Annual Survey of Judicial Developments Pertaining to Private Equity and Venture Capital

*By The Annual Survey Working Group of the Jurisprudence Subcommittee, Private Equity and Venture Capital Committee, ABA Business Law Section**

The Annual Survey Working Group reports annually on judicial decisions involving private equity and venture capital law.[1] The decisions selected for this year's Annual Survey are the following:

1. *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.* (Chancery Court Invalidates Common Provisions Contained in a Stockholders' Agreement)
2. *Wagner v. BRP Group, Inc.* (Chancery Court Finds Blocking Rights Contained in a Stockholders' Agreement Violate Delaware Law)
3. *Hyde Park Ventures Fund, III, L.P. v. FairXchange* (Chancery Court Finds Deal Price to Be the "Least Bad Method" of Determining the Appraisal Value of a Venture-Backed Company)
4. *Firefighters' Pension System of Kansas City Trust v. Foundation Building Materials, Inc.* (Chancery Court Denies Motion to Dismiss Breach of Fiduciary Duty and Aiding and Abetting Claims Asserted Against Private Equity Fund, Its Board Designees, and Financial Advisor in Connection with the Sale of a Portfolio Company)

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1. To be included in the survey, cases must meet the following criteria: (a) the decision must address either a preferred-stock financing or a change in control of a company that previously issued preferred stock; (b) the court must (i) interpret preferred-stock terms, (ii) interpret a statute pertaining to preferred-stock financing, or (iii) address a breach-of-fiduciary-duty claim brought in the context of a transaction described in (a) above; or (c) the decision must involve a company that has been funded primarily by private investors.

5. *Luxor Capital Group, L.P. v. Altisource Asset Management Corp*. (New York Court Declines to Order Partial Payment of Redemption Price Under Terms of Certificate of Designation)

1. *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.* (Chancery Court Invalidates Common Provisions Contained in a Stockholders' Agreement)

Summary

In *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.*,[2] the Delaware Court of Chancery held that various provisions contained in a stockholder agreement, which were intended to give Ken Moelis, the founder and largest stockholder (the "Founder") of Moelis & Co. ("Moelis"), control over Moelis following the company's initial public offering (the "IPO"), were invalid under section 141(a) of the General Corporation Law of the State of Delaware (the "DGCL").[3] Under section 141(a) of the DGCL, the board of directors of a Delaware corporation, not stockholders or others, manages the business and affairs of the corporation unless the certificate of incorporation otherwise provides.[4] Following the *Moelis* decision, the Delaware General Assembly enacted new section 122(18) of the DGCL to give corporate boards clear authority to enter into agreements with the corporation's stockholders and beneficial owners that may contain the types of provisions that the *Moelis* court invalidated.[5]

Background

Moelis is an investment bank that went public in 2014.[6] Before Moelis' shares began trading publicly, it entered into a stockholder agreement (the "Stockholder Agreement") with the Founder and three of his affiliates.[7] The Court of Chancery characterized the Stockholder Agreement as a "new wave" stockholder agreement that, rather than governing how the stockholder-signatories would vote or otherwise exercise rights attendant to their shares, imposed affirmative obligations and restrictions on Moelis itself.[8]

In particular, the Stockholder Agreement required the Moelis board of directors to obtain the Founder's prior written consent before taking eighteen enumerated categories of corporate action (the "Pre-Approval Requirements").[9] The court described the Pre-Approval Requirements as so broad that they required "[the Foun-

2. 311 A.3d 809 (Del. Ch. 2024).
3. *Id.* at 822–24.
4. Del. Code Ann. tit. 8, § 141(a) (2024) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.").
5. Del. Code Ann. tit. 8, § 122(18) (2024).
6. *Moelis*, 311 A.3d at 823.
7. *Id.* at 817–18.
8. *Id.*
9. *Id.* at 825–26.

der's] signoff in advance for virtually any action the directors might want to take," including hiring and firing key officers, amending the governing documents or any material contract, issuing debt or equity above certain thresholds, adopting a stockholder rights plan, annual budget, or business plan, entering into new lines of business, initiating or settling material litigation, paying dividends, and entering into fundamental transactions like mergers, consolidations, recapitalizations, sales of all or substantially all of the assets, liquidation, and dissolution.[10]

The Stockholder Agreement also contained seven Board Composition Provisions (the "Challenged Provisions," which include the Pre-Approval Requirements).

First, the Board must maintain its size at not more than eleven directors (the "Size Requirement"). Second, the Founder is entitled to name a number of designees equal to a majority of the Board (the "Designation Right"). Third, the Board must nominate the Founder's designees as candidates for election (the "Nomination Requirement"). Fourth, the Board must recommend that stockholders vote in favor of the Founder's designees (the "Recommendation Requirement"). The Company must use reasonable efforts to elect and maintain the Founder's designees as directors to serve (the "Efforts Requirement"). Fifth, the Board must fill any vacancy in a seat occupied by a Founder designee with a new Founder designee (the "Vacancy Requirement"). Finally, the Board must populate any committee with a number of the Founder's designees proportionate to the number of designees on the full Board (the "Committee Composition Provision").[11]

While the Founder controlled 96.8 percent of Moelis's outstanding voting power at the time of its IPO in 2014, he sold down to 40.4 percent by the time of the lawsuit.[12]

In March 2023, a Moelis stockholder who had purchased shares shortly after the 2014 IPO brought suit in the Court of Chancery arguing that the Challenged Provisions violated the DGCL by improperly infringing upon the board's statutory power to manage the corporation's business and affairs under section 141(a).[13] The parties cross-moved for summary judgment.[14] In an initial, separate opinion, the Court of Chancery rejected defendants' equitable defenses of laches and acquiescence, reasoning that void acts (like those resulting from a statutory violation) are not susceptible to equitable cure and that the statutory violations at issue were best viewed as "continuing wrongs" rather than discrete acts for which claims accrued in 2014.[15] The court rejected a ripeness defense under similar logic.[16]

10. *Id.*

11. *Id.* at 818.

12. *Id.* at 828–29. While the Founder held 40.4 percent of the outstanding voting power, the Founder held approximately 6.5 percent of the outstanding equity and possessed the right to obtain additional shares that would bring his equity interest to 11.5 percent. *Id.*

13. Del. Code Ann. tit. 8, § 141(a) (2024).

14. *Moelis*, 311 A.3d at 823.

15. W. Palm Beach Firefighters' Pension Fund v. Moelis & Co., 310 A.3d 985, 993–1003 (Del. Ch. 2024).

16. *Id.* at 1003–10.

