ESSAY

THE “SECTION 122 REVOLUTION” IN DELAWARE CORPORATE LAW AND WHAT TO DO ABOUT IT

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Recently, the Delaware General Assembly amended Delaware's corporate code to allow boards to delegate their decision-making powers to stockholders via contract. These amendments are significant because they effectively overturn a recent Delaware Chancery opinion. They're also problematic, for two reasons: (1) because they are out of step with the best reading of Delaware corporate law—what I have referred to elsewhere as "the perpetual entity model" of the corporation and (2) because they are inconsistent with Delaware law's tendency to eschew monetary penalties in favor of a system built on informal reputation-based sanctions and norm internalization, all of which assumes that the board is at the helm. These problems could be largely addressed by limiting the amendments' application to contracts with stockholders that either exercise control or are themselves members of the board. Otherwise, the law as written threatens to destabilize what we know about what corporations are and how corporate law works.

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Could stockholders amend a corporation's certificate of incorporation to require the board to delegate substantial decision-making powers to a single stockholder or stockholder group? Is there ever a situation where the board's own fiduciary duties might require it to carry out such a delegation, for example, if it was thought necessary to maximize profits? And even if not obligated to do so, couldn't a board simply decide via contract, as an exercise of business judgment, to delegate its powers to some stockholders on the basis that it's no different from the board creating a committee, which is allowed under Delaware corporate law?

I would answer all of these questions in the negative.[1] It appears that some academics and many practitioners would answer at least some of these questions in the affirmative. And I think the disagreement represents a significant difference of opinion over what the corporation is and how Delaware law functions. The disagreement is currently playing out in dramatic fashion in the Delaware General Assembly's recent adoption of Section 122(18), which among other things overturns *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.*,[2] a Delaware Chancery case that invalidated a

1 Although I would be willing to answer the last one in the affirmative with some important caveats. *See infra* notes 60–62 and accompanying text.

2 311 A.3d 809 (Del. Ch. 2024).

stockholder agreement granting comprehensive governance rights to the chairman of the board and founder of the company who at the time the stockholder agreement was made was no longer a controlling stockholder.[3] But Section 122(18) would go much further than overturn *Moelis*, allowing a corporation to adopt governance arrangements that until recently many commentators would have thought foreclosed by Delaware law and to do so in an agreement between the board and a stockholder or stockholder group.

To retain what I think is the interpretation of Delaware law that best fits and justifies both the case law and the statute (what I've referred to elsewhere as the "perpetual entity model" of the corporation),[4] and to preserve Delaware's non-sanction-based approach to law,[5] I think that Section 122(18) should be amended to reflect that a board's discretion can be limited or removed in a "very substantial way" by stockholder agreement only if the counterpart to the agreement is themself a current board member or controlling stockholder. Doing so would, at least on an ex ante basis,[6] effectively overturn *Moelis*,[7] consistent with what many practitioners seem to want, while perhaps also hinting at how that opinion might have reached a different result despite being correct on the law. At the same time, this modest change would preserve the corporate form as a unique vehicle for fostering long-term capital allocation and avoid turning it into an LLC by another name.

I
STOCKHOLDER GOVERNANCE AGREEMENTS, *MOELIS* AND SECTION 122(18)

A fundamental feature of the American corporate law landscape is the ability of stockholders to customize the internal rules that govern the corporation to fit the facts and circumstances of a particular business or industry. Delaware law provides that all members of the board must stand for re-election every year.[8] But stockholders might decide to stagger the board so that only one-third of the board stands

3 *See id.* at 828.

4 *See* Zachary J. Gubler, *The Neoclassical View of Corporate Fiduciary Duty Law*, 91 U. CHI. L. REV. 165, 170 (2024).

5 *See infra* notes 36–54 and accompanying text.

6 Section 122(18) isn't retroactive and so technically leaves *Moelis* in place.

7 This is because Moelis was the Chairman of the Board.

8 DEL. CODE ANN. TIT. 8, § 141(D) (2021).

for re-election in a given year.[9] Or they might decide to waive monetary liability for certain fiduciary breaches.[10] Normally, this customization process is brought about through amendments to the bylaws or the certificate of incorporation. In recent years, however, it is increasingly common to find such customization accomplished through agreements between the corporation, represented by the board, and some subset of the stockholders, often a single stockholder. This phenomenon has not escaped the notice of scholars[11] or courts.[12]

The issue raised by these governance-related stockholder agreements is whether they are valid under Section 141(a) of the Delaware General Corporation Law ("DGCL"), which provides that "[t]he business and affairs of every [Delaware] corporation . . . shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."[13] If a stockholder agreement places too great a constraint on the board's ability to manage the corporation, it could potentially be invalid for violating Section 141(a).

