Insights: Alert

Changes to Stockholder Consent Rights after Moelis Decision

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After the a recent decision of the Delaware Court of Chancery, *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.*, venture capitalists and other stockholders of Delaware corporations may consider amending or moving some of their approval and consent rights from stockholder agreements or other governance agreements to the Company's charter to ensure their rights are enforceable. The National Venture Capital Association (the "NVCA") is expected to amend its recently updated model investment documents again in the near future to address the new legal situation.

The court found that several provisions of an agreement between Moelis & Company (the "Company") with its founder, CEO and then-controlling stockholder, Ken Moelis, were either facially invalid unless they can "operate legitimately". The provisions at issue required the prior approval of the stockholder Mr. Moelis before the Company could make key decisions, including stock issuances, incurrence of debt over a specified amount, removal or appointment of certain officers of the Company, approval of annual budgets, and entering into material contracts. Other provisions entitled Moelis to nominate candidates for the election of the Company's Board of Directors and required the Board to include a proportionate number of directors designated by Moelis on each Board committee. As a result, the Board could not create an independent committee without Moelis's consent.

Internal Governance Arrangements

As a first step, the Court determined that the challenged provisions in the stockholder agreement were part of an internal governance arrangement because they regulated the Company's internal affairs, and "look[ed] like the type of governance arrangements that would appear in a charter or a certificate of designations as rights appurtenant to preferred stock." W. Palm Beach Firefighters' Pension Fund v. Moelis & Co., No. 2023-0309-JTL, 2024 WL 747180, at *41 (Del. Ch. Feb. 23, 2024). The Court considered several factors, including: (1) statutory grounding in the Delaware General Corporation Law (the "DGCL"); (2) whether the counterparties were officers, directors, stockholders and their affiliates; and (3) whether the agreement revealed an underlying commercial exchange.

Limiting in a very substantial way the freedom of director decisions

As a second step, the Court applied the *Abercrombie* test to determine whether the provision in question imposes a restriction that violates Section 141(a) of the DGCL, which states that "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." Under *Abercrombie*, governance restrictions violate Section 141(a) of the DGCL if they "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 director decisions on matters of management policy ...." *Id.* at *44.

Using this framework, the Court concluded that most of the challenged provisions were facially invalid, because they

removed the directors' ability to exercise their judgment freely in the best interests of stockholders without stockholders' input. However, the Court determined that some of the provisions were not facially invalid if they can "operate legitimately," but offered little guidance as to when that would be the case. It also added that the provision requiring a proportionate number of directors designated by Moelis on each Board committee, was facially invalid because it also violated Section 141(c) of the DGCL.

Impact on NVCA Legal Documents

While it is unknown whether *Moelis* will be appealed, the decision should be a consideration for evaluating contracts that involve governance arrangements, such as board decision-making in corporations. Provisions and covenants in model legal documents by the NVCA may potentially be unenforceable. For example, an optional provision in the NVCA's model Investors' Rights Agreement requiring a company to establish and maintain certain board committees may be better addressed in amendments to the certificate of incorporation. The model legal opinions may also need to be modified.

To overcome potentially unenforceable provisions, companies should consider: (1) to include such provisions in the Charter, either by spelling them out of by referencing specific provisions from the NVCA documents; or (2) adding "fiduciary-out" language directly in the specific documents (e.g., Investors' Rights Agreement, Voting Agreement, Right of First Refusal and Co-Sale Agreement), allowing the board to not comply with a specific covenant if doing so would violate its fiduciary duties. In *Moelis*, the Court emphasized that a Company of course cannot include provisions in its Charter that are expressly prohibited by the DGCL. Non-standard stockholder consent or approval rights may have to be analyzed on a case-by-case basis with consideration of this decision. It should be noted, however, that the *Moelis*-decision has no direct impact on other non-corporate entities, such as limited liability companies (LLCs), and their governing documents.

Related People



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