# Another SPAC Merger Case Draws Entire Fairness Review

**January 20, 2023**

On January 4, 2023, the Delaware Court of Chancery declined to dismiss a stockholder claim that the sponsor and directors of a SPAC (GigCapital3, Inc., or "Gig3") breached their duty of loyalty in connection with alleged misstatements and omissions in Gig3's merger proxy statement. The court's conclusion in this case, *Delman v. GigAcquisitions3*,[1] was similar to that reached in 2022's *MultiPlan Corp* case[2] (Debevoise In Depth update linked here), although for somewhat different reasons.

The court in both cases focused on alleged misstatements and omissions in the context of the pre-closing option for the SPAC's public stockholders to redeem their shares for $10, plus interest, rather than participate in the SPAC merger transaction. As in *MultiPlan*, the court in *Delman* found that the plaintiff's claims were subject to the entire fairness standard of review due to "inherent conflicts" between the SPAC's fiduciaries and its public stockholders, focusing on the fact that Gig3's sponsor (which was alleged to control the company's board) stood to reap extraordinary profits even in a "bad deal." Gig3 had a typical SPAC structure in which "founder shares," which were acquired for a nominal price, represented 20% of Gig3's equity, meaning the sponsor stood to realize an enormous return on its investment in almost any consummated merger.[3]

In declining to dismiss the claims against Gig3's directors, the court found that a reasonable inference of control by the sponsor could be drawn based on the fact that the sponsor's founder and controlling equity holder was a director of the SPAC and connections between him and the other SPAC directors, including based on the expectation of future board appointments.

**Disclosure Claims.** Unlike in *MultiPlan*, where the alleged omission related to a specific business risk (the potential loss of the SPAC target's most important customer), the types of alleged misrepresentations and omissions in *Delman* are likely more common

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1 C.A. No. 2021-0679-LWW (Del Ch. Jan 4, 2023).

2 *In re MultiPlan Corp. S'holder Litig,* C.A. No. 2021-0300-LWW (Del Ch. Jan 3, 2022).

3 The court calculated that these shares were worth $32.7 million at the time the litigation was filed.

across SPAC transactions and therefore the *Delman* decision has the potential to be of broader applicability.

- **Per Share Value**. The first principal alleged disclosure violation on which the court focused related to the fact that, when accounting for the expenses and dilution typical of SPAC capital structures—including transaction costs, the value of the warrants, and the dilutive effect of the founder shares—there was only $5.25 per share (according to plaintiff's calculation) in Gig3's pre-closing trust account—far less than its $10 IPO price. Although significant dilution would not come as a surprise to a reader of Gig3's IPO prospectus, the court focused on a reference in the proxy statement to the company's stock paid as consideration to the target's stockholders being "valued at $10 per share", pointing out that "[i]f Gig3 had less than $6 per share to contribute to the merger, the Proxy's statement that Gig3 shares were worth $10 each was false—or at least materially misleading."

- **Projections**. The second principal alleged disclosure violation related to "unrealistic revenue and production projections" for the target, an electric vehicle company. Those projections, which were included in the proxy statement for the de-SPAC merger, showed production capacity increasing from fewer than 100 vehicles in 2019 and 2020 combined to 20,000 vehicles annually by 2025. Although the projections were qualified by customary cautionary language, and the opinion did not take issue with the fact of their disclosure in the proxy, the court faulted Gig3's board for not also including countervailing information about what stockholders could "realistically expect" from the post-merger company. The court found that the nature of the target's business model was knowable "through the sort of diligence and analysis expected of the board of a Delaware corporation undertaking a major transaction", implying that, had the board conducted such diligence and analysis, it would have been skeptical of the projections.

- **Conflicted Negotiators**. The court found that the plaintiff's disclosure claims were bolstered by the fact that the negotiations on behalf of Gig3 were conducted by individuals—the company's Executive Chairman (who was the founder of the sponsor) and his wife (who was also a director)—who "arguably stood to gain the most in a value-destructive deal," and that the board's two advisors had a large financial incentive in a completed transaction, both in terms of contingent consideration that would not otherwise be realized and their ownership of a large number of private placement shares that would be worthless in the absence of a deal.

- **Absence of Fairness Analysis**. The court also noted the board's failure to obtain a fairness opinion or even an informal presentation on fairness from a financial advisor, citing this as evidence that the board had not conducted the level of diligence expected of Delaware directors for a major transaction. The court implied

that this failure indirectly led to the omission of information that would have called the projections into question, because that information was never developed.

**Failure of Vote to Cleanse.** The court found that the Gig3 stockholder vote approving the merger, with more than 98% of shares voting in favor, failed to cleanse the transaction and subject it to business judgment review under the doctrine set forth in *Corwin*.[4] This was the case both because of the alleged material misstatements and omissions in the proxy statement, given Corwin's requirement of a fully informed vote, as well as the incentive structure affecting the stockholder vote. Regarding the latter, the court focused on the fact that, as is standard in SPAC transactions, a stockholder could vote in favor of the merger while also redeeming its shares for $10 each and retaining the warrants it was issued in the Gig3 IPO. According to the court, this gave the SPAC's stockholders an incentive to vote for virtually any merger, as a result of which the vote was "of no real consequence" and "its effect on the standard of review . . . equivalently meaningless."

**Takeaways.** *Delman's* holdings address issues inherent in SPAC transactions in a way that *MultiPlan* did not. In virtually every SPAC deal, the SPAC's trust will contain less than $10 per share on a fully diluted basis, because of the dilution caused by the warrants and founder shares. While that fact does not in and of itself mean that virtually every de-SPAC merger is inherently unfair, it creates a significant valuation hurdle for the SPAC's board to overcome. Likewise, it is standard practice—and probably legally required—to disclose projections prepared by the SPAC target's management in a proxy statement, however optimistic those projections might be, and it is vanishingly rare for SPACs to receive fairness opinions in respect of de-SPAC mergers.

In terms of steps that SPAC sponsors and directors might take to seek to mitigate the disclosure issues found in *Delman*:

- Consider including in the merger proxy statement disclosure regarding the cash per share in the SPAC's trust on a fully diluted basis, and, if possible, avoid statements in the proxy regarding the SPAC shares issued as consideration in the merger being valued at $10 per share.

- Take steps to pressure test the target's projections, document those steps and describe them in the proxy statement, along with any specific findings as to reasons the projections may not ultimately be achieved.

- The *Delman* opinion cited the lack of a financial advisor presentation or fairness opinion as evidence the SPAC board did not take seriously its work to arrive at an

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[4] *Corwin v. KKR Financial Holdings LLC*, C.A. No. 9210-CB (Del Ch. Oct. 14, 2014).

appropriate valuation for the target. While we would expect any fairness opinion to rely on the target's projections, a presentation from a financial advisor could improve the record. A report from a consultant familiar with the target's industry, addressing potential challenges relevant to the target, could also help demonstrate a more robust diligence process.

- The *Delman* case indicates that Delaware courts will be inclined to apply entire fairness review to de-SPAC mergers, given the structural issues inherent in SPACs and the potential conflicts they create in respect of such mergers. Absent significant changes in how SPACs are structured (including the use of founder shares), SPAC fiduciaries would be well served to keep in mind when negotiating a merger and drafting related disclosure that the transaction may well end up before a Delaware court for entire fairness review, especially if things head south after closing.[5]

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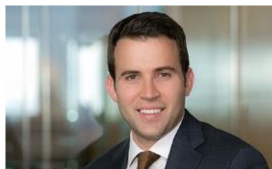

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[5] The stock of the surviving company in Gig3's merger currently trades under $1.00 per share.