



Moelis and the DGCL Amendments

Where do we go from here?

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Speakers

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Learning Objectives

A February 2024 decision of the Delaware Court of Chancery invalidated (facially) a number of provisions of a shareholder agreement between Ken Moelis and the company of the same name. In July 2024, Delaware revised the DGCL in light of this case.

- Analysis of *Moelis* and related cases, which caused uncertainty regarding enforceability of:
 - Protective provisions in shareholder agreements and activist settlement agreements
 - Pre-closing remedies in merger agreements
 - Any other agreement that implicates board's management of company under DGCL Section 141(a)
- Understand the July 2024 amendments to Section 122 of the DGCL
- Historical overview of shareholder agreements and practice trends – How did we get here?
- Practice points – What happens now that the dust has settled?
- How to advise investors, companies and boards

Moelis

“*Moelis I*”

West Palm Beach Firefighters’ Pension Fund v. Moelis & Co., No. 2023-0309-JTL (Del. Ch. Feb. 12, 2024)

“*Moelis II*”

West Palm Beach Firefighters’ Pension Fund v. Moelis & Co., No. 2023-0309-JTL (Del. Ch. Feb. 23, 2024)

Michele D. Johnson

Moelis – Background

- The plaintiff, a stockholder of Moelis & Co. (the “Company”), challenged the facial validity of provisions of the stockholders’ agreement between the Company and its founder, Ken Moelis.
 - The stockholders’ agreement was adopted in 2014, in connection with the Company’s initial public offering.
 - The stockholders’ agreement provided Ken Moelis “pre-approval” rights over multiple categories of acts and transactions and included provisions governing nominations to the board, committee composition and other internal matters.

Moelis – Key Provisions of the Stockholders' Agreement

Pre-Approval Requirements

- The stockholders' agreement required the Company to obtain Ken Moelis' written consent before taking or authorizing 18 categories of acts or transactions, including:
 - Stock issuances
 - CEO appointment / removal
 - Amendments to the charter and bylaws
 - Adoption of the annual budget
 - Name change

Moelis – Key Provisions of the Stockholders' Agreement (cont'd)

Board Composition Provisions

- *Number of Directors.* The stockholders' agreement required the total number of directors to be fixed at 11.
- *Designation Right.* The stockholders' agreement provided Ken Moelis with the right to designate a majority of the nominees for election to the board.
- *Nomination/Recommendation Requirement.* The stockholders' agreement required the Board to nominate and recommend Ken Moelis' nominees for election to the board.

Moelis – Key Provisions of the Stockholders' Agreement (cont'd)

Board Composition Provisions

- *Efforts Requirement.* The Company was required take all actions to cause Ken Moelis' nominees to be elected and remain in office.
- *Vacancy Requirement.* The board was required to fill any vacancy resulting from the resignation of one of Ken Moelis' designees with another designee of Ken Moelis.

Committee Composition Provision

- The stockholders' agreement required the board to ensure that each committee of the board included a number of Ken Moelis' designees proportionate to the number of Ken Moelis' designees on the board.

Moelis – Plaintiff’s Claims

- The plaintiff alleged that the provisions of the stockholders’ agreement violated Section 141(a) of the DGCL in that they impermissibly infringed upon the board’s statutory power to direct or oversee the direction of the business and affairs of the Company.
 - The plaintiff claimed that Section 141(a) of the DGCL, which provides that, except as otherwise provided in the DGCL or the certificate of incorporation, the business and affairs of the corporation shall be managed by or under the direction of the board of directors, does not allow for contractual limitations on a board’s fundamental power outside limitations validly included in the certificate of incorporation.
- The plaintiff also alleged that the provisions of the stockholders agreement dealing with the composition of board committees violated Section 141(c) of the DGCL, which provides that the board has the power to create and populate committees of the board.

Moelis – Defenses

- The defendant argued, among other things, that the plaintiff's claims were either barred by laches, given that the stockholders' agreement had been in place for nearly ten years, or were not ripe, given that there was no live dispute as to whether Ken Moelis had thwarted the board from taking an action it otherwise wished to take or that the board was not otherwise in alignment with the provisions of the stockholders' agreement.
- The defendant also argued that the nothing in the DGCL rendered the provisions invalid on their face, pointing to multiple examples where corporations had entered into contracts that limit the board's discretion.