ANALYSIS

The Court of Chancery's subsequent opinion on the merits found most of the Challenged Provisions to be facially invalid—a result only justified if they "[could not] operate lawfully in the face of section 141(a) *under any circumstances*."[17] In concluding that most of the Challenged Provisions met that high bar for facial invalidity, the court created a new, two-part test: first, the court must determine whether the challenged provision constitutes part of an "internal governance arrangement," and, second, if so, whether the challenged provision violates section 141(a).[18]

In creating the new test, the court surveyed existing precedents that the court found collectively supported a "clear rule" that the court "must first determine whether the challenged provision constitutes part of the corporation's internal governance arrangement" rather than an "external commercial agreement."[19] If the latter, the inquiry will end and the facial validity challenge under section 141(a) will fail. If the former, the reviewing court will proceed to the second step of applying the test set forth in *Abercrombie v. Davies*[20] and ask whether the provision removes "in a very substantial way" directors' "duty to use their own best judgment on management matters" or "freedom . . . on matters of management policy."[21] In so holding, the court expressly parted with *Sample v. Morgan*,[22] which had sponsored "jettisoning section 141(a) review for corporate contracts"[23] as anathema to the boards' practical need to contract with commercial third parties, on grounds that the new test's first prong would give courts a way to rationally balance boards' commercial priorities with their statutory mandate to manage the corporation under section 141(a).[24]

Next, the court offered guidance on how to apply each prong. As for the first, the court listed seven factors suggestive of an internal governance arrangement rather than a commercial contract: (1) "One factor is that governance agreements frequently have a statutory grounding in a section of the DGCL";[25] (2) "A second factor is that the corporation's counterparties in a governance agreement hold roles as intra-corporate actors";[26] (3) "A third factor is that the challenged provisions seek to specify the terms on which intra-corporate actors can authorize the corporation's exercise of its corporate power";[27] (4) "A fourth factor is that, unlike a commercial contract, a governance agreement does not readily reveal an underlying

17. *Moelis*, 311 A.3d at 829 (emphasis in original) (internal quotation marks omitted) (quoting Salzberg v. Sciabacucchi, 227 A.3d 102, 113 (Del. 2020)).
18. *Id.* at 828.
19. *Id.* at 828–56.
20. 123 A.2d 893, 899 (Del. Ch. 1956), *rev'd on other grounds*, 130 A.2d 338 (Del. 1957).
21. *Id.* at 860.
22. 914 A.2d 647 (Del. Ch. 2007).
23. *Id.* at 672.
24. *Moelis*, 311 A.3d at 852–55.
25. *Id.* at 859.
26. *Id.*
27. *Id.*

commercial exchange";[28] (5) "A fifth and related factor is the relationship between the contractual restrictions and a commercial purpose. In a commercial agreement, features that touch on governance seek to protect the underlying transaction";[29] (6) "A sixth and related factor is the presumptive remedy for breach";[30] and (7) "A final factor is duration of the contract and the corporation's ability to terminate it."[31] As for the second prong, the court observed that provisions directly restricting the company or board will generally be invalid, whereas those that merely influence action by imposing adverse consequences may be decided on a case-by-case basis.[32]

Applying the new test, the court held that most of the Challenged Provisions were invalid. First, the court concluded that they were "prototypical governance provisions in a prototypical governance agreement" under each of the seven factors listed above.[33] In particular, the court noted that the Stockholder Agreement was grounded in section 218 of the DGCL, that all counterparties were intra-corporate actors, and that the Challenged Provisions constrained board action, supported no underlying commercial bargain, lacked terminability, and would likely support an injunction remedy rather than money damages.[34]

The court split its assessment of the second prong into two parts. First, the court held that the Pre-Approval Requirements, taken collectively and not individually, violated section 141(a) by imposing direct restrictions on the board's ability to act.[35] In so holding, the court rejected defendants' argument that the pre-approval mechanism would operate legitimately where the board and the Founder agreed, on the basis of the court's finding, that in that scenario "the provisions are not operating at all."[36] The court further rejected the related argument that the board could operate freely under the Pre-Approval Requirements subject to the sole limitation of a potential veto, reasoning that "the power to review is the power to decide" and that directors' anticipation of the constraint "results in a present, negative, and detrimental effect" that substantially curtails their authority.[37]

Second, the court analyzed the Board Composition Provisions one by one. It concluded that the Recommendation Requirement, Vacancy Requirement, Size Requirement, and Committee Composition Provision were each invalid because they prevented the board from using "their own best judgment on a management matter"—namely, the size and composition of the board and its committees.[38] By

28. *Id.*
29. *Id.*
30. *Id.*
31. *Id.* at 860.
32. *Id.* at 860–61.
33. *Id.* at 863–66.
34. *Id.*
35. *Id.* at 821.
36. *Id.*
37. *Id.* at 867–68.
38. *Id.* at 870–74. The court held that the Committee Composition Provision also violated Section 141(c) of the DGCL, which empowers the board to determine committee composition. *Id.* at 876–77.

contrast, the Designation Right was valid because it did not require board action, the Nomination Requirement was valid because nominating directors is a right the board shares with stockholders, and the Efforts Requirement was valid because it could operate legitimately to "obligate the Company to take ministerial steps" in furtherance of the Founder nominees' candidacy.[39]

In holding that most of the Challenge Provisions were invalid, the court rejected Moelis's arguments regarding the impact of such a holding on market practice and the thousands of agreements that could be invalidated as a result thereof,[40] noting that "market practice is not law."[41] The court further concluded the opinion by noting that "[w]hen market practice meets a statute, the statute prevails. . . . Of course, the General Assembly could enact a provision stating what stockholder agreements can do. Unless and until it does, the statute controls."[42]

New Section 122(18)

Following the court's decision in *Moelis*, the Delaware General Assembly enacted section 122(18), which expressly authorizes a corporation, notwithstanding section 141(a), to make contracts with one or more current or prospective stockholders (or one or more beneficial owners of stock), in which the corporation may, among other things, agree to:

> (a) restrict or prohibit itself from taking actions specified in the contract, (b) require the approval or consent of one or more persons or bodies before the corporation may take actions specified in the contract (which persons or bodies may include the board of directors or one or more current or future directors, stockholders or beneficial owners of stock of the corporation), and (c) covenant that the corporation or one or more persons or bodies will take, or refrain from taking, actions specified in the contract (which persons or bodies may include the board of directors or one or more current or future directors, stockholders or beneficial owners of stock of the corporation).[43]

As explained in the legislative synopsis, section 122(18) provides "bright-line authorization" for the contractual provisions invalided in *Moelis*.[44] Thus, section 122(18) provides "for a different rule than the portion of the *Moelis* decision in which the court held that contract provisions of this nature must be included in the certificate of incorporation to be valid."[45]

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39. *Id.* at 874–75.
40. *Id.* at 857 n.245.
41. *Id.* at 878.
42. *Id.* at 881.
43. Del. Code Ann. tit. 8, § 122(18) (2024). Under section 122(18), the entry into any such agreement must be in exchange for such minimum consideration (including "inducing 13.2(c) stockholders or beneficial owners of stock to take, or refrain from taking, one or more actions") as may be determined by the board of directors. *Id.*
44. S.B. 313 Synopsis, 152nd Gen. Assemb., Reg. Sess. (Del. 2024).
45. *Id.*

