RIGHTS AFFORDED VS. RIGHTS AVAILABLE – SHOULD DELAWARE CORPORATE LAW ALLOW DIRECTORS OF INSOLVENT CORPORATIONS TO ENTER INTO PRIVATE FORECLOSURE SALES WITHOUT MAJORITY SHAREHOLDER APPROVAL?

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Abstract

Under Section 271 of the Delaware General Corporation Law ("DGCL"), "[e]very corporation may . . . sell, lease or exchange all or substantially all of its property and assets . . . when and as authorized by a resolution adopted by the holders of a majority of the outstanding stock of the corporation." After the Delaware Supreme Court's ruling in Stream TV Networks, Inc. v. SeeCubic, Inc., Section 271 probably applies to privately structured foreclosure transactions. Consequently, controlling shareholders will be able to use their authority under Section 271 to stop private foreclosure transactions and force their corporation into bankruptcy. This Note argues the Delaware General Assembly should amend Section 271 to allow directors of insolvent corporations to sell all or substantially all of the corporation's assets without majority shareholder approval, because doing so will allow Delaware to more effectively carry out its goals.

[*]J.D., The University of Iowa College of Law, 2024; B.A., Miami University, 2021. Many thanks to my parents, siblings, and significant other, Devin, for their unfaltering love and support. This Note is dedicated to my dearest friend, Cole P. Kilty.

INTRODUCTION

The Delaware General Corporation Law ("DGCL") provides corporations with the freedom to contract and the flexibility to manage themselves in accordance with whatever rules and structures "they believe will best serve the needs of the particular enterprise."[1] In addition to promoting contractual freedom, the DGCL provides "default rules" that are designed to emphasize corporate efficiency and "minimize transaction costs."[2] In other words, the DGCL theoretically embodies the ideals of libertarian paternalism[3]—a philosophy that promotes framing choices in a way that influences or 'nudges' people to make one decision over another without hindering individual autonomy.[4] This Note asserts that Section 271 of the DGCL does not adequately embody the ideals of libertarian paternalism and considers the broader economic consequences of applying Section 271 to private foreclosure transactions. [5]

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[1] Edward P. Welch & Robert S. Saunders, *Freedom and Its Limits in the Delaware General Corporation Law*, 33 DEL. J. CORP. L. 845, 848 (2008).

[2] *Id.*

[3] Tom Ginsburg, Jonathan S. Masur & Richard H. McAdams, *Libertarian Paternalism, Path Dependence, and Temporary Law*, 81 U. CHI. L. REV. 291, 292 n.1 (2014) ("The term 'libertarian paternalism' comes from Cass R. Sunstein and Richard H. Thaler, *Libertarian Paternalism Is Not an Oxymoron,* 70 U Chi L Rev 1159, 1174-77 (2003)."). *See generally* RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS (2009) (providing a comprehensive understanding of the phrase "libertarian paternalism").

[4] Eldar Shafir, *Introduction*, *in* THE BEHAVIORAL FOUNDATIONS OF PUBLIC POLICY 9 (Eldar Shafir ed., 2013); *see also* Brett H. McDonnell, *Sticky Defaults and Altering Rules in Corporate Law*, 60 SMU L. REV. 383, 392 (2007) ("In a libertarian paternalist way, the corporate law tries to protect shareholders by making it somewhat hard to opt out of some default rules, but still gives corporations real choice by not making the altering rules impossibly sticky. However, in doing so, corporate law is dealing with shareholder collective action problems, not with the concerns of libertarian paternalism literature regarding individual deviations from economic rationality.").

[5] On August 1, 2023, the Delaware General Assembly's 2023 amendments to Section 272 of the DGCL went into effect. These amendments provided that, under certain circumstances, stockholder votes are not required to authorize a sale, lease, or exchange of collateral to secure a mortgage or pledge. Essentially, the 2023 amendments provide a vehicle for directors to manage insolvency and debt without majority shareholder approval. 8 DE Code § 272 (2023). Although the recent amendments to Section 272 are adjacent to the relief proposed in this Note, literary value remains in the rationalization and justification of such amendments. Moreover, this Note stands to justify further amendments

In June of "2022, the Delaware Supreme Court reversed a decision by the chancery court and found that a transfer by an insolvent corporation of substantially all of its assets to a newly created entity . . . controlled by its secured creditors, in full satisfaction of its debts, violated the corporation's charter."[6] Though the court held that insolvency does not obviate the need for majority shareholder approval before the sale of all or substantially all of the corporation's assets, it "declined to answer whether a private foreclosure transaction . . . falls within the plain language of Section 271"[7] of the DGCL.[8] A private foreclosure transaction constitutes a "strict foreclosure" under Section 9-620(a) of Article 9 of the Uniform Commercial Code ("UCC"), whereby secured parties can foreclose upon tangible and intangible[9] personal property in full or partial satisfaction of the obligation to be repaid.[10]

with larger breadth than the now effective amendments. Drafted in Fall 2022, this Note addresses contemporary Delaware law and continues to contribute to the legal academia of today.

[6] Larry G. Halperin, Joon P. Hong & Helena Honig, *Delaware Supreme Court Holds Transfer of Assets by Insolvent Company to Its Creditors Required Shareholder Vote; Leaves Open Question of Statutory Requirements*, CHAPMAN (July 11, 2022), https://www.chapman.com/publication-delaware-supreme-court-holds-transfer-of-assets-by-insolvent [https://perma.cc/M84K-CELZ]; Stream TV Networks, Inc. v. SeeCubic, Inc., 279 A.3d 323, 326 (Del. 2022).

[7] Halperin et al., *supra* note 6. Private foreclosure transactions can be pursued by secured creditors "pursuant to [the] strict foreclosure process provided by Section 9-620 of the Uniform Commercial Code." *Id.*; *see also* PETER E. FISCH & HARRIS B. FREIDUS, MEZZANINE LOAN FORECLOSURES (2023), Westlaw 8-385-3969 ("In a strict foreclosure, the secured party retains the debtor's collateral in full or partial satisfaction of the secured debt."); PRACTICAL LAW FINANCE, LENDER'S REMEDIES AND ENFORCEMENT ISSUES (2023), Westlaw 8-500-5970 ("The UCC sets out the notice requirements for the lender before it can dispose of the collateral . . . . For a commercial transaction, notice of disposition of the collateral which is sent after default, and ten days or more before the disposition, is reasonable notification."). In *Stream TV*, the Delaware Supreme Court phrases the term, "privately structured foreclosure transaction." 279 A.3d at 325.

[8] *Stream TV*, 279 A.3d at 337 ("[B]ecause we conclude that a vote is required because the Omnibus Agreement falls within the materially broader definition of Asset Transfer, we need not resolve whether such a vote is also required under the plain language of Section 271, *i.e.*, whether the Omnibus Agreement effects a 'sale, lease or exchange' within the meaning of Section 271.").

[9] Equity interests in a corporation are an example of intangible personal property.

[10] W. Bryan Rakes, *Foreclosure Remedies: Knowing Them Is the First Step*, VENABLE LLP (July 31, 2009), https://www.venable.com/insights/publications/2009/07/foreclosure-remedies-knowing-them-is-the-first-ste [https://perma.cc/CY2Y-CDAB].

Under Section 271(a), "[e]very corporation may . . . sell, lease or exchange all or substantially all of its property and assets, . . . *when and as authorized* by a resolution adopted by the holders of a majority of the outstanding stock of the corporation entitled to vote thereon."[11] While some scholarship has analyzed Section 271's impact on asset sales through wholly[12] and partially[13] owned subsidiaries, minimal research has been conducted on Section 271's applicability to privately structured foreclosure transactions.

Despite the Delaware Chancery Court holding otherwise,[14] it is probable that private foreclosure transactions fall within the plain language of Section 271(a).[15] Under this interpretation, majority shareholders are automatically granted the authority to stop the corporation's directors —no matter the context—from selling all or substantially all the corporation's assets. Facially, Section 271 seems to appropriately limit director authority and protect shareholders' beneficial ownership of potential business property. However, when considering the competing interests that form upon a corporation's insolvency, Section 271 primes controlling shareholders to limit corporate efficiency and shareholder wealth

[11] DEL. CODE ANN. tit. 8, § 271(a) (2023) (emphasis added).

[12] *See, e.g.*, Robert K. Clagg Jr., Comment, *An "Easily Side-Stepped" and "Largely Hortatory" Gesture?: Examining the 2005 Amendment to Section 271 of the DGCL*, 58 EMORY L.J. 1305, 1308–09 (2009) (explaining how Delaware corporations can use Section 271 of the DGCL to circumvent the shareholder vote requirement in "Cash-Out Merger" situations); Mark A. Morton & Michael K. Reilly, *Clarity or Confusion: The 2005 Amendment to Section 271 of the Delaware General Corporation Law*, POTTER ANDERSON CORROON LLP (Nov. 1 2005), https://www.potteranderson.com/newsroom-publications-149.html (addressing whether directors of a parent corporation should need majority shareholder approval before transferring all or substantially all of the parent corporation's assets to a wholly-owned subsidiary) [https://perma.cc/S92L-WEA9]; John J. Paschetto, *Statutory Clarification Regarding Sales of All or Substantially All Assets of a Delaware Corporation*, YOUNG CONWAY STARGATT & TAYLOR, LLP: DEL. TRANSACTIONAL & CORP. L. UPDATE, Spring 2006, at 3, https://www.youngconaway.com/content/uploads/2018/06/spring2006.pdf (addressing the pros and cons of requiring directors of a parent corporation to receive majority shareholder approval before transferring all or substantially all of the parent corporation's assets to a wholly owned subsidy) [https://perma.cc/EA3R-U2TA].

[13] *See* Alex Righi, Comment, *Shareholders on Shaky Ground: Section 271's Remaining Loophole*, 108 NW. U. L. REV. 1451, 1455 (2014) (addressing whether directors of a parent corporation need majority shareholder approval before transferring all or substantially all of the parent corporation's assets to a partially owned subsidiary).

[14] Stream TV Networks, Inc. v. SeeCubic, Inc., 250 A.3d 1016, 1041 (Del. Ch. 2020).

[15] *See infra* Section III.A.1.

maximization.[16] When accounting for the endowment effect—a behavioral phenomenon describing how people are more likely to retain a right vested to them than acquire that same right when it is not vested to them[17]—Section 271, by way of its majority shareholder approval "default setting," may incidentally increase the cost of borrowing and cause controlling shareholders to breach their fiduciary duties more often. This Note argues that, to prevent the adverse outcomes associated with inclusion of private foreclosure transactions under Section 271(a), the Delaware General Assembly should amend Section 271(a) to explicitly exclude private foreclosure transactions from requiring majority shareholder approval.

In Part I, this Note summarizes the facts of *Stream TV Networks, Inc. v. SeeCubic, Inc.*, a notable 2022 Delaware Supreme Court case that highlights how controlling shareholders can hinder private foreclosure transactions. In Part II, this Note provides an overview of directors' fiduciary duties when selling all or substantially all the corporation's assets under Delaware corporate law. In doing so, this Note outlines the history of shareholder ownership and power, the origin of the trust fund doctrine and the board-only insolvency exception, the Delaware Supreme Court's recent rejection of the board-only insolvency exception at Delaware common law, and the emergence of directors of Delaware corporations owing enhanced *Revlon* duties to shareholders when selling all or substantially all the corporation's assets. Additionally, Part II reviews the progression of the director-creditor relationship under Delaware law. In Part III, this Note explains why Section 271(a) of the DGCL likely applies to private foreclosure transactions and theorizes that such application will create economic inefficiencies and weaken minority shareholder interests. In Part IV, this Note argues that Section 271 should be amended to allow directors of insolvent corporations to enter private foreclosure sales without majority shareholder approval.

I. THE FACTS OF *STREAM TV NETWORKS, INC. V. SEECUBIC, INC.*

An explanation of the facts in *Stream TV Networks, Inc. v. SeeCubic, Inc.* helps glean issues stemming from Section 271(a).

A. Formation of Stream TV Networks, Inc.

In *Stream TV*, Mathu and Raja Rajan held a majority of the Class B common stock of Stream TV Networks, Inc. ("Stream"), "a Delaware corporation that was founded in 2009 to develop and commercialize technology that enables viewers to

[16] *See infra* Sections III.B.2–3.
[17] *See infra* note 209.

watch three-dimensional content without 3-D glasses."[18] As a result, the Rajan brothers held a majority of Stream's outstanding voting power and used such voting power to control Stream as the corporation's directors.[19] During the course of Stream's pre-revenue development stage, Stream entered into various secured agreements with SLS Holdings VI, LLC ("SLS"), whereby SLS loaned $6 million through a series of senior secured notes to Stream in exchange for Stream's pledge to authorize SLS to take control of its assets to satisfy its debts in the case of default.[20] Additionally, Stream entered into various secured agreements with Hawk Investment Holdings Limited ("Hawk"), whereby Hawk would loan approximately $60 million[21] through a series of junior secured notes to Stream in exchange for Stream's pledge to authorize SLS to take control of its assets to satisfy its debts in the case of default.[22]

B. Stream's Financial Distress

By the end of February 2020, Stream had defaulted on both the SLS and the Hawk notes and was insolvent.[23] Consequently, SLS, Hawk, and Alistair Crawford, a stockholder of Stream and the representative of fifty-two of Stream's stockholders (the "Equity Investors"), urged the Rajan brothers to appoint new directors.[24] When a corporation defaults on its secured notes, professional

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[18] Stream TV Networks, Inc. v. SeeCubic, Inc., 279 A.3d 323, 326 (Del. 2022).

[19] *Id.* at 326 n.4. In other words, the Rajan brothers were "controlling shareholders." Note, *Controller Confusion: Realigning Controlling Stockholders and Controlled Boards*, 133 HARV. L. REV. 1706, 1708 (2020) ("Under Delaware law, a controlling stockholder is a stockholder who . . . controls a majority of the company's voting power . . . .").

[20] *Stream TV*, 279 A.3d at 327.

[21] Stream TV Networks, Inc. v. SeeCubic, Inc., 250 A.3d 1016, 1023 (Del. Ch. 2020) ("Between 2010 and 2014, Hawk loaned more than £50 million to Stream, plus another $1.336 million . . . ."). Based on historical conversion data, the loans amount to approximately $60 million.

