

## DEFENDING THE DE-SPAC MERGER: WHAT STANDARD OF REVIEW APPLIES?

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*“A business model that incentivizes promoters to do something—anything—with other people’s money is bound to lead to significant value destruction on occasion.”<sup>1</sup> However, “some entities have more bespoke structures intended to address [these] conflicts.”<sup>2</sup> Under Delaware law, a “bespoke” SPAC structure may allow private companies to access the public markets in accordance with “well-worn fiduciary principles.”<sup>3</sup>*

### INTRODUCTION

A special purpose acquisition company—or SPAC—is a public company with no operations, products, or assets.<sup>4</sup> Unlike a traditional public company, a SPAC’s primary function is to seek out and combine with a private operating company.<sup>5</sup> Indeed, the “special purpose” of a SPAC is to take a private company public while avoiding the traditional initial public offering (IPO) process.<sup>6</sup> Upon merging with the SPAC in the “de-SPAC” transaction, the target company takes the SPAC’s place on the public market as an operating, public company.<sup>7</sup>

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<sup>1</sup> *MultiPlan: Private Equity Necrophilia Meets the Great 2020 Money Grab*, MUDDY WATERS RESEARCH (Nov. 11, 2020), <https://www.muddywatersresearch.com/research/mpln/mw-is-short-mpln/>.

<sup>2</sup> *In re MultiPlan Corp. S’holders Litig.*, 268 A.3d 784, 792 (Del. Ch. 2022).

<sup>3</sup> *Id.*

<sup>4</sup> *Id.* at 793.

<sup>5</sup> *Id.*

<sup>6</sup> *See id.* at 791.

<sup>7</sup> *See infra* Part II.B.B

SPACs are typically formed and controlled by a management group, referred to as the SPAC's "sponsor."<sup>8</sup> The sponsor's primary role is to identify a target company for acquisition.<sup>9</sup> Upon formation, the SPAC will raise capital in its own IPO, typically offering public shareholders interests at \$10.00 per share.<sup>10</sup> Public shareholders do not know what the target is, nor do they actively participate in the pursuit of a target company.<sup>11</sup> Truly, the investors are betting on the jockey, not the horse. Then, ahead of the de-SPAC merger, the public shareholders may convert their shares into common stock in the combined company—ideally increasing their value.<sup>12</sup>

The sponsor is compensated differently than the public investors.<sup>13</sup> Upon the SPAC's founding, the sponsor generally takes a 20% stake (referred to as the "promote") in the SPAC entity.<sup>14</sup> The sponsor purchases the promote for nominal consideration, sometimes as low as \$0.0003 per share.<sup>15</sup> Upon the de-SPAC merger, the sponsor's shares convert into common stock in the combined company at a one-to-one ratio with the public shareholders.<sup>16</sup> Accordingly, upon the de-SPAC, the sponsor receives shares in the now-public target company for a fraction of the price the public shareholders will. It is this disparity that creates diverging interests between the sponsor and public shareholders.

Diverging interests are illustrated by mechanisms such as the "drop-dead date." A SPAC typically has a two-year completion window to find a suitable

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<sup>8</sup> *In re MultiPlan*, 268 A.3d at 793.

<sup>9</sup> *Id.*

<sup>10</sup> *See, e.g., id.* at 794 ("Churchill sold 110,000,000 units at \$10 per unit in its IPO. Each unit consisted of one share of Churchill Class A common stock and a quarter of a warrant with an exercise price of \$11.50. Both the unit price and the composition were market standard." (footnotes omitted)).

<sup>11</sup> *See id.* at 812, 816.

<sup>12</sup> *Manichaeon Cap., LLC v. SourceHOV Holdings, Inc.*, No. 2017-0673, 2020 WL 496606, at \*4 (Del. Ch. Jan. 30, 2020) ("Investors in SPACs like Quinpario have the right to require the SPAC to redeem their shares rather than roll their shares into a post-acquisition company.").

<sup>13</sup> *See, e.g., In re MultiPlan*, 268 A.3d at 794 (describing the 20% stake purchased by the sponsor for an upfront capital contribution of \$25,000).

<sup>14</sup> *Id.*

<sup>15</sup> *E.g., GS Acquisition Holdings Corp. II*, Registration Statement (Form S-1/A) 18 (June 24, 2020), <https://sec.report/Document/0001193125-20-177690> (disclosing that the SPAC's sponsor held 20% ownership after paying approximately \$5,000 for 20,125,000 founder shares—a purchase price approximately less than \$0.0003 per share).

<sup>16</sup> *See, e.g., In re MultiPlan*, 268 A.3d at 794.

target and negotiate the merger.<sup>17</sup> If no transaction is completed by the drop-dead date, the SPAC liquidates, and public stockholders receive back the full value of their investment with interest.<sup>18</sup> In stark contrast, the promote is rendered worthless upon the SPAC's liquidation, leaving sponsors empty handed.<sup>19</sup>

This conflict is best illustrated by a simple (albeit oversimplified) example.<sup>20</sup> The public investors paid, for example, \$10.00 per share in the SPAC's IPO, composing 80% of the SPAC's outstanding stock. The sponsor takes its 20% stake as a promote, paying \$0.0003 per share. Upon execution of the de-SPAC merger, the target company, now public, performs poorly and its value plummets to \$5.00 per share. The public investors lose half their investment, while the sponsor continues to see significant gains—despite the company's declining value.<sup>21</sup> In fact, this upside is realized by the sponsor so long as the value of the promote does not drop below their \$0.0003 per share purchase price—a rare and catastrophic failure.

This mismatched incentive here is known to public stockholders who choose to invest in a SPAC—nobody claims they are blindsided by this information late in the game.<sup>22</sup> The issue arises when stockholders claim that they were “robbed of their right to make a fully informed decision about whether to redeem their shares.”<sup>23</sup> Public shareholders' decision about whether to redeem their shares is based, in large part, on the disclosures issued to them in the proxy statement.<sup>24</sup> The question then becomes: If those disclosures are incomplete or misleading, did the public investors really have a meaningful choice? This is where investors claim they are blindsided by those who owe them a fiduciary duty to protect their interests.<sup>25</sup>

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<sup>17</sup> See, e.g., *id.* (“Churchill’s ‘completion window’ for a business combination ended 24 months after the IPO—also market standard.”).

<sup>18</sup> See, e.g., *id.*

<sup>19</sup> See, e.g., *id.*

<sup>20</sup> This hypothetical parallels a more detailed illustration by Vice Chancellor Will found in *In re MultiPlan*, 268 A.3d at 813–14.

<sup>21</sup> The hypothetical sponsor in Vice Chancellor Will's example referenced *supra* note 20 sees gains upward of half a million dollars in the otherwise “value-decreasing transaction,” even after accounting for unvested sponsor shares and a lock-up provision.

<sup>22</sup> See, e.g., *In re MultiPlan*, 268 A.3d at 792.

<sup>23</sup> *Id.*

<sup>24</sup> See *id.* (“The SPAC issued a proxy statement that solicited stockholder votes on the deal and informed public stockholders’ redemption decisions.”).

<sup>25</sup> *Id.* (“But those stockholders were allegedly robbed of their right to make a fully informed decision about whether to redeem their shares.”).

Courts have developed a jurisprudence in similar contexts to determine whether a fiduciary has breached its duty. For example, “[w]hen determining whether [defendants] have breached their [fiduciary] duties, Delaware corporate law distinguishes between the standard of conduct and the standard of review.”<sup>26</sup> The standard of conduct “describes what directors are expected to do and is defined by the content of the duties of loyalty and care.”<sup>27</sup> The standard of review, on the other hand, “is the test that a court applies when evaluating whether directors have met the standard of conduct.”<sup>28</sup> Delaware’s default standard of review is the business judgment rule.<sup>29</sup> Application of this deferential standard, however, is rebuttable.<sup>30</sup> If rebutted, courts will apply “entire fairness,” Delaware’s “most onerous standard of review.”<sup>31</sup> Practically speaking, determining which standard applies—business judgment rule or entire fairness—effectively decides the victor.<sup>32</sup>

Until very recently, Delaware courts have not had an opportunity to consider the application of its law in the SPAC context.<sup>33</sup> Nevertheless, “well-worn fiduciary principles” can be applied to claims under the SPAC structure.<sup>34</sup> While common SPAC characteristics may predestine defendants for entire-fairness scrutiny, a new, “bespoke” SPAC structure can address potential conflicts, safely placing defendants in business-judgment-rule territory.<sup>35</sup> Part I of this Article explains the SPAC and its key players. Part II describes the mechanics and effects of the de-SPAC. Part III illustrates how Delaware courts will examine SPACs. Part IV then develops the “bespoke” SPAC, and tailors its structure under Delaware law.

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<sup>26</sup>Chen v. Howard-Anderson, 87 A.3d 648, 666 (Del. Ch. 2014).

<sup>27</sup>*In re Trados Inc. S’holder Litig.*, 73 A.3d 17, 35 (Del. Ch. 2013).

<sup>28</sup>*Id.* at 35–36.

<sup>29</sup>*Id.* at 43.

<sup>30</sup>*Solomon v. Armstrong*, 747 A.2d 1098, 1111–12 (Del. Ch. 1999).

<sup>31</sup>*Frederick Hsu Living Tr. v. ODN Holding Corp.*, No. 12108-VCL, 2017 WL 1437308, at \*26 (Del. Ch. Apr. 14, 2017).

<sup>32</sup>Or, at the very least, how long it will take. “Because the inquiry is fact intensive, ‘it is rare the court will dismiss a fiduciary duty claim on a Rule 12(b)(6) motion when entire fairness is the governing standard of review.’” *In re MultiPlan Corp. S’holders Litig.*, 268 A.3d 784, 815–16 (Del. Ch. 2022) (quoting *Tornetta v. Musk*, 250 A.3d 793, 812 (Del. Ch. 2019)).

<sup>33</sup>*Id.* at 792 (“Though SPACs are a popular vehicle for private companies to access the public markets, Delaware courts have not previously had an opportunity to consider the application of our law in the SPAC context.”).