Section 122(18) became effective on August 1, 2024, and, subject to a limited exception, applies to all contracts made by a corporation, whether or not the contract was made on or before August 1, 2024.[46] However, section 122(18) does not apply or affect any civil action or proceeding completed or pending on or before August 1, 2024.[47] As such, following August 1, 2024, except with respect to situations in which there is completed or pending litigation, a stockholder agreement that includes one or more permitted covenants is no longer susceptible to challenge on the basis of facial invalidity for violating section 141(a), whether or not the stockholder agreement was entered into before or after August 1, 2024.[48]

Importantly, while section 122(18) authorizes a corporation to enter into stockholder agreements and to include one or more permitted covenants in such agreements, it addresses the statutory validity of such agreements and covenants and does not guaranty their enforceability.[49] Rather, section 122(18) expressly provides that "no provision of such contract shall be enforceable against the corporation to the extent such contract provision is contrary to the certificate of incorporation or would be contrary to the laws of [the State of Delaware] (other than § 115 of [the DGCL]) if included in the certificate of incorporation."[50] Accordingly, while section 122(18) dispenses with the need to amend the certificate of incorporation in order for a corporation to have the power and authority to agree to a permitted covenant, to the extent that any permitted covenant is contrary to the certificate of incorporation, an amendment to the certificate of incorporation would be necessary to ensure the enforceability of such covenant.[51] Notably, for purposes of applying this limitation on enforceability, section 122(18) specifies that "a restriction, prohibition or covenant in any such contract that relates to any specified action shall not be deemed contrary to the laws of [the State of Delaware] or the certificate of incorporation by reason of a provision of [the DGCL] or the certificate of incorporation that authorizes or empowers the board of directors (or any one or more directors) to take such action."[52] As explained in the legislative synopsis, a general recitation in the certificate of incorporation of section 141(a) that the business and affairs of the corporation shall be managed by or under the direction of the board of directors of the corporation "would not be sufficient to render inoperable the provisions of section 122(18) because such recitation merely authorizes the board of directors to manage, or direct the management of, the business and affairs of the corporation."[53]

46. *Id.*
47. *Id.*
48. *Id.*
49. *Id.*
50. Del. Code Ann. tit. 8, § 122(18) (2024). Section 115 of the DGCL is expressly carved out to allow a stockholder agreement to include exclusive forum and arbitration provisions that do not select the courts of the State of Delaware to adjudicate claims under such agreement. *See* S.B. 313.
51. *See* Del. Code Ann. tit. 8, § 122(18).
52. *Id.*
53. *See* S.B. 313. To the extent that a corporation desired to limit or eliminate its ability to enter into the types of contracts permitted by section 122(18), it could do so by including express language

In addition to the express limitation of enforceability set forth in section 122(18), the entry into a stockholder agreement with one or more permitted covenants does not dispense with the corporate actions required to give effect to such covenants, nor does it "relieve any directors, officers or stockholders of any fiduciary duties they owe to the corporation or its stockholders, including . . . with respect to deciding whether to perform, or cause the corporation to perform or to breach, the contract."[54] For example, a permitted covenant requiring a corporation to amend its certificate of incorporation under one or more circumstances would still require that such amendment be approved and declared advisable by the board of directors and adopted by the stockholders as required under section 242 of the DGCL.[55] Additionally, as noted above, the decision to take such actions in compliance with the permitted covenant would be subject to any fiduciary duties owed to the corporation and would not relieve the board of directors from making a determination that such action is in the best interests of the corporation and all of its stockholders.[56] Furthermore, under section 122(18), any remedies for a breach or an attempted breach of the stockholder agreement must be imposed upon the corporation, and a stockholders agreement may not impose remedies or other consequences against the directors, in their capacities as such, nor may such an agreement bind or purport to bind the board of directors or individual directors as parties to the agreement.[57]

With respect to remedies for a breach or an attempted breach of a stockholder agreement, the legislative synopsis makes clear that there are circumstances where specific performance of a permitted covenant would be unavailable, such as if performance of a permitted covenant required stockholder approval and such approval is not obtained.[58] With respect to money damages for a breach, the legislative synopsis further notes that enforceability of such a claim "may be subject to equitable review, and related equitable limitations, if the making or performance of the contract constitutes a breach of fiduciary duty."[59]

Conclusion

Following the Court of Chancery's decision in *Moelis*, there were numerous questions raised regarding stockholder agreements, in both the public and private company contexts, including with respect to the validity and enforceability

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in the certificate of incorporation limiting or eliminating the power and authority of the corporation to enter into the contracts authorized by section 122(18). *See id.*

54. *Id.* The decision whether to enter into a stockholders' agreement in and of itself is also subject to any fiduciary duties owed to the corporation by the directors, officers, and stockholders.

55. *Id.*

56. *Id.*

57. Del. Code Ann. tit. 8, § 122(18) (2024) ("With respect to all contracts made under this paragraph (18), the corporation shall be subject to the remedies available under the law governing the contract, including for any failure to perform or comply with its agreements under such contract."); S.B. 313.

58. S.B. 313 ("[T]he lack of stockholder approval of an action under [the DGCL] requiring such approval would render specific performance of the covenant unavailable.").

59. *Id.*

thereof. New section 122(18) clearly grants Delaware corporations the power and authority to enter into such agreements and to agree to one or more permitted covenants. However, the decision to enter into such an agreement, as well as to perform thereunder, remains subject to any fiduciary duties owed to the corporation and its stockholders and corporations. Practitioners should diligently monitor any developments in subsequent cases analyzing stockholder agreements and applying new section 122(18).

2. *Wagner v. BRP Group, Inc.* (Chancery Court Finds Blocking Rights Contained in a Stockholders' Agreement Violate Delaware Law)

Summary

In *Wagner v. BRP Group, Inc.*,[60] applying the framework developed in *Moelis*,[61] the Delaware Court of Chancery found that three approval rights granted to stockholders under a stockholders' agreement violated section 141(a) of the DGCL, which, at the time of the court's decision, provided that the directors of a Delaware corporation manage the business and affairs of the corporation unless the corporation's certificate of incorporation or the DGCL otherwise provides.[62] The court concluded that a stockholder's approval right with respect to significant decisions regarding senior officers violated section 142 of the DGCL and a stockholder approval right over amendments to the corporation's certificate of incorporation violated section 242 of the DGCL.[63] After litigation began, the corporation and certain stockholders entered into a consent and defense agreement to mitigate the effects of the approval rights (the "Consent Agreement"), which the court found cured the section 141(a) violations but not the section 142 or 242 violations.[64] This decision was rendered prior to the effectiveness of new section 122(18) of the DGCL.

