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Delaware Corporate Law Update

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Proposed Legislation to Amend the Delaware General Corporation Law

On February 17, 2025, legislation to amend the Delaware General Corporation Law (the "DGCL") was introduced to the Delaware General Assembly. If enacted, the legislation would, among other things:

- Amend Section 144 of the DGCL to provide a safe harbor for transactions in which a director or officer or a controlling stockholder may have a conflict of interest. The changes to Section 144 would set forth clear procedures for corporations and transaction planners to follow to obtain the protection of the safe harbor for transactions that might otherwise be subject to judicial review under the entire fairness standard. As the procedural protections are obtained through disinterested director or disinterested stockholder approval, revised Section 144 provides statutory definitions of those and other terms necessary to implement and uniformly apply the statute. Revised Section 144 also defines when a party may be found to be a controlling stockholder, relying principally upon notions of ownership and control of voting stock.

- Amend Section 220 of the DGCL, which governs stockholders' and directors' statutory rights to inspect books and records, to specify the core corporate documents that are required to be produced in a books and records action. The amendments also permit a corporation to impose reasonable restrictions on the confidentiality, use or distribution of books and records, to require that the stockholder agree that any information included in the corporation's books and records is deemed incorporated by reference in any complaint filed by or at the direction of the stockholder in relation to the subject matter referenced in the demand, and to redact portions of any books and records produced not specifically related to the stockholder's purpose.

Section 144 of the DGCL: Interested Directors and Officers; Controlling Stockholder Transactions; Quorum

Section 144 currently provides that contracts or transactions between a corporation and one or more of its directors or officers (or an entity in which one or more of its directors or officers are directors or officers or have a financial interest) will not be "void or voidable" solely for that reason if approved by disinterested directors or a vote of the disinterested stockholders, in each case upon disclosure of material facts, or if the transaction is fair as to the corporation. While Section 144 appears on its face to provide safe harbor protection to insulate transactions from equitable review, its application is far more limited, applying only to eliminate the specter of voidability from a

technical authorization standpoint that resulted under old common law that did not recognize the presence of "common or interested" directors for quorum purposes.

If the proposed legislation is enacted, revised Section 144 would provide safe harbor protection for acts or transactions in which directors, officers or controlling stockholders may have an interest, so long as the procedures set forth in the statute are utilized or the acts or transactions are fair to the corporation.

Transactions Involving Directors and Officers

Revised Section 144(a) would provide that a transaction between the corporation and a director or officer may not be the subject of equitable relief or give rise to an award of damages or other sanction against a director or officer as a result of the fact that (i) the director or officer is interested in the transaction, (ii) the director or officer received any benefit from the transaction or (iii) the director or officer is present at or participates in the meeting of the board or committee which authorizes the transaction, or was involved in the initiation, negotiation or approval of the transaction, if any of the following conditions are met:

(1) the material facts as to the director's or officer's relationship or interest in the transaction, including any involvement in the initiation, negotiation or approval of the transaction, are disclosed or known to the board of directors or the committee, and the board or committee in good faith authorizes the transaction by the affirmative vote of a majority of the disinterested directors;

(2) the material facts as to the director's or officer's relationship or interest in the transaction, including any involvement in the initiation, negotiation or approval of the transaction, are disclosed or are known to the stockholders entitled to vote thereon, and the transaction is approved or ratified by the uncoerced affirmative vote of a majority of the votes cast by the disinterested stockholders; or

(3) the transaction is fair as to the corporation.

New Section 144(e)(6) specifically defines "fair as to the corporation" for purposes of the statute to mean the act or transaction at issue, as a whole, is beneficial to the corporation or its stockholders given the consideration paid to or received by, or other benefits conferred on, the corporation or its stockholders and taking into appropriate account whether the act or transaction is fair in terms of the fiduciary's dealings with the corporation and is comparable to what might have been obtained in an arm's-length transaction available to the corporation. Thus, the revised statute takes into account principles of both fair dealing and fair price. With respect to the latter, the revised statute emphasizes that the price should be measured against what might be obtained in a third-party transaction, with a recognition that those transactions actually available to the corporation should be considered for such purposes.

New Section 144(d)(1) would continue to provide that common or interested directors may be counted in determining the presence of a quorum at a meeting of the board of directors or of a committee which authorizes an interested transaction. Notably, revised Section 144(a) continues to require that, to benefit from the safe harbor, a transaction in which a director or officer has an interest must be approved by a majority of disinterested directors (but does not require that a

majority of the board or committee approving the transaction be comprised of disinterested directors) and specifies that the voting standard for stockholder approval of such a transaction is the affirmative vote of a majority of the votes cast by the disinterested stockholders (but does not require the transaction to be conditioned upon approval by a separate vote of the disinterested stockholders).

