

Chancery Court Decides First Action Under New Section 205

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On April 1, Trupanion Inc. and its chief executive officer filed what is believed to be the first petition seeking relief in the Delaware Court of Chancery pursuant to Section 205 of the Delaware General Corporation Law. In less than a month, the Chancery Court issued a final order in the action, resolving multiple questions relating to Trupanion's corporate existence and actions it had taken over several years, in *In re Trupanion*, C.A. No. 9496-VCP (Del. Ch. April 28, 2014). Prior to the adoption of Section 205, such a timely and comprehensive resolution of the issues Trupanion faced would not have been possible.

Section 205, which was included in the 2013 amendments to the DGCL but did not become effective until April 1, is an innovative statutory provision that allows Delaware corporations and other specified parties, under certain circumstances, to petition the Chancery Court to validate or invalidate, as the case may be, corporate acts. Section 205 provides that the corporation may bring the action directly and that no other parties need be joined in order for the Chancery Court to adjudicate the validity issues. It also provides, however, that the Chancery Court may order notice "to other persons specified by the court," and those parties may intervene in a Section 205 proceeding.

Trupanion's petition sought rulings on the validity of multiple corporate acts, ranging from relatively minor violations of the DGCL's provisions governing stockholder action by written consent to major transactions calling into question the corporation's existence. Given the nature of the defects identified, Trupanion apparently determined it could not confirm the validity of its board of directors and, as a result, determined to seek relief pursuant to the court-supervised procedures under Section 205 rather than the "self-help" procedures set forth in Section 204, the companion statute that authorizes corporations to ratify defective corporate acts by following the specified statutory procedures.

Through its petition, Trupanion sought to correct what appeared to be an innocent error that resulted in disproportionately severe consequences. Trupanion was incorporated in Delaware in 2006. Two years later, an employee in Trupanion's accounting department, in an effort to reduce Trupanion's franchise taxes but with no apparent appreciation for the significance of his actions, filed documents to reincorporate Trupanion to Arizona. Not long after the putative reincorporation, upon learning that Trupanion should have remained incorporated in Delaware, the employee attempted to reincorporate Trupanion to Delaware. No vote of the board of directors or the stockholders of Trupanion was sought or obtained for either reincorporation. To address this morass, which left Trupanion unable to determine the validity of its board of directors, Trupanion petitioned the Chancery Court to invalidate each of the reincorporations.

The petition also alleged that, beginning in 2006, Trupanion's stockholders purported to approve various matters by written consent. According to the petition, those actions by written consent did "not appear to have been dated strictly in accordance with the DGCL," and there was no evidence that the notices of such actions required by the

DGCL were delivered. The potentially invalid acts for which Trupanion sought remedy included the issuance of common stock and preferred stock. The potential infirmities resulted in the election of only one of Trupanion's 10 putative directors being free from doubt. For that reason, Trupanion felt it was required to proceed under Section 205, rather than employing the self-help provisions of Section 204.

While it is still too early to tell how the Chancery Court will resolve various types of issues arising from petitions filed pursuant to Section 205, Trupanion's petition provides a unique glimpse into the utility of Section 205. Prior to the enactment of Section 205, Trupanion may have been without a viable course of action. In considering the validity of corporate acts suffering from an authorization or other defect, the Delaware courts would examine whether the defect rendered the act void or voidable, with the former being incapable of cure, regardless of the equities, and the latter being susceptible to cure through ratification. Whether an act was void or voidable, however, often depended on the facts and circumstances surrounding its effectuation and was difficult to determine, leaving corporations suffering from defective acts with little certainty as to their capital structures or other internal organizational matters.

Section 205 was expressly designed to overturn this harsh line of case law and to give the Chancery Court the power to untangle the thorny questions that arise when corporate acts, such as the issuance of stock and the election of directors, have not been duly authorized. But many practical issues remain to be sorted out. For example, the statute expressly empowers the Chancery Court to require that notice of the action be provided to various people and to permit such people the right to intervene in the action.

In *Trupanion*, at least, it appears the Chancery Court was satisfied with the company's notice efforts. Within a month, the court held a hearing on the petition and issued a final order: (1) holding that the defective reincorporations were to be disregarded and the Delaware secretary of state would accept certain filings and recognize the initial Delaware corporation as the validly existing entity; (2) confirming that Trupanion's stock issuances were valid; and (3) determining Trupanion's board of directors. Future Section 205 petitions will undoubtedly present the Chancery Court opportunities to provide additional guidance on the use and application of this innovative statutory provision. But this early test confirms the utility of Section 205 as well as the Chancery Court's ability to deal with actions brought under that section on a timely basis.

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