Background

In 2011, Lowry Baldwin, his son, and two other partners co-founded an insurance company, Baldwin Risk Partners, L.L.C. (the "LLC").[65] Lowry owned a majority of the LLC's equity through Baldwin Insurance Group Holdings, LLC ("Holdings").[66] In 2019, Lowry and all of the other equity holders in the LLC (collectively, the "Holders") prepared to sell equity to the public through an IPO.[67] In connection with the IPO process, the Holders formed BRP Group, Inc. as the publicly listed IPO vehicle and entered into a stockholders' agreement

60. 316 A.3d 826 (Del. Ch. 2024).
61. W. Palm Beach Firefighters' Pension Fund v. Moelis & Co., 311 A.3d 809 (Del. Ch. 2024).
62. Del. Code Ann. tit. 8, § 141(a) (2024).
63. *Wagner*, 316 A.3d at 838.
64. *Id.* at 843, 883.
65. *Id.* at 839.
66. *Id.*
67. *Id.*

with BRP (the "Stockholders Agreement"), which required the Holders' consent before BRP could take significant corporate actions to ensure that Holdings maintained control over BRP post-IPO.[68]

Specifically, the Stockholders Agreement provided that BRP or the LLC could not take specified actions "without first receiving the approval of the Holders holding a majority of the shares of Class B Common Stock held by the Holders [(the "Holder Majority")]."[69] Specifically, without the consent of the Holder Majority, neither BRP nor the LLC could (i) hire, fire or otherwise replace, or make certain decisions with respect to the compensation and benefits of certain key executive officers (the "Officer Pre-Approval Requirement");[70] (ii) amend BRP's certificate of incorporation (the "Charter Pre-Approval Requirement");[71] or (iii) acquire or dispose of 5 percent or more of BRP's total assets (the "Transaction Pre-Approval Requirement" and, collectively, with the Officer Pre-Approval Requirement and the Charter Pre-Approval Requirement, the "Pre-Approval Requirements").[72] Certain Holders and Mr. Baldwin entered into a separate agreement whereby such Holders agreed to vote as Mr. Baldwin directed.[73] Mr. Baldwin "therefore control[led] the exercise of the Pre-Approval Requirements [under the Stockholders Agreement]."[74]

After plaintiff brought the present action challenging the Pre-Approval Requirements, BRP and Holdings entered into the Consent Agreement.[75] Pursuant to the Consent Agreement, Holdings granted its and the other Holders' irrevocable consent to matters requiring the Holders' approval under the Stockholder Agreement if a committee of the independent members of BRP's board unanimously determined in good faith that such matter was in the best interests of BRP and its stockholders.

In this decision, the court ruled on the parties' cross-motions for summary judgment on the pleadings.[76] The court granted plaintiff's motion in part, finding that the Officer Pre-Approval Requirement and the Charter Amendment Pre-Approval Requirement were facially invalid under sections 142 and 242, respectively, of the DGCL, and noted that, without the Consent Agreement, each Pre-Approval Requirement would have been facially invalid under section 141(a) of the DGCL.[77]

Analysis

First, the court rejected BRP's equitable defenses of laches, waiver, acquiescence, and estoppel.[78] The court rejected a related argument that the Pre-Approval

68. *Id.* at 839–40.
69. *Id.*
70. *Id.* at 842.
71. *Id.*
72. *Id.* at 842–43.
73. *Id.* at 841.
74. *Id.*
75. *Id.* at 843.
76. *Id.*
77. *Id.* at 883.
78. *Id.* at 845, 849–50.

Requirements were voidable in equity, as opposed to void under *Grimes v. Donald* (*Grimes I*).[79] In so finding, the court reiterated Delaware's position that violations of the DGCL are void, rather than voidable, acts, and equity cannot render void acts valid.[80] Second, the court denied BRP's claim that the Consent Agreement rendered plaintiff's claims moot.[81] Specifically, BRP argued that Lowry waived his right to invoke any of the Pre-Approval Requirements if the independent committee unanimously determined in good faith that an action was in the best interests of BRP and its stockholders.[82] According to the court, the Consent Agreement modified rather than eliminated the Holders' ability to invoke the Pre-Approval Requirements.[83]

Third, the court evaluated plaintiff's facial challenges to the Pre-Approval Requirements using the standard the court developed in *Moelis*.[84] *Moelis* requires a court to assess whether a contractual restriction on the authority of a board of directors violates section 141(a) of the DGCL by, first, asking whether "the challenged provision appears in a governance arrangement addressing internal affairs issues."[85] If so, a court then asks whether the provisions "have the 'effect of removing from directors in a very substantial way their duty to use their own best judgment on management matters' or 'tend[] to limit in a substantial way the freedom of directors' decisions on matters of management policy.'"[86]

On the first *Moelis* inquiry, the court described the Stockholders Agreement as a "paradigmatic governance agreement."[87] In *Moelis*, the court discerned seven considerations that guided the court's analysis in finding that a stockholders' agreement constituted part of a corporation's governance arrangement.[88] Although the *Wagner* court concluded that the *Moelis* stockholders' agreement "closely resemble[d]" the Stockholders Agreement, the court still applied each of the seven *Moelis* considerations to the Stockholders Agreement in support of its conclusion.[89] Specifically, the court observed that (i) the Pre-Approval Requirements were in a stockholders' agreement authorized by section 218 of the DGCL; (ii) BRP and its pre-IPO owners, including some holding intra-corporate roles, were parties to the Stockholders Agreement; (iii) Mr. Baldwin's approval was required before BRP could exercise its authority over certain significant internal corporate matters; (iv) the Pre-Approval Requirements were akin to class

79. *Id.* at 845–47 (rejecting BRP's interpretation of *Grimes v. Donald* (*Grimes I*), C.A. No. 13358, 1995 WL 54441 (Del. Ch. Jan. 11, 1995), *aff'd*, 673 A.2d 1207 (Del. 1996) (en banc)).

80. *Id.* at 845, 849–50.

81. *Id.* at 850–51.

82. *Id.* at 875–78.

83. *Id.*

84. *Id.* at 851–52.

85. *Id.* at 851 (quoting W. Palm Firefighters' Pension Fund v. Moelis & Co., 311 A.3d 809, 828 (Del. Ch. 2024)).

86. *Id.* at 851–52 (alteration in original) (relying on *Moelis*, 311 A.3d at 860 and quoting Abercrombie v. Davies, 123 A.3d 893, 899 (Del. Ch. 1956), *rev'd on other grounds*, 130 A.3d 338 (Del. 1957)).

87. *Id.* at 854.

88. *See id.* at 852–55 (describing and applying *Moelis*, 311 A.3d at 858–60).

