April 15, 2011

Extract from Legal Opinion Newsletter (2011), citing Bigler & Tillman's Void or Voidable? -- Curing Defects in Stock Issuances Under Delaware Law

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ABA
SECTION OF
BUSINESS LAW

COMMITTEE ON
LEGAL OPINIONS

LEGAL OPINION NEWSLETTER

JAMES F. FOTENOS, EDITOR

Volume 10 – Number 3 Spring 2011

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7. *Postscript: Curing Prior Deficiencies in Authorizations of Share Issuances*

Jeffrey Ostrager of Curtis, Mallet-Prevost, Colt & Mosle LLP, New York, had what appeared to be a general housekeeping question by his inquiry of February 24, 2011 when he asked whether, for any "deficiencies" in prior board authorizations of share issuances and equity award grants, it would be "sufficient for the Board to adopt a general resolution authorizing all prior share issuances/equity awards, . . ." Several commenters suggested various techniques for the Board to pursue in providing the corrective authorization, including specifying varying amounts of detail as to the prior issuances. The dialogue turned more serious when Wena Poon, San Francisco, cited an important article by Stephen Bigler and Seth Tillman from the August 2008 issue of *The Business Lawyer* ("Void or Voidable?—Curing Defects in Stock Issuances Under Delaware Law, 63 Bus. Law. 1109). As that article develops at length, and as the authors/editors presciently noted in the headnote to the article, curing defective authorizations of share issuances is not as easy as it might first look, even to the experienced business practitioner:

> "It is not unusual for a Delaware corporation's stock records to have omissions or procedural defects raising questions as to the valid authorization of some of the outstanding stock. Confronted with such irregularities, most corporate lawyers would likely attempt to cure the defect through board and, if necessary, stockholder ratification. However, in a number of leading cases, the Delaware Supreme Court has treated the statutory formalities for the issuance of stock as substantive prerequisites to the validity of the stock being issued, and the court has determined that failure to comply with such formalities renders the stock in question void, i.e., not curable by ratification."

Gail Suniga of Fenwick & West LLP, Palo Alto, brought Steve Bigler himself into the discussion to confirm that the void/voidable distinction retains its robustness in Delaware and continues as a trap for the unwary. To accentuate the point, Gail forwarded a copy of the then three-days' old opinion of Vice Chancellor Laster in *Olson v. EV3, Inc.*, 2011 WL 704409 (Del. Ch. Feb. 21, 2011). The decision is important reading for any counsel confronted with an opinion request to address the valid issuance of prior issuances of shares, and we thank Gail for bringing it to the listserve's attention.

In his decision, Vice Chancellor Laster addresses the payment by ev3 for services rendered by plaintiff's class-action counsel in securing corrective provisions and procedures in a two-step merger agreement between ev3, Inc. and Covidien Group S.a.r.l. The merger agreement provided for the grant of a top-up option by ev3 to Covidien to permit Covidien, upon a successful tender offer for the outstanding shares of ev3, to effect a short-form merger under Delaware law. (By exercise of the top-up option, Covidien could acquire a sufficient number shares to effect a short-form merger.) The merger agreement initially presented by the parties provided for a top-up option with an exercise price equal to the share price offered by Covidien in its tender offer, and permitted Covidien to pay for the shares in cash or by the issuance of a promissory note "on terms as provided by [Covidien], which terms shall be reasonably satisfactory to [ev3]."

In the process of settling the case, plaintiff's counsel negotiated revisions to these terms, including a specification of the material terms of the promissory note and a requirement that the par value of the shares subject to the top-up option be paid in cash in all events. Moreover, the agreement settling the litigation required that the amendments be approved by the ev3 board of directors at a meeting where the terms and operation of the top-up option were to be thoroughly reviewed and the necessary statutory determination of the sufficiency of the consideration payable for the shares would be made.

Vice Chancellor Laster concluded that the services rendered by plaintiff's counsel justified the fee. His characterization of the deficiencies in the original terms of the top-up option should give pause to all counsel contemplating the giving of an opinion on prior issuances of shares:

> "As originally structured in the Merger Agreement, the Top-Up Option and any shares issued upon its exercise likely were void. *See STAAR Surgical Co. v. Waggoner*, 588 A.2d 1130, 1137 (Del. 1991). To the extent a short-form merger closed in reliance on the resulting shares, the validity of the Merger could be attacked. The invalidity of that transaction in turn could have called into question subsequent acts by the surviving corporation."

2011 WL 704409 at *11.

The *ev3* decision did not directly address how or when defective share issuances could be cured or as of when a cure would be effective. The ability to cure defects may turn on the nature of the defect. For example, a defect in authorizing the corporation's capital may not be subject to cure, while defects in board actions authorizing an issuance might more easily be dealt with. Sometimes, the situation may require extensive actions such as a curative merger, an exchange offer or even a bankruptcy filing. What the *ev3* decision illustrates is that one should carefully consider the nature of the "deficiencies" in prior board authorizations of share issuances and equity award grants before crafting corrective measures.

Bigler – Tillman in their article (at pages 1144-1148 and see note 194 at page 1142) suggest that in many cases the UCC should provide a cure for shares in the hands of a "protected purchaser." Unfortunately, an unreported bench decision by Chancellor Chandler of the Delaware Chancery Court handed down after publication of the Bigler – Tillman article held that a "protected purchaser" under the

UCC is not "protected" and has no interest in shares issued by a Delaware corporation whose issuance was void. *Noe v. Kropf* (no. 4050-CC) (Del. Ch. January 15, 2009), available here [Control + Click].[1]

We have not been able to summarize all of the opinion dialogues that have occurred on the listserve since the Fall 2010 issue of the newsletter. Those not summarized here address opinions on a spouse's community property exposure for pre-marital debts and on the propriety of assuming an original mortgage was duly recorded when rendering an opinion on an amendment to the mortgage; negative assurance letters on disclosure documents used in follow-on offerings when the precise underwriting discount is not disclosed to investors at the time of sale; customary diligence for LLC member or manager power and authority opinions; and enforceability opinions on "make-whole premiums" in convertible notes. To review these dialogues, go to the "Archives" link under "Listserves" on the Committee's website.

As always, members are encouraged to raise legal opinion issues on the listserve and to participate in the exchange. Members also are encouraged to bring new developments (such as recent case law or newly identified issues) to the attention of Committee members through the listserve.

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[1] The URL is http://works.bepress.com/seth_barrett_tillman/107/