[22] *Id.*

[23] *Id.* at 1024. While the court does not outwardly admit Stream's insolvency, it is reasonable to assume the corporation's insolvency status. *See id.* ("In addition to the debts that Stream owed to its secured creditors, Stream carried more than $16 million in trade debt and had fallen months behind on payments to customers and suppliers. Stream even failed to make the payments necessary to maintain the patents on its technology, which are the key to Stream's potential success. In January 2020, Stream missed payroll at least once. In February, Stream managed to make payroll, but only due to an emergency infusion of capital from Hawk and a short-term loan from another investor.").

[24] *Stream TV*, 279 A.3d at 327.

turnaround management is often brought in to advance the interests of shareholders and other interested parties entitled to repayment.[25] While the Rajan brothers certainly could ignore the creditors' and other shareholders' pleas to appoint new directors and relinquish control, doing so would have likely resulted in SLS and Hawk employing their Article 9 powers to take possession of the collateral they were entitled to: Stream's assets.[26] While it is unknown why SLS and Hawk did not chose to immediately take possession of Stream's assets, it is reasonable to speculate that the secured creditors believed some form of reorganization of Stream would afford them the maximum likelihood of recouping their investment and profiting.[27]

As internal and external pressures mounted, the Rajan brothers appointed four independent outside directors (collectively, the "Outside Directors") to manage the corporation's affairs.[28] After participating in various board meetings, the Outside Directors concluded that the best path forward for the corporation would be "to negotiate a resolution with the Company's secured creditors and the Equity Investors."[29] To accomplish such resolution, the Outside Directors voted to create a Resolution Committee that would be made up of two of the four Outside Directors who "would have 'the full power and authority . . . to resolve any existing or future debt defaults or claims, and any existing or future litigation, or threats thereof, on behalf of [Stream], without further action being required from the

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[25] DANIEL J. BUSSEL, DAVID A. SKEEL, JR. & MICHELLE M. HARNER, BANKRUPTCY 610 (11th ed. 2020).

[26] U.C.C. §§ 9-609–610 (AM. L. INST. & UNIF. L. COMM'N 2010).

[27] Such speculation is supported by the business rationale of carrying out a Chapter Eleven bankruptcy.

> Reorganized debtors use their future earning to repay . . . creditors. Liquidated debtors' assets are sold to repay those claims. If the present value of a given firm's future earning power (the "going concern" value) is great than the liquidation value of its assets, . . . reorganization is an attractive alternative to . . . liquidation.

See BUSSEL ET AL., *supra* note 25, at 599.

[28] *Stream TV*, 279 A.3d at 327.

[29] *Id.* at 328.

Board of Directors or any executive of the [C]ompany.'"[30] As a result, the Rajan brothers *facially* lost control of Stream.[31]

C. The Omnibus Agreement

After establishing its control over Stream's restructuring, the Resolution Committee entered into an omnibus contract ("Omnibus Agreement") with SLS, Hawk, and certain Equity Investors.[32] According to the Delaware Supreme Court, the Omnibus Agreement indicated that the secured creditors "agreed to stay the [f]oreclosure and . . . extinguish each of the SLS Notes and the Hawk Notes in their entirety subject to [Stream] assigning all right, title and interest in and to all assets of [Stream] to a newly-formed holding company [SeeCubic] established by SLS and Hawk."[33] Furthermore, in exchange for selling all of Stream's property and assets to SeeCubic, the holders of Stream's Class A common stock— other than the Rajan brothers and their affiliates—would have "the right to exchange their shares of Stream's Class A common stock for an identical number of shares of SeeCubic's common stock at no cost."[34]

Having lost control of their business—and facing the prospect of losing an ownership stake in the revolutionary technology they worked to develop—the Rajan brothers moved to protect their interests.[35] More specifically, during post-default refinancing negotiations, the Rajan brothers threatened to challenge the legality of the Omnibus Agreement in exchange for various "personal benefits

[30] *Id.* (alterations in original) (quoting Stream TV Networks, Inc. v. SeeCubic, Inc., 250 A.3d 1016, 1025 (Del. Ch. 2020)).

[31] I specify that the Rajan Brothers *facially* lost control of Stream because they did not *actually* lose control of Stream. The Rajan Brothers were still majority shareholders of Stream. Therefore, the Rajan Brothers could use their ownership authority to remove the directors that issued a policy to exclude them from Stream's business decisions. See *supra* note 19 and accompanying text for a discussion of the directors control powers.

[32] *Stream TV*, 279 A.3d at 328.

[33] *Id*. (alterations in original) (quoting Omnibus Agreement WHEREAS clause (No. A136)); *Omnibus Contract Definition: Everything You Need to Know*, UPCOUNSEL, https://www.upcounsel.com/omnibus-contract-definition ("[An omnibus agreement] may stipulate all involved parties' responsibilities and outline the various aspects of the relationship between all the parties. These contracts are legally binding and may outline the penalties that will be enforced if any party violates the terms of the agreement.") [https://perma.cc/YD3Y-6RYD].

[34] *Stream TV*, 279 A.3d at 328.

[35] *Id.* at 329 (describing how the Rajan brothers challenged the authority of the Resolution Committee and the legality of the Omnibus Agreement).

includ[ing] employment, compensation, and indemnification for litigation expenses."[36] Eventually, negotiations between the Rajan brothers and the parties to the Omnibus Agreement broke down.[37] The Rajan brothers, as majority shareholders of Stream, "moved for a temporary restraining order ('TRO') to bar SeeCubic from seeking to enforce the Omnibus Agreement."[38] Consequently, "SeeCubic filed counterclaims and third-party claims."[39] Eventually, all standing claims were brought before the Delaware Supreme Court.[40]

D. The Omnibus Agreement Litigation

The crux of the Stream-SeeCubic dispute came down to whether the "privately structured foreclosure transaction" between the insolvent Stream and its secured creditors implicated a provision in Stream's certificate of incorporation requiring the approval of a majority of Stream's Class B shareholders (the "Class Vote Provision").[41] The chancery court held that "[t]he language of the Class Vote Provision tracks Section 271 of the DGCL," and thus, does not nullify the common law board-only insolvency exception.[42] However, such interpretation was short-lived.[43] Upon appeal, the Delaware Supreme Court rejected the contention that a

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[36] *Id.* at 329 n.15.

[37] *See id.* at 329.

[38] *Id.*

[39] *Id.*

[40] *Id.* at 335.

[41] *Id.* at 332–33. The Charter's Class Vote Provision provides:

> For so long as shares of Class B Voting Stock remain outstanding, in addition to any other vote or consent required herein or by law, the affirmative vote or written consent of the holders of a majority of the then-outstanding shares of Class B Voting Stock, voting as a separate class, shall be necessary for the Company to consummation [sic] an Acquisition or Asset Transfer.

Id. (quoting A124 (Charter § IV.D.2(d)))); Halperin et al., *supra* note 6.

[42] Stream TV Networks, Inc. v. SeeCubic, Inc., 250 A.3d 1016, 1043 (Del. Ch. 2020); *see also infra* Section III.A.1 (expanding on the holding of the case). For a description on why the chancery court held that the board-only insolvency exception existed at common law, see *Stream TV*, 250 A.3d at 1033–43.

[43] The Delaware Supreme Court reversed the chancery court's granting of SeeCubic's motion for a preliminary injunction less than two years after the chancery court's opinion. *See Stream TV*, 279 A.3d at 343–54.

board-only insolvency exception existed at common law, and held that even if such exception previously existed at common law, it did not survive the enactment of Section 64a of the DGCL (which later became Delaware's existing statute, Section 271).[44] Consequently, absent the Rajan brothers' approval, the Resolution Committee could not move forward with the Omnibus Agreement without violating Stream's Charter.[45] Whether directors satisfy their fiduciary duties when they make strategy plays similar to those made by the Rajan brothers is partly the subject of Part II of this Note.

II. DIRECTORS FIDUCIARY DUTIES UNDER DELAWARE CORPORATE LAW

Under Delaware law, directors owe duties of care and loyalty to the shareholders of the corporation they are elected to oversee and manage.[46] Absent a breach of either of these duties, directors' business decisions are immune from judicial review by way of the business judgment rule.[47] As a result, the separation of ownership and control persists with the hope that such bifurcation will spur both

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[44] *See infra* Section II.A.1.

[45] *Stream TV*, 279 A.3d at 336.

[46] *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (2023) (allowing Delaware corporations to eliminate or limit the personal liability of directors who breach their duty of care but restricting Delaware corporations from eliminating or limiting the personal liability of directors who breach their duty of loyalty); Addison D. Braendel, *Winding Up a Delaware Corporation: Directors' Fiduciary Duties and Statutory Procedures*, 26 SEC. REGUL. L.J. 344, 345–46 (1999) ("The duty of loyalty generally requires that directors' actions be motivated only by the best interests of the corporation and its stockholders. The duty of care . . . requires a director to be attentive and inform himself or herself of all material facts regarding a transaction before voting on it."). *See generally* Guth v. Loft, Inc., 5 A.2d 503 (Del. 1939) (expounding upon directors' duty of loyalty); Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985), *overruled by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009) (expounding upon directors' duty of care).

[47] *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (2020) ("The business and affairs of every corporation . . . 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."); William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 26 DEL. J. CORP. L. 859, 870 (2001) ("[A] standard formulation of the business judgment rule in Delaware is that it creates a presumption that (i) a decision was made by directors who (ii) were disinterested and independent, (iii) acted in subjective good faith, and (iv) employed a reasonable decision making process.").

productivity and innovation.[48] The only limitations to the director-control framework are the right of majority shareholders to elect directors,[49] vote on mergers,[50] and—most relevant to this Note—vote on the sale of all or substantially all of the assets of the corporation.[51]

A. Board of Director's Fiduciary Duties When Selling All or Substantially All of the Corporation's Assets Under Delaware Corporate Law

i. History of Shareholder Ownership and Power

Historically, sales of all or substantially all a corporation's assets were viewed with a high degree of skepticism because of their conclusory nature; in effect, such asset transactions wash away shareholders' beneficial ownership of potential business property.[52]

In the early nineteenth century, the Supreme Court strengthened judicial interpretations of the Contracts Clause and the protections it provides to investors in corporate entities.[53] Through this lens, courts viewed shareholders' interests as

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[48] Professor Stephen G. Marks has outlined the origin of the separation of ownership and control as an outgrowth of the intersection of three factors: (1) the efficiency of hierarchical decision making; (2) economies of scale in production and decision making causing the optimal corporate size to be large; and (3) optimal investment strategy requiring rapid diversification of assets. STEPHEN G. MARKS, *The Separation of Ownership and Control*, *in* 3 ENCYCLOPEDIA OF LAW AND ECONOMICS: THE REGULATION OF CONTRACTS 692, 694 (Boudewijn Bouckaert & Gerrit de Geest eds., 2000). *See generally* ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 69–118 (1932) (describing the functions and rationales behind the separation of ownership and control).

[49] DEL. CODE ANN. tit. 8, § 211 (2023).

[50] *Id.* § 251.

[51] *Id.* § 271.

[52] *See* Clagg, *supra* note 12, at 1306 ("[I]n the nineteenth century, . . . legal thinkers viewed the merging of two independent corporations with deep suspicion.").

[53] *See* Trs. of Dartmouth Coll. v. Woodward, 17 U.S. (4 Wheat.) 518, 593, 675 (1819) (invalidating an act by the New Hampshire Legislature that would have amended Dartmouth College's charter and effectively turned the university into a public institution on the grounds that "[t]he crown *cannot oblige* a man to be a corporator without his consent" (quoting R v. Dr. Askew (1768) 98 Eng. Rep. 139 (KB) 147)); *Dartmouth College Case Decided by the U.S. Supreme Court*, DARTMOUTH, https://home.dartmouth.edu/about/dartmouth-college-case-decided-us-supreme-court ("[Trustees of Dartmouth College v. Woodward] is still referenced today as the basis for

inalienable property rights that could not be impaired by legislation.[54] Because "the charter of a corporation . . . was [in part] a contract among all of the shareholders that could not be altered except by consent of all the parties to the contract or in the manner provided by the contract itself," directors of a corporation could not sell, lease, or exchange all the corporation's assets without unanimous shareholder approval.[55] Rather, directors were vested with only managerial powers over ordinary business affairs.[56]

Over time, this approach generated economic and practical inefficiencies, as individual shareholders could use their approval rights to slow and even stop important business restructuring decisions.[57] Consequently, courts began to accept the tradeoff of less individual shareholder protection for increased corporate risk taking.[58] More specifically, courts began to permit majority shareholders to authorize the sale of the corporation's assets if the corporation was hopelessly insolvent with no prospects of generating a profit.[59] By 1921, the Supreme Court clarified the majority shareholder exception rule in *Geddes v. Anaconda Copper Mining Co.*:

> [W]hen . . . a corporation . . . has proved so unprofitable that there is no reasonable prospect of conducting the business in the future without loss, or when the corporation has not, and cannot obtain, the money necessary to pay its debts and to continue the

the protection of corporate persons under the Constitution . . . .") [https://perma.cc/LD8C-AHKQ].

[54] William J. Carney, *Fundamental Corporate Changes, Minority Shareholders, and Business Purposes*, 5 AM. BAR FOUND. RSCH. J. 69, 77–78 (1980).

[55] *Id.* at 78; Voeller v. Neilston Warehouse Co., 311 U.S. 531, 535 n.6 (1941) ("At common law, unanimous shareholder consent was a prerequisite to fundamental changes in the corporation. This made it possible for an arbitrary minority to establish a nuisance value for its shares by refusal to cooperate."); HENRY WINTHROP BALLANTINE, BALLANTINE ON CORPORATIONS § 281, at 666 (rev. ed., 1946); *see* Lynne L. Dallas, *The Control and Conflict of Interest Voting Systems*, 71 N.C. L. REV. 1, 6–8 (1992) (describing the contractual theory of shareholder consent).

[56] BALLANTINE, *supra* note 55, at 666.

[57] *See* Dallas, *supra* note 55, at 10 (noting that unanimous shareholder consent hindered corporate expansion).

[58] *See* Carney, *supra* note 54, at 79–82 (describing the liberalization of shareholder rights overtime). *See generally* JAMES WILLARD HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780–1970 (1970) (describing the liberalization of shareholder rights overtime).

[59] Carney, *supra* note 54, at 86–87; Dallas, *supra* note 55, at 10.

