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Garfield v. Boxed

SPAC Companies May Need to Evaluate Stock Structure in Wake of Delaware Court of Chancery Ruling

Companies that previously became public by merger with a Special Purpose Acquisition Company (“SPAC”) may need to re-evaluate their stock structure after a new ruling by the Delaware Court of Chancery. On December 27, 2022, the Court of Chancery decided *Garfield v. Boxed, Inc.*, ruling that companies with multiple series of common stock were required to hold separate votes for each class of shares in order to expand the number of outstanding shares issued in connection with going-public mergers with SPACs. No. 2022-0132-MTZ, 2022 WL 17959766 (Del. Ch. Dec. 27, 2022). This ruling has already sparked a surge in companies seeking guidance from the Delaware Court of Chancery concerning their own common stock structure.

Boxed was initiated as a dispute over attorneys’ fees. Seven Oaks Acquisition Corp. (“Seven Oaks”), a Delaware corporation formed as a SPAC, had a Charter authorizing both Class A and Class B Common Stock. To effectuate a de-SPAC merger with Boxed, Seven Oaks needed shareholder approval to amend its charter to increase the number of authorized shares. Before the vote could take place, a shareholder plaintiff sent the Seven Oaks board a pre-suit demand, asserting that Section 242(b)(2) of the DGCL required two separate shareholder votes for each class of common stock, rather than one combined vote. After Seven Oaks agreed, the shareholder plaintiff filed suit seeking attorneys’ fees, claiming to have conferred a “corporate benefit” on Seven Oaks by preventing it from holding a faulty combined vote.

In order to rule on the propriety of the attorneys’ fees, the court in *Boxed* had to consider whether separate votes for each class of stock were indeed required. Seven Oaks argued that a separate vote was not required because the Class A and Class B common stock were merely different *series* of stock, not different *classes* of stock. This interpretation was in keeping with common practice in de-SPAC mergers, where combined shareholder votes often have been the norm. Overturning this *status quo*, the court held that a separate vote was indeed required, and that attorneys’ fees were therefore warranted.

Given the court’s decision in *Boxed*, many former SPAC companies are now considering the possibility that their prior votes were procedurally deficient. Indeed, in the weeks since the decision in *Boxed*, more than twenty-five public companies have filed cases before the Delaware Court of Chancery seeking retroactive validation of their combined shareholder votes. These cases are brought pursuant to Section 205 of the DGCL, which allows parties to petition the Court of Chancery to ratify invalid



corporate acts, including those related to the creation of stock. Section 205 affords Delaware corporations re-thinking the validity of their stock structures the opportunity to gain retroactive court approval. In an initial round of hearings, the Court of Chancery has recently granted several of these validations, confirming the availability of this remedy. For public companies not incorporated in Delaware, many other states have adopted ratification statutes analogous to Section 205, including Alabama, Colorado, Connecticut, Delaware, Idaho, Kansas, Nevada, North Carolina, Montana, Oklahoma, Oregon, Texas, Virginia, and Washington.

Given the potential uncertainties and risks created by the *Boxed* opinion, public companies that have solicited potentially invalid joint shareholder votes in SPAC transactions must carefully consider their options. Delaware corporations can utilize either Section 204 or Section 205 of the DGCL to remedy any previous improper shareholder votes. But, Section 204, which provides for ratification of a prior act by repeating the prior shareholder vote, is almost certainly impractical, given that shares will likely have passed to different owners so many times as to be untraceable.

The more practical approach to retroactively validate any defective stock issuances is Section 205, which utilizes a court-approved ratification process with the Delaware Court of Chancery. When considering whether to validate the prior shareholder vote, the Delaware Court of Chancery considers:

- (1) Whether the defective corporate act was originally approved with the belief that the shareholder vote was valid;
- (2) Whether the corporation and board of directors have treated the shareholder vote as a valid act;
- (3) Whether any person will be or was harmed by the ratification or validation of the shareholder vote;
- (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.

This inquiry is fact intensive, and companies should consult with experienced securities counsel to determine whether seeking relief under Section 205 is appropriate for their circumstances.

Aside from providing clarity and assurance that any issue with prior shareholder votes has been resolved, proactively instituting a Section 205 proceeding may also allow companies to avoid expensive plaintiffs' attorneys' fees. As in *Boxed*, a shareholder that makes a demand on a company concerning a previous joint shareholder vote may subsequently move to recover fees for a "conferred corporate benefit." Preemptive corporate action may limit such exposure.

Should you have any questions regarding the impact of this holding or the steps that should be taken to validate past shareholder votes, please contact one of the authors of this article or your primary King & Spalding attorney contact.

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