89. *Id.*

voting rights that would be granted in a charter or to a class or series of preferred stock; (v) the Stockholders Agreement centered around control rights rather than evidencing a commercial exchange; (vi) BRP was unable to terminate the Stockholders Agreement so long as the Holders owned a minimum percentage of BRP's equity; and (vii) the Pre-Approval Requirements were control rights likely to be enforced through injunctive relief.[90]

The court also found that each of the Pre-Approval Requirements, on an individual basis, failed the second *Moelis* inquiry and, because they were not contained in the certificate of incorporation, were facially invalid under section 141(a) of the DGCL.[91] With respect to the Officer Pre-Approval Requirement, the court emphasized that one of the most important decisions a board can make is to hire, monitor, and fire the CEO, and described any significant decision regarding senior officers as a "core management matter."[92] The court rejected BRP's argument that this restriction on the board's authority was merely a consent right—Mr. Baldwin's "expansive power to pre-review" the board's decisions with respect to hiring and firing BRP's key officers "g[ave] him the power to decide."[93] As to the Charter Pre-Approval Requirement, the court viewed the DGCL as establishing the board as "the gatekeeper for charter amendments," and the Board's "authority over that topic [as] a matter of management policy."[94] The Charter Pre-Approval Requirement swapped the board for Mr. Baldwin as a gatekeeper over charter amendments, preventing the board from acting to amend the certificate of incorporation without Mr. Baldwin's consent.[95] Finally, the court viewed the Transaction Pre-Approval Requirement as permitting Mr. Baldwin to decide "whether BRP w[ould] engage in a broad range of material transactions, neutering the traditional prerogative of the Board to make those decisions."[96]

The court rejected BRP's arguments that the Stockholders Agreement did not impose a real restriction on the board's ability to exercise its decision-making authority.[97] The court found that BRP would not have any "meaningful way to defeat the exercise of the Pre-Approval Requirements [under the Stockholders Agreement], including the Officer Pre-Approval Requirement."[98] In support of this conclusion, the court considered factors bearing on the strong likelihood that the Holders would be able to enforce the terms of the Stockholders Agreement, specifically noting the possibility of injunctive relief, the availability of other remedies to the Holders in the event of an efficient breach of the Stockholders Agreement and the effect of a severability clause in supporting the Stockholders Agreement's enforceability, and the low likelihood that the board would be able to successfully invoke its fiduciary duties, either generally

90. *Id.*
91. *Id.* at 855–57, 875–78.
92. *Id.* at 855.
93. *Id.* at 856–57.
94. *Id.* at 875.
95. *Id.* at 876.
96. *Id.* at 878.
97. *Id.* at 857, 873.
98. *Id.* at 873.

or at the time of contracting, the implied covenant of good faith, or the fiduciary duties (if any) of Mr. Baldwin as a means of escaping the Stockholders Agreement.[99] In the course of this discussion, the court noted that the Holders' blocking rights likely could be replicated through a "golden share of preferred stock" but cautioned that such rights, even if housed in a charter, could still be unenforceable, as charter provisions may not "override mandatory features of the DGCL."[100]

In addition to the section 141(a) violations, the court found that the Officer Pre-Approval Requirement violated sections 142(b) and 142(e) of the DGCL, which permit the charter or bylaws of a corporation to establish the manner in which officers will be selected and how vacancies will be filled.[101] The court noted that "neither the Charter nor the Bylaws authorize[d] the Officer Pre-Approval Requirement," and section 142 does not authorize a stockholders' agreement to include the sort of restrictions imposed by the Officer Pre-Approval Requirement.[102] Because the Charter Pre-Approval Requirement circumvented section 242's process for charter amendments, the court found the Charter Pre-Approval Requirement to be invalid under section 242 of the DGCL.[103]

Finally, the court found that the Consent Agreement enabled the independent committee "to override the Pre-Approval Requirements [under the Stockholders Agreement]" and "sufficiently free[d] the Board to make substantive decisions on matters otherwise governed by [such] Pre-Approval Requirements," which cured the section 141(a), but not the section 142 or 242, violations.[104] The Consent Agreement did not introduce other decisionmakers into the independent committee's process, and the independent committee members were empowered to determine the best interests of the stockholders through a subjective good faith lens, the court observed.[105] While the independent committee's acts were subject to unanimous quorum and voting standards, the court distinguished such procedural limitations from substantive limitations on a board's authority, noting that procedural limitations do not affect the section 141(a) analysis.[106]

Conclusion

On August 1, 2024, after the court decided *Wagner*, amendments to the DGCL took effect, which, among other things, responded to *Moelis*. The *Moelis*-related amendments (the "*Moelis* Amendments") apply retroactively and permit a stockholders' agreement to restrict a board's authority to the same extent as would be

99. *Id.* at 857–73.
100. *Id.* at 861, & n.135.
101. *Id.* at 873–74.
102. *Id.* at 874.
103. *Id.* at 877.
104. *Id.* at 880, 883.
105. *Id.* at 881.
106. *Id.* at 881–83 (relying on CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227 (Del. 2008) (en banc)).

permissible in a charter.[107] In a post-*Moelis* Amendment landscape, the court's distinction between a charter and stockholders' agreement for section 141(a) purposes is no longer applicable. Regardless, *Wagner* cautions that even if a restriction on a board's authority placed in a charter, or, post-*Moelis* Amendment, in a stockholders' agreement, passes muster under section 141(a), such restriction may still be invalid under other provisions of the DGCL. Practitioners should carefully review the drafting of stockholder control or blocking rights included in documents that could be construed as part of a corporation's governance arrangement not just for compliance with section 141(a) of the DGCL but also other DGCL provisions.

3. Hyde Park Ventures Fund, III, L.P. v. FairXchange (Chancery Court Finds Deal Price to Be the "Least Bad Method" of Determining the Appraisal Value of a Venture-Backed Company)

Summary

In *Hyde Park Ventures Fund III, L.P. v. FairXchange*,[108] a statutory appraisal proceeding, the Delaware Court of Chancery found that the "fair value" of the shares of preferred stock of a venture-backed company owned by petitioner at the effective time of a merger equaled the deal price even though neither party argued that the court should look to the deal price when determining the appraised value of the shares.[109] According to the court, the deal price was "the least bad method for determining fair value" of the shares.[110] This decision illustrates the difficulty in valuing the shares of an early-stage, venture-backed company.[111]

Background

Prior to its acquisition by Coinbase Global, Inc. in 2022, FairXchange, Inc. operated a commodity futures trading exchange.[112] In the fall of 2021, large cryptocurrency companies sought to acquire exchanges and valuations of securities exchanges, such as FairX, soared.[113] After one of FairX's peers was acquired for $550 million, FairX's CEO sought to sell FairX and solicited acquisition proposals without the input of FairX's board of directors or an investment banker.[114] According to the court, FairX's CEO was most interested in optimizing his personal payout and did little to engage bidders other than Coinbase.[115]

107. Del. Code Ann. tit. 8, § 122(18) (2024).
108. 2024 Del. Ch. LEXIS 270 (July 30, 2024).
109. *Id.* at *2.
110. *Id.* at *4.
111. *Id.* at *1.
112. *Id.* at *3.
113. *Id.*
114. *Id.*
115. *Id.*

