

IN OUR OPINION

THE NEWSLETTER OF THE LEGAL OPINIONS COMMITTEE

ABA BUSINESS LAW SECTION

Volume 16 — Number 4

Summer 2017

RECENT DEVELOPMENTS

***Nguyen v. View, Inc.*: The Delaware Court of Chancery Holds That Acts Deliberately Rejected by Stockholders Are Not Subject to Ratification under Section 204 of the Delaware General Corporation Law**

Since it became effective on April 1, 2014, Section 204 of the Delaware General Corporation Law (the “DGCL”) has served its purpose by enabling corporations to retroactively cure defects in their corporate records and by allowing corporate practitioners to give clean legal opinions as to, among other things, a corporation’s capitalization. As the Delaware courts have noted, however, Section 204 of the DGCL (“Section 204”) is not “a license to cure just any defect.” In a recent opinion, *Nguyen v. View, Inc.*, 2017 WL 2439074 (Del. Ch. June 6, 2017), the Delaware Court of Chancery held in a proceeding brought pursuant to Section 205 of the DGCL (“Section 205”) that Section 204 may not be used to ratify a “deliberately unauthorized corporate act” (2017 WL at *2) in order to “undo a stockholder vote rejecting a transaction proposed by the company’s board of directors.” 2017 WL at *10.

The concern expressed by the *View* Court that corporations may misuse Section 204 to ratify actions that were deliberately rejected by the stockholders is among the specifically enumerated factors that the Court of Chancery is entitled to consider in a proceeding brought pursuant to Section 205. Section 205(d)(1), for example, expressly provides that the Court of Chancery may consider “whether the defective corporate act was originally approved or effectuated with the belief that such approval or effectuation was in compliance with the provisions of [the DGCL], the certificate of incorporation or bylaws of the corporation.” In addition, as with any other action taken pursuant

to the DGCL, any ratification under Section 204 is subject to equitable review, and the Court of Chancery is expressly authorized under Section 205(d)(5) to consider “[a]ny other factors or considerations that the Court deems just and equitable” in determining whether to sustain a ratification under Section 204. Nonetheless, absent facts indicating the stockholders have deliberately rejected an act or transaction, the *View* opinion should not be interpreted as a broad curtailment of a corporation’s power to ratify an otherwise void or voidable act or transaction. Rather, as with any action brought in the Court of Chancery challenging any corporate act or transaction, the outcome of any proceeding under Section 205 challenging a ratification under Section 204 will necessarily be heavily dependent on the particular facts and circumstances at issue.

A. The *View* Decision

In *View*, the founder of View, Inc. (the “Company” or “View”) challenged the ratification of several rounds of financing in which View had raised an aggregate of approximately \$500 million. The first of the challenged financings was a Series B preferred stock financing round (the “Series B Financing”). Prior to the Series B Financing, the founder held approximately 70% of View’s outstanding common stock and was entitled, pursuant to View’s certificate of incorporation and the terms of a voting agreement (the “Voting Agreement”), to fill one of five seats on View’s board of directors. In connection with the Series B Financing, View’s certificate of incorporation and the Voting Agreement were to be amended to eliminate the common stockholders’ separate right to appoint a director and to enable the Company to increase or decrease the number of authorized shares of common stock without a separate class vote of the common stock. The founder would also lose his right to consent to any amendment to the Voting Agreement.

Prior to the consummation of the Series B Financing, the founder’s employment with View was terminated and he was removed as a member and chairperson of View’s board of

directors. The founder disputed his removal and termination, following which the parties entered into a settlement agreement to resolve the claims. At View’s insistence, the settlement agreement required the founder to consent to the Series B Financing. The settlement agreement provided, however, that either View or the founder could rescind the agreement within seven days of its execution.

Following the execution of the settlement agreement but before the seven-day revocation period had expired, View consummated the Series B Financing. After the consummation of the Series B Financing, the founder notified View that he was rescinding the settlement agreement. View and the founder agreed to submit various claims relating to the founder’s termination to binding arbitration, including whether the founder had properly rescinded the settlement agreement. While the arbitration was pending, View proceeded to consummate a series of additional financing rounds. The arbitrator subsequently determined that the founder had properly rescinded the settlement agreement, including his consent to the Series B Financing, and that the Series B Financing was void and invalid. Due to the invalidity of the Series B Financing, the subsequent financings were also effectively invalidated due to the failure to obtain the founder’s required consent.

After the arbitrator’s decision, View proceeded to ratify each of the financings under Section 204. In connection with the ratification, the holders of View’s Series A preferred stock converted their shares into common stock, which resulted in their holding a majority in voting power of the outstanding common stock at the time of the ratification and eliminated View’s need to obtain the founder’s consent to authorize the ratification of the financings under Section 204. Following the ratification of the Series B Financing and the subsequent financings rounds, the founder filed suit pursuant to Section 205 challenging the ratification and seeking a declaration of invalidity under Section 205. View moved to dismiss the complaint for failure to state a claim upon which relief can be granted on the basis that the founder failed to plead facts

that would support a reasonable inference that View's ratification was technically invalid or that it should be disregarded as a matter of equity under Section 205.

