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Case Number 13,2014

IN THE SUPREME COURT OF THE STATE OF DELAWARE

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

# *Appellant's reply brief*

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## *Argument*

As explained in Mary Schaheen's ("Mary") opening brief ("OB"), the Court of Chancery erred by: (1) holding that 8 *Del. C.* § 151(a) requires a written instrument evidencing a common stock issuance, and (2) refusing to consider Mary's equitable arguments due to its conclusion that a failure to issue common stock by a written instrument resulted in void stock. The answering brief filed by appellants, Ann Boris ("Ann") and John Boris ("John"), did nothing to change that result. For the reasons explained in the opening brief, and those below, reversal is required.

### *I. 8 Del. C. § 151(a) does not require a board of directors to act "by written instrument" when it approves an issuance of common stock, as the trial court erroneously concluded*

Despite fourteen pages of argument, Ann and John never directly confront, or even address, the central focus of this appeal: that nothing in 8 *Del. C.* § 151(a) requires a board of directors to act by written instrument when it approves an issuance of *common stock*. For an issuance of common stock, section 151(a) provides simply that: "[e]very corporation *may issue* 1 or more classes of stock . . . ." 8 *Del. C.* § 151(a) (emphasis added). *See also* 8 *Del. C.* § 161 ("The directors may . . . issue or take subscriptions for additional shares of its capital stock . . . ."). The statute is straightforward and, when applied here, the result is inescapable: the trial court erred in concluding that the disputed stock issuances were void because the boards did not approve them by a written instrument—a written resolution or a written consent.

As it must, this Court should follow the legislature's intent, expressed in the language of section 151(a), by applying the plain language of the statute and reversing the decision below. For an issuance of common stock, 8 *Del. C.* § 151(a) provides simply that: "[e]very corporation *may issue* 1 or more classes of stock . . . ." *Id.* (emphasis added). With no specific requirement for a writing or a written instrument in the case of common stock, the companies, acting through their directors, "may issue" common stock, and nothing required the boards to act "by written instrument" as the Court of Chancery determined. The court below thus erred by ignoring the express language of section 151(a).

Instead of confronting, or attempting to explain away, the plain language of section 151(a), Ann and John use misdirection. They do not: (1) provide an alternative reading of 8 *Del. C.* § 151(a) which requires a writing, or (2) provide authority for the specific proposition that a corporation must issue *common stock* by a written instrument. Instead, Ann and John rely exclusively upon cases relating either to issuances of *preferred stock* governed by 8 *Del. C.* § 151(g) (*STAAR Surgical*) or grants of "rights or options" governed by 8 *Del. C.* § 157(b) (*Grimes*). But this authority does not control this appeal as, unlike here, the statutes addressed in those cases expressly require a writing. *See* 8 *Del. C.* §§ 151(g) (requiring a "certificate of designations") & 157(b) (requiring an "instrument or instruments").

This Court's decision in *STAAR Surgical*, upon which the Court of Chancery based its decision, illustrates the distinction well. In *STAAR Surgical*, the Court considered the validity of preferred stock that was not authorized by the certificate of incorporation, and where "[t]he directors never formally adopted either the December 17, 1987 resolution or the certificate of designation . . . " detailing the preferences of the challenged stock as required by 8 *Del. C.* § 151(a) and (g). *STAAR Surgical Co. v. Waggoner*, 588 A.2d 1130, 1136 (Del. 1991). Because the Court considered the validity of an issuance of "blank check" preferred stock in *STAAR Surgical*,[1] the language of 8 *Del. C.* § 151 not only expressly required the board to act by "resolution" under subsection (a), but subsection (g) also plainly required a writing: "a certificate of designations." *Id.* at 1136-37. These requirements, however, do not govern common stock issuances authorized by the charter, as was the case here.

*STAAR Surgical* explains that "Section 151(a) . . . requires, in part, that all new stock voting powers, designations, preferences and other special rights must *either* be in the certificate of incorporation *or*: '[i]n 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.* at 1135

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[1] *See id.* at 1135 ("There is no dispute that the STAAR certificate of incorporation authorizes the board to issue, by resolution, 'blank check' preferred stock . . . .").

(emphasis altered). Even where section 151(a) requires a resolution, because the board is setting the blank check preferences at issuance, the language requires only a "resolution," not a *written resolution*. *See Feldman v. Cutaia*, 956 A.2d 644, n.67 (Del. Ch. 2007), *aff'd*, 951 A.2d 927 (Del. 2008) ("[S]ection 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.").[2] Moreover, that language does not apply to common stock issuances.