<sup>34</sup>*Id.*

<sup>35</sup>*See id.*

## I. UNPACKING THE SPAC

As discussed, a SPAC is a vehicle that takes companies public more efficiently and effectively than the typical public offering.<sup>36</sup> Unlike the company it acquires, the SPAC has no business operations; instead, investors purchase stock in the public SPAC entity with the understanding that those funds will be used in a future acquisition. Once the SPAC acquires the private target company, the target will merge with and into the SPAC, taking the SPAC's ticker on the public market. Ultimately, the SPAC investors are left with public ownership in the previously private, target company.

At the SPAC's IPO, the SPAC has not yet identified acquisition candidates, which is why SPACs are often referred to as "blank-check companies."<sup>37</sup> Investors write "blank checks" without a clue as to where the SPAC will cash it. This uncertainty and potential for abuse is precisely why SPACs have undergone unprecedented scrutiny.<sup>38</sup> For example, in 2013, a mere ten SPACs went public, raising a total of \$1.4 billion.<sup>39</sup>

However, notwithstanding decades of criticism, over half of the companies that went public in 2020 did so through a SPAC, raising an impressive \$83.4 billion in capital.<sup>40</sup> Not to be outdone, 295 SPACs went public in the first three months of 2021, raising over \$90 billion.<sup>41</sup> We are in the midst of what has been referred to as the "SPAC boom."<sup>42</sup> Market participants are skeptical that these rates can continue, but SPACs show no signs of slowing down.<sup>43</sup>

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<sup>36</sup> *What You Need to Know About SPACs—Updated Investor Bulletin*, U.S. SEC. & EXCH. COMM'N (May 25, 2021), <https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin>.

<sup>37</sup> *Id.*

<sup>38</sup> John Coates, *SPACs, IPOs and Liability Risk Under the Securities Laws*, U.S. SEC. & EXCH. COMM'N (Apr. 8, 2021), <https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws>.

<sup>39</sup> *In re MultiPlan*, 268 A.3d at 793.

<sup>40</sup> *Id.*; see also SPAC ANALYTICS, <https://spacanalytics.com> (last visited Dec. 10, 2021).

<sup>41</sup> *The SPAC Phenomenon Continues and Attracts Corporate Entrants*, JEFFERIES, <https://www.jefferies.com/IdeasAndPerspectives/2/2802> (last visited Dec. 10, 2021).

<sup>42</sup> *In re MultiPlan*, 268 A.3d at 793.

<sup>43</sup> See *id.*

While this vehicle appears as efficient and effective as it purports to be, SPACs are not without risk—particularly in the courtroom.<sup>44</sup> SPACs find themselves in the crosshairs of corporate, contract, and securities laws.<sup>45</sup> The sparse case law and commentary on SPACs has primarily focused on the federal securities law governing the IPO, but as we will see, much more focus ought to shift to the courts’ treatment of the de-SPAC merger.<sup>46</sup>

## II. THE DE-SPAC MERGER

### A. *Proposal and Proxy.*

Once the sponsor has identified a target candidate, the SPAC board of directors will vote to approve and recommend the acquisition to the shareholders.<sup>47</sup> With its recommendation, the board will furnish stockholders with a “proxy statement” describing the proposed acquisition and disclosing any necessary information.<sup>48</sup> Using that information, stockholders decide whether to approve the transaction, reject the transaction, and/or redeem their shares in the SPAC.<sup>49</sup> In fact, under the common SPAC structure, a stockholder can vote against the merger without requiring an automatic redemption of their shares.<sup>50</sup> Upon the shareholder’s approval, the target company will merge with and into the SPAC.<sup>51</sup>

Because the SPAC does not know exactly how much the business combination will cost initially, additional funds may be raised through private investments in public equity (PIPE), which allow institutional investors to contribute funds as consideration for shares at a discount.<sup>52</sup> In

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<sup>44</sup> *Litigation Risk in the SPAC World*, QUINN EMANUEL TRIAL LAWS., <https://www.quinnemanuel.com/the-firm/publications/litigation-risk-in-the-spac-world/> (last visited Jan. 17, 2022).

<sup>45</sup> *See id.*

<sup>46</sup> *SPACs & Entire Fairness: What Standard of Review Applies to the De-SPACing Transaction*, VINSON & ELKINS LLP (Dec. 11, 2020), <https://www.velaw.com/insights/spacs-entire-fairness-what-standard-of-review-applies-to-the-de-spacing-transaction/>.

<sup>47</sup> *See, e.g., In re MultiPlan*, 268 A.3d at 796.

<sup>48</sup> *See, e.g., id.* at 797.

<sup>49</sup> *See id.* at 795.

<sup>50</sup> *Id.*

<sup>51</sup> *See, e.g., id.* at 792.

<sup>52</sup> CREDIT SUISSE, MAKING WAVES: THE EVOLUTION OF SPACS 7 (2020), <https://www.credit-suisse.com/media/assets/investment-banking/docs/corporate-insights/csci-2020-q4-making-waves-spacs.pdf>.

fact, the proceeds from the SPAC IPO typically will only cover a mere 30% of the purchase price, with the remainder of funds coming from PIPE financing.<sup>53</sup> While this “friends and family” discount may appear unfair to IPO investors, PIPE financing is generally cost and time efficient—enabling the SPAC to pursue a more desirable target.<sup>54</sup>

The combined company now finds its place on the public markets with any remaining shareholders (those who did not redeem their shares) holding a slice of the pie. However, the company’s performance post-merger is far from guaranteed. The SPAC directors may have presented forward-looking projections of performance to stockholders in the proxy statement, but these directors are not equipped with a crystal ball—projections are merely speculative and often optimistic.<sup>55</sup> Additionally, without enduring the typical IPO process, it is difficult to know exactly how the market will react to the new listing.<sup>56</sup> The pressure of completing the de-SPAC may be over, but a new burden of performance takes over for the public company.

### B. The Business Combination.

The business combination—or de-SPAC merger—takes the form of a reverse triangular merger, with the private target company merging with and into the SPAC.<sup>57</sup> The SPAC itself is typically a subsidiary of a parent company overseeing multiple funds at once.<sup>58</sup> The SPAC contributes the purchase price to the target company, and SPAC shares are converted into common stock of the target company.<sup>59</sup> Once the target takes the SPAC’s place on the public market, it continues its operations much like it did

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<sup>53</sup> *Id.*; *What Is a SPAC?*, CB INSIGHTS, <https://www.cbinsights.com/research/report/what-is-a-spac> (last updated Apr. 5, 2022).

<sup>54</sup> See CREDIT SUISSE, *supra* note 52, at 11.

<sup>55</sup> Hassan Espahbodi et al., *Did Analyst Forecast Accuracy and Dispersion Improve After 2002 Following the Increase in Regulation?*, 71 FIN. ANALYSTS J., no. 5, 2015, at 20, 23, 34.

<sup>56</sup> Liz Ann Sonders & Kevin Gordon, *SPACs: What Investors Should Know Now*, CHARLES SCHWAB (Feb. 7, 2022), <https://www.schwab.com/resource-center/insights/content/spacs-what-are-they-and-are-they-risk-to-market>.

<sup>57</sup> SOUMYA SHARMA ET AL., BUREAU OF NAT’L AFFS., SPAC LIFECYCLE AND CONSIDERATIONS FOR PRIVATE COMPANIES 4 (2020), <https://www.troutman.com/images/content/2/7/272572/2020-November-Bloomberg-SPAC-Lifecycle-and-Considerations-fo.pdf>.

<sup>58</sup> See, e.g., *In re MultiPlan Corp. S’holders Litig.*, 268 A.3d 784, 796 (Del. Ch. 2022).

<sup>59</sup> See, e.g., *id.* at 797.

before.<sup>60</sup> The key difference for the target is that its shares are now listed on an exchange such as NYSE or NASDAQ.<sup>61</sup>

### III. STANDARDS OF REVIEW

Under well-established Delaware corporate law, a company's directors owe their shareholders a duty of care and a duty of loyalty.<sup>62</sup> The duty of care is the duty to exercise informed business judgment,<sup>63</sup> while the duty of loyalty imposes the duty to act in good faith and in the best interests of the corporation.<sup>64</sup> If a claim for breach of duty is brought against the directors, then Delaware courts will apply one of three standards of review to determine whether or not a breach occurred.<sup>65</sup> A court may apply the business judgment rule, enhanced scrutiny, or the entire fairness standard—each increasing in rigidity, respectively.<sup>66</sup> A key consideration in determining which standard applies is whether or not there are any conflicts of interest between the directors and shareholders.<sup>67</sup>

Determining which standard applies is almost as effective as deciding who wins the litigation—or at least how early it may be disposed of.<sup>68</sup> While Delaware courts have not definitively applied these principles to SPACs, well-established corporate law tells us what it might look like once the flood of SPAC litigation makes its way through the courts.<sup>69</sup> The standards of review shift depending on whether the transaction is a “conflicted

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<sup>60</sup> SHARMA ET AL., *supra* note 57, at 6.

<sup>61</sup> CREDIT SUISSE, *supra* note 52, at 7.

<sup>62</sup> Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985), *superseded by statute*, Act of June 18, 1986, ch. 289, §§ 1, 2, 65 Del. Laws (codified as amended at DEL. CODE ANN. tit. 8 § 102(b)(7) (West 2022)), *and overruled by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009).

<sup>63</sup> *Id.*

<sup>64</sup> Avande, Inc. v. Evans, No. 2018-0203-AGB, 2019 WL 3800168, at \*8–9 (Del. Ch. Aug. 13, 2019).

<sup>65</sup> Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 456 (Del. Ch. 2011) (“Delaware has three tiers of review for evaluating director decision-making: the business judgment rule, enhanced scrutiny, and entire fairness.”).

<sup>66</sup> *Id.* at 457–59.

<sup>67</sup> See *In re Trados Inc. S’holder Litig.*, 73 A.3d 17, 43 (Del. Ch. 2013).

<sup>68</sup> See generally *In re Multiplan Corp. S’holders Litig.*, 268 A.3d 784 (Del. Ch. 2022) (refusing to grant defendants’ motion to dismiss).

<sup>69</sup> See *id.* at 792 (“Delaware courts have not previously had an opportunity to consider the application of our law in the SPAC context. In this decision, well-worn fiduciary principles are applied to the plaintiffs’ claims despite the novel issues presented.”).



transaction”]; thus, the logical place to start is with the conflict at issue.<sup>70</sup> After establishing the conflict as a backdrop, this section proceeds with an examination of the relevant standards of review under Delaware law.

