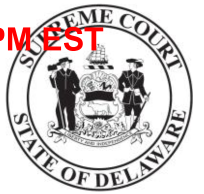
EFiled: Feb 24 2014 07:23PM EST
Filing ID 55044566
Case Number 13,2014



IN THE SUPREME COURT OF THE STATE OF DELAWARE

Mary S. Schaheen,	:	
	:	
Defendant below, Appellant,	: :	No. 13, 2014
	:	Court below: Court of Chancery
v.	:	
	:	No. 8160-VCN
John A. Boris and Ann S. Boris,	:	
	:	
Plaintiffs below, Appellees.	: :	

Appellant's opening brief

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February 24, 2014

Table of contents

Table of authorities iii

Nature and stage of the proceeding 1

Summary of argument 3

Statement of facts 4

I. Numoda Corporation 4

A. The board 4

B. NC's board recorded the stock issuances 5

C. The NC board approved additional stock issuances 6

1. The 2004 issuances 6

2. The issuance of non-voting stock 6

3. Houriet's issuance 7

4. Mary's issuance 8

D. The October 2006 directors' written consent 9

E. The board approved and relied on the spreadsheets 9

II. Numoda Technologies, Inc 10

III. Ann's and John's prior actions contradict their litigation positions 11

IV. The opinion 14

Argument 16

I. The Court of Chancery erred by refusing to consider Mary's evidence of board approval of the challenged issuances 16

A. Questions presented 16

B. Scope of review 16

C. Section 151(a) does not require a board to approve a stock issuance by a "written instrument"....................16

i. *STAAR Surgical Co. v. Waggoner*....................17

ii. The language of 8 *Del. C.* § 151(a)....................19

iii. *Grimes v. Alteon Inc.*....................23

II. The Court of Chancery erred by refusing to consider Mary's equitable defenses, because even if this Court affirms the decision that a board may only issue commons stock approved "by written instrument," a board's failure to do so only renders the stock voidable, not void 26

A. Questions presented....................26

B. Scope of review 26

C. At worst, the purported infirmities in the stock issuances rendered the stock voidable, not void, and thus susceptible to Mary's equitable arguments....................26

i. The *Finch* doctrine....................27

ii. Void versus voidable corporate acts....................29

Conclusion 34

Exhibits

Exhibit 1
John A. Boris and Ann S. Boris v. Mary S. Schaheen
C.A. No. 8160-VCN, Noble, V.C. (Dec. 2, 2013)
(Memorandum Opinion) (ID 54633380)

Exhibit 2
John A. Boris and Ann S. Boris v. Mary S. Schaheen
C.A. No. 8160-VCN, Noble, V.C. (Dec. 10, 2013)
(Final Order Entered Pursuant to Rule 54(b)
(ID 54683977)

Table of authorities

Cases

Alpine Inv. Partners v. LJM2 Co-Investment, L.P.,
794 A.2d 1276 (Del. Ch. 2002)....................23

Blades v. Wisehart,
2010 WL 4638603 (Del. Ch. Nov. 17, 2010)....................31

Bovay v. H.M. Byllesby & Co.,
22 A.2d 138 (Del. Ch. 1941)....................27

Brown v. Fenimore,
1977 WL 2566 (Del. Ch. Jan. 11, 1977)....................27

CarrAmerica Realty Corp. v. Kaidanow,
321 F.3d 165 (D.C. Cir. 2003)....................32

Colonial Ins. Co. v. Ayers,
772 A.2d 177 (Del. 2001)....................22

Danvir Corp. v. Wahl,
1987 WL 16507 (Del. Ch. Sept. 8, 1987)....................27, 28

Feldman v. Cutaia,
956 A.2d 644 (Del. Ch. 2007) *aff*, 951 A.2d 927 (Del. 2008)....................22, 24

Finch v. Warrior Cement Corp.,
141 Atl. 54 (Del. Ch. 1928)....................27

Gaskill v. Gladys Belle Oil Co.,
146 Atl. 337 (Del. Ch. 1929)....................34

Grimes v. Alteon Inc.,
804 A.3d 256 (Del. 2002)....................23, 24

Harbor Fin. Partners v. Huizenga,
751 A.2d 879 (Del. Ch. 1999)....................33

In re Krafft-Murphy Co.,
82 A.3d 696 (Del. 2013)....................24

Kalageorgi v. Victor Kamkin, Inc.,
750 A.2d 531 (Del. Ch. 1999), *aff'd*, 748 A.2d 913 (Del. 2000) 30, 32, 34

Kelty v. State Farm Mut. Auto. Ins. Co.,
73 A.2d 926 (Del. 2013) 25

Lawson v. Household Finance Corp.,
Del. Supr., 152 A. 723 (1930)..30

Leatherbury v. Greenspun,
939 A.2d 1284 (Del. 2007) 22

Liebermann v. Frangiosa,
844 A.2d 992 (Del. 2002) 34

MBKS Company Ltd. v. Reddy,
924 A.2d 965 (Del. Ch. 2007 34

Michelson v. Duncan,
407 A.2d 211 (Del. 1979) 33, 34

Morente v. Morente,
2000 WL 264329 (Del. Ch. Feb. 29, 2000) 27

Morris v. American Public Utilities Co.,
Del. Ch., 122 A. 696 (1923)..30

Nevins v. Bryan,
885 A.2d 233 (Del. Ch. 2005), *aff'd*, 884 A.2d 512 (Del. 2005) 30, 32

Solomon v. Armstrong,
747 A.2d 1098 (Del. Ch. 1999).. 33, 34

STAAR Surgical Co. v. Waggoner,
588 A.2d 1130 (Del. 1991) .... passim

Stegemeier v. Magness,
728 A.2d 557 (Del. 1999) 16, 26

Testa v. Jarvis,
1994 WL 30517 (Del. Ch. Jan. 12, 1994)..27

Topkis v. Delaware Hardware Co.,
2 A.2d 114 (Del. Ch. 1938) 27

Triplex Shoe Co. v. Rice & Hutchins Inc.,
152 Atl. 342 (Del. 1930) 31, 34

Waggoner v. Laster,
581 A.2d 1127 (Del. 1990) 18, 21, 29, 34

Statutes

8 *Del. C.* § 102 .... 19, 22

8 *Del. C.* § 104 30

8 *Del. C.* § 141 .... 17, 22

8 *Del. C.* § 151 .... *passim*

8 *Del. C.* § 157 24

8 *Del. C.* § 161 28

8 *Del. C.* § 225 1

8 *Del. C.* § 242 34

Nature and stage of the proceeding

In December 2012, Ann Boris ("Ann") and John Boris ("John") filed an action under 8 *Del. C.* § 225 (the "225 Action") seeking a declaration that Mary Schaheen ("Mary") was validly removed from the boards of Numoda Corporation ("NC") and Numoda Technologies, Inc. ("NT"), both Delaware corporations, and that they validly elected themselves to the boards. A16-19. They purportedly took such action as majority stockholders of both corporations by signing written consents in November 2012.