> business for which it was organized, . . . the owners of a majority of the capital stock, . . . may authorize the sale of all the property of the company for an adequate consideration, and distribute among the stockholders what remains of the proceeds after the payment of its debts . . . over the objection of the owners of the minority of such stock.[60]

The *Geddes* Court defended the majority shareholder exception rule on the grounds that it preserved "the implied contract among the stockholders to pursue the purpose for which [the corporation] was chartered."[61] Delaware statutory law does not clearly specify the purposes for which corporations are chartered.[62] Nevertheless, Delaware case law and extra-judicial statements made by Delaware jurists indicate that the corporation's purpose is to advance shareholder interests by maximizing shareholder wealth.[63] Thus, when applying *Geddes* in the context of Delaware law, directors of an insolvent corporation maximally advance shareholder interests when they sell all or substantially all the corporation's assets if authorized to do so by the corporation's majority shareholders. As the jurist Victor Morawetz stated in his 1886 treatise, "[t]o continue the business of the company under [insolvency] would involve both an unauthorized exercise of corporate franchises, and a breach of the contract between the shareholders."[64]

Approximately four years before *Geddes*,[65] the Delaware General Assembly enacted Section 64a of the DGCL, which permitted directors to "sell, lease or exchange all [of the corporation's] property and assets" no matter the financial standing of the corporation, if authorized to do so by the holders of a majority of

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[60] Geddes v. Anaconda Copper Mining Co., 254 U.S. 590, 596 (1921).

[61] *Id.*

[62] David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKELEY BUS. L.J. 181, 185 (2013).

[63] *See, e.g.*, *id.* at 185–98; Righi, *supra* note 13, at 1453 (explaining "Delaware's philosophy that the board of directors' primary goal should be to maximize shareholder wealth.").

[64] Carney, *supra* note 54, at 87 n.69 (quoting 1 VICTOR MORAWETZ, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS § 412, at 390 (2d ed. 1886)).

[65] *See* Stream TV Networks, Inc. v. SeeCubic, Inc., 250 A.3d 1016, 1037 n.11 (Del. Ch. 2020) ("Sources conflict on whether the statute was adopted in 1916 or 1917.").

all the outstanding stock.[66] Section 64a was amended in 1929[67] and 1967[68] to clarify and broaden the permitted forms of consideration under the majority shareholder exception rule. After the General Assembly comprehensively revised and restructured the DGCL in 1967, Section 64a became what is known today as Section 271.[69]

[66] Stream TV Networks, Inc. v. SeeCubic, Inc., 279 A.3d 323, 350–51 (Del. 2022) (quoting Del. Corp. Laws 29, § 64(a) (1923)) ("Every corporation organized under the provisions of this chapter, may at any meeting of its board of directors, sell, lease or exchange all of its property and assets, including its good will and its corporate franchises, upon such terms and conditions as its board of directors deem expedient and for the best interests of the corporation, when and as authorized by the affirmative vote of the holders of a majority of the stock issued and outstanding having voting power given at a stockholders' meeting duly called for that purpose, or when authorized by the written consent of a majority of the holders of the voting stock issued and outstanding, provided, however, that the certificate of incorporation may require the vote or written consent of a larger proportion of the stockholders.").

[67] *Id.* at 331 (explaining that section 64a was amended to clarify that assets sold "could consist 'in whole or in part [of] shares of stock in, and/or other securities of, any other corporation or corporations'" (alteration in original) (quoting *Stream TV*, 250 A.3d at 1037)).

[68] *Id.* ("In 1967, the General Assembly revised the statute again by expanding the expressly permitted forms of consideration to include 'money or other property.' In addition, the court noted that the 1967 revision made two related changes to the DGCL: adding a new provision, Section 272, and eliminating a provision that did not require either board approval or a stockholder vote to accomplish a sale of assets to a secured creditor by decree because that provision was unnecessary given the rights generally available to secured creditors." (footnote omitted) (quoting *Stream TV*, 250 A.3d at 1038)).

[69] *Id.* at 351; DEL. CODE ANN. tit. 8, § 271(a) (2023) ("Every corporation may at any meeting of its board of directors or governing body sell, lease or exchange all or substantially all of its property and assets, including its goodwill and its corporate franchises, upon such terms and conditions and for such consideration, which may consist in whole or in part of money or other property, including shares of stock in, and/or other securities of, any other corporation or corporations, as its board of directors or governing body deems expedient and for the best interests of the corporation, when and as authorized by a resolution adopted by the holders of a majority of the outstanding stock of the corporation entitled to vote thereon or, if the corporation is a nonstock corporation, by a majority of the members having the right to vote for the election of the members of the governing body and any other members entitled to vote thereon under the certificate of incorporation or the bylaws of such corporation, at a meeting duly called upon at least 20 days' notice. The notice of the meeting shall state that such a resolution will be considered.").

According to various treatises, the General Assembly adopted Section 64a "to confer authority on corporations that did not exist at common law" and ensure that the common law unanimity requirement could be superseded.[70] The General Assembly's willingness to do away with the insolvency requirement likely stems from the view "that a majority should not be forced to wait until the business was in decline but should be able to sell out whenever it appeared in the best interests of the shareholders to do so."[71]

Various "[s]cholars have asserted . . . rationales for the continuing viability of requiring a shareholder vote to approve . . . sales of substantially all assets."[72] Some argue this requirement exists partly because shareholders and directors possess equal expertise in investment decisions, warranting both parties' input on such transactions.[73] In contrast, others have "argue[d] that [the majority shareholder requirement] reflects the importance of the decision involved."[74] In their view, shareholder interests outweigh the potential collective action issues arising from a shareholder vote because sales of all or substantially all of the corporation's assets can bring about large gains or losses that impact the corporation's trajectory.[75] Furthermore, Ronald Gilson and Bernard Black argue that the majority shareholder approval requirement exists "because directors will presumably lose their positions following a sale of substantially all assets," and thus, the directors may not have

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[70] *Stream TV*, 250 A.3d at 1037, 1037 n.12; R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS § 10.1 (4th ed. 2023) ("The statutory predecessor to Section 271 was first enacted in 1917 to supersede and mitigate the common law requirement of unanimous stockholder consent to the alienation of all or substantially all of the corporation's property. [5] The statutory change was intended to eliminate the veto power of minority stockholders and not to limit the powers of the directors to manage the business of the corporation."); ERNEST L. FOLK, III, THE DELAWARE GENERAL CORPORATION LAW: A COMMENTARY AND ANALYSIS 400 (1972) (explaining that the statute was intended to alter the common law rule "that neither the directors nor stockholders of a prosperous going concern could sell all or substantially all of the property of the corporation if a single stockholder objected").

[71] Carney, *supra* note 54, at 89; *Stream TV*, 250 A.3d at 1036–37 n.11 ("Apparently, the sale of assets statute was first enacted in 1916, probably as a legislative reaction to the restrictive dicta in *Butler* . . . ." (quoting FOLK, *supra* note 70, at 399 n.1)).

[72] Franklin A. Gevurtz, *Removing Revlon*, 70 WASH. & LEE L. REV. 1485, 1505 (2013).

[73] MELVIN ARON EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS 14–16 (1976).

[74] Gevurtz, *supra* note 72, at 1505; Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 416 (1983).

[75] Easterbrook & Fischel, *supra* note 74, at 416.

an incentive to remain impartial to shareholders when winding down the corporation.[76]

Ultimately, there is no consensus on the purpose that majority shareholder consent requirements such as Section 271 serve.[77] However, these provisions enhance corporate maneuverability at the expense of minority shareholder interests and the sanctity of the shareholders' contract.[78]

ii. Origin of the Trust Fund Doctrine and Board-Only Insolvency Exception

From the late 1800s to the early 1900s, at least 15 states further strengthened director control by allowing directors to sell all or substantially all the assets of the corporation without majority shareholder approval if the corporation was insolvent

[76] Gevurtz, *supra* note 72, at 1506; RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 720–21 (2d ed. 1995).

[77] Gevurtz, *supra* note 72, at 1506.

[78] *See* Carney, *supra* note 54, at 89 (describing how, without the insolvency requirement, the majority shareholder exception rule would put minority shareholders in a position where they would be "forced to take shares in a new enterprise, which they had not consented to join").

with no prospects of profit.[79] During this period, various treatises recognized this exception,[80] which is now known as the "board-only insolvency exception."[81]

The origin of the "board-only insolvency exception" can be traced to the "trust fund" doctrine—the idea that upon liquidation of corporate assets, or in some instances insolvency, creditors have a "constructive trust or equitable lien upon corporate assets to guarantee the absolute priority of payment to creditors before any distribution to stockholders."[82] The trust fund doctrine was first effectuated

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[79] Stream TV Networks, Inc. v. SeeCubic, Inc., 279 A.3d 323, 347–48 (Del. 2022) (noting that "Alabama, California, Connecticut, Illinois, Indiana, Iowa, Massachusetts, Michigan, Minnesota, Missouri, Montana, New York, Pennsylvania, Texas, and Wisconsin" had board-only exceptions "from the late 1800's to the early 1900's" (footnotes omitted)).

[80] *Id.* at 343–44; 1 CHARLES FISK BEACH, JR., COMPANY LAW: COMMENTARIES ON THE LAW OF PRIVATE CORPORATIONS § 357, at 582 (Chicago, T.H. Flood & Co. 1891) (For "a failing company the rule is different, and sale of the whole property may be made by the directors."). Beach's treatise was published before *Geddes* and cites to various cases to support the board-only exception. Buell v. Buckingham & Co., 16 Iowa 284, 296 (1864); *see* Town v. Bank of River Raisin, 2 Doug. 530, 533–35 (Mich. 1847) (banking corporation assigned all the corporate assets in trust to pay debts); Revere v. Bos. Copper Co., 32 Mass. (15 Pick.) 351, 356–57 (1834); Bos. Glass Manufactory v. Langdon, 41 Mass. (24 Pick.) 49, 49 (1834) (insolvent corporation assigned all its property to trustees for the payment of its debts, and the court makes no mention of shareholder approval); State v. President & Dirs. of the Bank of Md., 6 G. & J. 205, 206 (Md. 1834) (a failing bank's directors transferred all its property to trustees for the equal benefit of all its creditors); Union Bank of Tenn. v. Ellicott, 6 G. & J. 363, 363 (Md. 1834); Catlin v. Eagle Bank of New-Haven, 6 Conn. 233, 237 (1826); Sargent v. Webster, 54 Mass. (13 Met.) 497, 497 (1847); THOMAS CONYNGTON & R.J. BENNETT, CORPORATION PROCEDURE 232 (Hugh R. Conyngton rev. ed., Ronald Press Co. 1927) ("The directors may, however, without authorization of the stockholders, sell the corporate assets if necessary to pay the corporate debt, and they may, in the absence of statutory or other prohibitions, make an assignment for the benefit of creditors." (footnote omitted)); BALLANTINE, *supra* note 55, § 281, at 667 ("If a corporation is insolvent or in failing condition[,] the board of directors have authority to sell the entire assets in order to pay the debts and avoid the sacrifice of an execution sale[,] even without the vote or consent of the shareholders. They may also make an assignment for the benefit of creditors or file a voluntary petition in bankruptcy." (footnote omitted)).

[81] *See generally Stream TV*, 279 A.3d 323 (referring to the exception throughout the opinion as the "board-only insolvency exception" and "'board only' common law exception").

[82] JARED A. ELLIAS & ROBERT J. STARK, *Delaware Corporate Law and the "End of History" in Creditor Protection*, *in* FIDUCIARY OBLIGATIONS IN BUSINESS 207, 209

into law in Justice Story's 1824 opinion in *Wood. v. Dummer*.[83] The doctrine was intended to protect creditors from corporations seeking to avoid debt repayment.[84]

Under common law, corporations ceased to exist as legal entities after dissolving.[85] Consequently, if a corporation distributed its liquidated assets to shareholders and dissolved before settling its debts, it would be immune to creditor claims.[86] In *Wood*, the U.S. Circuit Court for the District of Maine ruled that during an asset liquidation, "stockholders have no right to any thing but the residuum of the capital stock, after payment of all the debts of the bank."[87] For the rest of the century and the first half of the 20th century, courts grappled with whether corporate formation, asset liquidation, or insolvency would trigger directors owing equitable duties to creditors.[88]

(Arthur B. Laby & Jacob Hale Russell eds., 2021); *see* Jonathan C. Lipson, *Directors' Duties to Creditors: Power Imbalance and the Financially Distressed Corporation*, 50 UCLA L. REV. 1189, 1203–05 (2003) (noting that in *Wood v. Dummer* and *Hollins v. Brierfield Coal & Iron Co.*, duties to creditors arose upon the occurrence of an event, while in *Curran v. Arkansas* and other cases, duties to creditors arose upon the development of a condition); Henry T.C. Hu & Jay Lawrence Westbrook, *Abolition of the Corporate Duty to Creditors*, 107 COLUM. L. REV. 1321, 1332–36 (2007) (providing a historic overview of the trust fund doctrine); Gregory V. Varallo & Jesse A. Finkelstein, *Fiduciary Obligations of Directors of the Financially Troubled Company*, 48 BUS. LAW. 239, 245–48 (1992) (providing analysis of various trust fund cases).

[83] Wood v. Dummer, 30 F. Cas. 435, 439–40 (C.C.D. Me. 1824) (No. 17,944).

[84] Lipson, *supra* note 82, at 1203–04; Ellias & Stark, *supra* note 82, at 208.

[85] Ellias & Stark, *supra* note 82, at 209.

[86] *See id.*

[87] *Wood*, 30 F. Cas. at 439.

[88] In 1853, the Supreme Court expanded the trust fund rule to where corporate formation would trigger equitable duties to creditors. Lipson, *supra* note 82, at 1204. However, forty years later, the Court re-constrained the scope of the "trust fund" doctrine by affirming the *Wood* holding. *Id.* at 1204–05. Thus, liquidation—not corporate formation—would result in corporate assets being placed "in a condition of trust, first for the creditors, and then for the stockholders." Hollins v. Brierfield Coal & Iron Co., 150 U.S. 371, 383 (1893). In the 1953 case, *New York Credit Men's Adjustment Bureau, Inc. v. Weiss*, the New York Court of Appeals "noted that '[i]f the corporation was *insolvent* at that time [of the alleged breach of duty,] it is clear that [the] defendants, as officers and directors thereof, were to be considered as though trustees of the [corporation's] property for the corporate creditor-beneficiaries.'" Lipson, *supra* note 82, at 1205–06 (alterations in original) (quoting N.Y. Credit Men's Adjustment Bureau, Inc. v. Weiss, 110 N.E.2d 397, 398 (N.Y. 1953)).

