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Revisiting The Void/Voidable Distinction For Stock Issued Defectively

Abstracted from: *Void Or Voidable? - Curing Defects In Stock Issuances Under Delaware Law*
By: C. Stephen Bigler and Seth Barrett Tillman *Richards Layton & Finger, Wilmington DE*
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Stock issued in error: void or voidable? Delaware case law offers little guidance to lawyers who must opine on whether a defect in stock issuance is substantive or merely technical. If the defect is substantive, it *voids* the stock, explain attorneys Stephen Bigler and Seth Barrett Tillman; if merely technical, it makes the stock *voidable*, which means that ratification by the board (plus, if needed, by the shareholders) would cure the defect. A substantive defect *voids* the stock because the corporation acted illegally, contrary to public policy, or beyond the authority granted in its charter. The stock with a technical defect is *voidable* because the corporation acted within the scope of its authority but did not observe all the statutory formalities.

Logic of leading case is off base. Delaware's leading case on the void/voidable question is *Triplex Shoe Co. v. Rice & Hutchins Inc.* (1929). The Supreme Court invalidated all the no—par—value common shares issued by Triplex, because the charter did not indicate the number of authorized common shares or their par value at a time when Delaware law required the charter to do so. Since the charter had violated the statute, the court reasoned, the charter gave the corporation no authority to issue common shares; hence, neither the board's ratification of the issuance nor the shareholders' unanimous espousal of that ratification was effective. For the authors, the court's rationale for its holding is obscure. The court gave no standard that would bar ratification on the facts of the case, it cited authorities that did not use the void/voidable distinction, and it barely raised the situational equities.

Later decisions are catch-as-catch-can. A 1990 Delaware Supreme Court case arguably extended the *Triplex* holding—that shares issued without statutory authority are void—to shares that a corporation is allowed to issue under its charter but has done so without observing the statutory formalities. Even where the consequences are inequitable, the court in *Wagonner v. Laster* held, the *Triplex* rule would apply. This suggested that any statutory violation might render shares void. A series of chancery court cases followed. One court allowed a board to ratify a defective issuance but failed to distinguish the troubling 1990 decision. Another held that shares were void due to the board's inequitable actions even though the board had observed all statutory formalities. Still another decision found that shares were not void if issuance did not violate an explicit charter provision. However, in the most recent chancery court opinion analyzed by the authors, *MBKS Co. Ltd. v. Reddy* (2007), the court called the void/voidable line not "as clear as it could be."

DUCC policy could be a home run. The Delaware courts have considered the void/voidable distinction only when the owner of the shares was the party to whom they were originally issued, not a subsequent purchaser. Section 202 of the Delaware Uniform Commercial Code provides that, with certain exceptions, a security "issued with a defect going to its validity" is nevertheless "valid in the hands of a purchaser for value and without notice" of the defect. (Delaware's General Corporation Law incorporates the UCC, but—in the event of a conflict—the former controls.) In the authors' opinion, the courts should adopt Section 202 as a principle of law as well as equity for cases covered by the Delaware UCC. The courts should deem innocent

buyers' shares voidable at worst and allow boards to cure or ratify technical defects of issuance, unless the issuance breached the board's duty of loyalty or a declaration of validity would cause an inequitable outcome. The void/voidable distinction is a mere judicial gloss, the authors argue, not an explicit command of the Delaware General Corporation Law. Furthermore, defects in issuance are usually inadvertent, so meticulous compliance with corporate formalities is unlikely to result from a harsh judicial rule requiring it. A new judicial rule based on Section 202 would allow lawyers to opine on shares whose issuance defects are curable and remove the risk that courts will void innocent buyers' shares.

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