In the case of both entities considered below, their charters authorized the boards to issue the challenged common shares. Numoda Corporation's certificate of incorporation states that "the Corporation is authorized to issue . . . Common Stock," and "the holders of outstanding shares of Common Stock shall exclusively possess the voting power for the election of directors . . . ." A668; A670. *See also* A919, A921 & A925. Moreover, because section 151(g) governs only issuances of blank check preferred, its language requiring a certificate of designations has no bearing on common stock issuances.

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[2] In *STAAR Surgical*, the board of directors considered, but never approved, an existing written resolution. *Id.* at 1133 ("In fact, the trial court found, and we affirmed in *Waggoner I*, that the board *never formally adopted* the resolution and only Waggoner signed the minutes.") (emphasis in original). Nothing in the opinion suggests that a board may only act by *written* resolution, or that the language of 8 *Del. C.* § 151(a) requires a resolution when a board issues common stock as authorized in the charter.

For an issuance of *common stock*, therefore, the statutory language which compelled this Court's conclusions in *STAAR Surgical* does affect the result here; as neither the "resolution" language of section 151(a) nor the "certificate of designations" language of Section 151(g) apply to common stock issuances authorized by the charter, such as those considered below. Without the language requiring a resolution or a certificate of designations, a corporation simply "may issue" stock, acting as it must through its board of directors.

Although the Court of Chancery did not rely extensively upon *Grimes v. Alteon, Inc.*, Ann and John do so on appeal. And even though, as Mary acknowledged in her opening brief,[3] this Court used broad language in explaining its holding in *Grimes* that "Section 157, relating to rights and options respecting stock, requires board approval and a written instrument to create such rights or options. . . ," the statutory language at issue in *Grimes* compelled that specific result because section 157(b) expressly requires an "instrument or instruments." *Grimes v. Alteon*, 804 A.2d 256, 261 (Del. 2002). Unlike the language in section 157(b), or the language of 8 *Del. C.* § 151(g) at issue in *STAAR Surgical* (which requires a "certificate of designations"), section 151(a) does not impose a writing requirement on common stock issuances. Section

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[3] OB at 23 ("Although some broad language in *Grimes* appears to support [Ann and John's] position, close inspection of this Court's decision reveals that it does not control the question on appeal.").

151(a) only requires a "resolution" for certain issuances of preferred stock not relevant here, and the statute does not require a *written resolution* in any event.

As with section 157(b), at issue in *Grimes*, the legislature has expressly required a writing in numerous other corporate contexts—and even in other circumstances affected by the same statute at issue here. *See* 8 *Del. C.* § 151(g) (requiring a board to cause execution of a "certificate of designations" detailing the preferences established by the board when it issues blank check preferred). But the General Assembly's decision against imposing a writing requirement in section 151(a) for a common stock issuance controls the result here because the Court must apply the "'clear and easily followed legal roadmap'" of our corporate code. *Grimes*, 804 A.2d at 260 (citation omitted). Thus, Delaware law does not permit this Court to insert a writing requirement into the language selected by the legislature in passing section 151(a). *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 omissions."); *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 Capital Mgmt., L.P.*, 794 A.2d 1276, 1286

(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.").

Again, Mary acknowledges that *Grimes* includes broad statements regarding stock issuances, but that language is broader than the Court's specific holding: that 8 *Del. C.* § 157(b) requires an "instrument or instruments evidencing such rights or options" when a corporation grants rights or options. The language in section 157(b) compelled that particular result, but that statute did not apply below, where the court considered common stock issuances, not grants of rights or options. Accordingly, this Court's broad language in *Grimes* should apply only where, as in section 157(b), 151(g), and elsewhere, the governing statutory language expressly requires a writing. *Grimes*, 804 A.2d at 261 ("To ensure certainty, these [statutory] provisions contemplate board approval and a written instrument evidencing the relevant transactions affecting issuance of stock and the corporation's capital structure."). Thus, to the extent the broader language in *Grimes* can be read to apply to common stock issuances under section 151(a), which does not require a writing, the Court's statements are dicta and without precedential effect. *See, e.g.*, *Brown v. United Water Delaware*, 3 A.3d 272, 276 & n.17 (Del. 2010) ("[T]hat holding is *obiter dictum* and 'not the result of an adversarial argument'". . . and thus "is without precedential

effect.") (citation omitted); *Crown EMAK Partners, LLC v. Kurz*, 992 A.2d 377, 398 (Del. 2010) ("Any adjustment to the intricate scheme of which section 219 is but a part should be accomplished by the General Assembly through a coordinated amendment process. Therefore, the Court of Chancery's interpretation of stock ledger in section 219 is *obiter dictum* and without precedential effect."); *In re MFW S'holders Litig.*, 67 A.3d 496, 502 (Del. Ch. 2013) ("Like the U.S. Supreme Court, our Supreme Court treats as dictum statements in opinions that are unnecessary to the resolution of the case before the court.") (citations omitted).

