

## United States: Delaware Chancery Court Provides Roadmap for Retroactive Validation of Shareholder Votes

### In brief

In December 2022, the Delaware Chancery Court sent shockwaves throughout the SPAC world when it ruled that single class votes on charter amendments were invalid under Delaware law. This is the process utilized by many, if not most, SPACs seeking approval of their merger with the target company.

In *Garfield v. Boxed, Inc.*,<sup>i</sup> the Delaware Court of Chancery held that a stockholder vote was invalid under Section 242 of Delaware General Corporation Law ("DGCL") where a special purpose acquisition company (SPAC) had a multi-class stock structure and Class A and Class B stockholders voted together as a single class on charter amendments to increase the number of shares. Plaintiff, a Class A common stockholder, argued that the vote was invalid because holders of Class A shares had a right to vote on the amendments as a standalone class. The Chancery Court agreed. By invalidating these votes, the *Boxed* decision cast doubt on the capital structure for dozens of post de-SPAC companies with billions worth of securities. The Chancery Court explained that where the de-SPAC M & A transaction closed in reliance on the challenged amendments, the validity of the merger could be attacked.

*Boxed* resulted in the immediate creation of a new brand of securities claims and a potential tsunami of SPAC litigation. Recognizing the widespread harm this would cause, on February 20, 2023, searching for a way to reconcile belated challenges to the very reverse merger by which hundreds of SPAC targets were taken public and where such companies had long since been operating as public companies, the Chancery Court held that affected companies could retroactively validate these "pooled" stockholder votes under Section 205 of the DGCL. The Court's first written decision regarding Lordstown Motors Corp. illustrates how affected companies may seek retroactive validation of stockholder votes taken in contravention of Section 242.

Accordingly, post-de-SPAC companies should follow the Court's guidance to seek retroactive validation of pooled shareholder votes under Section 205 to resolve any concerns about their capital structure stemming from the *Boxed* decision and avoid related securities litigation.

### In Depth

The SPAC at issue in the *Boxed* litigation had two types of common stock—Class A common stock held by public stockholders and Class B common stock held by insiders (the typical structure for SPACs formed at that time). The SPAC planned for its Class A and Class B common stockholders to vote together as a single class on amendments in connection with its de-SPAC merger to increase the number of authorized shares of Class A common stock, and to alter the vote required to change the number of authorized shares going forward (the process used by most SPACs at the time).

Prior to the SPAC's stockholder meeting, the plaintiff, a stockholder of the SPAC, submitted a pre-suit demand letter to the SPAC claiming that Section 242 of the DGCL required Class A common stock to vote on the amendments as a separate class from Class B. "The SPAC, in turn, believed Class A and Class B could vote together under the charter as one "class" of common stock with two "series."

<sup>i</sup> *Garfield v. Boxed, Inc.*, No. 2022-0132-MTZ, 2022 WL 17959766 (Del. Ch. Dec. 27, 2022)

<sup>ii</sup> The text of Section 242(b)(2) provides, in part, that "The holders of the outstanding shares of a class shall be entitled to vote as a class upon a proposed amendment, whether or not entitled to vote thereon by the certificate of incorporation, if the amendment would increase or decrease the aggregate number of authorized shares of such class, increase or decrease the par value of the

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Following the plaintiff's demand letter, the SPAC obtained a separate class vote for Class A stockholders. (Note, not all SPACs obtained a separate vote for Class A shares). The plaintiff then filed suit against the SPAC seeking an award of attorneys' fees. The *Boxed* court ruled that the contemplated voting structure was inconsistent with Section 242 and awarded attorneys' fees to the plaintiff.

By invalidating the vote, the *Boxed* ruling caused significant uncertainty over the validity of publicly traded shares of companies that went public—in some cases months or even years ago—by merging with a SPAC incorporated in Delaware, affecting dozens of companies with billions in securities.

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## Key Takeaways

Following the *Boxed* decision, post-merger de-SPAC companies were left in a state of purgatory.

Companies like Lordstown, with many more post de-SPAC companies joining this collective mea culpa, filed petitions for relief with the court under Section 205 of the DGCL, which permits the court to retroactively "[v]alidate and declare effective any defective corporate act."<sup>iii</sup>

Like the company in *Boxed*, the petitioner companies had proposed amendments—in connection with their de-SPAC mergers—to their certificates of incorporation to increase the number of authorized Class A common stock shares. These companies, believing the Class A shares to be a series of common stock as opposed to a separate class, did not hold a separate Class A vote on the proposed amendments. Instead, the charter amendments were approved by a majority of the common stockholders entitled to vote, voting as a single class. Thereafter, the amendments were effectuated and the companies issued billions of shares with the understanding that they were authorized by the certificates of incorporation. Through their Section 205 petitions, these firms sought to retroactively validate these amendments adopted in connection with their de-SPAC transactions that were now called into question by the *Boxed* decision.

