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How the Proposed DGCL Amendments Responding to the *Moelis* Decision Depart From the Historical Approach to Evolving Delaware's Shareholder Activism and Takeover Defense Law

By Keith E. Gottfried

When Delaware Governor John Carney applies his signature to Senate Bill 313, which is expected to occur shortly, the market practice amendments to the Delaware General Corporation Law (the "*DGCL*") will officially be incorporated into the DGCL. Thereafter, if things work as intended by the drafters, the market practice amendments will mitigate much of the uncertainty created by the Delaware Court of Chancery's decision in *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.* (Feb. 23, 2024) ("*Moelis*") with regards to whether shareholder, governance, and activism settlement agreements unlawfully limit the discretion of a company's board of directors in violation of Section 141(a) of the DGCL.

The Moelis decision, while not in connection with a shareholder activism situation, calls into question the continued viability of the longstanding model for activism settlements. Since at least the early 2000's, activism settlement agreements have become relatively standardized in overall form with the key feature being that the company's board agrees to appoint and/or nominate one or more activist recommended director candidates in return for the activist agreeing to various standstill and other restrictive covenants for a limited period of time. In addition, the board may agree to various other governance-related covenants, including a limit on the size of the board, restrictions on when the annual meeting can be held, and restrictions on amendments to the company's bylaws. Not only is the enactment of the market practice amendments expected to restore the status quo that preceded the *Moelis* decision, but we may also see activists emboldened

to seek governance restrictions from the company that heretofore were easily rebuffed as being potentially in violation of Section 141(a) of the DGCL.

In Delaware, the Council of the Corporation Law Section of the Delaware State Bar Association (the "*Council*") is responsible for formulating and recommending to the Delaware General Assembly, after approval by the Delaware State Bar Association, amendments to the DGCL. The Council includes some of the most highly respected, qualified, and experienced attorneys in the State of Delaware. Less than a month after the *Moelis* decision, the Council began drafting the market practice amendments to the DGCL to, among other things, neutralize the impact of the *Moelis* decision and to specifically permit under Section 141(a) of the DGCL the type of governance contracts and arrangements with current or prospective shareholders that the *Moelis* decision called into question. While the *Moelis* decision is on appeal to the Delaware Supreme Court, the Council chose not to wait until the Delaware Supreme Court weighed in and issued its decision. By the end of May 2024, the market practice amendments were submitted for approval to the Delaware General Assembly as Senate Bill 313.

Having been an advisor on shareholder activism and takeover defense since the early 1990s, I have become accustomed to the numerous uncertainties and lack of predictability in Delaware corporate law with respect to shareholder activism and takeover defense matters. Such lack of certainty and predictability results, in part, from Delaware's long reliance on its highly regarded and specialized Delaware Court of Chancery to evolve, shape, and clarify its corporate law as well as the review and oversight provided by the Delaware Supreme Court.

Considering the amendments that the Council has proposed to the DGCL in the past, the Council has not shown much interest in wading into certain areas of Delaware corporate law that were being evolved, shaped, and clarified by the Delaware courts in response to particular sets of facts and circumstances. Those areas would include much of the Delaware corporate law regarding shareholder activism and takeover defense. Accordingly, there are few provisions in the DGCL that directly address the issues most commonly litigated in connection with shareholder activism and takeover defense matters, the major exception being Section 220 of the DGCL which provides the statutory underpinning for shareholder inspection demands.

The approach taken by the Council and the Delaware General Assembly to quickly amend the DGCL in response to the *Moelis* decision, rather than allow the Delaware Supreme Court the

opportunity to weigh in and possibly either overturn or clarify, shape, and evolve the *Moelis* decision, appears to be at odds with historical practice. Looking back at some of the landmark, pivotal, and/or impactful decisions issued by the Delaware courts over the past forty years that relate to shareholder activism or takeover defense, it does not appear that the Council's historically typical approach was to move quickly to propose an amendment to the DGCL to neuter, clarify, or evolve such a decision.