In 1923, the Delaware Supreme Court first examined the applicability of the trust fund doctrine in *Mackenzie Oil Co. v. Omar Oil & Gas Co.*[89] In *Mackenzie*, the Delaware Chancery Court held that, if not for Delaware's newly enacted receivership statute,[90] insolvency would not trigger equitable duties to creditors.[91] Put simply, *Mackenzie* established that creditors are only owed duties stemming from their contract with debtors unless a statute specifies otherwise.[92] Nevertheless, eight years later in *Asmussen v. Quaker City Corp.*, the chancery court reversed its stance and held that even in the absence of an authorizing statute, when receivership or bankruptcy proceedings begin, "the assets of an insolvent corporation [are to] be regarded . . . as 'a trust fund for the benefit of creditors'".[93]

During the 19th century, the trust fund doctrine was a generally accepted legal principle.[94] However, with the advent of the modern bankruptcy system and the widespread enactment of statutory remedies for creditors, such as claims of

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[89] Mackenzie Oil Co. v. Omar Oil & Gas Co., 120 A. 852, 857 (Del. Ch. 1923).

[90] DEL. REV. CODE § 3883 (1915) ("Whenever a corporation shall be insolvent, the Chancellor, on the application and for the benefit of any creditor or stockholder thereof, may, at any time, in his discretion, appoint one or more persons to be receivers of and for such corporation, to take charge of the estate, effects, business and affairs thereof, and to collect the outstanding debts, claims, and property due and belonging to the company, with power . . . . Provided, however, that the provisions of this section shall not apply to corporations for public improvement.").

[91] *Mackenzie Oil Co.*, 120 A. at 857 ("It is well settled that insolvency on the part of a corporation can have no effect as impressing upon corporate assets a trust which creditors may appeal to equity to take cognizance [sic] of and administer for their benefit. Accordingly, if the statute in question had never been enacted, the suggestion that insolvency converts corporate assets into a quasi-trust for the benefit of creditors would find no countenance.").

[92] *Id.*

[93] *See* Asmussen v. Quaker City Corp., 156 A. 180, 181 (Del. Ch. 1931); Alan W. Tompkins, Comment, *Directors' Duties to Corporate Creditors: Delaware and the Insolvency Exception*, 47 SMU L. REV. 165, 172–73 (1993) ("It is important to note that the language of *Asmussen* may have signalled [sic] a shift in the chancery court's thinking about the nature of the trust fund doctrine. In *Mackenzie Oil*, the court stated that the 'right to assert an interest now exists where it did not exist before.' Read in context, it seems apparent that the *Mackenzie Oil* court considered the newly created interest to be the right to petition the court for a receiver under the receivership statute. However, the language of *Asmussen* . . . implies that a court of equity will treat the assets of an insolvent corporation as a trust fund for the benefit of creditors *even without* the commencement of receivership proceedings.").

[94] Johnathan C. Lipson, *The Expressive Function of Directors' Duties to Creditors*, 12 STAN. J.L., BUS. & FIN. 224, 231 (2007).

fraudulent conveyance or unlawful dividend distribution, the trust fund doctrine became an unnecessary redundance and fell out of favor.[95] Notwithstanding, the doctrine directly contributed to the formation of the board-only insolvency exception,[96] which has retained relevance throughout the twentieth century.[97] Such link is evidenced by the Delaware Chancery Court's ruling in *Harff v. Kerkorian* and the Delaware Supreme Court's rulings in *Simons v. Cogan*.[98] In both cases, the courts addressed whether defendant corporations that issue convertible debentures owed fiduciary duties to the holders of the convertible debentures.[99] Accordingly, the courts articulated three conditions that trigger the trust fund doctrine—"fraud, *insolvency*, or a violation of a statute."[100] In other words, under the trust fund doctrine, a director of an insolvent corporation is a trustee to a propriety creditor or convertible debenture holder.[101] Because requiring a trustee to attain permission from a residual claimant to administer property to its beneficiary would negate the trust relationship, the board-only insolvency exception appears to be inherently intertwined with the early trust fund doctrine.

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[95] *See id.* (noting how the trust fund doctrine was useful before the modern bankruptcy system developed); Lipson, *supra* note 82, at 1206 (discussing how "the trust fund [doctrine] is usually redundant when combined with other existing creditors' remedies, such as claims of fraudulent conveyance or unlawful dividend distribution").

[96] *See* Sylvan H. Hirsch, *Tracing Trust Funds—Modern Doctrines*, 11 TEMP. L.Q. 11, 15–16 (1936) (purporting that courts, including Delaware courts, found there to be "no difference between a trust and a fiduciary relationship" (quoting *In re* Hallett's Estate, 13 Ch. D. 696 (1879)); *see also* Christopher L. Barnett, Comment, *Healthco and the "Insolvency Exception": An Unnecessary Expansion of the Doctrine?*, 16 BANKR. DEVS. J. 441, 446–47 (2000) (stating how the insolvency exception stemmed from "the Delaware Chancery Court in *Mackenzie Oil Co. v. Omar Oil & Gas Co.*").

[97] One of the main issues litigated in *Stream TV Networks, Inc. v. SeeCubic, Inc.*, the June 2022 case that is central to this Note, is whether the Delaware Chancery "[C]ourt erred by applying a common law insolvency exception to Section 271 [of the DCGL] in interpreting the" plaintiff-corporation's charter. Stream TV Networks, Inc. v. SeeCubic, Inc., 279 A.3d 323, 325–26 (Del. 2022).

[98] *See* Harff v. Kerkorian, 324 A.2d 215, 222 (Del. Ch. 1974), *overruled by* Harff v. Kerkorian, 347 A.2d 133 (Del. 1975); Simons v. Cogan, 549 A.2d 300, 303 (Del. 1988) (indicating the Chancellor's substantive analysis in *Harff* should be upheld).

[99] *Harff*, 324 A.2d at 217–18; *Simons*, 549 A.2d at 301.

[100] *Harff*, 324 A.2d at 222 (emphasis added); *Simons*, 549 A.2d at 303.

[101] *See* Varallo & Finkelstein, *supra* note 82, at 244 ("The so-called 'trust fund doctrine,' where strictly applied, holds that upon insolvency directors no longer owe a duty to stockholders who no longer have any viable economic interest in the entity. Instead, directors owe their duty to corporate creditors.").

iii. Delaware Not Recognizing the Board-Only Insolvency Exception

In Justice Valihura's June 2022 opinion in *Stream TV*, the Delaware Supreme Court reversed the chancery court's holding that the board of directors of an insolvent or failing firm could transfer its assets to creditors *ultra vires*.[102] To support its reversal, the court first held that a board-only exception never existed in Delaware common law.[103] In making this determination, the court analyzed the holding in *Butler v. New Keystone Copper Co.,* a 1915 case where the chancery court was confronted with litigation involving a sale of all the assets of a corporation.[104] When *Butler* was decided, Section 64a was not yet enacted to statutorily permit directors to sell all of the corporation's assets with majority shareholder approval.[105] As a result, the *Butler* court embraced the common law unanimity requirement "that 'neither the directors nor a majority of the shareholders of a corporation have power at common law to sell or otherwise transfer all its property . . . .'"[106] Notwithstanding, the court held that the majority shareholders of a corporation may, even against the dissent of the minority, "sell all, or substantially all, the property of the [corporation]."[107] Thus, the court in *Stream TV* held that the board-only insolvency exception did not exist at common law.[108] Ostensibly, the court disregarded the idea that *Harff* and *Simons* implicitly created a common law board-only exception, as neither case was mentioned in the opinion.[109]

Next, assuming *arguendo* that the board-only insolvency exception did exist at common law, the court held that the exception did not survive the enactment of Section 64a and its amended form, Section 271.[110] Consequently, the Delaware Supreme Court reversed the lower court's "conclu[sion] that Section 271 superseded only one aspect of the common law rule, namely, the unanimity requirement[,] but 'did not supersede the common law's recognition that directors could sell the assets of an insolvent or failing firm without stockholder

[102] *Stream TV*, 279 A.3d at 349–50, 355.

[103] *Id.* at 337.

[104] *Id.* at 344 (discussing Butler v. New Keystone Copper Co., 93 A. 380 (Del. Ch. 1915)).

[105] *Id.*

[106] *Butler*, 93 A. at 383–84 (quoting Traer v. Lucas Prospecting Co., 99 N.W. 290, 292 (Iowa 1904)).

[107] *Id.* at 383.

[108] *Stream TV*, 279 A.3d at 349–50.

[109] *See generally id.* (noting that *Harff* and *Simons* are not cited once).

[110] *Id.* at 350.

approval.'"[111] To support its ruling, the court inquired into whether Section 271's explicit language superseded or limited the board-only exception and whether Section 271's statutory scheme evidenced a legislative intent to override the board-only exception.[112] Because Section 271's majority shareholder approval requirement applies to "[e]very corporation,"[113] "contains no exceptions[,] and is not ambiguous," the court held that plain language of the statute implicitly nullified any insolvency exception.[114] Under common law, when a statute's language is clear and unambiguous, it "must be held to mean that which it plainly states, and no room is [left] for construction."[115]

Thus, as a matter of "maintain[ing] balance, efficiency, fairness, and predictability" within the DCGL, "unearthing a 'board only' insolvency exception" would misalign with Delaware corporate law's broader principle of maintaining textual statutory construction.[116] Additionally, the court argued that it would be illogical to view Section 271 as an expansion, rather than a restriction, on stockholder rights because Section 64a was adopted to supersede and mitigate the common law unanimity requirement.[117] Thus, Section 271's statutory scheme evidenced a legislative intent to override the board-only exception and affirm the majority shareholder exception rule.[118]

iv. Revlon Duties and Section 271 Asset Sales

In light of the business judgment rule,[119] it is logical to assume that a board of directors, when granted permission from majority shareholders, could sell all or

[111] *Id.* at 352 (quoting Stream TV Networks, Inc. v. SeeCubic, Inc., No. 2020-0766, 2021 WL 5816820, at *13 (Del. Ch. Dec. 8, 2021)).

[112] *Id.* at 352–53.

[113] DEL. CODE ANN. tit. 8, § 271(a) (2023).

[114] *Stream TV*, 279 A.3d at 353.

[115] *Id.* at 353 n.172 (alteration in original) (quoting Balma v. Tidewater Oil Co., 214 A.2d 560, 562 (Del. 1965).

[116] *Id.* at 353.

[117] *See id.* at 350–51, 352 n.170 ("The origins of § 271 did not rest primarily in a desire by the General Assembly to protect stockholders by affording them a vote on [the] transactions previously not requiring their assent. Rather, § 271's predecessors were enacted to address the common law rule that invalidated any attempt to sell all or substantially all of a corporation's assets without unanimous stockholder approval." (alteration in original) (quoting Hollinger Inc. v. Hollinger Int'l, Inc., 858 A.2d 342, 376 (Del. Ch. 2004))).

[118] *Id.* at 353.

[119] *See, e.g.*, DEL. CODE ANN. tit. 8, § 141 (a) (2020); Allen et al., *supra* note 47.

substantially all of a corporation's assets without breaching their fiduciary duties.[120] However, such transactions may be subject to enhanced *Revlon* scrutiny.[121] There are three scenarios where directors must satisfy *Revlon* duties:

> First, they apply 'when a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear breakup of the company.' Second, they apply 'where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the breakup of the company.' Third, they apply 'when approval of a transaction results in a sale or change of control.'[122]

Once *Revlon* duties are triggered, "[t]he duty of the board . . . change[s] from the preservation of . . . [the] corporate entity to the maximization of the company's value at a sale for the stockholders' benefit."[123] Directors' decisions to sell or breakup the company need not be perfect to satisfy *Revlon* review.[124] "Thus, under *Revlon* review, directors bear the burden of showing that they [were] 'adequately informed and acted reasonably,'" when deciding to sell or break up the company.[125]

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[120] So long as a board of directors has a rational basis as to how the sale of all or substantially all of the corporation assets will advance the shareholder's wealth maximization, such directors' decision will be immune from judicial scrutiny. *See In re* Walt Disney Co., 907 A.2d 693, 746 (Del. Ch. 2005).

[121] Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1150 (Del. 1989) ("*Revlon* duties may . . . be triggered where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the breakup of the company.").

[122] Zachary J. Gubler, *What's the Deal with* Revlon*?*, 96 IND. L.J. 429, 436 (2021) (footnotes omitted) (quoting Arnold v. Soc'y for Sav. Bancorp, Inc., 650 A.2d 1270, 1289–90 (Del. 1994)).

[123] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986).

[124] Gubler, *supra* note 122, at 434.

[125] *Id.* (quoting Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34, 45 (Del. 1994)).

In a Section 271 cash deal, *Revlon* duties are likely triggered, because the transaction results in a breakup of the company.[126] Thus, in Section 271 cash deals, the directors of the corporation that transfers substantially all of its assets likely need to "maximize present, not long-term, share value because for the present shareholders, there is no long term."[127] Rather, the only upside shareholders face in such liquidation acquisitions is the attainment of the remaining equity—if any—post-sale.

In a private foreclosure transaction[128] where the debtor corporation's controlling shareholder is cutout from maintaining an interest in its business venture, and the minority shareholders of the debtor corporation are given the right to exchange their shares in the debtor corporation for an identical number of shares in the secured creditor's business entity, *Revlon* is undoubtedly triggered.[129] In

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[126] *See* TW Servs., Inc. v. SWT Acquisition Corp., Nos. 10427, 10298, 1989 WL 20290, at *8 (Del. Ch. Mar. 2, 1989) ("May a board find itself thrust involuntarily into a Revlon mode in which it is required to take only steps designed to maximize current share value and in which it must desist from steps that would impede that goal, even if they might otherwise appear sustainable as an arguable step in the promotion of 'long term' corporate or share values? *Revlon* did not address that subject but implied that a board might find itself in such a position when it said that the duty it spoke of arose 'when the break-up of the company is inevitable.'" (quoting *Revlon, Inc.*, 506 A.2d at 182)); Marcel Kahan, *Paramount or Paradox: The Delaware Supreme Court's Takeover Jurisprudence*, 19 J. CORP. L. 583, 599 (1994) ("The only case where the court has found that a 'break-up' triggered *Revlon*, however, was *Revlon* itself." (quoting *Revlon, Inc.*, 506 A.2d at 177, 182)); Marc I. Steinberg, *Nightmare on Main Street: The Paramount Picture Horror Show*, 16 DEL. J. CORP. L. 1, 16 (1991) (discussing how the Delaware courts have failed to demonstrate what percentage of corporate assets must be sold to constitute a "break up" and arguing that the courts should find there to be a break-up whenever "restructuring materially impacts both qualitatively and quantitatively on the fundamental characteristics of the corporation" (footnotes omitted)); Gubler, *supra* note 122, at 440–41.

