

The Failure of the 'Failing Business' Exception Under Delaware Law

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In *Stream TV Networks v. SeeCubic*, the Delaware Supreme Court vacated a permanent injunction imposed by the Delaware Court of Chancery that prohibited Stream TV Networks, Inc. and the Rajan brothers, who collectively held a majority of the company's stock, from blocking a negotiated transfer of all of Stream's assets to satisfy its secured creditors. In so doing, the Supreme Court held that a provision of Stream's certificate of incorporation requiring stockholder approval for certain asset transfers (the Stream charter provision) unambiguously applied to the transaction. While not necessary to its holding in light of its interpretation of the Stream charter provision, the Supreme Court also found that the common law "failing business" exception to the stockholder approval requirement for a sale of substantially all assets, if it ever existed in Delaware, did not survive the adoption of Section 271 of the Delaware General Corporation Law (the DGCL).

In 2020, Stream encountered financial difficulties, and, at the urging of certain of its stockholders and secured creditors, several independent directors were appointed to the board of directors. The board subsequently formed a resolution committee comprised of two of the new independent directors, and the committee negotiated and approved an omnibus agreement pursuant to which Stream would assign all of its assets to a new entity established by the company's secured creditors in exchange for forgiveness of Stream's outstanding debt. Stream's stockholders other than the Rajan brothers were given the opportunity to exchange their Stream shares for an identical number of shares in the new entity, and the Rajan brothers would be permitted to maintain an indirect interest in the new entity through Stream, which would be issued shares in the new entity as well. The Rajan brothers brought suit to block the asset transfer contemplated by the omnibus agreement, claiming that stockholder approval of the transaction was required under the Stream charter provision and under Section 271.

In the lower court opinion, the Court of Chancery first analyzed whether stockholder approval was required under Section 271, which requires stockholder approval for a corporation to "sell, lease or exchange all or substantially all" of its assets. After analyzing the legislative and common law history of asset sales in Delaware, the Court of Chancery concluded that the common law exception that permits the board of directors to sell all or substantially all of a corporation's assets without stockholder approval if the corporation is insolvent was not preempted by the adoption of Section 271 and thus was applicable. The Court of Chancery found that the language of the Stream charter provision was substantially similar to Section 271 and that, as a result, the same common law failing business exception applied to the Stream charter provision as well. Based on these findings, the Court of Chancery concluded that stockholder approval was not required for the transfer of assets contemplated by the omnibus agreement under the Stream charter provision or Section 271.

On appeal, the Supreme Court held that the Court of Chancery had erred in equating the Stream charter provision with Section 271, concluding that the Stream charter provision was "materially different" from and broader than Section 271 because the Stream charter provision applied to a "sale, lease or other disposition" of all or substantially all assets, whereas Section 271 applies to a "sale, lease or exchange" and that the asset transfer contemplated by the omnibus agreement unambiguously involved a "disposition" of the company's assets.

In light of this conclusion, the Supreme Court stated that it was unnecessary to consider Section 271 as an interpretive guide for the Stream charter provision. Nevertheless, because of the potential implications of the Court of Chancery's interpretation of Section 271 on future transactions, the Supreme Court directly addressed whether the failing business exception to Section 271 exists. The Supreme Court noted that, while there was some support for such an exception at common law in the late 1800s and early 1900s, no Delaware case had expressly adopted the exception. Regardless of whether the common law existed at one time in Delaware, the Supreme Court ultimately concluded that the failing business exception did not survive the enactment of Section 271 and its predecessor statute because it effectively "occupied the field" with respect to sales of all or substantially all assets and did not expressly provide for the exception.

The Supreme Court's opinion has several implications for Delaware corporations and practitioners. The opinion expressly rejected the concept that there is a failing business exception to the Section 271 stockholder vote requirement for a sale, lease or exchange of all or substantially all assets under Delaware law. Accordingly, the fact that the corporation selling assets is insolvent will not in and of itself exempt the company from the Section 271 stockholder vote requirement. In an insolvency situation, the stockholders would not be likely to recover any proceeds of the liquidation and may have little incentive to approve such a transaction. On the other hand, the Supreme Court notes that Section 271 would not pose an obstacle to a foreclosure sale arising out of mortgage or pledge of assets granted pursuant to Section 272 of the DGCL, which expressly provides that stockholder approval is not required for the mortgage or pledge of a corporation's assets. So while Section 271 may require stockholder approval for an insolvent corporation to enter into a negotiated asset transfer or sale transaction with a secured creditor, it should not prevent a secured creditor from foreclosing on the debtor's assets in accordance with applicable law.

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