The Court of Chancery issued its post-trial decision on December 2, 2013 and entered an implementing order on December 10, 2013. Ex. A; Ex. B. Mary appeals both. The court ruled that, under 8 *Del. C.* § 151(a), stock is valid only if it is approved by a written instrument. Ex. A at 8, 37-38. The court further ruled that because the NC's Class B voting stock issued in 2002,[1] 2004, 2005,[2] and 2006 was not approved by a written instrument, they were void. *Id.* at 44. Because Ann and John held a majority of the NC voting stock issued in 2000, the

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[1] Mary presented evidence that the board approved the issuance of 30,000 shares to Patrick Keenan ("Keenan") in 2002 in consideration for a $15,000 investment he made in NC. A1035 (line 9).

[2] Mary presented evidence that John was issued 232,656 shares for a cash contribution in 2005. *Id*. (line 19). Because the 2002 and 2005 issuances do not affect the determination of majority ownership, we will focus on the 2004 and 2006 issuances.

court held that their November 2012 written consent (the “NC Written Consent”) was valid and, therefore, that Ann and John constituted its board.

Ann and John also signed a written consent purportedly as majority stockholders of NT. After they filed the 225 Action, Ann and John changed their legal position and argued that no stock had even been issued by NT, despite their testimony and actions to the contrary.

The court ruled that all of the NT stock was void because the NT board did not approve the issuances by a written instrument. Ex. A at 46. Because NT never validly issued stock, the court determined that the NT November 2012 written consent (the “NT Written Consent”) was invalid. Additionally, the court held that because Mary was the sole director of NT at the time of the NT Written Consent, she remained the sole director. *Id.* at 49.

Mary timely filed an appeal. This is her opening brief on appeal.

Summary of argument

1. The boards of NC and NT did not approve the challenged stock issuances by a contemporaneous written instrument; namely, a written board resolution or a written consent. Despite nothing in 8 *Del. C.* § 151(a) requiring that board approval of the issuance of common stock be by a written instrument, the Court of Chancery erroneously construed it to require such a "written instrument" and, as a result of that error, the court also erred in determining that the challenged stock was void as a matter of law. Accordingly, the lower court's decision should be reversed and this matter should be remanded for further proceedings.

2. Even if board approval of an issuance of common stock must be by written instrument, the boards' failure to do so renders the stock voidable and not void, because the alleged infirmities did not involve a charter violation. Thus, the lower court should have considered Mary's equitable arguments. Accordingly, the lower court's decision should be reversed and this matter should be remanded for further proceedings.

Statement of facts

I. Numoda Corporation

A. The board

Siblings Ann, Mary, and John constituted the initial board of NC (incorporated in 2000), which provides clinical trial services to the biotechnology and pharmaceutical industries. Ex. A at 2-3. At the time Ann and John executed the NC Written Consent, Mary served as NC's sole director. *Id.* at 10-11. Mary served as NC's Chief Executive Officer since its inception. John served as General Counsel and, until April 2006, Secretary. A124-25. Ann was the Chief Operating Officer and Secretary after John resigned. Ex. A at 3, 10-11.

NC's bylaws required John, as Secretary, to send notice of, and keep minutes for, board meetings. *Id.* at 4-5. John, however, could not recall whether he provided notice, and he did not keep minutes. *Id.* at 4.[3] NC's board conducted meetings with a process involving making proposals, exchanging information, and coming to a consensus on a proposal. A195-96, 280-82. After reaching a decision, the board communicated its decisions to others to implement. A284.

John also was responsible for keeping NC's stock book (the "NC Stock Book"), which contained the "vitally important" corporate records. A132; Ex. A at 5. The NC Stock Book contains a stock ledger on which John recorded six

[3] John admitted that he never researched or sought legal advice on whether he should be keeping board minutes. A130, 131 ("I'm not sure if I thought it was important or not" to know whether he should have been keeping minutes).

issuances in 2000: Cert. 1: Philip Gerbino 2,500 shares; Cert. 2: Barry Unger 2,500 shares; Cert. 3: Ann 5,100,000 shares; Cert. 4: Mary 3,333,333 shares; Cert. 5: John 1,266,667 shares; and Cert. 6: Meyer Rohtbart 300,000 shares. Ex. A at 5-6.[4] Ann and John admitted that this stock ledger is inaccurate and incomplete. *Id.* at 6.[5] The issuances to Ann, Mary, and John are not disputed for purposes of this appeal. Ann and John claimed that NC never approved (formally or informally) any additional issuances. Ann also denied that she returned stock.

Neither Ann nor John ever objected to the process employed by NC's board, the lack of notice, or the lack of minutes. A280-81, 284-85, 296. In addition, as discussed below, Ann and John took many actions inconsistent with the stock ownership reflected on the stock ledger created by John.

B. NC's board recorded the stock issuances

After 2000, NC's board did not rely on the stock ledger that John created. Rather, the board relied upon documents created by John Dill ("Dill"), under the direction of Ann, to reflect the stock ownership. A246-47, 325-26; A558, 561-64, 567-68. At various times, Dill prepared spreadsheets (the "Common Stock

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[4] The court below did not address the issuances to Gerbino, Unger, or Rothbart because they would not affect the question of whether Ann and John held a majority of the voting stock.

[5] Not only did some of these purported issuances never occur (Gerbino/Unger), other transactions which Ann and John had admitted later occurred were not reflected on the stock ledger. For example, the PIDC Penn Venture Fund ("PIDC") was issued 1,016,950 shares in 2008, reflected by certificate no. 23. John, however, never recorded the issuance on the stock ledger. Ex. A at 6; A142.

Analysis" or "Common Stock Ledger and Analysis"), to reflect the stock ownership and which were approved by the board. A298, 316, 331.[6]

C. The NC board approved additional stock issuances

1. The 2004 issuances

To obtain favorable loan terms, NC's board approved a recapitalization in 2004 to convert debt to equity. Ex. A at 9. The board approved stock issuances to themselves in exchange for debt resulting from loans, and deferred compensation over years. *Id.* at 9. The board also approved an issuance to Keenan in exchange for the forgiveness large loan. *Id.* at 9; A101-02, 191, 287-88, 290-92, 295-96.

The court found that circumstantial evidence shows how much stock was issued by the NC board in 2004. The Common Stock Analysis reflects the following issuances: John – 1,546,238 shares; Ann – 4,645,500 shares; Mary – 5,109,053 shares; and Keenan – 1,005,000 shares. *Id.* at 10; A1042.[7]

2. The issuance of non-voting stock

The board again improved the balance sheet by converting loans to stock. The board, however, did not want to issue voting stock to the convertible loan

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[6] While there is other information on the spreadsheets added by Dill, the board focused on and approved the number of shares issued to each person and the percentages of ownership. A332-33.