Addressing whether to grant View's motion to dismiss, the Court of Chancery noted that it must first determine whether the Series B Financing and the subsequent financings constituted defective corporate acts that were eligible for ratification under Section 204. In framing the issue, the Court stated that it "must consider whether an act that the majority of stockholders entitled to vote deliberately declined to authorize, but that the corporation nevertheless determined to pursue, may be deemed a 'defective corporate act' under Section 204 that is subject to later validation by ratification of the stockholders." 2017 WL 2439074 at *6. After considering the plain language of the statute and the synopsis to the legislation enacting Section 204, the Court noted that Section 204 is a remedial statute that requires the action that is the subject of the ratification to be an action that was within the corporation's power at the time the act was purportedly taken. In considering whether View had the power to consummate the Series B Financing and the subsequent financing rounds, the Court did not limit its consideration to whether the act taken was an act within the power of corporations generally under the DGCL. Rather, the Court considered whether, at the time the acts were initially taken, View had the power to take such actions under its governing documents in light of its "operative reality." 2017 WL at *9. In this regard, the Court noted that the founder, as the majority common stockholder at the time of the Series B Financing, was required to consent to the Series B Financing and that he had deliberately declined to do so.

In finding that the Series B Financing and the subsequent financings were not defective corporate acts, the Court explained that the validity of the Series B Financing was not due to a "failure of authorization," but rather by "the classic exercise of the stockholder franchise to say 'no' to a Board-endorsed proposal." 2017

WL 2439074 at *9. The Court stated: "The plain meaning of 'failure' in [the context of Section 204] is distinct from a 'no' vote or outright rejection of the proposal by a majority of the stockholders entitled to vote." *Id.* Thus, because the Series B Financing was deliberately rejected by the founder, the Series B Financing was not an act that was subject to ratification under Section 204. To hold otherwise, the Court noted, would "allow a corporation to ratify an act that stockholders years earlier had expressly voted not to take and to certify that act as effective on the date the stockholders rejected it," (*id.*) a result that was clearly not intended by the Delaware General Assembly in adopting Section 204. The Court therefore concluded that the founder had pled facts that supported a reasonable inference that the Series B Financing was void and the ratification thereof was invalid under Section 204.

B. Motion for Reargument

Following the Court's decision, View filed a motion for reargument on the grounds that the Court's opinion misunderstood the nature of a corporation's power to take and then correct a defective corporate act under Section 204 and impermissibly carved out "rejected" acts from ratification under Section 204. In denying View's motion for reargument on the basis that it merely rehashed arguments the Court had previously rejected, the Court again distinguished between acts taken without a required vote of the stockholders and acts taken in the face of deliberate rejection by the stockholders.

C. Statutory Support for Court's Decision

As noted above, the *View* Court's assertion that the Delaware General Assembly did not intend to permit a corporation to retroactively ratify acts that were deliberately rejected by the stockholders is supported by the factors enumerated in Section 205(d). In a proceeding challenging a ratification under Section 204, Section 205(d) expressly entitles the Court of Chancery to consider, among other things, whether the action sought to be ratified was

originally approved with the belief that it was being approved in compliance with the DGCL and the corporation's organizational documents as well as any other factors the Court deems just and equitable. Although the Court grounded its analysis of the validity of the ratification in the definitions of "defective corporate act" and "failure of authorization," the framework established by Section 205, including Section 205(d), provided a basis upon which the Court could decline to give effect to View's ratification of the Series B Financing. Viewed in this light, the Court's decision thus provides insight into the relative weight the Court of Chancery may accord to the factors enumerated in Section 205(d) in considering a validation under Section 204. Based on the analysis in *View*, evidence of the deliberate rejection of a transaction by the stockholders entitled to vote thereon will factor significantly into the Court's decision whether to sustain a ratification under Section 204.

- C. Stephen Bigler
Richards, Layton & Finger, P.A.
bigler@rlf.com
- Stephanie M. Norman
Richards, Layton & Finger, P.A.
norman@rlf.com

D. Continued Reliance on § 204 by DE Corporations and Opinion Givers

Accordingly, to the extent an act or transaction is void or voidable due to a corporation's failure to obtain a required stockholder consent (as opposed to a corporation's decision to proceed with an act or transaction in the face of an affirmative stockholder rejection of it), corporations should continue to have confidence in proceeding with, and opinion providers should continue to have confidence opining on, the ratification of the act or transaction under Section 204. In addition, absent facts indicating the stockholders have affirmatively rejected an act or transaction, the *View* opinion should not be read as curtailing a corporation's power to ratify an otherwise void or voidable act or transaction, or the ability of an opinion provider to opine on the ratification or the underlying act or transaction. The *View* opinion is a reminder that, as with any transaction, the equities matter, and the Court of Chancery has the authority under Section 205 to invalidate a ratification if it concludes the equities favor that result.

© 2018 American Bar Association
ALL RIGHTS RESERVED