All of this came to a head in *Moelis*.[14] There, Ken Moelis, the founder and Chairman of the Board of the investment bank Moelis & Company (the "Company"), entered into a stockholder agreement with the Company right before taking it public.[15] That stockholder agreement granted Moelis the right to pre-approve essentially any decision made by the board and at the same time gave him the right to select a majority of the board's members.[16] While Moelis was a controlling stockholder at the time of the IPO, by the time of the litigation, he owned only about 12% of the equity but still had 40% of the vote because of his ownership of a class of super voting stock.[17] The plaintiff, a pension fund and stockholder, challenged the

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9 *See id.*

10 *See id.* at §102(b)(7).

11 *See, e.g.*, Jill E. Fisch, *Stealth Governance: Shareholder Agreements and Private Ordering*, 99 WASH. U. L. REV. 913 (2021).

12 *See, e.g.*, Jackson v. Turnbull, No. CIV. A. 13042, 1994 WL 174668 (Del. Ch. Feb. 8, 1994) *aff'd*, 653 A.2d 306 (Del. 1994); Nagy v. Bistricer, 770 A.2d 43 (Del. Ch. 2000); ACE Ltd. V. Cap. Re. Corp., 747 A.2d 95 (Del. Ch. 1999).

13 DEL. CODE ANN. TIT. 8, § 141(a) (2021).

14 311 A.3d 809 (Del. Ch. 2024).

15 *See id.* at 824.

16 *See id.* at 825–27.

17 *See id.* at 828.

agreement on the grounds that it violated Section 141(a).[18]

In a thoughtful, learned opinion, VC Laster carefully discussed the many cases that make up the Chancery Court's Section 141(a) jurisprudence. He explained that that jurisprudence draws a distinction between governance-related stockholder agreements that are part of a larger commercial bargain (for example, a no-shop clause in a merger agreement that is part of the deal protection provisions necessary to motivate the acquirer to come to the negotiating table) and an agreement that has no such link to a commercial bargain.[19] There was no evidence that the Moelis agreement was a part of some underlying deal, other than the one granting Moelis control rights, and so the court made relatively quick work of concluding that the agreement fell on the purely non-commercial side of the dividing line.[20]

Having concluded that the Moelis agreement was a non-commercial governance agreement, the next step in the inquiry was to determine if those provisions violated Section 141(a).[21] VC Laster did so by drawing on *Abercrombie v. Davies*, where governance restrictions were found to violate Section 141(a) when they "have the effect of removing from directors in a very substantial way their duty to use their own best judgment on management matters" or "tend[] . . . to limit in a substantial way the freedom of director decisions on matters of management policy."[22] Considering that the agreement in question basically delegated all board powers to Moelis, the pre-approval provisions failed this standard.[23] Additionally, VC Laster found that certain of the provisions pertaining to Moelis's rights to select a majority of the directors also violated the *Abercrombie* standard, including provisions requiring the board to recommend Moelis's nominees to the stockholders for their approval; to fill a vacancy on the board involving a Moelis director with another one of his choosing; and to use best efforts to not allow more than a certain number of seats on the board.[24]

As already mentioned, stockholder agreements like the one

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18 *See id.* at 818.

19 *See id.* at 855–56.

20 *See id.* at 856–60.

21 *Id.* at 860–66.

22 *Id.* at 866 (quoting Abercrombie v. Davies, 123 A.2d 893, 899 (Del. Ch. 1956)).

23 *See id.* at 866–70.

24 *Id.* at 870–77.

in *Moelis*, have been on the rise in recent years, and the *Moelis* opinion threatened to disrupt this evolving market practice. As has happened before when the Court of Chancery has been perceived as out of step with practitioners' expectations, the Delaware General Assembly, in response to *Moelis*, intervened in a way that has been swift and decisive but not necessarily positive for Delaware corporate law. The Delaware General Assembly quickly adopted an amendment to the DGCL, Section 122(18), which, notwithstanding Section 141(a), authorizes Delaware corporations to enter into contracts through which one or more stockholders can do whatever can be done by a majority of stockholders amending the certificate of incorporation. At the same time, Section 122(18) effectively expands the type of customization that can be accomplished in the certificate by identifying the types of provisions permitted in contracts authorized by an amended certificate, including those that

> restrict or prohibit [the corporation] from taking actions specified in the contract, (b) require the approval or consent of one or more persons or bodies before the corporation may take actions specified in the contract . . . (c) covenant that the corporation or one or more persons or bodies will take, or refrain from taking, actions specified in the contract.[25]

Thus, Section 122(18) very clearly overrules *Moelis*, prospectively, but it also seems to do a lot more, pushing the corporation in a maximally contractarian direction and allowing that contractual customization to take place either in the certificate of incorporation or a stockholder agreement.

