

More Than a Majority: Chancery Court Provides Rare Guidance on Charter Amendments

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It is well known that the Delaware General Corporation Law (DGCL) provides that a majority of the voting power of all stockholders entitled to vote is required for a Delaware corporation to take certain fundamental actions, including mergers, sales of all or substantially all of the corporate assets, and dissolutions. Included in this list are amendments to a corporation's charter, but a recent decision from the Delaware Court of Chancery is a reminder to corporations and practitioners alike that a class (or series) vote of stockholders can be, and often is, required under the DGCL, in addition to the general majority rule, when undertaking certain amendments to a corporate charter.

Facts

In *Garfield v. Boxed, Inc.*, the court considered the corporate benefit created by a stockholder who signaled to the board of directors of a special purpose acquisition company (SPAC) that two proposed amendments to the SPAC's charter were not in compliance with Delaware law. Prior to a proposed merger, the SPAC had Class A common stock and Class B common stock outstanding. As part of the proposed acquisition, the SPAC stockholders were asked to approve (1) an amendment to the SPAC's charter that would increase the number of authorized shares of Class A common stock (the Increase Proposal) and (2) an amendment to the SPAC's charter that would alter the stockholder vote required for the board to change the number of authorized shares of all common stock in the future (the Opt-Out Proposal). When soliciting the stockholder vote, the SPAC took the view that a majority of the common stock as a whole was required to approve the proposed amendments. The plaintiff asserted that each amendment required, instead, the vote of the Class A common stock as a separate class under the plain language Section 242(b)(2) of the DGCL.

Analysis

In addressing the matter, the court primarily relied upon Section 242 of the DGCL and contract interpretation principles. Section 242(b)(1) provides that an amendment to a corporation's charter requires a majority of the outstanding stock entitled to vote approve the amendment. However, Section 242(b)(2) requires that a separate class vote of stock is required, irrespective of whether the class is entitled to vote, if the amendment would (1) increase or decrease the aggregate number of authorized shares of such class, (2) increase or decrease the par value of the shares of such class, or (3) alter or change the powers, preferences, or special rights of the shares of such class so as to affect them adversely. Section 242(b)(2) also provides for a special vote to a *series* (as opposed to an entire class) of stock^[1] if any proposed amendment would alter or change the powers, preferences, or special rights of one or more series of any class so as to affect them adversely, but shall not so affect the entire

class, in which case the affected series would be entitled to vote as a separate class. Noticeably absent from this list requiring a series vote are charter amendments increasing or decreasing the aggregate number of shares or the par value of the shares. Finally, Section 242(b)(2) provides that the number of authorized shares of any class of stock may be increased or decreased by the holders of a majority of the stock of the corporation entitled to vote (and not by the separate class of stock otherwise required by Section 242(b)(2)) if previously authorized by a charter amendment approved by the holders of a majority of that class of stock. Consequently, if the Class A common stock and Class B common stock were construed as constituting separate classes of stock, then a separate class vote of the Class A common stock would be required on the Increase Proposal and the Opt-Out Proposal, while no separate class vote would be required if they were construed as separate series of stock.

The court held that the Class A common stock and Class B common stock constituted separate classes rather than series of stock. In so doing, the court noted that no section of the SPAC's charter labeled the Class A or Class B common stock as series but instead referred to them as classes. The charter also prescribed the number of authorized shares of Class A common stock and Class B common stock and the par value of each, which the court interpreted as an intention to establish classes, rather than series, of stock consistent with Section 102(a)(4) of the DGCL. That section provides that if the corporation will have authority to issue more than one class of stock, then the charter must include the number of shares of all classes and of each class and the par value of those shares, whereas no such prescription is required for a series. The court also pointed to the charter's blank check preferred provision, which granted the SPAC's board authority to issue preferred stock in one or more series, noting by way of contrast that there was no similar provision included in the charter for the common stock. Having held that the Class A common stock and Class B common stock constituted separate classes, the court held that both the Increase Proposal and the Opt-Out Proposal required the separate class vote of the Class A common stock.

Takeaways

Delaware law requires strict adherence to corporate formalities when changing a corporation's capital structure. As the court's decision demonstrates, Section 242 of the DGCL in particular can be a trap for the unwary who may assume that a general majority rule governs all fundamental transactions under the DGCL, which is not the case. The decision also provides rare guidance from the court as to the nature of a class versus a series of stock. In this regard, the decision serves as a reminder that a class of stock is afforded a default consent right under Section 242(b)(2) of the DGCL over amendments that would increase the authorized share count of the class, as well as amendments that would have an adverse effect on the rights of that class, while a series of stock is only afforded a default consent right over amendments that would have a disproportionate adverse effect. Thus, drafters of corporate charters are well-advised to include terms, denoting whether a class is really a class or a series is really a series, to negotiate for charter-based consent rights for any series of stock over changes to the authorized share count of the series (which are not afforded to the series by Section 242 of the DGCL) and to consult with experienced Delaware law practitioners when undertaking a corporate charter amendment to ensure the required votes are being sought and obtained.

[1] Classes of stock are separate and distinct from series, which are construed as being within a class.

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