

Defective Corporate Action by Delaware Corporations ? with Multiple Classes of Common Stock

WRITTEN BY

Stanley Keller

A number of Delaware corporations with two or more classes of common stock, especially SPACs (special purpose acquisition companies) that have completed deSPAC transactions, are discovering that they may not have properly approved charter amendments that increased their authorized shares of common stock. In *Garfield v. Boxed, Inc.* (Del. Ch. Dec. 22, 2022), the Delaware Court of Chancery ruled that under section 242(b)(2) of the Delaware General Corporation Law (DGCL) a SPAC with Class A and Class B Common Stock needed to have a separate Class A vote on a charter amendment that increased its authorized shares of Class A Common Stock. A Class A stockholder raised the issue before the stockholder vote and in response the company added a separate Class A vote. The court decided that the stockholder added a substantial benefit by raising the issue, so its attorney was entitled to a fee award.

The *Boxed* decision raises the concern for many other companies whose deSPAC transactions followed a similar approach. Section 242(b)(2) allows companies to opt out of a separate class vote for adding authorized shares to a class, but many SPACs did not have that provision in their charters (the National Venture Capital Association form does contain that provision). Section 242(b)(2) also does not require a class vote for an increase of shares of a series within a class, but the court ruled in *Boxed* that the corporation's certificate of incorporation established separate classes rather than separate series of common stock.

The uncertainty resulting from the *Boxed* decision has prompted a number of companies to petition the Court of Chancery under DGCL section 205 to validate their capital structures and subsequent corporate actions. These petitions are pending, with the first hearing on some of them scheduled for February 20. While the problem has been focused mainly on former SPACs, it is not limited to them and there are situations when ordinary corporations have taken similar actions based on treating separate classes of common stock as a single class.

There are two different situations to consider:

- (i) a majority vote of both Class A and Class B shares voting together and of Class A shares voting separately was obtained, although no separate Class A vote was held or its need disclosed; and
- (ii) a majority of Class A and Class B shares voting together was obtained but not a majority of Class A shares.

It might be possible to conclude that the stockholder approval in the first situation was legally sufficient despite the failure to hold a separate Class A vote and disclose to stockholders the need for that separate vote, as well as to

conclude that the increase in Class A shares and their issuance in the deSPAC transactions and otherwise are unlikely to be invalidated on equitable grounds in the absence of evidence of any real prejudice resulting from the deficient actions. However, that has not been judicially decided. Consequently, many companies, to avoid uncertainty, are pursuing validation under DGCL section 205, which is anticipated to be obtained in short order. In the second situation, the alternative of concluding that the vote was legally sufficient is unavailable and therefore companies in that situation also are filing for relief under section 205. There is optimism that the Court of Chancery will use its broad authority under section 205 to validate those actions in that situation.

Public companies with this issue need to consider what to do about disclosure, about the status of shelf registration statements and about dealing with their auditors who, in some cases, have raised concerns about the effect of the uncertainties on the financial statements. Companies are filing Form 8-Ks ([Lordstown Motors Corp](#); [Lucid Group](#); [ChargePoint Holding](#)) to disclose the situation and the remedial steps being taken, including seeking court validation under DGCL section 205, and are suspending use of existing registration statements pending resolution of the problem. Law firms who have given Exhibit 5 validity opinions are relying for now on the client's suspension of use of the registration statement without taking further action to withdraw the opinion in view of the anticipated curative actions in Delaware. Companies in the first situation described above are reserving for now on the question whether they can proceed on the basis that the stockholder approval was likely legally sufficient.

The question of the need for a class vote under Delaware law is not limited to the increase in authorized shares involved in the Boxed and similar situations described above. For example, there are lawsuits pending in Delaware (see, for example, complaints filed against Fox Corporation and Snap Inc.) claiming that a class vote was required for a charter amendment adding limited exculpation for officers, as now permitted under a recent amendment to DGCL section 102(b)(7), on the grounds that adding such a provision adversely affects the rights of the holders of shares of that class. The Court of Chancery has yet to rule on these claims.

Takeaway

Companies with more than one class of common stock should review their prior actions to determine whether there are any concerns regarding the adequacy of the approvals that were obtained. If there are, they should consider what remedial steps to take. Public companies also should consider what disclosure to make and the status of any effective registration statements. They also should be dealing with their auditors about any concerns and the remedial steps being taken to address them.

RELATED INDUSTRIES + PRACTICES

- [Capital Markets](#)