IN OUR OPINION

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RECENT DEVELOPMENTS

Proposed Amendments to Section 204 of the Delaware General Corporation Law Resolve Uncertainty Created by the Reasoning in *Nguyen v. View, Inc*.

A. Introduction

In 2017, the Delaware Court of Chancery in *Nguyen v. View, Inc.*, 2017 WL 2439074 (Del. Ch. June 6, 2017), held in a proceeding brought pursuant to Section 205 ("Section 205") of the General Corporation Law of the State of Delaware (the "DGCL") that the consummation of a financing by View, Inc. ("View") that required the approval of, but was deliberately rejected by, the founder and then-majority common stockholder, was not a "defective corporate act" subject to ratification under Section 204 of the DGCL ("Section 204"). In so holding, the Court interpreted the definition of "defective corporate act" as requiring the court to take into account the corporation's "operative reality" at the time the act was taken in order to determine whether the corporation would have had the power to take such action at that time. Because View knew that the approval of the financing required the consent of the founder, and because the founder had intentionally revoked his consent, the Court concluded View's operative reality was that it did not have the corporate power to effect the financing without the founder's consent, and thus that the financing was not a "defective corporate act" for which ratification pursuant to Section 204 was available.

Following the *View* opinion, we suggested that, absent facts indicating a corporation proceeded with a transaction it knew that stockholders were required to approve and had intentionally rejected, the *View* opinion should not be read as curtailing (i) a corporation's power to ratify an otherwise void or voidable act or transaction where the transaction had not received the requisite stockholder approval, or (ii) the ability of a lawyer to opine on the ratification of the underlying act or transaction in such a situation.[12] We further noted that in a proceeding brought pursuant to Section 205, the Court of Chancery is expressly entitled to consider, among other things, "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." Accordingly, the *View* opinion was a reminder that, as with any action brought in the Court of Chancery challenging any corporate act or transaction, the equities matter, and the outcome of any proceeding under Section 205 necessarily will depend heavily on the particular facts and circumstances at issue, with the Court of Chancery having the authority, on a case-by-

[12] See the authors' article on the View decision, "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," in the Summer 2017 (vol. 16, no. 4) issue of the Newsletter, at 4-7.

case basis, to invalidate a ratification if it concludes the equities favor that result.

On April 6, 2018, the Corporation Law Section of the Delaware State Bar Association (the "DSBA") approved an amendment to the definition of "defective corporate act" in Section 204(h) that would, if enacted, eliminate any implication from the reasoning in the *View* opinion that an act or transaction that was not approved in accordance with the corporation's "operative reality" (*i.e.*, the provisions of the DGCL, the corporation's certificate of incorporation and bylaws, and any plan or agreement to which the corporation is a party) is not susceptible to ratification under Section 204. Importantly, the proposed amendment is not intended to disturb the ability of the Court of Chancery to decline to validate a defective corporate act that was ratified under Section 204 where the Court determines that such act was deliberately rejected by the corporation's stockholders at the time that it was initially taken or that the equities otherwise weigh in favor of invalidating that ratification. The amendment thus is not intended to alter the Court's conclusion in *View* that the ratification that was the subject of that case should not be given effect under Section 205 in light of the facts in that case.

B. The *View* Decision

In *View*, the founder of View challenged the ratification of several financing rounds in which View had raised an aggregate of approximately $500 million. At the time of the first financing round (the "Series B Financing"), the founder held approximately 70% of View's outstanding common stock, and his consent was required to approve the consummation of the Series B Financing. Although the founder had agreed, in connection with a settlement agreement entered into with View, to consent to the Series B Financing, he later rescinded the settlement agreement in accordance with its terms and revoked his consent to the Series B Financing. In an arbitration to resolve claims relating to the rescission of the settlement agreement, the arbitrator 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. Because the Series B Financing was void, subsequent financings that had been consummated while the arbitration was pending were also effectively invalidated due to the failure to obtain the founder's consent.

After the arbitrator's decision, certain of View's preferred stockholders converted their preferred stock into common stock such that the founder's consent was no longer required to approve a financing (and, by extension, the ratification of the financings under Section 204), and the then common stockholders ratified each of the financings under Section 204. Thereafter, the founder filed suit pursuant to Section 205 challenging the ratification. During the course of the proceeding, the *View* Court considered the "gating issue" of whether the financings constituted defective corporate acts that were eligible for ratification under Section 204. In analyzing the term "defective corporate act" (which is defined in Section 204(h)(1)), in relevant part, as "any act or transaction purportedly taken by or on behalf of a corporation that is, and at the time such act or transaction was purportedly taken would have been, within the power of a corporation under subchapter II of this chapter, but is void or voidable due to a failure of authorization"), the *View* Court acknowledged that View had the power under subchapter II of the DGCL to, among other things, issue one or more classes of stock and rights and options in respect of those classes of stock. Nevertheless, the *View* Court explained that the term "defective corporate act" also required the act to have been within the corporation's power "*at the time such act was purportedly taken*," which it found implicated View's "operative reality" at such time. The *View* Court then reasoned that, because the founder's consent was required at the time of the Series B Financing pursuant to the provisions of the DGCL and because the founder had effectively revoked his consent, View did not have the power to consummate the financing at the time it was consummated. Therefore, the Series B Financing was not a defective corporate act for purposes of Section 204. In so holding,

the *View* Court acknowledged that the failure to give effect to the ratification of the financings would be "problematic if not potentially devastating for View." The *View* Court further noted that, in light of its holding that Section 204 could not be used to ratify the financing rounds, it could not "sustain View's attempted ratification on equitable, rather than statutory, grounds." citing *STAAR Surgical Co. v. Waggoner*, 588 A.2d 1130 (Del. 1991).