[7] A unanimous written consent of directors executed in 2000 provides that "all shares shall be uncertificated and stock certificates shall not be issued to stockholders except upon request." A725-29; Ex. A at 7. After 2000, none of Ann, Mary, John, or Keenan requested that they be issued a stock certificate. Ex. A at 7.

holders. Ex. A at 11. Thus, in April 2006, Ann and Mary executed a written consent of directors authorizing two classes of NC common stock: non-voting and voting; which became effective in December 2007. *Id.* at 11-12; A994; A313. Before this non-voting stock could be issued, however, certain calculations had to be completed, which took some time. Accordingly, between July and December 2008, stock certificates were issued to twelve Class A stockholders: Certificate numbers 21-32. Ex. A at 12; A823-30, 832-41.[8]

3. Houriet's issuance

John Houriet ("Houriet"), Chief Technology Officer of NC, had made significant contributions to NC and NT, including developing products, creating standard operating procedures, and rebuilding the data systems. A300-01; 513-516. In addition, he made loans, deferred part of his compensation, and held stock options. Ex. A at 12. Given his integral role, Houriet insisted on having an ownership interest in the companies. A301-02; A518.

Houriet rejected the board's initial offer of a ten percent, contingent ownership. Ex. A at 12. After discussions, in July 2006, the board (Ann and Mary) approved the issuance to Houriet in an amount sufficient to give him a fifteen percent ownership interest on a fully diluted basis, in exchange for forgiveness of his loans and deferred compensation, waiver of the stock options,

[8] Despite these issuances not being listed on John's stock ledger, both Ann and John testified that this was validly issued. A122, 197, 235-36. Because this was non-voting stock, the lower court did not reach the question of whether it was validly issued. Ex. A at 43.

and recognition for his past services. *Id.* Ann and Mary confirmed to Houriet that they approved this issuance, which was "funded" in part by Ann giving back two million of her shares. A308, 314; A523-24. Although the board approved this issuance in 2006, the stock was not issued at that time because the calculations for the convertible loan holders had to been completed first. A314-15. Afterwards, Houriet repeatedly requested a certificate. He received Certificate 33, dated September 18, 2009, for 5,100,000 shares of NC, signed by Ann and Mary. Ex. A at 14. Ann denied that she had approved the issuance. *Id.* at 13.[9] While the board approved the issuance of voting stock to Houriet, a Class A certificate (non-voting) was used instead of Class B (voting). A308, 319-20. The error was not realized until the 225 Action. A530.

4. Mary's issuance

Mary initially held approximately thirty-three percent of the stock, on a fully diluted basis. With the 2004 issuances and Houriet's issuance, Mary's ownership was diluted. *See* A1042. In 2006, in recognition of her past services (that had not been compensated by prior issuances), the board approved additional issuances to Mary that would restore her ownership to approximately thirty-three

[9] Ann continually changed her position with respect to Houriet. After signing the written consent but before the 225 Action was filed, Ann took the position that Houriet owned no NC stock. A237. At trial, she testified that she had contemplated a ten percent stake for Houriet, but that instead he was given a larger research budget, a sales force, and the use of a car. A198.

percent on a fully diluted basis. A309-10. After convertible loan calculations were completed, Mary was issued an additional 5,725,000 shares. *See* A1035.

D. The October 2006 directors' written consent

The NC board's actions taken prior to October 2006 were among trusted siblings. Prior to outside directors being elected, the NC board (Ann and Mary) wanted to ratify their prior acts, including the stock issuances and therefore, they signed a written consent of directors, dated October 2, 2006, providing that the directors '"hereby accept, adopt, ratify and approve of all prior acts, business and transactions of the Company, . . . as have been done by, on behalf of and in the best interest of the Company . . . ."' Ex. A at 16; A323-24. The written consent was in the NC Stock Book maintained by John. A731.

E. The board approved and relied on the spreadsheets

In December 2007, Ann directed Dill to update the spreadsheets to reflect the approved issuances to Houriet and to Mary and her "giveback" of two million shares. The Common Stock Ledger and Analysis 12/11/2007 reflects the additional issuances to Mary (lines 10, 11, and 18) and Houriet (line 16) that were approved by Ann and Mary, and Ann's stock return. A597, 648-49; A1036.

The Common Stock Ledger and Analysis 12/31/2008, approved by Ann and Mary, records the Class B stockholders of NC as: Ann - 7,745,500; Mary -

10,839,053; John - 3,045,561; Houriet - 5,100,000; Keenan - 1,035,000; and PIDC - 1,018,950. A329-30; A602; A1035.

II. Numoda Technologies, Inc.

Initially, Ann, John, and Mary comprised the board of NT (incorporated in 2000), which would not meet separately from NC board. Thus, the same meeting process was used. A335-36. Neither Ann nor John objected. A338. The court found that Ann and John resigned from the NT board no later than 2006. Ex. A at 49. Thus, Mary was the sole director of NT since that time. *Id.* at 49.

NT was intended to be a subsidiary of NC until it was spun-off, effective January 2005, and its common stock was distributed *pro rata* to NC's stockholders. *Id.* at 2-3. As a tax-free transaction, at the time of the spin-off, NT stock was issued to Ann, Mary, John, and Keenan. A1162-75; A606.

Additional NT stock was issued to Mary and Houriet, as approved by the NT board in 2006, to match their ownership of NC. A337, 315-16; 522-23. Thus, at the time the NT Written Consent was signed, the ownership of NT was: Ann - 7,745,500 shares; John -3,045,561 shares; Mary - 10,839,053 shares; Keenan - 1,035,000 shares; and Houriet - 5,100,000 shares. A1025-28.[10]

[10] NT had only one class of stock. To qualify as a tax-free transaction, there had to be at least eighty percent overlap of ownership. A606. In connection with the issuances to the convertible loan holders, they were granted warrants in NT. A607. PIDC declined a warrant in NT. *Id*.

The NT stock ledger was blank. John testified that it was not necessary to issue NT certificates because the stockholders of NC were the same as the stockholders of NT. A1095 at 194-196.

III. Ann's and John's prior actions contradict their litigation positions

For several years, until November 2012, every corporate action taken by NC and NT, and representations to third-parties (including taxing authorities, banks, and the State of Delaware), was, without exception, consistent with the ownership reflected in the Common Stock Ledger and Analysis 12/31/2008. A333; A612-13; A1035. This is because the parties, including Ann and John, used this document as the accurate reflection of the number of issued shares, as approved by the boards. A602. Neither Ann nor John disputed this capitalization until November 2012. A334; A536-37, 602.

