

Void-Voidable Distinction Revisited by Delaware Court of Chancery

In three recent memorandum opinions, the Delaware Court of Chancery revisited the distinction between void and voidable acts under Delaware common law.

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In three recent memorandum opinions, *Southpaw Credit Opportunity Master Fund v. Roma Restaurant Holdings* (Del. Ch. Feb. 1, 2018), *CompoSecure v. CardUX* (Del. Ch. Feb. 1, 2018, revised Feb. 12, 2018), and *In re Oxbow Carbon Unitholder Litigation* (Del. Ch. Feb. 12, 2018), the Delaware Court of Chancery revisited the distinction between void and voidable acts under Delaware common law.

Under Delaware law, a “void” act is one that the company lacks the power or capacity to take. Examples of void acts include an issuance of shares in excess of the number authorized by a corporation’s certificate of incorporation, or the entry into a contract to perform an illegal act. By contrast, an act is “voidable” if it was within the company’s power or capacity to take, but was not properly authorized or carried out in a specific case. If an act is void, it is not capable of being cured through ratification by common law means, such as subsequent approval or endorsement by the company’s board of directors or equityholders. Unlike void acts, voidable acts are capable of being validated by equitable means, such as ratification or acquiescence.

In *Southpaw*, the court held that stock purportedly issued by the corporation pursuant to an equity compensation plan was void because the recipients of the shares had not signed a joinder to a stockholders agreement. The stockholders agreement provided that shares issued by the corporation were “void ab initio” unless the recipients executed a joinder in substantially the form attached to the stockholders agreement. Although the recipients acknowledged and agreed to be bound by the terms of the stockholders agreement in a signed award agreement in respect of the shares, the court held that the failure to execute the joinder in the form required by the stockholders agreement was a fatal flaw to the validity of the issuance and that the terms of the stockholders agreement clearly mandated a finding by the court that the shares were “void ab initio.”

Notably, the plaintiffs seeking to void the shares contended that the stockholders agreement was a governing instrument of the corporation akin to its certificate of incorporation or bylaws, and that the share recipients’ failure to comply with an express requirement of a governing document rendered the issuance void, not voidable. Noting that the defendants had not contested—and therefore waived—the issue of whether the stockholders agreement should be given equal footing with the corporation’s other governing instruments, the court stated that it was not addressing in its opinion “whether stock issued in violation of contractual obligations is void or voidable under Delaware case law.”

In *CompoSecure*, a limited liability company had unknowingly failed to obtain the necessary approvals under its limited liability company agreement to enter into a related-party contract. For a period of time after execution, the company performed the contract as if it was binding on the company. The company eventually grew unhappy with

the economic terms of the contract and began to look for ways to renegotiate or terminate it. At this point, the company discovered that, in entering into the contract, it had not complied with the related-party approval provision, and the company petitioned the court to have the contract declared void.

The court found that under both the Delaware Limited Liability Company Act and the company's limited liability company agreement, the company had the capacity and power to enter into the contract and would have validly done so had the proper approvals been obtained. As a result, the court concluded that the contract was voidable, not void, and that the lack of authority that would otherwise render the contract unenforceable had been effectively ratified by the company's subsequent performance of the contract.

Oxbow involved a dispute between members of a limited liability company over certain forced sale provisions in the limited liability company agreement. As part of the larger overall dispute, one group of members alleged that the limited liability company units held by a small group of members were void because the necessary approvals for admission and issuance of the units under the limited liability company agreement had not been obtained. The court suggested that Delaware courts have not taken as strict a view of the void-voidable distinction in the alternative entity context because, as creatures of contract, alternative entities are more flexible and less formal than corporations. As in *CompoSecure*, the court found that the unit issuance was voidable, not void, because the company had the power to issue the units if the specific procedures in the limited liability company agreement had been followed. Notably, the court contrasted its determination that the units were voidable with the court's contrary decision with respect to the share issuance in *Southpaw*, noting that the approval provision in the limited liability company agreement at issue did not provide that units issued in violation of the provision would be void ab initio.

Given the sometimes narrow distinctions between void and voidable acts under Delaware law as demonstrated by these three cases, Delaware corporations seeking to ratify defective corporate acts would be well-advised to use Section 204 of the Delaware General Corporation Law as an alternative to common law ratification. Unlike ratification under common law, Section 204 may be used to validate both voidable *and* void acts. While Delaware's alternative entity statutes do not contain a provision analogous to Section 204, the court's holdings in *CompoSecure* and *Oxbow* demonstrate that the Delaware courts may be willing to take a more flexible, "substance over form" approach to the void-voidable distinction in the alternative entity context. Alternative entities seeking to validate potentially defective acts should nevertheless take formal action to ratify such acts by obtaining the approvals required by law and under their governing instruments.

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