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In novel SPAC ruling, court questions fundamental SPAC structure under Delaware law

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With all the SPAC activity and scrutiny over the past several years, it was only a matter of time before the Delaware courts had an opportunity to weigh in on SPAC stockholder litigation.

Early last year, in January 2022, Vice Chancellor Lori Will of the Delaware Court of Chancery issued a groundbreaking opinion in *MultiPlan Corp. Stockholders Litigation* that paved the way for SPAC stockholders to bring direct breach of fiduciary duty claims against SPAC boards and sponsors.

Among the notable aspects of the decision, *MultiPlan* clarified that "well-worn fiduciary principles" under Delaware law would apply to Delaware SPAC board decisions (regardless of the fact that SPACs were not exactly the same as other Delaware corporations).

There, the court went on to deny a motion to dismiss by applying traditional fiduciary principles, concluding that the sponsor (because of its financial interest in the SPAC) and the board (based on skewed personal interests) were conflicted, and that the process was faulty because of a lack of independent financial advice or a fairness opinion.

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The *MultiPlan* ruling also largely turned on what the court held were misleading disclosures that interfered with a SPAC stockholder's ability to decide whether to approve the merger or redeem their shares.

Many practitioners and commentators chalked the decision up to "bad facts making bad law," and that more attention to process and more robust disclosures could help avoid the same result with future challenged deals.[1]

Flash forward a year, to January 2023, where Vice Chancellor Will had yet another opportunity to weigh in on SPAC breach of fiduciary duty claims. In *Delman v. GigAcquisitions3*, the court went well beyond her earlier *MultiPlan* decision in finding that breach of fiduciary duty claims survived a motion to dismiss.

> *"By minimizing redemptions, the Sponsor reduced the risk that the merger would fail and increased the value of the Sponsor's interest if it closed," the court stated.*

Among the novel rulings making this a "must-read" for anyone involved with SPACs or SPAC transactions are the court's holdings that:

- The SPAC sponsor, even though it controlled less than 25% of the SPAC's voting power, could be considered a controlling stockholder based solely on the SPAC's structure;
- The SPAC's redemption feature is a "bespoke check on the sponsor's self-interest" and the "primary means protecting stockholders from a forced investment in a transaction they believe is ill-conceived" (making disclosure relating to the redemption option crucial); and
- The *Corwin* doctrine does not apply to SPAC mergers because stockholders' voting interests were decoupled from their economic interests as a result of the redemption feature.

Background

GigCapital3, Inc. (Gig3 or the Company) — now Lightning eMotors, Inc. (New Lightning) — was a Delaware SPAC.

Gig3's sponsor, GigAcquisitions3 (the Sponsor), was issued "founder's shares" for $25,000 (amounting to about 20% of Gig3's post-IPO equity), which could not be redeemed, lacked liquidation rights and were also subject to a lock-up. The Company's Sponsor was controlled by the defendant and alleged "serial founder of SPACs" Avi Katz.

According to the court, Mr. Katz, through the Sponsor, effectively ran Gig3, including serving as its executive chairman, secretary,

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president and CEO. He also appointed Gig3's initial directors and officers, which included his wife and four other directors with ties to himself and other Gig3 entities.

Following the IPO, Gig3's officer and directors identified Lightning eMotors Inc. (Old Lightning), an electric vehicle manufacturer, as the merger target. Mr. Katz and his wife "dominated" the Company's negotiations with Old Lightning.

According to the court, Nomura and Oppenheimer, Gig3's IPO bookrunners, were also hired to serve as Gig3's financial advisors, but they were not asked to provide a fairness opinion on the merger.

Gig3's legal analysis clearly illustrates the court's skepticism of the current SPAC structure that fueled some of its novel decisions.

The Company issued a proxy statement in connection with the Gig3 stockholder vote on the merger, which also contained disclosures about stockholders' redemption rights. Approximately 98% of stockholders voted in favor of the merger, with 28% redeeming.

After closing, New Lightning saw its stock price crater, and litigation followed. The defendants' move to dismiss these claims was denied.