On February 20, 2023, the Chancery Court issued a series of bench rulings<sup>iv</sup> that resolved the petitioners' uncertainty over their capital structures and the validity of their stock. In her February 21, 2023 written opinion that followed, Vice Chancellor Lori W. Will acknowledged that, as a result of the *Boxed* decision, many post-de-SPAC companies "could no longer determine which shares of their widely-traded stock were valid, threatening to undermine their financial positions and create market disruption."<sup>v</sup>

In an effort to avoid the "untold chaos" that would ensue without validation, the Chancery Court found that Section 205 relief was appropriate, as its purpose was to allow for an "equitable solution for such seemingly incurable problems."<sup>vi</sup> Thus, the Chancery Court granted relief under Section 205 and retroactively validated the petitioners' amendments to their certificates of incorporation, all shares of capital stock issued in reliance on their effectiveness, and all other corporate actions taken in reliance on such validity.

By granting the Section 205 petitions, the Chancery Court restored confidence to the market in post-de-SPAC companies which conducted stockholder votes in contravention of Section 242. Moreover, the Chancery Court's ruling provided a roadmap for other affected companies to retroactively validate their votes and capital structure following the *Boxed* decision.

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shares of such class, or alter or change the powers, preferences, or special rights of the shares of such class so as to affect them adversely." 8 *Del. C.* § 242(b)(2)

<sup>iii</sup> 8 *Del. C.* § 205(b)(2)

<sup>iv</sup> *In re: Lordstown Motors Corp.*, Case No. 2023-0083; *In re: Lucid Group Inc.*, Case No. 2023-0116; *In re: ChargePoint Holdings Inc.*, Case No. 2023-0113; and *In re: Fisker Inc.*, Case No. 2023-0119.

<sup>v</sup> Opinion Regarding Section 205 Petition, *In re: Lordstown Motors Corp.*, Case No. 2023-0083 (Del. Ch. Feb. 21, 2023) (*Lordstown Opinion*), at 2.

<sup>vi</sup> *Id.* at 2-3.

## The Chancery Court's Section 205 Analysis

While the Court's February 21, 2023 opinion is specific to the petitioner, Lordstown, the Chancery Court expressly stated that "its reasoning should prove instructive to other companies seeking the court's assistance to validate similar corporate acts."<sup>vii</sup> Thus, the Court's analysis provides guidance for how similarly affected companies should craft their Section 205 petitions to retroactively validate any stockholders' votes taken in contravention on Section 242.

The Chancery Court's analysis centered around the five factors it may consider under Section 205(d) to determine whether to validate a defective corporate act:

1. Whether the defective corporate act was originally approved or effectuated with the belief that the approval or effectuation was in compliance with the provisions of this title, the certificate of incorporation or bylaws of the corporation;
2. Whether the corporation and board of directors have treated the defective corporate act as a valid act or transaction and whether any person has acted in reliance on the public record that such defective corporate act was valid;
3. Whether any person will be or was harmed by the ratification or validation of the defective corporate act, excluding any harm that would have resulted if the defective corporate act had been valid when approved or effectuated;
4. Whether any person will be harmed by the failure to ratify or validate the defective corporate act; and
5. Any other factors or considerations the Court deems just and equitable.<sup>viii</sup>

The first factor concerns a good faith belief in the validity of the corporate act, i.e., the amendments to the corporate charter. In Lordstown's case, the Chancery Court held that it "ha[d] no reason to doubt that the Company and Board approved and effectuated the Charter Amendment with the good faith belief that the amendment complied with Delaware law and the [original corporate] Charter." The Chancery Court noted that there were no doubts raised as to the validity of the vote until after the *Boxed* decision. Yet, once these doubts were raised through the plaintiff's demand letter, the Chancery Court favorably cited the fact that the board of directors had "undert[aken] a review of the matters raised with the assistance of outside counsel" to determine whether its vote was valid.<sup>ix</sup>

Accordingly, other Section 205 petitioners should cite similar facts to substantiate their good faith belief in the validity of any charter amendments based on pooled votes, including (1) the absence of any doubts as to the validity of amendments before the *Boxed* decision, and (2) whether the company engaged outside counsel to review the validity of votes after any belated concerns were raised.

The second factor relates to whether the corporation or its board of directors treated the charter amendments as valid and whether any other person publicly acted in reliance on the validity of charter amendment. With respect to Lordstown, the Chancery Court found it had "consistently treated" the charter amendments as valid because, relying on the effectiveness of the amendments, the company issued over 100 million shares and disclosed those issuances in public filings. The Chancery Court also noted third parties' reliance on the validity of the charter amendments, including stockholders, PIPE investors, and company employees and directors who were compensated by equity grants issued under the charter amendments.

As such, similarly affected SPACs should bolster their showing as to the second factor by citing to: (1) the number of shares issued through charter amendments that were assumed to be effective, (2) public disclosures regarding these issuances, and (3) third parties' reliance upon the validity of stock issuances and grants, including stockholders, PIPE investors, and company employees and directors compensated with equity grants under the charter amendments.

