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Proposed Amendments to Delaware General Corporation Law Aim to Clarify Corporate Transaction Rules

If enacted, the amendments would significantly impact the risk-benefit considerations for public and private companies contemplating reincorporation or going public in a different jurisdiction.

On February 17, 2025, the Delaware legislature proposed significant changes to the Delaware General Corporation Law (DGCL) that would dramatically affect how transactions involving Delaware corporations are negotiated and litigated. If enacted in substantially this form, the amendments would clarify the rules for determining (i) whether a director is disinterested and independent, (ii) whether a significant stockholder can be considered a "controller," and (iii) which transactions require the twin protections of a special committee and majority of the minority vote to be insulated from entire fairness challenges. The proposed amendments also place new and important limitations on what "books and records" stockholders can demand pursuant to Section 220.

Public and private companies that may be considering reincorporating or going public in another jurisdiction should carefully evaluate these changes, which, if enacted in an undiluted form, would significantly alter their risk-benefit calculus of reincorporating in a different jurisdiction.

This Client Alert analyzes the proposed amendments, which include changes to controlling stockholder transactions, revisions to the definitions of "independent" directors and "controlling" stockholders, and significant alterations to Delaware's books and records statute.

Controlling Stockholder Transactions

Under current law, *any* transaction between a Delaware corporation and its controlling stockholder is automatically subject to "entire fairness" review. This includes both controller take-private transactions and any other transaction in which the controller receives a benefit that is not shared with the minority stockholders (e.g., a compensation grant or differential consideration). The only way to avoid entire fairness review of such transactions (and instead get more favorable "business judgment" review) is to make the transaction conditioned from the outset on approval of both (1) an independent and fully empowered special committee *and* (2) a fully informed, non-coerced vote of the disinterested stockholders.

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In practice, this path has been difficult to sustain, in part because a challenge to the independence of even *one* member of the special committee has been deemed sufficient to defeat these protections and subject a transaction to heightened entire fairness review, and because it is often challenging to obtain the votes of a majority of the outstanding disinterested shares.

The proposed amendment to the DGCL would alter current law in several ways:

First, the requirement to obtain both special committee *and* disinterested stockholder approval would be limited to "going private" transactions. For public companies, a going private transaction would mean a transaction subject to SEC Rule 13e-3, which in general means a transaction resulting in termination of SEC registration or SEC reporting obligations or listing on a national securities exchange; for any other corporation, a going private transaction would mean a transaction in which "all or substantially all of the shares" held by the disinterested stockholders (but not the controller) are canceled or acquired. The amendment would *not* require that the disinterested stockholder approval condition be in place from the outset of negotiations, as current law requires. Instead, the transaction could be conditioned on a disinterested stockholder vote "at or prior to the time it is submitted to stockholders for their approval."

Second, current law requires approval by a majority of all the *outstanding* disinterested shares, which effectively counts non-voting shares as being cast "against" the transaction by minority shareholders. By contrast, the amendment to the DGCL would require only approval by a majority of the "votes cast" by the disinterested stockholders, meaning non-voting shares would not count as voted "against" the transaction.

Third, with respect to the special committee, there would no longer be a requirement that all of its members be independent; instead, all that would be required is that the controller not be a member, and that a *majority* of the committee members be disinterested and independent. The special committee must have the power "to negotiate (or oversee the negotiation of) and to reject" the proposed transaction, and must approve or recommend the transaction in "good faith." The amendments do not appear to require the special committee to have independent legal and financial advisors.

For any transaction with the controller other than a going private transaction, *either* approval by a special committee *or* approval by the disinterested stockholders would be sufficient to avoid a challenge. The amendment also makes clear that such a transaction could be approved "or ratified" by an informed vote of the disinterested stockholders, which presumably means that if the initial disclosures were later found deficient, the deficient vote could be cured by a subsequent vote of the disinterested stockholders armed with full knowledge of the material facts.

Further, controlling stockholders would not be liable for monetary damages for breach of fiduciary duty except for (1) a breach of the duty of loyalty, (2) acts or omissions "not in good faith or which involve intentional misconduct or a knowing violation of law," or (3) transactions in which the controller derived an improper personal benefit. As a practical matter, this change would eliminate claims for monetary damages against the controlling stockholder based on any alleged breach of the duty of care — similar to the protection currently afforded to directors under DGCL 102(b)(7) via exculpatory bylaw or charter provisions.

Who Is "Independent"

Under current law, the fact that a director is independent under stock exchange standards does not suffice to show that the director is independent for purposes of a fiduciary duty analysis under Delaware corporate law. Plaintiffs may defeat a motion to dismiss by alleging facts making it "reasonably

conceivable" that a majority of the directors are interested in the transaction or lack independence based on personal, financial, or other interests. In practice, plaintiffs have been able to make this showing at the pleading stage under a fairly liberal standard, relying on facts such as overlapping club membership, charitable activities, or past business relationships to allege a lack of independence.

