

Delaware Supreme Court Holds Transfer of Assets by Insolvent Company to its Creditors Required Shareholder Vote; Leaves Open Question of Statutory Requirements

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In an opinion issued on June 15, 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 (“*SeeCubic*”) controlled by its secured creditors, in full satisfaction of its debts, violated the corporation’s charter.¹

Background

The Delaware Supreme Court considered whether the “privately structured foreclosure transaction” between the insolvent corporation, Stream TV Networks, Inc. (“*Stream*”), and its secured creditors implicated a provision in Stream’s certificate of incorporation (the “*Charter*”) requiring the approval of a majority of Stream’s Class B shareholders (the “*Class Vote Provision*”). The Court found that the unambiguous text of the Class Vote Provision controlled, which rendered the default voting rules of Section 271 of the Delaware General Corporation Law (“*Section 271*”)² irrelevant. Specifically, the Court found the transaction effected an “Asset Transfer” as defined in the Charter, thereby triggering the Class Vote Provision. As a result, the Court declined to look to Section 271 as an interpretive guide in construing the provision in the Charter.³

In the decision below, the Chancery Court originally found that Section 271 controlled over the language of the Charter, contrary to the Supreme Court’s analysis. The Chancery Court’s opinion hinged on the finding of a common law exception to the requirement set forth in Section 271 that a board of directors obtain shareholder approval in order to dispose of all or substantially all of a corporation’s assets, and held the shareholder approval requirement did not apply in the case of a failing or insolvent firm. However, in finding that the Class Vote Provision was triggered, the Delaware Supreme Court did not address whether shareholder approval is required in connection with lenders exercising their rights against an insolvent borrower under the Delaware General Corporate Law statute provisions. The opinion did, however, explicitly state that “a common law insolvency exception [to the shareholder approval requirement], if one existed in Delaware, did not survive the enactment of Section 271 and its predecessor.”⁴

While the Court found that a corporation’s insolvency does not obviate the need for a shareholder vote to dispose of its assets, it declined to answer whether a private foreclosure transaction (such as the one effected between Stream and its secured creditors) falls within the plain language of Section 271. If such a transaction qualified as a “sale, lease or exchange” within the meaning of Section 271, and the corporation’s certificate of incorporation did not vary from the default statutory language, then shareholder approval would be required to effect the foreclosure.

The implications of this possibility are far-reaching. Secured lenders regularly pursue private foreclosures on their collateral pursuant to a strict foreclosure process provided by Section 9-620 of the Uniform Commercial Code (the “*UCC*”). While Section 272 of the Delaware General Corporation Law (“*Section 272*”) allows a corporation’s board of directors to mortgage or pledge the corporation’s property without shareholder consent, a finding that shareholder approval is required for a lender to exercise certain types of remedies, such as consensual strict foreclosure, would drastically impede a lender’s ability to execute on its collateral in out-of-court arrangements.⁵

While the Delaware Supreme Court stopped short of deciding whether the borrower’s consent to or approval of a lender’s private foreclosure constitutes a “sale, lease or exchange” of property under Section 271 (which would require shareholder approval), the plain language of the statute makes such a conclusion likely. However, the Delaware Supreme Court acknowledged that a public policy exception to the requirements of Section 271 may be

applicable, in view of the practical difficulties for secured lenders, as well as the potential disruption to industry standards.

Takeaways

Given the Delaware Supreme Court's willingness to recognize deviations from Section 271 in a corporation's organizational documents, lenders should consider taking the following steps in connection with making a secured loan: (i) verify that the borrower's certificate of incorporation and other governing documents do not require a shareholder vote prior to effecting a "sale, lease or exchange" of all or substantially all of the borrower's assets; (ii) include negative covenants in loan documents restricting the borrower's ability to amend its own organizational documents without lender consent; and (iii) if practical, obtain shareholder consent at the time of the origination of the loan to any foreclosure at the time the asset pledge is executed. Alternatively, consider obtaining a pledge of 100% of the equity of the borrower so the lender can 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 in connection with the lender's exercise of remedies.

In short, it seems that whether shareholder approval is required for a lender to foreclose on collateral in Delaware depends on whether (i) the borrower's certificate of incorporation supersedes the statutory language of Sections 271 and 272 and (ii) the method a lender uses to foreclose on its collateral requires the consent or approval of the borrower.

For More Information

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- 1 For a discussion of the Chancery Court's decision, see our previous client alert "[No Shareholder Vote Needed for Insolvent Company to Transfer Assets to Secured Creditors](#)" (May 19, 2022).
 - 2 "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. . . 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." Code Ann. tit. 8, § 271.
 - 3 *Stream TV Networks, Inc. v. SeeCubic, Inc.*, No. 2020-0766 (KLV) (ECF No. 67727771) at 24.
 - 4 *Id.* at 25.
 - 5 The Delaware Supreme Court acknowledged that shareholder approval would not be required in connection with a judicial proceeding.

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