[127] Gubler, *supra* note 122, at 441.

[128] A private foreclosure transaction is a type of strict foreclosure. Halperin et al., *supra* note 6. For the purposes of this Note, a private foreclosure transaction is an out-of-court work-out whereby a debtor corporation agrees to transfer all or substantially all its assets to an entity controlled by its secured creditors in exchange for an extinguishment of its debt. *See also*, Gary M. Graber & Steven W. Wells, *UCC Article 9 Secured Party Sales*, Westlaw: Prac. L. (2017) ("The UCC provides a secured creditor with significant flexibility in determining: The method of disposing of collateral . . . .").

[129] *See* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1150 (Del. 1989) (setting forth the standard for what constitutes a change in control).

such circumstances, control[130] is not vested "in a fluid aggregation of unaffiliated shareholders representing a voting majority—in other words, in the market."[131] Rather, the creditors who established the entity on the receiving end of the transaction would replace the controlling shareholder. Consequently, the new creditors could fundamentally change the corporation's long-term strategy independent of the original minority shareholders—a situation the courts sought to avoid.[132]

With *Revlon* now in place, creditors of distressed corporations must account for their contractual rights to principal and interest being impacted by directors short-run 'sell-and-maximize-value' strategies. At one point, life was easier for lenders, because directors of Delaware corporations were obligated to consider the interests of creditors prior to the corporation's actual insolvency.[133] However, as outlined in the following Section, the weakening of creditors rights in recent years has reasserted shareholder primacy and reaffirmed traditional considerations of *Revlon* in Section 271 asset sales.

B. Fiduciary Duties Directors Owe to Creditors Under Delaware Corporate Law

i. Evolution of the Director Creditor Relationship

As referenced earlier, by the mid-twentieth century, courts began to disregard the trust fund doctrine.[134] As a result of the director-creditor relationship set forth

[130] "Delaware case law does not provide a fixed legal meaning for concept of 'control.' Rather, 'its definition varies according to the context in which it is being considered, e.g., fiduciary responsibility, tort liability, filing consolidated tax returns, sale of control.'" Morton & Reilly, *supra* note 12 (footnote omitted) (quoting Weinstein Enters., Inc. v. Orloff, 870 A.2d 499, 506 (Del. 2005)). This Note will assume "control" to mean having a majority stake in a corporation (i.e., having over 50 percent of the corporation's stock), because "*Revlon* duties are meant to protect shareholders' ability to override the board's decision to reject a tender offer." Kahan, *supra* note 126, at 595.

[131] *Paramount Commc'ns*, 571 A.2d at 1150 (quoting Paramount Commc'ns, Inc. v. Time Inc., Nos. 10866, 10670, 10935, 1989 WL 79880, at *21 (Del. Ch. July 14, 1989)).

[132] *See* Kahan, *supra* note 126, at 594–96 (describing the rational for *Revlon* duties in the change of control context).

[133] *See infra* Section II.B.1.

[134] *See supra* note 95; Edwin S. Hunt, *The Trust Fund Theory and Some Substitutes for It*, 12 YALE L.J. 63, 64 (1902) ("There would perhaps be little reason to object to calling the property of a corporation a trust fund for the benefit of its creditors, if all that the phrase meant was, that a corporation must pay its debts before dividing its assets among its

in *Mackenzie*, Delaware effectively created a business environment where directors of solvent but financially vulnerable corporations could use borrowed capital in a reckless manner without fear of repercussion if such uses were purported to be for the benefit of shareholders.[135] To prevent Delaware corporations from recklessly spending their loans and to further protect creditor interests, "a 'duty shifting' framework . . . emerge[d]."[136] In the 1991 case *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*, the Delaware Chancery Court stated that "where a corporation is operating in the vicinity of insolvency, a board of directors is not merely the agent of the residue risk bearers [e.g., shareholders], but owes its duty to the corporate enterprise."[137] In defining what a director's duty to the corporate enterprise entailed, the court explained that the defendant board "had an obligation to the community of interest that sustained the corporation, to exercise judgment in an informed, good faith effort to maximize the corporation's long-term wealth creating capacity."[138] Additionally, the court used a hypothetical to illustrate how directors should analyze the diverging interests of shareholders and creditors, each of whom are members of the corporate enterprise, to avoid breaching their fiduciary duties.[139]

The *Credit Lyonnais* decision was widely controversial.[140] Although the court's hypothetical provided some guidance on how to construe "informed judgment" and "good faith effort," many commentators criticized the standard's amorphousness and the burden it imposed on directors in determining whether the corporation is in "the zone of insolvency."[141] With no clear guidelines on how to

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stockholders. But the trouble is that the 'trust fund theory' thus originated has not been confined to the case to which Judge Story first applied it.").

[135] *See* Ellias & Stark, *supra* note 82, at 215 ("[T]he leveraged buy-out boom and rise of junk bonds in the 1980s increased the urgency of the call for corporate law to do more to protect creditors."); Morey W. McDaniel, *Bondholders and Stockholders*, 13 J. CORP. L. 205, 206 (1988).

[136] Ellias & Stark, *supra* note 82, at 214.

[137] Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp., No. 12150, 1991 WL 277613, at *34 (Del. Ch. Dec. 30, 1991).

[138] *Id.*

[139] *See id.* at *34 n.55; Varallo & Finkelstein, *supra* note 82, at 241.

[140] Lipson, *supra* note 94, at 234.

[141] *See id.* at 234–35 (describing how after the *Credit Lyonnais* decision, people did not know when directors' "zone of insolvency" duties would arise and the risks they would entail); N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 99 n.28 (Del. 2007); Lipson, *supra* note 82, at 1212; *see also* Douglas G. Baird & Donald S. Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115

balance shareholder and creditor interests, directors became confused on how to satisfy communication and monitoring duties.[142] Additionally, the lack of guidance posed further problems for directors in sale-of-control transactions, as such directors would have to choose between maximizing value for shareholders in accordance with their *Revlon* duties or taking a more conservative, well-rounded approach in accordance with their duties to the corporate enterprise.[143]

With the *Credit Lyonnais* issues in mind, the Delaware Supreme Court's 2007 decision in *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla* upheld the chancery court's finding that corporate directors owe no direct fiduciary duties to creditors.[144] The court reasoned that creditors' existing protections, such as "negotiated agreements, their security instruments, the implied covenant of good faith and fair dealing, fraudulent conveyance law, and bankruptcy law–render[s] . . . protection through direct claims for breach of fiduciary duty unnecessary."[145] The court further reasoned "that 'any benefit to be derived by the recognition of . . . direct claims appears minimal, at best, and [is] significantly outweighed by the costs to economic efficiency.'"[146] To ensure the protection of creditors' equitable interests, the court held that "creditors of an *insolvent* corporation" could "maintain derivative claims against directors on behalf of the corporation" as the "principal constituency injured by any fiduciary breaches that diminish the firm's value."[147] Through this framework, directors can focus on maximizing the value of the corporation without having their performance hindered by "zone of insolvency" creditor considerations.[148] Furthermore, once the

YALE L.J. 1930, 1943–44 (2006) ("Disparities in investors' views over how to value the enterprise and how the judge will value it drive much of the bargaining in large business reorganization cases.").

[142] Lipson, *supra* note 94, at 235–36.

[143] *Id.* at 236. Lipson mentions how the Delaware Supreme Court was confronted with this issue in *Omnicare, Inc. v. NCS Healthcare, Inc.* but chose not to resolve it. *Id.* at 236–37 n.58.

[144] *Gheewalla*, 930 A.2d at 99–101.

[145] *Id.* at 100.

[146] *Id.* (quoting N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla, No. 1456, 2006 WL 2588971, at *13 (Del. Ch. 2006)).

[147] *Id.* at 101–02 (quoting Prod. Res. Grp., LLC v. NCT Grp., Inc. 863 A.2d 772, 792 (Del. Ch. 2004)).

[148] *See id.* at 100–101 ("The Court of Chancery reasoned that 'an otherwise solvent corporation operating in the zone of insolvency is one in most need of effective and proactive leadership—as well as the ability to negotiate in good faith with its creditors—goals which would likely be significantly undermined by the prospect of individual liability

corporation *actually* becomes insolvent, creditors can step inside the shoes of the shareholder and receive the same protections shareholders would receive had the corporation remained solvent.[149]

Under the guise of *Gheewalla* and the business judgment rule, directors of solvent Delaware corporations can act without fear of creditor backlash.[150] Such immunity is evidenced by the holdings set forth in *Quadrant Structured Products Co. v. Vertin*.[151] In *Vertin*, the chancery court recognized "as a matter of business judgment, [directors can] favor certain non-insider creditors over others of similar priority without breaching their fiduciary duties."[152] Additionally, the chancery court further acknowledged that "[d]irectors cannot be held liable for continuing to operate an insolvent entity in the good faith belief that they may achieve profitability, even if their decisions ultimately lead to greater losses for creditors."[153] In other words, "directors need not shut down an insolvent firm and marshal its assets for distribution to creditors—but they *can* do so if as a matter of business judgment, taking into account all of the residual claimants' interests, they believe that it is the best course for the corporation to take."[154]

As previously indicated, Delaware directors' freedom to marshal assets as they see fit in the case of insolvency is impeded by Section 271(a) of the DGCL.[155] Under Section 271(a), "[e]very corporation may . . . sell, lease or exchange all or substantially all of its property and assets, . . . *when and as authorized* by a resolution adopted by the holders of a majority of the outstanding stock of the corporation entitled to vote thereon."[156] Consequently, as illustrated in the

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arising from the pursuit of direct claims by creditors.'" (quoting *Gheewalla*, 2006 WL 2588971, at *13)). *See generally* Trenwick Am. Litig. Tr. v. Ernst & Young, L.L.P., 906 A.2d 168 (Del. Ch. 2006) (holding that directors' duties to shareholders do not change regardless of whether the corporation is solvent, insolvent, or trending towards insolvency).

[149] *Gheewalla*, 930 A.2d at 101–02.

[150] See *supra* notes 144–49 and accompanying text for a discussion on the demise of the zone of insolvency doctrine.

[151] Quadrant Structured Prods. Co., Ltd. v. Vertin, 115 A.3d 535, 547 (Del. Ch. 2015).

[152] *Id.*

[153] *Id.*

[154] Brad Eric Scheler, Gary L. Kaplan & Jennifer L. Rodburg, *Director Fiduciary Duty in Insolvency*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 15, 2020), https://corpgov.law.harvard.edu/2020/04/15/director-fiduciary-duty-in-insolvency [https://perma.cc/7TWS-MNTT].

[155] See *infra* Section II.A.3. for a discussion on why the Delaware Supreme Court held in *Stream TV* that Section 271's majority shareholder approval requirement implicitly nullified any insolvency exception.

[156] DEL. CODE ANN. tit. 8, § 271(a) (2023) (emphasis added).

following Part, Section 271(a)'s majority shareholder approval requirement will likely increase the cost of borrowing and hinder minority shareholder interests.

III. ISSUE

A. Effects of Stream TV Networks, Inc. v. SeeCubic, Inc.

i. Section 271 Likely Applies to Privately Structured Foreclosure Transactions

Ultimately, the Delaware Supreme Court in *Stream TV* did not answer whether a privately structured foreclosure transaction falls within the plain language of Section 271(a) because the Class Vote Provision in Stream's Charter governed the relationship between the parties.[157] As a result, it remains unknown whether Section 271(a) "speak[s] to the ability of a failing or insolvent firm to transfer assets . . . in which a creditor holds a security interest to the creditor."[158] Section 271 does not define the terms "sale" or "exchange," and there is "[v]irtually no Delaware authority [that] addresses what constitutes a 'sale' or 'exchange.'"[159]

Despite the Delaware Chancery Court holding otherwise,[160] it is probable that private foreclosure transactions —like the Omnibus Agreement —fall within the plain language of Section 271(a).[161] Under Delaware law, "[i]f the statute is unambiguous, there is no room for interpretation, and the plain meaning of the words controls."[162] Conversely, "[i]f [a] statute is ambiguous, ... the statute must be read as a whole in a manner that will promote its purposes. . . . [and] courts

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[157] Stream TV Networks, Inc. v. SeeCubic, Inc., 279 A.3d 323, 337 (Del. 2022) ("[B]ecause we conclude that a vote is required because the Omnibus Agreement falls within the materially broader definition of Asset Transfer, we need not resolve whether such a vote is also required under the plain language of Section 271, *i.e.*, whether the Omnibus Agreement effects a 'sale, lease or exchange' within the meaning of Section 271.").

[158] Stream TV Networks, Inc. v. SeeCubic, Inc., 250 A.3d 1016, 1039 (Del. Ch. 2020).

[159] *Id.*

[160] *Id.* at 1041.

[161] Halperin et al., *supra* note 6 (indicating that the plain language of Section 271 makes it likely that Section 271 applies to borrower's consent to or approval of a lender's private foreclosure).

