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WHOOPS! SHOULD STOCKHOLDERS HAVE VOTED AS SEPARATE CLASSES ON THAT CHARTER AMENDMENT?

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What happened

A recent Delaware chancery court decision has called into question consolidated voting on charter amendments by some companies with multiple classes of common stock. In *Garfield v. Boxed, Inc.*, the court concluded that a voting structure was invalid where it provided for holders of class A and class B common stock to vote as a single class to, among other things, authorize an increase in the number of authorized shares of class A.

Takeaways

Delaware companies with multiple classes of common stock should review their charters in light of the *Boxed* decision to determine whether class voting would be required for charter amendments. The issue is most prevalent in de-SPAC transactions. However, it can surface in other public or private companies – although class voting rights are often a matter of heightened focus in those with fund investors.

Companies that have conducted stockholder votes using consolidated voting in the past, where multiple classes voted as a single class on charter amendments, should confer with counsel to determine whether corrective action may be needed. Factors that might be considered include:

- whether the language in the charter is clear (or not) that the different types of common stock are classes or series;
- whether the charter includes "opt-out" language permitted under Delaware law allowing consolidated voting on certain matters;
- whether the approval of a majority of each class was actually received on prior stockholder votes;
- whether the requirement for a class vote had been disclosed.

Delaware law provides for two alternative paths for ratification of defective shares issuances, as discussed below. However, practicalities may not allow the "self-help" alternative and a company may instead need to petition the court to validate prior acts.

This issue has potential significance because companies often need to verify the validity of their capitalization. For example, counterparties generally require representations of capitalization and validity of outstanding shares in capital market or financing transactions; legal counsel may need to opine on the validity of shares issued in equity-based compensation programs; and management and auditors typically rely on such representations for audits of financial statements and SEC filings. For public companies, plaintiff's counsel may feel incentivized to identify issues and contact vulnerable targets with the hope of receiving an award of legal fees. Public companies may also need to consider whether to make public disclosures and suspend registration statements.

Dive deeper

The *Boxed* decision arose out of a typical de-SPAC transaction and involved an award of attorneys' fees to plaintiff's counsel who had challenged the proposed stockholder voting structure as violating the rights of class A common stockholders. The company had proposed for class A and class B shares to vote as a single class on a proposal to increase the number of authorized shares of Class A common stock, as well as an amendment to alter the vote required to change the number of authorized shares in the future. In response, the company supplemented the proxy statement to provide for separate class voting but argued to the court that the original voting structure was statutorily compliant so that the award of attorneys' fees was not justified. The company believed consolidated voting was permissible because, in its view, the charter provided for one "class" of common with two "series" that may vote together under Section 242 of Delaware law.

The *Boxed* court disagreed with the company and held that the charter established two different classes of stock so that a separate class vote was required under the first sentence of Section 242(b)(2). That sentence requires a class vote on five types of charter amendments affecting that class: if the amendment would increase or decrease the number of authorized shares, increase or decrease the par value, or alter or change the powers, preferences or special rights of the class so as to affect it adversely.

By contrast, if the class A and class B shares were series, then no class vote would have been required under the second sentence of Section 242(b)(2). That sentence calls for a series vote if an amendment uniquely affects a series – but not for an amendment that increases or decreases the number of authorized shares or the par value.

The *Boxed* charter (perhaps like those of other Delaware corporations) provided that:

> "[t]he total number of shares of all classes of capital stock, each with a par value of $0.0001 per share, that the Corporation is authorized to issue is 401,000,000 shares, consisting of (a) 400,000,000 shares of common stock, including (i) 380,000,000 shares of Class A Common

> Stock (the "Class A Common Stock"), and (ii) 20,000,000 shares of Class B Common Stock (the "Class B Common Stock"), and (b) 1,000,000 shares of preferred stock. . . . the Board is hereby expressly authorized to provide out of the unissued shares of the Preferred Stock for one or more series of Preferred Stock . . . ."

The *Boxed* court concluded that class A and class B shares were separate classes because:

- the charter used the word "class," rather than "series," to describe the class A shares
- the charter authorized three classes of stock (class A, class B and preferred), fixing the number of shares and par value of each, as permitted by Section 102(a)(4) of Delaware law
- the charter allowed the board of directors to provide for series of preferred stock by resolution but did not include any board authority to similarly fix series of common stock.

The language in the *Boxed* charter and its voting structure have been utilized in other de-SPAC transactions. As a result, a number of petitions seeking DGCL Section 205 validation have been filed in Delaware by survivors of de-SPAC transactions since *Boxed* was decided. These petitioners include both (i) companies that did not solicit separate class votes and did not receive a favourable class vote, as well as (ii) companies that did not solicit separate class votes but did receive the favourable vote of a majority of outstanding shares. The companies are seeking court validation because the uncertainty is disrupting, among other things, their access to capital markets, ability to certify their capitalization in financing transactions, ability to make or administration equity-based compensation programs, and ability to stand-behind their representations required for audits of their financial statements and SEC filings.

Delaware has a self-help provision (Section 204) that allows companies to validate stock issuances, among other corporate defects, through stockholder ratification. However, in many circumstances, including de-SPAC transactions, it may not be possible to utilize Section 204 due to the inability to identify – or trace – the holders of shares entitled to vote on ratification. By contrast, Section 205 allows companies on their own initiative to petition the court to determine the validity of prior corporate acts, and provides courts with substantial discretion and flexibility to craft an equitable remedy. Hearings on the initial tranche of Section 205 petitions are scheduled for early next week with additional hearings on other petitions in the next several weeks.

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