Transactions Involving Controlling Stockholders

New Section 144(b) would provide that, except in the case of a going private transaction, an act or transaction between the corporation and a controlling stockholder or an act or transaction from which a controlling stockholder receives a financial or other benefit not shared with the corporation's stockholders generally (a "controlling stockholder transaction") may not be the subject of equitable relief or give rise to an award of damages or other sanction against a director or officer of the corporation or a controlling stockholder by reason of a breach of fiduciary duty by a director, officer or controlling stockholder if any of the following conditions are met:

(1) the material facts as to the controlling stockholder transaction are disclosed or known to a committee of the board of directors expressly delegated the authority to negotiate and to reject the controlling stockholder transaction, and such controlling stockholder transaction is approved (or recommended for approval) in good faith by the committee (provided that the committee does not include the controlling stockholder and that a majority of the members of the committee are disinterested directors);

(2) the material facts as to the controlling stockholder transaction are disclosed or are known to the stockholders entitled to vote thereon, the controlling stockholder transaction is conditioned on a vote of the disinterested stockholders at or prior to the time it is submitted to stockholders for their approval or ratification, and the controlling stockholder transaction is approved or ratified by the uncoerced affirmative vote of a majority of the votes cast by the disinterested stockholders; or

(3) the controlling stockholder transaction is fair as to the corporation.

New Section 144(c) would provide that a controlling stockholder transaction that constitutes a "going private transaction"—which is defined as a 13e-3 transaction (for a publicly listed corporation) and as a transaction in which all shares of capital stock held by disinterested stockholders are cancelled or acquired (for all other corporations)—may not be the subject of equitable relief or give rise to an award of damages or other sanction against a director or officer of the corporation or a controlling stockholder by reason of a breach of fiduciary duty by a director, officer or controlling stockholder if <u>both</u> disinterested director approval and disinterested stockholder approval are validly obtained as set forth in Section 144(b), or if the going private transaction is fair as to the corporation.

Notably, for approval of a controlling stockholder transaction or a going private transaction under Section 144(b) or (c), a separate vote (or recommendation) of a committee comprised of at least a majority of disinterested directors is required. As with Section 144(a), the standard for approval of such a transaction by the stockholders is a majority of the votes cast by the disinterested

stockholders, but in order to validly obtain disinterested stockholder approval under Section 144(b) or (c), the controlling stockholder transaction or going private transaction must be conditioned on a vote of disinterested stockholders prior to the time that it is submitted to stockholders for approval.

Exculpation of Controlling Stockholders

New Section 144(d)(5) sets forth an exculpatory provision for controlling stockholders that would eliminate liability of a controlling stockholder or member of a control group for monetary damages for breach of fiduciary duty other than for breach of the duty of loyalty, acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, or transactions from which they derive an improper personal benefit. In effect, Section 144(d)(5) confirms that controlling stockholders cannot be liable for monetary damages for a breach of the duty of care.

Definition of Disinterested Director

New Section 144(e)(4) defines "disinterested director" as a director who is not a party to the act or transaction and does not have a material interest in the act or transaction or a material relationship with a person that has a material interest in the act or transaction. New Section 144(d)(2) provides that any director of a publicly listed corporation shall be presumed to be a disinterested director with respect to an act or transaction that such director is not a party to if the board of directors shall have determined that such director is an independent director or satisfies the relevant criteria for determining director independence under any rules promulgated by an applicable exchange. The statute provides that the presumption arising out of satisfaction under the listing rules is heightened and may only be rebutted by substantial and particularized facts that a director who meets the criteria for independence under the applicable listing rules has a material interest in the transaction or has a material relationship with a person with a material interest in the transaction. New Section 144(d)(3) codifies the common law rule that the mere nomination or election of the director to the board of directors by any person that has a material interest in an act or transaction shall not, of itself, be evidence that a director is not a disinterested director with respect to an act or transaction to which such director is not a party.

Definition of Disinterested Stockholder

New Section 144(e)(5) defines "disinterested stockholder" as any stockholder that does not have a material interest in the act or transaction at issue or a material relationship with any person that has a material interest in the act or transaction.

Definitions of Material Interest and Material Relationship

New Section 144(e)(8) defines "material interest" as an actual or potential benefit, including the avoidance of a detriment, other than one which would devolve on the corporation or the stockholders generally, that (i) in the case of a director, would reasonably be expected to impair the objectivity of the director's judgment when participating in the authorization or approval of the act or transaction at issue, and (ii) in the case of a stockholder or any other person (other than a director), would be material to such stockholder or such other person.

New Section 144(e)(9) defines "material relationship" as a familial, financial, professional, employment, or other relationship that (i) in the case of a director, would reasonably be expected to impair the objectivity of the director's judgment when participating in the authorization or approval of the act or transaction at issue, and (ii) in the case of a stockholder, would be material to such stockholder.