On January 11, 2022, Coinbase agreed to acquire FairX for $330 million, or $10.42 per share.[116] The consideration took the form of $265 million in Coinbase stock and $65 million in cash. The transaction closed on February 1, 2022 (the "Merger").[117]

After the Merger closed, Hyde Park Venture Partners ("Hyde Park"), the owner of two venture capital funds that controlled approximately 15 percent of FairX's equity, made a demand for a statutory appraisal of its FairX stock under section 262 of the DGCL, Delaware's appraisal statute.[118] On April 18, 2022, Hyde Park filed an appraisal proceeding.[119] Although FairX was named as the respondent in the proceeding, the real parties in interest were FairX's selling stockholders, led by FairX's CEO (collectively, the "Selling Stockholders"),[120] because the Selling Stockholders agreed to indemnify Coinbase for any appraisal award that exceeded the Merger consideration. Accordingly, the Selling Stockholders took the lead in defending this appraisal action.[121]

The parties conducted discovery and litigated the case through trial.[122] The parties advanced vastly different valuations of FairX.[123] Hyde Park argued that FairX should be valued based on a discounted cash flow ("DCF") analysis, which yielded a fair value estimate of $573 million, or $19.76 per share.[124] In contrast, the Selling Stockholders did not offer a specific assessment of fair value other than that it was less than the merger consideration. Their position on valuation evolved over the course of the proceedings, and they relied on various market-based indications of value (other than the deal price), which the court found unreliable.[125] The court rejected the valuation methodologies advanced by all parties despite the parties' arguments that the court did not have the authority to choose a valuation methodology not advanced by the parties, and determined that the deal price was the most appropriate value.[126]

Analysis

The court began by noting that an appraisal proceeding under section 262 of the DGCL is a "limited legislative remedy" intended to provide dissenting stockholders with a judicial determination of the intrinsic worth (fair value) of their stockholdings.[127] To determine the fair value of a stockholder's proportionate interest in a corporation under section 262, the court must value the company as a going concern exclusive of any element of value arising from the accomplishment

116. *Id.*
117. *Id.*
118. *Id.* at *36.
119. *Id.*
120. *Id.* at *4.
121. *Id.*
122. *Id.*
123. *Id.*
124. *Id.* at *55.
125. *Id.* at *48–49.
126. *Id.* at *58–60.
127. *Id.* at *37.

or expectation of the merger.[128] When seeking to prove fair value, the parties to an appraisal proceeding may rely on "any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court," subject only to the statutory mandate to exclude value arising from the accomplishment of the merger, such as synergies.[129]

The court also addressed, as an initial matter, the Selling Stockholders' argument that the court did not have the authority to value FairX using a valuation methodology "neither party argued for" under the Delaware Supreme Court's decision in *Verition Partners Master Fund, Ltd. v. Aruba Networks, Inc.*[130] The Selling Stockholders reasoned that the valuation methodology adopted by the court must be subject "to the crucible of pretrial discovery, expert depositions, cross-expert rebuttal, expert testimony at trial, and cross examination at trial," which cannot occur if the court adopts its own methodology.[131] The court rejected the Selling Stockholders' arguments as contrary to section 262 of the DGCL and prior precedent.[132]

While the Selling Stockholders did not advance a specific assessment of value, they argued that fair value was less than the deal price and relied on market evidence of value.[133] To support their argument, the Selling Stockholders argued that FairX's three financing rounds, including an abandoned Series C round, were reliable indicators of value.[134] The court rejected a valuation based on the financing rounds because it believed that any price derived from the financing rounds relied too heavily on a trade-off between price and non-price terms, such that the purchase price did not necessarily reflect the value of the stock.[135] The Selling Stockholders also argued that Hyde Park's internal valuations of the book value of its stock in FairX, a valuation of FairX's stock for purposes of determining the amount of federal tax to be paid on equity grants to employees, the acquisition price paid for a different exchange, and the reactions of other stockholders to the deal price should all be taken into account when determining FairX's value.[136] The court found that these market-based indicators of value provided weak evidence of the fair value of FairX's stock.[137]

In contrast to the Selling Stockholders, Hyde Park offered a specific valuation based on a discounted cash flow (DCF) analysis model, which the court found to be an unreliable indicator of the going concern value of FairX.[138] The DCF model, which was based on management projections generated for FairX's abandoned Series C preferred stock financing round, yielded a fair value estimate of

128. *Id.* at *39.
129. *Id.* at *42.
130. 210 A.3d 128, 132–33 (Del. 2019) (per curiam).
131. *Hyde Park*, 2024 Del. LEXIS 270, at *41.
132. *Id.* at *45.
133. *Id.* at *48.
134. *Id.* at *48–51.
135. *Id.* at *51.
136. *Id.* at *53–54.
137. *Id.* at *54.
138. *Id.* at *56.

$573 million, or $19.76 per share.[139] With respect to the projections, the court noted that the "results for a new business are inherently speculative,"[140] "no one had ever tried to do what FairX hoped to accomplish for retail futures trading,"[141] and "FairX was a startup with no track record."[142]

Although both parties rejected the deal price as evidence of fair value for purposes of the appraisal proceeding, the court found it to be the most reliable indicator of fair value.[143] The court noted that although there had been defects in the sales process, the deal price represented what the market would pay for FairX.[144] Neither side presented persuasive evidence that the deal price reflected synergies or that there was a change in value between signing and closing that could have merited an adjustment to the court's finding that the deal price represented fair value.[145] Accordingly, the court ruled that Hyde Park was entitled to the deal price, plus pre- and post-judgment interest.[146]

Conclusion

This case illustrates the difficulty in valuing the stock of a venture-backed company. Although not addressed by the court, if the certificate of incorporation confers a specific value on the preferred stock solely in connection with a merger, the court is bound by the value set forth in the certificate of incorporation in a statutory appraisal proceeding.[147] Thus, investors in a venture-backed company have the opportunity to set the value of their preferred stock for purposes of an appraisal proceeding in the certificate of incorporation and avoid the result in this case.

