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Claims That SPAC Directors, Sponsors Breached Fiduciary Duties Survive Motions to Dismiss in Pair of Opinions

In two opinions by Vice Chancellor Will, *Delman* v. *GigAcquisitions3, LLC* and *Laidlaw* v. *GigAcquistions2, LLC.*, the Delaware Court of Chancery held on motions to dismiss that it was reasonably conceivable that the directors of the respective special purpose acquisition company (SPAC) and their sponsors breached their fiduciary duties by disloyally depriving the SPAC public stockholders of information material to their decision on whether to redeem their shares in connection with the applicable deSPAC transaction. In both opinions, the court evaluated the claims under the stringent entire fairness standard. The SPAC's sponsor qualified as a controlling stockholder due to its control and influence over the SPAC, even though it held a minority interest, and, in both opinions, the court concluded that the SPAC directors lacked independence from the sponsor. In addition, in both opinions, entire fairness review was warranted based on the divergent interests between the sponsor and public stockholders that are inherent in the SPAC structure, including the sponsor's unique incentive to take a "bad deal" over a liquidation of the SPAC and returning the public stockholders' investment. The opinions provide important key takeaways for sponsors, directors and investors in Delaware SPACs. For more on the *Delman* opinion, see here.

Delaware Court of Chancery Confirms Section 205 as a Means for Former SPACs to Validate Their Capital Structures Following *Boxed* Opinion

In *In re Lordstown Motors Corp.*, the Court of Chancery, in an opinion by Vice Chancellor Will, confirmed Section 205 of the Delaware General Corporation Law (DGCL) as a means for certain former SPACs to validate their capital structures following the uncertainty created by the Vice Chancellor Zurn's earlier decision in *Garfield* v. *Boxed*. In late December 2022, the court in *Boxed* addressed a mootness fee petition filed by an attorney whose demand letter delivered on behalf of a stockholder resulted in the SPAC obtaining a separate vote of the Class A common stock on a charter amendment to increase the number of Class A shares in connection with the applicable deSPAC transaction. In considering whether the demand letter was meritorious when made, the court determined that the SPAC's Class A and Class B shares were separate classes of stock, and not series of the same class, which, under the DGCL required the separate Class A vote for the charter amendment. This conclusion called into question the validity of the capital structures of many SPACs because their charters were substantively identical to the charter at issue in *Boxed*, yet they had not obtained a separate Class A vote in connection with their respective deSPACs. As a result, multiple SPACs, including the former SPAC in *Lordstown*, petitioned the Court of Chancery for relief under Section 205 of the DGCL, which, in certain circumstances, empowers the court to validate corporate acts and putative stock. In determining to validate the charter amendment, the court weighed certain equitable factors, including the company's good faith belief that the adoption of the charter amendment complied with Delaware law, its subsequent treatment of the charter amendment and related share issuances as valid and effective, and the potential harm resulting from not validating the charter amendment. Numerous other former SPACs have taken a similar path, filing Section 205 petitions to validate their capital structures. While the court noted in *Lordstown* that its reasoning was "addressed to the specific

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relief requested by Lordstown," it nonetheless "should prove instructive to other companies seeking the court's assistance to validate similar corporate acts."

Delaware Court of Chancery Issues Rare Post-Trial Finding of *Revlon* Liability

In a rare post-trial finding of liability on a *Revlon* claim, the Delaware Court of Chancery, in *In re Mindbody, Inc. Stockholder Litigation*, held that a conflicted CEO with an interest in near-term liquidity, a desire to sell quickly and a post-merger expectation of employment with significant equity-based incentives tilted the sale process in favor of a buyer that he "loved." In addition, the court's opinion by Chancellor McCormick found that the CEO breached his duty of disclosure by keeping stockholders in the dark regarding his conflicts and the ways in which the process favored the buyer. For its part, the buyer aided and abetted the CEO's breach of his duty of disclosure by failing to correct material omissions and incomplete disclosures in the company's proxy statement in accordance with the buyer's contractual obligations under the merger agreement. The opinion shows the need for fiduciaries of Delaware corporations to be transparent about their potential conflicts of interests and the deal process, as well as the need to ensure that the sale process does not favor a given buyer.

