SPAC Mergers Challenged for an Alleged Statutory Foot-Fault

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Stockholder-plaintiffs have filed a number of complaints in the Delaware Court of Chancery challenging at least five mergers involving Delaware special purpose acquisition companies (SPACs) in the last four months alleging that the SPAC's failure to solicit a "class vote" of the SPAC's Class A Common stockholders in connection with certain amendments to the SPAC's certificate of incorporation violates the requirements of Section 242(b)(2) of the Delaware General Corporation Law (the DGCL). This article explains the technical issue that is the focus of this recent litigation and the various ways deal counsel can address or avoid it.

Understanding this new spate of litigation requires a high-level understanding of Section 242, which sets forth the steps required to amend a corporation's charter—including the necessary filing, board approvals, and stockholder vote(s) (if any). Section 242(b)(1) requires most charter amendments to be approved by both holders of a majority in voting power of outstanding stock entitled to vote on the amendment and any additional vote required by Section 242(b)(2). Section 242(b)(2), in turn, provides, among other things, that a charter amendment to increase or decrease the number of authorized shares of a class of stock requires a separate vote of the affected class unless the charter contains a so-called "242(b)(2) opt-out" provision stating no such class vote is necessary. Importantly, Section 242(b)(2) does not require separate votes of each series of stock to increase or decrease the number of authorized shares of either a class or a series.

In at least five recent lawsuits filed in the Delaware Court of Chancery, stockholders have invoked Section 242(b)(2) to challenge business combinations involving SPACs, which, prior to the "de-SPAC" transaction, typically have two types of common stock: ordinary common stock held by the public, named "Class A Common Stock" and common stock with enhanced voting rights held by the sponsor, named "Class B Common Stock." In a typical de-SPAC transaction, a wholly owned subsidiary of the SPAC is merged with and into a private target, whose equity is converted into the right to receive shares of the SPAC's Class A Common Stock. In addition, the Class B Common Stock is usually converted into Class A Common Stock, which in most cases will be the only type of common stock outstanding after the de-SPAC transaction. Before the merger, the SPAC's charter is usually amended to increase the number of authorized shares of common stock in order to accommodate these issuances. This pre-merger charter amendment is what gave rise to the claims in the above-referenced lawsuits, each of which involves the following facts: the SPAC's charter authorizes a class of common stock that "includes" two separate types of common stock named "Class A Common Stock" and "Class B Common Stock"; the SPAC's charter contains no Section 242(b)(2) opt-out provision; the business combination requires the SPAC to amend its charter to increase the number of authorized shares of Common Stock and Class A Common Stock pre-merger; and in its proxy materials, the SPAC seeks approval of the charter amendment from the holders of the Class A Common Stock and Class B Common Stock, voting together as a single class, without seeking a separate vote of the holders of the Class A Common Stock, voting as a single class.

In each lawsuit, plaintiffs sought to enjoin the vote on the share increase amendment on the grounds that a separate vote of the Class A Common Stock, voting separately as a single class, is required under Section 242(b)(2). These plaintiffs have relied on the fact that the SPAC charters referred to "Class A Common Stock" and "Class B Common Stock" rather than "Series A Common Stock" and "Series B Common Stock" as dispositive of the notion that these are

separate classes of common stock rather than separate series within a single class of common stock, and thus that a "class vote" of the "Class A Common Stock" under Section 242(b)(2) is required.

This form-over-substance argument ignores the distinctions between classes and series found in the DGCL, Delaware case law and the terms of the SPAC charters. Giving corporations the option to transform a series of stock into a class of stock by simply renaming it would not only render mandatory aspects of Section 242(b)(2) meaningless, but also run contrary to various provisions throughout the DGCL that refer to classes of stock as the umbrella under which series fall by using phrases like "series of a class" or "series within a class." E.g., 8 Del. C. Sections 102(a)(4), 102(b)(3), 141(c), 151(a), 151(c), 151(e), 151(f), 151(g), 242(a), 242(b). The Delaware Court of Chancery has expressly stated that the "DGCL regards 'classes' of stock as separate and distinct from 'series' within a class." See Siegman v. Palomar Medical Technologies, 1998 WL 118201, at *4 (Del. Ch. Mar. 9, 1998) (Jacobs, V.C.). In the SPAC charters at issue here, the "Class A" and "Class B" Common Stock are clearly intended to be separate series of the overall class of "Common Stock" because they are listed in the key provisions of the SPAC charters as being separate subsets of the overall class of common stock. Indeed, the SPAC charters typically refer to there being "two classes of stock, Common and Preferred" and state that the "Common Stock shall include Class A Common Stock and Class B Common Stock," and often include an explicit reference to separate "series of Common Stock." In short, it is simply impossible under Delaware law to create a class within a class, but that is precisely what the plaintiffs in these cases have argued. Nonetheless, no Delaware court has yet addressed the merits of the plaintiffs' claims in the de-SPAC context, due in part to the fact that for timing and other reasons SPAC defendants have often decided to moot the litigation by supplementing their proxy materials to seek the separate class vote of the Class A Common Stock rather than litigate the claim.

In light of the lack of judicial guidance directly addressing this sort of language in SPAC charters, transaction planners should consider taking preemptive action to avoid these types of claims altogether. For example, at the SPAC formation stage, they might consider, among other things, including a Section 242(b)(2) opt-out provision in the SPAC's charter (which would obviate the need for a class vote even if the two series of common stock were deemed to be classes), referring to the two series of common stock as "Series A Common Stock" and "Series B Common Stock" rather than using the "class" nomenclature that is currently pervasive, and forming the SPAC with a number of authorized shares sufficient to obviate the need for a subsequent increase. If the SPAC has already been formed and gone public with the type of charter that is the subject of the recent lawsuits, transaction planners might consider, among other things, proactively seeking a separate series vote of the "Class A Common Stock" to implement the SPAC's share increase amendment in order to preempt a lawsuit, or implementing the SPAC's share increase amendment through a merger of a subsidiary with and into the SPAC. The latter option would provide an alternative legal path to amending the charter that, under Warner Communications v. Chris-Craft Industries, 583 A.2d 962, 969–70 (Del. Ch. 1989), would not implicate the class vote requirement imposed by Section 242(b)(2). However, the merger alternative would give rise to appraisal rights to holders of any outstanding class or series of the SPAC's securities that is not publicly listed at the time of the merger (which would typically be limited to the Class B Common Stock usually held by the sponsor who would be expected to vote in favor of the merger), and would remain subject to equitable review.

Given plaintiffs' ability to wield the threat of an injunction or disruptive litigation that could derail the vote to approve a de-SPAC transaction deemed to be in the best interests of the SPAC's stockholders, it is unsurprising that many SPACs have opted to seek a separate class vote on share increase amendments in order to moot these claims rather than spending the time and money to litigate them. Regardless of the merits of these claims, transaction planners

should strongly consider using one or more of the measures described above to avoid this issue until the Delaware courts have an opportunity to definitively address it.

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