Chancery Ruling Reiterates Its Skepticism Of De-SPAC Deals

By **Laura Oswell, Jacob Croke and Matthew Strand** (January 13, 2023)

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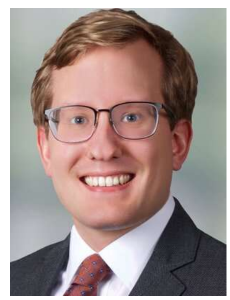

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Following its decision a year ago in In re: MultiPlan Stockholders Litigation, the Delaware Chancery Court's Jan. 4 Delman v. GigAcquisitions3 LLC decision rejects certain arguments left open following MultiPlan and indicates even robust disclosures will not entitle special purpose acquisition companies to business judgment review.

Summary

The Chancery's Delman v. GigAcquisitions3 decision denied a motion to dismiss a complaint brought by a SPAC stockholder against the SPAC's sponsor and its directors.[1]

This is the court's second decision addressing fiduciary duties of SPAC directors, and consistent with the court's first decision, In re: MultiPlan Corp.[2] the court held that the de-SPAC transaction at issue is subject to entire fairness review.

The court rejected the defendants' arguments that plaintiff's claims were derivative or constituted impermissible holder claims, and found that the sponsor controlled the SPAC through its "unrivaled authority over" the SPAC's business affairs.[3]

Moreover, the court held that the SPAC's proxy statement was materially false and misleading and, even if the proxy statement had been sufficient, the SPAC's structure rendered the stockholder vote approving the transaction "inconsistent with the principles animating" business judgment review under its 2015 Corwin v. KKR Financial Holdings LLC decision.[4]

As it did in MultiPlan, the court noted that typical SPAC features, such as the sponsor's compensation structure, the directors' connections to the sponsor's controller and the decoupling of the stockholders' voting and economic interests, created a scenario in which the sponsor and the SPAC's directors "were incentivized to undertake a value-decreasing transaction."[5]

The Court's Decision

As has become a common occurrence when a company that goes public through a de-SPAC transaction suffers a stock price decline, the plaintiff in GigAcquisitions3 alleged that defendants breached their fiduciary duties and were unjustly enriched in connection with the de-SPAC transaction by issuing a false and misleading proxy statement.

The proxy statement, the plaintiff alleged, did not accurately disclose the net cash per share to be invested in the SPAC's target and failed to provide the SPAC's public stockholders with an impartial picture of the target's financial prospects.

In denying the defendants' motion to dismiss, the court held that the SPAC sponsor's "interests diverged from public stockholders in the choice between a bad deal and a liquidation" by virtue of the sponsor's founders' shares which it purchased for nominal consideration and could not redeem for $10.00 per share, unlike the shares held by the SPAC's public stockholders.[6]

If the sponsor failed to complete a transaction and the SPAC was liquidated, the sponsor's shares would be worthless, while the public stockholders "would receive their investment plus interest from the trust in a liquidation."[7]

According to the court, this typical SPAC structure created a unique benefit for the sponsor "in the choice between a bad deal and a liquidation" that was not shared by the public stockholders.[8]

Although the GigAcquisitions3 directors, unlike the MultiPlan directors, were compensated for their services in cash, and the court found the GigAcquisitions3 directors lacked any self-interest in the de-SPAC transaction,[9] the court nonetheless held that at least a majority of the directors lacked independence due to their close ties to the SPAC sponsor and his "enterprise of entities."[10]

Notably, the court held that even if the stockholder vote on the transaction had been fully informed, the transaction would not be subject to business judgment review under the Delaware Supreme Court's opinion in Corwin.[11]

According to the court, the public stockholders' vote on the de-SPAC transaction does not reflect their "collective economic preferences" because the "public stockholders could simultaneously divest themselves of an interest in" the SPAC's target by redeeming their shares, while still voting in favor of the transaction.[12]

Further, the court reasoned that "redeeming stockholders remained incentivized to vote in favor of a deal — regardless of its merits — to preserve the value of the warrants" they received as part of their purchase of the SPAC's IPO units.[13]

These IPO units consisted of one share of common stock and three-quarters of a warrant to purchase a share of common stock at an exercise price of $11.50 per share.[14] If the de-SPAC transaction failed and the SPAC liquidated, the warrants would expire worthless.

In addition to finding that plaintiff sufficiently alleged that the SPAC's proxy statement "contained material misstatements and omitted material, reasonably available information," the court also indicated that other "additional grounds" supported its pleading stage conclusion that the de-SPAC transaction was not entirely fair to the SPAC's public stockholders, including that:

- The sponsor's controller and spouse "dominated" the negotiations with the SPAC's target;[15]
- The SPAC's financial advisers stood to gain significantly from the merger through both private placement shares that would be worthless if the de-SPAC transaction did not close and compensation that would only be realized with the consummation of the de-SPAC transaction;[16] and
- The board did not receive a fairness opinion.[17]

Implications

As a follow-on to the court's ruling in MultiPlan, the decision in GigAcquisitions3 is a further indication from the Chancery of its inherent skepticism of de-SPAC transactions.

The decision again emphasizes that common elements of de-SPAC transactions — including the features of the sponsor's founder shares, the composition of the SPAC's board and the decoupling of the stockholders' voting and economic interests — will likely subject many de-SPAC transactions to entire fairness review, which, as the decision notes in its concluding paragraph, places the burden of persuasion on defendants at trial.

Prophylactic steps, such as compensating SPAC directors in cash alone, will not be sufficient to avoid entire fairness review, particularly if the directors have other meaningful ties to the sponsor.

Moreover, the court's commentary on the availability of Corwin cleansing indicates that Delaware courts may decline to dismiss complaints that challenge the fairness of de-SPAC transactions even where a plaintiff has failed to demonstrate that the SPAC's proxy statement was false or materially misleading.

In practice, subjecting de-SPAC transactions to entire fairness review may make it more difficult to resolve shareholder litigation before discovery and, accordingly, may also increase the cost of that litigation.

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[1] Delman v. GigAcquisitions3 LLC, 2023 WL 29325 (Del. Ch. Jan. 4, 2023).

[2] 268 A.3d 784 (Del. Ch. 2022).

[3] GigAcquisitions3, LLC, 2023 WL 29325 at *16.

[4] Id. at *19.

[5] Id. at *13.

[6] Id. at *16.

[7] Id.

[8] Id.

[9] Id. at *17.

[10] Id. at *18.

[11] Id. at *19 (citing Corwin v. KKR Financial Holdings LLC, 125 A.3d 304, 306 (Del. 2015)). The Court further explained that "[t]he dual protections outlined in Kahn v. M&F Worldwide Corp. would also be an ill fit for a de-SPAC transaction." Id. at *19 n.201 (citing Kahn v. M&F Worldwide Corp., 67 A.3d 496, 528 (Del. Ch. 2013), aff'd, 88 A.3d 635 (Del. 2014)).

[12] Id. at *19.

[13] Id. at *20.

[14] Id. at *3.

[15] Id. at *5.

[16] Id. at *24.

[17] Id.