II
THE PERPETUAL ENTITY MODEL AND THE NATURE OF DELAWARE LAW

My primary claim in this Essay is that Section 122(18) makes assumptions about Delaware's approach to corporations and corporate law that are fundamentally inconsistent with the logic of the caselaw, the statute and the non-sanction-based nature of Delaware law, and that without any further modifications, Section 122(18) will likely make the corporation less effective as a tool for promoting long-term capital allocation with all of the accompanying social benefits. First, let's consider the logic of the caselaw and the statute. Then, we'll consider the non-sanction-based nature of

25 DEL. CODE ANN. TIT. 8, § 122 (West 2024).

Delaware law.

The theory of the corporation that I think best justifies and fits the caselaw and the DGCL is what I've referred to before as the "perpetual entity model" of the corporation.[26] Under the perpetual entity model, the corporation exists for a particular purpose that transcends current stockholders' profit-maximization goals. It exists to foster long-term capital allocation, and it proposes doing so by creating a board with considerable discretion subject to legal duties that are owed to a hypothetical permanent stockholder. Why a hypothetical permanent stockholder? Because, by "long-term," the law means something longer than the market's investment horizon. If that's the case, then the optimal long-term strategy will at times (although not always) depart from that of the current stockholders, and at those times the board will need the ability, and the legal mandate, to ignore, defiantly, if necessary, current stockholders' wishes. Thus, the perpetual entity model is unquestionably a board- rather than stockholder-centered model of corporate governance. To be sure, its goals are certainly related to those of stockholders. But its focus on the extreme long term, a period of time that will transcend the investment horizon of any flesh-and-blood stockholder, suggests that there's something else going on, and indeed there is.

This model of the corporation has an embedded public purpose, which is that focusing corporations on very long-term capital allocation will produce social benefits and is therefore a normatively desirable way of organizing economic activity. If this talk of "purposes that transcend goals of current stockholders" and "social benefits produced by a perpetual entity focused on long-term allocation" sounds like something that current stockholders, with their more immediate concerns, might not willingly contract for if given the opportunity, that's because it's not. The perpetual entity model contains a bold and perhaps controversial implication: that the corporation is not fundamentally contractarian. There are certain normative goals that underlie the structure that can't be tampered with, the reason being that they are thought to be necessary to the corporation's ultimate purpose, which is to foster long-term capital allocation.

The perpetual entity model of the corporation does a better job than alternatives at explaining various puzzling features of

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26 *See* Gubler, *supra* note 4, at 170.

corporate law. First of all, the model's "permanent equity value maximization norm" explains the classical formulation of fiduciary duties, the well-established fact that fiduciary duties are traditionally owed not to the stockholders but to the corporation as a whole.[27] At first glance, this language of "duties owed to the corporate entity itself" might suggest some sort of stakeholder-value maximization norm, but, curiously, the caselaw talks in terms of stockholder value maximization.[28] At the same time, the caselaw is careful to clarify that duties aren't owed to individual stockholders.[29] How does one reconcile this? The perpetual entity model's response is that this formulation means duties are owed to the only permanent feature of the perpetual entity, and that's the permanent (equity) capital itself. In other words, corporate fiduciary duties instantiate a "permanent equity value maximization norm," which accounts for the conflicting talk in the cases about duties being owed to the corporation as a whole but also to stockholders, just not individual ones.[30]

The perpetual entity model also explains other aspects of corporate law, including, for example, derivative lawsuits: how to explain the fact that the stockholders are the ones that bring a lawsuit alleging director wrongdoing but that any recovery bypasses the stockholders and goes to the corporation itself?[31] It's difficult to explain derivative lawsuits with principal-agent models of the corporation (why shouldn't the recovery go to the principal?) or property rights models (why shouldn't the recovery go to the property rights holders?) or stakeholder-oriented models (why shouldn't the recovery be allocated to the various stakeholders?).[32] The perpetual entity model, though, explains it: current stockholders should be the ones to bring the suit because, of the various corporate stakeholders, they are the ones whose interests most closely overlap with those of the hypothetical permanent stockholder. But any recovery should go to the corporation for the board to decide how to allocate over the long term.