In addition, Ann and John's litigation positions are contradicted by their own testimony and actions, including:

- John prepared a chart of "everything that was in the stock book" prior to the 225 Action, which reflected that PIDC owned 1,016,958 shares of Class B stock, despite it not being listed on the stock ledger created by John. Ex. A at 18.
- In July 2008, John sent a bank a "Share Register as of 16 July 2008," which he kept in the NC Stock Book, which reflects the NC Class B stockholders as:

Ann - 7,745,500; Mary - 10,839,053; John - 3,045,561; Houriet - 5,100,000; and Keenan -1,035,000. A908; Ex. A at 15.

- The 2005 NC tax return, signed by John, reflects that: in the spin-off of NT, its stock was distributed *pro rata* to the stockholders of NC; Keenan was a "significant distributee" of the NT stock; and, as of the time of the transaction, NC and NT each had 18,977,458 shares outstanding. A1005-06; A165-67. This is the same number of outstanding shares reflected in the Common Stock Analysis 12/31/2003. A1043; A167.

- In May 2007, John wrote to Dill "Please let me know if the info below is correct: . . . 'Stock Analysis 07-26-2006.xls', last modified 4/20/07, says Total outstanding shares are 20,020,369 . . . . I agree with you below that the 'shares outstanding,' which is 'the shares of a corporation's stock that have been issued and are in the hands of the public' is 19,720,369, bec[sic] the [Rothbart] stock is now the Treasury stock." A1136. The number of outstanding shares referenced by John matches the Common Stock Analysis 7/26/2006. A1042; A153-54.

- The NC 2006 and 2007 Franchise Tax Reports, signed by John, reflect that there were 19,270,369 and 30,702,327 shares outstanding, respectively. Ex. A at 17-18**;** A1144-46; A1147-48.

- The NT 2006 and 2007 Franchise Tax Reports reflect (in John's handwriting) that there were 18,910,114 and 28,065,114 shares outstanding, respectively. A120-22; A1144-46; A1147-48.

- On July 27, 2006, Dill told John that NC was "bumping" the "ceiling" on its authorized shares, and that it should be increased to fifty million. A1135; Ex. A at 17. John signed the amendment to NC's Certificate of Incorporation, filed on December 27, 2007, increasing the number of authorized shares to 50 million Class B common. A716-17.

- In January 2009, Ann sent an email to Keenan, stating: "Attached is a stockholders agreement that *records the fact that you own 3.62 percent of the company as part of a 'giveback' of stock I made many years ago* . . . . All the numbers are right per JD." A1009 (emphasis added).[11]

- In March 2010, Dill prepared a Cap Table for NC and NT, discussed at a meeting with Ann, Mary, John, Keenan, and Houriet, which reflected that Ann held 25.91 percent of NC. Ex. A at 18; A533-34; A1025-28; A1029-30.

- Ann and John signed, under penalty of perjury, the NT S-Election Form, reflecting the percentage ownership: Mary - 39.04 percent, Ann - 27.90 percent,

[11] When asked whether this email confirms that she gave stock back to Numoda, Ann responded "I can't say that it does." A245. When asked what her email means, tellingly, she responded "That is a good question. I'm sorry I can't help you." *Id.*

Houriet - 18.37 percent, John - 10.97 percent, and Keenan - 3.72 percent. A1029-30; A534-35, 609-10.

- Ann certified as "true and correct" personal financial statements, dated May 3, 2011 and June 1, 2012, showing her percentage ownership of NC as 25.91 percent and NT as 27.89 percent. Ex. A at 18.

- John sent Dill a text message in March 2012 stating: "D (as in JD), M wants me to list up just the percentages of ownership of the 5 mgt team people. Is it M 30, A 21, J 15, JB 10.5 and P 6? (Am guessing)." Dill responded: "These are NC pctgs BEFORE dilution . . . M-36.26%, AV-25.91%, JH- 17.06%, JB-10.19%, PK-3.46%. Remaining 7.12% is PIDC and Class A shareholders. NT and NCI are slightly higher because no present minority interests (but warrants outstanding)." John responded "K. Danke! You das Mann!" A1031-33; Ex. A at 19.

IV. The opinion

The court ruled that Ann and John established that NC had only one stock ledger, which was not the Common Stock Ledger and Analysis due to a lack of evidence that board resolved "by written instrument, to replace or to supplement" John's initial ledger. Ex. A at 43. Because the parties agreed that the stock ledger created by John was incomplete and inaccurate, the court looked to extrinsic evidence to determine if the stock issued in 2004 and 2006 was validly issued. *Id.* The court then found that Mary did not prove by a preponderance of the evidence

that the NC board approved, by written instrument, any of the disputed Class B stock. *Id.* at 8, 44. The NC board, the court ruled, "may well have informally decided to issue stock, and the directors and purported stockholders may have conducted themselves as if the stock had been issued. But, even a shared understanding of what was intended is insufficient . . . ." *Id.* at 44.

Because the court found that the stock was void, it ruled that it was without power to remedy defects with equity, "even though the beneficiaries of these subsequent stock issues being void – John and Ann – are likely the directors most responsible for the circumstances leading to this finding." *Id.* at 45. Because Ann and John held a majority of the outstanding voting stock on John's stock ledger, the court ruled that the NC Written Consent was valid.

With respect to NT, because the ledger was blank, the court looked to extrinsic evidence to identify its stockholders. *Id.* at 46. The court ruled that the requirement of a written instrument was not satisfied by the "professed intent to have the capitalization of [NT] mirror that of [NC] - as persuasively suggested by weight of the . . . evidence presented." *Id.* at 47. Because there was no evidence that NT's board approved any of the stock issuances by a written instrument (a board resolution or written consent), those issuances were void and, therefore, NT had no outstanding stock. *Id.* at 46. Again, the court ruled that this defect could not be remedied. Therefore, the NT Written Consent was invalid.

Argument

I. The Court of Chancery erred by refusing to consider Mary's evidence of board approval of the challenged issuances

A. Questions presented

Did the Court of Chancery err by determining that the boards were required to approve the issuances of the challenged stock "by written instrument" to validly issue such stock and that, absent such written instrument, the challenged stock is void? Mary raised the question below in her pre-trial answering brief (A95), her post-trial opening brief (A1196-97), and her post-trial answering brief (A1237 n.25).

B. Scope of review

The question presented is one of law. In an appeal from a decision of the Court of Chancery, the Supreme Court reviews conclusions of law *de novo*. *Stegemeier v. Magness*, 728 A.2d 557, 561 (Del. 1999).

