Maryland Law Review

Volume 80 | Issue 1 Article 5

Not Without Consent: Protecting Consent Rights Against Deliberate Breach

Karen A. Chesley

Recommended Citation
Karen A. Chesley, *Not Without Consent: Protecting Consent Rights Against Deliberate Breach*, 80 Md. L. Rev. 95 (2021)
Available at: https://digitalcommons.law.umaryland.edu/mlr/vol80/iss1/5

NOT WITHOUT CONSENT: PROTECTING CONSENT RIGHTS AGAINST DELIBERATE BREACH

KAREN A. CHESLEY*

Under Delaware law, corporate officers and directors are bound by two distinct obligations: fiduciary duties to stockholders as a whole, and contractual obligations entered into on behalf of the corporation. One species of contractual obligation is "consent rights," or limitations on what the corporation can do without approval from a specified party. Such rights are commonly granted by corporations in contracts governing loans, joint ventures, and the issuance of preferred stock.

When a consent rightsholder invokes its ability to block corporate conduct that management may otherwise believe is in the best interest of the corporation, management may face a conflict between its obligation to act in the best interests of stockholders and its obligation to respect the contractual rights to which the corporation voluntarily agreed. Are there any circumstances, for example, under which a joint venturer should abandon its contractual obligations and take action that its fellow partner has unreasonably refused to approve? At the extreme end of the spectrum, if the partner is blocking action indisputably in the best interests of the joint

* Karen A. Chesley is a partner at Boies Schiller Flexner LLP specializing in Delaware law and commercial disputes. She served as counsel to the plaintiffs in PWP Xerion Holdings III LLC v. Red Leaf Resources, Inc., C.A. No. 2017-0235-JTL (Del. Ch.). Ms. Chesley thanks Professor Eric L. Talley and S. Michael Sirkin for their helpful contributions to this Article, and Professor William J. Moon for inspiring it.

venture, does that justify breaching the partner's consent rights—and if so, how should courts address such a breach? And does it matter if the partner is clearly using its consent rights to harm the company, thereby holding the company hostage until it pays an unjustifiably high ransom?

Recent Delaware decisions have suggested that the doctrine of "efficient breach" may resolve this conflict. Under this theory, a corporation may breach a party's consent rights where doing so is in the best interest of stockholders, with the caveat—recently emphasized by the Delaware Supreme Court—that the corporation must pay damages to the consent rightsholder to fully compensate for its loss. The invocation of this doctrine, however, raises several problems, not the least of which is how those damages should be calculated. Although Delaware recognizes that rights may be valued based on a "hypothetical negotiation" for the rightsholders' consent, there is not a single Delaware case in which a court awarded a substantial sum of money for the breach of a consent right, despite the high value that rightsholders tend to attach to these provisions during contract negotiations. Equally troubling is the difficulty in determining whether a breach is truly "efficient," given the reputational harm that may befall a corporation that breaches its promises to key contractual counterparties like lenders, partners, and investors.

Like most matters of contract enforcement, these issues are best left to the bargaining table at the time of contracting—or, failing that, ex post negotiations between the parties once a dispute has arisen (fostered, if necessary, through injunctive relief). Absent a negotiated solution, there will continue to be a conflict between satisfying Delaware's well-established policy of enforcing contracts as they are written and the need to prevent a rogue consent rightsholder from inflicting harm through the misuse of its contractual privileges. In general, courts should not attempt to resolve this conflict by protecting companies that breach a consent rightsholder's interests under the "efficient breach" doctrine, as the difficulty of assessing damages ex post creates a substantial danger that any monetary remedy would be insufficient to satisfy the rightsholder's reasonable expectations that the protections it negotiated would be strictly enforced under Delaware law. Instead, courts should more readily look to equitable remedies to force the parties back to the bargaining table.

I. THE NATURE OF CONSENT RIGHTS

In Delaware, a corporation's board of directors generally has the sole authority to make decisions on behalf of a corporation. Consent rights, which are alternatively referred to as "approval rights," "protective provisions," "blocking rights," or "veto rights," chip away at this exclusive authority by vesting the right to approve or veto certain decisions with a third party (such as a lender, business partner, or group of stockholders). In essence, consent rights are a form of restrictive covenants that enable a contracting party to control certain corporate actions. Consent rights may be held by a single party, or they may be subject to the vote of a collective group (such as a class of investors). When they are controlled by a single party or a small, closely associated group of entities, consent rights can create substantial power to dictate corporate behavior.[1] Conversely, when they are diffuse among a large group of unrelated rightsholders, the corporation has more leverage to obtain the groups' approval.[2]

A. Common Types of Consent Rights

Consent rights are common features in at least three distinct types of contracts:[3]

i. Loan Agreements: Corporate debt lenders typically include a substantial number of restrictions designed to protect their right to repayment. The consent rights set forth in these documents frequently require that a borrower obtain the lender's approval to take on new debt or restructure the loan, engage in certain transfers, and issue new equity, and may also place restrictions on how loaned funds are to be used.[4]

---

1. *See generally* Marcel Kahan & Bruce Tuckman, *Do Bondholders Lose from Junk Bond Covenant Changes?*, 66 J. BUS. 499 (1993); *id.* at 512–13 (where bondholders with consent rights form coalitions, they modify consent terms and "realize some of the gains expected from covenant modifications").

2. *Id.* at 500 (when bondholders with consent rights cannot coordinate, they "will consent to covenant changes even when it is not in their collective interest to do so").

3. Of course, there are various types of consent rights, broadly defined, in many other types of documents. For example, bond instruments often contain restrictive covenants "that are thought to prevent stockholder expropriation of bondholder wealth, for example, covenants that restrict a company's ability to pay dividends, to incur additional debt, to engage in transactions with a controlling shareholder, or to sell assets without forcing the purchaser to assume the company's obligations with respect to the bonds." Kahan, *supra* note 1, at 500. When corporations look to remove these restrictions, they frequently do so by issuing consent solicitations to groups of bondholders at large. *Id.*; *see also* Steve V. Mann & Eric A. Powers, *Determinants of Bond Tender Premiums and the Percentage Tendered*, 31 J. BANKING & FIN. 547, 549 n.4. (2007) ("Consent solicitations can be stand-alone (which is relatively uncommon) or included with a tender offer or exchange offer . . . ."). However, because bonds are typically diffusely held, corporations' attempts to seek to modify the "consent rights" contained therein often involve an offer to the public rather than the type of one-on-one negotiations described throughout this Article. *See* Kahan, *supra* note 1, at 502. For this reason, this Article omits further mention of the somewhat unique circumstances of consent rights contained in bond offerings.

4. *See, e.g.*, Fletcher Int'l Ltd. v. ION Geophysical Corp., No. 5109-CS, 2013 WL 6327997, at *3 (Del. Ch. Dec. 4, 2013) (describing creditor approval rights associated with a $100 million credit facility); Timothy Davis, Steven Coury & Carlos Piñeiro, *Key Provisions to Focus on When Negotiating Senior/Subordinate Co-Lender Agreements*, WHITE & WILLIAMS LLP (2018), https://www.whiteandwilliams.com/resources-alerts-Key-Provisions-to-Focus-on-When-Negotiating-Senior-Subordinate-Co-Lender-Agreements.html.

ii. Joint Venture Agreements: When two companies form a joint venture, it is natural that each venturer will wish to have measure of control over key decisions by the jointly formed corporation.[5] Joint venture agreements typically vest managerial control over day-to-day activities in either one of the two partners or a third-party manager, but grant each of the individual corporate entities the power to veto major decisions.[6] In recent years, Delaware courts have addressed the unique problems that arise when one party has the ability to "lock up" corporate operations by exercising its veto rights to prevent the company from engaging in operations necessary to its survival.[7] In rare cases, courts will resolve true lock-up by dissolving or forcing a sale of the corporate entity.[8]

iii. Preferred Stock Certificates: Perhaps the most commonly analyzed type of consent rights are those that are associated with the issuance of preferred stock, as preferred stockholders' contractual rights create the possibility of a sharp divergence between the interests of preferred and common stockholders.[9] Generally, venture capitalists make investments

---

5. *See generally Minority Protections in Joint Ventures*, THOMPSON REUTERS: PRAC. L., https://us.practicallaw.thomsonreuters.com/Document/Id72c5839916511e79bef99c0ee06c731/View/FullText.html. I use the term "joint venture" here to refer to a structure in which both participants have roughly equal bargaining power (although perhaps unequal stakes), and thus have the ability to negotiate beneficial consent rights for themselves.

6. *See, e.g.*, Glidepath Ltd. v. Beumer Corp., No. 12220-VCL, 2019 WL 855660 at *6–7, 11–12 (Del. Ch. Feb. 21, 2019). *Glidepath* involved an LLC operating agreement which required a supermajority member approval for actions including "dissolving the Company, amending its certificate of formation, changing the legal form of the company, and admitting new members," and written approval of a simple majority of members for actions including the admission or removal of management, capital expenditures above $10,000, contracts above $3,000,000, and any "material deviation from the Business Plan." *Id.* at *5–6.