4. *Firefighters' Pension System of Kansas City Trust v. Foundation Building Materials, Inc.* (Chancery Court Denies Motion to Dismiss Breach of Fiduciary Duty and Aiding and Abetting Claims Asserted Against Private Equity Fund, Its Board Designees, and Financial Advisor in Connection with the Sale of a Portfolio Company)

Summary

In *Firefighters' Pension System of Kansas City Trust v. Foundation Building Materials, Inc.*,[148] the Delaware Court of Chancery granted in part and denied in part six separate motion to dismiss claims arising from the sale of Foundation Building Materials, Inc. ("Building Materials"), a portfolio company of funds managed

139. *Id.*
140. *Id.*
141. *Id.*
142. *Id.* at *56.
143. *Id.*
144. *Id.* at *58–60.
145. *Id.* at *61–62.
146. *Id.* at *62.
147. *In re* Appraisal of Ford Holdings, 689 A.2d 973, 978 (Del. Ch. 1997).
148. C.A. No. 2022-0466-JTL, 2024 WL 2795026 (Del. Ch. May 31, 2024).

by private equity firm Lone Star, to an unaffiliated third party.[149] Specifically, the court found that the complaint stated claims for breach of fiduciary duty against Lone Star, Lone Star's board designees, and Building Materials' CEO based on allegations that these defendants sold the company to secure a cash payment under a tax receivable agreement for the benefit of Lone Star.[150]

The court also held that the complaint stated a claim for breach of fiduciary duty against members of a special committee of the disinterested members of Building Materials' board because the committee deferred to Lone Star instead of acting independently and failed to explore alternatives to maximize stockholder value.[151] In addition, the court denied motions to dismiss disclosure claims asserted against Lone Star's board designees for failure to adequately disclose the role the tax receivable agreement played in the sales process and financial advisor conflicts and compensation.[152] Finally, the court held that the complaint stated aiding and abetting claims against the company's and the special committee's financial advisors because, among other factors, the advisors' compensation was tied to the payment of fees to Lone Star under the tax receivable agreement.[153]

Background

In 2015, private equity firm Lone Star acquired Building Materials in a take-private transaction.[154] Eighteen months later, Lone Star took Building Materials public again through an IPO.[155] Post-IPO, Lone Star controlled 65 percent of Building Materials' outstanding voting stock and possessed the right to appoint a majority of the members of its board.[156]

In connection with the IPO, Lone Star and Building Materials entered into a tax receivable agreement ("TRA"), pursuant to which Building Materials would pay Lone Star 90 percent of the economic benefits of any tax assets generated while Building Materials was privately held.[157] Lone Star was estimated to receive between $190 million and $220 million over a fifteen-year period under the TRA.[158] Lone Star had the right to terminate the TRA upon a change of control of Building Materials, which, if exercised, would result in Lone Star receiving an early termination payment in an amount equal to the present value of the payments due to Lone Star over the full term of the TRA (the "Early Termination Payment").[159] Following the effectiveness of the Tax Cuts and Jobs Act of 2017, the amount of Lone Star's expected payments under the TRA dropped

149. *Id.* at *1–2, *5–6, *36.
150. *Id.* at *2, *40, *56–57, *76.
151. *Id.* at *3–4, *40, *75–76.
152. *Id.* at *3, *40, *84, *87.
153. *Id.* at *4, *40, *110, *114, *120.
154. *Id.* at *5–6.
155. *Id.* at *6.
156. *Id.*
157. *Id.*
158. *Id.* at *6, *9.
159. *Id.* at *6–7.

by $68 million.[160] According to plaintiff, Lone Star believed that terminating the TRA in connection with a sale of Building Materials would generate more value for Lone Star than receiving periodic payments under the TRA over time.[161]

In early 2018, the board began a sale process for Building Materials and engaged Royal Bank of Canada ("RBC"), a financial advisor with long-standing ties to Lone Star, to assist in the sale process.[162] Specifically, between January 2016 and June 2019, RBC received $72.7 million in fees from Lone Star and its affiliates as compensation for Lone Star engagements.[163] RBC's engagement letter for the sale of Building Materials called for a success fee calculated as a percentage of deal size, including the value of the Early Termination Payment.[164] Building Materials engaged with multiple potential bidders and started a due diligence process with private equity firm American Securities LLC ("American").[165]

In September 2018, the board formed a special committee to address the potential conflict of interest arising from the Early Termination Payment under the TRA.[166] At the time, the board had already received multiple expressions of interest from several bidders, none of which mentioned the Early Termination Payment.[167] The board granted the special committee broad authority over the sale process.[168] However, despite the creation of the special committee, Building Materials' CEO and chairman continued to negotiate directly with bidders, and the special committee met sparingly, failed to address the potential conflict of interest created by the TRA, and generally aligned its decision-making with Lone Star's interests.[169] Toward the end of the sale process, the special committee engaged Evercore Group, LLC as its financial advisor to conduct a market check and deliver a fairness opinion.[170]

American emerged as the highest bidder during the sale process.[171] While initial indications of interest from American did not mention the TRA or an Early Termination Payment, the board approved a sale of Building Materials to American and agreed to pay the Early Termination Payment under the TRA pursuant to a Tax Receivable Termination Agreement (the "Termination Agreement").[172] The special committee approved a version of the Termination Agreement that did not include a calculation of the Early Termination Payment.[173] Lone Star approved the acquisition by written consent.[174] After the transaction closed, Lone

160. *Id.* at *8–9.
161. *Id.* at *9.
162. *Id.* at *9, *11.
163. *Id.* at *11.
164. *Id.* at *12.
165. *Id.* at *10, *14.
166. *Id.* at *13.
167. *Id.* at *10, *12–13.
168. *Id.* at *14.
169. *See id.* at *16–35, *101–09.
170. *Id.* at *23, *25.
171. *Id.* at *31–32.
172. *Id.* at *12, *35.
173. *Id.* at *34–35.
174. *Id.* at *35.

Star received payment for tax benefits arising prior to the closing date plus the Early Termination Payment of $74.8 million associated with future tax benefits.[175] Building Materials mailed an information statement to stockholders on or about December 4, 2020, which served as a notice of appraisal rights.[176] On December 21, 2020, Building Materials issued a Form 8-K that substantially revised the information statement but did not send the revised information statement to stockholders or extend the date for filing demands for appraisal.[177]

The Firefighters' Pension System of the City of Kansas City, Missouri Trust, brought this suit alleging, among other things, (i) breach of fiduciary duty by Lone Star, Lone Star affiliated directors serving on Building Materials' board of directors, and the members of the special committee, (ii) the aiding and abetting of such breaches of fiduciary duty against American, RBC, and Evercore, and (iii) violation of section 262 of the DGCL

Analysis

A. Sale Process Claims

Plaintiff asserted that Lone Star, its six affiliated directors on Building Materials' board and Building Materials' CEO (together, the "Loan Star Defendants"), and the three members of the special committee breached their fiduciary duties by approving the sale of Building Materials and triggering the Early Termination Payment instead of continuing to operate Building Materials as an independent entity.[178] Plaintiff argued, and the court agreed, that entire fairness was the applicable standard of review, given that Lone Star was a controlling stockholder that received a non-ratable benefit from the acquisition, and a majority of the members of Building Materials' board were not disinterested and independent.[179]

Specifically, the court found that it was reasonably conceivable that the Lone Star Defendants acted in a self-interested manner by initiating a sale process and then approving a sale, resulting in the Early Termination Payment and payment for Lone Star's shares in Building Materials.[180] All stockholders receive consideration for their shares.[181] However, only Lone Star received the Early Termination Payment; therefore, Lone Star received a non-ratable benefit.[182] The court found that the complaint supported an inference that continuing to operate Building Materials, resulting in lower aggregate payments to Lone Star under the TRA, represented a value-maximizing alternative for minority stockholders.[183] The court also held that the board was not a disinterested, independent

