Krista Griffith
STATE REPRESENTATIVE
12th District

HOUSE OF REPRESENTATIVES
STATE OF DELAWARE
411 LEGISLATIVE AVENUE
DOVER, DELAWARE 19901

COMMITTEES
Judiciary, Chair
Joint Finance
Appropriations
Economic Development/Banking/Insurance & Commerce
Natural Resources & Energy
Revenue & Finance
Technology & Telecommunications

House Judiciary Committee Meeting Minutes

6.18.24

House Committee Recording

Chair Griffith called the meeting to order at 12:05 p.m.

Members present:
Rep. Griffith, Chair
Rep. Romer, Vice Chair
Rep. Cooke
Rep. Lynn
Rep. Phillips
Rep. Schwartzkopf
Rep. Dorsey Walker
Rep. Dukes
Rep. Jones Giltner
Rep. Shupe
Rep. Spiegelman

Chair Griffith introduced **SB 313, AN ACT TO AMEND TITLE 8 OF THE DELAWARE CODE RELATING TO THE GENERAL CORPORATION LAW.**

Chair Griffith, a sponsor of the legislation, asked expert witness Srinivas Raju, Chair of the Corporation Law Council, to explain the significance and influence of the Delaware General Corporation Law.

Srinivas Raju explained that the Delaware franchise, including its corporation laws, relies on a "three-legged stool" consisting of the Delaware Court of Chancery, the Delaware Secretary of State's office, and the General Assembly. He highlighted that the General Assembly plays a crucial role by regularly reviewing and updating the business entity laws to ensure they remain effective and efficient.

Chair Griffith asked about who reviews the Delaware General Corporation Law besides the General Assembly and how frequently this review process occurs.

Srinivas Raju responded that the Delaware General Corporation Law is reviewed continuously, with the General Assembly considering and passing proposed amendments annually. Over the past decade, there has been a corporation law bill passed each year, along with updates to limited partnership, LLC, and other business entity laws overseen by the Corporation Law Council.

Chair Griffith asked for an explanation of the Corporation Law Council, including its composition and role.

Srinivas Raju explained that the Corporation Law Council is made up of 27 members, with 26 being voting members. These members are part of the Corporation Law Section of the Delaware State Bar Association, which has over 600 members in total.

Chair Griffith asked whether membership in the Corporation Law Section requires being a Delaware-barred attorney.

Srinivas Raju confirmed that this is the case.

Chair Griffith asked for a description of the process used by the Corporation Law Council to review amendments annually.

Srinivas Raju explained that the Corporation Law Council meets regularly throughout the year and reviews developments in law and business practices to determine if changes to the laws are needed. They also form subcommittees, which include both Council members and non-members, to study specific issues and provide recommendations. The full Council then considers these recommendations and decides whether to propose amendments.

Chair Griffith asked about the process that follows when the Corporation Law Council proposes amendments, specifically how these proposals are handled in relation to the Delaware State Bar Association.

Srinivas Raju explained that proposed amendments from the Corporation Law Council are first submitted to the Corporation Law Section. If approved, they are then reviewed by the Executive Committee of the Delaware State Bar Association. Only after receiving approval from the Executive Committee are the amendments submitted to the General Assembly for consideration.

Chair Griffith asked at what stage proposed amendments become publicly available and widely circulated.

Srinivas Raju replied that proposed amendments become widely circulated when the Corporation Law Council submits them to the Corporation Law Section.

Chair Griffith asked whether there is ongoing input and whether changes are made to proposed amendments between the time they are circulated to the Corporation Law Section and when they are considered by the DSBA Executive Committee.

Srinivas Raju explained that once proposed amendments are widely circulated, there is an opportunity for feedback and comments. The Corporation Law Council reviews this feedback and considers making revisions as needed throughout the process.

Chair Griffith asked for details on the process used to develop the specific set of amendments proposed in SB 313.

Srinivas Raju explained that Senate Bill 313 includes three categories of amendments. All three categories involve proposed changes to the statute based on recent developments and Delaware Court of Chancery cases, including two cases decided in February of this year.

Chair Griffith requested a more thorough explanation.

Srinivas Raju explained that the first category clarifies the authority in merger agreements to include penalties or damages for failure to consummate a merger, thereby strengthening the enforcement of monetary damages remedies. The second category allows a board to approve agreements, such as merger agreements, in final or substantially final form, ensuring all material terms are known or presented to the board at the time of approval. The third category introduces a new section to authorize certain contracts between corporations and stockholders, addressing the facial validity of such contracts from a power and authority perspective, while continuing to evaluate them based on equitable principles and fiduciary duties.

Chair Griffith asked what prompted the proposed changes in the bill this year.

Srinivas Raju explained that the proposed changes were prompted in part by the Corporation Law Council's ongoing review of developments and annual consideration of amendments, which is part of Delaware's reputation. He added that the amendments were also influenced by recent cases that raised concerns about the facial validity of many contracts.

Chair Griffith asked if the section addressing the issue raised by recent cases is the section generating the most discussion among the proposed amendments.

Srinivas Raju confirmed that this section garnered the most public attention and feedback among the proposed amendments.

Chair Griffith requested details on the understanding and practical effect of the law prior to February 2024, and what specifically changed with the Moelis decision.

Srinivas Raju explained that in the Moelis decision, the Delaware Court of Chancery ruled that provisions in a stockholder agreement requiring stockholder approval for certain corporate actions were impermissible corporate internal governance restrictions. This violated Section 141(a) of the corporation law, meaning such approval rights needed to be included in the certificate of incorporation or the charter to be valid.

Chair Griffith asked for clarification on the difference between a stockholder agreement and a certificate of incorporation.

Srinivas Raju explained that every Delaware corporation must have a certificate of incorporation, which is a foundational governing document that outlines the corporation's internal governance and must comply with Delaware corporate law. The certificate of incorporation is essential for setting up the corporation's governance structure.

Chair Griffith asked for the definition of a shareholder agreement.

Srinivas Raju explained that a shareholder agreement is a contract the company can enter into, but it cannot contradict or be inconsistent with the certificate of incorporation. This principle, which is a fundamental part of the governance structure of Delaware corporations, remains unchanged regardless of Senate Bill 313.

Chair Griffith asked about common practices regarding the interaction between certificate of incorporation and shareholder agreements, including what was typically included in each and the advice lawyers were giving clients on these matters.

Srinivas Raju explained that governance rights for stockholders could be documented through a stockholders agreement or preferred stock. The rights and preferences of preferred stock are automatically part of the certificate of incorporation. Historically, corporate practitioners believed it was acceptable to document these rights either in a stockholders agreement or as part of preferred stock, based on interpretations of Section 141(a) and existing case law. This practice allowed for flexibility in how governance rights were established.

Chair Griffith asked about the reasons for not including governance rights in the certificate of incorporation and the potential downsides of not making these agreements part of the certificate.

Srinivas Raju noted that the choice between including governance rights in a certificate of incorporation or a stockholders agreement can depend on the context. For public corporations, there may not be a significant difference, as both are publicly accessible. However, for private corporations, keeping governance rights in a stockholders agreement allows for confidentiality, as these agreements are not filed with the Secretary of State and remain private between the company and its investors.

Chair Griffith asked why maintaining confidentiality in governance rights might be important for a private company.

Srinivas Raju explained that confidentiality is important for private companies to keep sensitive information from being publicly accessible. While stockholders have rights to access information, private companies may want to prevent competitors, business entities, and the general public from seeing details about the company that are not necessary for broader disclosure. This privacy helps protect the company’s strategic and operational information.

Chair Griffith mentioned hearing claims that the proposed changes would have severe consequences on Delaware corporate law. She asked if the practice of including certain provisions in stockholder agreements, rather than certificates of incorporation, has been ongoing for many years without significant issues.

Srinivas Raju responded that the issue might be more about form rather than substance, as the marketplace has long accepted that rights could be included in stockholder agreements or preferred stock and still be considered part of the charter. Historically, companies have treated these rights as valid in contracts. Furthermore, there have not been significant abuses of stockholder agreements, likely due to strong protections for investors through fiduciary duties and equitable principles. These protections allow for challenges and remedies if agreements are not in the company's best interest.

Chair Griffith asked if the bill has any impact on fiduciary duties or equitable responsibilities of a corporation.

Srinivas Raju confirmed that the bill does not affect fiduciary duties or equitable principles.

Chair Griffith asked for an explanation of the importance of fiduciary duties and responsibilities.

Srinivas Raju explained that fiduciary duties involve managing a business or property for someone else's benefit with high standards of care and loyalty. The duty of care requires acting in an informed and thoughtful manner, while the duty of loyalty demands putting the interests of all stockholders above personal interests. He added that these duties are enforced rigorously, especially in the Delaware Court of Chancery, providing strong protection against abuses.

Chair Griffith asked how the legislation might affect any pending litigation, including the Moelis decision itself.

Srinivas Raju explained that the Moelis decision ruled the stockholder agreement invalid due to it containing impermissible internal governance restrictions, which should have been included in the charter according to Section 141(a). If Senate Bill 313 is passed, it would not affect the Moelis decision or any pending litigation as of August 1, 2024. The proposed amendments specifically exclude pending cases from its application.

Chair Griffith asked for details about the process used to draft Senate Bill 313, specifically addressing concerns about the time frame and amount of time allotted for considering and proposing amendments.

Srinivas Raju detailed that the process for drafting Senate Bill 313 followed the usual steps of examining issues, forming subcommittees, and holding multiple council meetings. He emphasized that despite a compressed time frame due to the need for timely action, no corners were cut. He added that the council conducted extensive work, with more hours dedicated to these amendments than in previous years. Proposed amendments were circulated on March 29, and further feedback led to additional revisions.

Chair Griffith asked if there was an opportunity to meet with critics, address their concerns, and possibly involve a mediator or someone to help consider both sides of the issue during the drafting of the amendments.

Srinivas Raju confirmed that meetings were held with law professors and members of the Corporation Law Section, facilitated by former Vice Chancellor Joseph Slights. He noted that they had a detailed discussion, followed by emails and phone calls.

Chair Griffith asked if there has been criticism that the legislation could lead to disputes being resolved outside of Delaware, potentially diminishing the significance of access to Delaware courts and affecting Delaware's business.

Srinivas Raju disagreed with this criticism, explaining that internal governance of a Delaware corporation must be governed by Delaware law regardless of any contract provisions. Fiduciary duty claims against directors are governed by Delaware law, even if a contract specifies a

different jurisdiction's law. He added that while parties can choose where to litigate disputes, Delaware courts remain central for fiduciary duty claims against directors. Courts nationwide frequently handle Delaware law issues, and Delaware law will continue to develop within Delaware. Additionally, a contract's forum selection clause binds only the signatories. Non-signatories, such as other stockholders, can still bring fiduciary duty claims in Delaware.

Chair Griffith questioned whether the legislation was merely a reaction from frustrated transactional attorneys displeased with a recent Court of Chancery decision and asked for Raju's response to that criticism.

Srinivas Raju emphasized that the Council aims to build and maintain efficient and responsible business laws. Although there are differing opinions on whether the Council's amendments are too extensive or insufficient, their stated goal is to act in Delaware's best interests.

Chair Griffith noted that the Corporation Law Council is made up of members beyond just transactional lawyers.

Srinivas Raju clarified that the Corporation Law Council is composed of approximately a 50/50 mix of transactional lawyers and litigation lawyers.

Chair Griffith asked Srinivas Raju about his concerns regarding the potential impact on Delaware if the legislation does not pass.

Srinivas Raju expressed concern that if the legislation does not pass, it could negatively impact Delaware's status as a leading jurisdiction for corporate law. He said that he believes that annual consideration of amendments to business entity laws is crucial for maintaining responsible and efficient regulations. He argued that the proposed amendments are intended to address primarily procedural issues while preserving essential protections for investors.

Rep. Phillips asked whether Srinivas Raju’s former firm or any other firms that are members of the council currently have paying clients with a financial interest in the proposed legislation.

Srinivas Raju responded that he and his firm are not paid specifically for the legislation's passage or failure. While they do represent clients who are both investors and corporations involved in these agreements, he could not provide specifics on the financial stakes of these clients in the proposed legislation.

Rep. Phillips asked why the proposed amendments are necessary if shareholders already have similar powers through other means.

Srinivas Raju explained that the proposed amendments fix problems with the validity of many existing agreements by providing clarity on their enforceability. He added that the amendments also preserve the confidentiality of governance arrangements for private companies, which don't need to publicly disclose such information, unlike public companies. Additionally, by placing certain provisions in the charter rather than in contracts, corporations gain more flexibility. He noted that provisions in the charter prevent certain actions unless approved, while those in contracts might allow actions with post-facto remedies or monetary damages.

Rep. Phillips asked if significant amendments were made to the bill after the Corporation Law Section's vote.

Srinivas Raju said that no new vote was taken after the Corporation Law Section's initial approval on April 8. He explained that the subsequent clarifying revisions actually narrowed the bill's scope, addressing concerns raised. Despite high attendance at the follow-up meeting, no motion for a new vote was made, indicating that the revisions were viewed as clarifications rather than substantial changes.

Rep. Romer pointed out that there may not have been enough time since the Moelis decision for lawsuits or complaints to emerge. She suggested that stakeholders might not have known their rights or that something was illegal, preventing them from filing complaints.

Srinivas Raju replied that there is already more than a dozen such lawsuits pending. He noted that people still have the opportunity to file lawsuits until August 1, even if SB 313 becomes law.

Vice Chair Romer expressed concern that while there is time to file lawsuits now, the passage of SB 313 would make those potential wrongs no longer actionable. She asked whether a contracting stockholder is empowered to unilaterally make agreements with new stakeholders or if it would need to come back to the board for approval.

Srinivas Raju clarified that the board cannot delegate its ultimate power to an individual. The board can create a committee under Section 141(c) of the Delaware General Corporation Law, but this committee must consist of board members, not non-board members like the CEO or CFO.

Rep. Cooke pointed out that since a new vote was not held after the alterations, there is no indication of whether these changes are supported by the committee.

Srinivas Raju reiterated that while some attendees expressed concerns, no one made a motion to approve or revisit the bill, as it had already been approved in the prior meeting.

Rep. Dorsey Walker noted that law schools across the country, which rely on Delaware's Chancery Court and corporate law, have expressed opposition to the bill

Chair Griffith clarified that it is specific law professors, not the law schools themselves, who have opposed the legislation. She added that while some professors have criticized the bill, others support it.

Rep. Wilson-Anton clarified that the Corporation Law Section is predominantly composed of defense attorneys with only two to four plaintiff attorneys. She questioned Srinivas Raju about the precedent of reversing a Court of Chancery decision while it is still being litigated, noting that in previous testimonies he cited several examples but later admitted that those cases were already concluded.

Srinivas Raju replied that he does not view the proposed legislation as reversing the Moelis decision but rather as clarifying the statute.

Rep. Wilson-Anton reiterated her earlier point, reminding the committee that Srinivas Raju had shared numerous instances where such actions had been done. She asked whether he was saying those examples were irrelevant since this had never been done before, and if this situation is not reversing a decision of the Chancery Court before its appeal.

Srinivas Raju clarified that the examples he provided were instances where amendments were made in response to a Court of Chancery decision before the Supreme Court had addressed the issue. He stood by his earlier statement, noting that in six of the seven cases, the court cases had formally concluded by the time the amendment became law.

Rep. Wilson-Anton noted that Srinivas Raju testified that the bill would not impact fiduciary duty and equitable principles. In response, Vice Chancellor Laster stated that the board's fiduciary duties would not pose a meaningful constraint at the time of counterparty enforcement. She asked if he thought Vice Chancellor Laster was mistaken.

Srinivas Raju replied that he did not know.

Rep. Wilson-Anton raised another issue regarding the need for the legislation due to the existence of thousands of agreements that were believed to be legal but were deemed unenforceable by a recent decision. She mentioned having seen several memos from years ago warning that these agreements were unenforceable and noted that the central case on this issue is almost 70 years old.

Srinivas Raju responded that he testified about the prevailing belief among corporate practitioners and the marketplace regarding the legality of the agreements in question.

Rep. Wilson-Anton asked about the individuals and entities that have been lobbying the Corporation Law Council regarding this legislation.

Srinivas Raju replied that they hear from a wide range of constituencies around the country, including corporations, investors, and various practitioners who use Delaware as a basis for their business entities or invest in Delaware entities.

Vice Chair Romer acknowledged feeling conflicted due to the compelling arguments on both sides, noting the challenge of balancing corporate power and governance. She asked expert witness Charles Elson, the Founding Director of the John L. Weinberg Center for Corporate Governance at the University of Delaware, to comment on the legislation.

Charles Elson emphasized Delaware's reputation for investor protection, which is crucial for the state's economic stability due to significant revenues from the corporate franchise and personal income taxes. He argued that the bill could undermine this reputation by giving excessive power to controlling shareholders, thus weakening the protection for minority investors.

Rep. Cooke asked Charles Elson if he attended the stakeholders meeting mentioned earlier, where no one raised objections.

Charles Elson responded that he had not been invited to the meeting.

Rep. Cooke questioned why no one in attendance at the meeting voiced objections if the amendments were controversial.

Charles Elson replied that he couldn't comment on the stakeholders' meeting as he wasn't present. He emphasized that while he hadn't initially focused on the case, conversations with judiciary members and others highlighted significant concerns about the amendment's impact on Delaware's corporate franchise.

Rep. Dorsey Walker asked expert witness Usha Rodrigues, M.E. Kilpatrick Professor of Law at the University of Georgia School of Law, to address concerns about future litigation being resolved through arbitration rather than in the public eye.

Usha Rodrigues explained that the primary concern is that these agreements might not be known or accessible in private contexts and that fiduciary duties offer limited protection in arbitration compared to traditional corporate law.

Rep. Lynn asked Usha Rodrigues to discuss her background in corporate law.

Usha Rodrigues replied that she has clerked for Judge Tom Ambro in Wilmington, practiced at Wilson Sonsini, and has taught corporate law at the University of Georgia for 20 years. She has previously testified before Congress and the SEC on Delaware corporate law. She added that she has written articles on Delaware law that have been cited in the Chancery Court and also presented to the full Delaware judiciary at their 2018 retreat.

Rep. Lynn questioned why this legislation is significant.

Usha Rodrigues pointed out that a shareholder could make a deal granting them significant control, such as veto power, even if they hold a small ownership stake. This deal would bind future boards, limiting their ability to act independently. This permanence of such agreements is why she is concerned, as it undermines the board's control and shareholder democracy.

Rep. Lynn asked Usha Rodrigues if she agreed with Chancellor McCormick's characterization of the proposal as reflecting the broadest set of substantive amendments since the 1960s, and her description of the council's process as rushed and flawed.