*A. The Conflict: Playing With House Money.*

Before attempting to assign a standard of review to the de-SPAC transaction, it is worth re-examining the potential conflict at issue.<sup>71</sup> As discussed, the most common SPAC structure provides that the sponsors receive “founder shares,” which typically amount to 20% of the SPAC entity.<sup>72</sup> For this 20% ownership, the sponsors offer nominal consideration. If a SPAC does not de-SPAC before the completion window closes, the sponsors may be entitled only to the consideration they paid for their founder shares. In any event, the value of the founder shares remains “nominal,” unless the de-SPAC transaction actually occurs.

After the de-SPAC merger, the founder shares convert into common stock of the post-merger company. Now, instead of nominal value, the sponsor has substantial ownership of the post-merger company—having paid pennies on the dollar compared to its IPO-stockholder counterparts. Put simply, the founder shares are worthless absent any deal, yet yield massive gains (often millions of dollars) if a deal closes.

Skeptics suggest that “[a] business model that incentivizes promoters to do something—anything—with other people’s money is bound to lead to significant value destruction on occasion.”<sup>73</sup> Under this business model, sponsors, on average, earned a 648% return on their investment over the past two years.<sup>74</sup> As exemplar, in *In re Multiplan Corp. Stockholders Litigation*,

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<sup>70</sup> *In re Trados*, 73 A.3d at 36 (“The standard of review may change further depending on whether the directors took steps to address the potential or actual conflict . . .”).

<sup>71</sup> Other conflicts exist aside from the founders’ units. For example, SPAC management may have some interest in the target company. Additionally, sponsors seek services from consulting or advisory teams with whom they have conflicts. In *In re Multiplan Corp. Stockholders Litigation*, the sponsor caused the payment of a \$30.5 million advisory fee by the SPAC to his affiliate, in connection with the de-SPAC transaction. The plaintiffs claimed that the board permitted such an egregious conflict “because a majority of the Board had their own multi-million-dollar windfalls riding on closing the deal that [Sponsor] preferred.” Verified Class Action Complaint, *Amo v. Multiplan Corp.*, No. 2021-0258, 2021 WL 1175073 (Del. Ch. Mar. 25, 2021).

<sup>72</sup> See *supra* notes 13–16 and accompanying text.

<sup>73</sup> MUDDY WATERS RESEARCH, *supra* note 1.

<sup>74</sup> Andrew Ross Sorkin, *Wall Street’s New Favorite Deal Trend Has Issues*, N.Y. TIMES (Feb. 10, 2021), <https://www.nytimes.com/2021/02/10/business/dealbook/spac-wall-street-deals.html>.

the stock price dropped nearly 40% within weeks of the de-SPAC transaction.<sup>75</sup> While this robbed public stockholders of any meaningful investment, the sponsor stood to realize hundreds of millions of dollars on the acquisition of this failing company. Does this present the type of “disabling conflict” that Delaware courts are looking for? Recent developments suggest it does.<sup>76</sup>

Delaware courts place conflicted transactions implicating entire fairness into one of two categories: (1) “where the controller stands on both sides” of the transaction, and (2) “where the controller competes with the common stockholders for consideration.”<sup>77</sup> In order to invoke the first category, the conflicted director must be affiliated with the target company—a rare challenge in the SPAC context.<sup>78</sup> The second category, however, is more appropriate here. A director competes with common stockholders for consideration when the director “receives a ‘unique benefit’ by extracting ‘something uniquely valuable to the controller, even if the controller nominally receives the same consideration as all other stockholders’ to the detriment of the minority.”<sup>79</sup>

At first glance, it appears there is no competition for consideration. There is no shift in value between the sponsor and the shareholders. In the de-SPAC, the common stock and founder shares convert to company shares at a one-to-one ratio, fair and square. But this logic overlooks the fact that this “rests on the assumption that [the SPAC actually does] complete[] a business combination.”<sup>80</sup> In other words, *if* a de-SPAC happens, there is not a competition for consideration; but the real issue is *whether* the de-SPAC should happen at all. The “unique benefit” of founder shares is only bestowed on the director if the public shareholders approve the transaction.<sup>81</sup> Thus, if the public shareholders are improperly induced (to their detriment) to approve the de-SPAC, this “unique benefit” to the director creates a conflicted transaction.<sup>82</sup>

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<sup>75</sup> 268 A.3d 784, 798 (Del. Ch. 2022).

<sup>76</sup> *See id.* at 792.

<sup>77</sup> *In re Crimson Expl. Inc. S’holder Litig.*, No. 8541-VCP, 2014 WL 5449419, at \*12 (Del. Ch. Oct. 24, 2014).

<sup>78</sup> *See id.* Rarely, if ever, could a SPAC director identify a target affiliated with themselves without running afoul of SEC regulation on target identification.

<sup>79</sup> *In re MultiPlan*, 268 A.3d at 810.

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*

<sup>82</sup> *Id.* at 811.

Notably, public stockholders are aware of this incentive from the beginning. The directors disclose this potential conflict in the prospectus.<sup>83</sup> Standing alone, founder shares do not present the conflict that Delaware courts are looking for. However, just because public stockholders implicitly consent to this incentive does not mean that they do “not require all material information” when deciding whether to redeem their shares.<sup>84</sup> Thus, if material information is withheld or misrepresented at this stage, the de-SPAC becomes a conflicted transaction.<sup>85</sup>

### B. Business Judgment Rule.

Delaware’s default standard of review, the business judgment rule, is famously forgiving to director-defendants.<sup>86</sup> The rule automatically presumes that “in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”<sup>87</sup> In determining whether the business-judgment rule was satisfied, “the court merely looks to see whether the business decision made was rational in the sense of being one logical approach to advancing the corporation’s objectives.”<sup>88</sup> It is only “when a decision lacks any rationally conceivable basis” that a court will “infer bad faith and a breach of duty.”<sup>89</sup>

In one rare instance, this high burden on plaintiffs was met in *Smith v. Van Gorkom*.<sup>90</sup> In *Van Gorkom*, the company’s directors determined the merger price without financial analysis and without obtaining a proper valuation.<sup>91</sup> Not a single director actually read the merger agreement or prepared a summary of terms.<sup>92</sup> The directors relied wholly upon the

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<sup>83</sup> See, e.g., *id.* at 812.

<sup>84</sup> *Id.*

<sup>85</sup> See *id.*

<sup>86</sup> See *In re Trados Inc. S’holder Litig.*, 73 A.3d 17, 43 (Del. Ch. 2013) (“Only when a decision lacks any rationally conceivable basis will a court infer bad faith and a breach of duty.”).

<sup>87</sup> *Id.* (quoting *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984)).

<sup>88</sup> *In re Dollar Thrifty S’holder Litig.*, 14 A.3d 573, 598 (Del. Ch. 2010).

<sup>89</sup> *In re Trados*, 73 A.3d at 43.

<sup>90</sup> 488 A.2d 858, 893 (Del. 1985) (holding that the trial court’s application of the business judgment rule in favor of the director-defendants was reversible error), *superseded by statute*, Act of June 18, 1986, ch. 289, §§ 1, 2, 65 Del. Laws (codified as amended at DEL. CODE ANN. tit. 8 § 102(b)(7) (West 2022)), and *overruled by* *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009).

<sup>91</sup> *Id.* at 877.

<sup>92</sup> *Id.* at 874.

representations made to them at face value.<sup>93</sup> Even with the help of the business judgment rule, the court concluded that the director defendants had breached their fiduciary duty “by their failure to make true and correct disclosures of all information they had, or should have had, material to the transaction submitted for stockholder approval.”<sup>94</sup> So, although the business judgment rule is often seen as a complete bar to a plaintiff’s success, there are certain facts which, if shown, can overcome the plaintiff’s steep burden.

To date, SPAC commentators have assumed that the business judgment rule will apply in the SPAC context.<sup>95</sup> There are two main arguments that could support this position. First, entire fairness requires a “disabling conflict,” and the sponsor’s promote is insufficient to cross that threshold.<sup>96</sup> Second, even if there is a conflict, a fully informed stockholder vote would cleanse the de-SPAC of any conflicts of interest.<sup>97</sup>

### 1. A Non-Conflicting Transaction.

The first defense to entire fairness scrutiny is a showing that there is no conflict at all. After all, the business judgment rule applies unless there is a disabling conflict of interest.<sup>98</sup> “Delaware courts place conflicted controller transactions implicating entire fairness into one of two categories: ‘where the controller stands on both sides’ and ‘where the controller competes with the common stockholders for consideration.’”<sup>99</sup> The first category—where a controller stands on both sides—is less common in the SPAC context, because it would require the fiduciary to have some affiliation with the target. The second category—where the controller competes with the common stockholders for consideration—however, may be implicated by the SPAC structure.<sup>100</sup>

SPAC directors have an interest in any transaction. This shouldn’t be held against them on its own. The shareholders have an interest too, and often

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<sup>93</sup> *Id.* at 877.

<sup>94</sup> *Id.* at 893.

<sup>95</sup> *See, e.g.*, VINSON & ELKINS LLP, *supra* note 46.

<sup>96</sup> *See id.*

<sup>97</sup> *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 308–09, 314 (Del. 2015).

<sup>98</sup> *In re MultiPlan Corp. S’holders Litig.*, 268 A.3d 784, 809 (Del. Ch. 2022) (“The plaintiffs must also adequately plead that the controlling stockholder engaged in a conflicted transaction.”).

<sup>99</sup> *Id.* (quoting *In re Crimson Expl. Inc. S’holder Litig.*, No. 8541-VCP, 2014 WL 5449419, at \*12 (Del. Ch. Oct. 24, 2014)).