C. Section 151(a) does not require a board to approve a stock issuance by a "written instrument"

The Court of Chancery erred in its determination that, under *STAAR Surgical Co. v. Waggoner*, 588 A.2d 1130 (Del. 1991), "[common] stock that is not issued pursuant to a written instrument evidencing board approval . . ." is void. Ex. A at 39. The court erred in reaching that conclusion because, even though Mary admitted that the boards did not approve the challenged common stock by a contemporaneous "written instrument," 8 *Del. C.* § 151(a) does not require that a

board of directors do so. As a consequence of that initial error, the court went on to determine that the challenged stock was void, and it refused to consider that stock in deciding the Section 225 election contest, both in error. The court also determined in error that, because that stock was void, it could not consider Mary's evidence of board approval of the issuances.

i. STAAR Surgical Co. v. Waggoner

In determining that the challenged stock was void, the court relied upon 8 *Del. C.* § 151(a) and *STAAR Surgical* to determine that:

> Under Section 151(a), the voting powers, rights, and preferences of stock to be issued "shall be stated and expressed in the certificate of incorporation . . . or in the resolution or resolutions providing for the issue of such stock adopted by the board of directors." That is, stock is valid only if it is issued pursuant to a written instrument evidencing board approval of the stock issue. This reading of Section 151(a) comports with that in *STAAR Surgical* . . . , in which the Supreme Court reviewed the effect of a board's failure to adopt a formal resolution to approve a certificate of designation for convertible preferred stock and the subsequent stock issue. That the board failed to comply with Section 151(a) by not approving the certificate or issue in a written instrument meant that the issued stock was void. Consequently, . . . Section 151(a) requires a written instrument.

Ex. A at 37-38.[12] The court erred in reaching this conclusion because this Court's opinion in *STAAR Surgical* does not suggest, let alone hold, that a board may only issue *common stock* by a written instrument.

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[12] The court also relied, in part, on 8 *Del. C.* §§ 141(b) & 141(f).

In *STAAR Surgical*, this Court considered an issuance of *preferred stock* which, under Section 151(a), requires that such preferences are included in the charter or a resolution adopted by the board pursuant to the authority expressly vested in it. *STAAR Surgical*, 588 A.2d at 1135. In addition, because the challenged preference (super-majority voting rights) were not in the charter, Section 151(g) required a certificate of designations detailing the rights of the preferred stock, as provided in a resolution adopted by the board and attached thereto. *Id* at 1133, 1135.[13] Waggoner conceded that the board never approved the resolution or the certificate of designations. Noting that preferred stock rights are in derogation of common law and, therefore, that the creation of such rights is strictly construed, this Court ruled that the company's failures resulted in void stock. *Id.* at 1136. It found that the failure to comply with the requirement that the board approve the resolution and the certificate of designation, which amends "the fundamental document which imbues a corporation with its life and powers, and defines the contract with its shareholders cannot be deemed a mere 'technical' error." *Id.* at 1137. Thus, *STAAR Surgical* did not address whether Section 151(a) mandates that a board approve a common stock issuance by a written instrument.

[13] *See Waggoner*, 581 A.2d at 1137 (holding that the super-majority voting rights granted by the corporation "were void because the Board lacked authority under STAAR's certificate of incorporation to authorize preferred stock with such special rights.").

ii. The language of 8 Del. C. § 151(a)

Section 151(a) does not expressly or implicitly require that a board issue common stock "by written instrument" as the Court of Chancery concluded. Ex. A at 37-38. The analysis, however, must begin with Section 102(a)(4).

Under Section 102(a)(4), if a corporation may issue one class of stock, the charter must state the total number of authorized shares and the par value of each share. If the corporation is authorized to issue more than one class of stock, the certificate must state the number of shares of each class and whether those share have par or no-par value and:

> shall also set forth a statement of the designations and the powers, preferences and rights . . . which are permitted by § 151 . . . in respect of any class or classes of stock . . . of the corporation and the fixing of which by the certificate of incorporation is desired, and *an express grant of such authority as it may then be desired to grant to the board of directors to fix by resolution* . . . any thereof that may be desired but which shall not be fixed by the certificate of incorporation.

(emphasis added). Section 151(a), in turn, partly provides:

> Every corporation may issue 1 or more classes of stock or 1 or more series of stock within any class thereof, any or all of which classes may be of stock with par value or stock without par value and which classes or series may have such voting powers, full or limited, or no voting powers, and such designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions thereof, as *shall be stated and expressed in the certificate of incorporation* or of any amendment thereto, *or in the resolution or resolutions providing for the issue of such stock adopted by the board of directors pursuant to authority expressly vested in it by the provisions of its certificate of incorporation.*

Id. (emphasis added). Thus, under Section 151(a), a corporation may issue stock as provided in the certificate of incorporation *or* in a resolution adopted by the board. The resolution language of Section 151(a), however, applies only when the board is exercising authority "expressly vested" in it by the certificate of incorporation. Under Section 102(a)(4), the only authority that may be expressly vested in the board is to fix the powers, preferences, and rights permitted by Section 151. If there are no such powers, preferences, and rights, and the certificate states the par value (as it must under Section 102(a)(4)), Section 151 requires nothing further to issue common stock.[14] There is no requirement in Section 151(a) that the board approve such an issuance in writing.

Both NC and NT's charter states the par value of its common stock and,[15] with that required information in the charters, Section 151(a) provides simply that the entities "may issue" common stock. The language of Section 151(a) imposes no additional requirements or restrictions. In that Section 151(a) imposes no

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[14] Similarly, if the charter specifies the powers, preferences, and rights of preferred stock, the board resolution provision of Section 151(a) is not triggered.

[15] Both of NC and NT's charters set the common stock par value at $.001 per share. A668; A950.

additional restrictions for common stock, the corporations "may issue" stock through their boards acting as they must under Section 141(a) and 141(b).[16]

The requirement of a board resolution in Section 151(a) is only triggered when the board of directors, as expressly authorized in the charter, establishes the rights and preferences of preferred stock *at the time of issuance*; that is, exercises its "blank check" authority. *See* 8 *Del. C.* §§ 151(a) & 151(g).

The General Assembly requires that a company detail the rights and preferences of preferred stock in the charter, either as originally filed, an amendment, or by "a certificate of designations" under Section 151(g), which amends the charter, because preferred rights are in derogation of common law and represent a fundamental change of the parties' rights. *STAAR Surgical*, 588 A.2d at 1136 ("When a corporation files a certificate of designation . . . , it amends the certificate of incorporation and fundamentally alters the contract between all of the parties.") (citations omitted); *Waggoner v. Laster*, 581 A.2d 1127, 1134 (Del. 1990) ("Since stock preferences are in derogation of the common law, they must

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[16] We agree that the best practice is to approve an issuance of stock by a written board resolution or written consent. However, the question before the Court is not best practices, but an interpretation of the statutory requirements for the issuance of such stock.

be strictly construed.") (citations omitted). Section 151(a) does not require a writing when a corporation issues common stock: it simply "may issue" it.[17]