And, finally, the perpetual entity model can explain voting rights. Other models of the corporation have a difficult time explaining why stockholder voting rights exist at all; why they

27 *See id.* at 166–67.
28 *See id.* at 173–75.
29 *See id.* at 175–77.
30 *See id.* at 198–202.
31 *See id.* at 182.
32 *See id.* at 188, 194–97.

are limited to so few decisions in particular; or why those rights are so easily avoidable by the board, at least when triggered by particular transactions like a merger or asset sale.[33] The perpetual entity model has an answer to all of these features: voting rights exist for director elections because somebody has to decide who decides, and the current stockholders seem to be as aligned as any stakeholder with the interests of the hypothetical permanent stockholder.[34] And voting rights exist for other matters that raise particularly thorny issues about long-term capital allocation (e.g., mergers, assets sales, and so on) providing the board the ability to poll the stockholders on the issue.[35] But, at the same time, the stockholder voting requirement is easily avoided by the board through transaction design in the event that the board doesn't need help with the decision. In other words, corporate voting rights function not as the realization of democratic norms but as a tool that the board can use, if it so elects, to gather information about what the stockholders think about various important issues implicating long-term capital allocation.[36]

The perpetual entity model operates deep in the background of Delaware law. It's what explains why the various pieces of the law are shaped the way they are and how they fit together. Another feature deeply embedded in Delaware law, something that supports the perpetual entity model's focus on board discretion, is Delaware's non-sanction-based approach to corporate law. In particular, there is something somewhat odd about Delaware law, which is that, in the absence of obvious conflicts of interest in board decision-making, it seems that Delaware courts eschew monetary sanctions. The duty of care says that the board has the duty to act as reasonably prudent persons under like circumstances, and yet the business judgment rule provides that courts can't actually question whether that sort of rational basis test is satisfied.[37] Section 102(b)(7) clarifies that monetary sanctions aren't even available for duty of care cases if the corporation so decides.[38] Boards have special

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33 *See id.* at 183–98.

34 *See id.* at 214–17.

35 *See id.*

36 *See id.*

37 *See, e.g.*, In re Walt Disney Co. Derivative Litig., 907 A.2d 693, 749 (Del. Ch. 2005) *aff'd*, 906 A.2d 27 (Del. 2006).

38 DEL. CODE ANN. TIT. 8, § 102(b)(7) (West 2022). There is some disagreement about how the business judgment rule actually works. It is sometimes characterized as an abstention doctrine meaning that it prevents

auctioneering duties when in *Revlon* mode,[39] but, at the same time, monetary sanctions aren't available as long as the stockholders approve the merger in a non-coerced vote with adequate disclosure.[40] They have a duty to act in good faith,[41] but the bar has been set so high, there's rarely going to be monetary sanctions there either.[42] And yet, despite all of this, the Delaware courts, boards and their advisors, all act as if the law matters a lot. As Ed Rock identified long ago, Delaware opinions spend considerable time admonishing and chastising director behavior that falls below the mark.[43] Board advisors translate these decisions and the best practices they articulate to board members.[44] And yet this is all done against a backdrop where monetary sanctions are extremely unlikely in the absence of obvious conflicts of interest. So what's going on?

The answer I think is that Delaware law relies on a non-sanction-based theory of law to get the job done. Rock identified how the Delaware Chancery's long judicial opinions, rich in hortatory, might help contribute to an ecosystem of informal reputation-based sanctions that have a disciplining effect on directors.[45] Corporate lawyers and other advisors inform board members of their duties, and the board members are encouraged to perform out of fear of embarrassment and ridicule, not to mention the effect on the prospect of future director positions at other companies, with a backstop that really bad behavior might explicitly get called out by the

courts from even questioning board decisions unless specific preconditions for review are satisfied. *Compare* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83 (2004) and *Shlensky v. Wrigley*, 237 N.E.2d 776, 781 (Ill. App. Ct. 1968) (characterizing it as an abstention doctrine, meaning that the rule prevents courts from even questioning board decisions unless specific preconditions for review are satisfied), *with* Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437, 444–45 (1993) (characterizing the rule as a standard of liability, which although establishing a very high bar, doesn't prevent courts from reviewing board conduct).

39 That is to say, under certain circumstances where a corporation is being acquired in a change of control transaction or where the corporation will inevitably be sold and its business divisions broken up.

40 Corwin v. KKR Financial Holdings LLC, 125 A.3d 304 (Del. 2015).

41 Stone ex rel. AmSouth Bancorporation v. Ritter, 911 A.2d 362, 369–70 (Del. 2006).

42 *See* Zachary J. Gubler, *Delaware's Internal Point of View*, 23–24 (2024) (unpublished manuscript).

43 *See* Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?* 44 UCLA L. REV. 1009, 1016 (1997).

44 *See id.* at 1009.

45 *See id.* at 1012–14.