<sup>100</sup> *See, e.g., id.* at 810–11.

these two interests are aligned: Get the most value for our shares. It is not enough for a stockholder to claim that the directors had *some* incentive in the transaction which differed from their own.<sup>101</sup> Rather, the stockholder must allege that a majority of the directors suffered from a *disabling* conflict, such that a director's judgment is impaired.<sup>102</sup>

In the SPAC context, sponsors are given "founders' units," which challenging stockholders may argue presents a disabling conflict.<sup>103</sup> However, this argument forgets that the conflict must be so significant that the directors' judgment is disabled in the particular transaction. If just any benefit was enough to trigger entire fairness, nearly every (if not every) transaction would be subject to entire fairness. Delaware courts have routinely held that an incidental benefit, unique to directors, does not automatically violate the duty of loyalty.<sup>104</sup> Thus, the real test is not whether such benefits exist, but whether the stockholder's claims support a showing that a director could not have impartially approved or recommended the transaction.<sup>105</sup> In other words, plaintiff-stockholders must come ready to point to specific and material conflicts that can cross the threshold of "disabling conflicts." However, as we will see, this burden on plaintiffs is not an impossible one.

## 2. The *Corwin* Cleansing Vote.

If, however, plaintiff-stockholders can point to material and specific facts that indicate a disabling conflict exists, defendant-directors are not entirely out of luck. As discussed, a conflict of interest would rebut the presumption of the business judgment rule, but this does not rid the presumption for good.<sup>106</sup> Even if there is a disabling conflict of interest, an uncoerced and

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<sup>101</sup> VINSON & ELKINS LLP, *supra* note 46.

<sup>102</sup> Orman v. Cullman, 794 A.2d 5, 24–25, 25 n.50 (Del. Ch. 2002).

<sup>103</sup> See, e.g., *In re OPENLANE, Inc. S'holders Litig.*, No. 6849-VCN, 2011 WL 4599662, at \*5 (Del. Ch. Sept. 30, 2011) (Plaintiffs alleged the board was improperly motivated because they stood to receive millions in accelerated options post-merger.); VINSON & ELKINS LLP, *supra* note 46.

<sup>104</sup> *In re BioClinica, Inc. S'holder Litig.*, No. 8272-VCG, 2013 WL 5631233, at \*5 (Del. Ch. Oct. 16, 2013).

<sup>105</sup> VINSON & ELKINS LLP, *supra* note 46.

<sup>106</sup> See *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 314 (Del. 2015); *In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 36 (Del. Ch. 2013) ("The standard of review may change further depending on whether the directors took steps to address the potential or actual conflict, such as by

fully informed stockholder vote will “cleanse” the conflict, thus re-invoking the business judgment rule.<sup>107</sup> This is often referred to as a “cleansing vote” or “*Corwin* vote.”<sup>108</sup>

The stockholder vote to approve a de-SPAC merger is unique. As noted, under the SPAC model, a stockholder may not only vote against the transaction, but can redeem their shares and take back their money. Thus, in a sense, every de-SPAC transaction will proceed with a sort of “unanimous” vote, because the only remaining stockholders will be those who decided to leave their money in the fund.<sup>109</sup> This proves as a major protection for SPAC management because they will virtually always have a “cleansing vote.”<sup>110</sup>

While it may appear that *Corwin* will always avail the defendants of the business judgment rule, such an argument is incomplete. *Corwin* does not call for just *any* stockholder vote, but instead calls for a vote that is “fully informed.”<sup>111</sup> The SPAC must provide comprehensive disclosures for a stockholder vote on the de-SPAC transaction to be considered a “fully informed” stockholder vote.<sup>112</sup> *Corwin* can protect the de-SPAC, but SPAC directors must be prepared to show that adequate disclosures were made to stockholders ahead of their approval, including disclosures as to their conflicts of interest.<sup>113</sup>

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creating an independent committee, conditioning the transaction on approval by disinterested stockholders, or both.”).

<sup>107</sup> *Corwin*, 125 A.3d at 314.

<sup>108</sup> *E.g.*, Itai Fiegenbaum, *Taking Corwin Seriously*, HARV. L. SCH. FOR. ON CORP. GOVERNANCE (Oct. 27, 2021), <https://corpgov.law.harvard.edu/2021/10/27/taking-corwin-seriously/> (focusing on the “court’s decision on whether to grant the standard-reducing effect of the *Corwin* vote”).

<sup>109</sup> This can make financing the transaction difficult because the SPAC might not know exactly how much of the existing fund will actually be available for the purchase price. This is why a majority of the financing comes from non-IPO investments, such as PIPE financing.

<sup>110</sup> Oftentimes, the only votes that “count” are those that come from the investors who are remaining in the SPAC. This creates a pseudo-unanimous “approval” because those investors who *disapprove* almost always take their ball and go home.

<sup>111</sup> *Corwin*, 125 A.3d at 312.

<sup>112</sup> *Id.* Not to mention any additional disclosure claims that a stockholder could bring under such circumstances.

<sup>113</sup> *See id.*

### C. Entire Fairness.

Entire fairness is Delaware’s “most onerous standard” and applies when the board labors under actual conflicts of interest.<sup>114</sup> When entire fairness applies, the defendant fiduciaries have the burden “to demonstrate that the challenged act or transaction was entirely fair to the corporation and its shareholders.”<sup>115</sup> This encompasses two aspects: fair dealing and fair price.<sup>116</sup> Fair price “relates to the economic and financial considerations of the proposed merger.”<sup>117</sup> Fair dealing “embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained.”<sup>118</sup> Notably, not even the directors’ honest belief that the transaction was fair will establish true fairness.<sup>119</sup> Thus, entire fairness imposes a major burden on defendants and avoiding its scrutiny is critical to any defense.

#### 1. Revisiting *Corwin* in the SPAC Context.

As discussed, *Corwin* provides that a fully informed stockholder vote will cleanse an otherwise conflicted transaction. Importantly, this stockholder vote is qualified by its accompanying adjectives: “fully informed” and “uncoerced.”<sup>120</sup> In the SPAC context, coercion is typically a non-issue; however, whether the vote is “fully informed” plays a critical role in this analysis.<sup>121</sup> As the *Corwin* court noted, “[I]f troubling facts regarding director behavior were not disclosed that would have been material to a voting stockholder, then the business judgment rule is not invoked.”<sup>122</sup>

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<sup>114</sup> *In re Trados Inc. S’holder Litig.*, 73 A.3d 17, 44 (Del. Ch. 2013).

<sup>115</sup> *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 52 (Del. 2006).

<sup>116</sup> *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1162 (Del. 1995) (quoting *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983)).

<sup>117</sup> *Id.*

<sup>118</sup> *Id.*

<sup>119</sup> *In re Trados*, 73 A.3d at 44 (finding that “the transaction itself must be objectively fair, independent of the board’s beliefs” (quoting *Gesoff v. IIC Indus., Inc.*, 902 A.2d 1130, 1145 (Del. Ch. 2006))).

<sup>120</sup> *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 312 (Del. 2015).

<sup>121</sup> *See, e.g., In re MultiPlan Corp. S’holders Litig.*, 268 A.3d 784, 792 (Del. Ch. 2022) (denying defendants’ motions to dismiss in part because the “stockholders were allegedly robbed of their right to make a fully informed decision about whether to redeem their shares”).

<sup>122</sup> 125 A.3d at 312.

Additionally, disclosures surrounding the de-SPAC are far less regulated than those made in connection with an IPO. Unlike in a traditional IPO, there is no “Quiet Period”—the SPAC is free to make future projections of the post-merger company.<sup>123</sup> Forward looking information includes financial projections of performance that might condition the market or entice investors to purchase shares.<sup>124</sup> These projections are practically prohibited in the IPO because they are often misleading and impossible to verify with any certainty.<sup>125</sup>

In light of the disparities in disclosure requirements, shareholder approval will not guarantee a cleansing vote.<sup>126</sup> If material information is withheld, the vote is not “fully informed.”<sup>127</sup> Information is material “if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote” or, in the SPAC context, in deciding whether to redeem.<sup>128</sup> In the two cases discussed below, the shareholders approved the transaction, only to discover that they may not have done so had they known key information. As a result, entire fairness applied.

## 2. *AP Services, LLP v. Lobell.*

In 2015, the New York Supreme Court first suggested that the business judgment rule is far from guaranteed when it comes to the de-SPAC.<sup>129</sup> In *AP Services, LLP v. Lobell*, the SPAC—“Paramount”—raised approximately \$53 million in its IPO, selling 9,775,000 units at \$6 per unit.<sup>130</sup> An additional

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<sup>123</sup>The “Quiet Period” is a term used to describe the period before a company files its registration statement with the SEC.

<sup>124</sup>*Plymouth Cnty. Ret. Ass’n v. Primo Water Corp.*, 966 F. Supp. 2d 525, 549–50 (M.D.N.C. 2013).

<sup>125</sup>Amanda Rose, *SPAC Mergers, IPOs, and the PSLRA’s Safe Harbor: Unpacking Claims of Regulatory Arbitrage*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 2, 2021), <https://corpgov.law.harvard.edu/2021/12/02/spac-mergers-ipos-and-the-pslras-safe-harbor-unpacking-claims-of-regulatory-arbitrage/>.

<sup>126</sup>See *Corwin*, 125 A.3d at 312.

<sup>127</sup>*In re MultiPlan Corp. S’holders Litig.*, 268 A.3d 784, 792 (Del. Ch. 2022) (“But those stockholders were allegedly robbed of their right to make a fully informed decision about whether to redeem their shares.”).

<sup>128</sup>*Morrison v. Berry*, 191 A.3d 268, 282 (Del. 2018) (quoting *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del. 1985)).

<sup>129</sup>*AP Servs., LLP v. Lobell*, No. 651613/12, 2015 WL 3858818, at \*6 (N.Y. Sup. Ct. June 19, 2015).