7. *See* DEL. CODE ANN. tit. 8, § 273(a) (1953) (permitting dissolution of a joint venture if two 50-50 owners are deadlocked); Shawe v. Elting, 157 A.3d 152, 154 (Del. 2017) (affirming the appointment of a custodian to sell a "hopelessly deadlocked" corporation). The unique problems created by the use of consent rights in a joint venture are not the focus of this Article because such joint ventures are less likely to have a broad base of common shareholders to whom the joint venturers would owe a fiduciary duty.

8. *See, e.g.*, *Elting*, 157 A.3d at 154–55 (affirming the Court of Chancery's judgment that "the circumstances of the case required the appointment of a custodian to sell the company").

9. *See In re* Trados Inc. S'holder Litig., 73 A.3d 17, 49 (Del. Ch. 2013) ("The cash flow rights of typical VC preferred stock cause the economic incentives of its holders to diverge from those of the common stockholders.") (citing William W. Bratton & Michael L. Wachter, 161 U. PA. L. REV. 1815, 1832 (2013)); Sarath Sanga & Eric Talley, Don't Go Chasing Waterfalls: Fiduciary Duties in Venture Capital Backed Startups 1 (Oct. 31, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3721814 (stating that companies backed by venture capitalists who own preferred stock can be "crucibles of conflict"). This is particularly true because preferred stock generally comes with a liquidation preference over common stock, meaning that preferred shareholders are often entitled to receive both repayment of their initial purchase price and any accrued dividends before common stockholders receive any money in a liquidation or other event that yields a change of control. *Trados*, 73 A.3d at at 47–50; *see generally* D. Gordon Smith,

through the purchase of preferred stock accompanied by a set of consent rights, commonly referred to collectively as "protective provisions."[10] Each set of consent rights associated with an issuance of preferred stock is typically "highly negotiated" and then incorporated into a certificate of designations.[11] "[T]hese provisions seek to protect the investment of the preferred stockholders from actions by the company that may dilute or diminish their investment" and must be strictly construed.[12] Common consent rights in this context include the right for a majority of the preferred stockholders to approve: (i) major corporate actions such as a merger, dissolution, IPO, or sale: (ii) the issuance of equity and incurrence of debt; (iii) changes to the business plan or major projects; and/or (iv) the compensation and termination of executive officers.[13] One less common but potentially powerful right is a stockholder redemption right, which "allow[s] [i]nvestors to force the [c]ompany to redeem their shares" for a set price.[14] While "redemption rights are not often used," they "do provide a form of exit and some possible leverage over the [c]ompany."[15] Conversely, while many certificates of designations include a "no impairment" provision stating that the "company will not take any action that would impair the rights, powers, and preferences

The Exit Structure of Venture Capital, 53 UCLA L. REV. 315, 339 (2005) (noting that preferred shareholders' liquidation preference includes "the original issue price of the preferred stock").

10. ANDREW METRICK & AYAKO YASUDA, VENTURE CAPITAL & THE FINANCE OF INNOVATION 150 (2d. ed. 2011) ("VCs typically purchase some form of preferred stock.") (emphasis omitted); Smith, *supra* note 9, at 339; C. Stephen Bigler & Jennifer Veet Barrett, *Words that Matter: Considerations in Drafting Preferred Stock Provisions*, 2014 BUS. L. TODAY 1, 2 (2014); *see also Trados*, 73 A.3d at 48 n.22 ("When investing in the United States, VCs almost exclusively use preferred stock.").

11. *See* Bigler & Barrett, *supra* note 10, at 2 ("Among the most highly negotiated contractual provisions related to preferred stock are the so-called 'protective provisions,' which are contained in the certificate of incorporation and set forth a list of actions that the company cannot take without the prior consent of a specified percentage of the outstanding preferred stock."); *see also* Edward Ackerman & Angelo Bonvino, *Preferred-Stock Minority Investments in the Private Equity Context*, LEXIS PRAC. ADVISOR J. at 1–4 (2017), https://www.paulweiss.com/media/3977420/bonvinoackerman_5oct2017.pdf; Smith, *supra* note 9, at 338–40 (noting that investors lacking board control "typically seek more targeted protection" during contract negotiations). Although less common, in addition to certificates of designations, preferred consent rights could theoretically appear in articles of incorporation, registration rights agreement, investor rights agreement, and/or stockholder agreements. *See* MCG Capital Corp. v. Maginn, No. 4521-CC, 2010 WL 1782271, at *6–7 & n.31 (Del. Ch. May 5, 2010) (citing DEL. CODE ANN. tit. 8, § 151 (a), (f) (2017) (noting that for corporations, the rights of preferred stock shall be set forth or summarized on the stock certificate but may also appear in certificates of incorporation or corporate board resolutions); *see also* Searchlight CST, L.P. v. MediaMath Holdings, Inc., No. 2020-0652-SG, 2020 WL 5758023, at *1 (Del. Ch. Sept. 28, 2020) (noting that an investor rights agreement executed in connection with the purchase of preferred stock created "certain limitations on the Defendant's freedom of action").

12. Bigler & Barrett, *supra* note 10, at 3.

13. Ackerman & Bonvino, *supra* note 11, at 7–8.

14. METRICK & YASUDA, *supra* note 10, at 474 n.11.

15. *Id.*

of the holders of the company's existing preferred stock," this provision is generally of limited value.[16] That is because courts have ruled that each consent right must be expressly set forth in the certificate or applicable document, and a "no impairment" provision cannot act as a "gap filler" to imply the existence of rights that were omitted.[17] Commentators have noted that the allocation of consent rights between preferred investors and a target corporation is important because these rights provide each side with key points of control in the management of the corporation.[18]

B. *Judicial Enforcement of Consent Rights*

Courts have consistently found that consent rights should be enforced as they are drafted, and that parties may use their contractual rights to approve or veto corporate action if they determine that doing so is in their "best interests."[19] This view is in keeping with Delaware's "especially strong principle" that the parties' contractual bargain *must* be enforced according to its express terms.[20] As the Delaware Supreme Court held, "A party does not act in bad faith by relying on contract provisions for which that party bargained where doing so simply limits advantages to another party. We cannot reform a contract because enforcement of the contract as written would raise 'moral questions.'"[21] Thus, when a party holds a set of consent

16. Bigler & Barrett, *supra* note 10, at 3.

17. *Id.* (citing WatchMark Corp. v. ARGO Global Capital, LLC, No. Civ.A 711-N, 2004 WL 2694894 (Del. Ch. Nov. 4, 2004)).

18. Thomas Hellmann, *The Allocation of Control Rights in Venture Capital Contracts*, 29 RAND J. ECON. 57, 60 (1998) (consent rights "matter either because they allow one party to make a decision in the presence of conflict of interest or because they affect the threat points in any renegotiation").

19. *See* Related Westpac LLC v. JER Snowmass LLC, No. 5001-VCS, 2010 WL 2929708, at *6 (Del. Ch. July 23, 2010) (holding that defendant was entitled to use its consent rights in its "best interests"); *In re* MONY Grp., Inc. S'holder Litig., 853 A.2d 661, 683 (Del. Ch. 2004) ("Stockholders of Delaware corporations have the right to vote their shares in their own interest."); Miller v. Am. Real Estate Partners, L.P., No. CIV.A.16788, 2001 WL 1045643, at *13 n.35 (Del. Ch. Sept. 6, 2001) ("Under Delaware corporation law, . . . a stockholder is entitled to vote its shares in its own self-interest.").

20. Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300-JTL, 2018 WL 4719347, at *60 (Del. Ch. Oct. 1, 2018) ("The proper way to allocate risks in a contract is through bargaining between parties. It is not the court's role to rewrite the contract between sophisticated market participants, allocating the risk of an agreement after the fact, to suit the court's sense of equity or fairness." (citation omitted)), *aff'd*, 198 A.3d 724 (Del. 2018); NACCO Indus., Inc. v. Applica Inc., 997 A.2d 1, 35 (Del. Ch. 2009) ("Delaware upholds the freedom of contract and enforces as a matter of fundamental public policy the voluntary agreements of sophisticated parties."); Pers. Decisions, Inc. v. Bus. Planning Sys., Inc., No. 3213-VCS, 2008 WL 1932404, at *6 (Del. Ch. May 5, 2008) ("Delaware is a freedom of contract state, with a policy of enforcing the voluntary agreements of sophisticated parties in commerce."), *aff'd*, 970 A.2d 256 (Del. 2009).