This conclusion is further supported by the General Assembly's express mandate, in other corporate contexts, that boards document their acts in writing. *See*, *e.g.*, 8 *Del. C.* § 141(f) ("[A]ny action required or permitted to be taken at any meeting of the board of directors or of any committee thereof may be taken without a meeting if all members of the board or committee, as the case may be, *consent thereto in writing* . . . ."). And the legislature similarly mandated that corporations document certain other rights in the charter. 8 *Del. C.* § 102(b)(1)-(7). Finally, the General Assembly specifically required a writing in other contexts,[18] and its failure to expressly require a writing in Section 151(a) must be considered deliberate. *See Leatherbury v. Greenspun*, 939 A.2d 1284, 1291 (Del. 2007) ("[W]hen provisions are expressly included in one statute but omitted from another, we must conclude that the General Assembly intended to make those

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[17] Even *if* the Court were to construe Section 151(a) to require a board "resolution or resolutions" for the common stock issuances considered below, which it should not do, an oral resolution meets that requirement. *See Feldman v. Cutaia*, 956 A.2d 644, n.67 (Del. Ch. 2007) *aff*, 951 A.2d 927 (Del. 2008). ("While airtight written documentation of a resolution granting options is a prudent course of action for directors who wish to avoid future legal challenges, section 157(b) does not expressly require that the resolution be included in the minutes of the board meeting at which it was adopted *or that the resolution be in writing*.") (emphasis added).

[18] *See*, *e.g.*, 8 *Del. C.* §§ 102(a)(1), 103(i)(1)(b), 103(i)(3), 108(b), 111(a)(3), 125, 136(a), 142(b), 145(d)(3), 151(f), 160(d), 163, 166, 202(a), 211(b), 212(c)(1), 217(b), 218(a), 218(b), 218(c), 220(b), 222(a), 228(a), 228(b), 229, 231(a), 232(a), 233(a), & 233(b).

admissions.”); *Colonial Ins. Co. v. Ayers*, 772 A.2d 177, 181 (Del. 2001) (referring to the “well-established principle of statutory construction that ‘different terms are used in various parts of a statute, it is reasonable to assume that a distinction between the terms was intended.’”); *Alpine Inv. Partners v. LJM2 Co-Investment, L.P.*, 794 A.2d 1276, (Del. Ch. 2002) (“[W]here a provision is expressly included in one section of a statute but, is omitted from another, it is reasonable to assume that the Legislature . . . intended it.”).

As such, Section 151(a) does not require boards to issue common stock “by written instrument,” and the court erred in that regard, making reversal here appropriate for the court to determine, factually, whether the boards validly issue the stock challenged below.

iii. Grimes v. Alteon Inc.

Although the Court of Chancery did not rely extensively upon *Grimes v. Alteon Inc.*, 804 A.3d 256 (Del. 2002), as distinct from *STAAR Surgical*, in reaching its conclusion, we expect that Ann and John will stress *Grimes* extensively on appeal as supporting the court’s determination. Although some broad language in *Grimes* appears to support their position, close inspection of this Court’s decision reveals that it does not control the question on appeal.

Central to the issues on appeal, *Grimes* did not involve an issuance of stock under Section 151(a), let alone an issuance of common stock under that section.

In *Grimes*, Mr. Grimes sought to enforce a purported oral agreement he reached with company's chief executive officer which would have allowed him to purchase a certain percentage of the company's stock in the future. Mr. Grimes admitted that the board of directors had not approved the oral agreement. *Id.* at 258. Finding that the agreement constituted a "right," this Court found that Section 157(a) was applicable, which plainly mandates that "such rights or options . . . *be evidenced by or in such instrument or instruments as shall be approved by the board of directors*." 8 *Del. C.* § 157(a) (emphasis added); *Grimes*, 804 A2d. at 265-66. It is this specific language in Section 157(a) which compelled Court's conclusion that "[t]o ensure certainty, these provisions contemplate board approval and a written instrument evidencing the relevant transactions . . . ." *Grimes*, 804 A.2d at 261. Thus, in *Grimes*, this Court simply enforced that straightforward direction of the General Assembly mandating that "rights or options" issued pursuant to Section 157(a) be evidenced by a writing.[19]

Admittedly, on its face, the language in *Grimes* is broader than its specific holding: whether an alleged oral agreement set forth in a written instrument as required by Section 157(a) is enforceable. But, if the Court were to apply *Grimes* in the manner sought here by Ann and John, it would be impermissibly altering

[19] In addition, Section 157 mandates that the right or option be evidenced by a writing, not the board's approval of such right or option. *See Feldman*, 956 A.2d at n.67 ("section 157(b) does not expressly require that the resolution be included in the minutes of the board meeting at which it was adopted *or that the resolution be in writing*.") (emphasis added).

the statutory language of Section 151(a) by grafting a requirement beyond that dictated by the legislature. This, it should not do; even if the Court disagrees from a policy perspective. *In re Krafft-Murphy Co.*, 82 A.3d 696, 702 (Del. 2013) ("'In interpreting a statute, Delaware courts must ascertain and give effect to the intent of the legislature. If the statute is found to be clear and unambiguous, then the plain meaning of the statutory language controls.'") (citation omitted); *Kelty v. State Farm Mut. Auto. Ins. Co.*, 73 A.2d 926, 933 (Del. 2013) ("State Farm has raised compelling arguments against providing coverage in this case, but we are judges, not legislators, and cannot substitute our opinions for those of the General Assembly."). Accordingly, the Court should apply Section 151(a) as written, and remand for further proceedings.

II. The Court of Chancery erred by refusing to consider Mary's equitable defenses, because even if this Court affirms the decision that a board may only issue commons stock approved "by written instrument," a board's failure to do so only renders the stock voidable, not void

A. Questions presented

Did the court below err in refusing to consider equitable arguments due to its conclusion that the challenged stock was void? Mary raised this issue in her opening post-trial brief (A1199-1202) and post-trial answering brief (A1234-38).

B. Scope of review

This question presents a question of law. In an appeal from a decision of the Court of Chancery, the Supreme Court reviews conclusions of law *de novo*. *Stegemeier*, 728 A.2d at 561.