[162] *Stream TV*, 250 A.3d at 1040 (quoting Rubick v. Sec. Instrument Corp., 766 A.2d 15, 18 (Del. 2000)); Ingram v. Thorpe, 747 A.2d 545, 547 (Del. 2000).

should consider the statute's history . . . and draw inferences concerning the meaning from its composition and structure."[163]

In analyzing Section 271, the chancery court recognized that "Section 271 is ambiguous as to whether it applies to [private foreclosure] transactions like the Omnibus Agreement."[164] Despite the chancery court's acknowledgement that an insolvent corporation's transfer of all or substantially all of its assets to its secured creditors could constitute a "sale"[165] or "exchange,"[166] the court held that such interpretation is not mandatory as it is more accurate to classify such transactions as foreclosures.[167]

Although parties in a private foreclosure transaction may seem more like "debtors" and "creditors" than "buyers" and "sellers,"[168] amounting such agreements to a secured creditor merely "levying on their security" runs contrary to the policies underlying the DGCL.[169] As recognized by the chancery court, "a 'foreclosure sale,' [is] . . . '[t]he sale of mortgaged property, authorized by a court decree or a power-of-sale clause, to satisfy [a] debt.'"[170] Furthermore, a "foreclosure," by definition, leads to a "terminat[ion] [of] a mortgagor's interest in property."[171] Conversely, in some[172] private foreclosure transactions, debtor

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[163] *Stream TV*, 250 A.3d at 1040 (quoting *Rubick*, 766 A.2d at 18); *see also Ingram*, 747 A.2d at 547 (discussing how to construe ambiguous statutory language).

[164] *Stream TV*, 250 A.3d at 1041.

[165] *Id.* at 1040 ("*Black's Law Dictionary* contains an extensive section on the term 'sale.' The hallmarks of the various definitions include (i) the status of the parties as 'buyer' and 'seller,' (ii) the exchange of money or other property in return for goods and services, and (iii) a transfer of title.").

[166] *Id.* ("*Black's Law Dictionary* defines 'exchange' to mean '[t]he act of transferring interests, each in consideration for the other,' and defines the related term 'bargained-for exchange' to mean '[a] benefit or detriment that the parties to a contract agree to as the price of performance.'" (first alteration in original) (first quoting *Exchange*, BLACK'S LAW DICTIONARY (11th ed. 2019); and then quoting *Bargained-For Exchange*, BLACK'S LAW DICTIONARY (11th ed. 2019))).

[167] *Id.* at 1041.

[168] *Id.* at 1040–41.

[169] *See* Stream TV Networks, Inc. v. SeeCubic, Inc., 279 A.3d 323, 353–54 (Del. 2022).

[170] *Stream TV*, 250 A.3d at 1040 (second alteration in original) (quoting *Sale*, BLACK'S LAW DICTIONARY (11th ed. 2019)).

[171] *Id.* (quoting *Foreclosure*, BLACK'S LAW DICTIONARY (11th ed. 2019)).

[172] The word "some" is used because debtor corporations can engage in private foreclosure transactions solely to satisfy their debt. In such circumstances, the debtor

corporations do not sell their mortgaged property solely to satisfy their debt, but also to protect their shareholders' interests in such property.[173]

The chancery court correctly indicated that "[Section 271] has never referred to forgiveness of debt as a [valid] form of consideration."[174] However, "forgiveness of debt" is not the only form of consideration debtor corporations can receive when selling all or substantially all its assets to secured creditors. As seen in the Omnibus Agreement in *Stream TV*, Stream's Resolution Committee[175] agreed to sell all of Stream's assets to SeeCubic in *exchange* for an extinguishment of Stream's debt *and* the right to have their equity holders, excluding their controlling holders (the Rajan brothers), "exchange their shares of Stream's Class A common stock for an identical number of shares of SeeCubic's common stock at no cost."[176] Put simply, the consideration Stream received was forgiveness of debt *and* shares of stock in a newly formed corporation.

Because Section 271(a) explicitly lists "shares of stock in, . . . any other corporation" as a valid form of consideration,[177] Section 271 appears to unambiguously apply to private foreclosure transactions that grant debtor corporation's (the "exchangers") shares in a different corporation. To hold otherwise would promote instability and unpredictability.[178] If the Delaware General Assembly sought to exclude private foreclosure transactions of this sort from Section 271's majority shareholder requirement, then it presumably would

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corporation transfers all or substantially all of their assets to their creditor solely in exchange for the extinguishment of their debt. Thus, no shareholders of the debtor corporation receive equity interests in the creditor-controlled entity as additional consideration.

[173] Insolvent debtor corporations engage in private foreclosure transactions to facilitate an out-of-court restructuring. *See infra* notes 184–86.

[174] *Stream TV*, 250 A.3d at 1042.

[175] The Resolution Committee members were the directors of Stream TV at this point. *Id.* at 1024–25.

[176] *Id.* at 1025; *see also supra* notes 32–35 and accompanying text (laying out the details of the Omnibus Agreement).

[177] DEL. CODE ANN. tit. 8, § 271(a) (2023).

[178] *See* Stream TV Networks, Inc. v. SeeCubic, Inc., 279 A.3d 323, 353–54 (Del. 2022); Hollinger Inc. v. Hollinger Int'l, Inc., 858 A.2d 342, 376–77 (Del. Ch. 2004) ("[I]t remains a fundamental principle of Delaware law that the courts of this state should apply a statute in accordance with its plain meaning, as the words that our legislature has used to express its will are the best evidence of its intent. To analyze whether the vote requirement set forth in § 271 applies to a particular asset sale without anchoring that analysis to the statute's own words involves an unavoidable risk that normative preferences of the judiciary will replace those of the General Assembly." (footnote omitted)).

have specified the types of sales Section 271 applies to[179] or conditioned the phrase "any other corporations" to mean "any other corporation not controlled by the recipient of the property or assets" in the 1967 revision of the statute.

ii. Controlling Shareholders May Use Section 271 to Stop Privately Structured Foreclosure Transactions

If Section 271 applies to privately structured foreclosure transactions, individuals with a majority ownership stake in an insolvent corporation, like the Rajan brothers, can use their voting power to impede a private foreclosure transaction for self-interested purposes even if the corporation's Charter does not include a Class Vote Provision. As a result, directors of insolvent corporations will effectively have their hands tied and will be forced to file for bankruptcy.[180] If otherwise, such directors will likely breach their duty of care by providing the corporation's secured creditors the opportunity to use their repossession and foreclosure powers to satisfy their debts free of the roadblocks[181] the creditors would face in bankruptcy.[182]

[179] Gunnerman v. Talisman Cap. Talon Fund, Ltd., C.A. No. 1894-VCS, 2006 BL 183094, tr. at 33–34 (Del. Ch. July 12, 2006) ("[T]he Delaware General Corporation Law clearly makes a distinction between financing transactions, mortgage transactions, collateral transactions, and sales of assets.").

[180] In light of the Delaware Bankruptcy Court's holding in *Friedman v. Wellspring Cap. Mgmt., LLC (In re SportCo Holdings, Inc.)*, No. 19-11299, 2021 WL 4823513 (Bankr. D. Del. Oct. 14, 2021), it is important to note that the directors in this circumstance would likely not breach their duty of loyalty to minority shareholders because the directors would not have to "put[] their own interests ahead of the [corporation's] interests in failing to negotiate an out-of-court restructuring." Shmuel Vasser, *Avoiding an Out-of-Court Restructuring May Breach Fiduciary Duties*, DECHERT LLP: NEWS & INSIGHTS (Dec. 2, 2021), https://www.dechert.com/knowledge/onpoint/2021/12/avoiding-an-out-of-court-restructuring-may-breach-fiduciary-duti.html [https://perma.cc/WSK5-5MLT]. Rather, in this circumstance, the controlling shareholder nullifies the directors' opportunity to put their own interests ahead of the corporation's interests by way of their refusal to approve the asset sale.

[181] 11 U.S.C. § 362 (2018); BUSSEL ET AL., *supra* note 25, at 189 ("The automatic stay . . . gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove [the corporation] into bankruptcy.").

[182] Under Delaware law, "directors . . . are bound to use that amount of care which ordinarily careful and prudent [persons] would use in similar circumstances." Graham v.

While bankruptcy can be optimal for insolvent corporations,[183] it is not always the strategy directors of insolvent corporations believe will maximize their shareholders' interests. Presumably, directors of insolvent corporations negotiate private foreclosure transactions when out-of-court private restructurings are predicted to be: (1) less costly than reorganizing in bankruptcy;[184] and (2) practically achievable.[185] However, because Section 271's majority shareholder requirement has the potential to take the private foreclosure option "off the table" for directors, it indirectly damages what it was designed to protect: shareholder interests.[186]

Despite Section 271 empowering majority shareholders to stop private foreclosure transactions, minority shareholder actions may deter controlling shareholders from interfering with the corporation's private reorganization. Under Delaware Law, a shareholder becomes a controlling shareholder when they: (1) own a majority of the corporation's stock; "or (2) exercise[] 'a combination of potent voting power and management control such that [they are] deemed to have

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Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963). Consequently, it can be assumed that an ordinarily careful and prudent director would not allow their secured creditors to invoke their Article 9 powers when bankruptcy is an option.

[183] *See* BUSSEL ET AL., *supra* note 25, at 189; Diane Lourdes Dick, *Hostile Restructurings*, 96 WASH. L. REV. 1333, 1335 (2021) ("[B]ankruptcy offers a legal framework to shift some bargaining power to the debtor, neutralize the holdout risk, and provide a limited pathway for nonconsensual restructurings."); COMM. ON BANKR. & CORP. REORGANIZATION, N.Y.C. BAR ASS'N, NON-BANKRUPTCY ALTERNATIVES TO RESTRUCTURINGS AND ASSET SALES 1, 1 (2010); Dov R. Kleiner, *Non-Bankruptcy Alternatives to Chapter 11 Restructurings and Asset Sales*, THOMSON REUTERS: PRAC. L. 1, 1 (2017), https://www.kkwc.com/wp-content/uploads/2017/06/Non-Bankruptcy-Alternatives-to-Chapter-11-Restructurings-and-Asset-Sales....pdf [https://perma.cc/2V9M-5DLH].

[184] Kleiner, *supra* note 183, at 1 ("[Private foreclosure transactions] can provide a shorter, less complicated, and cheaper solution to a workout situation than a formal bankruptcy process . . . ."); Dick, *supra* note 183, at 1334, 1336 ("The traditional wisdom holds that an out-of-court restructuring . . . is almost always more efficient [than bankruptcy] because it avoids the costs and uncertainties of a bankruptcy filing; . . . . [B]ankruptcy is generally perceived as a nuclear option—it can be expensive, time-consuming, and it has profound implications for the firm's entire capital structure.").

[185] *See* Dick, *supra* note 183, at 1335 (describing how competing interests amongst creditors can derail private foreclosure transactions).

[186] *See* Yosifon *supra* note 62, at 185–98; Righi, *supra* note 13, at 1453.

effective control of the board without actually owning a majority of stock.'"[187] Controlling shareholders are obligated to act in the best interests of the corporation and its stockholders[188] and "may also owe . . . duties of disclosure and care."[189] Additionally, if controlling shareholders involve themselves in a transaction, their actions will be "subject to entire fairness, Delaware's most onerous standard of review, rather than the default business judgment rule."[190] Thus, if a controlling shareholder impedes a private foreclosure transaction from taking place for self-interested reasons, they may be subject to derivative suits brought by minority shareholders.[191]

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[187] *Controller Confusion: Realigning Controlling Stockholders and Controlled Boards*, *supra* note 19, at 1708 (quoting Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 307 (Del. 2015)).

[188] Holger Spamann, *Corporations: The Basics*, H2O, https://opencasebook.org/casebooks/261-corporations/sections/2-the-basics [https://perma.cc/RZ3U-WZGJ]; Zipora Cohen, *Fiduciary Duties of Controlling Shareholders: A Comparative View*, 12 U. PA. J. INT'L BUS. L. 379, 380 (1991) ("The law imposes a fiduciary duty on anyone who has the power to control the property of another person."); Kerry E. Berchem, Ron E. Deutsch & Nicholas J. Houpt, *Duties of Controlling Stockholders-Murky Waters: Tread Carefully*, AKIN GUMP STRAUSS HAUER & FELD LLP 1, 3–4 (June 2012), https://www.akingump.com/a/web/22475/aohG6/duties-of-controlling-stockholders-pli_article_june-2012.pdf [https://perma.cc/5NKT-P6K2].

[189] *Controller Confusion: Realigning Controlling Stockholders and Controlled Boards*, *supra* note 19, at 1710; Cinerama, Inc. v. Technicolor, Inc., No. 8358, 1991 WL 111134, at *8, *21 (Del. Ch. June 24, 1991), *aff'd in part, rev'd in part sub nom*. Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993), *modified*, 636 A.2d 956 (Del. 1994); Jens Dammann, *The Controlling Shareholder's General Duty of Care: A Dogma That Should Be Abandoned*, U. ILL. L. REV. 479, 483 (2015).

[190] *Controller Confusion: Realigning Controlling Stockholders and Controlled Boards*, *supra* note 19, at 1711 ("[E]ntire fairness review is an exacting standard, requiring fair price (economic and financial considerations) and fair dealing (timing, structure, negotiations, disclosures, processes, and consents)."). "Once entire fairness applies, the defendants must establish 'to the court's satisfaction that the transaction was the product of both fair dealing *and* fair price.'" *In re* Trados Inc., 73 A.3d 17, 44 (Del. Ch. 2013) (quoting Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1163 (Del. 1995)). "Not even an honest belief that the transaction was entirely fair will be sufficient to establish entire fairness. Rather, the transaction itself must be objectively fair, independent of the board's beliefs." *Id.* (quoting Gesoff v. IIC Indus. Inc., 902 A.2d 1130, 1145 (Del. Ch. 2006)).

[191] *See* Cohen, *supra* note 187, at 380 (describing how controlling shareholders are considered fiduciaries and are deterred from misusing their power).

B. Effects of Controlling Shareholders Being Able to Use Section 271 to Stop Privately Structured Foreclosure Transactions

i. In Light of Section 271 Applying to Privately Structured Foreclosure Transactions, Creditors Will Likely Move to Protect Their Interests

As a result of Section 271 invalidating any board-only insolvency exception[192] and the overall weakening of creditors rights under Delaware law,[193] when determining whether to lend to a corporation, creditors will likely account for the possibility that a majority of the shareholders will oppose private foreclosure transactions. Such considerations will likely manifest in the following ways:

First, before effectuating a secured loan, creditors may demand that the debtor corporation pledge 100 percent of the equity of the borrower corporation. Through such a provision, the creditor could "exercise the voting rights granted under the pledge agreement to approve the 'sale, lease or exchange' of all or substantially all of the borrower's assets," if the borrower corporation were to default on its secured notes.[194]

Second, before effectuating a secured loan, creditors may demand that the debtor corporation utilize Section 271's "remaining loophole."[195] In 2005, after the court of chancery's notable decision in *Hollinger Inc. v. Hollinger International, Inc.*, subsection (c) was added to Section 271 to stop controlling shareholders from circumventing the majority shareholder approval requirement.[196] Under Section 271(c), a parent corporation's shareholders are required to approve the sale of all or substantially all of a wholly-owned and controlled subsidiary's assets.[197]

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[192] *See infra* Section II.A.3.