21. Nemec v. Shrader, 991 A.2d 1120, 1128 (Del. 2010). Interestingly, in *Nemec* it was the corporation that held a freestanding right to redeem former officer and directors' stock at book value after the expiration of a two-year period. *Id.* at 1123. The corporation chose to exercise this right

rights, it does not violate a duty to other stockholders "by exercising those rights as it wishe[s]."[22]

Parties arguing otherwise have generally failed to find traction in Delaware courts. For example, in *Superior Vision Services, Inc. v. ReliaStar Life Insurance Co.*,[23] ReliaStar, a shareholder with a 44% stake in the plaintiff company, had the ability to block all dividend payments (which required consent from two-thirds of all shareholders).[24] Over the course of a year, the plaintiff tried three times to issue a dividend, and ReliaStar initially refused to consent each time—allegedly in accordance with its "practice to withhold its consent to dividends in order to strong-arm individual stockholders or SVS to further its own agenda."[25] For the first dividend, ReliaStar relented and gave its consent only after a shareholder owning 32% of the outstanding stock promised to support a sale of the company.[26] ReliaStar refused to consent to the Board's next two attempts to pay dividends, prompting the company to seek a declaratory judgment that it was permitted to issue dividends, and that by wrongfully withholding its consent, ReliaStar breached its fiduciary duties and its duty of good faith and fair dealing.[27] Vice Chancellor Noble had little difficulty dismissing the complaint.[28] With respect to the "remarkably unconventional" argument that ReliaStar "breached its fiduciary duties by, among other things, withholding its consent to the payment of dividends without any economic justification or other bona fide reason," Vice Chancellor Noble held that a shareholder owes no fiduciary duties merely because it "exercises a duly-obtained contractual right that somehow limits or restricts the actions that a corporation otherwise would take."[29] The court also easily rejected the argument that ReliaStar

one month before closing the multi-billion dollar sale of a major line of business, thereby depriving the plaintiffs of approximately $60 million that they would have received had the redemption occurred after the sale. *Id.* at 1124–25. Because the corporation was contractually entitled to redeem the stock during this period, the court affirmed the Court of Chancery's dismissal of the case, stating that the corporation's "directors did nothing unfair and breached no fiduciary duty by causing the Company to exercise its absolute contractual right to redeem the retired stockholders' shares at a time that was most advantageous to the Company's working stockholders." *Id.* at 1127.

22. Ford v. VMware, Inc., No. 11714-VCL, 2017 WL 1684089, at *15 (Del. Ch. May 2, 2017).

23. No. Civ.A. 1668-N, 2006 WL 2521426 (Del. Ch. Aug. 25, 2006).

24. *Id.* at *1.

25. *Id.* at *1.

26. *Id.*

27. *Id.* at *2.

28. *Id.* at *7.

29. *Id.* at *3–5. The court left open the possibility, however, that fiduciary duties could arise under the "controlling shareholder" doctrine "where the holding of contractual rights [was] coupled with a significant equity position and other factors." *Id.* at *5. If a consent rightsholder is deemed a controller, it has fiduciary duties and the analysis changes considerably regarding how it can use its contractual rights. Recent case law suggests that this exception may have begun to swallow the rule. For example, Vice Chancellor Slights recently applied this rule to permit a case to survive a

breached any implied good faith obligation, given that the contract "place[d] no express limitation on ReliaStar's discretion."[30] Without an explicit condition that consent could not be unreasonably withheld, the court declined to "read a reasonableness requirement into a contract entered into by two sophisticated parties."[31] Such a result was required under Delaware law, the court held: "It is imperative that contracting parties know that a court will enforce a contract's clear terms and will not judicially alter their bargain, so courts do not trump the freedom of contract lightly."[32]

Four years later, in *Related Westpac LLC v. JER Snowmass LLC*,[33] a plaintiff again brought implied covenant and breach of fiduciary duty claims against an LLC member that refused to consent to certain "major decisions" in connection with the development of property in Colorado.[34] Then-Vice Chancellor Strine dismissed the complaint, again emphasizing that Delaware courts must enforce contracts according to their express terms: "Delaware

---

motion to dismiss where the complaint alleged that the minority members of a limited-liability company used their consent rights (called "blocking rights") to "drive [the LLC] into bankruptcy, and then pounced on the opportunity to acquire [the LLC]'s valuable assets on the cheap when they came up for sale as part of the debtor's bankruptcy plan." Skye Mineral Inv'rs, LLC v. DXS Capital (U.S.), Ltd., No. 2018-0059-JRS, 2020 WL 881544, at *1 (Del. Ch. Feb. 24, 2020). The court agreed with the general principle that merely having a consent right did not transform the minority members into controllers with attendant fiduciary duties, but held that the complaint alleged more: specifically, that the members also engaged "in a concerted effort" to place the company "in a precarious financial condition" before exercising their "unilateral power" to force a shutdown. *Id.* at *27; *see also* Voigt v. Metcalf, No. 2018-0828-JTL, 2020 WL 614999, at *1–2, 19 (Del. Ch. Feb. 10, 2020) (denying a motion to dismiss because it was "reasonably conceivable" that a private equity firm with 34.8% of a company's voting rights and substantial board representation was a controller with fiduciary duties, noting that its wide range of contractual veto rights "weigh[ed] in favor of an inference that [the fund] exercised control over the Company generally by giving [the fund] power over the Company beyond what the holder of a mathematical majority of the voting power ordinarily could wield"). While this exception appears to be increasingly important, for the purposes of this Article I assume that the consent rightsholder does not have other attributes that would render it a controlling stockholder.

30. *Superior Vision Servs., Inc.*, 2006 WL 2521426, at *5.

31. *Id.* at *6 (quoting Gildor v. Optical Solutions, Inc., No. 1416-N, 2006 WL 1596678, at *7 n.17 (Del. Ch. June 5, 2006)).

32. *Id.*

33. No. 5001-VCS, 2010 WL 2929708 (Del. Ch. July 23, 2010).

34. *Id.* at *1, 5. The "major decisions" included the right to: "'approve or disapprove the annual Business Plan, the annual proposed budget update or . . . any amendment or modification of the Business Plan then in effect or any amendment to the Approved Budget then in effect to the extent that such action would constitute a Material Action;' '"make expenditures on behalf of the LLC[s] or its subsidiaries to the extent such expenditures would constitute a Material Action;' 'incur, place, replace, renew, extend, substitute, add to, supplement, amend, modify, increase, restructure or refinance any borrowing by the LLC[s] or [their] subsidiaries . . . or to negotiate or enter into any binding agreement to do any of the foregoing' unless the borrowing is 'incurred in the ordinary course of business' and 'less than $50,000;'" and "'amend, modify, or deviate from, the Business Plan or the Approved Budget of the LLC in a manner which would constitute a Material Action.'" *Id.* at *2–3 (alterations in original) (quoting Complaint at Exhibit B §§ 6.3.1–6.3.13, *Related Westpac,* 2010 WL 2929708).

law respects the freedom of parties in commerce to strike bargains and honors and enforces those bargains as plainly written."[35] Because the plaintiff had "clearly relinquished any reasonableness condition to [defendant's] consent right as to future business plans and budgets" when the parties were "[a]t the bargaining table,"[36] Vice Chancellor Strine concluded:

Under the plain terms of the operating agreements, the defendant member had bargained for the right to give consents to decisions involving material actions or not, as its own commercial interests dictated. Having bargained for that freedom and gained that concession from the operating member, the defendant member is entitled to the benefit of its bargain and the operating member cannot attempt to have the court write in a reasonableness condition that the operating member gave up.[37]

As these cases make clear, Delaware courts' robust policy of enforcing contracts as written extends to the invocation of consent rights, even when the party using its consent rights is presumed to be doing so unreasonably or unfairly.[38]

This strong judicial enforcement of consent rights has important public policy implications. Consent rights are frequently negotiated as a material component of contracts that allow a corporation to raise capital, and investors therefore rely on these provisions in making decisions about whether to invest capital into a corporation. As Vice Chancellor Balick noted in the context of consent rights in certificates of designation for preferred stock, "[i]f there were no protections, investors would be afraid to take the risk. If corporations are able to market preferred stock, investors have to be able to rely on protections when they are expressed with reasonable clarity."[39] Thus,

---

35. *Id.* at *6.

36. *Id.*

37. *Id.* at *1; *see also id.* at *8 ("Under the Operating Agreements, JER Snowmass was left free to give consents to Major Decisions involving Major Actions as it chose, in its own commercial interest. That freedom was not qualified by any fiduciary duty of so-called 'reasonableness' and to imply such a duty in these circumstances would nullify the parties' express bargain.").

38. *See also* Thermopylae Capital Partners, L.P. v. Simbol, Inc., No. 10619-VCG, 2016 WL 368170, at *13–14 (Del. Ch. Jan. 29, 2016) (rejecting the argument that a preferred stockholder became a fiduciary obligated to act in the best interest of the company due to its "blocking rights" because "an individual who owns a contractual right, and who exploits that right—even in a way that forces a reaction by a corporation—is simply exercising his own property rights, not that of others, and is no fiduciary"); PWP Xerion Holdings III LLC v. Red Leaf Res., Inc., No. 2017-0235-JTL, 2019 WL 5424778, at *16 (Del. Ch. Oct. 23, 2019) (granting summary judgment to enforce preferred stockholder's consent rights, stating, "Stockholders in Delaware corporations have a right to control and vote their shares in their own interest . . . . It is not objectionable that their motives may be for personal profit, or determined by whim or caprice, so long as they violate no duty owed other shareholders." (quoting Bershad v. Curtiss-Wright Corp., 535 A.2d 840, 845 (Del. 1987))).