Usha Rodrigues agreed with Chancellor McCormick's characterization of the amendments. She highlighted that traditionally, there is a more deliberative process involving many months and multiple voices before changes are made, but in this case, the process has been compressed into just a few months. She expressed concern that the amendments would subvert the power of the board, affecting both private and public corporations in Delaware by taking away the board's power and bypassing shareholder votes on side agreements.

Rep. Lynn asked if Usha Rodriques had a financial interest in the outcome of this bill.

Usha Rodrigues confirmed that she did not.

Rep. Lynn asked if she was aware of any other law professor in academia who had publicly supported the bill.

Usha Rodrigues responded that she was not aware of any other law professor in academia who publicly supported the bill. She emphasized that law professors from across the political spectrum oppose these amendments because they allow individual shareholders to strike separate side deals that bind future boards.

Rep. Lynn expressed concern about the legislative body acting to effectively reverse a decision of the Court of Chancery in a case still pending and subject to appeal by the Delaware Supreme Court.

Usha Rodrigues concurred, adding that not allowing the judiciary to conclude its process before the legislature responds undermines the most critical component of Delaware corporate law.

Rep. Lynn asked about forced arbitration of derivative claims, noting that proponents of the bill argue it doesn't force non-signatories into arbitration.

Usha Rodrigues disagreed with this assertion, stating she does believe the bill allows for non-signatories to be forced into arbitration of derivative claims.

Rep. Lynn stated that he concurs with Vice Chancellor Laster's assertion that the legislation is not helpful or comprehensive.

Usha Rodrigues suggested that a more targeted approach would address past agreements more precisely, rather than creating widespread uncertainty for future agreements and corporations.

Chair Griffith opened the floor for public comment.

No members of the public provided testimony in support of the bill.

John Kowalko, Connie Merlet, Lauren Pringle, Chancery Daily, Joel Fleming, Equity Litigation Group, Jim An, Stanford Law School, Robert Erikson, Block & Leviton LLP, Dael Norwood, Anne Lipton, Tulane Law School, Joan Hemmingway, University of Tenessee College of Law, John Livingston, George Georgiev, Emory University School of Law, and Anne Tucker, Georgia State University College of Law provided testimony in opposition of the bill.

A motion was made by Rep. Schwartzkopf and seconded by Rep. Spiegelman to release SB 313 from committee; motion carried. Yes = 6 (Cooke, Dukes, Schwartzkopf, Shupe, Spiegelman, Griffith); No = 4 (Dorsey Walker, Jones Giltner, Lynn, Romer); Absent = 1 (Phillips). The bill was released from committee with a F=0, M=5, U=1 vote.

Chair Griffith adjourned the meeting at 1:55 p.m.

Respectfully submitted by:

Wyatt Patterson

Attendance List

- John Kowalko
- Connie Merlet

- Lauren Pringle, Chancery Daily
- Joel Fleming, Equity Litigation Group
- Jim An, Stanford Law School
- Robert Erikson, Block & Leviton LLP
- Dael Norwood
- Anne Lipton, Tulane Law School
- Joan Hemmingway, University of Tennessee College of Law
- John Livingston
- George Georgiev, Emory University School of Law
- Anne Tucker, Georgia State University College of Law

Harvard Law School Forum on Corporate Governance

Letter in Opposition to the Proposed Amendment to the DGCL

Posted by Sarath Sanga (Yale Law School), Gabriel Rauterberg (Michigan Law School), and Eric Talley (Columbia Law School), on Friday, June 7, 2024

Tags: **delaware**, **Delaware General Corporation Law**, **Delaware legislation**, **Delaware Supreme Court**, **moelis**
More from: **Eric Talley**, **Gabriel Rauterberg**, **Sarath Sanga**

Editor's Note: **Sarath Sanga** is a Professor of Law and Co-Director of the Center for the Study of Corporate Law at Yale Law School, **Gabriel Rauterberg** is a Professor of Law at the University of Michigan Law School, and **Eric Talley** is the Isidor and Seville Sulzbacher Professor of Law at Columbia Law School. This post provides the text of a letter to members of the Delaware legislature sent by the over fifty law professors listed below.

To the Honorable Members of the Delaware Legislature:

We write to express our opposition to the proposed amendment to Section 122(18) of the Delaware General Corporation Law ("the Proposal"), introduced by the Corporation Law Section of the Delaware State Bar Association and ostensibly designed to respond to the decision in *West Palm Beach Firefighters' Pension Fund v. Moelis & Company*, 2024 WL 747180 (Del. Ch. Feb. 23, 2024) ("*Moelis*").

We are professors of corporate law, and we routinely disagree over corporate law issues. Yet we are unanimous in our belief that the appropriate response to the *Moelis* decision is to allow the appellate process to proceed to the Delaware Supreme Court. The issues at stake warrant careful judicial review, not hasty legislative action.

The Proposal would do more than simply overturn *Moelis*. It would allow corporate boards to unilaterally contract away their powers without any shareholder input. It would also exempt such contracts from Section 115, thereby creating a separate class of internal corporate claims—including claims of breach of fiduciary duty—that could be arbitrated and decided under non-Delaware law. These would be the most consequential changes to Delaware corporate law of the 21st century, and they should not be made hastily—if at all.

Proponents of the Proposal argue that the *Moelis* decision struck down a common practice of Delaware corporations and that the Proposal merely restores the status quo ante. Not so. The contract in *Moelis* was far from typical, especially for public corporations, and the *Moelis* decision only held that certain of its provisions contravened the board-centric model of governance codified in Section 141(a). Those provisions could only be adopted in the corporate charter, and thus only after a majority of shareholders—who invested in reliance on Section 141(a)—gave their approval.

The Delaware Supreme Court may ultimately agree with or tweak the *Moelis* decision, or even undo it entirely. But it will do so only after careful consideration of the complex interplay between Delaware's commitment to contractual freedom—a commitment we wholeheartedly support—and its equal commitment to protecting shareholders through an empowered and accountable board of directors. Delaware's unique ability to uphold both commitments is what gives the public confidence to invest in Delaware corporations, and what makes Delaware the leading jurisdiction for corporate law.

Rather than hastily rewriting the rules, we should give the Delaware Supreme Court time to carefully weigh the issues and provide clear, reasoned guidance.

Respectfully,

Sarath Sanga
Professor of Law, Yale Law School

Gabriel V. Rauterberg
Professor of Law, University of Michigan Law School

Eric Talley
Isidor and Seville Sulzbacher Professor of Law, Columbia Law School

Marcel Kahan
George T. Lowy Professor of Law, New York University School of Law

Elisabeth de Fontenay
Karl W. Leo Distinguished Professor of Law, Duke University School of Law

Dorothy S. Lund
Professor of Law, Columbia Law School

Jeffrey N. Gordon
Richard Paul Richman Professor of Law, Columbia Law School

John C. Coffee, Jr.
Adolf A. Berle Professor of Law, Columbia Law School

Stephen M. Bainbridge
William D. Warren Distinguished Professor of Law, UCLA School of Law

Michal Barzuza
Professor of Law, University of Virginia School of Law

Yaron Nili
Professor of Law, University of Wisconsin Law School

Adam Badawi
Professor of Law, UC Berkeley School of Law

Robert E. Bishop
Associate Professor of Law, Duke Law School

Fernán Restrepo
Assistant Professor of Law, UCLA School of Law

Andrew C. Baker
Assistant Professor of Law, UC Berkeley School of Law

Edward Rock
Martin Lipton Professor of Law, NYU School of Law

John Coates
John F. Cogan, Jr. Professor of Law and Economics, Harvard Law School

James D. Cox
Brainerd Currie Distinguished Professor of Law, Duke University School of Law

Robert B. Thompson
Peter P. Weidenbruch, Jr. Professor of Business Law, Georgetown University Law Center

Donald Langevoort
Thomas Aquinas Reynolds Professor of Law, Georgetown University Law Center

Curtis J. Milhaupt
William F. Baxter-Visa International Professor of Law, Stanford Law School

Geeyoung Min
Associate Professor of Law, Michigan State University College of Law

Lucian A. Bebchuk
James Barr Ames Professor of Law, Economics, and Finance, Harvard Law School

Justin McCrary
Paul J. Evanson Professor of Law, Columbia Law School

Kathryn Judge
Harvey J. Goldschmid Professor of Law, Columbia Law School

Michael Klausner
Nancy and Charles Munger Professor of Law, Stanford Law School

Ian Ayres
Oscar M. Ruebhausen Professor of Law, Yale Law School

Robert Bartlett
W. A. Franke Professor of Law and Business, Stanford Law School

Brian Quinn
Professor of Law, Boston College Law School

Roberto Tallarita
Assistant Professor of Law, Harvard Law School

Andrew Verstein
Professor of Law, UCLA School of Law

Urska Velikonja
Professor of Law, Georgetown University Law Center Jesse M. Fried Dane Professor of Law, Harvard Law School

J.S. Nelson
Professor of Law, University of Pittsburgh School of Law

Jens Frankenreiter
Associate Professor of Law, Washington University in St. Louis School of Law

Simone M. Sepe
Chester H. Smith Professor, University of Arizona James E. Rogers College of Law

Usha Rodrigues
University Professor & M.E. Kilpatrick Chair of Corporate Finance and Securities Law, University of Georgia School of Law

Matteo Gatti
Professor of Law, Rutgers Law School

Frank Partnoy
Adrian A. Kragen Professor of Law, UC Berkeley School of Law

Claire Hill
James L. Krusemark Chair in Law, University of Minnesota School of Law

Scott Hirst
Associate Professor of Law, Boston University School of Law

Vikramaditya S. Khanna
William W. Cook Professor of Law, University of Michigan Law School

Brian J. Broughman
Professor of Law, Vanderbilt University Law School

Anne Tucker
Professor of Law, Georgia State University College of Law

Albert H. Choi
Paul G. Kauper Professor of Law, University of Michigan Law School

Mariana Pargendler
Professor of Law, Fundação Getulio Vargas Law School

George S. Georgiev
Associate Professor of Law, Emory University School of Law

Matthew Jennejohn
Professor of Law, Brigham Young University Law School

Cathy Hwang
Barron F. Black Research Professor of Law, University of Virginia School of Law

Emiliano M. Catan
Catherine A. Rein Professor of Law, NYU School of Law

John D. Morley
Augustus E. Lines Professor of Law, Yale Law School

Michael Guttentag
Professor of Law, Loyola Law School

Henry T. C. Hu
Allan Shivers Chair in the Law of Banking and Finance, University of Texas at Austin School of Law

Reinier H. Kraakman
Ezra Ripley Thayer Professor of Law, Harvard Law School

Ilya Beylin
Associate Professor, Seton Hall University Law School

Holger Spamann
Lawrence R. Grove Professor of Law, Harvard Law School

Anat Alon-Beck
Assistant Professor, Case Western Reserve University School of Law

Gina-Gail S. Fletcher
Professor of Law, Duke University School of Law

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Chair Krista Griffith
Honorable Members
Delaware House Judiciary Committee

Re: SB 313 and Proposed Amended Section 122(18)

Dear Chair Griffith and distinguished members of the Delaware House Judiciary Committee,

My name is Anat Alon-Beck, Associate Professor at Case Western Reserve University School of Law, and chair of the Academic Subcommittee of the Private Equity and Venture Capital Committee of the ABA Business Law Section. I write to you to strongly object to SB 313 and the proposed amendment to your state's corporate governance laws.

The Corporation Law Council of the Delaware State Bar Association drafted a proposed amendment creating Section 122(18) of the Delaware General Corporation Law ("the Proposal").

If the legislature adopts the Proposal, the *Moelis* decision will be reversed in its entirety less than six months after the opinion was issued and prior to any Supreme Court review.

The Proposal is broadly written. I must warn that it goes well beyond the *Moelis* decision and it will authorize virtually ANY provision in a stockholder agreement unless such a provision is explicitly prohibited elsewhere in the statute.

Most significantly, the Proposal authorizes contractual transfers of and limitations on both the power of the board of directors and its exercise of its statutorily granted discretion.

As such, the Proposal threatens to supplant the board-centric model fundamental to Delaware's corporate law with a model that allocates fundamental decision-making authority to corporate controllers, stockholder activists, private equity firms, or any other stockholders who are able to exert sufficient leverage to appropriate board authority pursuant to a stockholder agreement.

Delaware is renowned for its balanced corporate law framework, attracting numerous corporations to incorporate in the state. This proposed amendment, however, threatens to undermine that balance by diluting protections for outside shareholders, which could lead to increased corporate malfeasance and tunneling, a practice through which controlling or other entitled shareholders transfer corporate value for their own benefit to the detriment of others.

Stockholder agreements lack both the transparency of charter provisions and the formal mechanism by which charter provisions are adopted and amended through a process requiring both board and shareholder approval. These approval features provide important protection for the interests of all corporate shareholders. These protections are particularly valuable in private companies in which minority shareholders may have little or no access to critical governance

features if those are contained in shareholder agreements and may, as a result, have little understanding of their peers' rights and responsibilities, the existence of conflicts of interests and, as a result, the company's risk exposure.

Delaware's reputation as a leader in corporate law is built on fairness, transparency, and accountability. Delaware has long been a preferred jurisdiction for incorporation due to its well-established and predictable corporate law framework. Delaware's legal framework provides companies with the ability to design their corporate governance structures in a manner that aligns with the preferences and expectations of all their investors, and not a mere few insiders and controllers.

Consider this: according to my latest empirical study, 97% of unicorn firms, high tech firms that are worth over $1 billion dollars, are incorporated in Delaware. This dominance underscores your strategic advantage and the importance of maintaining strong shareholder protections. Diluting these protections risks eroding the unique environment that allows unicorns to thrive.

Many shareholders, from institutional investors, labor unions, pension funds to retail individual investors, find that incorporation in Delaware enhances a company's credibility and attractiveness. Rushed legislative changes that disrupt this stability and that do not give these issues the attention they deserve could erode Delaware's competitive advantage.

In conclusion, I urge you to reject this amendment to preserve Delaware's reputation and ensure a fair and equitable business environment for all shareholders.

Thank you for your time and attention.

Anat Alon-Beck
Associate Professor
Case Western Reserve University School of Law

cc
Cyndie Romer
Franklin D Cooke
Sean Lynn
Sophie Phillips
Peter Schwartzkopf
Sherry Dorsey Walker
Timothy Dukes
Valerie Jones Giltner
Bryan Shupe
Jeff Spiegelman

Joan MacLeod Heminway
8313 Alexander Cavet Drive
Knoxville, TN 36909

June 18, 2024

Delaware State House of Representatives
Judiciary Committee
411 Legislative Avenue
Dover, DE 19901
Attn: Krista Griffith, Chair

SB 313 – Proposed Delaware General Corporation Law § 122(18)

Madame Chair and Committee Members:

I appreciated the opportunity to speak briefly at today's hearing. As I explained earlier today, although I am a professor in the business law program at The University of Tennessee College of Law, my appearance before the committee relates more to my nearly 39 years as a corporate finance practitioner, which has included bar work (most recently and extensively in the State of Tennessee) proposing and evaluating corporate and other business entity legislation. This letter expands on the virtual oral comments I offered at the hearing on the proposed addition of § 122(18) to the General Corporation Law of the State of Delaware (DGCL). My goal is simply to best ensure that the committee and the General Assembly are well informed about the significance of this proposed new section of the DGCL.

Both proponents and critics of proposed § 122(18) concur that the stockholder agreements that would be authorized by that provision can currently be accomplished in a corporation's certificate of incorporation—the corporate charter. Indeed, as was alluded to in the testimony earlier today, current Delaware law expressly authorizes transferring governance authority from a corporation's board of directors to its stockholders through charter amendments and through certificates of designation (instruments providing for new classes or series of stock) as well as for statutory close corporations, a status designated in the certificate of incorporation. As a result, questions raised at today's hearing about why the new authority embodied in proposed DGCL § 122(18) is needed—or why it would be objectionable—are well taken. As I indicated in my oral testimony earlier today, the answer to those questions lies in public policy.

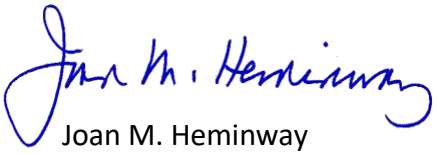
Current Delaware law on stockholder agreements promotes notice, transparency, and assent. Provisions in a Delaware corporation's certificate of incorporation are matters of public record in the State of Delaware on which stockholders and prospective stockholders rely. They must be filed with the Delaware Secretary of State. Thus, Delaware's corporate law currently requires that stockholders and potential future stockholders have public notice of any fundamental alteration in the statutory power of the board of directors to manage the corporation. Stockholder agreements like those authorized under proposed DGCL § 122(18) are not required

to be filed with the state (although they would have to be filed with the U.S. Securities and Exchange Commission under the federal securities laws at some point after they are signed, for public companies). Moreover, under current Delaware law, if an amendment to the certificate of incorporation is required to achieve a shift in governance authority from the board of directors, then a stockholder vote is required. These requirements, which evidence Delaware's public policies of notice, transparency, and assent, are what ultimately divide the supporters and detractors of proposed DGCL § 122(18). Your ultimate views on these policies—your determination as to whether they are important to the integrity of Delaware corporate law—should be strong factors in your determination of how to vote on proposed DGCL § 122(18). I submit that these policies should not be abandoned or reduced without careful consideration.

Last week, I wrote about my policy concerns relating to proposed DGCL § 122(18) in a blog post published on the Business Law Prof Blog. That post can be found here. Although my blog post was written for a different and broader legal audience (and therefore includes some technical legal references), it may be useful to you as additional statutory and judicial support for the positions I have taken in this letter and in my oral testimony. The post also includes several drafting observations relevant to the productive introduction of statutory authority for stockholder agreements that you may appreciate having.

I am grateful to have had the opportunity to share these insights with you today in writing and orally during the hearing this afternoon. I wish you well in your deliberations.

Best regards,



Joan M. Heminway
Rick Rose Distinguished Professor of Law, The University of Tennessee College of Law
Member and Former Chair, Tennessee Bar Association Business Law Section
Former Chair and Member, Boston Bar Association Corporate Law Committee

Public Comment re: SB 313

My name is Scott Holleman. I am a partner at Julie & Holleman LLP a New York-based firm with a Delaware-focused practice.

I have two points about proposed 122(18).

First, it's overbroad as to the rights involved.

Boards deal with lots of issues—issuing stock, amending bylaws, mergers, and so on.

Some of these the courts have called "core" board functions, like hiring or firing a CEO.

In *Moelis*, the pre-approval rights were challenged and struck down as a whole. But the judge specifically said that some of the rights, in isolation, might be permissible.

The Supreme Court can resolve that.

But as currently worded, 122(18) represents a wholesale shift from director primacy to specific stockholder primacy and obliterates the distinction between different types of board action.