Delaware courts.[46]

A complementary theory that I have proposed is that Delaware law treats directors as legal internalizers, legal subjects who regard the law as normative regardless of the existence of monetary sanctions.[47] Every legal system must have some legal actors, including judges and legislators, who internalize the law for one reason or another.[48] Perhaps, because of the nature of their appointment, they see their role as requiring compliance with the law.[49] This might be particularly apt with respect to corporate directors who are technically elected by stockholders and placed in a role that could be fairly interpreted to require compliance with the law rather than strategic non-compliance.[50] Or maybe they are boundedly rational actors who view legal compliance as a heuristic that is as good as any other at helping them pursue their self-interest.[51]

Delaware's non-sanction-based approach to corporate law has several advantages. Monetary sanctions can lead legal subjects to interpret legal duties as optional and sanctions as prices that one must pay if one wishes to breach, the efficient breach concept familiar to the law-and-economics literature.[52] If one wishes to create a system that avoids this interpretation of law, and Delaware courts are at times quite explicit in this desire,[53] one approach would be to eliminate monetary sanctions, provided there are reasons (other than fear of formal sanctions) that legal subjects might have to comply with legal duties. Moreover, this arrangement might create necessary space in which boards can create norms tailored to their own corporations that are grounded in these broad fiduciary duties.[54]

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46 *See id.* at 1070–72.

47 *See* Gubler, *supra* note 42, at 23–24.

48 *See id.*

49 *See id.*

50 One reason it might be fairly interpreted thusly is because Delaware courts have said as much. See McRitchie v. Zuckerberg, 315 A.3d 518, 572 (Del. Ch. 2024) (discussing how Delaware law does not encourage legal non-compliance even in the pursuit of profit).

51 *See* Gubler, *supra* note 42, at 34–35.

52 *See id.* at 31–33.

53 *See* McRitchie, 315 A.3d at 572 ("[A] fiduciary of a Delaware corporation cannot be loyal to a Delaware corporation by knowingly causing it to seek profit by violating the law.") (quoting In re Massey Energy Co., No. CIV.A. 5430-VCS, 2011 WL 2176479, at *20 (Del. Ch. May 21, 2011)).

54 *See* Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619 (2001)

But within this non-sanction-based approach to law, the board plays a crucial role. Under Rock's theory of legal sermonizing, courts usually admonish boards, not others. And then advisors counsel boards by translating those legal sermons into standards and codes of conduct. Under the theory of Delaware law as being organized around legal internalizers, the board is similarly front and center. The reasons one might believe that Delaware actors are legal internalizers are particularly suited to directors—people who are elected by others to comply with the law and who are tasked with very complex decisions that are susceptible to simplified heuristics that favor legal compliance. In other words, Delaware's non-sanction-based approach to law seems to only work because it tends to focus on directors. This fact will become more relevant when we consider the arguments in favor of Section 122(18) below.

III
HOW THE PERPETUAL ENTITY MODEL AND THE NATURE OF DELAWARE LAW RESPOND TO ARGUMENTS FOR *MOELIS*-TYPE AGREEMENTS

My argument is that the perpetual entity model underlying Delaware law and Delaware's non-sanction-based approach to the law together imply that Section 122(18) is a bad idea. To see why, let's consider the various arguments in favor of the amendment. There are four distinct arguments for why under Delaware law boards might be able to enter into the type of contracts at issue in *Moelis*.

A. Arguments for *Moelis*-Type Agreements

1. *The Argument That Fiduciary Duties Require Such Agreements*

First, such agreements might be required by the directors' duty to act as reasonably prudent persons to maximize the long-term value of the corporation. In other words, perhaps the board's fiduciary duties will in certain circumstances require it to enter into the type of governance contracts at issue in *Moelis*. The perpetual entity model would say however that a good bit of the governance structure of a corporation is fixed and can't be altered by anyone, whether the board or stockholders. The fact that a board makes the type of

(providing a theory that corporations are largely governed through nonlegally enforceable rules and standards).

open-ended decisions that are typical of fiduciaries and that fiduciary duties run to a hypothetical permanent stockholder are fixed stars in the corporate firmament that are thought to be essential to the corporation's purpose, which is to foster long-term capital allocation. The board itself can't second guess this purpose nor the structure that corporate law relies on to achieve it. Those are the normative underpinnings of the entire legal framework, and the duty to maximize the long-term value of the corporation must be understood in light of this framework.

