

**PRIVILEGED AND CONFIDENTIAL**  
**ATTORNEY-CLIENT COMMUNICATION**  
**MEMORANDUM**

**TO:**Avalon Bancorp Inc.

**FROM:**Outside Counsel

**DATE:**January 8, 2026

**RE:**Analysis of Legal Issues Arising from the Velridge Transaction and Stockholders' Agreement with Marcus Davenholt

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## **I. INTRODUCTION**

You have asked us to analyze the legal issues arising from Avalon Bancorp Inc.'s ("Avalon" or the "Company") decision to decline a significant contractual opportunity with Velridge Technologies Inc. ("Velridge"). This decision was made in deference to Marcus Davenholt's ("Marcus") exercise of his contractual veto right under the stockholders' agreement between Marcus and Avalon, which Marcus exercised based on personal animus toward Velridge's CEO rather than any business-related rationale.

This memorandum addresses three principal issues: (1) the authority of Avalon's board of directors and the enforceability of the stockholders' agreement with Marcus; (2) the potential fiduciary duty implications for Avalon's board in deferring to the stockholders' agreement and Marcus's veto; and (3) the potential fiduciary duty implications for Marcus in blocking the Velridge deal for personal reasons.

## **II. FACTUAL BACKGROUND**

Avalon is a Delaware corporation whose charter and bylaws provide that "the company's business and affairs shall be exclusively managed by the board of directors." In January 2024, Marcus made a substantial investment in Avalon, receiving a minority equity stake in exchange. Concurrently, Marcus entered into a stockholders' agreement with Avalon that grants him two significant governance rights: (i) the ability to appoint Avalon's directors and officers, and (ii) a pre-approval right over any corporate transactions involving Avalon.

In September 2024, Velridge offered Avalon a contract that would potentially increase Avalon's revenues tenfold. Marcus, however, informed the board that he would withhold consent to the transaction due to a personal dispute with Velridge's CEO arising from an unrelated incident

involving a golf game. The board subsequently declined the Velridge contract to comply with the stockholders' agreement.

### **III. BOARD AUTHORITY AND ENFORCEABILITY OF THE STOCKHOLDERS' AGREEMENT**

#### **A. The Statutory Framework: DGCL Section 141(a)**

Delaware General Corporation Law ("DGCL") Section 141(a) establishes the foundational principle of board primacy in Delaware corporate governance. The statute provides that "[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation." This provision reflects Delaware's long-standing commitment to centralized management through an empowered board of directors.

Avalon's charter reinforces this principle by providing that "the company's business and affairs shall be exclusively managed by the board of directors." This language tracks the statutory default and does not create any exceptions to board authority.

#### **B. West Palm Beach Firefighters' Pension Fund v. Moelis & Co.**

*In West Palm Beach Firefighters' Pension Fund v. Moelis & Co.*, 311 A.3d 809 (Del. Ch. 2024), Vice Chancellor Laster addressed the validity of stockholder agreement provisions that constrained board discretion. The case involved a stockholders' agreement granting the company's founder and controlling stockholder various governance rights, including consent rights over corporate transactions, the ability to designate directors and committee members, and approval rights over equity issuances and compensation decisions.

The Court of Chancery held that many of these provisions were facially invalid under Section 141(a) because they impermissibly constrained the board's statutory authority to manage the corporation's business and affairs. The court emphasized that Section 141(a) creates a "clear textual limit" on private ordering: parties may not use stockholder agreements to circumvent the board's statutory management authority unless the certificate of incorporation expressly provides otherwise.

The *Moelis* decision distinguished between "vertical" conflicts (stockholder agreements inconsistent with the charter) and "horizontal" conflicts (stockholder agreements that, while not conflicting with the charter, nonetheless violate Section 141(a) by constraining board authority without charter authorization). The court found that stockholder agreement provisions requiring board approval or consent from a stockholder for ordinary business decisions fell into the latter category and were therefore unenforceable.

#### **C. Delaware Senate Bill 313: The Legislative Response**

In direct response to the uncertainty created by *Moelis*, the Delaware General Assembly enacted Senate Bill 313, which became effective on August 1, 2024. SB 313 amended DGCL Section 122 by adding a new subsection (18), which expressly authorizes Delaware corporations to enter into agreements that grant stockholders various governance rights that *Moelis* had called into question.

Specifically, the new Section 122(18) provides that a corporation may "[e]nter into agreements with 1 or more current or prospective stockholders" granting rights including: (a) consent rights over specified actions; (b) the right to designate directors or officers; (c) governance provisions regarding meetings and voting; and (d) the right to acquire or sell stock. The statute explicitly validates stockholder agreement provisions that grant pre-approval or consent rights over corporate transactions.

Critically, however, SB 313 also includes an important limitation. Section 122(18) provides that such agreements "shall not limit the duties (including fiduciary duties) of directors to the corporation or its stockholders, *except to the extent a stockholder or stockholders may consent to or approve an action that would otherwise constitute a breach of a duty to such stockholder or stockholders.*" This carve-out preserves the fiduciary duty analysis for both directors and controlling stockholders.