In 1985, the Delaware Supreme Court issued its pivotal decision in *Moran v. Household International, Inc.* (Nov. 1985) ("*Moran*") upholding a shareholder rights plan (also known as a "poison pill") as a legitimate exercise of business judgment by Household International's board of directors. In the almost forty years that followed the *Moran* decision, the Delaware courts continue to address ambiguities regarding poison pills. Most recently, in *The Williams Companies, Inc v. Wolosky* (Nov. 2021) ("*William Cos*"), the Delaware Supreme Court upheld the decision of the Delaware Chancery Court invalidating a poison pill adopted at the beginning of the COVID-19 pandemic with a 5% trigger threshold and a controversial acting-in-concert provision. In the four decades since *Moran*, there have been numerous other noteworthy decisions of the Delaware courts evolving, shaping, and clarifying Delaware law regarding poison pills, including, but not limited to, the Delaware Supreme Court's decision in *Versata Enterprises, Inc., and Trilogy Inc. v. Selectica, Inc., et al.* (Oct. 2010) ("*Selectica*") affirming the Delaware Court of Chancery's decision in applying the *Unocal* standard and ruling that the adoption of a low-trigger poison pill designed to protect and preserve a company's net operating losses was valid.

While at least 28 other jurisdictions (e.g., Colorado, Connecticut, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kentucky, Maine, Maryland, Michigan, Nevada, New Jersey, New York, North Carolina, Ohio, Oregon, Pennsylvania, Rhode Island, South Dakota, South Carolina, Tennessee, Utah, Virginia, Washington, and Wisconsin) have statutes specifically endorsing, with varying degrees of permissibility and limitations, the adoption of poison pills and even providing guidance on related issues, some forty years after *Moran* was decided, Delaware has not amended the DGCL to specifically endorse the permissibility of the adoption of poison pills by the board of directors of a Delaware corporation. Arguably, both the *Selectica* and the *Williams Cos.* decisions, both of which dealt with, among other issues, the appropriateness of low triggering thresholds could have been opportunities for the Council to amend the DGCL to specifically address therein the permissibility of poison pills and the contours of what is permitted such as the permissibility of

various triggering thresholds under various circumstances. However, neither the impact of these decisions nor that of the numerous other Delaware court decision relating to poison pills has ever been addressed by the DGCL.

Likewise, numerous Delaware cases tell us that advance notice bylaw provisions are permissible and will be enforced. However, the DGCL contains no reference whatsoever to the permissibility of bylaw provisions requiring a shareholder that intends to present business before a company's annual meeting of shareholders to submit an advance notice of nomination(s) or proposal(s) within a fixed time period containing a litany of information set forth in the bylaws. Instead, we are left to rely on Delaware court cases to provide guidance on issues such as (i) what types of advance notice bylaw provisions are permissible, (ii) when should advance notice provisions be enforced, (iii) what can a company require an activist to include in an advance notice, (iv) when should deadlines for the submission of advance notices be modified due to changes in circumstances, (v) when can advance notice provisions be adopted or amended, (vi) what is the fiduciary duty standard to be applied to a director's decision to amend the company's advance notice bylaw provisions, and (vii) when can a board reject an activist's advance notice.

Looking back over the past year, and the Delaware Court of Chancery's decision in *Kellner v. AIM ImmunoTech, Inc. (Dec. 28, 2023*) ("*Kellner*"), which dealt with the enforceability of various advance notice provisions in a company's bylaws, imagine how much angst, ink, time, and money would have been spared if the DGCL addressed just the question of whether and the extent to which an "acting in concert" provision was permissible in an advance notice bylaw provision.

While Section 220 of the DGCL provides the statutory underpinning for shareholder inspection demands, it is only the "tip of the iceberg." Most of the law regarding shareholder inspection demands has been evolved, shaped, and clarified through the decisions of the Delaware courts that are rendered in response to particular sets of facts and circumstances.

With regards to fiduciary duties applicable to directors in general and with regards to various special situations such as when a company is threatened with a shareholder activism campaign or a change in control, the DGCL is also silent. We rely on the Delaware Supreme Court's decision in *Unocal v. Mesa Petroleum Co.* (Del. 1985) ("*Unocal*") and its progeny for guidance on the fiduciary duties applicable to the decision of a company's board to adopt a defense in response to a

shareholder activism campaign or takeover bid. While *Unocal's* two-part test has been a key doctrine of Delaware law for almost four decades, it has never been codified in the DGCL.