Definitions of Controlling Stockholder and Control Group

New Section 144(e)(2) defines "controlling stockholder" as any person that, together with such person's affiliates and associates, either (i) owns or controls a majority in voting power of the outstanding stock of the corporation entitled to vote generally in the election of directors, or (ii) has the power functionally equivalent to that of such a majority stockholder by virtue of ownership or control of at least one-third in voting power of the outstanding stock of the corporation entitled to vote generally in the election of directors and the power to exercise managerial authority over the business and affairs of the corporation. New Section 144(e)(1) defines a "control group" as two or more persons that are not individually controlling stockholders, but that, by virtue of an agreement, arrangement or understanding between them, collectively constitute a controlling stockholder. In general, the provisions described above applicable to a "controlling stockholder" are also applicable to a "control group." New Section 144(d)(4) provides that no person will be a controlling stockholder or a control group unless the criteria set forth in the foregoing definitions are met.

Miscellaneous

New Section 144(d)(6) clarifies that revised Section 144 is not intended to limit the right of any person to seek equitable relief on the grounds that an act or a transaction, including a controlling stockholder transaction, was not validly authorized or approved in compliance with Delaware law. Thus, the safe harbor procedures do not displace any existing authorization requirements under the corporation's certificate of incorporation or bylaws or the default provisions of the DGCL. Section 144(d)(6) also clarifies that revised Section 144 is not intended to limit judicial review for purposes of injunctive relief of provisions or devices designed to deter, delay or preclude a change of control or other transaction (such as stockholder rights plans) or a change in the composition of the board of directors.

Section 220 of the DGCL: Inspection of Books and Records

Section 220 currently provides that stockholders and beneficial owners may inspect a corporation's stock ledger, a list of its stockholders and its other "books and records" upon written demand under oath stating the purpose of the demand. Existing Section 220 does not specifically define the term "books and records," and as a result, the scope of the books and records that may be obtained by a stockholder under Section 220 has largely been developed by common law. In recent years, books and records demanded under Section 220 have often included informal documents and other materials, such as emails, text messages and other forms of electronic communication and documentation, that would traditionally have been produced only in the context of discovery during adversarial litigation. As a result, books and records demands under Section 220 have become increasingly costly, time-consuming and burdensome on Delaware corporations.

The proposed amendments to Section 220 seek to relieve some of this burden by statutorily defining the scope of "books and records" available for inspection to documents and materials that are most relevant to the business and governance of Delaware corporations. The list of books and records is largely consistent with the list set forth in the corresponding provisions of the Model Business Corporation Act. Specifically, new Section 220(a)(1) would define "books and records" to mean all of the following:

(1) the corporation's certificate of incorporation (including a copy of any agreement or other instrument incorporated by reference therein);

(2) the corporation's bylaws (including a copy of any agreement or other instrument incorporated by reference therein);

(3) the minutes of all meetings of stockholders and any actions taken by consent of stockholders without a meeting, in each case in the past three years;

(4) all communications by the corporation in writing or by electronic transmission to stockholders generally within the past three years;

(5) the minutes of any meeting of the board of directors or any committee thereof and any actions taken by consent of the board or a committee thereof without a meeting;

(6) the annual financial statements of the corporation for the past three years;

(7) any agreement entered into under Section 122(18) of the DGCL; and

(8) any director and officer independence questionnaires.

New Section 220(f) would permit the Delaware Court of Chancery to order a corporation that does not have records of stockholder or board meetings or actions by consent or financial statements (or, in the case of a publicly listed corporation, that does not have director independence questionnaires) to produce additional records of the corporation constituting the functional equivalent of any such books and records in response to an otherwise proper demand for inspection to the extent doing so would be necessary and essential to fulfill the stockholder's proper purpose. Section 220(f) would also expressly permit the Delaware Court of Chancery to impose reasonable restrictions on any such additional information that it orders the corporation to produce in this manner.

New Section 220(b)(2) sets forth procedural requirements relating to a stockholder's demand to inspect books and records. In order for a stockholder or beneficial owner to inspect a corporation's books and records, (i) the stockholder's demand must be made in good faith and for a proper purpose, (ii) the stockholder's demand must describe with reasonable particularity the stockholder's purpose and the books and records the stockholder seeks to inspect, and (iii) the books and records that are sought must be specifically related to the stockholder's purpose. New Section 220(b)(3) expressly permits a corporation to impose reasonable restrictions on the confidentiality, use or distribution of books and records produced in response to a demand under Section 220 and to

require, as a condition to producing any such books and records, that the stockholder agree that any such books and records be deemed incorporated by reference in any complaint filed by or at the direction of the stockholder in relation to the subject matter of the demand.

New Section 220(b)(4) clarifies that nothing in Section 220 would affect the right of a stockholder to seek discovery of books and records of the corporation if the stockholder is in litigation with the corporation or the power of a court to compel the production of corporate records for inspection by a stockholder who has otherwise met the requirements of Section 220 and to impose reasonable restrictions on the production of such books and records. Consistent with the corresponding provision of the Model Business Corporation Act, this provision merely preserves whatever independent rights of inspection exist under the sources referenced in the statute and does not create any additional rights, either expressly or by implication.

Revised Section 220(d) clarifies that a director's inspection rights are not limited to the "books and records" of the corporation as defined in Section 220(a)(1), but also would include inspection of other records of the corporation for a purpose reasonably related to the director's position as a director.