

No Shareholder Vote Needed for Insolvent Company to Transfer Assets to Secured Creditors

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The Delaware Supreme Court is currently considering an appeal of a series of decisions by the Court of Chancery which held that a vote of a majority of shareholders is not required for an insolvent company to transfer its assets to its secured creditors.

Background

Stream TV Networks, Inc. (“*Stream*”) was founded in 2009 to develop and commercialize technology that enables viewers to watch three-dimensional content without 3D glasses. Stream had issued senior and junior notes to its secured creditors and pledged all of its assets as security for the notes. When it became clear that Stream could not satisfy its debts, it entered into an agreement (the “*Omnibus Agreement*”) pursuant to which Stream agreed to transfer all of its assets to a newly created entity (“*SeeCubic*”) controlled by its secured creditors in full satisfaction of its debts. The Omnibus Agreement was entered into by Stream’s board of directors, which did not solicit consent from Stream’s shareholders prior to doing so.¹

Chancery Court Litigation

In the litigation that followed the execution of the Omnibus Agreement, Stream and two of its founders, who were also its majority shareholders, sought a preliminary injunction to prevent the enforcement of the agreement. Stream argued (i) that the Omnibus Agreement was invalid because it constituted a sale of all of Stream’s assets, which required stockholder approval pursuant to Section 271 of the Delaware General Corporation Law (the “*DGCL*”), and (ii) a transfer of the assets under the Omnibus Agreement constituted an “Asset Sale,” as defined in Stream’s certificate of incorporation (the “*Charter*”), which required a separate approval by holders of a majority of Stream’s Class B Common Stock (the “*Class Vote Provision*”). SeeCubic brought a countercomplaint and motion for preliminary injunction seeking to enjoin the plaintiff from interfering with its rights under the Omnibus Agreement.

In its opinion denying Stream’s motion for a preliminary injunction, the Chancery Court found that entry into the Omnibus Agreement (i) did not require the approval of a majority of Stream’s shareholders under Section 271 of the DGCL and (ii) also did not require the approval of Stream’s Class B common shareholders under the Class Vote Provision of the Charter.

Section 271 of the DGCL empowers a board of directors to “sell, lease or exchange all or substantially all of [a company’s] property and assets. . . when and as authorized by a resolution adopted by the holders of a majority of the outstanding stock of the corporation entitled to vote thereon.”³ However, under Section 272 of the DGCL, “[t]he authorization or consent of stockholders to the mortgage or pledge of a corporation’s property and assets shall not be necessary, except to the extent that the certificate of incorporation otherwise provides.”⁴

The Chancery Court observed that interpreting Section 271 to require a stockholder vote before an insolvent or failing corporation can transfer its assets to secured creditors would produce an absurd result. Essentially, it would prevent corporations from availing themselves of Section 272’s grant of authority to pledge assets as security without a vote, thereby depriving them of the ability to secure financing without shareholder consent. Such an interpretation would require creditors to obtain a stockholder vote authorizing foreclosure when entering into any credit agreement, contrary to the plain language of Section 272. Further, the Chancery Court found that a longstanding common law exception to the requirements of Section 271 permits the directors of a failing company to sell its assets without seeking consent from stockholders. Accordingly, “Section 271 does not apply to a transaction like the one

contemplated by the Omnibus Agreement, in which an insolvent and failing firm transfers its assets to its secured creditors in lieu of a formal foreclosure proceeding.”⁵

Addressing Stream’s Class Vote Provision argument, the Chancery Court found that the language of the Class Vote Provision tracked the language in Section 271 of the DGCL, resulting in the same outcome. Specifically, the Chancery Court noted that if the drafters of the Class Vote Provision wanted to require a class vote before a secured creditor could foreclose on pledged assets, then the definition of “Asset Sale” should have referred to that type of transaction, and concluded that the transfer of assets pursuant to the Omnibus Agreement did not implicate the Class Vote Provision.

Accordingly, the Chancery Court granted SeeCubic’s motion for a preliminary injunction and subsequently converted the preliminary injunction into a permanent injunction and further declared that the Omnibus Agreement was valid and binding.

Appeal to Delaware Supreme Court

Stream and its majority shareholders have appealed the Chancery Court decision to the Supreme Court of Delaware, arguing that the Chancery Court misread the plain language of Stream’s Charter, and that the enactment of Section 271 superseded any prior common law insolvency exception to shareholder voting requirements. The Delaware Supreme Court heard arguments from the parties on April 6, 2022 but has not yet rendered a decision.

Takeaways

As Delaware case law currently stands, an insolvent company may transfer pledged assets to its secured creditor per Section 272 of the DGCL and/or common law without the need for majority shareholder approval under Section 271 of the DGCL. However, lenders should be aware that corporate charters could contain heightened voting thresholds that apply to asset transfers and foreclosure situations. In such cases, a board’s ability to transfer assets to a secured lender may be limited.

For More Information

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- 1 Stream’s board of directors formed a committee populated by two outside directors and empowered the committee to negotiate and resolve the outstanding claims against Stream. The committee negotiated and entered into the Omnibus Agreement with Stream’s secured creditors.
 - 2 Stream and the majority shareholders made additional arguments which do not relate to the issue of shareholder voting, and which we do not address here.
 - 3 Del. Code Ann. tit. 8, § 271.
 - 4 Del. Code Ann. Tit. 8, § 272.
 - 5 [Stream TV Networks, Inc. v. SeeCubic, Inc., No. 2020-0766 \(JTL\) \(ECF No. 86929981\) at 41.](#)

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