The third factor involves the harm that would result from retroactively validating the charter amendments. The Chancery Court found that "no legitimate harm" would result because the only objections to validation came from plaintiffs' counsel and "the stockholders who sent the Demand Letter."<sup>x</sup> Other than that, the company's stockholders all appeared to expect that the charter amendments—and the stock issued in reliance thereon—were valid. Validation would, therefore, restore the understanding of essentially all stockholders. The Chancery Court also cited to the fact that no stockholders objected to the Section 205 petition at the hearing.

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<sup>vii</sup> *Id.* at 16.

<sup>viii</sup> 8 *Del. C.* § 205(d).

<sup>ix</sup> *Lordstown Opinion*, at 22.

<sup>x</sup> *Id.* at 24.

In light of this, affected SPACs should demonstrate that no harm would result from validation by citing to the lack of any bona fide objections to their Section 205 petition, and emphasizing that validation would instead restore the settled expectations of the company regarding its capitalization.

The fourth factor—the harm that would result without validation—is significant.

Absent validation, the Chancery Court found that past and future results of SPAC stockholder votes would be called into question. Such companies would not know how many of its shares were outstanding and capable of voting at its upcoming annual meeting. Companies would not be able to issue public filings, especially if its auditors raised concerns about the effect of uncertainties on a company's financial statements. Further, companies could even be at risk of delisting.<sup>xi</sup>

Notably, Lordstown provided specific examples of why it needed to validate the amendments, including its need to close an upcoming equity financing transaction and its ongoing need to obtain capital to meet its production targets. Thus, the Chancery Court concluded that "[t]his uncertainty could cause market disruption, impair the Company's commercial relationships, chill strategic opportunities, and jeopardize employee relationships."<sup>xii</sup>

Similarly affected SPACs should, therefore, provide specific examples of the substantial harm that would result to their financing, operations, and business opportunities absent the validation of their charter amendments and capital structure.

The fifth factor permits courts to consider any other reasons why validation would be "just and equitable."<sup>xiii</sup> The Chancery Court found that such factors were present because Section 205 provided the "most efficient and conclusive—and perhaps the only—recourse available to the Company."<sup>xiv</sup> That is because the only other statutory method for validation, Section 204 ("the self-help provision"), allows for the board of directors to validate a corporate act, but only upon stockholder approval.<sup>xv</sup> Yet, in this context, ratification of the amendments under Section 204 would not be a practicable alternative because it was unclear whether and which stockholders would be entitled to vote.<sup>xvi</sup> In addition, the Chancery Court reasoned that judicial validation was appropriate because it aligned with Section 205's purpose to remedy "defective corporate acts that would otherwise be considered incurable."<sup>xvii</sup>

Accordingly, other Section 205 petitioners should emphasize that judicial validation is "just and equitable" since this section provides the only recourse available and because its application is consistent with the statute's purpose to validate otherwise incurably defective corporate actions

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## Best Practices For Drafting A Section 205 Petition

In sum, to retroactively validate stockholder votes post-de-SPAC companies affected by the *Boxed* decision should abide by these best practices to draft their Section 205 petition and establish the following five factors needed for retroactive validation of their stockholder votes:

1. ***Good Faith Belief In Validity***. Affected SPACs should substantiate their good faith belief in the validity of any charter amendments adopted by pooled votes by citing to facts such as: (1) the absence of any doubts as to the amendments' validity before the *Boxed* decision, and (2) whether the company engaged outside counsel to review the votes' validity after belated concerns were raised.
2. ***Treatment Of The Act As Valid And Reliance Thereupon***. SPACs should demonstrate their treatment of any amendments as valid by citing to facts such as: (1) the number of shares issued through charter amendments that were assumed to be effective, (2) public disclosures regarding these issuances, and (3) third parties' reliance upon the validity of stock issuances

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<sup>xi</sup> *Id.* at 25.

<sup>xii</sup> *Ibid.*

<sup>xiii</sup> See 8 Del. C. § 205(d)(5).

<sup>xiv</sup> *Id.* at 26.

<sup>xv</sup> See *id.* at 17; 8 Del. C. § 204(b)(2).

<sup>xvi</sup> See *Lordstown Opinion*, at 27.

<sup>xvii</sup> *Id.* at 26.

and grants, including stockholders, PIPE investors, and company employees and directors compensated with equity grants under charter amendments.

3. ***Harm From Validation Of Charter Amendments.*** Affected SPACs should demonstrate that no harm would result from validation by emphasizing the lack of any bona fide objections to their Section 205 petition and emphasizing that validation would instead restore settled expectations of the company regarding its incorporation and capitalization.
4. ***Harm Absent Validation.*** Section 205 petitioners should provide specific examples of the substantial damage that would result to their financing, operations, and business opportunities absent the validation of their charter amendments and their capital structure.
5. ***Other factors.*** SPACs should emphasize that judicial validation is "just and equitable" since Section 205 provides the only recourse available and because its application is consistent with the statute's purpose to validate otherwise incurably defective corporate actions.

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