To be sure, beyond these fixed parameters, the board has considerable discretion and could exercise that discretion to limit their decision-making power for certain specific commercial reasons (for example, through pre-commitments and the like). But they can't go beyond that, even if they think that doing so would be profit-maximizing. For this reason, we need something like the distinction the *Moelis* opinion draws between agreements that permissibly limit the board's discretion within commercial bargains and those that don't. Section 122(18) by contrast eliminates any such distinction.

2. *The Argument that a Stockholder-Amended Charter Provision Could Approve Them*

The second argument in favor of *Moelis*-type stockholder agreements is based on the stockholders' ability to engage in private ordering: if the stockholders are allowed to alter the corporation's governance structure by amending the certificate of incorporation, then why can't the board do the same thing through stockholder agreements? But again, the perpetual entity model would say that there are significant constraints on stockholders' ability to do just that. Under the perpetual entity model, the board is in some theoretical sense the agent of the hypothetical perpetual stockholder (although certainly not the agent of the current actual flesh and blood stockholders). And if that hypothetical permanent stockholder existed, then perhaps they would have absolute discretion in determining the governance structure of the corporation. But because that hypothetical stockholder doesn't exist in reality, and yet such questions of "who must decide" must still be determined, the current stockholders step into the fray, but in a much more diminished role. They get to decide who serves on the board and can make some limited changes to the governance structure—for example, they could change the board's term or the number of directors who stand for election

in a given year or the rules around notice—but not much more than that. Thus, Section 122(18)'s expanding stockholders' ability to amend the certificate is problematic.

3. *The Argument that a Board-Amended Bylaw Could Approve Them*

The third argument for Section 122(18)'s contractual freedom focuses on the board's ability to amend the bylaws. If the board can amend the bylaws (either prior to the sale of stock, by statute, or after such a sale, by amendment to the certificate)[55] to delegate their decision-making power to a stockholder or stockholder group, then why can't they do the same thing through a stockholder agreement? I think the answer is that the board can't actually do that—such a bylaw amendment delegating substantial discretion to non-board members would be invalid for the same reasons addressed below with respect to the fourth argument.[56] But even if they could, I don't think that the argument ultimately works because under the DGCL, stockholders have the right to amend the bylaws, and they typically wouldn't be able to amend a stockholder agreement between a particular stockholder or group of stockholders and the board. So, the analogy seems inapt.

4. *The Argument that Such Agreements Are No Different From Delegating Decision-Making Power to a Board Committee*

Finally, there's a fourth argument that admittedly I haven't seen made in the wake of the debate over *Moelis*, but unlike these others, I actually think this fourth argument is successful in endorsing certain *Moelis*-type agreements. The argument is this: Since the board could, under the DGCL, create a board committee consisting of a single director and then give that committee all of the functions and powers of the board, why shouldn't the board, by a majority vote, be able to delegate these functions to a stockholder by contract, essentially creating a board committee by contract?[57] Notice that the perpetual entity model would I think endorse this argument. The perpetual entity model says that the board

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55 *See* DEL. CODE ANN. TIT. 8 § 109 (2021).

56 *See infra* notes 57–60 and accompanying text.

57 *See* DEL. CODE ANN. TIT. 8 § 141(c)(2021); *see also* Zapata Corp. v. Maldonado, 430 A.2d 779, 785 (citing §141(c) for the proposition that the DGCL "allows a board to delegate all of its authority to a committee").

owes fiduciary duties to a hypothetical permanent stockholder, but it doesn't matter if "the board" in a particular case consists of a board committee or the entire board.

But there's one necessary refinement that must be made for this argument to be successful, a refinement that draws from the non-sanction-based nature of Delaware law discussed previously. Notice that the non-sanction-based nature of Delaware corporate law is premised on certain assumptions about the way the board works. The market for directors, combined with an advisor-rich ecosystem surrounding board functions, is what makes possible Ed Rock's theory about how informal reputation-based sanctions explain in part how Delaware fiduciary duty law works.[58] Similarly, the internalizing view of Delaware law—that directors tend to internalize fiduciary duty law, viewing it as normative—is based in large part on how the director perceives her role as in part being elected to comply with the law and how that perception gets reinforced through Delaware law.[59]

The point is that Delaware law's non-sanction-based approach is premised on the assumption that it will be members of the board alone who will be doing the high-level decision-making at the corporation (or employees whom the board closely monitors). Those directors can then create internal rules at their individual corporations to keep their employees in check and also in compliance with the law. Delaware's non-sanction-based approach is not really designed for non-board members who fall beyond the reach of the director reputation markets (on Rock's theory of Delaware law) or who don't perceive themselves as having been elected to a position where legal compliance is an important value (on the theory of boards as legal internalizers). Nor is it designed for any non-employee of the corporation overseen by such a board. For these reasons, it seems there is a difference in how Delaware law might function to regulate how a director makes decisions, compared with a non-director stockholder (who, for example, exercises that decision-making power pursuant to a *Moelis*-type stockholder agreement), even assuming they are both subject to the same fiduciary duties.[60] In other words, a single director making all governance decisions might be more

58 *See* Rock, *supra* note 43, at 1012–14.