The second point relates to disparity between interest and influence.

A lot of stockholder agreements start when there's a controller. And a lot of them preserve the pre-approval rights long after the stockholder sells down below a controlling position. This isn't fiction like Succession, nor is it a phantom concern. It happens. In Moelis, it was 5%. In BRP, it was 10%. In Goosehead, it was 10%.

Should a minority stockholder have autonomy over the board? No. But SB 313 will endorse it.

Testimony of Jim An Regarding SB 313

Thank you Madam Chair. My name is Jim An. I'm a former judicial clerk of the Delaware Supreme Court. And I used to live right off 113 in Georgetown. Currently, I'm a lecturer at Stanford Law School.

I love the state of Delaware. And I want it to remain the world's foremost destination for incorporation. Accordingly, want to make few points about SB 313, a bill that would seriously undermine Delaware corporate law.

First, as a point of clarification, although this bill purports to legalize "shareholder agreements," that phrase is misleading in many ways. These "shareholder agreements" are not agreements among all shareholders, or even most shareholders.

Rather, they are sweetheart deals, often called "side letters" in corporate dealmaking, that usually benefit only one single shareholder. Furthermore, these side agreements are not subject to the approval of other stockholders, and they can be entered into after the fact of investment.

Second, you've heard this bill validates long-standing market practice. But selling lead paint was also market practice, discrimination was market practice, and backdating options was market practice. Simply because something is market practice does not make it good or right, nor is it a reason to change the law to legalize that something.

Third, although Mr. Raju says that they considered the opinions of academics, dozens of academics continue to oppose this bill. The large and diverse group of academics who oppose this bill includes the top three most cited corporate law professors in America. They continue to say that this bill is procedurally rushed and substantively ill-conceived.

Finally, you've heard from the CLC that *Moelis*, the case that SB 313 seeks to overturn, is an unprecedented surprise. But in fact, *Moelis* is the reaffirmation of settled precedent that reach back decades to the 1956 *Abercrombie v. Davies* decision. Likewise, a Delaware law firm represented on the CLC publicly warned in 2018 that, and I quote, "if shareholders wish to limit the power of the board to manage the corporation . . . this power needs to be restricted in the certificate or bylaws of the corporation," and not in the side agreements that SB 313 seeks to legalize. If there's any surprise from *Moelis*, that is a product of questionable legal advice—certainly, there were qualified Delaware attorneys who could explain the law correctly.

Thank you all for your time. And I hope you all vote against Senate Bill 313.

UCLA School of Law

ANDREW VERSTEIN
PROFESSOR OF LAW
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FOR BUSINESS LAW AND POLICY

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November 19, 2024

Dear Chair Krista Griffith:

I am a full Professor of Law at UCLA. I have previously taught elsewhere, such as at Yale Law School and two law schools in Shanghai. I am also the author of a leading corporate law textbook. In class and through my book, I teach thousands of students about Delaware law.

Delaware's corporate law is a success in large part because of what professors tell their students about it. Currently, I tell my students Delaware law is made carefully and incrementally. I empathize that no one interest group dominates the lawmaking process. Instead, the state somehow balances the interests of pension funds, individual investors, corporate managers, big private equity funds, and others. This is why there has been no "race to the bottom."

From California to China, my students learn to respect Delaware. They confidentially recommend Delaware corporations to their clients and encourage their clients to do business with Delaware corporations.

Unfortunately, I fear I will soon teach my students something quite different. SB313 is not careful. It is insultingly slapdash. Nor is it incremental. It changes the rules so thoroughly that Delaware law may become unteachable. It certainly will be a new experience to teach it.

Moreover, SB313 does not result from a careful balancing of the state's key constituents. It is evident that a few private equity firms sought illegal and secretive privileges to the detriment of everyone else. When a pension fund successfully and properly voided one such scheme, those PE funds asked for these amendments. That's it. There is little pretense that that SB313 gives a fair shake to all of Delaware's stakeholders. Indeed, the legislative history is so blatant and galling that it will become a major part of what I teach and publish about Delaware, and I am sure that I am not alone in this.

Delaware prospers in part because people pay extra for Delaware's corporate law. It has a good brand. But brands exist in how people talk about them. People will talk about Delaware very differently if SB313 passes. Delaware's biggest brand ambassadors will instead say very critical (and true) things about it. Our students will no longer see such a big difference between Delaware corporations and those of, say, Texas.

In closing, and speaking of distant places, let me apologize for not appearing before you to deliver these remarks. I am currently located in Beijing. You will meet in the middle of my night. I fear my comments would not be very coherent at that hour.

Sincerely,

Andrew Verstein
Professor of Law
Faculty Co-Director, Lowell Milken Institute for Business Law and Policy

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June 17, 2024

VIA ELECTRONIC MAIL

Delaware House Judiciary Committee
411 Legislative Avenue
Dover, DE 19901
HouseCommitteeComment@delaware.gov

Re: SB 313 / Proposed DGCL Section 122(18)

To the Members of the Delaware House Judiciary Committee

I write with respect to SB 313, the currently proposed amendment to the Delaware General Corporate Law. I am a partner at Julie & Holleman LLP, a New York-based law firm that focuses almost entirely on representing stockholders in matters involving Delaware corporations, in Delaware's courts. The views expressed herein are entirely my own.

SB 313 is a reaction to three trial court decisions: *Crispo v. Musk*, 304 A.3d 567 (Del. Ch. 2023); *Sjunde AP-Fonden v. Activision Blizzard, Inc.*, 2024 WL 863290 (Del. Ch. Feb. 29, 2024) (corrected March 19, 2024); and *West Palm Beach Firefighters' Pension Fund v. Moelis & Company*, 2024 WL 747180 (Del. Ch. Feb. 23, 2024). There is merit in amending Delaware law to address the issues in *Crispo* and *Activision*, and I do not offer criticism on those amendments. But the *Moelis* amendments, embodied in proposed Section 122(18), are different.

I heard, listened to, and considered the mostly scripted remarks of every participant at last week's Senate Judiciary Committee hearing and will not regurgitate what has already been said. I have also reviewed the extensive commentary on the proposed legislation, including from academics, commentators such as *The Chancery Daily*, plaintiffs' lawyers, and defense lawyers. Every voice counts, but I would urge you to appreciate what Chancellor McCormick and Vice Chancellor Laster have written on this issue. Indeed, the Delaware judiciary's role in the First State's rise to corporate prominence should afford due consideration to the views of its jurists. I wish here only to emphasize issues I believe were given inadequate attention last week.

- **The Potential Disparity Between Interest and Power.** Many stockholder agreements arise when the party securing the rights already enjoys (or is buying into) a position of power. Controlling stockholders (*i.e.*, those with 50% or greater *voting power* even if their financial interest is much lower because of a dual-class structure) frequently secure certain rights in a stockholder agreement just before taking a company public. Sometimes these rights fall away after time or once the controller's ownership (or voting power) drops below a certain percentage. This scenario (*i.e.*, where the rights exist only if the shareholder retains majority control) has been argued in certain cases

to merely formalize the control they already enjoy.[1] But what about the stockholder agreement that continues to confer control even after the ownership or voting power drops to 25%, or lower, especially with no expiration date? Or what about the board that gives a new minority investor rights disproportionate to the investor's ownership interest. It would be value-destructive for a private equity firm that invested in, say, mid-2020 during the coronavirus-induced trough to retain veto power over myriad board functions a decade later at mere 5% voting power (and potentially even lower ownership). But that's what SB 313 would allow.

- **The Particular Governance Rights at Issue.** Proponents of SB 313 believe that stockholders should get something return for investing in a company, beyond the financial stake and voting power that comes with owning stock. Not only has this premise not been tested, but it also raises the question: What *additional* rights are warranted? Stockholder agreements can involve veto rights over numerous actions, including: hiring and firing the CEO, hiring and firing other executive officers, setting executive compensation, issuing equity, taking out and repaying loans, changing the nature of the company's business, expanding into a different market, hiring an investment bank to evaluate a merger proposal, or accepting and recommending to stockholders a merger proposal. Other rights include board and committee membership rights, or proxy recommendation rights. And on the easier end, rights can include "board observer" or "access to information" rights. Whereas Delaware courts have previously said it is one of the board's most important functions to select the CEO, the courts have not specifically addressed several others. Indeed, consent rights against further dilution may be justifiable, but neutering the board over established "core" board functions is not. SB 313 extinguishes even the possibility of any distinction, broadly endorsing a limitless array of rights that will reshape the role of elected directors in the corporate structure.

- **The Procedural Posture of *Moelis*.** The *Moelis* plaintiff took a broad approach and challenged a bevy of rights given to the company's eponymous founder, chairman, and CEO. Other cases have involved much narrower challenges. The trial court in *Moelis* struck down almost all the rights, including all the "consent" or "pre-approval" rights, as well as several rights associated with board and committee membership. On appeal, the Supreme Court could affirm Vice Chancellor's decision in whole, reverse in whole, or rule that certain rights are permissible under a balancing standard while others contravene the *board's* (as opposed to a *stockholder's*) prerogative under Section 141(a) to manage a corporation's affairs. A narrowed, more nuanced outcome would clarify the current state of Delaware law, which would benefit all stakeholders and could potentially obviate SB 313 altogether. SB 313 is thus premature.

- **The "Fiduciary Out" Myth.** Certain speakers at last week's Senate Judiciary hearing attempted to downplay the real-world effect of the *Moelis* amendment by explaining

[1] There are, to be sure, valid arguments to the contrary, as Delaware law has established that "director primacy" is the law irrespective of how many shares someone might hold and the functional consequence of such ownership.

that fiduciary duties still exist, and that Section 122(18) does not preclude a suit for breach of fiduciary duty. This is illusory. The subjective impact of a veto right will chill board action in the areas surrounding a particular stockholder's consent rights, and it is difficult to imagine how any fiduciary claim for subverting the company's interest in furtherance of the stockholder's expressed *or perceived* preferences would ever come to light. And the imposition of fiduciary duties in a vacuum, without any mechanism for discerning or policing them, is useless. The hammer need not strike for a gun to deter, and the mere presence of veto rights over board action will unquestionably encumber boards of directors.

- **The Disutility of Proposed Section 122(18).** The amendment, at bottom, is unnecessary. Section 141(a) already permits parties to include provisions in a corporate charter to accommodate such interests. Numerous companies have already taken this approach. Short of a charter amendment, the same powers sought by the private equity firms behind the *Moelis* amendments can be secured through the issuance of preferred stock. The proponents' argument—"We're just conforming to what you can already do via charter amendment or issuance of blank check preferred stock"—ignores two very basic things. Charter amendments like this require stockholder approval, and common stock and preferred stock are purposefully designed to differ in significant ways.

- **Market Practice.** The argument that proposed Section 122(18) merely molds longstanding law to fit recent market practice is also flawed. "Everybody's doing it!" does not work for my children, and it does not work here. In fact, *not* everybody is doing it. These agreements exist in only a relatively small percentage of listed companies, and private equity firms are overwhelmingly the largest beneficiaries of such agreements over the past decade. Moreover, the frequency of such agreements is irrelevant to whether they upset the board's traditional role. There are already two alternative mechanisms for conferring such rights—charter amendments and preferred stock issuances—but SB 313 will forever signal a shift that Delaware now favors private equity and special interest investors over the broader investment community of pension funds, mutual funds, and retail investors.

Based on the foregoing, I would urge the House to defer consideration of proposed Section 122(18) until after the Delaware Supreme Court has had a chance to weigh in on the issue. Alternatively, I would urge an amendment to curtail the limitless nature of the rights Section 122(18) purports to endorse.

Thank you for the opportunity to voice my views. I am available by email at scott@julieholleman.com or by telephone at (917) 325-3798 if you have any questions. I would also be happy to discuss this further, or to provide you with any underlying source materials.

Sincerely,

W. Scott Holleman

BOSTON COLLEGE LAW SCHOOL

Representative Krista Griffith
Chair, House Judiciary Committee
Delaware General Assembly
411 Legislative Avenue
Dover, DE 19901

BY EMAIL

June 17, 2024

Dear Representative Griffith:

I am writing to offer my input on a series of proposed amendments to the Delaware General Corporation Law being considered by your committee. In summary, I believe the proposed amendments to be premature and ill-considered. These are not mere technical changes to the Corporation Law. Indeed, their impact may be more radical than is immediately apparent. I would encourage you to vote no on these amendments.

As the Delaware State Bar Association ("DSBA") was considering these proposed amendments in April, I submitted lengthy comments. I am attaching a copy of that letter for your benefit. Since that time, the DSBA made revisions to its proposed amendments. In short, I do not believe these revised amendments alleviate any of the concerns I raised in my April 12, 2024 letter. Rather than rehash the entirety of that letter, I would like to make four points, the first with respect to process and timing of these proposed amendments and then three points with respect to the substance of the proposed amendments.

First, the amendments are unnecessarily rushed. As you are no doubt aware, the amendments your committee is presently considering have been rushed before you. I must admit that I remain perplexed by this. The amendments are intended to overturn three Chancery Coury opinions *even before* the Delaware Supreme Court has had an opportunity to hear arguments and decide any appellate issues raised by the trial court's work.

The speed at which these amendments have been rushed to the legislature suggests there must be some exigency at work. But, there does not appear to be any legitimate impetus for the legislative panic to adopt these provisions. Proponents of this legislation point to "thousands" of stockholder agreements that they say are adversely affected by the Chancery Court opinion in *Moelis* as reason to move so quickly. Maybe that's true, but then why is the legislature in such a rush to overturn *Activision* and *Crispo* as well?

I have yet to hear any normative arguments in favor of what are – to be frank – rather radical changes to the corporate law other than the proposed amendments conform the law to "market practice." While it is true that the Chancery Court opinions in question place an imposition on current market practices, there is no reason to believe that market practices are objectively correct or that market practices should drive substantive amendments of the Corporation Law.

Given the lack of real exigency, I find it hard to find any other rationale for the current changes other than regulatory capture. This is obviously disappointing for those of us who teach and research the Delaware corporation law.[1] If Delaware has decided to treat its corporate law like every other state by deferring to interest groups, Delaware will have made an own goal of New Jersey proportions.[2] I am perplexed by how you find yourself at this crossroads, but I encourage you and your colleagues to resist moving too quickly with respect to the proposed amendments.

Changes like the ones you are considering are a one-way street. Once you go down this road, there is no coming back.

Moelis Amendments

Regarding the substance of the proposed amendments, proposed § 122(18) does damage to § 141(a) with little obvious benefit other than to conform the statute to "market practice." There is no reason

[1] I have heard criticisms of people like me as "outsiders" with no right to comment on legislative changes to the Delaware corporate law. This criticism ignores the externalities associated with Delaware's corporate law franchise. Many outside Delaware are affected by substance of the Corporation Law and the process by which that law is made. My comments are offered in good faith with a hope that they will provide you with additional insight as you make decisions that will impact many beyond your state.

[2] New Jersey's own goal is described on an official Delaware "Facts and Myths" page:

> In 1899, Delaware enacted a general corporation law modeled on New Jersey's. More than a decade later, New Jersey enacted a series of changes to its corporate law that limited its corporation's ability to engage in merger activity. These changes were pushed through the New Jersey legislature by then-Governor Woodrow Wilson following a highly contested Presidential campaign. This caused corporate attorneys and others to question the political and legal climate in New Jersey. At the time, Delaware's corporate law had the same attractive features of New Jersey law, without New Jersey's newly enacted restrictions. Delaware also offered more stability than other states, exemplified by a requirement in the Delaware Constitution of 1897 that required a two-thirds majority in each house of the legislature to approve changes to the Delaware General Corporation Law. Those features of Delaware's law made it more advantageous for incorporation than other U.S. states. Since then, Delaware's emphasis on consistency, predictability, stability and quality—further exemplified by its excellent court system—has allowed it to maintain its advantage.

Delaware Corporate Law, Facts & Myths, available at https://corplaw.delaware.gov/facts-and-myths/.

why the courts or the legislature should genuflect to market practice with respect to stockholder agreements. Market practice can be, and often is, wrong.

If the corporation and its stockholders wish to tailor the board's powers with respect to matters of internal governance, the statutory framework under § 141(a) requires that they do so within the certificate of incorporation. Through the years, § 141(a) has been a tentpole of the Delaware corporate law. It is strange that the legislature would consider such an ignoble end to § 141(a)'s position by endorsing the outsourcing of internal governance to stockholder contracts. Has § 141(a) and board centric corporate governance become so antiquated? I am not aware of anyone putting forward the proposition that the certificate of incorporation has outlived its usefulness or that its amendment procedures are so onerous as to make amendments unworkable or that stockholder no longer rely on the certificate of incorporation when making investment decisions. Indeed, sophisticated market players, like venture capitalists, are adept at documenting governance powers in certificates of incorporation and examine them carefully before making investment decisions.

However, proposed § 122(18) re-homes internal governance matters to a contract between the corporation and current or prospective stockholders in a manner that gives other stockholders no voice in that decision and does not place them on notice. This, despite what proponents argue, is a radical departure from the current state of affairs.

Worse – again for no discernible reason – proposed § 122(18) specifically envisions side-stepping exclusive forum provisions in certificates of incorporation so that stockholders who are party to a stockholder agreement governing the internal affairs of the corporation can have their disputes over internal corporate governance resolved by an out of state arbitrator in a confidential arbitration proceeding.

By sending review of stockholder agreements to private arbitrators, proposed § 122(18) contains the seeds of the Delaware corporation law's own destruction. Future litigation about § 122(18) will be resolved out of the public eye through arbitration, seriously eroding the value of Delaware's corporate law franchise. One of the reasons why Delaware's corporate law is so valuable is the fact that the Delaware courts have a deep body of case law. Permitting § 122(18) stockholder agreements to be adjudicated by confidential, private arbitrators sends Delaware down a path that reduces the value of the state's corporate law franchise.

Perhaps discarding the DGCL's board centric governance framework is what the legislature intends. I can't imagine it is, but maybe that's what the legislature wants. But, then why rush to the cliff with so little consideration?

Activision Amendments

With respect to the *Activision* amendments, I understand these amendments are intended to make sure boards are not penalized for foot-faults when doing a merger. As you might know, a merger is a complex transaction with lots of moving parts up until the very end. I am sure getting a merger agreement signed is not all that dissimilar to the end of a legislative session here in Dover. The

proposed *Activision* amendments are intended to grant some grace to boards who might let one or two things slip while the agreement is getting done. But, these provisions grant a little *too much* grace.

Specifically, proposed § 268(b) provides that disclosure schedules, which can materially alter the meaning of the merger agreement, "shall not be deemed part of the agreement for purposes of any provision of this title." Now, disclosure schedules can be big, messy documents. They are worked on until the very end of the process, so getting a completed disclosure schedule, or at least one that is substantially completed, can be a challenge for lawyers.