Unlike the longstanding approach of Delaware to eschew reliance on amendments to the DGCL to clarify, shape, and evolve its corporate law with regards to shareholder activism and takeover defense, Maryland takes a different approach. In contrast to the DGCL, the Maryland General Corporation Law (the "*MGCL*") specifically authorizes the adoption of poison pills (Section 2-201 of the MGCL) and advance notice bylaw provisions (Section 2-504 of the MGCL). Unlike Delaware, where a director's fiduciary duties are completely grounded in case law, the MGCL codifies the fiduciary duties of directors of a Maryland corporation (Section 2-405 of the MGCL). Section 2-405 of the MGCL expressly provides that it is the sole source of duties of a director to the corporation or the shareholders of the corporation, whether or not a decision has been made to enter into an acquisition or a potential acquisition of control of the corporation or enter into any other transaction involving the corporation and applies to any act of a director, including an act as a member of a committee of the board of directors. The MGCL makes it abundantly clear that Delaware's *Unocal* standard is specifically disclaimed. Section 2-405.1(h) of the MGCL provides as follows: "*An act of a director of a corporation relating to or affecting an acquisition or a potential acquisition of control of the corporation or any other transaction or potential transaction involving the corporation may not be subject to a higher duty or greater scrutiny than is applied to any other act of a director*."

The members of the Council are likely familiar with how the DGCL contrasts with the corporate statutes of other jurisdictions, particularly ones that compete with Delaware to be the domicile of choice. It would be unfathomable that the Council has never discussed the possibility of amending the DGCL to at least add provisions endorsing the adoption of poison pills and advance notice bylaws similar in form to what other jurisdictions have in their corporate statutes. It is also possible that the Council has considered going much further in these areas, perhaps even considering codifying one or more of Delaware's well-known legal doctrines. I would suggest that the absence of provisions in the DGCL addressing poison pills, advance notice bylaws, board fiduciary duties, and almost anything else related to shareholder activism and takeover defense, other than shareholder inspection demands, represents evidence of an historically conservative approach by the Council to avoid traversing a "slippery slope" that would lead the Council further

into being responsible for developing the law with respect to these areas, areas that appear to be largely ceded by historical custom to the Delaware courts to evolve, shape and clarify.

The approach recently followed by the Council and the Delaware General Assembly with respect to the market practice amendments is not easily reconciled with the approach taken over the past forty years with respect to poison pills, advance notice bylaw provisions, board fiduciary duties, and other areas related to shareholder activism and takeover defense. Perhaps, the market practice amendments signal a change in approach for how Delaware corporate law will be evolved, shaped, and clarified. There would likely be merit in having the DGCL evolve more in response to Delaware court decisions in the areas of shareholder activism and takeover defense, particularly after allowing the Delaware Supreme Court the opportunity to weigh in. The benefits would include providing more certainty and predictability in how Delaware corporate law would be applied to a particular set of facts and circumstances as well as providing a path for more efficient and less expensive compliance with Delaware corporate law. Perhaps, a DGCL that codifies more of the corporate law generated by the Delaware courts would lead to fewer disputes and less litigation. The countervailing argument is that one of the hallmarks of Delaware's corporate law is its resiliency, flexibility, and adaptability. Undoubtedly, if Delaware moved to a more statutorily focused, "fixed" model of corporate law, some if not much of that resiliency, flexibility, and adaptability would be sacrificed.

However, any argument that the market practice amendments are the beginning of a sea-change in how Delaware corporate law is clarified, shaped, and evolved, particularly with regards to shareholder activism and takeover defense, is easily rebutted. It is noteworthy that, while the Delaware Court of Chancery's December 2023 decision in *Kellner* (like *Moelis*, also on appeal to the Delaware Supreme Court) has created a significant amount of uncertainty and unpredictability as to the enforceability of various advance notice bylaw provisions, such as acting-in-concert provisions, and has caused an extensive amount of consternation for those companies with acting-in-concert provisions in their advance notice bylaws, the Council has not seem inclined to take steps to resolve that uncertainty with the market practice amendments. Instead, by default, at least with respect to the *Kellner* decision, we are back to the more traditional practice of relying on the Delaware courts to clarify, shape, and evolve Delaware corporate law in response to particular sets of facts and circumstances. As *Kellner* is currently before the Delaware Supreme Court and oral arguments were held weeks ago, a decision is expected any day now.

Assuming Governor Carney signs into law the market practice amendments, as is expected, we should have a fair amount of predictability and certainty as to whether activism settlement agreements comply with Delaware corporate law. That will not be the case with respect to most of the other areas of Delaware corporate law with respect to shareholder activism and takeover defense. Rather, we will continue to look to the Delaware courts to evolve, shape, and clarify such law in response to particular sets of facts and circumstances.

About Gottfried Shareholder Advisory LLC

Gottfried Shareholder Advisory LLC is a strategic advisory firm focused on advising public companies and their boards of directors on shareholder activism preparedness and defense. More information about the firm is available at our website.