Moelis – Holding

- The Court issued two separate opinions—one addressing defendant’s procedural defenses (*Moelis I*) and the other addressing the merits (*Moelis II*)—in which it ruled largely in favor of the plaintiff.
 - *Laches*. The Court held that, to the extent a plaintiff’s claim that an action or provision is void is correct, an equitable claim (e.g., laches) will not apply. The Court also held that invalid provisions create a “continuing harm.”
 - *Ripeness*. The Court held that a facial challenge to the legality of a provision presents a ripe question of law—the plaintiff should not have to wait until misconduct based on the provision occurs.

Moelis – Holding (cont'd)

- The stockholders' agreement was an internal governance arrangement subject to Section 141(a).
- The Pre-Approval Requirements collectively violated Section 141(a) because the requirements directly limited the board's ability to exercise key board level functions without Ken Moelis' prior consent.
- The Size Requirement, Recommendation Requirement, Vacancy Requirement and the Committee Composition Provision were invalid on their face for interfering with the directors' ability to use their own best judgment.
- The Designation Right, Nomination Right and Efforts Requirement were not facially invalid (but could be attacked on an as applied basis).

Moelis – Holding (cont'd)

Factors for whether an agreement is an “internal governance arrangement”

- Whether the agreement has a statutory grounding in a section of the DGCL. (As this applies to all agreements, it is not a distinguishing factor.)
- Whether the counterparties are corporate actors (e.g., stockholders) or third parties (e.g., outside lenders or commercial counterparties).
- Whether the agreement seeks to specify the terms on which intra-corporate actors can authorize the corporation’s exercise of its corporate power.
- Whether the agreement involves an underlying commercial exchange.
- The relationship between the contractual restrictions and a commercial purpose. Is the restriction intended to protect a third party’s economic bargain or control?
- The presumptive remedy for breach—damages vs. an injunction.
- The duration of the agreement and the corporation’s ability to terminate it.

Moelis – Holding (cont'd)

Violation of DGCL Section 141(a)

- A challenged provision that is part of an internal governance arrangement violates Section 141(a) when it:
 - “[H]as the effect of removing from the directors in a very substantial way their duty to use their own best judgment on management matters”; or
 - “[T]ends to limit in a substantial way the freedom of director decisions on matters of management policy.”
- If a challenged provision is not part of an internal governance arrangement, Section 141(a) is inapplicable.

Related Cases

- *Seavitt v. N-able, Inc.*
- L3Harris Technologies, Inc.
- Crown Castle Inc.

Michele D. Johnson & John Mark Zeberkiewicz

Related Case — *Seavitt v. N-able, Inc.*

Background

- The plaintiff, a stockholder of N-able, brought a *Moelis*-style complaint to invalidate a company stockholder agreement that provided affiliates of Silver Lake and Thoma Bravo (collectively, the “PE Funds”) with contractual power to control certain board decisions, including:
 - Veto power over hiring or terminating the CEO, approving change in control transactions, acquiring assets and incurring indebtedness, among others; and
 - Provisions requiring the board to recommend the PE Funds’ nominees to the board.

Related Case — *Seavitt v. N-able, Inc.*

Supplemental Briefing

- Vice Chancellor Laster requested supplemental briefing on the following issues:
 1. Whether Delaware law permits a certificate of incorporation (or bylaws) to incorporate the terms of a stockholders agreement by reference such that the agreement's provisions gain the same status as if set forth expressly in the charter (or bylaws).
 2. If so, whether N-able's charter and bylaws, in which various provisions were “subject to” the stockholders agreement, adequately incorporated the stockholders agreement by reference.

Related Activist Settlement Cases

– L3Harris Technologies, Inc. (“L3Harris”)

- The plaintiff, a stockholder of L3Harris, filed a complaint in the Court of Chancery challenging provisions of a cooperation agreement between defendants L3Harris and D.E. Shaw that required the L3Harris board to recommend to stockholders and use reasonable best efforts to support the election of certain directors in connection with the Company’s annual meeting (the “Recommendation Provisions”).
- The Court of Chancery granted the plaintiffs’ motion to expedite proceedings.
- L3Harris and D.E. Shaw subsequently executed a “Limited Mutual Waiver” pursuant to which, among other things, D.E. Shaw irrevocably waived any and all obligations of the company pursuant to the Recommendation Provisions.
- Shortly thereafter, Vice Chancellor Laster agreed to dismiss the lawsuit.

Related Activist Settlement Cases

– Crown Castle Inc. (“Crown Castle”)

- The plaintiff, a stockholder of Crown Castle, filed a similar challenge against Crown Castle in connection with a cooperation agreement with Elliott Investment Management LP (“Elliott”), which also included recommendation provisions.
- The Court of Chancery granted the plaintiff’s motion to expedite proceedings.
- After the Elliott defendants waived the recommendation provisions (thereby eliminating any *Moelis* concerns) and the Crown Castle defendants agreed to conduct a new process to evaluate director nominees, Vice Chancellor Laster issued an Order de-expediting proceedings.