#### **D. Application to the Stockholders' Agreement with Marcus**

Under the post-SB 313 framework, the stockholders' agreement with Marcus is likely enforceable as a matter of statutory authorization. The agreement grants Marcus (i) the right to appoint directors and officers and (ii) pre-approval rights over corporate transactions—both of which are expressly contemplated by Section 122(18)(a) and (b). The stockholders' agreement was entered into in January 2024, and the Velridge transaction arose in September 2024, after SB 313 took effect on August 1, 2024. SB 313 applies to existing agreements "regardless of when such agreement was created."

Accordingly, the stockholders' agreement provisions granting Marcus appointment and consent rights are presumptively valid under Delaware statutory law. However, as discussed below, the statutory validation of these provisions does not eliminate the fiduciary duty obligations of either the board or Marcus himself.

### **IV. FIDUCIARY DUTY IMPLICATIONS FOR AVALON'S BOARD**

#### **A. The Board's Continuing Fiduciary Obligations**

As noted above, SB 313 expressly provides that stockholder agreements "shall not limit the duties (including fiduciary duties) of directors to the corporation or its stockholders." This means that while the board may be contractually obligated to obtain Marcus's consent before proceeding with the Velridge transaction, the board cannot simply delegate its fiduciary decision-making to Marcus or blindly defer to his veto without independent analysis.

Delaware law imposes on directors a duty of loyalty and a duty of care. The duty of loyalty requires directors to act in the best interests of the corporation and its stockholders, rather than in the interest of a particular stockholder or third party. The duty of care requires directors to act on an informed basis and with appropriate deliberation.

*In McMullin v. Beran*, 765 A.2d 910 (Del. 2000), the Delaware Supreme Court emphasized that directors may not "abandon" their fiduciary duties by deferring to a controlling stockholder's preferences without exercising independent judgment. The court held that "[a]lthough the board of directors may have acceded to [the controlling stockholder's] wishes, that fact, alone, does not satisfy the requirements of entire fairness." Directors must make an independent determination that the course of action serves the best interests of the corporation, even when a controlling stockholder expresses a contrary preference.

### **B. The Problem of Blind Deference**

The facts suggest that Avalon's board declined the Velridge contract solely to comply with the stockholders' agreement and "appease Marcus," without conducting an independent evaluation of whether refusing the transaction was in the best interests of the corporation. If the board simply deferred to Marcus's veto without assessing the merits of the Velridge opportunity, this raises significant fiduciary concerns.

A board that mechanically follows a stockholder's direction—particularly when that stockholder's motivation is personal animus rather than business judgment—may be found to have breached its fiduciary duties. The existence of a contractual consent right does not relieve directors of their obligation to evaluate transactions independently and advocate for what they believe to be in the corporation's best interest.

The board's potential exposure is heightened by the magnitude of the opportunity foregone. A contract that would "10x Avalon's revenues" represents a transformative business opportunity. Declining such an opportunity without proper deliberation, based solely on a minority stockholder's personal vendetta, could constitute a breach of the duty of care (failure to act on an informed basis) and potentially the duty of loyalty (prioritizing a single stockholder's personal interests over the corporation's interests).

### **C. What the Board Should Have Done**

To fulfill their fiduciary obligations, Avalon's directors should have: (1) independently evaluated the Velridge opportunity on its merits; (2) engaged with Marcus to understand his objections and attempt to address them; (3) if persuaded that the transaction was in the company's best interest, advocated to Marcus for approval or explored whether the consent right could be waived or modified; and (4) documented the board's deliberations and independent judgment. The record as presented suggests the board may not have undertaken this process.

## **V. FIDUCIARY DUTY IMPLICATIONS FOR MARCUS**

### **A. Marcus's Potential Status as a Controlling Stockholder**

Although Marcus holds only a minority equity stake in Avalon, he may nonetheless be deemed a "controlling stockholder" for fiduciary duty purposes based on his contractual governance rights. Delaware law recognizes that control can be established through means other than majority stock ownership.

*In Voigt v. Metcalf*, C.A. No. 2018-0828-JTL (Del. Ch. Dec. 28, 2020), the Court of Chancery articulated a framework for determining when a minority stockholder exercises sufficient control to be treated as a controlling stockholder. The court held that a stockholder exercises "general control" when it has "the ability to exercise a controlling influence over the corporation's governance and operations, including through any combination of stockholdings, contractual rights, positions with the corporation, or other means." Under this test, the question is whether the stockholder has "the ability to use its influence to control the corporation generally."

*Basho Technologies Holdco B, LLC v. Georgetown Basho Investors, LLC*, C.A. No. 11802-VCL (Del. Ch. July 7, 2018), provides particularly instructive guidance. In that case, the Court of Chancery found that a minority stockholder was a controlling stockholder where it held "contractual rights that created a combination of negative and affirmative control." The minority stockholder had contractual veto rights over significant corporate actions and the ability to designate board members—rights strikingly similar to those held by Marcus.