[193] *See infra* Section II.B.1.

[194] Halperin, et al., *supra* note 6.

[195] *See* Righi, *supra* note 13, at 1471–76 (examining how a corporate transaction may take advantage of Section 271's loophole in practice).

[196] *Id.* at 1469; Clagg, *supra* note 12, at 1305.

[197] DEL. CODE ANN. tit. 8, § 271(c) (2023) ("For purposes of this section only, the property and assets of the corporation include the property and assets of any subsidiary of the corporation. As used in this subsection, 'subsidiary' means any entity wholly-owned and controlled, directly or indirectly, by the corporation and includes, without limitation, corporations, partnerships, limited partnerships, limited liability partnerships, limited liability companies, and/or statutory trusts. Notwithstanding subsection (a) of this section, except to the extent the certificate of incorporation otherwise provides, no resolution by stockholders or members shall be required for a sale, lease or exchange of property and assets of the corporation to a subsidiary.").

However, if a subsidiary is partially[198] owned or controlled by its parent, the parent's shareholders need not vote to approve the sale of all or substantially all of the subsidiary's assets.[199]

Thus, before effectuating a secured loan, creditors may demand their borrower: (1) form a new subsidiary that is incorporated in Delaware; (2) place all or substantially all their assets in their newly formed subsidiary in exchange for all the shares of the subsidiary; [200] (3) transfer a percentage of the subsidiary's stock to them (i.e., the creditor) or a trusted third-party;[201] and (4) promise to not appoint individuals that are controlling shareholders of the parent (and thus, controlling shareholders of the subsidiary) as the directors of the subsidiary for the loan term.[202] In doing so, creditors will be able to circumvent the majority shareholder approval requirement and avoid a potential scenario where a controlling shareholder selfishly rejects a private foreclosure sale.[203]

Lastly, if creditors cannot induce prospective borrowers to consent to either of the forementioned requests, they may, before effectuating a secured loan, demand the borrower corporation's certificate of incorporation not include a stockholder vote provision.[204] Additionally, creditors may seek to include negative covenants in their proposed loan documents that restrict the borrower corporation from amending its own organization documents without lender consent.[205] In doing so, creditors will render shareholder approval unnecessary in order to carry out a

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[198] For the purposes of this Note, a subsidiary is "partially" owned or controlled by its parent if its parent owns anything less than 100 percent of the subsidiary's stock. *See* Righi, *supra* note 13, at 1474.

[199] *Id.* at 1453–54.

[200] This exchange would not require shareholder approval under Section 271(c). *Id.* at 1473 n.152.

[201] Through this exchange, the parent's subsidiary would become a partially owned subsidiary. *Id.* at 1473.

[202] The fourth step would likely be demanded by lenders to avoid a situation where the corporate veil is pierced. For more information on when the corporate veil is pierced under Delaware law, see Fredric J. Bendremer, *Delaware LLCs and Corporate Veil Piercing: Limited Liability Has Its Limitations*, 10 FORDHAM J. CORP. & FIN. L. 385, 389–91 n.27 (2005).

[203] *See infra* Section I.D.

[204] One example of these provisions is the Class Vote Provision in *Stream TV Networks, Inc. v. SeeCubic, Inc.*, 279 A.3d 323, 332–35 (Del. 2022).

[205] Delaware code grants stockholders a class vote on any amendment that "alter[s] or change the powers, preferences, or special rights of the shares of such class so as to affect them adversely." DEL. CODE ANN. tit. 8, § 242(b)(2) (2023).

private foreclosure transaction if Section 271 were to be amended to codify a board only insolvency exception.

Notwithstanding, under this third option, creditors will be unable to procedurally prevent majority shareholder opposition hindering a private foreclosure transaction. Thus, it is logical to assume that creditors will increase their interest rates to compensate for such risks.[206]

ii. The Endowment Effect May Deter Directors From Contractually Navigating Around Section 271's Majority Shareholder Approval Requirements

Because Section 271 places the onus on creditors to negotiate for further security and flexibility in the event of their borrower's default, it is likely that creditors will receive less protection than they otherwise would with a statutory board-only insolvency exception. The endowment effect helps explain this assumption.

The endowment effect is a behavioral phenomenon that indicates, contrary to Coase Theorem,[207] that "[p]eople are reluctant to part with their property, and the amount that they are willing to accept (WTA) to sell it far exceeds the amount that others are willing to pay (WTP) for it."[208] In other words, under the endowment

[206] "When the borrower is considered to be low risk by the lender, the borrower will usually be charged a lower interest rate. If the borrower is considered high risk, the interest rate that they are charged will be higher, which results in a higher cost loan." Caroline Banton, *Interest Rates: Different Types and What They Mean to Borrowers*, INVESTOPEDIA (Mar.28,2023), https://www.investopedia.com/terms/i/interestrate.asp#:~:text=If%20the%20borrower%20is%20considered,qualify%20for%20the%20best%20loans [https://perma.cc/4846-WV5L]. The possibility of a controlling shareholder hindering a private foreclosure transaction is presumed to be a "risk" for creditors because private foreclosure transactions can be an optimal work-out option for a distressed borrower and creditor. *See infra* Section III.A.2.

[207] ROBERT COOTER & THOMAS ULEN, LAW & ECONOMICS 85 (Sally Yagan et al. eds., 6th ed. 2012) (summarizing the Coase Theorem as the following: "When transaction costs are zero, an efficient use of resources results from private bargaining, regardless of the legal assignment of property rights."). *See generally* R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960) (being the first article to discuss the theorem).

[208] Christopher Buccafusco & Christopher Sprigman, *Valuing Intellectual Property: An Experiment*, 96 CORNELL L. REV. 1, 4 (2010).

effect, individuals value goods they own higher than goods they do not own.[209] Consider the following example:

> Half the students in a class are given coffee mugs with the insignia of their home university embossed on it. The students who do not get a mug are asked to examine their neighbor's mugs. Then mug owners are invited to sell their mugs and nonowners are invited to buy them. They do so by answering the question 'At each of the following prices, indicate whether you would be willing to (give up your mug/buy a mug).' The results show that those with mugs demand roughly twice as much to give up their mugs as others are willing to pay to get one. . . . Once I have a mug, I don't want to give it up. But if I don't have one, I don't feel an urgent need to buy one.[210]

The cause of the endowment effect, and/or peoples' reluctance to "sell the mug," has been "attributed [sic] . . . to the broader phenomenon of loss aversion—the tendency for people to attach more importance to losses than to gains."[211]

In the legal context, there is evidence to support that the endowment effect not only applies when one sells tangible property, but also with property rights.[212] For example, in a 1998 study[213] conducted by Russell Korobkin, "people resist deviating from default rules[214] in contract negotiations" partly because of "the

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[209] *Why Do We Value Items More If They Belong to Us?*, DECISION LAB, https://thedecisionlab.com/biases/endowment-effect [https://perma.cc/6S2T-T9SM]; Richard Thaler, *Toward a Positive Theory of Consumer Choice*, 1 J. ECON. BEHAV. & ORG. 39, 44–45 (1980); Jack L. Knetsch & J.A. Sinden, *Willingness to Pay and Compensation Demanded: Experimental Evidence of an Unexpected Disparity in Measures of Value*, 99 Q. J. ECON. 507, 516 (1984); Daniel Kahneman, Jack L. Knetsch & Richard H. Thaler, *The Endowment Effect, Loss Aversion, and Status Quo Bias*, 5 J. ECON. PERSPS. 193, 194 (1991).

[210] THALER & SUNSTEIN, *supra* note 3, at 33.

[211] Jeffrey J. Rachlinski & Forest Jourden, *Remedies and the Psychology of Ownership*, 51 VAND. L. REV. 1541, 1556 (1998).

[212] *Id.* at 1542 ("[P]eople do not regard rights protected by damages remedies as being owned in the same way as rights protected by injunctive relief").

[213] *See* Russell Korobkin, *Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608, 637–47 (1998).

[214] "A default rule is one that applies only in the absence of an agreement by the relevant parties to be governed by a different rule." McDonnell, *supra* note 4, at 384.

regret that parties might feel if they traded into a regime that has some chance of leaving them worse off."[215] Additionally, in a 2006 paper, Yair Listokin brought forth evidence supporting the "stickiness"[216] of default rules in corporate law. Specifically, "Listokin considered variations among state anti-takeover statutes, some of which require corporations to opt in and others to opt out."[217] Through their research, "[Listokin] found large differences in the two types of states—corporations rarely opt out of antitakeover statutes, but states with opt in statutes see a mix."[218] Thus, contemplation of the endowment effect raises the issue of whether the law should frame default rights in a way that reduces the cost of trade and maximizes economic efficiency.[219]

Notwithstanding the endowment effect's acceptance as an emotional bias by behavioral economists, its validity has been challenged by several social scientists.[220] Notably, some argue that the endowment effect observed in research studies is attributable to the mechanics of the studies themselves and not psychological biases.[221] Additionally, others argue that the endowment effect is

Conversely, a mandatory rule is "[a] legal rule that is not subject to a contrary agreement." *Rule*, BLACK'S LAW DICTIONARY (11th ed. 2019).

[215] Rachlinski & Jourden, *supra* note 211, at 1557.

[216] A rule is "sticky" if "more people stay in that position than would were it not the default." Lauren E Willis, *When Nudges Fail: Slippery Defaults*, U. CHI. L. REV. 1155, 1157 n.3 (2013).

[217] McDonnell, *supra* note 4, at 391.

[218] *Id.*

[219] *See* Korobkin, *supra* note 213, at 611–12 (describing default rules in the context of maximizing economic efficiency); *see also* THALER & SUNSTEIN, *supra* note 3, at 6–8 (explaining how default rules can "help solve many of society's major problems").

[220] Behavioral economists support and propagate the endowment effect. *See* Max Witynski, *Behavioral Economics, Explained*, UNIV. CHI. NEWS, https://news.uchicago.edu/explainer/what-is-behavioral-economics ("Behavioral economics combines elements of economics and psychology to understand how and why people behave the way they do in the real world. [Behavioral economics] differs from neoclassical economics, which assumes that most people have well-defined preferences and make well-informed, self-interested decisions based on those preferences.") [https://perma.cc/ZJU6-G28T].

[221] *See generally* Charles R. Plott & Katheryn Zeiler, *The Willingness to Pay–Willingness to Accept Gap, the "Endowment Effect," Subject to Misconceptions, and Experimental Procedures for Eliciting Valuations*, 95 AM. ECON. REV. 530 (2005) (challenging the validity of the endowment effect).

likely less prevalent in large-scale corporate transactions where there are sophisticated market participants and arbitrage opportunities.[222]

Despite the cogency of the arguments made by many endowment effect skeptics, it is still reasonable to assume that the endowment effect can cause controlling shareholders acting as directors of a corporation to be disinclined to forgo their Section 271 authority when negotiating for a loan. While large, highly-sophisticated, profit-maximizing institutions may be likely to act in an entirely unemotional and rational manner when making business decisions, the same cannot be said for the controlling directors of closely held corporations, middle-market companies, and family operated entities.[223] Such corporations are often developed, operated, and managed by "people with an intense personal stake in the business" that "usually do not tap into sophisticated financial markets."[224]

Thus, in accordance with the principles of the endowment effect, controlling shareholders acting as directors will be more likely to protect their control interest by not agreeing to jeopardize[225] such interests in credit negotiations. As a result, creditors who negotiate with controlling-shareholder-led corporations will likely account for the possibility of a controlling shareholder opposing a private foreclosure transaction by increasing interest rates or choosing not to lend. Consequently, minority shareholders will be forced to either bear such increased costs, sell their shares, or further invest to become the controlling shareholder that dictates whether to afford creditors with a board-only insolvency exception.

Considering most shareholders will not have the financial means or overall interest to become the corporation's controlling shareholder, most minority shareholders will resort to maintaining or selling their interests if the corporation refuses to afford their creditors a board-only insolvency exception. Realistically, such decisions will not immediately impact minority shareholder actions, as minority shareholders need to request the corporation's books and records and loan agreement to know whether the directors refused a request to navigate around the majority shareholder approval requirement.[226] Thus, if a borrower corporation becomes insolvent, it is likely that minority shareholders will unknowingly take a

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[222] Jennifer Arlen, Matthew Spitzer & Eric Talley, *Endowment Effects Within Corporate Agency Relationships*, 31 J. LEGAL STUD. 1, 18–21 (2002).

[223] McDonnell, *supra* note 4, at 391–92.

[224] *Id.* at 392.

[225] A controlling-shareholder-director could "jeopardize" their control interest by agreeing to the first two covenants in a loan agreement with creditors. *See infra* Section III.B.1.

[226] DEL. CODE ANN. Tit. 8, § 220 (2023).

financial "hit" as a result of directors disallowing a board-only insolvency exception in their loan agreement.

iii. Section 271 Will Likely Result in Controlling Shareholders Breaching Their Fiduciary Duties More Than They Otherwise Would If Section 271 Adopted a Board-Only Insolvency Exception

When accounting for the endowment effect, it is reasonable to suspect that the controlling shareholders of insolvent debtor corporations will be put in positions where they will have to choose between breaching their fiduciary duties[227] or authorizing a private foreclosure transaction more often than they otherwise would if Section 271 had a board-only exception.[228] As a result of controlling shareholders being placed in "the hot seat" more often,[229] it is reasonable to speculate that more fiduciary breaches will occur. In conjunction with sheer probability,[230] such conclusion is, in itself, supported by the endowment effect, because controlling shareholders will be cognitively primed to highly value the control they are subject to losing.[231] Besides facing minority shareholder derivative suits,[232] controlling shareholders of insolvent corporations have nothing to lose by obviating a private foreclosure transaction that terminates their equity position in the corporation.

By permitting such private foreclosure transactions to move forward, controlling shareholders lock in their losses and lose the possibility of ever profiting from a successful corporate recovery. The companies they develop end up in the hands of their creditors and their entrepreneurial ambitions are possibly crushed. Thus, with more controlling shareholders being presented with the "forbidden fruit" they are conditioned to want to "bite into," it is likely that more

[227] *See infra* Section III.A.2. (outlining the fiduciary duties controlling shareholders owe to their fellow minority shareholders).