39. Matheson v. Kaiser Aluminum Corp., No. 14900, 1996 WL 33167234, at *3 (Del. Ch. Apr. 8, 1996).

without the assurance that consent rights would be enforced by Delaware courts, the ability of corporations to secure capital would be at risk.[40]

On the other hand, courts' refusal to recognize any good faith or "reasonableness" check on the use of consent rights means that parties are free to abuse those rights to hold a company hostage until its demands are met—even where those demands are wholly untethered from the issue for which consent is sought. It is understandable why a company, when faced with such onerous circumstances, would look for an escape hatch.

II. UNDER DELAWARE LAW, MANAGEMENT HAS NO FIDUCIARY OBLIGATION TO ABIDE BY A COMPANY'S CONTRACTUAL OBLIGATIONS

Meanwhile, Delaware has been developing a separate body of law exploring what happens when a party's contractual rights create a potential conflict with director and officers' fiduciary obligations to the corporation and its common shareholders. While the former line of cases emphasizes the importance of contractual consent rights, these cases highlight managements' countervailing fiduciary duties—which in some circumstances, at least, would seem to open up the possibility that management should breach contractual consent rights so long as it serves the best interests of the corporation as a whole. It is worth noting that this potential approval of a corporation's decision to violate its contractual obligations is starkly at odds with Delaware's treatment of a corporation that violates statutory or regulatory law, which is prohibited in all circumstances no matter how beneficial such a violation might be for the corporation.[41]

Chancellor Allen previewed the possibility of efficient breach in *Orban v. Field*,[42] a case brought by common stockholders who received nothing in a corporate merger because the amount owed to the preferred stockholders was greater than the total merger consideration.[43] The plaintiffs alleged that the board had "exercised corporate power against the common and in favor of the preferred and, thus, breached a duty of loyalty to the common" by helping preferred stockholders "overcome a practical power that the common

40. *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 48–49 (Del. Ch. 2013); Smith, *supra* note 9, at 319–20, 346–47.

41. *See* Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003) ("[O]ne cannot act loyally as a corporate director by causing the corporation to violate the positive laws it is obliged to obey." (citing DEL. CODE ANN. tit. 8, § 102(b)(7) (1953) (barring a corporation from exculpating directors for personal liability for breaches of fiduciary duty based on, *inter alia*, "a knowing violation of law")).

42. No. 12820, 1997 WL 153831 (Del. Ch. Apr. 1, 1997).

43. *Id.* at *1.

held to impede the closing of the merger."[44] The court rejected this argument, finding that the board's conduct satisfied the applicable fairness standard.[45] In so doing, the court recognized the doctrine of efficient breach as a "fact of legal life,"[46] but held that it would be "bizarre" to use it to find that the board had a duty to the common stockholders to breach "the corporation's legal obligations to its other classes of voting securities."[47]

More recently, courts—led by Vice Chancellor Laster—have been more willing to recognize the possibility that fiduciary duties may create an obligation to breach a company's contractual obligations to preferred shareholders. The seminal case discussing fiduciary obligations when a conflict arises between the interests of preferred and common shareholders is Vice Chancellor Laster's opinion in *In re Trados Inc. Shareholder Litigation*[48] Prior to *Trados*, there was uncertainty as to "whether a fiduciary duty should be owed in a particular situation to the preferred stockholders, or whether their rights should be limited to their contractual rights."[49] Much ink has been spilled regarding the implications of the *Trados* decision, which need not be repeated here.[50] For the purposes of this Article, it suffices to say that *Trados* reaffirmed that "the rights and preferences of preferred stock are contractual in nature,"[51] and consequentially, "[p]referred stockholders are owed fiduciary duties only when they do not invoke their special contractual rights and rely on a right shared equally with the common

44. *Id.* The board allowed plaintiffs' common stock to be diluted by preferred shareholders exercising their warrants, thereby preventing the plaintiff stockholders from holding sufficient shares to block the merger. *Id.* at *8.

45. *Id.* at *9.

46. *Id.* ("Certainly in some circumstances a board may elect (subject to the corporation's answering in contract damages) to repudiate a contractual obligation where to do so provides a net benefit to the corporation. To do so may in some situations be socially efficient.") (citing Richard Craswell, *Contract Remedies, Renegotiation, and the Theory of Efficient Breach*, 61 S. CAL. L. REV. 629 (1988)); *see also* Merck & Co. v. SmithKline Beecham Pharm. Co., No. C.A. 15443-NC, 1999 WL 669354, at *51 (Del. Ch. Aug. 5, 1999), *aff'd mem.*, 746 A.2d 277 (Del. 2000), *and aff'd*, 766 A.2d 442 (Del. 2000) ("Our courts have recognized, even if only by implication, that in appropriate circumstances breach of contract is justified and efficient.") (citing E.I. DuPont de Nemours & Co. v. Pressman, 679 A.2d 436, 445 (Del. 1995)).

47. *Orban*, 1997 WL 153831, at *9.

48. 73 A.3d 17, 35–36 (Del. Ch. 2013).

49. Marilyn B. Cane, Joong-Sik Choi & Scott B. Gitterman, *Recent Developments Concerning Preferred Stockholder Rights under Delaware Law*, 5 VA. L. & BUS. REV. 377, 382 (2011).

50. *See, e.g.*, Adam M. Katz, *Addressing the Harm to Common Stockholders in Trados and Nine Systems*, 118 COLUM. L. REV. ONLINE 234, 234 (2018) (*Trados* "involved the peculiar corporate law equivalent of a burglary in which nothing was stolen"); Abraham J.B. Cable, *Opportunity-Cost Conflicts in Corporate Law*, 66 CASE W. RES. L. REV. 51, 57 (2015) ("*Trados* is an important case, but one that should be invoked sparingly."); Lisa R. Stark, *Side-Stepping Fiduciary Issues in Negotiating Exit Strategies for Preferred Stock Investments After Trados*, 2013 BUS. L. TODAY 1 (2013).

51. *Trados*, 73 A.3d at 39 (quoting *In re Trados Inc. S'holder Litig. (Trados I),* No. 1512-CC, 2009 WL 2225958, at *7 (Del. Ch. July 24, 2009)).

stock."[52] The principle that emanates from this rule is that directors must "maximize the value of the corporation for the benefit of its residual claimants, the ultimate beneficiaries of the firm's value, not for the benefit of its contractual claimants."[53] While prior case law had stated that directors are bound "to pursue the best interests of the corporation and its common stockholders, *if that can be done faithfully with the contractual promises owed to the preferred*,"[54] *Trados* went a step further and stated that a director could potentially breach its fiduciary obligations by favoring the preferred's contractual rights at the expense of common stockholders.[55] Despite this warning shot, however, the court ultimately ruled that the board did not violate its fiduciary duties by approving the sale at issue—in which common stockholders ended up with nothing—because the company "did not have a reasonable prospect of generating value for the common stock."[56]

Vice Chancellor Laster faced another preferred-common rift four years later in *Frederick Hsu Living Trust v. ODN Holding. Corp.*[57] There, the founder of a California corporation called Oversee.net sued a venture capitalist that had invested $150 million in exchange for preferred shares in ODN Holding Corporation ("ODN"), a holding company for Oversee.net.[58] The preferred shares carried a redemption right after five years if the company had "legally available funds" to redeem the stock.[59] ODN was contractually obligated to "take all reasonable actions (as determined by the [Company's] Board of Directors in good faith and consistent with its fiduciary duties) to generate, as promptly as practicable, sufficient legally available funds to redeem all outstanding shares of [Preferred Stock]."[60] The founder alleged, however, that the ODN board had violated its fiduciary obligations by harming the long-term prospects of the company by maximizing the redemption of preferred stock.[61] Vice Chancellor Laster

52. *Id.* at 39–40.

53. *Id.* at 40–41.

54. *Id.* at 41 (quoting *LC Capital Master Fund, Ltd. v. James*, 990 A.2d 435, 452 (Del. Ch. 2010)) (emphasis added).

55. *Id.* at 41–42; *see also* Bigler, *supra* note 10, at 3–4 (citing *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 49 (Del. Ch. 2013) ("If there is a divergence of interests between the holders of the preferred stock and common stock in a sale because, for example, all of the sale proceeds would go to the preferred stock and none of it would reach the common stock, it will generally be the duty of the board of directors to prefer the interests of the common stockholders to those of the preferred stockholders. In fact, directors could breach their fiduciary duties if they favor the interests of the preferred stockholders under these circumstances.").

56. *Trados*, 73 A.3d at 76–78.