The *Basho* court emphasized that a stockholder need not exercise "day-to-day managerial supremacy" to be a controller; rather, "[c]ontrol can be exercised at particular times regarding particular decisions." The combination of (i) Marcus's ability to appoint all of Avalon's directors and officers and (ii) his pre-approval right over corporate transactions gives him comprehensive control over both the composition of Avalon's leadership and the company's ability to pursue business opportunities. This degree of contractual control strongly suggests that Marcus would be treated as a controlling stockholder under Delaware law.

### **B. Fiduciary Duties of Controlling Stockholders**

Under Delaware law, controlling stockholders owe fiduciary duties to the corporation and its minority stockholders. As the Delaware Supreme Court explained in *Kahn v. Lynch Communication Systems, Inc.*, 638 A.2d 1110 (Del. 1994), "[a] controlling or dominating shareholder standing on both sides of a transaction, as in a parent-subsidiary context, bears the burden of proving its entire fairness." The duty extends beyond self-dealing transactions to any exercise of control that affects the minority stockholders' interests.

*In re Sears Hometown and Outlet Stores, Inc. Stockholder Litigation*, 309 A.3d 474 (Del. Ch. 2024), further clarified that "[a] fiduciary may not use its control over corporate property or processes to obtain an advantage at the expense of the entity or its beneficiaries." The court

emphasized that controlling stockholders must exercise their power in a manner consistent with the corporation's best interests, not for personal benefit at the minority's expense.

### **C. Marcus's Exercise of the Veto for Personal Reasons**

The facts indicate that Marcus exercised his veto right "purely because of his personal animus against Velridge's CEO" arising from "an unrelated personal relationship... that soured over a golf game," and not for any business-related reason. This presents a textbook case of a controlling stockholder using corporate governance power to advance personal interests at the corporation's expense.

Marcus's conduct is analogous to that condemned in *Basho*, where the court found fiduciary breaches when a controlling stockholder "used its contractual control to block" corporate transactions and opportunities for reasons unrelated to the corporation's welfare. The court held that "[w]hen exercising its rights, [a controlling stockholder] was required to have a proper purpose and act in good faith. Instead, [it] put its interests ahead of Basho's."

By blocking a transaction that would have generated transformative revenue growth for the company based solely on a personal grudge unrelated to Avalon's business interests, Marcus may have breached his fiduciary duties to Avalon and its other stockholders. The existence of a contractual consent right does not immunize Marcus from fiduciary liability when that right is exercised in bad faith or for improper purposes.

Notably, SB 313's preservation of fiduciary duties applies to stockholders as well as directors. While Section 122(18) validates stockholder consent rights as a matter of corporate authority, it does not create a safe harbor for the bad-faith exercise of those rights. A controlling stockholder who uses contractual governance rights to harm the corporation or extract personal benefits at the minority's expense remains subject to fiduciary duty claims.

### **D. Standard of Review and Burden of Proof**

If Marcus is deemed a controlling stockholder, the standard of review applicable to his exercise of the veto would likely be the stringent "entire fairness" standard. Under *Kahn v. Lynch*, entire fairness requires the controlling stockholder to prove that the transaction (or in this case, the blocked transaction) was entirely fair to the minority stockholders with respect to both fair dealing and fair price.

Given that Marcus's sole motivation was personal animus rather than any business judgment, it would be exceedingly difficult for him to satisfy the entire fairness standard. The fair dealing prong requires good faith and honest purpose, and the exercise of a veto right based on a personal grudge—causing the corporation to lose a 10x revenue opportunity—cannot plausibly be characterized as either fair dealing or acting in the corporation's interest.

## **VI. CONCLUSION**

Based on the foregoing analysis, we conclude:

*First*, the stockholders' agreement with Marcus is likely enforceable under Section 122(18) as amended by SB 313. The statutory provisions validate consent rights and director designation rights in stockholder agreements. However, statutory enforceability does not eliminate fiduciary duty obligations.

*Second*, Avalon's board faces potential fiduciary liability for blindly deferring to Marcus's veto without independently evaluating the Velridge opportunity. Directors may not delegate their fiduciary judgment to a stockholder, even one with contractual consent rights. The board's apparent failure to advocate for the company's interests or exercise independent judgment could support breach of fiduciary duty claims.

*Third*, Marcus likely qualifies as a controlling stockholder based on his comprehensive contractual governance rights, notwithstanding his minority equity position. As a controlling stockholder, Marcus owes fiduciary duties to Avalon and its other stockholders. His exercise of the veto right based solely on personal animus—causing the company to forfeit a transformative business opportunity—constitutes a potential breach of those duties. Under the entire fairness standard, Marcus would bear a heavy burden to justify conduct motivated entirely by personal vendetta rather than corporate welfare.

We recommend that Avalon consider the potential exposure outlined above and evaluate options for addressing the situation, including possible engagement with Marcus regarding the Velridge opportunity and assessment of the company's litigation risk profile. We are available to discuss these matters at your convenience.

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