, 2024 and apply to all contracts made by a corporation, whether made or approved before or after August 1, 2024. However, the amendments will not apply to or affect any civil action or proceeding completed or pending before August 1, 2024 (which means the *Moelis* decision itself is not directly overturned by the amendments). In a subsequent decision involving stockholders agreement provisions and facts similar to *Moelis*, Vice Chancellor Laster expressed his displeasure that the DGCL amendments do not apply to cases completed or pending at the time the amendments become effective, pointing out that the "donut hole" created by doing so means the Delaware judiciary must "expend judicial resources dealing with

those cases and applying old law that has now changed.” He requested that, for any future DGCL amendment with both retroactive and prospective effect, the Delaware State Bar Association “skip the donut hole.”³

Both the substance of the amendments and the process by which they were enacted have been the subject of considerable debate and challenge in legal, academic, judicial and legislative circles. It seems likely that at least some controversy will remain after the amendments become effective, which could in turn lead to further litigation or even revised legislation. Corporations and stockholders considering entering into or revising stockholder agreements with provisions akin to those challenged in *Moelis* should consult with counsel to stay abreast of these issues.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email authors James Z. Fang (partner) at 212.701.3790 or jfang@cahill.com; Susanna Suh (partner) at 212.701.3686 or ssuh@cahill.com; Geoffrey E. Liebmann (senior counsel) at 212.701.3313 or gliebmann@cahill.com; or email publicationscommittee@cahill.com.

³ *Seavitt, supra*, pp. 69, 71.

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