2024 Amendments to DGCL Sec. 122

Legislative Response to *Moelis*

John Mark Zeberkiewicz

2024 “*Moelis*” Amendments to the DGCL

- Section 122 of the DGCL, which enumerates express powers that a corporation may exercise, was being amended in response to the Court of Chancery’s opinion in *Moelis*.
 - While *Moelis* was decided based upon Section 141(a), the amendments are to Section 122 because this section of the DGCL controls contracts between a corporation and current/prospective shareholders.
- New Section 122(18) provides that a corporation may enter into a governance agreement with existing and prospective stockholders and beneficial owners to provide that a corporation may:
 - Restrict itself from taking action under circumstances specified in the contract
 - Require contractually specified approvals before taking corporate action
 - Covenant that it or one or more persons or bodies (which persons or bodies may include the board or one or more current or future directors, stockholders or beneficial owners of stock) will take, or refrain from taking, contractually specified actions.

2024 “*Moelis*” Amendments to the DGCL (cont’d)

- The corporation may only enter into a contract pursuant to Section 122(18) in exchange for consideration from the counterparty.
 - The board has broad latitude in determining the minimum consideration
 - The consideration may include inducing the stockholder or beneficial owner to take or refrain from taking action
- No provision of a contract entered into under Section 122(18) will be enforceable against the corporation to the extent the provision is contrary to the certificate of incorporation or would be contrary to Delaware law (other than Section 115) if included in the certificate of incorporation.
 - The exclusion of Section 115, which prohibits non-Delaware exclusive forum provisions in certificates of incorporation, makes clear that governance agreements may select forums (including arbitral forums) outside of Delaware
 - A standard recitation of Section 141(a) in the charter will not result in governance agreements being contrary to the charter

2024 “*Moelis*” Amendments to the DGCL (cont’d)

- Section 122(18) provides that the corporation may be subject to the remedies available under applicable contract law, including in connection with any breach or attempted breach of the contract.
- The reference in the statute to the law “governing” the contract is intended to refer to Delaware law if and to the extent choice of law principles (e.g., the internal affairs doctrine) so require.

2024 “*Moelis*” Amendments to the DGCL (cont’d)

- Section 122(5), which deals with powers delegated to officers and agents, was revised to make clear that the delegation of authority to an officer or agent is still subject to Section 141(a) and the related common law addressing a board’s over-delegation of duties.
- Section 122(18) does not authorize a corporation to enter into contracts with stockholders or beneficial owners that impose remedies or other consequences against directors if they take, or fail to take, specified actions as required by the contract or that purport to bind the board of directors or individual directors as parties to the contract.
- Section 122(18) does not by its terms relieve directors, officers or stockholders of fiduciary duties they owe to the corporation or its stockholders.

Shareholder Agreements

Practice Points post-Amendments

Gerald Brant

Practice Points & Shareholder Agreements

- Shareholder Agreements, briefly
 - Past, Present, and Future – How did we get here?
- New Section 122(18) quells litigation in respect of historical stockholders' agreement.
 - Opportunity to claim overreach through 141 and fiduciary duties remains since *Moelis* is not summarily overturned.

Practice Points & Shareholder Agreements

(cont'd)

- Despite the adoption of new Section 122(18) and related amendments, it often may be advisable to include specified governance arrangements in the certificate of incorporation to ensure that they operate as intended.
 - Any provision that doesn't entirely match enumerated rights is still technically subject to Section 141(a) and by extension, director fiduciary duties.
 - Repeating provisions in the COI or COD eliminates these issues.
 - Shareholder rights outside of the COI or COD measured with an eye to consideration and enumerated provisions of 122(18).
 - Generally, a predictable result, but just enough latitude for the courts to punish “bad facts.”

Practice Points & Shareholder Agreements

(cont'd)

- Nothing in the amendments overturns the provisions of Section 141(a) providing that the charter may affirmatively delegate board-level powers to one or more identified parties such that the identified party may cause governance actions to occur without relying on contractual remedies.
- In addition, rights attributable to special classes or series of stock or other charter-based rights would help to allow for the operation of provisions dealing with the removal and replacement of directors.

Hypotheticals

Discussion

Panelists

Questions?

All online attendees can submit questions using the Q&A function on their screen

Panelists

For More Information

Materials will be available online through the ABA website.

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Summary

- Please see *Practice Points* slides.



Moelis and the DGCL Amendments

Thank You!