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Delaware Ruling Retroactively Validates De-SPAC Stockholder Votes Approving Share Increase Charter Amendments and Subsequent Share Issuances, Providing Welcome Certainty in the Wake of “Boxed” Decision

Insights
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Key Takeaway

Companies that merged with Delaware-incorporated SPACs with more than one class of common stock should act quickly to review their prior share issuances and other corporate actions to assess whether any stockholder approvals were obtained in potential violation of Delaware law and, if so, to consider filing a Section 205 petition for relief.

Please reach out to your regular Gunderson Dettmer attorney if you have questions or would like more information.

Background and Overview

In a series of bench rulings on February 20 and February 27, Vice Chancellor Will of the Delaware Court of Chancery granted petitions by Lordstown Motors Corporation and more than a dozen other public companies—all former SPACs incorporated in Delaware with dual-class share structures—seeking relief for potentially invalid share increases in connection with their de-SPAC merger transactions under Section 205 of the Delaware General Corporation Law (DGCL), which allows the court to

retrospectively remedy “defective corporate acts that would otherwise be considered incurable” (including those related to the creation of stock) if they were done in good faith. When determining whether to validate a potentially defective corporate act, the court may consider a variety of factors it deems just and equitable, including whether any person has acted in reliance on the validity of the act or will be harmed by the failure to validate the act.

In 2020 and 2021, the petitioners went public by merging with SPACs incorporated in Delaware that had dual-class common stock structures consisting of Class A and Class B shares. To effectuate their mergers and provide flexibility for future share issuances, they held a combined vote of Class A and Class B stockholders to approve charter amendments increasing the number of authorized Class A common shares.

Under Delaware law, classes of stock are separate and distinct from series of stock, which are construed as being within a class. Section 242(b)(2) of the DGCL provides that an amendment to increase or decrease the number of authorized shares of a class of securities requires a separate vote of such class, unless the charter contains a provision permitting the company to opt out of the separate class vote requirement. Section 242(b)(2) does not require a separate series vote on changes to the number of authorized shares in a series within a class.

Believing the Class A and Class B shares constituted two ***series*** of common stock that were part of a single class (rather than two separate ***classes*** of stock) that under the DGCL could vote together on amendments affecting the common class, the companies did not hold a separate vote of the Class A stockholders on the proposed share increase charter amendments. Subsequently, the amendments were effectuated and billions of shares were issued with the understanding the requisite vote had been obtained and the shares were validly authorized.

The *Boxed* Decision

A December 2022 decision by the Chancery Court appeared to reject this understanding, however, casting doubt on the validity of the issued shares. In *Garfield v. Boxed, Inc.* (Del. Ch. Dec. 27, 2022), the court ruled that, under Section 242(b)(2) of the 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 in connection with a de-SPAC merger transaction. The court interpreted the plain text of the relevant charter provision (which was substantially the same as, or similar to, the language in the petitioners’ original charters) to provide that the company’s Class A and Class B common shares were

separate ***classes*** of stock rather than separate ***series*** of the same common stock class.[1]

Because a significant number of SPACs had charter provisions that, similar to the one in *Boxed*, referred to the shares of common stock existing at the time as "Class A" and "Class B," and given that it has been common practice for SPACs to present charter amendments to increase the number of authorized shares of Class A common stock for approval by a majority of the Class A and Class B stockholders voting together as a single class, the *Boxed* decision created pervasive uncertainty regarding the soundness of many post-de-SPAC companies' capital structures and the validity of their stock.

The resulting uncertainty has since prompted dozens of Delaware public companies to file petitions pursuant to Section 205 of the DGCL with the Chancery Court requesting retroactive approval of potentially defective charter amendments adopted in connection with their de-SPAC merger transactions based on combined stockholder votes and of the shares issued in reliance thereon.

