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Delaware Decision Has Lessons for Lenders and Others

WRITTEN BY

Stanley Keller

On December 8, 2020, the Delaware Court of Chancery in *Stream TV Networks, Inc. v. SeeCubic, Inc.*[1] upheld a unique structure established by secured lenders to protect their interests and in doing so the Court addressed a number of corporate law issues.

Stream TV Networks, Inc. ("Stream") was a family-controlled Delaware corporation with outside investors and two secured lenders that held security interests in substantially all of Stream's assets. Stream was in financial difficulties, having defaulted on the secured loans, missed payroll and failed to pay trade debt. Under pressure, the two controlling family members who were the directors increased the size of the board and added four independent outside directors. The outside directors then formed a committee with full authority to resolve any debt defaults. Following negotiations, the committee authorized and Stream executed a restructuring agreement providing that the secured lenders would not foreclose on Stream's assets but instead would accept the voluntary transfer of Stream's assets to SeeCubic, Inc. ("SeeCubic"), a new entity controlled by the secured lenders. As part of the understanding, Stream's minority stockholders would receive shares in SeeCubic in exchange for their Stream shares and Stream itself would receive shares, benefitting its remaining stockholders, principally the controlling family. Stream also granted a power of attorney to implement the agreement and consummate the transaction. The controlling family members, unhappy with the arrangement, then sought to remove the outside directors, purportedly (but the Court found not actually) before the board committee authorized the restructuring agreement and they otherwise sought to challenge the status of the outside directors. They then filed the lawsuit to enjoin enforcement of the restructuring agreement, and SeeCubic responded by seeking to enforce the agreement.

In resolving the dispute in favor of SeeCubic's right to enforce the restructuring agreement and exercise the power of attorney to accomplish that, the Court addressed the following issues:

Expanding board and filling vacancies. The Court found that the board was validly expanded and the outside directors validly appointed to fill the vacancies so created because the two family members were the sole members of the two-person board. As authorized by §141(b) of the Delaware General Corporation Law (the "DGCL"), the bylaws provided for the number of directors to be set by the board and, consistent with §141(f), authorized directors to act by unanimous written consent. The Court stated that the issue would have been more complicated if the number of directors had been five, with three vacancies, because then under §223(a) the two directors, since they would not have been a quorum, could only have filled the vacancies and not increase the board to six (citing *Applied Energetics, Inc. v. Farley*, 239 A.3d 409 (Del. Ch. 2020)). The Court went on to explore

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other alternatives the two directors could have followed in this hypothetical circumstance, but one was not to act as stockholders to increase the size of the board because that authority was given solely to the directors. The Court also gave advice on how to draft the resolutions to properly effect the increase in the size of the board and fill the vacancies.

Authority of de facto directors. Even if the outside directors were not validly appointed and thus would not be *de jure* directors, in the circumstances of this case they would be *de facto* directors with the authority to take the actions they took, including approving the restructuring agreement. The Court cited several Delaware decisions addressing the status of *de facto* directors as applied to protect third parties.

Imposing director qualifications. Although the resolution designated the outside directors as "Interim ?Directors" and required certain conditions to be met for their service to begin, the Court ruled that Delaware law ?does not contemplate such a position and conditions on the ability to become and remain ?a director would be a qualification provision that under §141(b) of the DGCL can ?only be imposed by the certificate of incorporation or bylaws. In addition, a director qualification ?must be reasonable, and the Court found that those being asserted were not reasonable.?

Need for stockholder approval for sale of substantially all the assets. Under §271 of the DGCL, stockholder approval is required for a sale of all or substantially all the assets of a corporation. The approval is not required, however, for the mortgage or pledge of the corporation's assets, as provided in §272. The Court noted that the exclusion of a mortgage or pledge must, as a matter of policy, encompass the ability of the creditor to realize on its security. The question for the Court was whether the transfer of Stream's assets under the restructuring agreement in lieu of a foreclosure of the lenders' security interest in those assets was subject to the stockholder approval requirement of §271. After reviewing the history? ?of Delaware law on mergers and sales of assets, the ?evolution of the DGCL provisions and relevant case law, the Court held that §271 does not apply to a transaction like the one under the restructuring agreement in which an insolvent corporation transfers its assets to its secured creditors in lieu of a formal foreclosure proceeding. The Court pointed to the past common law rule that, although a board of directors did not have the authority to sell all the corporation's assets, it did have that authority to transfer the assets to creditors when the corporation was insolvent, and that the legislature's having added the authority for the board to sell assets with stockholder approval should not be read to limit the authority that existed under common law. Moreover, the addition of the statutory exclusion for mortgages supported that conclusion.

Need for class vote for such sale. Stream had a class of stock that required the approval of the holders of that class in order to consummate an "Asset Transfer," which was defined in the same terms as §271 of the DGCL. Because a charter provision that tracks a statutory provision is to be given the same meaning as the statutory provision, the Court ruled that the class vote provision did not apply to Stream's transfer to the secured creditors of the assets in which they held a security interest.

Application of business judgment rule. The final claim was that the restructuring agreement was void because the members of the committee breached their fiduciary duties in approving it. The Court described the three tiers of judicial review of director actions and ruled that the business judgment rule, as the default rule, applied in this case. Under that rule, unless rebutted, "the court merely looks to see whether the business decision made was rational in the sense of being one logical approach to advancing the corporation's objectives." The Court found that no basis existed to rebut the protections of the business judgment rule and therefore it rejected the breach of

fiduciary duty claim.

Conclusion

The *Stream* decision illustrates a creative way lenders can successfully deal with a distressed borrower situation. The Court's decision upholding the actions taken by the lenders also provides a primer on some basic corporate law rules that are worth noting.

[1] C.A. No. 2020-0310-JTL (Del. Ch. Dec. 8, 2020) here.

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