57. No. 12108-VCL, 2017 WL 1437308, at *23–24 (Del. Ch. Apr. 24, 2017).

58. *Id.* at *1.

59. *Id.* at *1, 6.

60. *Id.* at *4 (alterations in original).

61. *Id.* at *5. Although both *Trados* and *ODN* assume that venture capitalists are excessively interested in short-term returns, potentially to the detriment of common stockholders' long-term

denied ODN's motion to dismiss, rejecting the preferred stockholders' argument that ODN's contractual obligations meant that "the corporation had an obligation to fulfill its contractual commitment":[62]

> It is true that the fiduciary status of directors does not give them Houdini-like powers to escape from valid contracts . . . . But the fact that a corporation is bound by its valid contractual obligations does not mean that a board does not owe fiduciary duties when considering how to handle those contractual obligations; it rather means that the directors must evaluate the corporation's alternatives in a world where the contract is binding. Even with an iron-clad contractual obligation, there remains room for fiduciary discretion because of the doctrine of efficient breach. Under that doctrine, a party to a contract may decide that its most advantageous course is to breach and pay damages. Just like any other decision maker, a board of directors may choose to breach if the benefits (broadly conceived) exceed the costs (again broadly conceived).[63]

If breaching a contract may be in the best interest of all stockholders, then, there exists a "corollary" principle that "directors who choose to comply with a contract when it would be value-maximizing (broadly conceived) to breach could be subject, in theory, to a claim for breach of duty."[64]

Understandably, Vice Chancellor Laster's decision in *ODN* triggered a number of alarmist articles warning preferred stockholders that their contractual rights may not be as secure as they had previously believed.[65] Various law firms issued practitioner notes recommending that attorneys negotiating the purchase of preferred stock take additional precautions to

interests, others have written that "[a] growing literature in behavioral finance and psychology now provides sound reasons to conclude that corporate managers often fall prey to long-term bias—excessive optimism about their own long-term projects" to which venture capitalists "can provide a symbiotic counter-ballast." Michal Barzuza & Eric Talley, *Long-Term Bias* (ECGI Working Paper Series in Law, Paper No. 449, 2019).

62. *ODN Holding Corp.*, 2017 WL 1437308, at *23.

63. *Id.* at *23–24.

64. *Id.* at *24. Following *ODN*, Vice Chancellor Laster issued an opinion in *Glidepath Ltd. v. Beumer Corp.* extending these core principles to decide whether the buyer of an LLC breached its fiduciary duty to the seller, who remained a member of the LLC, when it operated the company in a way that prevented the seller from obtaining an additional earn-out payment. No. 12220-VCL, 2019 WL 855660 (Del. Ch. Feb. 21, 2019). In holding that the buyers did not violate any duty to the sellers, Vice Chancellor reiterated the principle that management does not owe any special duty to contractual rightsholders, and "a fiduciary violates the standard of conduct if the fiduciary seeks to maximize the value of a contractual claim at the expense of the fiduciary's beneficiaries." *Id.* at *19. The only duty owed by management is "to act in good faith to maximize the value of the Company over the long term" and, therefore, there is "no fiduciary obligation to protect the value of a contractual claim." *Id.* at *20–21.

65. *See, e.g.*, Thompson Hine LLP, *Let the Buyer (of Preferred Stock) Beware*, LEXOLOGY (June 26, 2019), https://www.lexology.com/library/detail.aspx?g=925ca358-fb5b-4087-b213-322e767c637a.

"safeguard their preferred status," such as ensuring the inclusion of "cumulative dividends, favorably priced conversion options of the preferred stock to common stock, automatic issuance of common stock or even a mandatory sale of the company."[66] Other options might include the creation of a liquidated damages clause for any breach,[67] or, more appropriately for a joint venture agreement, adding other onerous consequences like a default provision with a forced buy-sell mechanism (whereby the breaching party risks losing its investment entirely if it does not cure the breach). The purpose of such provisions would "be to put a thumb on the scale in favor of honoring the privileges associated with its preferred status. Making it more painful for a board to breach contractual obligations increases the likelihood that the preferred stockholder's preferences will be upheld, thereby providing greater protection from loss."[68] In addition to strengthening contractually negotiated rights, practitioners also recommended considering whether investment capital would be better placed in mezzanine debt or some other investment structure rather than preferred stock to avoid the uncertainty surrounding stockholder consent rights created in the wake of *Trados* and to ensure the parties' contractual agreements would be enforced as written by removing them from the realm of shareholder rights.[69]

Many scholars have been similarly critical of the treatment of preferred stockholders in both *Trados* and *ODN*.[70] Notwithstanding this criticism,

66. *Id*.

67. Liquidated damages provisions are enforceable under Delaware law where they are not intended to act as a "punishment for default" but instead represent "the parties' best guess of the amount of injury that would be sustained in a contractual breach, a way of rendering certain and definite damages which would otherwise be uncertain or not easily susceptible of proof." S.H. Deliveries v. TriState Courier & Carriage Inc., No. 96C–02–086–WTQ, 1997 WL 817883, at *2 (Del. Super. Ct. May 21, 1997). They are permissible where (i) damages are uncertain or incapable of accurate calculation, and (ii) the specified amount is reasonable. Del. Bay Surgical Servs., P.C. v. Swier, 900 A.2d 646, 651 (Del. 2006) (citing Brazen v. Bell Atl. Corp., 695 A.2d 43, 48 (Del. 1997)). Given the inherent difficulty of valuing consent rights, as set forth in this article, it appears that the first part of this test would generally be satisfied in most cases involving the breach of a consent right.

68. Thompson Hine LLP, *supra* note 65.

69. Benet J. O'Reilly et al., *Between Contractual and Fiduciary Duties: ODN Holding and the Rights of Preferred Stockholders*, CLEARY M&A AND CORP. GOVERNANCE WATCH (June 8, 2017), https://www.clearymawatch.com/2017/06/contractual-fiduciary-duties-odn-holding-rights-preferred-stockholders/.

70. *See, e.g.*, Robert P. Bartlett, III, *Shareholder Wealth Maximization as a Means to an End*, 38 SEATTLE U. L. REV. 255, 256 (2015) (critiquing *Trados* as advocating an approach that would "seem to require as a matter of complying with directors' fiduciary duties the type of reckless, go-for-broke gambles known to plague leveraged firms nearing financial distress"); Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155, 190–91 (2019) ("Corporate law scholars have pointed out that this interpretation [in *Trados* and *ODN*] can give rise to inefficient outcomes that fail to maximize aggregate welfare. Consequently, they argue for an understanding of fiduciary duty that requires directors to maximize the aggregate value of all classes of equity—otherwise stated as firm value—without regard to its allocation."); Sanga & Talley, *supra* note 9, at 4 ("[C]ourts can more

Delaware courts have continued to state the rule that a "board can readily comply with its fiduciary duties while making a decision that breaches a contract, just as a board could opt to comply with a contract under circumstances where its fiduciary duties would call for engaging in efficient breach."[71] Under the legal analysis that continues to prevail in Delaware, then, the fact that a company is bound by certain contractual obligations is completely divorced from the question of whether the company acted in accordance with its fiduciary obligations to all stockholders.

III. SHOULD CONSENT RIGHTS BE "EFFICIENTLY" BREACHED?

What are we to make of these two parallel strains on law? On one hand, Delaware law promises investors that its courts will enforce a corporation's contractual obligations as the parties negotiated them, but on the other, it tells preferred stockholders that the corporation is free to breach those same contractual obligations so long as doing so benefits *other* stockholders. Under Delaware's prevailing standard, if a company refrains from taking action to benefit common stockholders in order to respect its preferred investors' contractual rights, it appears that courts will not assume that its decision to abide by its contract was appropriate—even though investors undoubtedly expect that the corporation will honor their rights in the normal course of business. Such an expectation is especially reasonable given that corporations are strictly prohibited from violating positive laws,[72] and it is not immediately apparent why contractual obligations should be treated differently from other types of legal obligations. Indeed, if investors believed the corporation was free to breach its contractual obligations at will, it is difficult to imagine that they would make an investment at all.[73] This state of affairs is all the more unusual because it seems to undermine the longstanding rule that "Delaware respects 'the primacy of contract law over

---

effectively induce value-maximizing decisions through an 'anti Trados' rule that grants primacy to preferred shareholders (rather than common). This result stands in stark contrast to the Trados doctrine, which mandates the opposite approach and ultimately achieves less").

71. PWP Xerion Holdings III LLC v. Red Leaf Res., Inc., No. 2017-0235-JTL, 2019 WL 5424778, at *15 (Del. Ch. Oct. 23, 2019) (citing Frederick Hsu Living Tr. v. ODN Holding Corp., No. 12108-VCL, 2017 WL 1437308, at *24 (Del. Ch. 2017)).

72. *See supra* note 41 and accompanying text.

