ALERT MEMORANDUM

Delaware Court of Chancery Finds Lock-Up Inapplicable in de-SPAC Transaction

January 19, 2022

In a recent opinion addressing the enforcement of trading restrictions ("lock-ups") that are commonly agreed in connection with a business combination transaction between a special purpose acquisition company ("SPAC") and a target company ("de-SPAC transaction"), the Delaware Court of Chancery determined that the restrictions at issue did not apply to certain shares held by the target company's former Chief Executive Officer because he did not actually hold SPAC shares immediately after the consummation of the transaction.[1] The decision illustrates that common formulations of lock-ups may give rise to unintended consequences which allow relevant major parties, insiders or management to trade during the intended lock-up period. Given frequent share price volatility both pre- and post-combination, lock-ups are a critical element of de-SPAC transactions and the agreements creating them must be drafted carefully.

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[1] *Brown v. Matterport, Inc.*, Del. Ch., C.A. No. 2021-0595-LWW (Jan 10, 2022) (Mem. Op.).

Background

In a typical de-SPAC transaction, a target company combines with the SPAC (often by merging into a subsidiary of the SPAC), and the stock of the target is cancelled and exchanged for the right to receive shares of the SPAC. The issuance of those shares is generally handled by the SPAC's transfer agent, either directly or pursuant to an exchange agreement and letters of transmittal which must be completed by stockholders (and which may include additional steps before the merger consideration is issued). While target shareholders beneficially own SPAC shares at the effective time of the business combination transaction, they are not legally holders of such shares until any applicable exchange steps are completed.

The ability of the target company's insiders (as well as insiders of the SPAC itself) to sell their SPAC shares after the merger is a key point of negotiation in any de-SPAC transaction. Trading restrictions are commonly imposed on shares of the post-closing combined company in order to (1) mitigate any share "overhang" that may exist shortly after closing, (2) provide proper incentives to all major parties to the business combination, including the SPAC sponsor, key target stockholders and management, and (3) encourage the parties to work together to create long-term stockholder value for a meaningful period of time after the consummation of the transaction.

Accordingly, it is common for key stockholders of the target company to agree not to transfer their shares of the SPAC for a certain period following the closing, typically 6 or 12 months, subject to certain customary exceptions. These transfer restrictions are often paired with corresponding restrictions on the SPAC's sponsors, who may be subject to a similar or identical lock-up applicable to their shares, warrants or other securities of the SPAC. These restrictions can project confidence to the market and serve as an incentive for performance, particularly because such restrictions commonly fall away if the combined company's share price surpasses certain pre-determined price thresholds before the end of the lock-up period.

Matterport

In February 2021, Matterport Operating, LLC ("Legacy Matterport") entered into an agreement to merge with a SPAC, Gores Holding VI, Inc. ("Gores"). Shortly before the merger was intended to close in July 2021, William J. Brown, Legacy Matterport's former Chief Executive Officer, sued for declaratory relief from the lock-up trading restrictions imposed in connection with the business combination, arguing that they did not apply to certain of his shares.[2]

The lock-up provision in question is codified in the Amended and Restated Bylaws of the combined company ("New Matterport"), which provided as follows (emphasis added):

> [T]he term "Lockup Shares" means the shares of Class A common stock *held by the Lockup Holders immediately following the closing of the Business Combination Transaction* (other than shares of Class A common stock acquired in the public market or pursuant to a transaction exempt from registration under the Securities Act of 1933, as amended, pursuant to a subscription agreement where the issuance of shares of Class A common stock occurs on or after the closing of the Business Combination Transaction) . . . .

Following an accelerated trial (in order to enable the Court to render its decision before the expiration of the lock-up trading restrictions), the Court found that the plain meaning of the bylaw was that it should apply only to shares <u>actually outstanding</u> immediately after the business combination—and not to shares which were issuable at such time but not actually issued for some time because the holder failed to exchange their target company shares.[3]

[2] *Id*. at 1, 5.

[3] *Id*. at 10.

In reviewing the relevant provision of the New Matterport bylaws, the Court looked to their plain meaning and found the language to be unambiguous. In particular, the Court found that the common meaning of "immediately"—"without delay"—meant that Brown's shares, which were received over 100 days after closing, could not be viewed as held "immediately" after closing.[4]

The Court rejected the contention that limiting the trading restrictions in this manner was an unreasonable construction of the bylaw, pointing to the fact that certain New Matterport stockholders received their shares within a few days of closing, a period of time which the Court noted "could be viewed as consistent with a plain reading of the bylaw."[5] Similarly, the Court was not swayed by the argument that the parties could not have reasonably intended to give Brown the unilateral discretion to avoid his lock-up commitments simply by postponing the submission of his Legacy Matterport shares.

Takeaways:

— In de-SPAC transactions where target company shares are to be exchanged for SPAC shares via submission to the transfer agent or an exchange agent with a letter of transmittal, shareholders can delay receiving their SPAC shares and thereby evade the lock-up restrictions.

— Existing lock-up agreements containing the "immediately following" formulation used in *Matterport* may not be enforceable against holders who did not exchange their target company shares for SPAC shares reasonably promptly following the closing of the business combination transaction.

— Even in transactions where the transfer agent issues such shares automatically to holders of the target company's stock, there is often a day or longer period between the closing and when the stockholders actually hold their public shares. Whether that short delay counts as "immediately" enough for the restrictions to apply has yet to be tested.

— For parties negotiating or considering entering into a future de-SPAC transaction, it is critical to carefully negotiate the scope of the lock-up and any other restrictions on alienation of the shares of the combined company. To avoid ambiguity, it may be preferred to add language clarifying that the restrictions apply to any shares "held by the holders immediately after the effective time ***or otherwise issued or issuable to the holders in connection with the business combination transaction***".

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[4] *Id*. at 8, 10.

[5] *Id*. at 8-9.