

Delaware Corporate Charters Cannot Incorporate Provisions of Third-Party Agreements by Reference

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In [Seavitt v. N-able, Inc.](#), the Delaware Court of Chancery held that certain governance rights granted to a corporation's significant stockholders were statutorily invalid. This included a provision purporting to allow those stockholders to remove directors while holding less than a majority of the voting power and that the Delaware General Corporation Law (the DGCL) does not authorize a corporate charter to incorporate substantive provisions of a stockholders agreement by reference because those substantive provisions are not "facts ascertainable" under the DGCL. The decision also highlights the need for companies to review any existing stockholders agreements to ensure that any director removal provisions comply with Section 141(k) of the DGCL. We anticipate that these provisions may serve as an easy incentive for plaintiffs to extract mootness fees from public companies in the short term.

N-able, Inc. (the Company) entered into a Stockholders Agreement that granted certain governance rights to two significant private equity investors (the Investors). These rights contemplated, among other things: (i) requiring the Company's board to obtain the Investors' approval prior to taking certain actions, including effecting a change of control transaction, removing the CEO, and incurring debt; and (ii) allowing the Investors to control the board composition by changing the size of the board, requiring the board to recommend the Investors' nominees for election, filling board vacancies of an Investors' nominee with another one of their nominees, and vetoing nominees for any Board seat. The rights granted under the Stockholders Agreement also included a right that authorized a director to be removed from the Company's classified board without cause and with less than a majority vote (the Removal Provision). The Company's charter included numerous instances where its various provisions were made "subject to" the various provisions of the Stockholders Agreement.

The court held that most of the governance provisions were statutorily invalid for the same reasons as set forth in the court's decision in [West Palm Beach Firefighters' Pension Fund v. Moelis & Company](#), with the court noting that the outcome of its holding would have been different following the effectiveness of the [amendments to the DGCL as of August 1](#). The court also held that Section 102(d) of the DGCL, which provides that a corporate charter may include "facts ascertainable," defined under that section to mean "the occurrence of any event, including a determination or action by any person or body," does not authorize the incorporation by reference of substantive provisions from a third-party agreement. Thus, attempts by the Company to make any charter provision "subject to" the substantive provisions of the Stockholders Agreement were deemed to be ineffective. In so doing, the court reasoned that allowing the Company to incorporate the Stockholders Agreement in the charter by reference would mean that the parties to the Stockholders Agreement could effectively amend the Company's charter without following the requirements to amend a charter under Section 242 of the DGCL. The court also held that the Removal Provision violated Section 141(k) of the DGCL, which provides that stockholders may, by

majority vote, remove directors only for cause in the case of a classified board, because it purported to grant the Investors the right to remove directors without cause and by less than a majority vote.

Takeaway

The court's decision in *Seavitt* provides practitioners with important guidance on structuring future transactions involving Delaware corporate charters. While stockholders agreements containing governance rights have been authorized by the recent amendments to the DGCL, companies and their counsel should be aware that provisions of third-party agreements will need to be pulled into the terms of the charter rather than by cross-reference since those amendments did not change the concept of a "fact ascertainable" under the DGCL.

In addition, plaintiffs may begin to seize on provisions similar to the Removal Provision in existing stockholders agreements as incentive to secure a mootness fee with the court. Companies and their counsel would be well-advised to promptly amend any stockholders agreements to remove those provisions or restructure arrangements with their significant stockholders entirely.

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