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Chartering Your Corporation's Course: Reducing Litigation Risk When Amending a Corporate Charter With Multiple 'Classes' of Stock

By Josh Bloom

When companies wish to take extraordinary corporate action, they may find they need to amend their certificate of incorporation (also referred to as a charter) to do so. Requirements for amending a charter are usually set forth in both the charter itself and in the governing corporate law. Complying with those requirements is a must. Failure to honor them can render any charter amendment null and void with disastrous consequences. Notwithstanding their fundamental importance, companies can make decisions about the meaning and scope of requirements for amending a certificate of incorporation that leave their amendments vulnerable to challenge by stockholders (and their lawyers). That is particularly true when the company seeking to amend its charter has multiple types of stock.

For example, under Delaware law, when a corporation has multiple "classes" of stock, a separate vote for each class is required to approve any charter amendment that "would 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). Thus, failing to correctly determine whether a proposed charter amendment will change the "powers, preferences, or special rights" of a class of stock, or whether a type of stock constitutes a separate "class," can invalidate charter amendments for want of necessary stockholder approval.

Recent decisions from the Delaware Court of Chancery provide important guidance about correctly interpreting § 242(b). Companies can help themselves avoid distracting and expensive stockholder litigation by understanding these decisions and continuing to track the imminent further developments in this area.

A. How Do You Determine Whether an Amendment Changes Any 'Powers, Preferences, or Special Rights?'

Recently, in *Electrical Workers Pension Fund, Local 103, IBEW v. Fox Corp.*, C.A. No. 2022-1007-JTL (Del. Ch. Mar. 29, 2023) (TRANSCRIPT), the Court of Chancery examined what it means for a charter amendment to change any "powers, preferences, or special rights" of a class of stock.

In August 2022, Delaware amended § 102(b)(7) of its general corporation law (DGCL) to allow corporations to amend their charters to provide certain officers protections previously only available to corporate directors. Specifically, amended § 102(b)(7) allows companies for the first time to eliminate monetary liability for officers for breaching their duty of care in direct stockholder lawsuits.

Hundreds of companies have tried to amend their charters and adopt amended § 102(b)(7). Two examples are Fox Corporation and Snap Inc. Both corporations have multiple

classes of stock, including a class of non-voting common stock. But when seeking stockholder approval to amend their charters, neither corporation sought approval of the non-voting common stockholders as a separate class. Consequently, holders of non-voting stock from each corporation sued, alleging the corporations violated § 242(b)(2) by not seeking their separate vote even though a charter amendment exculpating officers from liability affected a fundamental "power" of their stock: the power to sue.

The Court of Chancery disagreed. On summary judgment, the Court determined it was constrained by precedent to hold that § 242(b)(2) only requires a class vote when there is an adverse change to a power, preference, or special right that is expressly stated in the corporation's charter. Tr. Ruling at 4:10-5:5, 61:21-23. And because the power to sue was not expressly stated in either corporation's charter, neither charter "require[d] a class vote of the defendants' non-voting stock because the officer exculpation amendment d[id] not affect a power, preference, or special right that appear[ed] expressly in the charter." *Id.* at 69:4-14.

However, despite ruling against the stockholder plaintiffs, the court noted the outcome may very well have been different if it was writing on a clean slate. The court acknowledged the importance of stockholders' power to sue and opined that the plaintiffs' plain language interpretation that § 242(b) was not limited to powers listed in the charter was persuasive. Tr. Ruling at 27:15-19, 62:5-63:30. The court also expressed concerns about both the theoretical and practical implications of limiting class votes to situations where the affected powers or rights are expressly stated in the charter. *Id.* at 57:8-16, 63:1-65:20.

While *Fox Corp.* may be reassuring to companies, it appears that the Delaware Court of Chancery will not have the last word on this important issue. The Delaware Supreme Court heard argument on an appeal of the decision in mid-October 2023.

B. How Do You Determine Whether a Stock Is a Different 'Class' or Merely a Different Stock in the Same Series?

Delaware courts have also recently addressed another important issue relating to § 242(b): whether two different types of stock are actually distinct "classes."