[228] *See* Korobkin, *supra* note 213, at 637–47 (discussing people's general resistance to deviating from defaults rules in contract negotiations); *see also* McDonnell, *supra* note 4, at 391–92 (explaining why controlling-shareholder-directors may be hesitant to agree to jeopardize their control rights).

[229] *See infra* Section III.B.2.

[230] If more controlling shareholders are put in scenarios where they have to choose between "breaching" and "not breaching" their fiduciary duties to minority shareholders, then it is likely that more breaches will occur.

[231] McDonnell, *supra* note 4, at 391–92.

[232] For fiduciary breaches of the duty of care owed to minority shareholders, see *infra* Section III.A.2.

fiduciary breaches will occur in the private foreclosure transaction context.[233] Consequently, more minority shareholders will bring derivative suits against controlling shareholders, which, in turn, will further reduce the functional capacity of distressed corporations. Presumably, if a distressed corporation has to allocate resources to address derivative suits, then the corporation has less resources to overcome financial distress.

IV. RESOLUTION

A. The Delaware General Assembly Should Amend Section 271 to Provide for a Board-Only Insolvency Exception

Although the Delaware General Assembly regularly assesses the functionality of the DGCL, they are often hesitant to finalize amendments.[234] When considering alterations, "the legislature proceeds with the goal that any revisions must derive 'significant benefit . . . without any countervailing disruption.'"[235] In light of the Delaware Supreme Court in *Stream TV* opening the door to the possibility of Section 271 applying to privately structured foreclosure transactions, legislative review of Section 271 is warranted.

The Delaware General Assembly should codify a board-only insolvency exception to carry out its goal of enhancing corporate efficiency and retain its status as one of the premier States for business formation.[236] Currently, Section 271 can be considered a faulty construction of "choice architecture."[237] Because of

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[233] McDonnell, *supra* note 4, at 391–92.

[234] Righi, *supra* note 13, at 1463 ("The Delaware legislature actively works to promote a favorable business environment by routinely considering and revising the DGCL. . . . — so the typically reluctant General Assembly steps in to clarify and restore predictability to a DGCL provision.").

[235] Righi, *supra* note 13, at 1482 (quoting Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1772 (2006)).

[236] *Id.* at 1477.

[237] Choice architecture is a term of art describing the idea "that our decisions are influenced by the way that choices are presented." *Choice Architecture*, DECISION LAB, https://thedecisionlab.com/reference-guide/psychology/choice-architecture [https://perma.cc/Y5BA-6RWK]; *see also* Richard H. Thaler, Cass R. Sunstein & John P. Balz, *Choice Architecture*, *in* THE BEHAVIORAL FOUNDATIONS OF PUBLIC POLICY 428, 428 (Eldar Shafir ed., 2013) ("A choice architect has the responsibility for organizing the context in which people make decisions.").

the default[238] rule requiring majority shareholder approval, Section 271 forces controlling-shareholder directors to grapple with their biases when deciding whether to navigate around the majority shareholder approval requirement or to retain the right to stop or delay the commencement of a private foreclosure transaction. As a result, the corporate form is subject to inefficiency and minority shareholder interests are weakened.[239] Thus, to further streamline the lending process and decrease the likelihood of controlling shareholder fiduciary breaches, the Delaware General Assembly should amend Section 271 to automatically grant directors the authority to sell all or substantially all the corporation's assets when the corporation is deemed insolvent.

B. Addressing Concerns That Would Arise as a Result of Amending Section 271 to Provide for a Board-Only Insolvency Exception

i. Determining Insolvency

As recognized by preeminent bankruptcy experts, "litigation on the meaning of insolvency 'generates a formidable and, on the surface, not always consistent stream of adjudications.'"[240] Outside of "a few discrete areas of Delaware law that do have statutory definitions of insolvency, such as Delaware's fraudulent transfer statute and commercial code," Delaware solvency law "developed from years of common law jurisprudence."[241] Despite the inherent imprecision associated with determining insolvency,[242] Delaware has established two legal tests for

[238] In actuality, Section 271 is a mandatory rule because directors cannot opt in or out of the majority shareholder approval requirement. *See supra* note 214 (defining "default rule" and "mandatory rule"). Notwithstanding, because there are contractual loopholes that allow parties to navigate around the Section 271 majority shareholder approval requirement, Section 271 will be treated as a highly sticky default rule for the purposes of this Note. *See* McDonnell, *supra* note 4, at 385 (applying a similar logic).

[239] *See infra* Section III.A.2.

[240] J.B. Heaton, *Solvency Tests*, 62 BUS. LAW. 983, 984 (2007) (quoting 2-101 COLLIER ON BANKRUPTCY 101.32 [4] (15th rev. ed., 2009)).

[241] Robert J. Stearn, Jr. & Cory D. Kandestin, *Delaware's Solvency Test: What Is It and Does It Make Sense? A Comparison of Solvency Tests Under the Bankruptcy Code and Delaware Law*, 36 DEL. J. CORP. L. 165, 174 (2011) (footnotes omitted).

[242] Quadrant Structured Prods. Co. v. Vertin, 102 A.3d 155, 174 n.4 (Del. Ch. 2014) ("Of course, the point at which a corporation becomes insolvent remains debatable, is difficult to perceive in real-time, and can only be determined definitively by a court in hindsight."); Prod. Res. Grp., L.L.C. v. NCT Grp., Inc., 863 A.2d 772, 789 n.56 (Del. Ch.

determining when a corporation actually becomes insolvent: the "balance sheet" test and the "cash flow" test[243] (also known as the "ability-to-pay" test).[244] If a corporation cannot satisfy either test, the corporation is deemed insolvent.[245]

Under the balance sheet test, except in receivership cases,[246] a Delaware corporation is deemed insolvent if the corporation "has liabilities in excess of a reasonable market value of assets held."[247] Thus, under the balance sheet test, if the board of directors of a Delaware corporation were to determine that the corporation's liabilities were in excess of a reasonable market value of assets held, then the directors could move forward with a private foreclosure transaction.

Under the cash flow test, precedential ambiguity has created confusion as to whether the test is forward or present-looking.[248] In cases suggesting the test to be forward-looking, a corporation is insolvent if it "is 'unable to pay its debts as they fall due in the usual course of business.'"[249] In other words, "the 'cash flow test' . . . examines whether a company can 'reasonably meet its *anticipated* fixed (on-balance sheet and contingent) obligations as they become due.'"[250] Conversely,

2004) ("[I]t is not always easy to determine whether a company even meets the test for solvency.").

[243] Stearn & Kandestin, *supra* note 241, at 165.

[244] *See* Heaton, *supra* note 240, at 988 (describing the ability-to-pay solvency test).

[245] Geyer v. Ingersoll Publ'ns Co., 621 A.2d 784, 789 (Del. Ch. 1992).

[246] *See* Quadrant Structured Prods. Co. v. Vertin*,* 115 A.3d 535, 556–61 (Del. Ch. 2015) ("A close examination of precedent thus demonstrates that that [sic] the irretrievable insolvency test only applies in receivership proceedings for reasons unique to that remedy.").

[247] *Geyer*, 621 A.2d at 789; *see also* Trenwick Am. Litig. Tr. v. Ernst & Young, L.L.P., 906 A.2d 168, 195 n.74 (Del. Ch. 2006) ("Insolvency in fact occurs at the moment when the entity 'has liabilities in excess of a reasonable market value of assets held."' (quoting Blackmore Partners, L.P. v. Link Energy LLC, No. 454, 2005 WL 2709639, at *6 (Del. Ch. Oct. 14, 2005), *abrogated by* Hoeller v. Tempur Sealy Int'l, Inc., No. 2018-0336, 2019 WL 551318 (Del. Ch. Feb. 12, 2019))); *Blackmore Partners*, 2005 WL 2709639, at *6 ("Under long established precedent, one of those circumstances is insolvency, defined not as statutory insolvency but as insolvency in fact, which occurs at the moment when the entity 'has liabilities in excess of a reasonable market value of assets held.'" (quoting *Geyer*, 621 A.2d at 789)); U.S. Bank Nat'l Ass'n v. U.S. Timberlands Klamath Falls, L.L.C., 864 A.2d 930, 947 (Del. Ch. 2004) ("[A] company may be insolvent if 'it has liabilities in excess of a reasonable market value of assets held."' (quoting *Geyer*, 621 A.2d at 789)), *vacated*, 875 A.2d 632 (Del. 2005).

[248] Stearn & Kandestin, *supra* note 241, at 182.

[249] *Id.* (quoting *U.S. Bank Nat'l Ass'n*, 864 A.2d at 947).

[250] *Id.* (quoting *Blackmore Partners*, 2005 WL 2709639, at *3).

under the present-looking cash flow test, a corporation is insolvent if "it ha[s] failed to pay debts that *already ha*[*ve*] come due."[251]

Undoubtedly, determining a corporation's insolvency under Delaware corporate law is not a clear-cut process.[252] Thus, if Section 271 were to automatically afford Delaware directors the authority to sell all or substantially all the corporation's assets upon insolvency, it is reasonable to speculate that directors may erroneously judge their corporation's insolvency status and fallaciously sell all or substantially all the corporation's assets. In such circumstances, directors would improperly wash away shareholders' beneficial ownership of potential business property. To rectify the unauthorized sale of the corporation's assets, shareholders would have no other choice but to file suit against the board of directors for breach of fiduciary duties of care or loyalty.[253] Thus, if the Delaware General Assembly were to amend Section 271 and codify the board-only insolvency exception, shareholders would be beholden to the judgment of the directors during times of financial distress.

Despite the inherent relinquishment of shareholder power that would stem from a board-only insolvency exception, shareholder interests would remain sufficiently preserved if lawmakers codified a board-only insolvency exception, because directors owe enhanced *Revlon* duties in the private-foreclosure context.[254] Specifically, when deciding to sell all or substantially all of the corporation's assets in exchange for the relinquishment of a debt, directors must maximize the company's value for the stockholder's benefit.[255] Therefore, private foreclosure transactions, such as the one in *Stream TV*, will likely only survive enhanced *Revlon* scrutiny in a limited circumstance: when the corporation is so hopelessly and clearly insolvent that selling all or substantially all of the corporation's assets, in exchange for the relinquishment of debt and the right for all shareholders to exchange their shares for shares in the creditor-corporation receiving the sold assets, would maximally advance shareholder interests. While "there is no single blueprint that a board must follow to fulfill its [*Revlon*] duties,"[256] directors would

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[251] *Id.* at 183 (emphasis added).

[252] *Id.* at 166 ("Delaware case law on solvency is confusing and can lead to inconsistent results. Indeed, the precedent that a court chooses to follow may be outcome determinative.").

[253] *See* Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031, 1033, 1039 (Del. 2004) (outlining the test for determining whether a claim is direct or derivative).

[254] *See infra* Section II.A.4.

[255] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986).

[256] Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989).

be expected to provide an evidentiary analysis on why a private foreclosure transaction would best serve shareholder interests.[257] To successfully complete this analysis, directors would likely need to show that a Chapter Eleven restructuring would be infeasible and that the stock offered to the equity holders of the insolvent corporation would be greater in value than the residual equity received—if any could be received—from a Chapter Seven liquidation.[258]

Ultimately, there is always a possibility that a board will misjudge a corporation's insolvency status, ability to successfully restructure, or liquidation value. Directors are subject to human error and can make decisions that negatively impact the shareholders they represent. In addressing such wrongs, the Delaware General Assembly must choose between two orthogonal principles: divesting directors of control or placing the onus on shareholders to elect competent and trustworthy directors.

Considering the controlling shareholder problem illustrated in Part I of this Note and the protections *Revlon* provides to shareholders in the private-foreclosure context, the increased economic efficiency attained from a board-only insolvency exception outweighs the reduction in shareholder control. Additionally, because private-foreclosure transactions, such as the one in *Stream TV*, can only initiate lawfully in a limited number of circumstances, the benefits that private-foreclosure transactions provide to minority shareholders and the broader economy reduce and outweigh the risk of director exploitation. Therefore, the Delaware General Assembly should amend Section 271 to provide for a board-only insolvency exception despite the difficulties in determining insolvency.

ii. Accounting for Fraudulent Conveyances

In addition to accounting for *Revlon* duties owed to shareholders, directors would also need to account for other creditors' interests before effectuating a private foreclosure transaction through a board-only insolvency exception. Specifically, because Delaware law protects creditors from the fraudulent conveyance of their debtor's property, all secured and unsecured creditors would

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[257] *See id.* at 1287 (describing the factors that courts may consider in determining whether a board of directors satisfied their *Revlon* duties); Gubler, *supra* note 122, at 442–43 (describing what *Revlon* requires from directors).

[258] If a corporation were to be deemed insolvent, bankruptcy would be a course of action that would align with the directors' fiduciary duties. *See supra* text accompanying note 184 (describing the benefits the bankruptcy process can provide to distressed corporations).

need to consent to the debtor corporation's private foreclosure sale.[259] Presumably, creditors would only consent to the debtor corporation's private foreclosure sale if they were to receive a satisfactory percentage of the debtor's assets and/or sufficient shares in the acquiring creditor-corporation's company. Thus, the inherent difficulties of insolvent debtor corporations having to account for all their creditors outside of bankruptcy would limit the degree to which a Section 271 board-only exception would impact commercial lending.

CONCLUSION

The Delaware General Assembly should amend Section 271 to automatically provide directors with the authority to sell all or substantially all the corporation's assets in the case of insolvency to decrease the instances where controlling shareholders find themselves 'nudged' in the wrong direction. If directors of Delaware corporations automatically had such rights, controlling-shareholder directors would likely be less willing to contract for a majority shareholder exception because of the endowment effect. As a result, the capital procurement process would become more efficient, and the cost of borrowing would decrease. Furthermore, with fewer majority shareholder exceptions in place, there will likely be a reduction of controlling shareholders breaching their fiduciary duties by objecting to private foreclosure transactions. Thus, by merely changing Section 271's default setting, the DCGL will preserve shareholders' "right to choose" while 'nudging' them in a direction that optimizes economic efficiency.

[259] DEL. CODE ANN. tit. 6, §§ 1304–1305 (2023).