175. *Id.* at *36.
176. *Id.*
177. *Id.*
178. *Id.* at *37–38.
179. *Id.* at *54–55.
180. *Id.* at *56.
181. *Id.* at *55.
182. *Id.*
183. *Id.* at *56.

body because a majority of the directors were Lone Star affiliates.[184] Finally, the court found that it was reasonably conceivable that the members of the special committee breached their fiduciary duties by consciously disregarding their duties and deferring to the Lone Star Defendants in approving the sale.[185]

B. Disclosure Claims

The court found that the complaint stated claims against all Lone Star affiliated directors on Building Materials' board for breach of the fiduciary duty of disclosure because the information statement sent to stockholders failed to sufficiently disclose (1) the TRA and its significance in the sale process, (2) that Building Materials' and the special committee's financial advisors' fees took into account Lone Star's receipt of the Early Termination Payment, and (3) the close ties between Lone Star and Building Materials' financial and legal advisors.[186] On the other hand, the court held that Lone Star, despite being a controlling stockholder, did not owe an independent duty of disclosure to the minority stockholders.[187]

C. Aiding and Abetting Claims

Plaintiff also brought aiding and abetting claims against RBC, Evercore, and American and its merger subsidiary.[188] With respect to RBC, the court denied RBC's motion to dismiss, finding that plaintiff sufficiently alleged that RBC knowingly participated in Lone Star's alleged breach of fiduciary duties given that RBC's success fee depended, in part, on the receipt of the Early Termination Payment.[189] The court also denied Evercore's motion to dismiss for the same reason.[190] The court granted American's motion to dismiss because it had negotiated the transaction at arm's length.[191]

Conclusion

Firefighters' Pension System serves as a cautionary tale for private equity firms and their advisors in connection with sales of portfolio companies, even where a special committee is created to mitigate conflicts. Deal lawyers should closely scrutinize the conflicts of interest, presented by the receipt of non-ratable benefits, in sale transactions involving controlling stockholders and ensure that any special committee appointed to mitigate the conflicts of interest act independently of the controlling stockholders. In addition, all material information concerning any financial advisors' relationships and fee structures must be disclosed in a notice of appraisal rights and stockholder solicitation materials.

184. *Id.* at *55.
185. *Id.* at *76, *109–10.
186. *Id.* at *3, *77, *84, *87–88.
187. *Id.* at *3, *90–91.
188. *Id.* at *38–39, *110.
189. *Id.* at *111–12, *114, *140.
190. *Id.* at *115, *120, *140.
191. *Id.* at *120–21, *140.

5. Luxor Capital Group, L.P. v. Altisource Asset Management Corp. (New York Court Declines to Order Partial Payment of Redemption Price Under Terms of Certificate of Designation)

In *Luxor Capital Group, L.P. v. Altisource Asset Management Corp.*,[192] the Supreme Court of New York, Appellate Division, held that Altisource Asset Management Corp. ("Altisource"), an asset management firm, was not required to effect a partial redemption of plaintiffs' shares of Altisource preferred stock to the extent of lawfully available funds where the certificate of designations governing plaintiffs' preferred stock required Altisource to redeem "all, but not less than all" of plaintiffs' preferred stock out of lawfully available funds.[193] This decision illustrates the need for parties to negotiate specific terms for the partial redemption of preferred stock where a corporation has some but not all of the funds lawfully available to effect the redemption.

Background

In January and February 2020, plaintiffs submitted redemption notices for all of their outstanding preferred shares in Altisource.[194] Upon receipt of the redemption notice, Altisource informed plaintiffs that it did not have lawfully available funds to pay the full redemption price of approximately $250 million and would not be effecting a partial redemption of plaintiffs' shares.[195] Plaintiffs then brought this action seeking a partial redemption of their preferred shares to the extent Altisource had lawfully available funds to effect the redemption.[196] Defendant Altisource argued that, based on a plain reading of the certificate of designation governing plaintiffs' preferred shares, it had no obligation to redeem plaintiffs' preferred shares unless it had lawfully available funds to effect a full redemption of plaintiffs' preferred stock.[197] Both parties moved for summary judgment, which the Supreme Court of New York denied.[198] On appeal, the Supreme Court of New York, Appellate Division, granted defendant Altisource's motion for summary judgement, finding that Altisource had no obligation to effect a partial redemption of plaintiffs' preferred stock.[199]

Analysis

The court approached the case based on a plain reading of the terms of the certificate of designation governing plaintiffs' preferred stock.[200] Specifically,

192. 217 A.D.3d 499 (N.Y. App. Div. 2023).
193. *Id.* at 499.
194. *Id.*
195. *Id.*
196. *Id.*
197. *Id.*
198. *Id.*
199. *Id.* at 501.
200. *Id.* at 500.

the court found that the plain reading of the certificate of designation did not support plaintiffs' argument that they were entitled to partial payment out of available surplus if, on any given redemption date, Altisource lacked lawfully available funds, and to full payment out of surplus as it becomes available.[201] Section 5(b) of the certificate of designation stated that upon receiving a timely redemption notice from the holders of shares of preferred stock, Altisource "shall redeem for cash on [a certain date within 45 business days of receipt], out of funds legally available therefor, all, but not less than all, of the outstanding . . ." preferred stock held by such holders.[202] According to the court, the "all or nothing" language did not support an argument that allowed for a partial redemption, to the extent funds were lawfully available, and it would not read terms into a contract that was negotiated by sophisticated business parties.[203] Plaintiffs also contended that the phrase "out of legally available funds" constituted a promise, rather than a condition, and that the remedy for breaching this promise was damages equal to the unpaid amount.[204] The court rejected this agreement in light of clear contractual language to the contrary and the fact that all parties to the transaction were sophisticated business entities.[205] The court noted that "where there is no redemption, because sufficient funds are not legally available, there is no duty to pay and consequently no default."[206] The court suggested however that had there been bad faith or fraudulent conduct, it might have reached a different conclusion.[207]

Conclusion

Luxor Capital Group serves as a reminder that sophisticated parties negotiating preferred stock terms should consider negotiating for specific terms in a preferred stock designation requiring a partial payment of the redemption price to the extent of lawfully available funds where the issuer lacks lawfully available funds to effect a redemption or declare a dividend (the payment of which also is dependent on there being lawfully available funds). A Delaware court has ordered a partial redemption to the extent of lawfully available funds where the preferred stock designation at issue required the issuer to effect a partial redemption of shares on any given redemption date.[208]

201. *Id.*
202. *Id.*
203. *Id.*
204. *Id.*
205. *Id.*
206. *Id.* at 501.
207. *Id.*
208. Cont'l Invs. Fund, L.L.C. v. TradingScreen, Inc., C.A. No. 10164-VCL, 2021 WL 3120860, at *2 (Del. Ch. July 23, 2021), *aff'd*, 275 A.3d 754 (Del. 2022).