

## DELAWARE BUSINESS COURT INSIDER

October 10,  
2012 |

Exclusive Business Court News & Analysis from *The Legal Intelligence*

An ALM Publication



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### Chancery Court Blocks Suit to Void Completed Merger as Ultra Vires

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*Delaware Business Court Insider* | October 10, 2012

In *Southeastern Pennsylvania Transportation Authority v. Volgenau*, 2012 WL 4038509 (Del. Ch. Aug. 31, 2012), Vice Chancellor John W. Noble dismissed a direct action challenging a consummated merger transaction on the grounds that the merger violated the company's certificate of incorporation and was ultra vires, but left standing a claim for breach of fiduciary duty against the directors of the company for approving the transaction in violation of the certificate of incorporation.

SEPTA brought a class action on behalf of itself and all other similarly situated former common stockholders of SRA International Inc. challenging the merger of SRA and affiliates of Providence Equity Partners LLC. Among other counts, SEPTA alleged the merger was invalid under the company's certificate of incorporation because, although the certificate required that all of the company's common stockholders receive equal per share payments in the event of a merger, an official of the company was permitted to roll a portion of his holdings into equity ownership in the surviving private company and thus received consideration that was different in kind from the consideration received by the company's other common stockholders. SEPTA also alleged that the individual directors breached their duty of loyalty to the public stockholders of SRA by approving the invalid merger. Although the complaint initially sought injunctive relief, SEPTA abandoned that claim and the merger was completed.

The SRA defendants argued SEPTA's claim that the merger was invalid failed as a matter of law since it was procedurally barred by Section 124 of the Delaware General Corporation Law. Under Section 124, a claim that corporate action is "invalid by reason of the fact that the corporation was without capacity or power" must be brought as a claim for injunctive relief or as a derivative claim, or it must be a claim initiated by the attorney general. The SRA defendants argued SEPTA's claim that the merger was invalid could not stand because it was a non-injunctive, direct claim brought by a private party and not the attorney general.

SEPTA contended that the disputed count actually presented two separate claims: a contract claim and a fiduciary duty claim. SEPTA argued the requirement of uniformity in the certificate of incorporation constituted a contract with the stockholders and the board's approval of the merger was a breach of that contract, which rendered the merger invalid and voidable. SEPTA also argued the directors breached their fiduciary duty of loyalty and care to the other stockholders by approving a merger that favored one of the company's officials in violation of the certificate's requirement of uniformity, which also rendered the merger voidable.

The court looked to the purposes of Section 124, which are to prevent corporations and those contracting with them from avoiding contracts that could be classified as outside the scope of the corporation's authorized powers and to promote predictability and confidence in the efficacy of corporate agreements. To accomplish these purposes, Section 124 provides that corporate acts will be deemed valid, and a corporation's capacity to undertake them may not, except in specified circumstances, be challenged as ultra vires. However, although a corporation's acts in violation of its authorized powers may be deemed valid and effective, the same acts may nevertheless constitute a breach of fiduciary duty by the directors who approved them. As the court explained, when a corporation undertakes an act in violation of its certificate of incorporation, the act may stand but it may also be the basis for a direct shareholder lawsuit against the directors.

Thus, SEPTA may state a direct claim that SRA's directors breached their fiduciary duties by approving the merger, which violates the company's certificate of incorporation, but it may not challenge the validity of the merger or SRA's capacity to enter into the merger. The court stopped short of determining whether a decision by directors to cause the corporation to take an action that violates its certificate of incorporation is a breach of the duty of care or the duty of loyalty, although it suggested that such a decision might be analogous to a decision to cause the corporation to take an illegal act, which is typically viewed as a breach of the duty of loyalty.

The court believed that its holding would have little future effect. First, the court observed that the holding is not likely to apply beyond the sale context, since a stockholder will likely not have standing to bring a direct claim against a director who causes the corporation to undertake an ultra vires act during the corporation's ongoing operations. Any claim for harm that results from such an act would most likely inure to the corporation itself and thus would provide a basis only for a derivative claim. Second, the court noted there is no suggestion in its holding that Section 124 alters the shareholders' ability to sue directors for their failure to adhere to common law protections applicable in the sale context, such as those imposed by *Revlon* and its progeny. If the protections in the certificate are equivalent or less than the protections available at common law, then any claim for violation of the certificate will be duplicative of or less effective than a claim under common law.

It is not clear whether SEPTA really wanted to block the merger or merely sought to have the merger declared ultra vires to support its claim for breach of fiduciary duty against the directors who approved it. If the latter is the case, as is very likely since SEPTA abandoned its effort to enjoin the merger, the result does little to undermine the suit. At the same time, the decision advances the twin objectives of predictability and confidence in corporate acts that Section 124 was intended to serve.

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