However, the proposed § 268, as written, contemplates a scenario where the board can validly approve a merger agreement without any knowledge of how a disclosure schedule material affects the terms of the merger agreement. It is hard for me to imagine that the legislature intends for directors to do this, but by adopting this language, the legislature is giving board license, in effect, to violate their duty of care.

Crispo Amendments

With respect to proposed § 261 (the *Crispo* amendments), there appears to be a lack of exigency to justify moving forward with respect to a provision that has the potential for upsetting market reliance on deal certainty in merger agreements. Proponents suggest that in the absence these proposed amendments merger agreements will become simple options for buyers. This vastly overstates the reality of deal making. Rather, approving this change is more likely to undermine deal certainty.

While provisions of the type described by § 261 (so-called *Con Ed* provisions) are not unknown in merger agreements, they are not uniformly present. When they are present they are usually treated like a contractual step-child, that is to say they are generally ignored. On the other hand, specific performance clauses and uniformly present in merger agreements. Specific performance clauses in merger agreements, and not *Con Ed* provisions, do the important work to ensure deal certainty.

As a matter of contract law doctrine, specific performance has always been a disfavored remedy. When at all possible, courts will seek to fashion a cash damages remedy rather than look to specific performance. However, since *IBP*[3] in 2001, practitioners have come to rely on the willingness of the Chancery Court to enforce negotiated specific performance provisions in merger agreements. In a recent article Chancellor McCormick noted that the Delaware court has departed from the traditional doctrinal aversion to ordering specific performance to honor the contracting parties desire for deal certainty:

> As specific performance provisions became ubiquitous in M&A agreements, Delaware law's analysis of specific performance in the merger context shifted away from the traditional equitable approach to instead prioritize the parties' contractual scheme. This contractarian approach led the court to, in effect, invert the common-law framework for specific

[3] *In re IBP Shareholders Litigation*, 789 A.2d 14 (2001).

performance and treat specific performance as the presumptive remedy in the event of breach.[4]

Deal makers have come to understand that when sophisticated parties have negotiated for specific performance and deal certainty, they will get it in Delaware.

I worry about the adverse effect on deal certainty of the legislature raising *Con Ed* provisions from occasional boilerplate to a statutorily authorized remedy favoring cash damages. This provision raises the prospect of reversing the current Chancery Court's approach to remedies in the merger context. The increased salience of a cash damages remedy endorsed by this legislature may signal to the court, as well as parties to merger contracts that, as a matter of policy, Delaware disagrees with the Chancery Court's reliance on specific performance as the presumptive remedy for breach in the context of merger agreements.

Currently, when a reluctant buyer seeks to walk away from a deal, the negotiation between buyer and seller is against the backdrop of specific performance. Sellers know that Delaware courts will enforce specific performance of merger agreements, thus increasing the likelihood of the deal actually closing. On the other hand, should proposed § 261 become law, future negotiations with reluctant buyers will take place against a backdrop of a damages remedy, making it much more likely that buyers will be able to pay to walk away from deals, thus reducing deal certainty. If sellers believe that signing merger contracts under Delaware law will result in less deal certainty, they may seek certainty in other jurisdictions.

It may well be that the legislature believes that statutory damages should be preferred to specific performance for merger contracts and that specific performance should remain a disfavored remedy. However, it does not appear that the legislature – or the DSBA – has given much consideration to the downstream implications of adoption of proposed § 261.

For the reasons stated above, I encourage you to not to adopt the proposed amendments presently before the committee.

Sincerely,

Brian JM Quinn
Professor of Law

[4] Chancellor Kathaleen St. Jude McCormick & Robert Erikson, *Delaware's Approach to Specific Performance in M&A Litigation*, 20 NYU J. L & BUS. 7, 8 (2023).

Attachment: April 12, 2024 Letter to DSBA

cc. Rep. Cyndie Romer
Rep. Franklin D Cooke
Rep. Sean Lynn
Rep. Sophie Phillips
Rep. Peter Schwartzkopf
Rep. Sherry Dorsey Walker
Rep. Timothy Dukes
Rep. Valerie Jones Giltner
Rep. Bryan Shupe
Rep. Jeff Spiegelman

BOSTON COLLEGE LAW SCHOOL

Kate Harmon, Esq.
President
Delaware State Bar Association
704 North King Street, Suite 110
Wilmington, DE 19801

BY EMAIL

April 12, 2024

Dear President Harmon:

As a professor of law at Boston College Law School with over fifteen years experience teaching and writing in the area of the corporate law and mergers & acquisitions, I am writing to offer my input on a series of amendments to the Delaware General Corporation Law being considered for this legislative cycle. In summary, I believe the proposed amendments to be premature and ill-considered at the very least. I would encourage you to resist the urge to rush these amendments forward during the current legislative cycle.

In essence, these amendments attempt to resolve conflicts between market practice and the Chancery Court's limitations on market practice in favor of market practice. While it is true that *Moelis*, *Activision*, and *Crispo* place an imposition on current market practices, there is no reason to believe that market practices should drive substantive amendments of the Corporation Law. Rather, amendments to the Corporation Law should be guided by an understanding of the public good, incorporating market practices where appropriate without being dictated by them.

I would encourage the Delaware State Bar Association not to move too quickly in making substantive changes to the corporate law that may upset the important balance between competing interests. Considering amendments to the statute even *before* the Delaware Supreme Court has had an opportunity to weigh in on any of the cases in question strikes me as extremely premature, exhibiting an undue sense of panic. The world will not end because the Chancery Court has restrained market practice to conform within the limits of the statute.

Of course, the tension between market practice and the law is a real one. Transaction planners will regularly push the envelope of statutory limits. In the absence of the court's oversight, market practice can deviate widely from the constraints of the statute and the common law. The court's proper role is to regulate market practice and remind practitioners of the limits of corporate action and pull them back from the edge when they over-reach.

From time to time, the corporate bar has had their knuckles rapped by the Delaware courts for market practices that go beyond what the law permits. You will remember in 2003, the Delaware Supreme Court ruled against market practice in *Omnicare*, a case that was widely derided by the corporate bar as contrary to market practice.[1] In *Omnicare*, the Court held that directors who enter into fully locked-up merger agreements violate their fiduciary duties. The ruling was decried by the corporate bar as a terrible decision in part because it went contrary to market practice at a time when locking-up deals involving private sellers was commonplace. But yet, more than 20 years later *Omnicare* remains on the books as good law. The corporate bar has learned how to do deals while staying within the fiduciary constraints imposed on them by the statute and the common law.[2]

Or, perhaps you will remember that market practice during the 1990s in Silicon Valley included the back-dating of options. Now, one looks back on that practice and is slightly embarrassed that we ever considered it acceptable. But, we did. It was only when the SEC and Chancery Court stepped into curb that market practice that we realized just how far astray market practice had gone.[3] Imagine what the world might look like, if, following protestations about how back-dating options was "just market practice," Delaware had amended Section 157 to permit boards of directors to back-date options, pushing the statute into accordance with market practice.

Of course, I understand there are many pressures on the Bar Association. Perhaps, you are attempting to separate the organized bar from an iconoclastic tech entrepreneur who is seeking to lead corporations to reincorporate into Nevada and Texas. You might believe that by moving quickly to respond to the organized bar's concerns about regulation of their market practices that you might forestall any momentum behind corporations considering a reincorporation into other jurisdictions at the instigation of Mr. Musk.[4] If that is the case, I believe your fear is misplaced.

The last time a well-known stockholder sought to lead a parade out of Delaware was in 2007. Carl Icahn had hopes of moving corporations out of Delaware and to a jurisdiction with laws more amenable to shareholder activists.[5] Mr. Icahn selected North Dakota and worked with their

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[1] *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2D 914 (2003).
[2] *The Long, Slow Death of Omnicare*, DEALBOOK, NEW YORK TIMES, Aug 28, 2008 (Noting that although practitioners and academics criticized the opinion, the "parade of horribles" that they warned of did not come to pass.) available at https://shorturl.at/EHTW0.
[3] *See* e.g. *Desimone v. Barrows*, 924 A.2D 908 (Del. Ch., 2007); *Ryan v. Gifford*, 918 A.2D 341 (Del. Ch., 2007); *SEC v. Ryan Ashley Brant*, USDC, SDNY, Civil Action No. 1:07-CV-1075 (DLC) (S.D.N.Y. February 14, 2007).
[4] Maruf Ramishah, *Elon Musk Doubles Down on His Promise to Ditch Delaware*, CNN.COM, February 14, 2024, available at https://shorturl.at/jkrvD; Lora Kolodny, *SpaceX Files to Move Incorporation Site from Delaware to Texas*, CNBC.COM, Feb. 14, 2024, available at https://shorturl.at/ACQY7.
[5] Carl C. Icahn, *North Dakota's Pro-Shareholder Law: A Major Advancement*, 84 *N.D. L. REV.* 1039 (2008).

legislature to pass revision of the North Dakota Corporation Law. The sponsors of the legislation intended North Dakota's corporate law to become an activist-friendly corporate governance regime tilting their law's balance in favor of stockholders, thereby attracting corporations away from Delaware and Delaware's board centric governance model.[6] That particular parade made a lot of noise, but ultimately went nowhere. By 2009 only one publicly-traded corporation made the move to North Dakota.[7] During the 2009 legislative session, Delaware adopted (without an unnecessary rush) measured provisions providing for stockholder proxy access and proxy expense bylaws (§§ 112, 113) that maintained a balance between Delaware's director centric approach and the need for corporate boards to be responsive to the stockholder's voice.

Mr. Musk's current attempt to lead others out of Delaware is similarly likely to fail. Mr. Musk's motivations for reincorporating out of Delaware are mostly self-serving. Mr. Musk has shown his indifference to corporate governance norms.[8] His efforts to move out of Delaware are an obvious effort to avoid the jurisdiction of the Delaware courts, courts that have demanded he treat unaffiliated stockholders fairly.[9] Mr. Musk is in search of a jurisdiction that will protect controlling stockholders at the expense of unaffiliated investors. He is searching for a jurisdiction that has placed its thumb on the judicial scale against stockholders and in favor of controlling shareholders like himself. For that reason, he will likely fail to move any business out of Delaware that he does not already control.

A rush to make substantive changes to the Corporation Law to stem a feared parade out of Delaware behind Mr. Musk's social media campaign will upset the balanced approach to the Corporation Law that Delaware has always sought and will ultimately not be worth the cost.

Proposed Section 122(18) is being offered to overturn *Moelis*. This amendment threatens to upset the basic structure of the corporate contract. The corporate contract has long been a motivating practical and intellectual framework for Delaware's corporate law.[10] The certificate of incorporation

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[6] Larry Ribstein, *The North Dakota Experiment*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE, April 23, 2007, available at https://corpgov.law.harvard.edu/2007/04/23/the-north-dakota-experiment/.
[7] Dale Wetzel, *Investors Not Buying ND Law for Shareholders*, THE ASSOCIATED PRESS, June 11, 2009 (Noting that only one corporation – an Icahn controlled entity – reincorporated into ND from Delaware. Also, reporting that shareholders from 15 corporations voted "no" on shareholder proposals about reincorporation into ND.).
[8] See e.g. *Tornetta v. Musk*, C.A. No. 2018-0408-KSJM, 2024 WL 343699 (Del. Ch. Jan. 30, *2024*), *In re Tesla Stockholders Litigation*, 298 A.3D 667 (2023).
[9] See e.g. "Never incorporate your company in the state of Delaware" @elonmusk (Twitter) Jan 30, 2024 at https://twitter.com/elonmusk/status/1752455348106166598?lang=en.
[10] *Dartmouth College v. Woodward*, 17 U.S. 518 (1819) ("The opinion of the court, after mature deliberation, is, that [the corporate charter] is a contract, the obligation of which cannot be impaired, without violating the constitution of the United States."); *Lawson v. Household Finance Corp.*, 17 DEL. CH. 343 (1930)("[I]t has been generally recognized in this country that the charter of a corporation is a contract both between the corporation and the state and the corporation and its stockholders. It is not necessary to cite authorities to support this proposition."); *STAAR Surgical Co. v. Waggoner*, 588 A.2D 1130 (1991)("[A] corporate charter is both a contract between the State and the corporation, and the corporation and its shareholders."); *Boilermakers Loc. 154 Ret. Fund v. Chevron Corp.*, 73 A.3D 934 (2013)("As our Supreme Court has made clear, the bylaws of a Delaware corporation constitute part of a

and the corporate bylaws are the embodiment of that contract. Stockholders consent to that contract when they acquire shares with either actual or constructive notice of the certificate and bylaws' terms and when they vote to approve or amend them.

As a matter of basic corporate law, amendments to the certificate that seek to alter the contractual relationship between stockholders and the corporation in a material manner require a vote of the stockholders to ensure consent of the contracting parties.[11] Voting to approve amendments to the basic relationship amongst the investing parties is central to Delaware's corporate governance framework; without it, directors can hardly be expected to legitimately act on behalf of stockholders.[12] Through voting in annual director elections, for amendments to the certificate and bylaws, Delaware achieves a balance between director primacy and accountability to stockholders.

Proposed Section 122(18) threatens to disturb Delaware's balanced approach by accomplishing material changes to the corporate contract without the consent of stockholders.

Stockholder agreements permitted under proposed Section 122(18) will govern the internal affairs of the corporation in the same sense a certificate or bylaw might, but they will not require a vote of stockholders, nor will stockholder have any actual or constructive notice of substantive changes to their rights as stockholders. There is no obvious restriction in the proposed amendment on the matters that might be governed by such agreements. Indeed, the proposed language is permissive, rather than restrictive ("without limiting…"). I encourage you to use your imagination at the corporate shenanigans that could well ensue relying on this provision. For example, an iconoclastic tech entrepreneur might well enter into an agreement with the corporation to covenant the corporation to refrain from suing the entrepreneur for breaches of the duty of loyalty for engaging in insider trading of the corporation's stock, thus blocking any potential future derivative claim. Or, perhaps the corporation and the stockholder agree to waive the corporation's exclusive forum provision with respect to any disputes involving the stockholder sending them off to a private arbitrator in Nevada. In either case, these are substantive changes affecting the governance of internal affairs of the corporation and stockholders have no notice have not consented to them.

It is true that in a publicly-traded corporation such agreements will be filed with the SEC as "material contracts." However, a reasonably well-informed stockholder seeking information from the SEC about the corporation's governance documents cannot be reasonably expected to engage in a treasure hunt to unearth hidden stockholder agreements governing the corporation's internal affairs.

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binding broader contract among the directors, officers, and stockholders formed within the statutory framework of the DGCL."). Other jurisdictions, when applying Delaware law, rely on the corporate charter as contract framework. See e.g. *Drulias v. 1st Century Bancshares, Inc.*, 30 CAL.APP.5TH 696, 708 (2018)(*citing Boilermakers* for the same proposition); *North v. McNamara*, 47 F.SUPP.3d 635, 643 (2014)(*citing Boilermakers* for the same proposition).

[11] DGCL § 242.

[12] *Blasius Industries, Inc. v. Atlas Corp.*, 564 A.2D 651, 659 (Del. Ch., 1988) (The stockholder vote is "... critical to the theory that legitimates the exercise of power by some (directors or officers) over vast aggregations of property that they do not own.").

Most Delaware corporations are not publicly-traded corporations, however. As you are aware, although the certificates of incorporation are accessible via a public database (for a fee), absent a costly Section 220 books and records action, stockholders of private corporations have no ability to access stockholder agreements that a board decides not to proactively share with them. To the extent boards of privately corporations enter into stockholder agreements governing matters of the corporation's internal affairs with some, but not all, stockholders, the proposed amendment ensures that stockholders will acquire shares without notice of potentially material matters of internal corporate governance.

Unlike the board adopted bylaws that were the subject of litigation in *Boilermakers*,[13] the proposed amendment provides the board the power to enter into such agreements *whether or not* the certificate of incorporation puts stockholders on notice that such agreements are possible ("shall have the power, whether or not so provided in the certificate of incorporation"). Compare that with requirements that bylaws and certificates specifically reserve rights to the board for future changes to the corporate contract and thus put stockholders on notice that changes to the substantive rights might occur in the future. No such notice is provided with respect to potential stockholder agreements under Section 122(18), meaning that a stockholder's decision to invest in a Delaware corporation will be uninformed. Stockholders may discount the price of all Delaware corporations because the corporate contract may be unilaterally changed by the board at any point without notice to the stockholder by a stockholder agreement.

Perhaps worse still, the proposed amendment permits the board to enter into agreements governing the internal affairs of the corporation with "prospective stockholders." While I can imagine a number of situations whereby a corporation might enter into an agreement with a prospective stockholder that would be innocuous, I can also imagine a host of scenarios in which a stranger to the corporation has more say in the internal affairs of the corporation than stockholders themselves by way of a stockholder agreement. For example, an iconoclastic tech entrepreneur might enter into a stockholder agreement with a corporation, in which the stockholder agrees to invest in the corporation at some point in the future on the condition that for the next three years the prospective stockholder has the power veto any material corporate transaction as well as board nominees. At the end of the three year period the prospective stockholder may or may not invest, but the prospective stockholder has had a voice in the internal governance of the corporation in the meantime. Seem ridiculous? Maybe.

Proposed Section 122(18) detaches stockholder voting and stockholder consent from the governance of the corporation's internal affairs, decreasing transparency about the corporation's internal governance, and thus it hollows out a vital source of the corporation law's legitimacy.

One might argue that stockholder agreements are already commonplace, and that the addition of Section 122(18) will not upset the existing balance. It is true that stockholder agreements are common in a number of contexts. For example, in the world of venture-backed corporations, voting

[13] *Boilermakers Loc. 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (2013).

agreements are a standard part of a venture financing.[14] However, voting agreements in that context are limited to stockholder's exercise of their rights as a stockholder to vote their shares. NVCA model voting agreements do not grant stockholders power over the internal affairs of the corporation. Such agreements are entirely reasonable and do not cause concern.

The typical venture financing also includes an Investor Rights Agreement ("IRA").[15] The NVCA model IRA includes a number of provisions, many of which are troubling from an internal governance perspective. First, the typical IRA permits preferred stockholders to force a corporation to list the corporation's shares on a public exchange. The decision whether or not to go public is clearly a matter of internal corporate governance and not a decision to be made by stockholders as evidenced by the IRA. Second, the standard form IRA also includes covenants by the company to adopt both anti-harassment and DEI policies. The standard provision covenants the company to use its commercially reasonable efforts "to interview at least one person who self-identifies as a member of a currently underrepresented population (*e.g.,* race, gender, ethnicity, sexual orientation or disability) within the Company for each open executive-level employment position and each vacant independent director seat on the Board of Directors."[16] While all those things are commendable, they lie squarely within the purview of the board of directors, not the stockholders. Finally, the model IRA also makes provision for the resolution of disputes in connection with the IRA to be accomplished in accordance with the JAMS rules or under the Delaware Rapid Arbitration Act. Again, the forum for disputes about matters of internal corporate governance is quite obviously covered by Section 115. However, this dispute resolution provision exists in the IRA and not the certificate of incorporation or bylaws as required by Section 115.