Key aspects of the motion to dismiss ruling

- **Sponsor-controller and entire fairness.** The court held that the plaintiff pled facts supporting two independent grounds for reviewing the merger under entire fairness.
  - **Sponsor-controller.** The court held that the de-SPAC merger with Old Lightning was a conflicted controller transaction. Even though the Sponsor held less than 25% of Gig3's pre-merger equity and voting power, the court concluded that the Sponsor controlled Gig3 because, as is typical of SPAC sponsors, it controlled all aspects of the Company from creation until the de-SPAC merger. Moreover, the court determined that the Sponsor was conflicted because the SPAC's economic structure allowed the Sponsor to extract unique value at the expense of the public stockholders in two ways: (i) The Sponsor's interest diverged from the public stockholders in the choice between a "bad deal" and a liquidation, and (ii) the Sponsor had an interest in minimizing post-merger redemptions because the merger was conditioned on Gig3 contributing $150 million in cash, $50 million of which was required to come from the trust account. "By minimizing redemptions, the Sponsor reduced the risk that the merger would fail and increased the value of the Sponsor's interest if it closed," the court stated.
  - **Conflicted board.** A majority of the board was not disinterested or independent, the court held. It determined that Mr. Katz, through his ownership and control of the Sponsor, had a material conflict based on the 155,900% return on its initial $25,000 investment, and his wife (also a director) shared these interests. The court also found it reasonably conceivable that the remaining directors, who held "multiple positions within Katz's GigCapital Global enterprise of entities," were not independent of Mr. Katz.
- **Redemption right.** The court placed significant importance on the redemption right, explaining that "[t]he right to redeem is the primary means of protecting stockholders from a forced investment in a transaction they believe is ill-conceived. It is a bespoke check on the sponsor's self-interest, which is intrinsic to the governance structure of a SPAC. It follows that a SPAC's fiduciaries must ensure that right is effective, including by disclosing 'fully and fairly all material information' that is reasonably available about the merger and target to inform the redemption decision." Here, the plaintiff alleged that the defendants acted disloyally, hindering the stockholders' ability to exercise that important redemption right.
- **The *Corwin* doctrine.** The court rejected a *Corwin* defense, not only because there were well-pled disclosure deficiencies but also "because the structure of the Gig3 stockholder vote is inconsistent with the principles animating *Corwin*." According to the court, "[u]nlike the typical merger or acquisition," the "stockholder vote on the de-SPAC merger could not reflect its investors' collective economic preferences" because stockholders' voting interests were decoupled from their economic interests. However, in a footnote the court remarked that if the SPAC's voting structure changed and the voting and economic interests were "recoupled" (such that stockholders could not redeem unless they voted against the de-SPAC merger), *Corwin* might be available.
- **Additional fairness concerns.** The court also delved into issues relating to disclosure and process.
  - **Disclosure issues.** The court explained that "compliance with the duty of disclosure is included within the fair dealing facet" of the entire fairness analysis. The court found the proxy had two main disclosure deficiencies: The proxy (i) misstated the cash per share that Gig3 would invest in the combined company; and (ii) omitted the true value that Gig3 and its nonredeeming stockholders would receive in exchange as part of the merger.
  - **Process deficiencies.** Among other points, the court highlighted the alleged (i) lack of fair dealing due to Mr. Katz and his wife directing the merger negotiations, (ii) skewed motivations for Nomura and Oppenheimer, which had large stakes in private placement shares that would be worthless and $8 million in contingent compensation that would not be paid if a deal was not completed; and (iii) board failure to obtain a fairness opinion or even an informal financial presentation about the fairness of the transaction. The court also held that unfair price could be inferred from the allegation that Gig3 stockholders were left with New Lightning shares worth far less than the $10 per share redemption price. The court

held that at the pleading stage, this all amounted to an entire fairness claim allowing the case to move forward to trial.

Takeaways

It is important to remember that, like *MultiPlan, Gig3* was a pleading stage decision where the court is required to accept the plaintiff's allegations as true. Moreover, the Delaware Supreme Court has not yet had an opportunity to weigh in on the issues addressed in either *MultiPlan* or *Gig3*.

That said, *Gig3*'s legal analysis clearly illustrates the court's skepticism of the current SPAC structure that fueled some of its novel decisions.

- The court held that a SPAC sponsor without a 50% equity interest nevertheless was considered a controlling stockholder because it controlled all aspects of the SPAC from creation until the de-SPAC merger, as is typical in a SPAC transaction. This suggests that a Delaware de-SPAC transaction could potentially be subject to entire fairness review for this reason alone.
- The court also noted in a footnote that, similar to the *Corwin* "decoupling" analysis, *MFW* was also "ill-suited" for SPAC purposes. Thus, core Delaware doctrines that normally apply to allow transactions to be afforded business judgment review may not be available in SPAC transactions using the typical SPAC structure.2
- Many aspects of the opinion in *Gig3* appear to have been driven by the fact that the board was not independent of the SPAC sponsor. *Gig3* thus emphasizes the need for SPACs to have independent directors, and for such directors to thoroughly evaluate any potential SPAC target, with advice from unconflicted advisors.
- As with *MultiPlan*, *Gig3* highlights that adequate proxy disclosures remain paramount.

Notes

[1] See our client alert "Court of Chancery Issues SPAC-Related Decision of First Impression" for more on *MultiPlan*, http://bit.ly/3rqKilG.

[2] See our article "*Corwin*, *MFW* and Beyond: Developing Trends in Delaware Disclosure Law" for more on these two cases, http://bit.ly/3E6Tt0y.

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