In *Garfield v. Boxed, Inc.*, 2022 WL 17959766, at *1 (Del. Ch. Dec. 27, 2022), the Court of Chancery considered whether a company's charter permitting "Class A" and "Class B" common stock created separate classes of stock, or merely different series within a single class of stock.

The issue arose after the company sought stockholder approval to amend its charter in connection with a "de-SPAC" transaction. The company only sought approval of the common stockholders voting together, and not a separate Class A vote, even though the proposed charter amendments would affect the rights of the Class A stock. Class A stockholders objected to the lack of a separate vote, and the company changed course and held a separate Class A vote.

In a proceeding to determine whether the Class A stockholders' counsel was entitled to a fee from the company for raising the separate class vote issue, the Court of Chancery agreed that Class A and Class B were distinct classes, not different series of the same class. That meant a separate Class A vote was indeed required. The court based its conclusion on the language in the company's charter that (i) used "class" rather than "series" to describe the different types of common stock; (ii) separately identified the number of authorized shares and par value for both the Class A and Class B stock; and (iii) authorized the Board to create "series" of preferred stock, but did not include a similar authorization for common stock.

Notably, the charter language at issue in *Boxed* is not unique. Many companies have multiple share types governed by similar charter language. Before *Boxed,* prevailing practice was to treat Class A and Class B common stock as different series of the same class of stock. As a result, when companies amended charters with *Boxed*-like language, they did not solicit separate "Class A" or "Class B" votes. *Boxed* raised the very real and very problematic possibility that many charter amendments, and the many transactions based on those amendments, were invalid for failing to comply with § 242(b).

Following *Boxed*, companies searched for options to address the uncertain validity of their corporate actions. One option several companies pursued was petitioning the Court of Chancery under § 205 of the DGCL. Section 205 empowers the Court of Chancery to validate defective corporate actions that otherwise would be void or voidable.

A case from earlier this year illustrates the advantage of using § 205. In *In re Lordstown Motors Corp.*, 290 A.3d 1 (Del. Ch. 2023), a company with substantively identical charter language as in *Boxed* asked the court to ratify a charter amendment that affected the rights of its Class A stockholders, but was made without obtaining a separate Class A vote. After considering each of the five permissive factors in § 205 for validating defective corporate acts, including the company's good-faith belief no vote was required and the lack of harm that would result from ratification, the court granted the company's petition to validate its actions. In doing so, *Lordstown Motors* serves as an important reminder of the power (and availability) of § 205 to remedy defective corporate acts, and provides a helpful roadmap for companies seeking to utilize the statute.

C. Key Takeaways

With the lessons learned from the cases discussed above, in-house counsel should pay attention to several key takeaways when contemplating corporate action that may require a charter amendment.

• **Do not overlook corporate formalities.** When taking any significant corporate action, no matter how complex it may be, it is important to start with the basic, fundamental corporate formalities that must be followed. Keep in mind that there can be multiple sources of required formalities (e.g., the charter and the relevant corporate statute), and multiple requirements within each source, all of which must be complied with.

• **Do not rely on market practice.** While companies should consider prevailing market practice for the action they are planning on taking, companies should not rely on market practice alone. Market practice, no matter how prevalent, is not a substitute for critically examining any statutory or contractual requirements that need to be complied with. Moreover, the law can and does change (indeed, it may change again imminently based on the *Fox* appeal). Following market practice is no substitute for monitoring changes in the law that can affect the validity of both past and present actions.

• **Understand options to address problems, and tackle problems promptly.** When corporate action fails to comply with the requisite formalities, understanding the available options to remedy the defective act, including seeking judicial intervention, is crucial. Equally important is taking necessary corrective action, such as holding another vote or seeking relief under § 205, promptly. The longer a company waits to address a defective corporate act, the more likely the company is to compound the problem by taking other actions that depend on that defective act's propriety. At a minimum, prompt remediation can prevent having to pay fees to plaintiff's lawyers who discover the issue and force the company to take corrective action.

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