Arguably, this agreement is the type that would be covered by Section 122(18).[17] No doubt, market players will argue that stockholders have constructive knowledge of this agreement's provisions because they are standard market practice in the industry. That is not necessarily true. The terms of the IRA are never formally presented to common stockholders. In connection with a financing, common stockholders are only asked to vote to approve the amended certificate of incorporation, which does not include language with respect to forcing a public offering, covenants about corporate policies, or the arbitration provision.[18]

Meanwhile, in the world of venture-backed companies sophisticated investors have shown great facility in the use of the certificate of incorporation to exert substantive control over the internal affairs of the corporation. Venture-backed certificates of incorporation covering all matter of internal governance matters can be quite detailed.[19] Removing the questions of internal corporate

[14] NVCA, Model Voting Agreement (January 2024), available at https://nvca.org/model-legal-documents/.
[15] NVCA, Model Investor Rights Agreement (April 2024), available at https://nvca.org/model-legal-documents/.
[16] Id.
[17] The most current version of the NVCA's Model Investor Rights Agreement *already* includes commentary with references to the Moelis opinion as well as the DSBA's proposed amendments. Id.
[18] Indeed, it may well be the case that the amended certificate of incorporation approved by stockholders includes a exclusive forum provision that is at odds with the IRA's designation of private arbitration.
[19] NVCA, Model Certificate of Incorporation (April 2024), available at https://nvca.org/model-legal-documents/.

governance from the IRA to the certificate of incorporation would not pose much of imposition on market players while still providing common shareholders and other less sophisticated investors in the start-up at least constructive knowledge of their rights.

One might also argue that stockholder agreements are already contemplated by the DGCL. It is true that stockholder agreements are already provided for in the context of the Delaware Close Corporation. However, stockholders acquiring stock of close corporations established under Subchapter XIV are specifically on notice via the certificate of incorporation that stockholders are subject to the requirements and limitations of Subchapter XIV. Stockholder agreements made with respect to the internal affairs of the corporation under Section 350 relieve the board of any liability and impose that liability directly on stockholders who are parties to the stockholder agreement. Stockholders who are parties to stockholder agreements governing the internal affairs under proposed Section 122(18) do not similarly accept the board's liability for managerial acts or omissions. Consequently, stockholders acquiring shares of Delaware close corporations do so with full knowledge of their rights and obligations, while accepting liability for their actions. Stockholders who will acquire shares of Delaware corporations with stockholder agreements pursuant to proposed Section 122(8) do so without notice.

One might also argue that other states permit their corporations to enter into shareholder agreements, so the addition of Section 122(18) merely matches actions by other states. It is true that shareholder agreements that directly affect the internal affairs of the corporation are permitted in states that follow the MBCA. For example, Massachusetts follows the MBCA, and its corporation law specifically contemplates the existence of shareholder agreements. However, unlike the proposed Section 122(18), Massachusetts General Law Section 7.32(b) & (c) require *actual notice* of such agreements:

> (b) An agreement authorized by this section shall be:
>
> > (1) set forth (i) in the articles of organization or bylaws and approved by all persons who are shareholders at the time of the agreement or (ii) in a written agreement that is signed by all persons who are shareholders at the time of the agreement and is made known to the corporation;
> > (2) subject to amendment only by all persons who are shareholders at the time of the amendment, unless the agreement provides otherwise; and
> > (3) valid for 10 years, unless the agreement provides otherwise.
>
> (c) The existence of an agreement authorized by this section shall be noted conspicuously on the front or back of each certificate for outstanding shares or on the information statement required by subsection (b) of section 6.26.

A shareholder of a corporation incorporated in an MBCA state like Massachusetts will acquire shares with actual notice of their rights with respect to the corporation's internal affairs, as defined in the certificate of incorporation, the bylaws, as well as any shareholder agreements that might exist. Indeed, by statute, Massachusetts the substance of any shareholder agreement be forth in the certificate of incorporation. As part of the certificate of incorporation, these shareholder agreements

make up a core part the corporate contract that all shareholders must have an opportunity to consent to. Absent actual notice of the impositions of shareholder agreements on the rights of shareholders, such agreements are not binding on the shareholders. The same cannot be said of a Delaware corporation should Section 122(18) pass.

For the reasons stated above, I believe that proposed Section 122(18) unwisely threatens to upset the balance that Delaware seeks in the establishment and maintenance of the Corporation Law. I urge to you reconsider this proposed provision.

Prior to adoption, proposed Section 261 deserves more serious discussion about its potentially adverse implications.

This provision specifically permits parties to merger agreements to include so-called "Con Ed" provisions. The typical Con Ed provision provides for a remedy for the corporation to seek damages, including "lost stockholder premium" on behalf of selling stockholders in the event the buyer willfully breaches the merger agreement and fails to close. Con Ed provisions are relatively common in merger agreements, but not uniformly so. A search using EDGAR for Con Ed provisions in merger agreements over the past three years turned up only 85 merger agreements with versions of these provisions. For the most part, Con Ed provisions are mostly treated like Consequential Damages Waivers, surplus boilerplate rarely to be enforced.[20]

On the other hand, parties to merger agreements uniformly agree to include specific performance clauses. As a matter of contract law doctrine, specific performance has always been a disfavored remedy. When at all possible, courts will seek to fashion a cash damages remedy rather than look to specific performance.[21] However since *IBP*[22] in 2001, practitioners have come to rely on the willingness of the Chancery Court to enforce negotiated specific performance provisions in merger agreements. This has been especially true in recent years when buyers pointed to exogenous events

[20] Consequential Damages Waivers ("CDW") appear in about 30% of public company deals and purport to waive any access to post-closing consequential damages. In short, CDW restates the holding in the venerable *Hadley v. Baxendale* (9 Exch 341; 156 Eng Rep 145 (1854)) that contract damages do not include consequential damages. Consequently, such provisions are mere surplusage. CDW appear in some public company merger agreements, notwithstanding the fact that public company representations expire at closing and there is no possibility of post-closing contract claims. In that sense CDW are surplus boilerplate that somehow persists in many merger agreements.

[21] DOUGLAS LAYCOCK, MODERN AMERICAN REMEDIES: CASES & MATERIALS at 370 (3d ed., 2002) ("It is hornbook law that equity will not act if there is an adequate remedy at law."); E. ALLAN FARNSWORTH, CONTRACTS at 737 (4th ed., 2004) ("[S]pecific performance should generally not be required, at least where compensation in damages is an adequate substitute for the injured party"); TRACEY E. GEORGE & RUSSELL KOROBKIN, A COMMON LAW APPROACH TO CONTRACTS at 498 (2d ed., 2017) ("[T]he principle that damages are the standard remedy for contractual breach, and that injunctive relief is extraordinary, remains black letter contract law in this country to this day."); ROBERT E. SCOTT & JODY S. KRAUS, CONTRACT LAW AND THEORY at 108 (5th ed., 2013) ("[S]pecific performance is an extraordinary remedy, not generally available to the promisee.").

[22] *In re IBP Shareholders Litigation,* 789 A.2d 14 (2001).

(e.g. Global Financial Crisis & COVID-19) as reasons to walk away from deals.[23] In a recent article Chancellor McCormick noted that the Delaware court has departed from the traditional doctrinal aversion to ordering specific performance in order to honor the contracting parties desire for deal certainty:

> As specific performance provisions became ubiquitous in M&A agreements, Delaware law's analysis of specific performance in the merger context shifted away from the traditional equitable approach to instead prioritize the parties' contractual scheme. This contractarian approach led the court to, in effect, invert the common-law framework for specific performance and treat specific performance as the presumptive remedy in the event of breach.[24]

Deal makers have come to understand that when sophisticated parties have negotiated for specific performance and deal certainty, they will get it in Delaware.[25]

I worry about the effect on contracting parties and the court of raising Con Ed provisions from occasional boilerplate to a statutorily authorized remedy favoring cash damages will cause these provisions to proliferate in merger contracts. And, once Con Ed provisions get a statutory blessing these provisions will proliferate in merger agreements. Increasing the salience of a damages remedy by way of statutory availability will result in lawyers adding them into their merger agreements.

A future court may find itself facing a situation in which a reluctant buyer wishes to walk away from a deal that includes two contractual remedies: a doctrinally disfavored specific performance provision and a statutorily authorized cash damages provision. In that situation, we may begin to see Delaware courts opt to fashion cash damages remedies for jilted sellers and step away from treating specific performance as the presumptive remedy in the event of breach of a merger agreement.

A contractual damages remedy would not be difficult to fashion. Experts are regularly deployed in the Delaware Chancery Court to estimate share premia in the context of statutory appraisal remedies on a normal briefing schedule. Compare that to fashioning a specific performance remedy on an expedited schedule. Expedited proceedings are costly for the court. Ordering specific performance in the face of an unwilling buyer is obviously not easy. In that case, one could well imagine courts leaning heavily on these statutorily authorized provisions and moving towards appraisal-like proceedings for busted deals.

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[23] *Hexion Specialty Chemicals, Inc. v. Huntsman Corp*., 965 A.2d 715 (Del. Ch. 2008); C*hannel Medsystems, Inc. v. Boston Scientific Corp*., 2019 WL 6896462 (Dec. 18, 2019); *Snow Phipps Group v. KCAKE Acquisition Corp.,* 2021 WL 1714202 (Del. Ch. April 30, 2021); *Bardy Diagnostics, Inc. v. Hill-Rom, Inc.*, 2021 WL 2886188 (July 9, 2021); *Level 4 Yoga, LLC v. CorePower Yoga, LLC*, 2022 WL 601862 (Del. Ch. March 1, 2022).

[24] Chancellor Kathaleen St. Jude McCormick & Robert Erikson, *Delaware's Approach to Specific Performance in M&A Litigation*, 20 NYU J. L & BUS. 7, 8 (2023).

[25] Even in the context of *Crispo*, the underlying facts related to a reluctant buyer who was litigating an MAE with the seller in separate litigation. When the buyer ultimately closed on the deal – because it became apparent that the court would order specific performance, the *Crispo* litigation was mooted. See *Twitter, Inc. v. Elon R. Musk et al.*, C.A. No. 2022-0613-KSJM.

It may be that the Delaware State Bar Association ("DSBA") believes that Chancellor McCormick's view that contracted for specific performance remedies should be the presumptive remedy in Delaware is incorrect. In that case, it makes sense for the DSBA to recommend new statutorily authorized remedies that place cash damages for breach of merger agreements at least on par with specific performance; that way dealmakers will include them in more merger agreements and courts will award them rather than order specific performance. However, if that is not the intention of the DSBA, then I would encourage the DSBA to hit pause on this proposed provision as it could totally reverse the current state of affairs with respect to deal certainty in Delaware.

For all the reasons stated above, I encourage you to not to move too quickly with adoption of the proposed amendments to the DGCL. I would be happy to elaborate on these views at the meeting of the DSBA Executive Committee on April 18 should you find them helpful in your consideration of the amendments.

Sincerely,

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June 17, 2024

Re: House Judiciary Committee SB 313

Dear Chair Krista Griffith,

I provided the following written comments to the Senate Judiciary Committee on June 11th. While I plan to speak at the hearing on June 18th, I wanted to provide my comments in advance.

Thank you for your time and attention to SB 313 today. I submit these written comments to document and extend my public comments made during the hearing earlier today.

I am a Professor of Law and Associate Dean of Research and Faculty Development, at Georgia State University College of Law. I am a corporate law professor who studies and teaches Delaware law.

SB 313 should not be passed as written; please consider returning it to the Delaware Bar's Council of the Corporation Law (CCL) for a more tailored response.

Corporate charters are super contracts, super because of their public nature and relative permanence. To relegate the most important corporate voting and control rules to ordinary contracts, like a shareholder agreement, subverts the foundational statutory design of Delaware corporate law where the charter is king.

First, investors in private companies are at risk of having the most important voting and control issues decided in contracts with no guarantee of notice or access. Keeping game altering rules in charters and stock designations, and out of shareholder agreements, is important for investor transparency, security and confidence. The example provided by Mr. Raju, to keep a sale price private in a secret shareholder agreement protects the controlling shareholder, but not the other investors, who likely don't have representation in this process. Further, due diligence alone is not enough to protect ordinary investors because shareholder agreements can be entered into after diligence is completed, or subsequently modified without required notice to the other shareholders.

Just last year, the United State Securities and Exchange Commission (SEC) finalized rules prohibiting preferential treatment in private funds through side letters—a practice that

parallels shareholder agreements.[1] The proposed Delaware amendments take the opposite approach, allowing some shareholders to change the rules of the game for all investors, without required notice or consent. The SEC concluded that such preferential treatment is bad for investors in funds,[2] and I caution that the same may be true for investors in private companies.

Second, the proposed amendments also affect public companies. Here the main issue is process. A company could go public with a single class capital structure and convert it post-listing to comprehensive control by an ordinary contract. Such a control-converting contract would not require a shareholder vote and would cast uncertainty over disclosure obligations under the current exchange rules.[3] Procedurally, a shareholder agreement differs from blank check preferred stock—an analogy that was made in the hearing today. If a company adopted blank check preferred stock after formation, it would require board action and a shareholder vote and would be subject to the board of directors' fiduciary obligations. The proposed amendments authorizing blank check shareholder agreements are not equivalent. There are no similar procedural safeguards, rather just a blank check for the controller.

Finally, a claimed breach of contract arising under such a shareholder agreement would not be reviewed under the canonical business judgment rule but would proceed under traditional contract law principles and procedures. Converting the most important questions of corporate control to contractual interpretation casts aside the long-standing norms and protections of Delaware corporate law.

Such consequential changes as those proposed in SB 313 deserve more contemplation and a measured approach that provides both flexibility and safeguards.

Thank you for your time and consideration of these matters.

Anne Tucker

Anne M. Tucker
Professor Law
Georgia State University College of Law

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[1] Private Fund Advisors; Documentation of Registered Investment Adviser Compliance Reviews, 88 Fed. Reg. 63206 (Aug. 23, 2023) (to be codified at 17 C.F.R. pt. 275) [hereinafter Final Rule]. Preferential treatment rules are discussed at 63389-90 in the Final Rule.

[2] "We are also adopting the preferential treatment rule, in part, because all investors will benefit from increased transparency regarding the preferred terms granted to certain investors in the same private fund (*e.g.*, seed investors, strategic investors, those with large commitments, and employees, friends, and family). In some cases, these terms materially disadvantage other investors in the private fund or otherwise impact the terms applicable to their investment. This new rule will help investors better understand marketplace dynamics and potentially improve efficiency for future investments, for example, by expediting the process for reviewing and negotiating adviser's fees and expenses." Final Rule at 63279-80.

[3] The shareholder agreement would be disclosed to the SEC as a material agreement, but the effects of the control may be downplayed to ordinary investors.

Written remarks Re: SB 313
Submitted for Consideration as a Public Comment
Delaware House Judiciary Committee Meeting
June 18, 2024

Dear Rep. Griffith, and Members of the House Judiciary Committee:

My name is Dael Norwood. By trade, I am a historian, specializing in the history of business and politics in the United States. By residence, I am a citizen of Newark, Delaware.

As both a historian and a citizen of Delaware, I urge this committee to kill Senate Bill 313, a hasty, badly-written, and dangerous piece of legislation that threatens Delaware's privileged position as the center of corporate law – and thus the stability of the state's revenues.

SB 313 proposes a host of unwise changes to the Delaware General Corporation Law. Collectively, they aim to overturn recent decisions in the Court of Chancery, and replace longstanding Delaware jurisprudence, that centers corporate boards, with governance contracted out to third parties, using expansive secret side deals. The bill also degrades Delaware law by making these side deals un-adjudicable in our courts. These changes appear intended to benefit a small number of litigants, concentrated in private equity, pursuing extremely risky business strategies.

Hurriedly drafted by advocates of these special clients with narrow needs, this bill has alarmed the wider corporate law world. In the weeks since this draft bill was announced, a broad coalition of legal experts in practice and in academia, from around the country as well as here in Delaware, have arrived at a shared consensus: that this bill will cause legal chaos – and in doing so, it will threaten Delaware's status as the preferred venue for corporate residency.[1]

I will not rehearse these experts' critiques. **Instead, as you contemplate this bill, I would urge you to consider our state's history – and the message that passing this bill would send.**

As you may know, Delaware became America's "corporate capital" by accident – or rather, by taking advantage of New Jersey's impulsive mistake. Prior to 1913, New Jersey was the most popular place in the US to charter a corporation: close to major capital markets, it had the most business-friendly laws, and an advanced court system ready to handle disputes. But in 1913, New Jersey amended its general corporation law – hastily, to serve the short-term interests of its lame-duck governor, Woodrow Wilson. Corporations left in droves to recharter in Delaware – which had already copied New Jersey's code, and stood ready with the Court of Chancery to serve businesses' needs.[2]

In short, New Jersey's legislators leapt before they looked – and Delaware benefitted from the resulting mess.

Since then, our state has arranged its revenues to take advantage of being the center of business formation. As our state's own marketing materials note, that system's continued success is the result of a carefully maintained reputation – our good credit, if you will – that depends on the state's carefully-considered laws, and the expert adjudication offered by the "highly-respected Court of Chancery."[3]

SB 313 threatens all of that. If the General Assembly passes this law, you as legislators will send a clear, loud message to litigants around the world: Delaware courts do not matter; Delaware jurists are not the legal experts we advertise them to be; and Delaware law is not a sound foundation upon which to make business decisions.

Proponents of this bill argue it adjusts the corporate code to match existing "market practice." A chorus of legal experts has convincingly debunked this claim – but even if it's granted, I think the legislature should think very carefully before altering settled law on a defendant's say-so. Hawking heroin on the street corner is an established "market practice," but the General Assembly has not seen fit to make it legal. Why should a sudden frenzy for secret stockholder agreements be any different? Conferring *post hoc* sanction to any action, however harmful, whenever the parties involved cry "existing market practice" is a short road to disaster.

SB 313 is a rushed bill. This haste only hurts Delawareans. So I urge you to listen to the legal experts whose collective opinion has made Delaware the jurisdiction of choice for business formation. I urge you to put our state's needs before the transient tantrums of a small number of private equity's special pleaders. And I urge you to keep New Jersey's example in mind – and remember that Delaware's privileged status can vanish with one bad decision.