<sup>130</sup>*Id.* at \*1; McDermott Will & Emery LLP, *SPAC Directors Cannot Take the Protection of the Business Judgment Rule for Granted*, 5 NAT’L L. REV., no. 295, Oct. 2015, at 1,



2,125,000 shares, approximately 20% of the SPAC's common stock, were reserved for and purchased as founder's shares at \$0.01176 per share (or \$25,000 total).<sup>131</sup> As a result, Paramount's promote, which was purchased for \$25,000, had a value of \$12,006,250.<sup>132</sup>

If Paramount failed to close by a drop-dead date, it would dissolve and distribute funds in liquidation to the public stockholders.<sup>133</sup> The defendants were not entitled to receive any of the funds held in trust upon liquidation.<sup>134</sup> In other words, if Paramount did not de-SPAC by the drop-dead date, the public stockholders get their money back, and the sponsors take nothing—rendering their promote worthless.<sup>135</sup>

After a proposed deal fell through, Paramount “began frantically searching for a new merger target,” signing more than twenty non-disclosure agreements with potential acquisition candidates.<sup>136</sup> Paramount representatives met with the target company—Chem Rx—and its intermediaries.<sup>137</sup> At the meeting, Chem Rx rejected the terms set forth in the term sheet and the intermediaries pulled out due to issues surrounding Chem Rx's management.<sup>138</sup> Paramount's management was “desperate for a deal and forged ahead, undeterred by the fact that those who had first suggested Chem Rx as a business partner of Paramount, had withdrawn due to ‘significant issues with Chem Rx and its management.’”<sup>139</sup>

Three days before its deadline to do so, Paramount entered into a letter of intent for a business combination with Chem Rx.<sup>140</sup> Paramount's board of directors met to vote on the proposed transaction for less than two hours before signing off and voting to recommend the deal to the public

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<https://www.natlawreview.com/article/spac-directors-cannot-take-protection-business-judgment-rule-granted>.

<sup>131</sup> *Lobell*, 2015 WL 3858818, at \*1; McDermott Will & Emery LLP, *supra* note 130, at 1.

<sup>132</sup> *Lobell*, 2015 WL 3858818, at \*1.

<sup>133</sup> *Id.*

<sup>134</sup> *Id.*

<sup>135</sup> *Id.*

<sup>136</sup> *Id.* at \*2 (quoting First Amended Complaint ¶ 37, *Lobell*, 2015 WL 3858818 (No. 651613/12)).

<sup>137</sup> *Id.*

<sup>138</sup> *Id.*

<sup>139</sup> *Id.* (quoting First Amended Complaint, *supra* note 136, ¶ 43).

<sup>140</sup> *Id.*

stockholders.<sup>141</sup> Five days before the drop-dead date, Paramount acquired Chem Rx for \$133 million, completing the de-SPAC merger.<sup>142</sup>

Plaintiff-stockholders pointed out that the \$133 million purchase price for Chem Rx was more than double the \$65 million implied valuation of the company reflected by its stock repurchase less than one year earlier.<sup>143</sup> Eighteen months after the combination, the now-public company announced that it was unable to file its annual report because it was in violation of certain financial covenants under its credit agreements.<sup>144</sup> The company admitted that the historical audited financial statements on which the de-SPAC was based were false.<sup>145</sup> With no way out, the company filed for bankruptcy leading to a distressed sale and Chapter 11 plan liquidation.<sup>146</sup>

According to plaintiff-stockholders, Paramount's management was self-interested in approving and recommending the transaction.<sup>147</sup> Specifically, it was argued, Paramount's management was motivated by the desire to avoid a liquidation rendering their \$13 million investment worthless.<sup>148</sup> The stockholders argued that, in Paramount's rush to avoid liquidation, the defendant-directors "closed their eyes" and "willfully ignored" several red flags that were evident from the face of the transaction documents themselves.<sup>149</sup> Had Paramount's directors conducted even a cursory due diligence, defendant-directors would have been alerted to the fact that the financial statements were both untrustworthy and incomplete, and that the transaction was not in the best interests of the SPAC.<sup>150</sup>

As would be expected, the defendants filed a motion to dismiss, arguing that the duty of loyalty was not implicated because they were protected by the favorable business judgment rule.<sup>151</sup> To their unpleasant surprise, the court cited the Court of Chancery, explaining:

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<sup>141</sup> *Id.*

<sup>142</sup> *Id.* at \*2–3.

<sup>143</sup> *Id.* at \*3.

<sup>144</sup> *Id.*; McDermott Will & Emery LLP, *supra* note 130, at 2.

<sup>145</sup> *Lobell*, 2015 WL 3858818, at \*3.

<sup>146</sup> *Id.*

<sup>147</sup> *Id.*

<sup>148</sup> *Id.* (quoting First Amended Complaint, *supra* note 136, ¶¶ 90–91).

<sup>149</sup> *Id.* (quoting First Amended Complaint, *supra* note 136, ¶¶ 48, 91–92).

<sup>150</sup> *Id.*

<sup>151</sup> *Id.* at \*4.

To rebut successfully business judgment presumptions in this manner, thereby leading to the application of the entire fairness standard, a plaintiff must normally plead facts demonstrating that a majority of the director defendants have a financial interest in the transaction or were dominated or controlled by a materially interested director.<sup>152</sup>

Notably, there was no claim that any of the SPAC directors appeared on both sides of the de-SPAC merger.<sup>153</sup> However, the plaintiff-stockholders could rely purely on the fact that the SPAC directors stood to make substantial profits on their personal investment if the de-SPAC closed, and that liquidation would have rendered their shares worthless.<sup>154</sup>

The plaintiff-stockholders' theory is not new—in fact, it is generally a losing argument.<sup>155</sup> Delaware courts recognize that stock ownership by decision-makers aligns with the interest of stockholders: maximizing price.<sup>156</sup> A mutual interest of maximizing price is not the type of “disabling conflict” Delaware courts are generally looking for.<sup>157</sup> But isn't this different? Here, defendants would not have been entitled to receive *any* of the net proceeds of the IPO.<sup>158</sup> The proxy statement itself stated that the directors “have interests in the Transaction that may be different from [the shareholders] because if the Transaction is not approved the securities held by them may become worthless.”<sup>159</sup>

The court determined that this nuance was sufficient to show that the SPAC directors had a financial interest—which was not aligned with the stockholders' interest—in entering into the de-SPAC with the target.<sup>160</sup> As such, the plaintiff-stockholders pled sufficient facts to rebut the presumption of the business judgment rule and shifted the burden to the defendants to

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<sup>152</sup> *Id.* (quoting *Orman v. Cullman*, 794 A.2d 5, 22 (Del. Ch. 2002)).

<sup>153</sup> *Id.* at \*5.

<sup>154</sup> *Id.*

<sup>155</sup> *See, e.g., In re BioClinica, Inc. S'holder Litig.*, No. 8272-VCG, 2013 WL 5631233, at \*5 (Del. Ch. Oct. 16, 2013) (explaining that the decision-makers' goal of maximizing price is not a conflict because it is generally an interest shared by the stockholders generally).

<sup>156</sup> *Id.*

<sup>157</sup> *Id.* (Delaware courts “have therefore routinely held that an interest in options vesting does not violate the duty of loyalty.”).

<sup>158</sup> *Lobell*, 2015 WL 3858818, at \*1.

<sup>159</sup> *Id.* at \*5.

<sup>160</sup> *Id.*

prove the entire fairness of the transaction to the trier of fact.<sup>161</sup> The court held that the plaintiff-stockholders pled a claim sufficient to survive the motion to dismiss,<sup>162</sup> and the parties settled a few months later.<sup>163</sup>

### 3. *In Re Multiplan Stockholder Litigation.*

In *Lobell*, the New York Supreme Court suggested that entire fairness applies to the de-SPAC transaction due to the conflicts implicated by founder's units.<sup>164</sup> However, in the several years since the decision, *Lobell* has not led to additional filings citing its holding.<sup>165</sup> In fact, some practitioners suggest the opposite is more likely: "Nor, in our view, should [*Lobell*] be viewed as an indication that courts will reflexively deny motions to dismiss complaints alleging fiduciary duty claims against SPAC directors."<sup>166</sup> However, an action commenced in March 2021 in the Delaware Court of Chancery signals that the effects of *Lobell* are alive and well.<sup>167</sup> In fact, this ongoing class-action bolsters the very conclusion reached in *Lobell*.<sup>168</sup>

In February 2020, Churchill Capital Corp. III ("Churchill"), a SPAC, closed its IPO of 110 million units—80% of the SPAC's float.<sup>169</sup> The units were sold at an offering price of \$10 per unit, generating a total of \$1.1 billion gross proceeds.<sup>170</sup> The other 20% was reserved by the sponsor and purchased for a nominal aggregate payment of \$25,000.<sup>171</sup> The closing price of Churchill's common stock was \$11.09, meaning the 20% reserved by the

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<sup>161</sup> *Id.* at \*6.

<sup>162</sup> *Id.* at \*12.

<sup>163</sup> Brian Herman, J. Warren Rissier & Charlene Shimada, *The Future of SPACs: Increasing Litigation and Regulation*, MORGAN LEWIS (Dec. 1, 2021), <https://www.morganlewis.com/pubs/2021/12/the-future-of-spacs-increasing-litigation-and-regulation>.

<sup>164</sup> See discussion *supra* Part III.C.2.

<sup>165</sup> VINSON & ELKINS, *SPACs & Entire Fairness: What Standard of Review Applies to the de-SPACing Transaction* (Dec. 11, 2020), <https://www.velaw.com/insights/spacs-entire-fairness-what-standard-of-review-applies-to-the-de-spacing-transaction/>.

<sup>166</sup> *Id.*

<sup>167</sup> *In re MultiPlan Corp. S'holders Litig.*, 268 A.3d 784, 819 (Del. Ch. 2022) (denying the director-defendants' motion to dismiss).

<sup>168</sup> See *id.*

<sup>169</sup> *Id.* at 794.

<sup>170</sup> *Id.* at 792.

<sup>171</sup> *Id.* at 794.

sponsor implied a market value of approximately \$305 million.<sup>172</sup> For clarity, the founder shares purchased for \$25,000 had a value of \$305 million within a matter of months—a 1,219,900% gain.<sup>173</sup>

Ahead of the de-SPAC merger, the board presented the acquisition candidate—MultiPlan—purporting to have conducted “extensive due diligence” on the target.<sup>174</sup> According to the proxy, this diligence gave Churchill management “knowledge of, and [familiarity] with, MultiPlan’s business, financial condition, [and] results of operations.”<sup>175</sup> Further, Churchill claimed it had communicated “with senior leaders of several large customers of MultiPlan to better understand the quality and nature of those relationships, as well as the competitive environment in which MultiPlan operates.”<sup>176</sup>

On its face, it appears that Churchill conducted fair and rigorous due diligence on the target MultiPlan.<sup>177</sup> It is easy to imagine the stockholder’s surprise when they learned that MultiPlan depended on one customer for 35% of its revenues—a customer that was in the process of abandoning MultiPlan to pursue its own competing platform.<sup>178</sup> This seems like information that would have come up when Churchill management communicated with “several large customers of MultiPlan.”<sup>179</sup> Additionally, Churchill management’s “knowledge of, and [familiarity] with . . . the recurring nature of MultiPlan’s revenues” overlooked the fact that the loss of this customer effectively cratered MultiPlan’s financial position, which of course caused the SPAC’s trading price to plummet.<sup>180</sup>

MultiPlan had experienced a downward trend in revenue over the three years prior to the de-SPAC merger.<sup>181</sup> Not to be discouraged, Churchill

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<sup>172</sup> *Id.* at 798.