In *Grimes*, this Court applied the language of the statute at issue there—as it must do here—which compelled a different result. But because the language at issue here does not require a writing, this Court must give effect to the legislature's will on the issue disputed by the parties in this particular case. *See, e.g.*, *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). If it does so, the statute compels the conclusion that the common stock issuances disputed below did not require a writing. Not only that, but the result reached by the Court of Chancery, and the result sought by Ann and John on appeal, *directly offends the legislature's intent* expressed in section 151(a).

Thus, although Ann and John quote *Grimes* and maintain that the "'*statutory scheme consistently requires board approval and a writing*,'" the opposite is true. AB at 21. As shown above, section 151(a) does not require a writing for a common stock issuance. Similarly, other sections which potentially affect an issuance of common stock do not require a writing,[4] unlike 8 *Del. C.* §§ 151(g) or 157(b) at issue in *STAAR Surgical* and *Grimes*, which expressly require writings. The contrast between these two types of statutes is both stark and controlling on this appeal.

For all of these reason, the Court should reverse the decision below, and confirm that a board is not required to use a writing when issuing common stock, because section 151(a) does not require a writing.[5]

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[4] *See, e.g.*, 8 *Del. C.* §§ 152 ("The board of directors may authorize capital stock to be issued for consideration . . . ."), 154 ("Any corporation may, by resolution of its board of directors, determine that only a part of the consideration . . . for any shares of its capital stock which it shall issue from time to time shall be capital . . . ."), 155 ("A corporation may, but shall not be required to, issue fractions of a share.") & 156 ("Any corporation may issue the whole or any part of its shares . . . .").

[5] Ann and John assert that "Mary concedes that there are no notices of board meetings, no board minutes, no board resolutions, no formal board votes and no unanimous written consents associated with any of the disputed stock issuance." AB at 19 (citing OB at 3, 16). While substantial documentation shows that the boards approved and relied upon the challenged stock issuances, Mary does agree that discovery did not reveal any *written* notices of board meetings, minutes, written resolutions, written consents, or written records documenting board votes, but Delaware law does not require that a board act by written resolution, or that a board evidence its votes by a writing. *See, e.g.*, 8 *Del. C.* § 141(a) & (b); *Feldman*, 956 A.2d at n.67. As such, these claims should not affect this Court's decision here and, in any event, the Court of Chancery did not rely upon those arguments in its decision.

## *II. Even if accepted, the challenges to the common stock disputed below do not result in void stock*

Once again, instead of directly facing Mary's argument that any issuance problems relating to the common stock challenged below do not result in void stock, Ann and John use misdirection and refuse to acknowledge that any distinction between void and voidable acts might affect the result here. AB at 29-30. Yet, our law unquestionably distinguishes between those two results, and this Court should examine the precise nature of the purported infirmity at issue: common stock issued without a contemporaneous written instrument. As explained above, section 151(a) does not require that a board of directors use a writing when issuing common stock. Thus, and because Ann and John do not contend that 8 *Del. C.* § 151(a) requires a writing, their only remaining complaint, apparently, is that the issuances offend the language of *Grimes* because the stock was not issued by a written instrument.[6]

This Court recently confirmed that the distinction between void and voidable acts continues to exist under our law. *Klaassen v. Allegro Dev. Corp.*, 2014 WL 996375, at *8 (Del. Mar. 14, 2014) ("This result is congruent with the well-established distinction between void and voidable corporate actions. As this Court discussed in

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[6] Ann and John even now appear to concede that they did intend to issue the challenged stock: "Even if John and Ann *had* intended that Mary own the amount of shares she claims to own, that intent does not outweigh the failure of corporate formalities." AB at 27 (citation omitted, emphasis in original).

*Michelson v. Duncan*, '[t]he 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.'"). In fact, Ann and John ignore the plain statements by this Court in one of their principal authorities, *STAAR Surgical*, where the Court stated:

> The Court of Chancery has correctly recognized that the available form of equitable relief depends on the facts of each case. If the stock is indeed void, the "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 accord with all of the equities of the case.'"

*STAAR Surgical*, 588 A.2d at 1137. *See also Waggoner v. Laster*, 581 A.2d 1127, 1136 (Del. 1990) ("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.").

Here, the fact that the boards did not issue the disputed common stock by written instrument does not render that stock void, and thus the Court of Chancery erred in refusing to consider Mary's equitable arguments on that basis. As advanced in Mary's opening brief,[7] Delaware law consistently supports the conclusion that corporate acts are void *only where those acts*: (1) violate the corporation's charter, or

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[7] OB at 29-34.