SB 313 is that bad decision; you should reject it, and the process that produced it, entirely.

Thank you for your consideration.

Dael Norwood
Newark, DE

[1] For a selection of these critiques, see: Iliana Ongun, Dean Sattler, and Neil Whoriskey, "Delaware Court of Chancery Rejects Validity of 'New Wave' Stockholder Agreement Terms That Constrain Traditional Board Authority," *The Milbank General Counsel Blog* (blog), February 26, 2024, https://www.milbankgeneralcounsel.com/2024/02/delaware-court-of-chancery-rejects-validity-of-new-wave-stockholder-agreement-terms-that-constrain-traditional-board-authority/; "Important Chancery Decision Upends Practice of Providing Certain Governance Rights in Stockholder Agreements—Moelis," *FriedFrank M&A/PE Briefing* (blog), March 4, 2024, https://www.friedfrank.com/news-and-insights/important-chancery-decision-upends-practice-of-providing-certain-governance-rights-in-stockholder-agreements-moelis-11629; Benjamin P. 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[2] For more or this episode of Delaware's history, see: Christopher Grandy, "New Jersey Corporate Chartermongering, 1875–1929," *The Journal of Economic History* 49, no. 3 (September 1989): 677–92, https://doi.org/10.1017/S0022050700008810 and Hal Weitzman, *What's the Matter with Delaware?: How the First State Has Favored the Rich, Powerful, and Criminal—and How It Costs Us All* (Princeton, NJ: Princeton University Press, 2022).

[3] "Business & Economy," Department of State, State of Delaware, accessed June 10, 2024, https://sos.delaware.gov/business/.

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June 16, 2024

Dear Chair Griffith:

I write to express my concerns about S.B. 313, and in particular the proposed amendments to Section 122 of the Delaware General Corporation Law (DGCL). I believe the proposed amendments will cause Delaware to lose control over its law.

As proposed, the statute authorizes a shift of corporate governance from the charter to private contracts. Corporate charters are subject to the law of the chartering state, thus, Delaware law. Private stockholder agreements are not necessarily subject to the law of the chartering state. That means other states' laws would govern the interpretation of these contracts, and the appropriate remedies for any breaches.[1]

Additionally, the Federal Arbitration Act (FAA) provides that agreements to arbitrate disputes "shall be valid, irrevocable, and enforceable."[2] In practical effect, the FAA bars states, including state courts, from prohibiting or regulating arbitration agreements, and requires that such agreements be enforced as written. It is likely that the FAA does not apply to corporate charters,[3] which is why Delaware was able to adopt Section 115 of the DGCL, prohibiting corporations from including forum provisions in their charters that would bar access to the Delaware courts.[4]

By contrast, the FAA almost certainly would apply to stockholder agreements. If parties to a stockholder agreement agree to arbitrate disputes, a Delaware court will be required to enforce that provision. Those disputes could easily include questions about the legality of the contract under Delaware law, or whether a stockholder took on fiduciary obligations, and abused them, as a result of the control conferred by the contract.[5] As a result, important questions of Delaware law would be decided by non-Delaware actors, often in confidential proceedings. Arbitration provisions could also bind public stockholders who bring derivative actions on the corporation's behalf.[6] Even stockholders who bring direct actions regarding stockholder agreements, on

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[1] *See generally* Ann M. Lipton, *Inside Out (or, One State to Rule Them All): New Challenges to the Internal Affairs Doctrine*, 58 Wake Forest L. 321 (2023); *see also* KT4 Partners v. Palantir, 203 A.3d 738 (Del. 2019) (involving an investor in a Delaware corporation with a stockholder agreement governed by California law).
[2] 9 U.S.C. § 2.
[3] *See generally* Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 Geo. L.J. 583 (2016).
[4] Del. Code tit. 8, § 115.
[5] *See, e.g.*, Basho Techs. Holdco B, LLC v. Georgetown Basho Invs., LLC, No. 11802, 2018 WL 3326693 (Del. Ch. July 6, 2018) (involving such a scenario).
[6] *See, e.g.*, Ernst & Young, LLP v. Tucker ex rel. HealthSouth Corp., 940 So. 2d 269 (Ala. 2006).

behalf of themselves rather than the corporate entity, may find themselves bound to arbitrate disputes regarding the agreement.[7]

Moreover, as drafted, the amendments would explicitly permit stockholder agreements to select a forum for disputes outside of Delaware – either in arbitration or another state. Once again, that would mean that other states, or arbitrators, would decide whether the stockholder contract violated Delaware law, and whether the stockholder abused its governance rights under the contract.

Delaware's value to incorporators includes its robust body of caselaw decided by expert Delaware judges. The proposed amendments endanger that value proposition.

Sincerely,

Ann M. Lipton

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[7] *See* Richard J. Tyler, *Kicking and Screaming: Joinder of Non-signatories in Arbitration Proceedings*, 75 Disp. Resol. J. 111 (2020).

Harvard Law School Forum on Corporate Governance

Proposed DGCL § 122(18), Long-term Investors, and the Hollowing Out of DGCL § 141(a)

Posted by Marcel Kahan and Edward Rock (New York University School of Law), on Tuesday, May 21, 2024

Tags: delaware, Delaware law, DGCL, moelis, Quickturn, stockholder agreements
More from: Edward Rock, Marcel Kahan

Editor's Note: Marcel Kahan is the George T. Lowy Professor of Law and Edward B. Rock is the Martin Lipton Professor of Law at New York University School of Law. This post is part of the Delaware law series; links to other posts in the series are available here.

Delaware is on the verge of gutting DGCL § 141(a)'s iconic principle of board-centricity: "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." If the proposed DGCL § 122(18) is adopted by the Delaware legislature, § 141(a) will no longer impose meaningful limits on a board's ability to delegate key governance functions and responsibilities. If such a change is to be made, it should only occur after the Delaware Supreme Court has had a chance to review the *Moelis* opinion on appeal, only after extensive deliberation among key stakeholders, and only after all of its implications are sorted out. To make such a major change in response to a group of transactional lawyers frustrated by a recent Court of Chancery opinion threatens Delaware's legitimacy as the de facto promulgator of U.S. corporate law.

Background

In *West Palm Beach Firefighters' Pension Fund v. Moelis & Company*, the Delaware Chancery Court held that a stockholder agreement that provided founder Ken Moelis with comprehensive governance rights was void because it was inconsistent with DGCL § 141(a). Mr. Moelis' rights under the stockholder agreement included "pre-approval" rights, director designation rights and committee composition rights. Among the pre-approval rights was a requirement that the board not pursue a variety of actions without Mr. Moelis's prior approval including "the entry into any merger, consolidation, recapitalization, liquidation, or sale of the Company or all or substantially all of the assets of the Company or consummation of a similar transaction involving the Company."

The opinion has caused considerable consternation among a group of transactional lawyers because it raises doubts about the validity of a current market practice in which significant governance provisions are apparently included in stockholder agreements rather than in the certificate of incorporation ("COI). In response to that consternation, the Delaware Bar Association's Executive Committee, upon recommendation of its Corporation Law Council, has proposed amending the General Corporate Law to add § 122(18) to provide "bright-line authorization" for provisions of the sort at issue in Moelis. In particular, the proposed amendment to § 122 provides in relevant part that:

> Every corporation created under this chapter shall have the power, whether or not so provided in the certificate of incorporation, to: . . .
>
> (18) Notwithstanding § 141(a) of this title, make 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 exchange for such minimum consideration as determined by the board of directors (which may include inducing stockholders or beneficial owners of stock to take, or refrain from taking, one or more actions); provided that no provision of such contract

> shall be enforceable against the corporation to the extent such contract provision is contrary to the certificate of incorporation or would be contrary to the laws of this State (other than § 115 of this title) if included in the certificate of incorporation. Without limiting the provisions that may be included in any such contracts, the corporation may agree to: (a) restrict or prohibit itself from taking actions specified in the contract, (b) require the approval or consent of one or more persons or bodies before the corporation may take actions specified in the contract (which persons or bodies may include the board of directors or one or more current or future directors, stockholders or beneficial owners of stock of the corporation), and (c) covenant that the corporation or one or more persons or bodies will take, or refrain from taking, actions specified in the contract (which persons or bodies may include the board of directors or one or more current or future directors, stockholders or beneficial owners of stock of the corporation).

We oppose this amendment for two main reasons.

Dual-Class by Another Route?

First, we think that providing "bright-line authorization" for stockholder agreements that contain the aggregate of provisions at issue in the *Moelis* case would substantially disadvantage long term investors. Currently, for a powerful founder to have full control rights – of the sorts granted to Mr. Moelis – a company must put those provisions into the COI for all to see. In the current environment, it is difficult to grant such control rights after a company has gone public. First, stock exchange listing requirements prohibit mid-stream dual-class recapitalizations. Second, institutional investors' opposition would doom the stockholder vote required for an amendment. By contrast, if new § 122(18) is enacted, a company will be able to go public with a single-class capital structure and then, after the company is already public, confer comprehensive control rights by contract on a powerful founder without any stockholder vote. Stockholders' only protection would be a fiduciary duty suit against the directors who approved the agreement. Long term investors – whether they object to dual class capital structures or not — should find this very troubling and should pay particular attention to whether and how a company can commit in its pre-IPO COI not to do so.

Undermining § 141(a)'s Traditional Limits on Board Delegation

Second, new § 122(18), by rejecting DGCL § 141(a)'s traditional limitations on board delegation, will introduce a fundamental change into Delaware law without adequate examination. DGCL § 141(a) has long been the heart of Delaware's "board centric" governance system. Thus, for example, "dead hand" and "slow hand" shareholder rights plans (a/k/a "poison pills") were held to be invalid because, by giving greater power to one group of directors over other directors, the provisions were inconsistent with § 141(a) unless included in the COI (Quickturn Design Systems, Inc. v. Shapiro, 721 A.2d 1281 (Del. 1998); Carmody v. Toll Brothers, Inc., 723 A.2d 1180 (Del. Ch. 1998)). Similarly, bylaws providing for mandatory reimbursement of proxy expenses were held to be invalid because inconsistent with § 141(a), again unless included in the COI (CA, Inc. v. AFSCME Employees Pension Plan, 953 A.2d 227 (Del. 2008)).

The stockholder agreement at issue in *Moelis*, as the vice chancellor points out, is a comprehensive delegation of board responsibilities: "The Challenged Provisions look like something a law professor dreamed up for students to use as a prototypical Section 141(a) violation." To reject this holding is to reject the idea that § 141(a) imposes *any* limits on "private ordering." In doing so, the amendment authorizing Ken Moelis type stockholder agreements will infuse the DGCL with the "freedom of contracting" approach of the **LLC Act**. The only restrictions that would then remain would be a matter of fiduciary duties and whatever "public policy" exceptions there are to contractual freedom. This may or may not be a good idea. But because it is such a major change in Delaware corporate law, it requires deep consideration.

The Potential Implications of § 122(18)'s Transformation of § 141(a)

Consider the implications of abandoning this approach by reviewing the limits that the traditional interpretation of § 141(a) has imposed on "private ordering."

First, it could allow boards to impose significant limits on stockholder power by effectively removing § 141(a)'s limitations on such efforts. In *Quickturn*, the Delaware Supreme Court prohibited "slow hand" poison pills (which limited newly elected

directors' ability to redeem a poison pill) "because the Delayed Redemption Provision impermissibly circumscribes the board's statutory power under Section 141(a) and the directors' ability to fulfill their concomitant fiduciary duties."

What, then, will protect against "slow hand' and "dead hand" poison pills after § 122(18)? According to the synopsis, "new § 122(18) would not change the outcome in cases [such as *Quickturn*, Carmody and CA] that invalidated bylaws, and other arrangements, where consideration had not been provided to the corporation and the provisions at issue conflicted with § 141(a) of this title."

But this is a weak and ad hoc limitation in a statute that begins "Notwithstanding § 141(a) of this title . . ." While a "lack of consideration" limitation may be a plausible discriminating factor for distinguishing commercial from non-commercial contracts, it is easily avoided or manipulated. As the standard first year Contracts class demonstrates, "consideration" provides few limits when, e.g., reliance interests count as "consideration." Indeed, any competent transactional lawyer could restructure a delayed redemption provision to involve consideration. But, worse, "lack of consideration" is not the reason that "dead hand" or "slow hand" pills are unacceptable. The objection to such pills, as the Delaware Supreme Court explained above, is the inconsistency with § 141(a).

Second, this new "contractual freedom," untethered to limits imposed by § 141(a), could and, to be consistent, *should* provide *stockholders* with much greater freedom to set the "rules of the game," as **Lucian Bebchuk** has argued. Under DGCL § 109, stockholders have broad, inherent powers to adopt, amend or repeal bylaws so long as they are not inconsistent "with law or with the certificate of incorporation." In *Teamsters v. Fleming Companies*, 975 P.2d 207 (Okl. 1999), the Oklahoma Supreme Court held that under Oklahoma's corporate law (which gives stockholder a right to adopt bylaws similar to **DGCL § 109**), a stockholder adopted bylaw could impose restrictions on a board's ability to issue rights plans. Would such a bylaw be valid under DGCL § 109? Prior to § 122(18), **many** took the view that, in light of cases like *Quickturn* and *Carmody*, a Delaware court would view such a mandatory bylaw as inconsistent with § 141(a). But post § 122(18), why should that be the case? Stockholder's inherent right to adopt, amend or repeal bylaws is protected by § 109 so long as the bylaws do not contain any provision inconsistent "with law or with the certificate of incorporation." With § 122(18) having abandoned the statutory limits on private ordering imposed by § 141(a), and permitting the unlimited delegation of governance rights by stockholder agreement, in what way would such a bylaw be inconsistent with § 141(a)?

Finally, the synopsis emphasizes the principle that, notwithstanding agreements with stockholders on governance terms, the board will still have a role in deciding whether to breach the agreement, and may have a fiduciary obligation to do so. If taken seriously, this obligation to consider breaching corporate contracts has wide reaching implications, and will create confusion about the scope and content of fiduciary duties (not to mention the value of such stockholder agreements). While the text provides "bright-line" authorization of governance provisions, the synopsis accompanying the amendment provides that

> New § 122(18) does not relieve any directors, officers or stockholders of any fiduciary duties they owe to the corporation or its stockholders, including with respect to deciding to cause the corporation to enter into a contract with a stockholder or beneficial owner of stock and with respect to deciding whether to perform, or cause the corporation to perform, or to breach, the contract, whether in connection with their management of the corporation's business and affairs in the ordinary course or their approval of extraordinary transactions, such as a sale of the corporation.

How will contractual governance rights fit with fiduciary duties? To what extent should new § 122(18) – and the validation of broad governance agreements such as the agreement at issue in *Moelis* – affect the advice provided to boards? We think the somewhat surprising answer should be some combination of "who knows?" and "almost not at all."

According to the synopsis, we should not worry about the delegation of governance by stockholder agreement because, in any corporate decision, the board will have to consider the costs of breaching the governance agreement as simply one more cost of doing business. We are skeptical that this will actually happen. Contrary to what law and economics theorists may preach, most business people feel an obligation to abide by contracts and are unconvinced by the theory of "efficient

breach." One should expect the typical director to take seriously the stockholder agreements with the corporation and do his or her best to abide by them.

But even if a board is filled with law & economic theorists looking for an opportunity to engage in "efficient breach," how will a board calculate what those costs will be? On the one hand, as **Karen Chesley** points out, "consent rights have proven notoriously difficult to value" and typically require determining the outcome of a purely hypothetical negotiation. On the other hand, damages for "efficient breach" could be very large if the corporation is liable for a counter-party's full expectation damages. In practice, the possibility of a very large damage remedy will likely discourage counterparties from entering into a transaction with the firm over the objections of the Ken Moelis type controller. A counterparty may also worry about a suit alleging tortious interference with contract as in the notorious 1985 Texaco Pennzoil litigation, and will have **no assurance** that contractual disputes will be subject to Delaware law or receive a Delaware forum.

Open Questions

If this analysis is correct, there are a variety of implications. First, the same analysis would apply to any board decision addressed by a stockholder agreement, including both day to day management as well as transformative transactions like a going private merger. In each case, the contract damages potentially arising from breach of the stockholders agreement will have to be taken into account as an additional cost of pursuing a course of action, but the stockholder agreement should have no significance beyond that.

Second, control rights granted by contract pursuant to § 122(18) stockholder agreements are far less robust or durable or predictable than control rights created by dual class capital structures. Entered into with the corporation, the synopsis claims that stockholder agreements will not be enforceable against a board that may have a fiduciary duty to breach when doing so is in the interests of the stockholders.

Third, a stockholder agreement may render a counterparty a "controller" with all of the accompanying fiduciary obligations but far fewer of the benefits. The likelihood of a court finding that the counterparty is a controller is enhanced in two circumstances: (a) when pre-approval rights are so extensive that they arguably confer a high degree of general control to the counterparty (as in *Moelis*); (b) when pre-approval rights can be specifically enforced or when they, as a practical matter, deter an efficient breach, they arguably confer transaction-specific control on the counterparty. In that regard, pre-approval rights differ from covenants in credit agreements. Credit agreement covenants are not nearly as extensive as those in *Moelis*, are generally not subject to specific enforcement, and will ordinarily not deter an efficient breach. Indeed, the risk of "lender liability" discourages creditors from contracting for significant control rights. Likewise, the risk of fiduciary liability should discourage stockholders from doing so.

Fourth, the complexity and uncertainty introduced by broad stockholder agreements will complicate the disclosure of "risk factors" in a registration statement and other disclosure documents.

Conclusion

It may be that the limitations on delegation that have traditionally been found in § 141(a) have outlived their usefulness as "contractarian" approaches have become more accepted in Delaware corporations. There have certainly been powerful arguments made over the years for doing so. But surely such a major move should only be taken after substantial thought with input from all stakeholders. The Delaware General Assembly should hold off until after the Delaware Supreme Court has had an opportunity to address these issues. This would allow critics of the *Moelis* decision to submit amicus briefs that describe the market confusion supposedly introduced by the Chancery Court's decision and to suggest ways to ameliorate that confusion. It would also allow the appellant and other supporters of the *Moelis* decision to explain why preserving § 141(a) as an outer limit on the delegation of board responsibilities is appropriate. This sort of reasoned process is surely a better way to develop Delaware law than a hasty legislative change driven by a group of deal lawyers frustrated by a Delaware Chancery Court opinion.

Delaware's legitimacy as the de facto national corporate law-giver derives from its expert judges impartially interpreting and applying its rich store of case law to concrete and complex factual disputes, not from the superiority of its legislature.

To the extent that U.S. corporate law is the product of Delaware interest group politics, it is hard to see why Congress or the S.E.C. should defer.