<sup>173</sup> *Id.* at 810.

<sup>174</sup> *Id.* at 797; Churchill Cap. Corp. III, Definitive Proxy Statement (Schedule 14A), at 108 (Sept. 18, 2020).

<sup>175</sup> Churchill Cap. Corp. III, Definitive Proxy Statement (Schedule 14A), at 108 (Sept. 18, 2020).

<sup>176</sup> *Id.* at 104; *In re MultiPlan*, 268 A.3d at 803.

<sup>177</sup> *See In re Multiplan*, 268 A.3d at 797.

<sup>178</sup> *Id.* at 797, 803.

<sup>179</sup> *See id.* at 797.

<sup>180</sup> *See id.* at 799; Churchill Cap. Corp. III, Definitive Proxy Statement (Schedule 14A), at 108 (Sept. 18, 2020).

<sup>181</sup> Verified Class Action Complaint at ¶ 71, *Franchi v. MultiPlan Corp.*, No. 2021-0300-MTZ, 2021 WL 1402170 (Apr. 9, 2021).

presented its own financial projections to support the board's recommendation of the business combination.<sup>182</sup> These projections showed sudden growth in revenue moving forward.<sup>183</sup> This inexplicable growth was accompanied by Churchill's affirmations that the projections were reasonable in light of their "extensive due diligence."<sup>184</sup> Noticeably absent from these disclosures was an independent third-party valuation or fairness opinion to objectively confirm these assurances.<sup>185</sup>

Thirty-five days after the deal closed, an independent research firm published a report exposing MultiPlan as a rapidly deteriorating business and pointed out a number of facts that were either omitted or disguised in the proxy.<sup>186</sup> Such information included the identity and loss of MultiPlan's largest client, the fact that this client was forming a competitor, and that—even with this customer—MultiPlan's revenue was in decline.<sup>187</sup> The very next day, the post-de-SPAC company's stock fell to a closing low of \$6.27 per share—37.3% below the IPO price of \$10 per share.<sup>188</sup> This falling stock price meant catastrophic losses for investors, while the sponsor stood to realize hundreds of millions of dollars for its initial \$25,000 contribution.<sup>189</sup>

The plaintiffs brought direct claims for breach of fiduciary duty against certain Churchill directors, offers, and its controlling stockholder.<sup>190</sup> The defendants moved to dismiss the complaint under Court of Chancery Rule 12(b)(6) for failure to state a claim upon which relief can be granted.<sup>191</sup> For our purposes, it is important to note that the standard underlying this motion to dismiss provides that "dismissal is inappropriate unless the 'plaintiff would not be entitled to recover under *any reasonably conceivable* set of

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<sup>182</sup> *In re MultiPlan*, 268 A.3d at 798 ("The financial analysis 'primarily relied upon' by Churchill and included in the Proxy was prepared by Churchill management with assistance from The Klein Group"—a wholly owned subsidiary of one of the defendant directors.).

<sup>183</sup> *Id.* at 797 ("The Proxy listed the 'attractive valuation' and 'opportunities for growth in revenues, adjusted EBITDA and free cash flow' as reasons that the Board was recommending the merger.").

<sup>184</sup> Verified Class Action Complaint, *supra* note 181, at ¶¶ 69, 72.

<sup>185</sup> *In re MultiPlan*, 268 A.3d at 798.

<sup>186</sup> *Id.*; MUDDY WATERS RESEARCH, *supra* note 1.

<sup>187</sup> MUDDY WATERS RESEARCH, *supra* note 1, at 2, 3.

<sup>188</sup> *In re MultiPlan*, 268 A.3d at 798.

<sup>189</sup> *See id.* at 794.

<sup>190</sup> *Id.* at 798–99.

<sup>191</sup> *Id.* at 799.

circumstances susceptible of proof.”<sup>192</sup> The plaintiffs’ well-pleaded factual allegations were accepted as true, and all reasonable inferences drawn in their favor.<sup>193</sup> Thus, the plaintiffs will have to prove these facts to be true at a later stage in the litigation.<sup>194</sup> For now, we can infer from the court’s response to the motion to dismiss how it might rule based on the facts pled.<sup>195</sup>

On January 3, 2022, the Delaware Court of Chancery denied the defendants’ motion to dismiss, holding that entire fairness applied under the facts pled.<sup>196</sup> The court determined that the potential conflict between the defendants and public stockholders was sufficient to pass the “reasonably conceivable” threshold under Rule 12(b)(6).<sup>197</sup> Vice Chancellor Will critically notes that “the plaintiffs’ claims are viable not simply because of the nature of the transaction,” but because “the Complaint allege[d] that the director defendants failed, disloyally, to disclose information necessary for the plaintiffs to knowledgeably exercise their redemption rights.”<sup>198</sup> For purposes of the defendants’ motion to dismiss, the allegations “sufficiently [gave] rise to a lack of overall fairness.”<sup>199</sup>

#### IV. THE DELAWARE “BESPOKE” SPAC

*MultiPlan* may appear to doom SPACs to entire fairness scrutiny, but SPAC participants should be optimistic given some language found in the order.<sup>200</sup> “If public stockholders, *in possession of all material information*

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<sup>192</sup> *Id.* (emphasis added) (quoting *Savor, Inc. v. FMR Corp.*, 812 A.2d 894, 896–97 (Del. 2002)).

<sup>193</sup> *See id.*

<sup>194</sup> *See id.*

<sup>195</sup> *Compare id.* at 816–17 (“But for purposes of the motion to dismiss, the alleged disclosure violations sufficiently give rise to a lack of overall fairness.”), *with id.* at 812 (“The defendants’ argument might be persuasive if it had been made about the Proxy and the plaintiffs had opted not to redeem despite adequate disclosures—but that is not the universe alleged in the Complaint.”).

<sup>196</sup> *See id.* at 812, 819.

<sup>197</sup> *Id.* at 812. That said, “the actual extent of these relationships is not altogether clear at this point in the litigation, the existence of these interests and relationships is enough to defeat a motion to dismiss.” *Id.* at 815 (quoting *In re New Valley Corp. Derivative Litig.*, No. CIV.A. 17649, 2001 WL 50212, at \*8 (Del. Ch. Jan. 11, 2001)).

<sup>198</sup> *In re MultiPlan*, 268 A.3d at 816.

<sup>199</sup> *Id.* at 817.

<sup>200</sup> Only days after the *MultiPlan* decision, defendants in another case distinguished the facts from *MultiPlan* as a basis for their argument to dismiss. *See* Defendants’ Opening Brief in Support of Their Motion to Dismiss Verified Class Action Complaint at ¶ 5, *Laidlaw v. Gigacquisitions2, LLC*, No. 2021-0821-PAF, 2022 WL 141478 (Del. Ch. Jan 10, 2022) (“[T]his case is

about the target, had chosen to invest rather than redeem, one can imagine a different outcome.”<sup>201</sup> Although, “[m]any of the features that [were considered] are common to SPACs . . . some entities have more *bespoke* structures intended to address conflicts.”<sup>202</sup> It is the ultimate purpose of this Article to define a “bespoke” SPAC structure and how it may avail participants of the business judgment rule. While the *MultiPlan* order could be seen as a step backwards for the SPAC, Vice Chancellor Will went to great lengths to settle such concerns.<sup>203</sup> In fact, SPAC hopefuls should be grateful that the ticking time-bomb looming over SPAC treatment has finally been diffused.

Constrained to the facts of the *MultiPlan* litigation, Vice Chancellor Will could not itemize the ingredients for the perfect SPAC for us, but we were gifted the next best thing: What *not* to do. By combining this guidance with well-established fiduciary principles and other SPAC commentary, we stitch together the bespoke SPAC. The ingredients of this structure include adequate disclosures, director independence, protective and exculpation provisions, and proper timing.

#### A. *Comprehensive, Objective, and Particularized Disclosures.*

Just like you would not bake cookies without flour, adequate disclosures remain a critical ingredient for the seamless SPAC. Disclosures are adequate when they are comprehensive, objective, and particularized. The *MultiPlan* conclusion “does not address the validity of a hypothetical claim where the disclosure is adequate and the allegations rest solely on the premise that fiduciaries were necessarily interested given the SPAC’s structure.”<sup>204</sup> Thus, when disclosures are adequate, a plaintiff’s claim will rest solely on the

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distinguishable in important respects from the circumstances presented in Vice Chancellor Will’s recent decision in *In re MultiPlan Corp. Stockholders Litigation.*”).

<sup>201</sup> *In re MultiPlan*, 268 A.3d at 816 (emphasis added).

<sup>202</sup> *Id.* at 792 (emphasis added).

<sup>203</sup> *Id.* at 816 (“Critically, I note that the plaintiffs’ claims are viable *not simply because of the nature of the transaction* or resulting conflicts. They are reasonably conceivable because the Complaint alleges that the director defendants failed, disloyally, to disclose information necessary for the plaintiffs to knowledgeably exercise their redemption rights. *This conclusion does not address the validity of a hypothetical claim where the disclosure is adequate and the allegations rest solely on the premise that fiduciaries were necessarily interested given the SPAC’s structure.*”) (emphasis added).

<sup>204</sup> *Id.*



premise that fiduciaries were interested, leaving the claim inadequate to invoke entire fairness.<sup>205</sup>

### 1. Comprehensive Disclosures.

We learn from *MultiPlan* that “[i]f public stockholders, in possession of all material information about the target, [choose] to invest rather than redeem,” it will be very difficult for a stockholder to claim that their redemption rights were impaired.<sup>206</sup> The court, without expressly stating, implied that comprehensive disclosures will cleanse an otherwise conflicted transaction, much like a *Corwin* vote in the traditional merger context.<sup>207</sup> After all, “well-worn fiduciary principles” can be applicable in the SPAC context, “despite the novel issues presented.”<sup>208</sup> The *Corwin* vote is a fabric cut from the same cloth as other well-worn fiduciary principles applied in *MultiPlan*. All that is left for the SPAC to determine is what constitutes “material information about the target,” and disclose it.