73. The counterargument, of course, is that investors—who are often sophisticated parties aided by legal counsel—already understand that any contractual rights they negotiate can be breached by the company so long as the company later pays damages. The relative scarcity of case law assessing damages for the breach of a consent right, however, suggests that this path is rarely followed so investors would have no reason to anticipate it (and no ability to accurately predict damages). *See infra* text accompanying notes 79–84.

fiduciary law in matters involving . . . contractual rights and obligations.'"[74] For that reason, courts generally refuse to create a fiduciary obligation inconsistent with a party's contractual rights.[75] But if contract law is supreme, how can a corporation legitimately disregard its contractual obligations in favor of fulfilling its fiduciary duties?

If these legal doctrines are to be meaningfully reconciled with respect to the enforcement of consent rights, it must be done through the remedies that flow from a breach of such rights. I address the issues of damages and injunctive relief in turn, along with other consequences that must be considered in determining whether a breach is truly "efficient." In short, given that consent rights are difficult to value and the breach of a contract with key investors, lenders, or other counterparties is likely to have wide-ranging repercussions, courts should strongly consider using injunctive relief to enforce consent rights. Once a company is ordered to refrain from acting without the rightsholder's consent, the power balance in negotiations for that party's consent shifts from the company to the rightsholder—which is precisely what the parties would have expected when they negotiated their respective contractual rights.

A. Calculating Damages for Breach of a Consent Right

Like all contractual breaches, the usual method for calculating damages for the breach of a consent right is based on the non-breaching party's expectation interest—that is, "an amount that will give the injured party 'the benefit of its bargain by putting that party in the position it would have been but for the breach.'"[76] "The primary element of expectation damages is the [sic] 'the value that the performance would have had to the injured party,' or the 'loss in value' caused by the deficient performance compared to what had been expected."[77] In the context of a consent right breach, expectation damages can be calculated based on (i) the actual harm caused by the breach,

74. Marubeni Spar One, LLC v. Williams Field Servs. – Gulf Coast Co., L.P., No. 2018-0908-SG, 2020 WL 64761, at *10 n.95 (Del. Ch. Jan. 7, 2020) (quoting Renco Grp., Inc. v. MacAndrews AMG Holdings LLC, No. 7668-VCN, 2015 WL 394011, at *7 (Del. Ch. Jan. 29, 2015)).

75. *See* Norton v. K-Sea Transp. Partners L.P., 67 A.3d 354, 362 (Del. 2013) (holding that the general partner could have no fiduciary duties regarding its merger approval where the contract gave it "sole discretion" to "consent to a merger"); Related Westpac LLC v. JER Snowmass LLC, No. 5001-VCS, 2010 WL 2929708, at *8 (Del. Ch. July 23, 2010) ("When a fiduciary duty claim is plainly inconsistent with the contractual bargain struck by parties to an . . . alternative entity agreement, the fiduciary duty claim must fall . . . .").

76. Leaf Invenergy Co. v. Invenergy Renewables LLC, 210 A.3d 688, 695 (Del. 2019) (quoting Genencor Int'l, Inc. v. Novo Nordisk A/S, 766 A.2d 8, 11 (Del. 2000)).

77. *Id.* (quoting RESTATEMENT (SECOND) OF CONTRACTS § 347 cmt. b (AM. L. INST. 1981)).

or (ii) the amount that the rightsholder could have obtained for its consent in a hypothetical negotiation.[78]

Unfortunately, consent rights have proven notoriously difficult to value. Litigants are rarely able to show the "actual harm" caused by the breach, given the intangible nature of the right and the fact that breaches frequently occur when a company is in some type of distress—thereby making it difficult to prove that the breach, rather than other circumstances, was the cause of the harm.[79]

That leaves only a second form of expectation damages, which may be "calculated based on the expected outcome of a hypothetical negotiation between these parties before" the decision to breach.[80] As then-Chancellor Strine acknowledged in *Fletcher v. ION*[81] in 2013, this is "an exercise in counterfactual historical imagination that is, by its very nature, fraught with uncertainty."[82] To determine the likely path of a hypothetical negotiation, a court must begin by considering "which parties would have been involved in the hypothetical negotiation and what leverage those parties would have had."[83] Then, a court must determine, "using its best effort, how the hypothetical negotiation likely would have ended."[84]

This analysis did not go particularly well for the *Fletcher* plaintiff, who alone held the right to consent to a $40 million bridge financing that was a minor portion of a much larger transaction.[85] Chancellor Strine held that the plaintiff lacked sufficient leverage to extract a large value for his consent due to several factors, including the need for other lenders to approve any consent payment to him and the fact that the defendant "could have structured the transaction to avoid implicating the *Fletcher* plaintiff's consent right."[86] The court suggested that it would be skeptical of any consent rightsholder who "viewed its consent right as an opportunity to coerce value from" a

78. Leaf Invenergy Co. v. Invenergy Wind LLC, No. 11830-VCL, 2018 WL 1882746, at *26, 31 (Del. Ch. Apr. 19, 2018), *rev'd on other grounds sub nom.*, *Invenergy Renewables LLC*, 210 A.3d at 695; Fletcher Int'l, Ltd. v. Ion Geophysical Corp., No. 5109-CS, 2013 WL 6327997, at *11 (Del. Ch. Dec. 4, 2013).

79. *See, e.g.*, *Fletcher*, 2013 WL 6327997, at *11; Zimmerman v. Crothall, 62 A.3d 676, 716 (Del. Ch. 2013) (holding plaintiff suffered no actual damages from defendants' contractual breach of awarding only nominal damages of $1).

80. *Fletcher*, 2013 WL 6327997, at *18; *see also* Cedarview Opportunities Master Fund, L.P. v. Spanish Broad. Sys., Inc., No. 2017-0785-AGB, 2018 WL 4057012, at *12 (Del. Ch. Aug. 27, 2018) (noting that "money damages in the form of a hypothetical consent fee could remedy a proven breach") (quoting Def.'s Opening Br. at 43-44, *Cedarview Opportunities Master Fund, L.P*, 2018 WL 4057012 at *1).

81. No. 5109-CS, 2013 WL 6327997 (Del. Ch. Dec. 4, 2013).

82. *Id.* at *19.

83. *Id.*

84. *Id.*

85. *Id.* at *1.

86. *Id.* at *2.

corporation, even for a transaction that "was highly beneficial to" the rightsholder.[87] Chancellor Strine further noted that in a prior consent rights case, *Zimmerman v. Crothall*,[88] the plaintiff had "learned a lesson about overplaying one's hand" after the court awarded it only nominal damages for the breach of a consent right that benefited the plaintiff.[89]

Thus, *Fletcher* provided the "reasonableness" check for damages stemming from the use of consent rights that courts refused to apply in cases like *Superior Vision* and *Related Westpac* when addressing the *existence* of a breach.[90] While a party can be as unreasonable as it wishes in refusing to grant consent, the party assumes the risk that the corporation can simply breach the contract and—if the rightsholder cannot prove it was harmed—pay nothing. With those guidelines in place, the parties are presumably encouraged to work to find a negotiated solution without court intervention. However, a consent rightsholder's leverage in such a negotiation is undermined by uncertainty surrounding a potential future damages award. As explained below, the availability of equitable relief (in the form of a temporary injunction or specific performance) would bring a rightsholder's leverage in these negotiations more in line with the parties' expectations at the time of contracting, particularly where that consent is required to move forward with a corporate action highly desired by the company.

In the end, the *Fletcher* plaintiff was awarded a meager $300,000, far less than the multimillion dollar "king's ransom" that he had sought.[91] What is more remarkable is that this appears to be the *highest* amount of damages ever awarded under a "hypothetical negotiation" framework, which is admittedly seldom used.[92] It is possible that when parties have sufficient leverage to extract large concessions or payments for their consent, they do not need a court's help to do so; it is equally possible that corporations generally respect consent rights and do not often breach them (at least when the rightsholder would be likely to seek judicial intervention). Regardless of the reason, the absence of any substantial damages awards as measured by a "hypothetical negotiation" suggests that this measure of damages may be more theoretical than practical.

The difficulty in valuing consent rights is further shown by Vice Chancellor Laster's initial decision in *Leaf Invenergy Co. v. Invenergy Wind*

87. *Id.* at *18.
88. 62 A.3d 676 (Del. Ch. 2013).
89. *Fletcher*, 2013 WL 6327997, at *18.
90. *See supra* Section I.B.
91. *Id.* at *2, *26.
92. *See supra* notes 79–84 and accompanying text.