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Harvard Law School Forum on Corporate Governance

Section 122(18) DGCL: A proposed compromise

Posted by Marcel Kahan and Edward Rock (New York University School of Law), on Monday, June 10, 2024

Editor's note: Marcel Kahan is the George T. Lowy Professor of Law and Edward B. Rock is the Martin Lipton Professor of Law at New York University School of Law. This post is part of the Delaware law series; links to other posts in the series are available here.

Delaware finds itself in a post-*Moelis* crisis. On the one hand, the Chancery Court's opinion is a well-supported interpretation of current Delaware law. If DGCL § 141(a) imposes any restrictions at all, the stockholder governance agreement at issue in that case – an agreement that gave founder Ken Moelis almost complete control over corporate decisions and governance – must violate those limits.

On the other hand, there are a host of existing stockholder governance agreements drafted by lawyers following current market practice whose validity has been called into question by the *Moelis* holding. The resulting uncertainty has led the DSBA's Corporation Law Council to propose an amendment to DGCL § 118 that provides "bright-line authorization" for provisions of the sort at issue in *Moelis*.

This proposed amendment, in turn, has elicited opposition by us and others (here, here and here) because of its potentially far reaching effects on Delaware law, as well as because of the uncertainty that it introduces. This controversy, in turn, has complicated the normally smooth process of amending the DGCL.

Is there a solution that validates existing stockholder governance agreements while not destabilizing Delaware corporate law? We think there is: convert proposed DGCL § 122(18) into a safe harbor that validates stockholder governance agreements for three years.

How would this work? Quite simply. As with the current proposed amendment, revised § 122(18) would validate existing (and future) stockholder agreements. But those agreements would only be valid for a period of three years (for existing agreements, three years from enactment of the amendment; for new agreements, three years from entering into the agreement). As a safe harbor, it would not preclude longer term stockholder governance agreements, so long as those agreements were consistent with DGCL § 141(a). But for agreements of less than three years, the issue of consistency with § 141(a) would disappear, thus providing time-limited legal certainty for existing and future stockholder agreements.

For the most important and common stockholder agreements, this three year safe-harbor would be sufficient to accomplish their goals. As far as we can tell, there are currently three principal use-cases for stockholder governance agreements:

- Private equity exits: we understand that when private equity sponsors take portfolio companies public, they often use stockholder governance agreements to maintain a degree of control as they exit their investments. A three year safe-harbor preserves this practice. Longer term control by the private equity sponsor could and should be included in the IPO charter.

- Hedge fund settlements: we understand that stockholder agreements are used to memorialize settlements between firms and hedge funds that include covenants to recommend hedge fund board nominees, to limit the size of the board and other similar governance provisions. Again, a three year safe harbor would validate stockholder agreements of this sort, without changing the long term governance structure of the firm.

- Venture capital financing: we understand that in venture capital financed private companies, governance arrangements are often memorialized in a stockholder agreement in combination with the preferred stock's certificate of designations, arrangements that generally do not survive an IPO. Here, again, the safe harbor would validate existing stockholder governance agreements for three years, after which they would terminate or be included in the charter or be limited by § 141(a).

By limiting the safe harbor to three years, our proposed compromise preserves the traditional structure of Delaware corporate law. The certificate of incorporation would remain the corporation's "constitution" and the foundation for corporate governance. Any significant, long-term governance arrangements would have to be included in the charter. In doing so, we preserve DGCL § 141(a)'s traditional role as imposing limits on the delegation of board functions, thereby preserving Delaware's board-centric system and allowing the law to develop workable limits on delegation through common law adjudication. Our proposal accomplishes all this while providing legal certainty for existing stockholder governance agreements and allowing transactional lawyers the flexibility to experiment with "contractual private ordering."

The choice of a three year sunset is obviously somewhat arbitrary. If it turns out that 70% of existing agreements would be safe under our three year safe harbor but 95% would be safe under a five year safe harbor, that could be a reason to extend it. On the other hand, if 95% would be safe under a three year safe harbor, that would be a reason to set it at three years.

By including new agreements in the safe harbor, our proposal allows for the continued use of governance agreements in the specific use-cases identified by the proponents of the amendment while limiting the effects on core principles of Delaware law. A time limited safe harbor will, we

predict, lead to sorting by deal lawyers: short term arrangements will be set forth in (time-limited) stockholder agreements; longer term arrangements will be put into the charter.

Our proposal would also address some of the process criticisms of the amendments to Section 122. Given the substantial uncertainty relating to a large number of stockholder governance agreements engendered by the *Moelis* decision, the DSBA's Corporation Law Council understandably felt a need to act quickly. But in doing so, it drafted an amendment before the Delaware Supreme Court had an opportunity to rule in a *Moelis* appeal and before some of the substantive criticisms against the proposal could get a full vetting. A three-year safe harbor satisfies the pressing need for immediate clarification and affords time for a *Moelis* appeal to take its course and for the policy discussion to continue. Beyond that, a three year safe harbor would enable companies with existing shareholder governance agreements to amend their charters to provide for long-term governance arrangements if the board and shareholders determine that doing so would be in the best interest of the company.

We can think of four other approaches to revising the proposed *Moelis* amendment to provide greater legal certainty for existing agreements while limiting the effects on established principles of Delaware corporate law. First, one could explicitly define the restrictions that can (and cannot) be included in stockholder governance agreements. Second, one could limit the mode of adoption as in MBCA § 7.32's requirement of unanimous shareholder approval. Third, one could limit stockholder governance agreements to stockholders who hold greater than a given percentage of shares, whether that be 20% or 5% or some other percentage. Fourth, one could limit stockholder governance agreements based on the time of adoption and permit greater flexibility for agreements entered into prior to an IPO.

We believe that our safe harbor approach provides the greatest legal certainty with the least displacement of existing Delaware law, but these other approaches are also worth considering. We understanding that this intervention comes late in the legislative process, maybe too late to be carefully considered in the current legislative session. However, adding a three-year sunset to the proposed § 122(18) would provide at least temporary certainty while preserving the ability for further legislation extending the sunset, or perhaps even eliminating it, after a more careful study of the terms of existing stockholder governance agreements. At the same time, in the event that proposed § 122(18) is adopted as written, we would urge the DSBA's Corporation Law Council to revisit the desirability of a sunset in January with the benefit of data on those agreements.

H.B. 417
A BILL THAT WOULD REVIVE TIME-BARRED CLAIMS

TESTIMONY OF CHRISTOPHER APPEL
ON BEHALF OF THE AMERICAN TORT REFORM ASSOCIATION

BEFORE THE DELAWARE HOUSE JUDICIARY COMMITTEE

JUNE 20, 2024

On behalf of the American Tort Reform Association (ATRA), thank you for the opportunity to testify today regarding H.B. 417, which would revive time-barred lawsuits against schools, nonprofit organizations, youth groups, sports leagues, daycare centers, and others alleging that they did not do enough to protect children from sexual abuse more than two decades ago.

I am senior counsel in the Public Policy Group of a national law firm, Shook, Hardy & Bacon L.L.P. and serve as counsel to ATRA, a broad-based coalition of businesses, municipalities, associations, and professional firms that have pooled their resources to promote fairness, balance, and predictability in civil litigation.

Sexual abuse of a child is abhorrent. Those who commit such acts should be prosecuted and survivors of abuse should have a reasonable time to file a lawsuit against those who are responsible. We respect those who support this bill and the courage of the survivors who may testify today. ATRA commends the Committee for considering steps to protect children and help survivors of abuse.

For any type of civil action, there should be: 1) a finite statute of limitations – even a lengthy one when warranted, and 2) any changes to a limitations period should be made prospectively (*i.e.* going forward). That is because statutes of limitations, while they may seem arbitrary, are an essential part of properly functioning civil justice system – one in which judges and juries can determine liability when the best evidence is available, before witnesses and records are gone.

As you know, Delaware already eliminated the statute of limitations for civil actions alleging injuries from childhood sexual abuse and opened a two-year window for expired claims in 2007. The 2007 law not only revived claims against perpetrators, but also claims against organizations that may have hired someone or had a volunteer who turned out to be a perpetrator. Those types of claims typically allege that an organization insufficiently screened applicants, did not sufficiently supervise them, or failed to have adequate policies or practices in place to promptly detect or respond to misconduct.

When the window closed in 2009, over 200 revived lawsuits had been filed, some dating as far back as the 1950s. At that time, a Wilmington lawyer whose firm filed

about half of those claims observed that "the two year window appears to have been sufficient."[1]

Now, H.B. 417 would reopen that window indefinitely. Since Delaware has had no statute of limitations since 2007, the result of enacting this bill would be lawsuits that are at least two decades old and some that, again, go back 50 or 60 years.

Since 2007, organizations serving children that operate in Delaware have been on notice of the state's infinite statute of limitations. They should understand the need to keep meticulous records of the steps they have taken to protect children. They know they must carefully document any allegations of abuse and how they responded, document their employment decisions, and save those records forever. In the age of electronic data storage, that can be done.

But when the legislature retroactively revives time-barred claims it means:

- Paper records will have already been discarded long ago under standard document retention policies.
- A supervisor who was 45 years old in 1990 and who could testify about what occurred at the time, if that person can be located, would be 79 years old today and may have no recollection of the individuals involved.
- In claims going back further than that, both the perpetrator and any staff from that period may no longer be alive.

An organization cannot go back in time to keep records, purchase more insurance, or even decide not operate in an area knowing that it could be sued in, say, 2035 for what previous employees may have failed to do in 1970. This is not how the civil justice system is supposed to operate – for any type of civil action.

ATRA is concerned about the precedent legislation like this sets for other types of lawsuits. It is never easy for a lawyer to tell someone that the time to sue has ended. Over time, there will be many sympathetic plaintiffs and important causes. There are also other past injustices that have not been remedied. Reviving time-barred claims here will eventually lead to calls to permit other claims asserting injuries based on conduct that occurred decades ago. ATRA has already observed several such attempts. For example, after New York revived time-barred childhood sexual abuse claims, it revived similar claims allege injuries from sexual abuse as *adults*.[2] California enacted similar legislation, adding related employment claims.[3] Vermont almost immediately expanded

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[1] *Deadline Approaching for Pre-2007 Child Sex Abuse Claims in Delaware*, PBS/WHYY, June 11, 2009) (interview with Wilmington lawyer Tom Neuberger).

[2] S. 66 (N.Y. 2022).

[3] A.B. 2777 (Cal. 2022).

its 2019 childhood sexual abuse claims-revival law to apply to *physical* abuse claims[4] and then introduced legislation to further extend that reviver to "emotional abuse."[5]

Plaintiffs' lawyers and advocacy groups may also seek to revive other types of tort claims, such as product liability[6] or environmental lawsuits.[7] States have also considered proposals to retroactively allow lawsuits alleging novel theories of liability. Bills have attempted to allow claims addressing social and political causes by applying today's moral values to conduct that occurred long ago.[8] In fact, during a Maryland briefing on reviving time-barred childhood sexual abuse claims, a legislator questioned whether the arguments made by proponents in support of the proposal would equally apply to legislation permitting claims for discrimination, segregation, and other civil rights violations experienced by his parents' generation during the 1950s.[9]

While these types of proposals are well intentioned, reviving any type of time-barred claim undermines the predictability and stability of a state's civil justice system, and will make it difficult, if not impossible, for courts to accurately and fairly evaluate liability. Cases will become more susceptible to being decided based on sympathy for plaintiffs and bias against defendants, rather than law and evidence. Opening the door to expired claims, yet again, will signal that those who operate in Delaware cannot rely on statutes of limitations and face a risk of indefinite liability for any type of claim. This undermines the balanced civil justice system for which Delaware is known.

Finally, while the bill's findings accurately note that about half of states have revived time-barred childhood sexual abuse claims to some degree, the Committee should be aware that Delaware's complete elimination of the statute of limitations and proposal to indefinitely revive time-barred claims is extreme. For example, Massachusetts, Rhode Island, Georgia, and Michigan[10] limited revivers to claims against the perpetrator of the abuse, recognizing the problems with evaluating negligence after decades have passed. Arizona, Oregon, Utah, and West Virginia revived claims only against organizations alleged to have engaged in criminal conduct or that knew of the

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[4] S. 99 (Vt. 2021).

[5] H. 8 (Vt., introduced Jan. 5, 2023).

[6] LD 250 (Maine 2019) (proposing retroactively expanding product liability statute of limitations from six to fifteen years) (reported "ought not to pass"); S.B. 623 (Or. 2011) (reviving time-barred asbestos claims during a two-year window) (died in committee).

[7] S. 8763A (N.Y. 2022) (reviving claims by water suppliers alleging injuries related to an "emerging contaminant").

[8] *See, e.g.*, A.B. 15 (Cal., as amended Mar. 26, 2015) (proposing a ten-year statute of limitations for torts involving certain human rights abuses that would have applied retroactively to revive time-barred claims for events that occurred up to 115 years earlier) (claims-revival provision removed and legislation made prospective before enactment).

[9] *See* Maryland House Judicial Proceedings Committee Session, Jan. 19, 2023, https://www.youtube.com/watch?v=ks45I1mnvNs, at 1:50-1:55.

[10] The Michigan law was tailored to revive only claims of victims of a convicted criminal, Dr. Larry Nasser. Mich. Public Act 183 (S.B. 872) (2018).

abuse but failed to act. The Colorado and Maryland laws did not permit unlimited damages in revived actions. And many of the states that enacted reviver laws extended the statute of limitations, rather than eliminate it, and applied the new period retroactively. They did not revive claims going back indefinitely, as H.B. 417 proposes.

Finally, while the Delaware Supreme Court has permitted the legislature to revive time-barred claims, three other state high courts in recent years – in Colorado, Kentucky, and Utah – have found otherwise. Constitutional challenges pending before state supreme courts in Maryland, Maine, and North Carolina may reach the same result. In sum, while you may hear that many states have revived time-barred childhood sexual abuse claims, the vast majority of those laws included significant constraints that are not found in H.B. 417.

Thank you for the opportunity to testify today and considering ATRA's concerns as you address this difficult and important issue.

CHILDUSA
FIGHTING FOR CHILDREN'S CIVIL RIGHTS

TO: Honorable Members of the House Judiciary Committee

FROM: Marci Hamilton, Founder & CEO, CHILD USA; Professor, University of Pennsylvania

RE: HB 417: An Act to Amend Title 10 of the Delaware Code Relating to the Statute of Limitations for Civil Claims Based on Sexual Abuse of a Minor

DATE: June 17, 2024

Dear Honorable Members of the House Judiciary Committee,

Thank you for allowing us to submit testimony in support of HB 417, which will retroactively eliminate the statutes of limitation ("SOLs") for all claims of child sexual abuse ("CSA"). This legislation will not only bring long overdue justice to survivors, but it will also greatly reduce the present danger to children in Delaware by exposing hidden predators who are still abusing children today.

By way of introduction, Professor Marci Hamilton is a First Amendment constitutional scholar at the University of Pennsylvania. She founded CHILD USA, a national nonprofit think tank devoted to protecting children's rights, which promotes science and trauma-informed CSA SOL reform.

I. Research on Trauma and Disclosure Supports SOL Reform for Child Sexual Abuse

A. There is a Nationwide Epidemic of CSA Causing Lifelong Damage to Victims

Currently, more than 10% of children are sexually abused, with at least one in five girls and one in thirteen boys sexually abused before they turn 18.[1] CSA is a social problem that occurs in all social groups and institutions, including familial, religious, educational, medical, and athletic. Nearly 90% of CSA perpetrators are someone the child knows; in fact, roughly one-third of CSA offenses are committed by family members.[2]

The trauma stemming from CSA is complex and individualized, and it impacts victims throughout their lifetimes:[3]

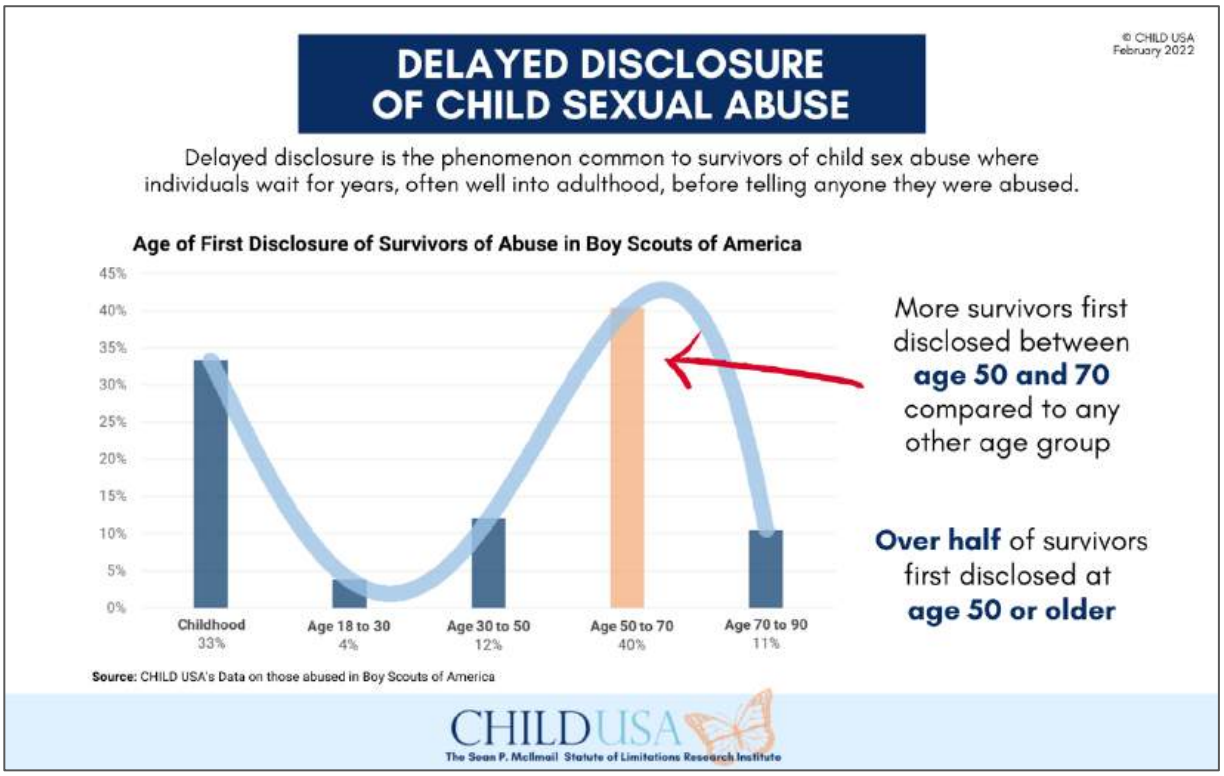
- Childhood trauma, including CSA, can have **devastating impacts on a child's brain**,[4] including disrupted neurodevelopment; impaired social, emotional, and cognitive development; psychiatric and physical disease, such as post-traumatic stress disorder (PTSD)[5]; and disability.[6]

- CSA victims suffer an **increased risk of suicide—**in one study, female CSA survivors were two to four times more likely to attempt suicide, and male CSA survivors were four to 11 times more likely to attempt suicide.[7]

- CSA leads to an increased risk of **negative outcomes across the lifespan**, such as alcohol problems, illicit drug use, depression, marriage issues, and family problems.[8]

B. It Often Takes Decades Before CSA Survivors Are Ready to Disclose Their Abuse

Many victims of CSA suffer in silence for decades before they talk to anyone about their traumatic experiences. As children, CSA victims often fear the negative repercussions of disclosure, such as disruptions in family stability, loss of relationships, or involvement with the authorities.[9] Additionally, CSA survivors may struggle to disclose because of trauma and psychological barriers such as shame and self-blame, as well as social factors like gender-based stereotypes or the stigma surrounding victimization.[10] Further, many injuries resulting from CSA do not manifest until survivors are well into adulthood. These manifestations may coincide with difficulties in functioning and a further delay in disclosure of abuse.