Luckily, as with most questions in the SPAC space, the traditional merger context tells us what “material information about the target” is. Information is material “if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote,” or, in the SPAC context, in deciding whether to redeem.<sup>209</sup> A comprehensive disclosure will ensure that public shareholders were “fully informed,” and their vote becomes sufficient to effectuate a cleansing result.<sup>210</sup> It is difficult to imagine a hypothetical scenario where defendants are able to point to a comprehensive proxy statement, and a shareholder’s claim survives.

In *MultiPlan*, the most egregious failure was Churchill’s failure to disclose that Multiplan’s largest customer was leaving the company and developing its own competing alternative.<sup>211</sup> Conceivably, many public shareholders would have redeemed their shares had they known the company they would be investing in was about to lose its largest client and source of 35% of its revenues. It is not clear whether the sponsor had actual knowledge of this fact, but we know that the client had publicly discussed its plans by

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<sup>205</sup> *See id.*

<sup>206</sup> *See id.*

<sup>207</sup> *See id.*

<sup>208</sup> *Id.* at 792.

<sup>209</sup> *Id.* at 816 (quoting *Morrison v. Berry*, 191 A.3d 268, 282 (Del. 2018)).

<sup>210</sup> *See id.* at 804.

<sup>211</sup> *See id.* at 816.

June 2020—predating the plan of merger.<sup>212</sup> The directors either knew and failed to disclose or didn't know and failed in performing adequate due diligence.<sup>213</sup> The shareholders, however, could not have known, because the identity of this key client was never disclosed to them.<sup>214</sup> To make matters worse, the proxy boasted of the SPAC's communication "with senior leaders of several larger customers of MultiPlan to better understand the quality and nature of those relationships, as well as the competitive environment in which MultiPlan operates."<sup>215</sup> To that end, SPAC management oversold its diligence and underdelivered its disclosures.

Multiplan's misstep highlights that vigorous due diligence is a necessary component of comprehensive disclosures. Any stone left unturned in preparation of the proxy statement will inevitably uncover itself in discovery. Renowned corporate law firm, Paul Weiss, offers the following counsel:

Shareholder complaints in SPAC litigation frequently allege that SPAC sponsors, directors and officers selected a poor de-SPAC target and/or failed to conduct adequate due diligence and uncover supposed red flags in a de-SPAC target. While experiences can vary from one situation to another, these types of allegations could be addressed by ensuring that diligence findings are appropriately documented and communicated to the board of directors. Disclosure of diligence efforts should generally conform to standard M&A disclosure practices.<sup>216</sup>

Notably, this guidance adds that diligence findings are appropriately documented, which will undoubtedly come in handy for potential SPAC defendants.<sup>217</sup>

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<sup>212</sup> *Id.* at 797–98 (“UHC had publicly discussed its plan for Naviguard by June 2020.”).

<sup>213</sup> *See id.* at 797.

<sup>214</sup> *Id.* (The proxy “did not disclose that the customer was UnitedHealth Group Inc. (“UHC”) or that UHC intended to create an in-house data analytics platform called Naviguard.”).

<sup>215</sup> Churchill Cap. Corp. III, Definitive Proxy Statement (Schedule 14A), at 104 (Sept. 18, 2020).

<sup>216</sup> *What SPAC Sponsors, Directors and Officers Can Do to Mitigate Their Litigation Exposure*, PAUL WEISS (Mar. 17, 2021), <https://www.paulweiss.com/practices/litigation/securities-litigation/publications/what-spac-sponsors-directors-and-officers-can-do-to-mitigate-their-litigation-exposure?id=39540>.

<sup>217</sup> *See id.*

After turning over every stone, documenting such findings, and providing comprehensive disclosures, plaintiffs' claims rest solely on the premise that fiduciaries were interested, leaving the claim inadequate to invoke entire fairness.<sup>218</sup> As a result, the business judgment rule will apply to protect any de-SPAC merger that "was rational in the sense of being one logical approach to advancing the corporation's objectives."<sup>219</sup> After all, "[o]nly when a decision lacks any rationally conceivable basis will a court infer bad faith and a breach of duty."<sup>220</sup>

## 2. Objective Disclosures.

In *MultiPlan*, the disclosures were compared to those in the context of a tender offer and described as "unilateral and not counterbalanced by opposing points of view."<sup>221</sup> The *MultiPlan* proxy "was not accompanied by an independent third-party valuation or fairness opinion."<sup>222</sup> Increasing the elevation on this already uphill battle, the financial analysis included in the proxy was prepared by the SPAC's management with assistance from The Klein Group—a wholly owned subsidiary of the controlling stockholder.<sup>223</sup> Of course, SPAC directors may participate in the preparation of information without triggering suspicion.<sup>224</sup> But when the time comes for directors to prove their objectivity, assistance from an independent and uninterested authority will carry some weight.<sup>225</sup>

### *a. Financial Advisors and Fairness Opinions.*

The Supreme Court of Delaware all but requires a fairness opinion as evidence of good faith diligence.<sup>226</sup> "We do not imply that an outside

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<sup>218</sup> See *In re MultiPlan*, 268 A.3d at 816.

<sup>219</sup> *In re Dollar Thrifty S'holder Litig.*, 14 A.3d 573, 598 (Del. Ch. 2010).

<sup>220</sup> *In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 43 (Del. Ch. 2013).

<sup>221</sup> *In re Multiplan*, 268 A.3d at 816 (quoting *Eisenberg v. Chi. Milwaukee Corp.*, 537 A.2d 1051, 1057 (Del. Ch. 1987)).

<sup>222</sup> *Id.* at 798.

<sup>223</sup> *Id.* at 796 (citing Churchill Cap. Corp. III, Definitive Proxy Statement (Schedule 14A), at 113–15 (Sep. 18, 2020)).

<sup>224</sup> *Smith v. Van Gorkom*, 488 A.2d 858, 876 (Del. 1985), *overruled by* *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009) (explaining that, "under appropriate circumstances, such directors may be fully protected in relying in good faith upon the valuation reports of their management").

<sup>225</sup> See *id.*

<sup>226</sup> See *id.*

valuation study is essential to support an informed business judgment; nor do we state that fairness opinions by independent investment bankers are required as a matter of law.”<sup>227</sup> However, that does not “end the matter.”<sup>228</sup> “Unless the directors had before them adequate information regarding the intrinsic value of the Company, upon which a proper exercise of business judgment could be made, mere advice [from the board] is meaningless . . . .”<sup>229</sup> In other words, Delaware law does not require a fairness opinion, but if the board does not get it right, absence of such requirement will constitute “no defense” for directors.<sup>230</sup>

With respect to fairness opinions, *MultiPlan* illustrates the point.<sup>231</sup> In fact, not only was there “no defense” for the directors, but the purported financial advisor was named as a defendant in the litigation for aiding and abetting breaches of fiduciary duty.<sup>232</sup> The same day the board approved the merger, the *MultiPlan* SPAC retained The Klein Group as a financial advisor, offering \$30.5 million as payment for such services.<sup>233</sup> The Klein Group is a wholly owned subsidiary of the SPAC’s controlling stockholder.<sup>234</sup> As a result, the controlling stockholder’s knowledge was imputed onto the financial advisor at the pleading stage.<sup>235</sup> Retention of The Klein Group as a financial advisor was not only an ineffective defense, but it actually *bolstered* the conclusion that the de-SPAC merger was a conflicted transaction.<sup>236</sup>

The *MultiPlan* defendants argued that knowing participation in any breach could not be established, because there were no allegations that The Klein Group actively concealed information or promoted any failure to disclose.<sup>237</sup> To this argument, the Court of Chancery quickly replied: “But unlike the precedent the defendants rely on, The Klein Group was not an

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<sup>227</sup> *Id.*

<sup>228</sup> *Id.* at 881.

<sup>229</sup> *Id.*

<sup>230</sup> *See id.*

<sup>231</sup> *In re MultiPlan Corp. S’holders Litig.*, 268 A.3d 784, 818 (Del. Ch. 2022).

<sup>232</sup> *Id.* at 796, 818.

<sup>233</sup> *Id.* at 796.

<sup>234</sup> *Id.*

<sup>235</sup> *Id.* at 818.

<sup>236</sup> *Id.* at 812 (“The allegation that Klein caused Churchill to retain The Klein Group as its financial advisor in connection with the merger and related financing for a \$30.5 million payment bolsters that conclusion. Entire fairness is therefore the applicable standard of review.”).

<sup>237</sup> *Id.* at 818 (defendants citing *Houseman v. Sagerman*, No. CIV.A. 8897-VCG, 2014 WL 1600724, at \*9 (Del. Ch. Apr. 16, 2014)).

independent third-party advisor.”<sup>238</sup> The motion to dismiss with regard to the aiding and abetting claim was therefore denied.<sup>239</sup>

No—Delaware law does not *require* independent third-party fairness opinions.<sup>240</sup> But when push comes to shove, it will always lend a helping hand.<sup>241</sup> Further, if the SPAC does seek a third-party fairness opinion, such third party ought to be independent from SPAC directors.<sup>242</sup> Otherwise, a conflicted advisor might just find itself a party to the litigation, bolstering the claims brought against directors.<sup>243</sup> An independent third-party fairness opinion provides directors with an objective source of good faith and fair dealing.

*b. Opposing Views.*

Similar to fairness opinions, Delaware law does not require that these SPAC directors present stockholders with opposing viewpoints on the target company. However, also similar to fairness opinions, opposing viewpoints will balance a proxy statement otherwise riddled with lofty projections of optimistic performance. In fact, disclosures that are “unilateral and not counterbalanced by opposing points of view”<sup>244</sup> will place “an even more exacting duty to disclose upon fiduciaries in possession of the information.”<sup>245</sup>

For example, in *MultiPlan*, the proxy failed to disclose that the target’s largest client was developing a competitive alternative to the target’s business that would eliminate its need for the target.<sup>246</sup> Obviously, this made the target less attractive. Conceivably, a large portion of the public stockholders would hold that fact against the de-SPAC when the time came to approve the

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<sup>238</sup> *Id.*

<sup>239</sup> *Id.*

<sup>240</sup> *Smith v. Van Gorkom*, 488 A.2d 858, 876 (Del. 1985), *overruled by* *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009).