Delaware Court of Chancery Declines to Enforce Non-Competes in Series of Opinions

In recent months, the Delaware Court of Chancery has, on several occasions, declined to enforce or blue pencil non-compete agreements. In the first of such opinions this quarter, Vice Chancellor Zurn in *Ainslie* v. *Cantor Fitzgerald, L.P.*, invalidated a non-compete provision in Cantor Fitzgerald's limited partnership agreement. Pursuant to the agreement, each former partner had a one-year non-compete provision and a two-year non-solicitation provision upon their withdrawal. The former partners had agreed to be paid the balances in their capital accounts in four installments over four years after their withdrawal, but would forfeit these payments if they engaged in competitive activity during the four-year period. The court held that the non-compete and non-solicitation provisions were unenforceable because they were overbroad due to their worldwide geographic scope. The court also found that the definition of "Competitive Activity" was overbroad because it encompassed "any Affiliated Entity," and the former partners could unknowingly engage in competitive activity. The court also found the four-year forfeiture provision to be unreasonable given its breadth, Cantor Fitzgerald's lack of legitimate business interest in the provision and the four-year scope. Accordingly, the court determined that Cantor Fitzgerald was required to pay to the former partners funds from their capital accounts that it had withheld.

In another opinion, *HighTower Holding, LLC* v. *Gibson*, the court denied the plaintiff's motion for a preliminary injunction seeking to enforce a non-compete covenant against the defendant. Defendant was a financial adviser from Alabama who agreed to the non-compete at issue when he sold a majority interest in his firm to the plaintiff. Defendant later resigned his employment with the plaintiff with the intent to start his own hedge fund and formed entities in both Alabama and Delaware to that end. Plaintiff sued the defendant in Delaware alleging breach of the non-compete covenant and sought to enjoin the plaintiff from engaging in the alleged competing behavior. In considering plaintiff's motion, Vice Chancellor Will acknowledged Delaware's general rule that a contractual choice of law will generally control, but that such rule is subject to exception, including where enforcement of the covenant would conflict with the fundamental policy of the default state's law and the default state has a materially greater interest in the issues than Delaware. The court held that here enforcement of the non-compete would subvert a "fundamental public policy" of Alabama against non-competes and restrictive covenants. The court determined that Alabama's prohibition on restrictive covenants would apply to the non-compete at hand, and even if it didn't, the covenant was overly broad and unenforceable under Alabama law. The court found that Alabama's interests here outweighed those of Delaware, and therefore, "apply[ing] Delaware law in these circumstances would undermine these legislatively expressed interests" of Alabama. Therefore, the court denied the defendant's request for a preliminary injunction.

In a third opinion, *Intertek Testing Services NA, Inc.* v. *Eastman*, the court declined to enforce a non-compete in a sale-of-business agreement. In that case, the plaintiff, a New York-based company, purchased a Texas-based business, co-founded by the defendant. In connection with the sale, the defendant agreed to a five-year, worldwide non-compete. About three years after the sale closed, the defendant invested in and became a director of a company formed by his son, which actions the plaintiff alleged were in violation of the non-compete. The court, in another opinion by Vice Chancellor Will, held that the non-compete provision was unreasonable and unenforceable, as its geographic scope "far exceeds any legitimate economic

interests" that the plaintiff might have in protecting the assets and goodwill it acquired. The court also declined on equitable grounds to blue pencil the provision to a more reasonable geographic scope.

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M&A Markets

The following issues of *M&A at a Glance*, our monthly newsletter on trends in the M&A marketplace and the structural and legal issues that arise in M&A transactions, were published this quarter. Each issue can be accessed by clicking on the date of each publication below.

January 2023 February 2023 March 2023

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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