LLC,[93] which awarded only nominal damages for the breach of a preferred investors' right to approve a certain type of sale.[94] Although the parties' contract provided that the sale would trigger a premium payment to the investor calculated according to a contractual formula (which totaled $126 million), Vice Chancellor Laster found that the company had engaged in an "efficient breach" and a hypothetical negotiation would have yielded no payment in light of the company's other options and the "lack of any financial pressure."[95] Thus, instead of awarding the plaintiff the $126 million that it had expected, the court awarded the plaintiff a single dollar.[96]

The Supreme Court of Delaware reversed, acknowledging the concept of "efficient breach" but clarifying that the doctrine "does not bar recovery or modify damages calculations in any way . . . . [E]fficient breach does not allow the breaching party to bypass the usual method of calculating damages."[97] It was similarly an error to attempt to reconstruct a hypothetical negotiation, the Court held, because the contract clearly specified the amount owed to the plaintiff.[98] The Court awarded the plaintiff the full $126 million.[99] Thus, while the Supreme Court of Delaware ultimately awarded significant damages, it did so based on the functional equivalent of a liquidated damages provision—not a hypothetical negotiation.[100] And if anything, this case further underscores how difficult it is to predict the amount of damages that a court will award for a defendant's breach of the plaintiff's consent right.

In short, while it is intuitively appealing to value consent rights based on what a hypothetical counterparty would pay for them, the "hypothetical negotiation" test has proved to be a failed experiment.

B. Availability of Equitable Relief

There are two potential equitable remedies that can effectively force the parties to engage in a negotiation to obtain the rightsholder's consent: (i) a preliminary injunction, which depending on the speed necessary for the desired corporate action may resolve the case entirely; and (ii) the remedy of specific performance, awarded after the court issues a final decision on the merits, which would bar further corporate action without consent. Each form

93. No. 11830-VCL, 2018 WL 1882746 (Del. Ch. Apr. 19, 2018), *rev'd*, 210 A.3d 688 (Del. 2019).

94. *Id.* at *33.

95. *Id.* at *31–32.

96. *Id.* at *38.

97. Leaf Invenergy Co. v. Invenergy Renewables LLC, 210 A.3d 688, 703 (Del. 2019).

98. *Id.* at 703–04.

99. *Id.* at 694, 704.

100. *See supra* text accompanying note 66.

of relief is considered to be an "extraordinary remedy" that is to be "granted sparingly."[101] Before granting both remedies, courts are required to engage in a balancing of the equities between the parties and to determine whether monetary damages are instead sufficient (and reasonably ascertainable) to remedy any harm.[102] While courts have traditionally favored awarding monetary damages whenever possible, recent scholarship demonstrates that in one of the most common scenarios—where common stockholders breach preferred stockholders' consent rights by wrongfully continuing a company that preferred stockholders wish to liquidate—no amount of money can efficiently compensate preferred stockholders for this breach.[103]

Courts have cautioned that "[t]he preliminary injunction 'burden is not a light one,'"[104] and that the remedy of specific performance "is a matter of grace and not of right."[105] But what if both forms of equitable relief were more readily available to prevent the breach of one party's consent right? If courts were more willing to grant injunctions or order specific performance to enforce consent rights, it would force the parties to negotiate a resolution (by either obtaining consent or foregoing the desired corporate action). This result would obviate the need for courts to engage in a post hoc recreation of a negotiation that did not occur.

101. Renco Grp., Inc. v. MacAndrews AMG Holdings LLC, No. 7668-VCN, 2013 WL 3369318, at *12 n.97 (Del. Ch. June 19, 2013) ("The granting of a preliminary injunction is an extraordinary remedy.") (citing DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 10.02(a), at 10–5 (2012)); W. Willow-Bay Court, LLC v. Robino-Bay Court Plaza, LLC, No. 2742-VCN, 2007 WL 3317551, at *12 (Del. Ch. Nov. 2, 2007), *aff'd*, 985 A.2d 391 (Del. 2009) ("*Specific performance* is an extraordinary remedy, appropriate where assessing money damages would be impracticable or would fail to do complete justice.").

102. C&J Energy Servs., Inc. v. City of Miami Gen. Empls.' & Sanitation Empls.' Ret. Tr., 107 A.3d 1049, 1066 (Del. 2014) ("To obtain a preliminary injunction, the [petitioner] must demonstrate: (1) a reasonable probability of success on the merits; (2) that they will suffer irreparable injury without an injunction; and (3) that their harm without an injunction outweighs the harm to the defendants that will result from the injunction."); Sarissa Cap. Domestic Fund LP v. Innoviva, Inc., No. 2017-0309-JRS, 2017 WL 6209597, at *26 (Del. Ch. Dec. 8, 2017) ("A party seeking specific performance must prove by clear and convincing evidence (1) the existence of a valid, enforceable contract; (2) the 'essential elements' of that contract; and (3) the absence of an adequate legal remedy. The party seeking relief must also establish that it is 'ready, willing and able to perform' its contractual obligations, and that the 'the balance of the equities' . . . favor[s] granting specific performance.'") (first quoting Osborn ex rel. Osborn v. Kemp, 991 A.2d 1153, 1158 (Del. 2010); then quoting *Robino-Bay*, 2007 WL 3317551, at *13).

103. Sanga & Talley, *supra* note 9 , at 23–24. Sanga and Talley's model demonstrates that the ability to engage in an efficient breach varies depending on who controls the decisionmaking process for the company. Where common control the ability to decide whether to liquidate a company, under the legal rule set forth in *Trados*, "efficient damages do not exist." *Id.* at 24.

104. Protech Sols., Inc. v. Delaware Dep't of Health & Human Servs., No. 2017-0642-TMR, 2017 WL 5903357, at *1 (Del. Ch. Nov. 30, 2017) (quoting Wayne Cty. Empls.' Ret. Sys. v. Corti, 954 A.2d 319, 329 (Del. Ch. 2008)).

105. *Robino-Bay*, 2007 WL 3317551, at *12.

Despite the difficulties inherent in calculating damages described above, courts have varied in their willingness to enjoin breaches of consent rights. For example, in *Fletcher*, the consent rightsholder sought a preliminary injunction to prevent the ION from issuing the $40 million loan in violation of its right to consent to the issuance.[106] Vice Chancellor Parsons denied the application, holding that the threat of injury was not irreparable but was instead compensable with damages.[107] Later, following the trial, then-Chancellor Strine applied the hypothetical negotiation test to award damages, but suggested that injunctive relief should have been granted in the first instance because "consent rights cases are better dealt with by injunctive relief if the court can act with alacrity and give the parties a reasonable period to have the negotiation or work around the consent rights."[108] In other words, why try to reconstruct a "hypothetical negotiation" if you could enter an injunction and force an *actual* negotiation?

Nonetheless, courts have not fully adopted this view and continue to maintain a reluctance to issue injunctions in support of consent rights. More recently, in *Tinicum Capital Partners II, L.P. v. Liberman Broadcasting, Inc.*,[109] Vice Chancellor Laster considered the plaintiff's motion to preliminarily enjoin the defendant company from violating a contractual provision that prevented it from entering into binding transactions related to a spectrum auction by the FCC scheduled to start on March 29, 2016.[110] Under the parties' agreement, the plaintiff was permitted the "absolute discretion" to "withhold or deny" its consent.[111] On March 17, 2016—twelve days before the auction was to start—the court denied the motion, holding that the need for consent could be delayed until June and the parties could complete arbitration by that time.[112] The court noted, however, that if there had been "a more imminent risk of decisions that could implicate the Consent Rights," then an injunction may have been appropriate.[113]

This scattered state of the law has left litigants confused about whether or not it is possible to obtain an injunction to secure consent rights. The *Invenergy* plaintiff, for example, stated that he "believed that Leaf could not obtain an injunction because a court would hold that Leaf could receive

106. Fletcher Int'l, Ltd. v. Ion Geophysical Corp., No. 5109-CS, 2013 WL 6327997, at *11 (Del. Ch. Dec. 4, 2013).

107. *Id.*

108. *Id.* at *19.

109. No. 11902-VCL, 2016 WL 1070480 (Del. Ch. Mar. 17, 2016).

110. *Id.* at *1.

111. *Id.*

112. *Id.* at *2.

113. *Id.*

money damages as a remedy."[114] While there are undoubtedly circumstances where such relief is not warranted based on a consent rightsholder's inequitable conduct, courts' overriding reluctance to award equitable remedies is misguided in light of the difficulties inherent in calculating damages for a breach after the fact.[115]

C. A Company's Inability to "Efficiently" Breach a Contract Is Less Important Given the Ancillary Consequences of a Breach

One consequence of a court's increased willingness to grant injunctive relief or specific performance to enforce a consent provision is that a company's ability to engage in an "efficient breach" of that provision would be severely curtailed. That is, if the consent rightsholder can obtain a court order enjoining the breach *before* it occurs, then a breach carries more onerous consequences than simply paying damages after the fact. Willfully disobeying a court order would almost inevitably result in the imposition of sanctions, which under Delaware law can range from penalty payments, to the admission of certain facts, to a default judgment.[116] At the most extreme, it could potentially lead to the cancellation of the entities' incorporation or formation documents.[117] Under these circumstances, it is difficult to imagine how one could efficiently breach a party's consent rights if that party is able to obtain an injunction to prevent it.

But how significant is the loss of a company's ability to breach a consent right? A discussion of the inherent difficulty of determining what constitutes an "efficient breach" would be incomplete if it did not consider the many indirect consequences of a breach. Even where a breach of consent rights would seem to make sense from an economic perspective, hard-to-predict costs and the intangible consequences of a breach mean that it is rarely, if ever, truly the most efficient path forward, at least when those consent rights are held by key investors or joint venture partners.