(2) are taken without express charter authority where such express charter authority is required by statute.[8] Even though Ann and John fail to address, or even acknowledge, this argument, the cases they rely upon both support that conclusion because both cases involved charter offenses. *Blades v. Wisehart*, 2010 WL 4638603, at *10 (Del. Ch. Nov. 17, 2010) (declaring a stock split void due to a failure to amend the charter as required by 8 *Del. C.* § 242(a)(3), stating that "[t]his 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 . . . ."); *Liebermann v. Frangiosa*, 844 A.2d 992, 1006 (Del. Ch. 2002) (rejecting preferred stock because the corporation did not amend its charter, either by amendment or a certificate of designations).

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[8] *See, e.g.*, *STAAR Surgical*, 588 A.2d at 1137 ("[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."); *Nevins v. Bryan*, 885 A.2d 233, 245 (Del. Ch. 2005) ("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."); *Harbor Fin. Partners v. Huizenga*, 751 A.2d 879, n.59 (Del. Ch. 1999) ("I refer to an act that is beyond the corporation's power either because it . . . is otherwise beyond the authority of the corporation under its charter to accomplish."); *Solomon v. Armstrong*, 747 A.2d 1098, 1114 n.45 (Del. Ch. 1999) ("In the context of defining 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 . . . .").

Importantly, none of the decisions in the *Finch* line of cases, in which the Court of Chancery used equity in similar circumstances, involved the use of equity in the face of charter offenses.[9] Consequently, the various opinions cited by the parties are consistent with Mary's arguments, because none of the *Finch* line of cases offend—and consequently their holdings were not affected or overruled by—*STAAR Surgical* as none of the purported defects at issue in the *Finch* line involved charter offenses.

Moreover, in *Grimes*, this Court *did not consider*: whether the violation of 8 *Del. C.* § 157(b) resulted in void rights, and it did not consider any equitable

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[9] *Topkis v. Delaware Hardware Store*, 2 A.2d 114, 117 (Del. Ch. 1938) (relying on *Finch* and rejecting a challenge to stock based on a lack of consideration); *Morente v. Morente*, 2000 WL 264329 (Del. Ch. Feb. 29, 2000) (using equity and *Finch* to reject a claim that the court should invalidate stock because it was issued without consideration and not recorded on the ledger); *Testa v. Jarvis*, 1994 WL 30517, at *8 (Del. Ch. Jan. 12, 1994) (using equity and relying on *Finch* to reject a challenge to the validity of stock based on a lack of consideration); *Danvir Corp. v. Wahl*, 1987 WL 16507, at *4 (Del. Ch. Sept. 8, 1987) (relying on *Finch* and refusing to consider challenges to stock due to, for example, a lack of evidence of board action to issue the stock, a lack of consideration paid for the stock, and that the stock certificates were not executed properly); *Brown v. Fenimore*, 1977 WL 2566, at *556 (Del. Ch. Jan. 11, 1977) (relying on *Finch* and rejecting a challenge to stock based on a lack of consideration, a lack of stock certificates, and because "corporate records keeping w[as] apparently conducted on a most informal basis."). *See also Kalegeorgi v. Victor Kamkin, Inc.*, 750 A.2d 531, 539 (Del. Ch. 1999) (using equity to bar challenge to stock issued without formal board approval or board minutes); *Finnegan v. Baker*, 2012 WL 6629636, at *24-25 (Mass. Super. Oct. 19, 2012) (applying Delaware law and reaching the same result); *CarrAmerica Realty Corp.*, 321 F.3d 165, 185-86 (DC Cir. 2003) (applying Delaware law and using equity to bar a challenge to stock based on a lack of consideration).

arguments. For this reason, the *Finch* line of cases continues to co-exists peacefully with the *STAAR Surgical* line in Delaware jurisprudence, even after *Grimes*. And, because the purported infirmity relied upon by the Court of Chancery—the boards' apparent failure to issue the challenged common stock by a written instrument—does not involve a charter offense, the challenged stock is not void, and reversal is required.[10]

Accordingly, the purported infirmities in the common stock considered below do not result in void stock, and the Court of Chancery was free to apply its equitable powers, contrary to its conclusion below.

[10] For the same reason, even *if* the Court determines that 8 *Del. C.* § 151(a) requires a writing for an issuance of common stock (which it should not do) and that the boards thus violated the statute's technical requirements, that would render only voidable stock. As explained above, voidable stock is susceptible to Mary's equitable defenses.

## *Conclusion*

For these reasons, the Court should reverse and remand this matter for further proceedings, both because the purported infirmities in the common stock issuances do not result in void stock, and because 8 *Del. C.* § 151(a) does not require a written instrument.

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