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Public Company Update

2023 DGCL Amendments Now Effective

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Today, August 1, 2023, the Delaware legislature's most recent amendments to the Delaware General Corporation Law ("DGCL") became effective. The amendments include a number of changes designed to simplify pertinent matters for Delaware corporations, particularly those that are publicly-traded or are seeking to go public in the future. Significant changes include: reducing the stockholder vote required by public company stockholders to approve an amendment to the certificate of incorporation to implement a reverse stock split or an increase or decrease to the number of authorized shares of a class of stock; enabling corporations to implement a forward stock split (and any necessary proportional increase in authorized stock incident thereto) without stockholder approval; and streamlining the process to ratify defective corporate acts, each of which is described below in further detail.

Reverse Stock Splits and Changing Number of Authorized Shares

Reserve stock splits are an important tool that public companies can use to increase the value of a share of the company's stock. Stock exchanges have minimum price requirements in order for a company to maintain its status as a listed company. When public companies experience a decrease in their stock price, and receive a delisting notification from Nasdaq or the NYSE, they often seek to implement a reverse stock split in order to regain compliance with the applicable exchange's listing standards.

Each of a reverse stock split or an increase or decrease in the number of authorized shares requires an amendment to the certificate of incorporation. To amend a Delaware corporation's certificate of incorporation, the minimum vote required by the statute is a *majority of the outstanding shares*. For public companies that have low voting participation by stockholders, due to a large retail stockholder base or otherwise, it is often difficult for them to get a majority of the outstanding shares to vote in favor of a proposal, even when a majority of the stockholders voting on the proposal overwhelmingly support it. This leaves some public companies struggling to obtain the requisite number of votes in order to implement a reserve stock split and stay listed or to increase their authorized shares in order to have adequate reserves to conduct a securities offering or issue shares pursuant to an equity incentive plan.

Under the amended provisions of the DGCL, a publicly-traded company is able to amend its certificate of incorporation to effect a reverse stock split utilizing the easier to obtain *majority of votes cast* standard so long as the applicable class of shares is listed prior to the amendment's effectiveness and the company will meet the Nasdaq or NYSE, as applicable, minimum shareholder requirements immediately following the amendment's effectiveness. This reduced voting standard also applies to a stockholder vote for amendments seeking to increase or decrease the number of authorized shares (subject to the same caveats). In each case, it will now be much easier for publicly-traded Delaware corporations to meet the stockholder approval requirements needed in order to implement a reserve stock split or change their authorized number of shares.

Forward Stock Splits

Delaware corporations can amend their certificate of incorporation in order to implement a forward stock split. Prior to the DGCL amendments, an amendment to the certificate of incorporation to implement a forward stock split required stockholder approval. The logistical challenges of obtaining stockholder approval, particularly for public companies, led many Delaware corporations to issue stock dividends, which generally does not require a stockholder vote, in order to effect a forward stock split.

Under amended provisions of the DGCL, Delaware corporations may now amend their certificates of incorporation to effect a forward stock split without obtaining stockholder approval so long as (1) they only have one class of stock outstanding and (2) that class of stock is not divided into series. Corporations are also able to further unilaterally amend their certificate of incorporation to proportionately increase their number of authorized shares so that they can maintain the same ratio of outstanding to authorized shares following the forward stock split.

While corporations may elect to continue implementing forward stock splits via stock dividends due to favorable accounting treatment, that is not always an option since corporations may only declare dividends from their surplus. Regardless, the Delaware legislature has streamlined the process for implementing forward stock splits in most cases, which will enable corporations to be more nimble—particularly in situations where forward stock splits occur in connection with a securities offering.

Ratification of Defective Corporate Acts

The DGCL amendments simplify the process for the ratification of defective corporate acts. Defective corporate acts may include the over issuance of shares or the unlawful election or appointment of directors or any other act of a corporation that is void or voidable because of a lack of proper authorization. The DGCL provides that a corporation may ratify defective corporate acts by following the procedures set forth in Section 204 of the DGCL or by seeking ratification by the Delaware Court of Chancery pursuant to its authority under Section 205 of the DGCL. Prior to the amendments, the procedures set forth in Section 204 were cumbersome, not uniformly applied, and required the filing of a certificate of validation for every defective corporate act ratified that would have required a filing with the Delaware Secretary of State, even if the filing was subsequently made. Under the amended rule, the procedure has been significantly streamlined, including requiring the filing of a certificate of validation *only* in instances where either the applicable filing was not made with the Delaware Secretary of State or it was, but it must be amended in order to implement the defective corporate act. In addition, to the extent that a certificate of validation is required under the new rules, the contents of the certificate have been cut down, eliminating much of the background narrative and contextual facts previously required.

Conclusion

The DGCL amendments impact a number of other provisions, ranging from changes impacting entities converting to Delaware corporations to specifying instances where no stockholder vote is needed to approve a sale, lease, or exchange of collateral securing a mortgage or pledge. Please contact us if you would like to discuss how the amendments might impact your company.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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