The *Lordstown* Opinion

Vice Chancellor Will began her review of the Section 205 petitions during an initial round of hearings on February 20, followed by a second round of hearings on February 27, granting relief to more than a dozen public companies, including Lordstown Motors Corporation (which was the first company to file such a petition after *Boxed*), thereby restoring certainty as to their capitalization. No stockholders filed objections to the petitions or appeared at the hearings to object. More than two dozen similar petitions are scheduled to be heard in the coming weeks. Additional petitions seeking judicial validation are likely to follow as the wave of affected companies grows.

On February 22, Vice Chancellor Will released a 29-page opinion, *In re Lordstown Motors Corp.* (Del. Ch. Feb. 21, 2023), finding that relief under Section 205 was "the most efficient and conclusive—and perhaps the only—recourse available" to the company. "Ratification will restore confidence in the company's capital stock and assuage market fears," she wrote. "A contrary ruling would invite untold chaos."

The decision notes that, while its legal analysis is addressed to the specific relief requested by Lordstown, the court's reasoning "should prove instructive to other companies seeking the court's assistance to validate similar corporate acts," thereby providing a path to clarity and certainty for similarly situated companies. It adds that any "[s]pecific reasoning applicable to each petition will be addressed in bench rulings or orders in the relevant Section 205 proceeding, as appropriate."

Though declining to address the court's analysis in *Boxed* as to whether the original charter established separate classes or separate series of common stock, the opinion analyzes each of the five factors under Section 205(d) of the DGCL that may be considered by the court when determining whether to retrospectively validate a potentially defective corporate act and concludes that each factor supported granting relief, including that:

- the company and its board of directors approved the share increase charter amendment with the good-faith belief that the amendment complied with the original charter and Delaware law;
- in particular, the board sought and relied on the advice of counsel, including a formal legal opinion from Delaware counsel, in concluding that a separate vote of the Class A common stock was not required to approve the charter amendment to raise the limit of authorized Class A common shares, because the Class A common stock was a ***series*** of the common stock, and not a separate ***class*** of the company's capital stock;
- the company, along with numerous third parties (including market participants, financing sources, business partners, stockholders, employees and directors), have acted in reliance on the validity of the charter amendment in the years since it was adopted;
- no legitimate harm would result from validating the charter amendment; and
- absent validation, the company, its stockholders and many other parties would face "substantial damage" and "widespread harm," including market disruption; uncertainty around the company's past and future results of stockholder votes; potential adverse effects on the company's commercial relationships, strategic opportunities, financing transactions, employee relationships, ability to issue financial statements and satisfy other public reporting obligations; and possible stock exchange delisting.

If you have any questions or would like more information about the impact of this ruling or other issues discussed in this client alert, please reach out to your regular Gunderson Dettmer attorney.

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[1] In *Boxed*, the court's analysis hinged on whether the company's original certificate of incorporation authorized Class A and Class B as two classes of common stock, or as series within a single class. *First*, explaining that "Delaware courts interpret contract terms [such as a company's certificate of incorporation] according to their

plain, ordinary meaning" and that the certificate of incorporation only used the word "class" and not the word "series" to describe the authorized common shares, the court interpreted the certificate of incorporation as designating the Class A and Class B as each being a *class* of common stock, not a *series*. *Second*, the court noted that DGCL Section 102(a)(4) prescribes that a corporation's certificate of incorporation set forth the number of shares of all classes and of each class and whether the shares are par or no-par, whereas no such preemptive recitation is required for series. Because the certificate of incorporation listed the number of shares of Class A common stock, the number of shares of Class B common stock, and the number of shares of preferred stock, and set forth the par value of the shares in each, the court read the certificate as authorizing three classes of stock in compliance with Section 102(a)(4). *Third*, the court observed that the section of the charter addressing preferred stock vested the board with authority to provide for "one or more series of Preferred Stock" and to establish "the number of shares to be included in each such series" by resolution, complying with Section 102(a)(4)'s prescription for granting board authority to fix the number and terms of series of stock that are not provided in the certificate of incorporation by resolution. By contrast, the charter did not include a similar provision granting the board authority to fix series of common stock.

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