The proposed amendment would raise the pleading bar by creating a presumption of independence and disinterestedness for a director if the board "shall have determined that such director is an independent director or satisfies the relevant criteria for determining director independence under" any national securities exchange rules. That presumption "shall be heightened and may only be rebutted by substantial and particularized facts that such director has a material interest in such act or transaction or has a material relationship with a person with a material interest in such act or transaction." The amendment also makes clear that the fact that a party nominated the person as a director would not, standing alone, be evidence of a lack of independence from that party.

Who Is a "Controller"

Under current law, a stockholder can be deemed a "controlling stockholder," and thus subject to fiduciary duties under Delaware common law, if they either (1) have over 50% of the voting power, or (2) have a combination of voting power and managerial control that gives them *de facto* control of either the corporation in general or the challenged transaction in particular. This second prong of the controller standard has led to significant confusion over exactly how large a stake or how much day-to-day control the stockholder must have to be deemed a "controller." Cases and commentary suggested that a stockholder with relatively low stakes (even 20%) could be considered a "controller" depending on the facts.

The proposed amendment would define a controlling stockholder as one who either (1) controls a majority of the corporation's voting power with respect to director elections, or (2) has "functionally equivalent" power "by virtue of ownership or control of at least one-third" of the voting power for election of directors *and* has "power to exercise managerial authority over the business and affairs of the corporation." As under existing law, a combination of voting power and managerial power would be required for any stockholder with less than 50% of the voting power before the stockholder would be considered a "controller." However, the amendment sets a clear lower limit of one-third of the voting power before a court could make such a finding.

What Is "Fair"

Under the proposed amendment, a transaction may still be immune from challenge if the transaction is "fair as to the corporation," just as a transaction under current law can be shown to be "entirely fair."

Under current law, entire fairness review requires the defendant to prove that the transaction is entirely fair to the corporation and its stockholders as a matter of both price and process. The proposed amendment clarifies this standard by defining "fair to the corporation" to mean that the transaction "as a whole, is beneficial to the corporation, or its stockholders" given the consideration paid (or received, as the case may be) "and taking into appropriate account whether the act" meets both of the following elements: (1) "It is fair in terms of the fiduciary's dealings with the corporation," and (2) "It is comparable to what might have been obtained in an arm's length transaction available to the corporation."

This new approach would deviate from the existing "entire fairness" standard by first asking whether the transaction "as a whole" is "beneficial" to the corporation or the stockholders, and then only taking into "appropriate consideration" whether there has been fair dealing and a fair price. It also makes clear that

for the fair price prong, the only requirement is that the terms be “comparable” to what might have been obtained in a third-party deal.

Books and Records Amendments

The proposed amendments would significantly alter Delaware’s books and records statute, which has become a significant weapon for plaintiffs seeking to challenge corporate transactions.

Under current law, stockholders may seek to review a corporation’s books and records upon a minimal showing of a credible basis to suspect wrongdoing, which has been described as the lowest pleading burden existing under Delaware law. The limits of what “books and records” the plaintiff may obtain have been developed through case law, and in recent years have been extended in some circumstances to require the corporation to search for and provide emails or even text messages of directors and officers.

The plaintiffs can then use these documents to formulate a substantive complaint challenging the transaction at issue. While defendants have argued that plaintiffs should not be allowed to cherry-pick documents helpful to their claims from among those produced while ignoring contradictory documents, courts have been reluctant to consider documents cited by the defendants on a motion to dismiss unless they are relied on in the complaint or directly refute the plaintiff’s claim.

The proposed amendment would, for the first time, limit the scope of the term “books and records” to a list of specifically identified categories of documents, including board minutes, bylaws, financial statements, and materials provided to the board or a committee with respect to the transaction at issue. Further, the proposed amendment would prohibit the Court of Chancery from ordering a corporation to produce any documents other than these specifically defined “books and records.” The stockholder’s demand for inspection must describe with “reasonable particularity” both the purpose of the demand and the books and records sought. The stockholder’s stated purpose must be “reasonably related to a stockholders’ interest as a stockholder,” and the demand for inspection must be made in good faith. The books and records sought must be “specifically related to” the stated purpose.

The amendments also would permit the corporation to require the stockholder to agree “that any information included in the corporation’s books and records is deemed incorporated by reference in any complaint” that is later filed. This change would significantly reduce, if not eliminate, plaintiffs’ ability to cherry-pick favorable documents in attempting to formulate a claim that could survive a motion to dismiss. The amendments would also permit the corporation to redact any information contained in those documents that are not “specifically related” to the stockholder’s stated purpose. This permission to omit unrelated information differs from current practice, as the courts have frowned upon broad relevance redactions.

If the corporation “does not have” minutes of stockholder meetings, board or committee minutes and records of board or committee actions, annual financial statements for the preceding three years, or (for public companies) director and officer independence questionnaires, the Court may order production of “additional records of the corporation constituting the functional equivalent of any such books and records,” but “only to the extent necessary and essential to fulfill the stockholder’s proper purpose.” This scope limitation, combined with the overall limitation of what constitutes “books and records,” would significantly reduce plaintiffs’ ability to use isolated emails taken out of context to support a pleading-stage narrative. It also would put a premium on corporations keeping appropriate formal records, to avoid any claim that the exception applies.

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