# DCGL Amendment May Breathe New Life Into Zombie Companies

Mark Joachim, Shareholder
Katie Devanney, Associate
January 2, 2024

On August 1, 2023, the Delaware General Corporation Law (DGCL) was amended to create an "insolvency exception" to Delaware's long-standing requirement that a sale of all or substantially all of a Delaware corporation's assets and property be approved by a majority of the company's stockholders (in addition to being authorized by its board of directors). The amendment, which was proposed in response to the Delaware Supreme Court's decision in *Stream TV*,[1] not only creates a path forward for so-called friendly foreclosures, but may also provide a new mechanism for "zombie companies"[2] to obtain new ownership, de-lever their balance sheets, and return to (or achieve) profitability.

### *Stream TV* and the Zombie Company Problem

By 2019, Stream TV was, by most definitions of the term, a "zombie company." Though brimming with potential, Stream remained a pre-revenue, development-stage company ten years after its founding, despite having raised approximately $160 million through financing and equity investments. Apparently dissatisfied with the way things were going, a group of equity holders proposed an out-of-court debt-for-equity exchange with the company's secured lenders. The company's board voted to accept the proposal, but a group of controlling shareholders disagreed, arguing that the transaction constituted a sale of substantially all of the company's assets that required a stockholder vote under Section 271 of the DGCL.[3] Following extensive litigation, the Delaware Supreme Court agreed with the shareholders, refusing to read a common-law insolvency exception into Section 271.

The *Stream TV* decision dealt a major blow to the ability of Delaware corporations to rebalance their balance sheets and align governance and ownership with the "true owners" of the business, absent stockholder approval. And the timing could not have been worse for zombie companies, which are particularly sensitive to rising interest rates and operational costs. But perhaps few felt the impact of the decision as acutely as private equity firms which may find themselves with ongoing board and fiduciary responsibilities, a minority (and worthless) ownership stake, and no easy way out.

---

[1] *Stream TV Networks, Inc. v. SeeCubic, Inc.*, 279 A.3d 323 (Del. 2022).

[2] For these purposes, we define "zombie company" as a company that has enough cash flow to continue operating (including, in some cases, servicing its funded debt), but not enough cash flow or value to pay off its funded debt or refinance it on serviceable terms. Often, "zombie companies" have board members and large shareholders that recognize that equity is "out of the money", but other constituencies that have not come to that difficult realization. This can leave a company in limbo, with a disconnect between corporate governance and real economic stake in the outcome.

[3] Section 271(a) of the DGCL provides—

> Every corporation may at any meeting of its board of directors or governing body sell, lease or exchange all or substantially all of its property and assets, including its goodwill and its corporate franchises, upon such terms and conditions and for such consideration, which may consist in whole or in part of money or other property, including shares of stock in, and/or other securities of, any other corporation or corporations, as its board of directors or governing body deems expedient and for the best interests of the corporation, 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 or, if the corporation is a nonstock corporation, by a majority of the members having the right to vote for the election of the members of the governing body and any other members entitled to vote thereon under the certificate of incorporation or the bylaws of such corporation, at a meeting duly called upon at least 20 days' notice. The notice of the meeting shall state that such a resolution will be considered.

### The DGCL Amendment

Though stopping short of abrogating *Stream TV*, the Delaware legislature amended Section 272 of the DGCL to provide for a “safe harbor” for the sale, lease, or exchange of property or assets that secure a mortgage or pledge to a secured party without stockholder consent. Under newly-amended Section 272, a company’s board of directors may authorize an alternative sale so long as: (i) the value of the property to be sold is less than or equal to the amount of liabilities being eliminated, and (ii) the sale is not otherwise prohibited by applicable law. However, a company may opt out of this new provision by expressly requiring stockholder approval in its certificate of incorporation.

### Possible solution to the zombie company problem?

Though it is too soon to know the full implications of this amendment, the amended DGCL does provide another tool for at least some Delaware zombie companies to quickly and cost-effectively de-lever their balance sheets through an out-of-court restructuring approved by the company’s board—even over the objection of a majority shareholder or shareholder group. In many cases, a sale of the company’s assets is the most efficient—and in some cases *only*—way for a company to restructure. By allowing a company’s board of directors to guide the enterprise in accordance with their fiduciary duties, a Delaware board now has a potential pathway towards breaking the logjam and executing on an out of court sale or consensual foreclosure that breathes new life into the zombie.

polsinelli.com | Polsinelli is very proud of the results we obtain for our clients, but you should know that past results do not guarantee future results; that every case is different and must be judged on its own merits; and that the choice of a lawyer is an important decision and should not be based solely upon advertisements. Copyright © 2023 Polsinelli PC. Polsinelli LLP in California, Polsinelli PC (Inc) in Florida.