C. At worst, the purported infirmities in the stock issuances rendered the stock voidable, not void, and thus susceptible to Mary's equitable arguments

The Court of Chancery erred by refusing to consider Mary's equitable defenses. The court held that, under *STAAR Surgical Co.*, "'[s]tock issued without authority of law is void and a nullity' and this includes stock that is not issued pursuant to a written instrument evidencing board approval." Ex. A at 39. Thus, the court's determination that NC and NT's boards failed to approve the challenged stock issuances "by written instrument" rendered those issuances

"void" and insusceptible to Mary's equitable challenges. Ex. A at 44, 46.[20] The court erred because, even if the stock issuances where "infirm" in some way, those infirmities would only render the stock voidable, not void.

i. The Finch doctrine

Mary asked the court to apply the "venerable and unbroken line of cases starting with *Finch v. Warrior Cement Corp.* . . ," decided in 1928, which allows the Court of Chancery to consider Mary's equitable defenses in assessing voidable stock. *Morente v. Morente*, 2000 WL 264329, at *2 (Del. Ch. Feb. 29, 2000) (citing *Finch v. Warrior Cement Corp.*, 141 Atl. 54, 61 (Del. Ch. 1928); *Topkis v. Delaware Hardware Co.*, 2 A.2d 114, 116 (Del. Ch. 1938); *Bovay v. H.M. Byllesby & Co.*, 22 A.2d 138, 141-32 (Del. Ch. 1941); *Brown v. Fenimore*, 1977 WL 2566, at *3 (Del. Ch. Jan. 11, 1977); *Danvir Corp. v. Wahl*, 1987 WL 16507, at *4 (Del. Ch. Sept. 8, 1987); *Testa v. Jarvis*, 1994 WL 30517 (Del. Ch. Jan. 12, 1994)). For example, the *Finch* doctrine described in *Morente* can "prevent[] a party to the transfer from arguing that the transaction should be set aside for failure to comply with corporate formalities, such as failure to secure formal approval by the board of directors." *Morente*, 2000 WL 264329, at *2.

Danvir Corporation v. Wahl, on which *Morente* relies, illustrates these principles in similar circumstances. In *Danvir*, as here, the court considered "a

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[20] Mary does not challenge here the court's factual conclusion that neither NC nor NT's boards approved the contested stock issues by a written board resolution or written consent.

family dispute over the ownership and control of two corporations . . . ." *Danvir Corp. v. Wahl*, 1987 WL 16507, at *1 (Del. Ch. Sept. 8, 1987). In order to resolve the Section 225 dispute, the Court of Chancery considered challenges to stock issuances, involving similar purported failures in corporate formality, including: (1) There were no board meeting minutes reflecting the issuances of Danvir stock at any time, other than the initial issuance, (2) Since incorporation, it was unclear who the officers and directors of Danvir have been, (3) The witnesses who testified on this point were unaware of any meetings of officers or directors of Danvir ever having been held, and (4) With respect to A&H, it was unclear whether it had a formal board of directors and if it did, the evidence indicated that the board never met. *Id.* at *1-2. Thus, the plaintiffs "argue[d] that the shares were not validly issued because there [was] not evidence that the board of directors of either corporation ever authorized the issuance of any stock to defendants as required by 8 *Del. C.* § 161 . . . ," that "the purported issuance of stock was invalid for lack of consideration . . . ," and "that the stock certificates [were] defective because they bear only one signature . . . ." *Id.* at *4. The court refused to consider these challenges, finding that "Dominick's estate . . . may not challenge the issuance of stock to defendants . . . ," because "[Dominick] would have been estopped from doing so because he participated in and acquiesced in the issuance of all the remaining stock." *Id.* at *4 (citations omitted).

The Court of Chancery erred in finding that it lacked the authority to consider Mary's equitable arguments under this and similar authority, because the purported infirmities would render the stock voidable, not void. *STAAR Surgical*, 588 A.2d at 1137 ("If the stock is indeed void, then 'cancellation is the proper remedy.' However, if the stock is voidable then a court may grant 'that form of relief [that] is to be most in accord with all of the equities of the case.") (citation omitted); *Waggoner*, 581 A.2d at 1136-37 ("In the corporate context, estoppel has often been used to prevent a stockholder from objecting to the validity of stock which he accepted with knowledge of the irregularities or infirmities in issuing it. . . . Estoppel, however, has no application in cases where the corporation lacks the inherent power to issue certain stock or where the corporate contract or action approved by the directors or stockholders is illegal or void.") (citations omitted).

ii. Void versus voidable corporate acts

As explained in Section I above, Section 151(a) did not require that the boards of NC and NT approved the challenged stock "by written instrument." If the Court nonetheless finds that the stock issuances challenged below are somehow infirm, those infirmities would only render the stock voidable because the alleged infirmities did not involve a charter violation; that is, the challenged issuances did not violate the charters, and they were not taken without charter authority where express charter authority is required. Thus:

> The essential distinction between voidable and void acts is that the former are those which may be found to have been performed in the interest of the corporation but beyond the authority of management, as distinguished from acts which are *ultra vires*, fraudulent or gifts or waste of corporate assets. . .
>
> Void acts are not ratifiable "because the corporation cannot, in any case, lawfully accomplish them." Void acts are "illegal acts or acts beyond the authority of the corporation." In contrast, voidable acts are ratifiable because the corporation can lawfully accomplish them if it does so in the appropriate manner.

Nevins v. Bryan, 885 A.2d 233, 245 (Del. Ch. 2005), *aff'd*, 884 A.2d 512 (Del. 2005) (citations omitted). *See also Kalageorgi v. Victor Kamkin, Inc.*, 750 A.2d 531, 539 (Del. Ch. 1999), *aff'd*, 748 A.2d 913 (Del. 2000).

Thus, the distinction between void and voidable acts stems from the nature of the challenged act: those acts which violate the charter, and those taken without charter authority where express authority is required, are void; while others are merely voidable. This Court's most recent explanation of its refusal to allow the use of equity in the face of void acts demonstrates this distinction best:

> [A] corporate charter is both a contract between the State and the corporation, and the corporation and its shareholders. *See Lawson v. Household Finance Corp.*, Del. Supr., 152 A. 723, 727 (1930). The charter is also a contract among the shareholders themselves. *See Morris v. American Public Utilities Co.*, Del. Ch., 122 A. 696, 700 (1923). When a corporation files a certificate of designation under § 151(g), it amends the certificate of incorporation and fundamentally alters the contract between all of the parties. *See* 8 *Del. C.* §§ 104, 151(g). *A party affecting these interrelated, fundamental interests, through an amendment to the corporate charter, must scrupulously observe the law.*

STAAR Surgical, 588 A.2d at 1136 (emphasis added). These basic principles led the Court to conclude that, where the corporation issued preferred shares with voting rights that were not authorized under the charter, "a board's failure to adopt a resolution and certificate of designation, *amending the fundamental document which imbues a corporation with its life and powers, and defines the contract with its shareholders*, cannot be deemed a mere 'technical' error." *Id.* at 1136-37 (emphasis added). *See also Blades v. Wisehart*, 2010 WL 4638603, at *10 (Del. Ch. Nov. 17, 2010) ("This conclusion rests on . . . *STAAR* itself, and the heavy weight that the Delaware Supreme Court placed on the fact that an issuance of new stock, like a stock split, requires an amendment to a corporation's certificate of incorporation, and can rightly be seen as 'an act of fundamental legal significance having a direct bearing upon questions of corporate governance, control and the capital structure of the enterprise.'").[21]

Since *STAAR Surgical*, the Court of Chancery has applied equity in the case of shares that were authorized by a charter but defectively issued. For example, in

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[21] *STAAR Surgical* relied upon *Triplex Shoe Co. v. Rice & Hutchins Inc.*, 152 Atl. 342, 347-348 (Del. 1930), which originally recognized the distinction between acts that are void because they violate or exceed the corporate charter and acts that are voidable because they are authorized by the charter but were defectively accomplished. In *Triplex Shoe*, the Court held that a no par value stock issue was void "when there was no grant from the State to issue the kind of stock that was issued," because "[t]he certificate of incorporation did not confer upon the board of directors authority to fix the consideration for no par value stock . . . ." *Id.* at 347, 348. The Court, however, distinguished the case from instances of voidable stock, which iscurable "either on the ground that in such cases the corporation had the power to issue the kind of stock that was issued, or on the ground of estoppel." *Id.* at 348 (emphasis added).