59 *See* Gubler, *supra* note 42, at 34.

60 For this reason, the assurances that Section 122(18) will still require a fiduciary duty analysis regarding the stockholder counterparty to the agreement don't really address the real concern.

responsive to Delaware fiduciary duty law than a stockholder performing the same functions and subject to the same fiduciary duties.[61]

5. *Preliminary Conclusions*

So, *Moelis*-type stockholder agreements might be valid under this fourth argument if the stockholder is a board member, and if so, probably only for so long as the stockholder retains that status. But what about controlling stockholders who are not board members? Doesn't the existence of controlling stockholders who are said to owe fiduciary duties under Delaware law undermine this argument that Delaware corporate law is primarily designed around boards and the employees hired by them? I don't think so, at least not if we're talking about stockholders who satisfy the traditional control test articulated under Delaware law.[62] In that case, such controlling stockholders could have appointed themselves to the board and so should be, and generally are, treated like de facto board members. In other words, this analysis implies I think that *Moelis*-type stockholder agreements are valid if the stockholder-counterparty to such agreements either is a current board member or current controlling stockholder, and if so, such agreements should be valid only for so long as the stockholder retains either status. This rule points to potential escape routes in *Moelis* and Section 122(18).

IV
FORGONE ESCAPE ROUTES AND NEXT STEPS

Moelis is an excellent opinion. It does a wonderful job of working through the caselaw and developing a test for stockholder governance agreements that largely tracks the perpetual entity model. The *Moelis* test asks whether the agreement is commercial or governance-related, and then if

61 The comparison being made here is between board members on the one hand and a non-controlling stockholder delegated board decision-making power pursuant to a *Moelis* type agreement who might be deemed in some sense to possess fiduciary duties because of that contractual delegation. How this comparative analysis might play out with respect to a true controlling stockholder is considered below. *See infra* notes 61–63 and accompanying text.

62 *See* In re KKR Financial Holdings LLC Shareholder Litigation, 101 A.3d 980 (Del. Ch. 2014) (characterizing the court's holding in *Kahn v. Lynch Communication Systems, Inc.*, 638 A.2d 1110, 1113–14 (Del. 1994), that the test for control can be satisfied in one of two ways: (1) if the stockholder owns more than 50% of the voting power of a corporation or (2) if the stockholder "exercises control over the business and affairs of the corporation"), *aff'd sub nom.* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304 (Del. 2015).

governance-related, it applies the *Abercrombie* standard as to whether the agreement removes from directors in a "very substantial" way their duty or freedom to decide.[63] All of this tracks the perpetual entity model's view that neither boards nor stockholders should be able to fundamentally alter a governance structure designed to favor long-term capital allocation. This should come as no surprise since VC Laster endorsed the perpetual entity model by name in *McRitchie*, although, to be clear, I'm not suggesting that the Vice Chancellor agrees with all of the implications that I believe follow from that model.[64]

Nevertheless, with respect to the ultimate outcome in the case, invalidating the agreement, I wonder if there wasn't a different possibility. The fact of the matter is that Moelis was a director of the company when the stockholder agreement was executed.[65] In addition, he may have satisfied the *Kahn v. Lynch* control test by "exercis[ing] control over the business affairs of the corporation" even without giving effect to the legally suspect board composition provisions in the stockholder agreement.[66] For these reasons, the fourth argument outlined above about when *Moelis*–type stockholder agreements might be valid arguably applies to the facts of the case. If the court had taken this escape route, it wouldn't have needed to alter its view of the law or its articulation of the relevant rule. That part of the opinion is in my view above reproach. Rather, on this analysis, the court might have held that the pre-approval and various board composition provisions are valid under the argument set forth in Part III above but only to the extent that Moelis remains a board member or controlling stockholder (assuming the court were to conclude that he was a controlling stockholder pursuant to *Kahn v. Lynch*, without giving effect to those board composition provisions that the court invalidated).

This forgone escape route in *Moelis* also points to how Section 122(18) might have been drafted (and might still be amended) to be consistent with the perpetual entity model and the non-sanction-based nature of Delaware law. It could have

63 West Palm Beach Firefighters' Pension Fund v. Moelis, 311 A.3d 809, 855–856 (Del. Ch. 2024).

64 *See* McRitchie v. Zuckerberg, 315 A.3d 518, 562 n.134 (Del. 2024).