Following the denial of a motion for reargument (in which View argued, among other things, that the Court impermissibly carved out "rejected" acts from ratification under Section 204) and the filing of additional claims against View by the founder in connection with a proposed exchange offer (pursuant to which the holders of stock issued in the financings would exchange their current shares and possible claims against View for newly issued shares with identical rights, powers and preferences of the void shares), the parties entered into a settlement agreement. On February 21, 2018, the Court of Chancery entered the proposed order of dismissal and, in connection with the dismissal, validated pursuant to Section 205, among other things, the issuance of all outstanding shares of capital stock and other securities of View listed as outstanding on View's records as of December 21, 2017, including the issuance of all shares that the Court had previously held were not susceptible to ratification. Order of Dismissal and to Validate View, Inc.'s Corporate Acts Under Section 205, *In re View, Inc. Litig.*, Consol. C.A. No. 201-0762-JRS (Del. Ch. Feb. 21, 2018).

C. The Proposed Amendment

The Court's reasoning in the *View* opinion concerning the impact of a failure of authorization on a corporation's "operative reality" created uncertainty regarding the scope of corporate acts subject to ratification under Section 204 and the necessity of additional factual diligence or assumptions relating to whether the failure of authorization was intentional. Because a "defective corporate act" necessarily involves a corporate act that was not taken in compliance with the corporation's "operative reality" at the time of the act (*i.e.*, a failure of authorization), there was some concern among Delaware lawyers that the *View* opinion, read broadly, significantly curtailed the utility of Section 204. Furthermore, the *View* Court's initial conclusion that it did not have the power and authority to validate View's capital structure on equitable grounds in light of *STAAR Surgical* was particularly troubling in light of the fact that the legislative synopsis accompanying the adoption of Section 204 indicated that the statute was intended to overturn, among other decisions, *STAAR Surgical* on precisely those grounds. While in approving the settlement agreement and entering an order that, among other things, validated under Section 205 the issuance of stock and other securities it had previously determined not to be susceptible to cure by ratification, the *View* Court appears to have clarified that its earlier analysis of the financings under Section 204 was based on equitable considerations and not on the failure of the financings to constitute acts that are susceptible to ratification under Section 204 and Section 205. Nevertheless, the Court's "operative reality" analysis with respect to the scope of corporate acts susceptible to ratification under Section 204 was concerning.

To eliminate the uncertainty created by the reasoning in the *View* opinion concerning the defective acts potentially subject to ratification under Section 204, the Corporate Council of the Corporation Law Section of the DSBA and the Corporation Law Section of the DSBA have each approved the proposed amendment to Section 204(h). The proposed amendment, if enacted, would amend the definition of "defective corporate act" to provide, in relevant part, that it "means . . . any act or transaction purportedly taken by or on behalf of the corporation that is, and at the time such act or transaction was purportedly taken would have been, within the power of a corporation under subchapter II of this chapter (*without regard to the failure of authorization identified in [the board resolutions adopted in connection with the ratification of such act]*), but is void or voidable due to a failure of authorization." (emphasis added).

Accordingly, if enacted by the Legislature, the proposed amendment to Section 204(h) will clarify that a "defective corporate act" is any act that the corporation would have had the power to take under subchapter II of the DGCL (essentially any act other than conferring honorary degrees or conducting a banking business) without regard to the failure of authorization (*i.e.*, the failure of the act to have been taken in light of the corporation's "operative reality"). The legislative synopsis to the proposed amendment to Section 204(h) states:

> The amendments to Section 204(h)(1) are intended to eliminate any implication from *Nguyen v. View, Inc.*, C.A. No. 11138-VCS (Del. Ch. June 6, 2017), suggesting that an act or transaction may not be within the power of a corporation—and therefore may not constitute a "defective corporate act" susceptible to cure by ratification—solely on the basis that it was not approved in accordance with the provisions of the Delaware General Corporation Law or the corporation's certificate of incorporation or bylaws.

Importantly, any concerns that a corporation may misuse Section 204 to ratify actions that were deliberately rejected by its stockholders continue to be addressed by the factors enumerated in Section 205(d). Indeed, the proposed amendment to Section 204(h) is not intended to overrule the Court's conclusion in *View* that the ratification that was the subject of its opinion not be given effect in light of the facts of that case. The legislative synopsis to the proposed amendment to Section 204(h) expressly notes that the proposed amendment would not disturb the power of the Court of Chancery to, among other things, "decline to validate a defective corporate act that had been ratified under Section 204 . . . on the basis that the failure of authorization that rendered such act void or voidable involved a deliberate withholding of any consent or approval . . . nor would it limit, eliminate, modify or qualify any other power expressly granted to the Court of Chancery under Section 205."

D. Conclusion

Counsel for Delaware corporations should continue to have confidence in proceeding with a ratification of a defective corporate act under Section 204 and in giving opinions on acts and transactions ratified pursuant to Section 204. Although the Court of Chancery continues to have the power and authority to invalidate any ratification under Section 204 if the equities favor that result, all actions taken by a corporation may be challenged on equitable grounds before the Court of Chancery. As such, we do not believe that the *View* opinion requires that opinions on acts or the issuance of stock properly ratified in accordance with Section 204 need to be qualified in a manner that is different from opinions given on acts or stock that are duly authorized at the outset.

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