---

114. Leaf Invenergy Co. v. Invenergy Wind LLC, No. 11830-VCL, 2018 WL 1882746, at *22 (Del. Ch. Apr. 19, 2018), *rev'd*, 210 A.3d 688 (Del. 2019).

115. *See supra* Sections III.A–B.

116. *See, e.g.*, Terramar Retail Ctrs., LLC v. Marion #2-Seaport Tr. U/A/D June 21, 2002, No. 12875-VCL, 2018 WL 6331622, at *11 (Del. Ch. Dec. 4, 2018).

117. In 2018 and 2019, Delaware enacted statutory law giving the state Attorney General the power to file proceedings to cancel or revoke an entities' formative documents where the entity has engaged in the "abuse" or "misuse" of its powers. *See* DEL. CODE ANN. tit. 8, § 284(a) (1953) (corporations); DEL. CODE ANN. tit. 6, § 18-112(a) (2018) (LLCs); DEL. CODE ANN. tit. 6, § 17-112 (2019) (partnerships). In the first year since these rules' enactment, the Attorney General has been sparing in their use, filing just six forfeiture actions against fifteen entities in 2019. *See* Denis Demblowski, *Analysis: Can Delaware Cancel My Company?*, BLOOMBERG L. ANALYSIS (Jan. 17, 2020), https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-can-delaware-cancel-my-company.

As others have mentioned, "expectation damages as awarded in law often fall short of a truly compensatory measure due to the exclusion of such items as attorneys' fees, unmeasurable subjective losses, and 'unforeseeable' damages."[118] This problem is worse in high-stakes commercial litigation, where legal fees can soar into the millions. Moreover, because the ultimate remedy that a court will award is uncertain,[119] a breaching party can easily end up worse off by paying substantial money for lawyers while also paying out damages that equal or exceed the amount that it would have cost simply to obtain the necessary consent.[120] Some scholars have also pointed out that although "the received wisdom is that contract remedies do not exist to punish a breaching party," in reality, often the remedies awarded by courts are harsher where the breaching party acted willfully.[121] A finding of willfulness also opens up the possibility that a breaching party will be ordered to pay the nonbreaching party's legal fees, which "may be awarded if it is shown that the defendant's conduct forced the plaintiff to file suit to secure a clearly defined and established right."[122]

Moreover, particularly salient in the context of investment capital, breaching a party's contractual consent rights can have substantial reputational consequences that may impact the corporation's ability to conduct future business.[123] As studies have shown, once a market participant is known to "cheat," "it becomes common knowledge that the person lacks integrity" and their reputation is damaged.[124] In other words, "the notion of a reputation is intimately tied to the concept of breach. A party loses its reputation for performance or for trustworthiness whenever they breach an agreement."[125] Because contract disputes frequently become public through a corporation's litigation disclosures, court filings, media attention, industry gossip, or other means, it is unreasonable to think that the market of investors or potential joint venturers would not learn about the breach of another

---

118. Craswell, *supra* note 46, at 637.

119. *See supra* Sections III.A–B.

120. Craswell, *supra* note 46, at 638 ("Since so many contract remedies depart in one direction or the other from the 'ideal' of perfect compensation, the prospect of inefficient breaches (or the deterrence of efficient breaches) would seem to loom large.").

121. Marco J. Jimenez, *Retribution in Contract Law*, 52 U.C. DAVIS L. REV. 637, 643 (2018).

122. Carlson v. Hallinan, 925 A.2d 506, 545 (Del. Ch. 2006) (awarding fees for refusal to recognize director's entitlement to corporate records) (quoting McGowan v. Empress Entm't Inc., 791 A.2d 1, 4 (Del. Ch. 2000)).

123. *See* Lewis A. Kornhauser, *Reliance, Reputation, and Breach of Contract*, 26 J. L. & ECON. 691, 693 (1983). *See generally* W. Bentley MacLeod, *Reputations, Relationships and the Enforcement of Incomplete Contracts* (IZA, Discussion Paper, Paper No. 1978, 2006), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=885347.

124. MacLeod, *supra* note 123 at 30–31 (citing ROBERT WILSON, *Reputation in Games and Markets*, in GAME-THEORETIC MODELS OF BARGANING 27-62 (Alvin E. Roth Ed., 1985).

125. *Id.* at 32.

party's consent rights. For an early-stage company seeking investment capital, this loss of reputation might well be fatal. Few investors would be comfortable relying on the contractual rights they negotiate with a corporation if they knew that the corporation was willing to breach its contractual obligations to previous investors.

IV. A PATH FORWARD

Thus, while courts have consistently floated the possibility of an "efficient breach" of a party's consent rights, the reality of breaching such rights is far more onerous than is contemplated in those decisions. Moreover, the full consequences of a breach are difficult to predict, making it impossible to determine at the time of breach whether that breach is in fact "efficient." In light of all these considerations, the idea that a board could breach its fiduciary duty by *honoring* a party's consent rights seems merely theoretical (at best). Corporations should generally respect consent rights not for some moralistic purpose, but because it is generally in the best interests of all stockholders to preserve the company's reputation and ability to seek out future capital.

More broadly, the tension between the strict enforcement of contractual rights and courts' willingness to accept that breach of those rights may be advisable (and free to the breaching party) can be resolved through the creation of a default rule that, in the usual course of business, consent rights are appropriately enforced with equitable relief. The use of injunctions to protect a party's right to consent would be consistent with courts' treatment of other forms of restrictive covenants, including those commonly found in employment agreements. For example, in enforcing classic restrictive covenants like noncompete and non-solicitation agreements, Delaware courts "use injunctive relief as the principal tool of enforcing covenants not to compete."[126] Similarly, much of the investor uncertainty and difficulty surrounding the enforcement of consent rights could be resolved simply by the adoption of this rule. While the ability to efficiently breach a contract would be effectively lost, Delaware courts' protection of bargained-for contractual rights through injunctive relief would send the same signal to potential investors as does their adherence to enforcing the plain terms of contractual language—that is, a signal that investor rights will be respected and enforced in Delaware.

Moreover, the issuance of a temporary injunction or the award of specific performance forces the parties back to the bargaining table to have a

126. Concord Steel, Inc. v. Wilmington Steel Processing Co., No. 3369-VCP, 2008 WL 902406, at *10 (Del. Ch. Apr. 3, 2008) (quoting Hough Assocs. v. Hill, No. Civ. A. 2385-N, 2007 WL 148751, *18 (Jan. 17, 2007)).

real negotiation. A court is then relieved of having to reimagine a "hypothetical negotiation" that, by definition, failed in reality (since the parties ended up coming to court to resolve their dispute) and that requires a court to engage in precisely the type of "speculation" and "conjecture" that Delaware courts typically reject as a basis on which to award monetary damages.[127] Instead, courts need only enjoin the breach of contract, and the parties can work out an optimal solution based on their own interests. Moreover, because the issuance of an injunction or specific performance requires a balancing of the equities,[128] the involvement of courts at this stage can also help mitigate the "hostage" problem, as the court has discretion to decline to act where necessary to prevent particularly grievous harm to the corporation. This procedure would have the additional benefit of insulating the corporation against a breach of fiduciary duty claim stemming from its recognition of contractual rights, as a corporation cannot possibly *breac*h its fiduciary obligations by complying with a court order forcing it to *abide* by those same contractual obligations.

Absent a greater judicial willingness to grant equitable relief, the current uncertainty will persist and consent rightsholders may not be as protected as they would have expected at the time of contracting. Given the current state of the law, where possible, parties negotiating consent rights should create enforceable consequences for a breach. On the flip side, a company can protect itself from improper hostage-taking by rightsholders by specifying that consent may not be unreasonably withheld. Until the parties can be confident that Delaware courts will adequately protect both a party's consent rights alongside the rights of the corporation, these protective measures are necessary to ensure that the parties' reasonable expectations about their contractual rights are fulfilled.

---

127. *See* OptimisCorp v. Waite, 137 A.3d 970, 2016 WL 2585871, at *3 n.11 (Del. 2016) ("[W]hen acting as the fact finder, [the Court of Chancery] may not set damages based on mere 'speculation or conjecture' where a plaintiff fails to adequately prove damages.") (alterations in original) (quoting Beard Research, Inc. v. Kates, 8 A.3d 573, 613 (Del. Ch. 2010)).

128. N.K.S. Distribs, Inc. v. Tigani, 2010 WL 2367669, at *5 (Del. Ch. June 7, 2010); *but see In re* Cencom Cable Income Partners, L.P., No. C.A 14634, 2000 WL 130629, at *8 (Del. Ch. Jan. 27, 2000) (finding that "the equities heavily favor the plaintiffs" who "raised colorable claims about the defendant's conduct" which was "precisely the conduct that the Agreement sought to prevent").