65 *Moelis*, 311 A.3d at 823–825.

66 Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1113–14 (Del. 1994) (citing Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1344 (Del. 1987)) (italics omitted).

been drafted (and might still be amended) to only apply to situations where the stockholder is a director or controlling stockholder under *Kahn v. Lynch* and for only so long as the stockholder remains such. That approach would have preserved (and could yet) the corporate form as a unique vehicle for fostering long-term capital allocation and avoid turning it into an LLC by another name.

The question is what happens next? I obviously think that Section 122(18) should be amended to only apply to situations where the stockholder is a director or a controlling stockholder under *Kahn v. Lynch* and for only so long as the stockholder remains such. If, however, Section 122(18) remains on the books as it currently reads, then I believe we need to rethink what is the best theory of corporate law in the wake of Section 122(18). Prior to it, I would have said, and have said, that it's the perpetual entity model.[67] If Section 122(18) remains on the books in its current form, I'm not so sure.

The problem though is that the perpetual entity model and the non-sanction-based nature of Delaware corporate are both so deeply embedded in Delaware law, I don't know how to read Section 122(18) without also calling into question all sorts of features of Delaware law that are now arguably inconsistent with that amendment. For example, I would say, and have said, that the overall societal purpose of the corporation is to organize economic activity toward the extreme long run, which is thought to be associated with a number of social benefits.[68] But to do so requires the board to maintain a certain independence from current stockholders, which is why it makes little sense to think of the relationship between stockholders and the board as analogous to one between principal and agent. However, under Section 122(18), the board apparently can agree to create through contract what is effectively a principal-agent relationship. And given Delaware law's non-sanction-based approach,[69] that seems like a major change.

So, it would seem that in the wake of Section 122(18), the corporation's purpose as a vehicle for long-term capital allocation is imperiled. Moreover, the fact that under Section 122(18), the corporation is one stockholder agreement away from being a principal-agent relationship calls into question why it simply isn't one now? And if that's so, then that raises

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67 *See* Gubler, *supra* note 4, at 202–03.

68 *See id.* at 170.

69 *See supra* notes 44–54 and accompanying text.

a whole host of questions about Delaware law. For example, doesn't that mean that settled law saying that fiduciary duties don't run to individual stockholders is now wrong?[70] Moreover, wouldn't the board's newfound agency status mean that we need to amend voting rights in major transactions so that they aren't so easily avoided by the board through choice of transactional form?[71]

Regardless of whether one views the rise of a principal-agent model of the corporation as a positive development or not, Section 122(18) also raises questions about the non-sanctioned-based nature of Delaware corporate law. If the reason for Delaware law's resistance to monetary sanctions has to do with certain assumptions about how boards might internalize law or be subtly incentivized by informal sanctions arising out of the market for directors,[72] then doesn't the fact that non-board members and non-actual controlling stockholders can now step into that decision-making role mean that Delaware needs to rethink the lack of monetary sanctions? Notice that this would be true even if one views the corporation as nothing but the stockholders' agent. In other words, the non-sanction-based nature of Delaware law isn't essentially tied to the perpetual entity model (although it's also not inconsistent with it). So, even if one were to reject the perpetual entity model and make the board the stockholder's agent, as Section 122(18) arguably does, one could still imagine the non-sanctioned-based nature of Delaware law serving an important purpose. But if the board itself can just delegate its functions entirely to *non-board members*, then I think that calls into question the wisdom of the non-sanction-based nature of Delaware law, which again is premised on a board-centric view of the corporation. In that case, maybe *Corwin v. KKR Financial Holdings*[73] needs to be reversed. Maybe the *Stone v. Ritter*[74] standard for bad faith conduct needs to be relaxed. Maybe courts will even need to reconsider the business judgment rule and actually reinvigorate the duty of care with some legal bite.

In other words, Section 122(18) is truly revolutionary. I personally think it makes the corporation a much more short-term focused thing. Not just at companies where they

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70 *See* Gubler, *supra* note 4, at 170.
71 *See id.* at 183–84.
72 *See supra* notes 39–54 and accompanying text.
73 125 A.3d 304 (Del. 2015).
74 911 A.2d 362, 370 (Del. 2006).

have *Moelis* type stockholder agreements, although certainly there. But even at companies that don't. I can't help but think that the mere fact that traditional board functions can be delegated to stockholders who won't face the same type of pressures to focus on the long term will have an effect on how one interprets "the long term" even at those companies that have tried to resist this brave new world. But even if one is at peace with all these consequences, the amendment nevertheless calls for a re-evaluation of many features of Delaware corporate law.