Kalageorgi v. Victor Kamkin, Inc., 750 A.2d 531 (Del. Ch. 1999), the validity of shares were attacked in a section 225 action because there was neither "a vote at a duly held meeting of the directors or a written unanimous consent of the directors filed in the minute book of the Company," as required under Section 141(b) or (f). *Id*. at 537. The authority of board to issue the shares was not disputed, and the court recognized "the proposition that where board authorization of corporate action that falls within the board's *de jure* authority is defective, the defect in authority can be cured retroactively by board ratification." *Id*. at 539. In holding that the shares were valid, the court concluded that it did not need to decide compliance with Section 141(b) or (f), because "any technical defect in authority was cured" retroactively by subsequent board ratification, which necessarily meant that the shares were, at most, voidable. *Id*. at 539.[22]

In this sense, Delaware case law shows that "illegal" or void acts are those the corporation "cannot . . . lawfully accomplish." *Nevins*, 885 A.2d at 245. For example, after stating that "void acts are said to be non-ratifiable because the corporation cannot, in any case, lawfully accomplish them . . . ," the Court of Chancery went on to explain that "I do not mean to imply . . . that the act itself is necessarily 'illegal' in the sense that the [act] is expressly or impliedly prohibited

[22] *See CarrAmerica Realty Corp. v. Kaidanow*, 321 F.3d 165, 185 (D.C. Cir. 2003) (*Kalageorgi* "incorporates the more fundamental principle that the shares, prior to ratification, were merely voidable, not void, because only voidable acts would be open to ratification.").

by a statute or the charter, or against morals, or against public policy' . . . , [r]ather, I refer to an act that is beyond the corporation's power either because it is illegal or, if not illegal, *is otherwise beyond the authority of the corporation under its charter to accomplish*." *Harbor Fin. Partners v. Huizenga*, 751 A.2d 879, 896 & n.59 (Del. Ch. 1999) (emphasis added). *See also Michelson v. Duncan*, 407 A.2d 211, 218-19 (Del. 1979) ("The essential distinction between voidable and void acts is that the former are those which may be found to have been performed in the interest of the corporation but beyond the authority of management, as distinguished from acts which are Ultra vires, fraudulent or gifts or waste of corporate assets."); *Solomon v. Armstrong*, 747 A.2d 1098, 1114 n.45 (Del. Ch. 1999) ("In the context . . . void acts, *ultra vires* acts fall under a much more narrow definition which includes acts specifically prohibited by the corporation's charter, for which no implicit authority may be rationally surmised, or those acts contrary to basic principles of fiduciary law."), *aff'd*, 746 A.2d 277 (Del. 2000).

Under this authority, any purported defects in stock issuance result in void stock only where an act violated the charter or lacked express charter authority

where required. Authority from this Court[23] and from the Court of Chancery[24] supports that conclusion. Thus, because none of the purported infirmities in the stock issuances involved charter violations, the court below erred in finding that the stock was void and refusing to consider equitable arguments.

Conclusion

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[23] *See*, *e.g.*, *Waggoner*, 581 A.2d at 1136-37 ("Estoppel, however, has no application in cases where the corporation lacks the inherent power to issue certain stock or where the corporate contract or action approved by the directors or stockholders is illegal or void.") (citations omitted); *Michelson*, 407 A.2d at 219-20 (treating an amendment to the corporation's stock option plan by its board, which violated the terms of the plan, as voidable, not void); *Triplex Shoe Co. v. Hutchins*, 152 Atl. 342, 363 (Del. 1930) ("We are unable to see how the amendment could have made stock valid that is void because issued without any authority from the State. Such an amendment might cure certain irregularities . . . and defects in a stock issue that is authorized . . . , but it does not seem to us that it can possibly relate back and validate a stock that was issued without any corporate authority. If the stock issue was void, a nullity, there was nothing to validate, nothing upon which the amendment could operate.").

[24] *Liebermann v. Frangiosa*, 844 A.2d 992, 1004, 1006 (Del. 2002) ("That stock could not be validly issued absent an amendment to the MobileToys certificate."); *Harbor Financial*, 751 A.2d at 896 & n.59 ("[V]oid acts are said to be non-ratifiable because the corporation cannot, in any case, lawfully accomplish them . . . ," but "I do not mean to imply by using this phraseology that the act itself is necessarily ''illegal' in the sense that the [act] is expressly or impliedly prohibited by a statute or the charter, or against morals, or against public policy'. . . , [r]ather, I refer to an act that is beyond the corporation's power either because it is illegal or, if not illegal, *is otherwise beyond the authority of the corporation under its charter to accomplish*.") (emphasis added); *Kalageorgi*, 750 A.2d at 537-40 (recognizing ratification where "it is undisputed that the issuance of VKI common stock was not approved at a board meeting or by a unanimous written consent . . ."); *Solomon*, 747 A.2d at 1114 ("Void acts are those acts that the board, or more generally the corporation, has no implicit or explicit authority to undertake or those acts that are fundamentally contrary to public policy."); *Gaskill v. Gladys Belle Oil Co.*, 146 Atl. 337, 339 (Del. Ch. 1929) ("The statute, by providing that the preferred stock which corporations created under it may issue shall possess such preferences as are stated in the certificate of incorporation, . . . unless the preferences are stated in the certificate of incorporation, they shall not exist."); *Blades*, 2010 WL 4638603, at *12 ("[A]dherence to formalities is even more important when, as in the case of a split, the change in capital structure and ownership requires a certificate amendment."); *MBKS Company Ltd. v. Reddy*, 924 A.2d 965, 972 (Del. Ch. 2007) (Cancellation of existing shares was without "legal authority" because an amendment to the certificate of incorporation was not effected pursuant to 8 *Del. C.* § 242(a)).

For the reasons explained above, the Court of Chancery erred in determining that the stock issuances challenged below violated the express terms of 8 *Del. C.* § 151(a). Further, the court erred in refusing to consider Mary's equitable defenses. Reversal is appropriate for both reasons.

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February 24, 2014