Moreover, disclosure of CSA to the authorities for criminal prosecution or an attorney in pursuit of civil justice is a difficult and emotionally complex process, which involves the survivor knowing that he or she was abused, being willing to identify publicly as an abuse survivor, and deciding to act against their abuser. In light of these barriers to disclosure, it is not surprising that:

- In a study of survivors of abuse in Boy Scouts of America, **51%** of survivors disclosed their abuse for the first time at **age 50 or older**.

- An estimated **70%** of child sexual assault victims **never contact police** to report abuse.

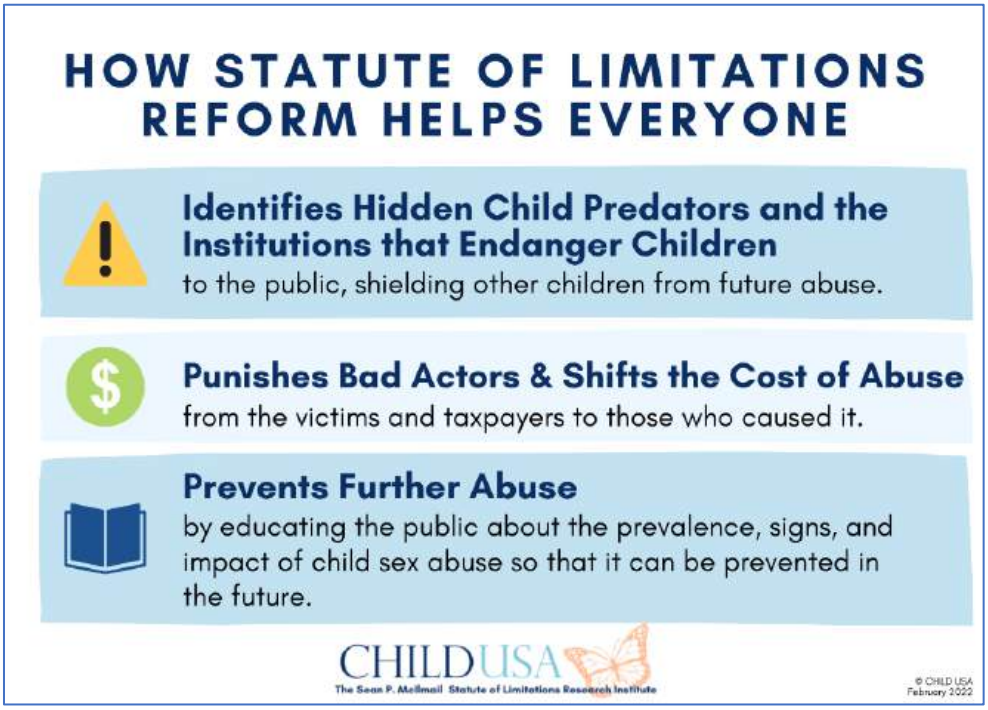
- **One-third** of CSA survivors **never report** their abuse to anyone.

For both children and adults, disclosure of CSA trauma is a process and not a discrete event in which a victim comes to terms with their abuse.[11] To effectively protect children from abuse, SOL laws must reflect this reality.

II. SOL Reform Serves the Public Good by Giving Survivors Access to Justice and Preventing Future Abuse

Historically, a wall of ignorance and secrecy was constructed around CSA, which has been reinforced by short SOLs that keep victims out of the legal system. Short SOLs for CSA play into the hands of the perpetrators and the institutions that cover up for them; they disable victims' voices and empowerment and leave future children vulnerable to preventable sexual assault.

CHILD USA is leading the vibrant national and global movement to eliminate civil and criminal SOLs and revive expired civil claims as a systemic solution to the preventable CSA epidemic.[12] **There are three compelling public purposes served by the child sexual abuse SOL reform movement**, which are explained in the graphic below:



A. SOL Reform Identifies Hidden Child Predators and Institutions that Endanger Children

It is in society's best interest to have sex abuse survivors identify hidden child predators to the public—whenever the survivor is ready. The decades before public disclosure give perpetrators and institutions wide latitude to suppress the truth to the detriment of children, parents, and the public. Some predators abuse a high number of victims and continue abusing children well into their elderly years. For example, one study found that 7% of offenders sampled committed offenses against 41 to 450 children, and the highest time between offense to conviction was 36 years.[13] SOL reform helps protect Delaware's children by identifying sexual predators in our

midst. By eliminating and reviving short, restrictive SOLs, especially allowing claims for past abuse to be brought to court, hidden predators are brought into the light and are prevented from further abusing more children in Delaware.

B. SOL Reform Punishes Bad Actors and Shifts the Cost of Abuse

CSA generates staggering costs that impact the nation's health care, education, criminal justice, and welfare systems. The estimated lifetime cost to society of child sexual abuse cases occurring in the US in 2015 is $9.3 billion, and the average cost of non-fatal per female victim was estimated at $282,734. Average cost estimates per victim include, in part, $14,357 in child medical costs, $9,882 in adult medical costs, $223,581 in lost productivity, $8,333 in child welfare costs, $2,434 in costs associated with crime, and $3,760 in special education costs. Costs associated with suicide deaths are estimated at $20,387 for female victims.[14]

It is unfair for the victims, their families, and Delaware's taxpayers to be the only ones who bear this burden; HB 417 levels the playing field by imposing liability on the ones who caused the abuse and alleviating the burdens on the victims and taxpayers. Further, if this revival law is passed, Delaware could gain millions of dollars in revenue from Medicaid reimbursements as a result of settlement funds and damages awards that survivors recover.

C. SOL Reform Prevents Further Abuse

SOL reform also educates the public about the dangers of CSA and how to prevent it. When predators and institutions are exposed, particularly high-profile ones like Larry Nassar, Jeffrey Epstein, the Boy Scouts of America, and the Catholic Church, the media publish investigations and documentaries that enlighten the public about the insidious ways child molesters operate to sexually assault children, as well as the institutional failures that enabled their abuse.[15] By shedding light on the problem, parents and other guardians are better able to identify abusers and responsible institutions, while the public is empowered to recognize grooming and abusive behavior and pressure youth serving organizations to implement prevention policies to report abuse in real time. Indeed, CSA publicity creates more social awareness to help keep kids safe, while also encouraging institutions to implement accountability and safe practices.

III. Delaware Should Continue Advancing the National CSA SOL Reform Movement by Reviving All Expired Claims

The SOL reform movement's gold standard for CSA is for states to eliminate civil and criminal SOLs and revive expired civil claims—like Vermont, Maryland, Guam, and NMI have already done. Delaware was originally a leader in the CSA SOL reform movement, becoming one of the first states to enact a civil revival window to give survivors an opportunity to file claims for decades-old abuse that were blocked by short SOLs. Delaware now sits amongst two-dozen states across the U.S., as well as three territories, that have similarly adopted civil revival windows. However, Delaware's two-year revival window has now been outpaced by states and territories such as Maryland and Vermont, who have adopted permanent revival windows so that all CSA survivors have unlimited access to justice.

There is only one way to restore justice to Delaware's CSA survivors blocked from pursuing their claims by unfairly short SOLs—to revive their expired civil claims. Revival laws are not solely

about justice for victims; there are also important public safety reasons for allowing older claims of abuse to proceed. When victims are empowered to disclose their abuse and sue for their injuries, the public benefits from finding out who the perpetrators are, learns how to prevent CSA, and the cost of abuse is shifted to those who created it.

Delaware has enacted a patchwork of civil SOLs for CSA that has left many survivors without meaningful recourse for their injuries. Up until 2007, CSA survivors were blocked from filing suit after their twenty-first birthday. In 2007, the legislature acknowledged this was unjust and eliminated the SOL for all future CSA claims, as well as opened a two-year revival window, which closed in July 2009—**nearly fifteen years ago**. As a result, it has been fifteen years since CSA survivors with pre-2007 claims have had the ability to pursue justice in Delaware; many adult survivors are still shut out of the courts and perpetrators have yet to be held accountable. As you can see in the graphic below, **Delaware's two-year revival law is relatively low-ranking because it does not currently help older survivors.**

The jurisdictions that have revived expired civil SOLs more broadly have gained valuable information about hidden child predators and the institutions that harbored them, enabling them to better empower victims. These revival laws do not yield a high number of cases, but instead provide long-overdue justice to older victims of child sex abuse. They also address the systemic issue of institutional CSA, which occurs with alarming frequency in athletic institutions, youth-serving organizations, medical facilities, and religious groups. Without institutional accountability for enabling or turning a blind eye to child sex abuse, the children these institutions serve remain at risk. This bill will incentivize youth serving organizations to implement prevention policies and

take action to immediately report abuse and safeguard victims and other children. A permanent revival law sends a strong message that the state will not tolerate "passing the trash" or looking the other way when a person is raping or molesting a child in their midst.

With HB 417, Delaware can remove all barriers to civil justice for survivors and achieve the gold standard for SOL reform. If passed, Delaware will stand alongside neighboring leaders, Maryland and Vermont, and the U.S. territories of Guam and the Northern Mariana Islands, who also revived all expired claims—allowing all CSA survivors to file claims for abuse whenever they are ready and no matter how long ago they were abused. HB 417 will give all survivors the time they need to do the legal and emotional work necessary to revisit their childhood traumas and coordinate with attorneys to file their cases. If there is sufficient evidence to prove civil liability, the mere passage of time should never prevent survivors from accessing justice.

IV. Conclusion

Once again, we commend you for supporting this legislation, which is desperately needed to validate adult survivors of CSA and protect Delaware's children from preventable sexual abuse. Permanently reviving expired claims is a positive step for Delaware's children and families. For more information about SOL reform, visit childusa.org/sol/ or email info@childusa.org. Please do not hesitate to contact us if you have questions regarding SOL reform or if we can be of assistance in any way on other child protection issues.

Sincerely,

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[1] G. Moody, et. al., *Establishing the international prevalence of self-reported child maltreatment: a systematic review by maltreatment type and gender*, 18(1164) BMC PUBLIC HEALTH (2018) (finding a 20.4% prevalence rate of CSA among North American girls); M. Stoltenborgh, et. al., *A Global Perspective on Child Sexual Abuse: Meta-Analysis of Prevalence Around the World*, 16(2) CHILD MALTREATMENT 79 (2011) (finding a 20.1% prevalence rate of CSA among North American girls); N. Pereda, et. al., *The prevalence of child sexual abuse in community and student samples: A meta-analysis*, 29 CLINICAL PSYCH. REV. 328, 334 (2009) (finding a 7.5% and 25.3% prevalence rate of CSA among North American boys and girls respectively).

[2] Perpetrators often being parents, stepparents, siblings, and grandparents. Sarah E. Ullman, *Relationship to Perpetrator, Disclosure, Social Reactions, and PTSD Symptoms in Child Sexual Abuse Survivors*, 16 J. CHILD SEX. ABUSE 19 (2007); David Finkelhor & Anne Shattuck, *Characteristics of Crimes Against Juveniles*, University of New Hampshire, Crimes Against Children Research Center (2012), available at http://www.unh.edu/ccrc/pdf/CV26_Revised%20Characteristics%20of%20Crimes%20against%20Juveniles_5-2-12.pdf.

[3] B. A. van der Kolk, *The Body Keeps the Score: Memory & the Evolving Psychobiology of Posttraumatic Stress,* 1(5) HARVARD REV. OF PSYCHIATRY 253-65 (1994); *see also* Hoskell, L. & Randall, M., *The Impact of Trauma on Adult Sexual Assault Victims*, JUSTICE CANADA (2019), https://www.justice.gc.ca/eng/rp-pr/jr/trauma/trauma_eng.pdf.

[4]As explained by the Center for Disease Control, "Adverse Childhood Experiences" ("ACEs"), like CSA, "have a tremendous impact on future violence victimization and perpetration, and lifelong health and opportunity." Vincent J. Felitti et al., *Relationship of Childhood Abuse and Household Dysfunction to Many of the Leading Causes of Death in Adults: The Adverse Childhood Experiences (ACE) Study*, 14(4) AM. J. PREV. MED. 245 (1998); S.R. Dube et al., *Childhood Abuse, Household Dysfunction, and the Risk of Attempted Suicide Throughout the Life Span: Findings from the Adverse Childhood Experiences Study*, 286 JAMA 24, 3089 (Dec. 2001).

[5] Josie Spataro et al., *Impact of Child Sexual Abuse on Mental Health: Prospective Study in Males and Females*, 184 Br. J. Psychiatry 416 (2004).

[6] *See* Felitti, at 245–58; *see also* R. Anda, et al., *The Enduring Effects of Abuse and Related Adverse Experiences in Childhood*, 256 EUR. ARACH PSYCHIATRY CLIN. NEUROSCIENCE 174, 175 (Nov. 2005) ("Numerous studies have established that childhood stressors such as abuse or witnessing domestic violence can lead to a variety of negative health outcomes and behaviors, such as substance abuse, suicide attempts, and depressive disorders"); M. Merricka., et al., *Unpacking the impact of adverse childhood experiences on adult mental health*, 69 CHILD ABUSE & NEGLECT 10 (July 2017); *see also* Sachs-Ericsson, et al., *A Review of Childhood Abuse, Health, and Pain-Related Problems: The Role of Psychiatric Disorders and Current Life Stress*, 10(2) J. TRAUMA & DISSOCIATION 170, 171 (2009) (adult survivors are thirty percent more likely to develop serious medical conditions such as cancer, diabetes, high blood pressure, stroke, and heart disease); T.L. Simpson, et al., *Concomitance between childhood sexual and physical abuse and substance use problems: A review*, 22 CLINICAL PSYCHOL. REV. 27 (2002) (adult survivors of CSA are nearly three times as likely to report substance abuse problems than their non-survivor peers).

[7] Beth E. Molnar et al., *Psychopathology, Childhood Sexual Abuse and other Childhood Adversities: Relative Links to Subsequent Suicidal Behaviour in the US*, 31 PSYCHOL. MED. 965 (2001).

[8] Shanta R. Dube et al., *Long-Term Consequences of Childhood Sexual Abuse by Gender of Victim*, 28 AM. J. PREV. MED. 430, 434 (2005).

[9] Delphine Collin-Vézina et al., *A Preliminary Mapping of Individual, Relational, and Social Factors that Impede Disclosure of Childhood Sexual Abuse*, 43 CHILD ABUSE NEGL. 123 (2015).

[10] Ramona Alaggia et al., *Facilitators and Barriers to Child Sexual Abuse (CSA) Disclosures: A Research Update (2000-2016)*, 20 TRAUMA VIOLENCE ABUSE 260, 279 (2019).

[11] Often, this happens in the context of therapy; sometimes it is triggered many years after the abuse by an event the victim associates with the abuse; other times it happens gradually or over time as a victim recovers their memory. Hoskell, at 24.

[12] For an analysis of the SOL reform movement since 2002, *see* CHILD USA, *History of US SOL Reform: 2002-2020*, CHILDUSA.ORG (last visited Aug. 30, 2021), available at www.childusa.org/sol-report-2020.

[13] Michelle Elliott et al., *Child Sexual Abuse Prevention: What Offenders Tell Us*, 19 CHILD ABUSE NEGL. 579 (1995).

[14] Elizabeth J. Letourneau et al., *The Economic Burden of Child Sexual Abuse in the United States*, 79 CHILD ABUSE NEGL. 413 (2018).

[15] *E.g.*, Netflix's *Jeffrey Epstein: Filthy Rich*; HBO's *At the Heart of Gold: Inside the USA Gymnastics Scandal*.

Dear Committee Members,
I was at the hearing today, Tuesday, but have a funeral in NJ Thursday at 11:00. Hence I submit the following:

I'm Donna Latteri and my calling is to be a voice for the voiceless.

The reason there are so few victims of abuse at this hearing is because victims are easily triggered by the very mention of their trauma and suffer greatly from PTSD, with all that entails. Their body keeps the score of what has been done to them.

Partial healing takes decades, and it may take decades **before** an adult survivor of child sex abuse understands the cause of their illness and delves into the actual events behind their trauma.
They will need a lifetime of specific "Trauma Informed Therapy" just to get back to some form of 'normalcy of life' whatever that may look like for them.
Here are some facts I have learned from research on this topic and from speaking with others I know in the arena:

1. Educator sexual misconduct is a "public policy" crisis.
2. Did you know that 1 in 10 school-aged children, that's more than 4.5 million students, are subjected to sexual misconduct by a school employee sometime between Kindergarten and 12th grade?
3. That on average, a teacher-offender will be passed to **three different districts before being stopped**? (Child USA statistics)
4. There are estimates of 'false reports' coverage of around 2-8% and at times they are politically motivated.
5. 86% of victims do not even come forward according to Hays-Caldwell Women's Center.
6. Only **29%** of reports for the rape or sexual assault of a child will result in an arrest, and prosecution is even less. *(Case in point - How many cases has Delaware prosecuted?)*
7. That number drops to just 19% if the child is under 6 years old. 😢

Delaware especially has a real and serious issue letting the perpetrators walk. The school systems are a clear and present danger to our children. Students go missing from one year to the next, especially many immigrants now, and no one is even concerned.
Our children are our future - what kind of a world will we live in if so many of them are messed up adults because we didn't protect them. The truth needs to be brought into the light - this bill will help that.

Dear Committee Members:

I'm writing to express my vehement support for HB 417.

As a licensed and board certified counselor, I can attest to the fact while a statue of limitations legally exists, there is no statute of limitations on the deep, crushing and crippling effects on individuals who've suffered sexual abuse.

I am thrilled to see this Bill and strongly encourage broad, bipartisan support of it.

Respectfully,

Stephanie Baffone, LPCMH, NCC