<sup>241</sup> *See id.* at 876, 881 (explaining that, although there is no fairness-opinion requirement, the lack thereof constitutes no defense).

<sup>242</sup> *See In re MultiPlan*, 268 A.3d at 818 (explaining that, because the third-party advisor was not independent, the controlling stockholder’s knowledge was imputed onto it).

<sup>243</sup> *See id.* at 812.

<sup>244</sup> *Eisenberg v. Chi. Milwaukee Corp.*, 537 A.2d 1051, 1057, 1059 (Del. Ch. 1987) (adding later that “[s]hareholders are entitled to be informed of information in the fiduciaries’ possession that is material to the fairness of the price”).

<sup>245</sup> *In re MultiPlan*, 268 A.3d at 816.

<sup>246</sup> *Id.*

merger, and, more importantly, to decide whether to redeem their shares.<sup>247</sup> Nevertheless, it is in the best interest of SPAC directors to disclose these unfavorable facts, risking redemption, than for a research firm to air the target's dirty laundry in a published report within weeks of the merger.<sup>248</sup>

*c. Special Independent Committee.*

Similar to the *Corwin* cleansing vote, the approval of a special independent committee can cleanse an otherwise conflicted transaction.<sup>249</sup> A SPAC may appoint one or more directors who do not own any founder shares—and are otherwise unaffiliated with the sponsor—to act as a special independent committee to approve the transaction. This mechanism could operate as a safety net in the event an informed stockholder vote fails.<sup>250</sup>

While sensible in theory, there are two considerations to keep in mind: (1) a selling point for the SPAC structure is that stockholders purchase their shares with an understanding that the sponsor has some expertise that will lead them to an attractive target—expertise that is lost with the imposition of an independent committee (remember, the stockholders are betting on the jockey, not the horse); and (2) expert sponsors use the SPAC structure because it gives them unfettered discretion to pursue and present a suitable target to stockholders—discretion that is no longer “unfettered” in the presence of an independent committee.<sup>251</sup> Each of these concerns, however, is addressable. Stockholders may be willing to bet on *another* jockey—the independent committee—to work hand-in-hand with interested directors to approve a suitable target. After all, the committee won't decide on a target until the directors submit it for consideration. If parties are willing to cooperate, this could provide a simple and effective solution to conflicted transactions.<sup>252</sup>

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<sup>247</sup> *Id.* (“[I]t is reasonably conceivable that a Class A stockholder would have been substantially likely to find this information important when deciding whether to redeem her Churchill shares.”).

<sup>248</sup> *See id.* at 798 (“On November 11, 2020, an equity research firm published a report about MultiPlan discussing, among other things, UHC’s formation of Naviguard.”).

<sup>249</sup> *In re Trados Inc. S’holder Litig.*, 73 A.3d 17, 36 (Del. Ch. 2013). (“The standard of review may change further depending on whether the directors took steps to address the potential or actual conflict, such as by creating an independent committee, conditioning the transaction on approval by disinterested stockholders, or both.”).

<sup>250</sup> *See id.*

<sup>251</sup> *See Manichaeon Cap., LLC v. SourceHOV Holdings, Inc.*, No. 2017-0673-JRS, 2020 WL 496606, at \*8 (Del. Ch. Jan. 30, 2020).

<sup>252</sup> *See In re Trados*, 73 A.3d at \*36.

If an independent committee is created, the SPAC must be cognizant of who occupies a seat at the table. In other words, it must be a truly *independent* committee. “[B]eing nominated or elected by a director who controls the outcome is insufficient by itself to reasonably doubt a director’s independence because ‘that is the usual way a person becomes a corporate director.’”<sup>253</sup> However, when the appointed directors are beholden to the interested appointee, the independence of those directors becomes suspect. “A director may be considered beholden to . . . another when the allegedly controlling entity has the unilateral power . . . to decide whether the challenged director continues to receive a benefit . . . .”<sup>254</sup>

Such was the case in the *MultiPlan* motion to dismiss. There, the plaintiffs alleged that five of the SPAC’s directors were beholden to the controlling stockholder “because he had appointed them to serve as directors of other . . . SPACs, providing them founders shares with the potential for more ‘multi-million-dollar payday[s].’”<sup>255</sup> Additionally, one of those directors was the controlling stockholder’s brother.<sup>256</sup> It was in these directors’ best interests to keep the controlling stockholder happy.<sup>257</sup> These directors did not claim to constitute an “independent committee,” but these are the same facts that would be used to determine whether a committee was truly independent. Thus, an independent committee is best made up of disinterested directors, who are unaffiliated with any other entity of the interested director(s).<sup>258</sup>

### 3. Particularized Disclosures.

Since the “SPAC Boom,” the SEC has closely monitored SPAC activity, both in the SPAC IPO stage and in the business combination de-SPAC merger.<sup>259</sup> While the SEC primarily concerns itself with the purchase and sale of securities, the de-SPAC merger has uniquely commanded its attention. Cases like *MultiPlan* generally focus on “bad facts”; however, the SEC has

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<sup>253</sup> *McElrath v. Kalanick*, 224 A.3d 982, 995 (Del. 2020) (quoting *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1984), *overruled by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000)).

<sup>254</sup> *Orman v. Cullman*, 794 A.2d 5, 25 n.50 (Del. Ch. 2002).

<sup>255</sup> *In re MultiPlan*, 268 A.3d at 814 (alteration in original).

<sup>256</sup> *Id.*

<sup>257</sup> *See id.* at 814–15.

<sup>258</sup> *See id.*

<sup>259</sup> *Special Purpose Acquisition Companies*, SEC. AND EXCH. COMM’N (Dec. 22, 2020), <https://www.sec.gov/corpfin/disclosure-special-purpose-acquisition-companies>.

issued particularized guidance—or “good facts”—for SPAC directors to consider in the de-SPAC merger.<sup>260</sup>

The SEC poses the following questions directors should ask themselves with regard to disclosures:

Do you disclose clearly any additional financing necessary to complete the business combination transaction and how the terms of such financing may impact public shareholders? If the terms of additional financing involve the issuance of securities, have you described how the price and terms of those securities compare to and differ from the price and terms of the securities sold in the IPO? Are sponsors, directors, officers, or affiliates participating in additional financing?<sup>261</sup>

These questions que us into a few additional issues. For example, as discussed, financing the de-SPAC includes much more than the IPO. An overwhelming majority of the purchase price is composed of PIPE financing. Was that disclosed to the public investors? Additionally, if enough shareholders redeem their shares ahead of the de-SPAC, are the remaining shareholders aware that even more PIPE financing may be necessary to complete the transaction? Particularized disclosures surrounding all aspect of the de-SPAC ensure safety under the business judgment rule.

These considerations were put to the test in *In re SmileDirectClub, Inc. Derivative Litigation*.<sup>262</sup> In *SmileDirectClub*, “the Court of Chancery held that because a prospectus disclosed specific insider transactions that would dilute public stockholder post-IPO, the plaintiff was barred from suing ‘by reason of its knowledge of the alleged wrong when it purchased the stock.’”<sup>263</sup> Notably, this estoppel argument was distinguished in *MultiPlan*, because, while the public stockholders agreed to trust the sponsor to identify a target, the stockholders did *not* agree that they would not require all material information when the time came to make their vote.<sup>264</sup>

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<sup>260</sup> *Id.*

<sup>261</sup> *Id.*

<sup>262</sup> No. 2019-0940-MTZ, 2021 WL 2182827, at \*12 (Del. Ch. May 28, 2021) (quoting 7547 Partners v. Beck, No. 13252, 1995 WL 106490, at \*3 (Del. Ch. Feb 24, 1995)).

<sup>263</sup> *In re MultiPlan*, 268 A.3d at 812 (quoting *In re SmileDirectClub, Inc. Derivative Litig.*, No. 2019-0940-MTZ, 2021 WL 2182827, at \*12 (Del. Ch. May 28, 2021)).

<sup>264</sup> *Id.*



2022]

## DEFENDING THE DE-SPAC MERGER

523

The SEC similarly advises that adequate disclosures are made concerning how the target was identified:

Have you provided detailed information about how you evaluated and decided to propose the identified transaction? Have you explained how and why you selected the target company? Who initiated contact? Why did you select this target over other alternative candidates? Have you explained the material terms of the transaction? How did you determine the nature and amount of consideration the SPAC will pay to acquire the private operating company? Have you clearly described the negotiations regarding the nature and amount of consideration?<sup>265</sup>

These disclosures provide context to the de-SPAC and allow public shareholders to peak behind the curtain of the merger. Many of these considerations would settle concerns shareholders might have with potential relationships between directors and the target company.

Finally, the SEC encourages comprehensive disclosures regarding SPAC management and any potential conflicts of interest that may be at issue:

Have you clearly described any conflicts of interest of the sponsors, directors, officers and their affiliates in presenting this opportunity to the SPAC and how the SPAC addressed these conflicts of interest? If the SPAC had a policy to address conflicts of interest and waived any provisions of that policy, have you disclosed the waiver and the reasons therefor? Have you described any interest the sponsors, directors, officers or their affiliates have in the target operating company, including, if material, the approximate dollar value of the interest, when the interest was acquired and the price paid?<sup>266</sup>

When disclosed, this information allows a stockholder to choose for themselves whether they are willing to assume the risk of a conflicted transaction. This assumption of the risk allows directors to employ an estoppel argument, similar to that which we saw in *SmileDirectClub*, barring plaintiffs from using these facts against them “by reason of [their] knowledge

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<sup>265</sup> SEC. AND EXCH. COMM’N, *supra* note 259.

<sup>266</sup> *Id.*

of the alleged wrong when [they] purchased the stock,” or—in the SPAC context—when they chose not to redeem their shares.<sup>267</sup>

Similar estoppel arguments to *SmileDirectClub* may appear as disclosures are specific and particularized as the SEC suggests. This standard joins the rank and file of other well-worn fiduciary principles that may be applied in the SPAC context.<sup>268</sup>

### *B. Maximizing Director Independence.*

One reason the business judgment rule was rebutted in *MultiPlan* was because the “complaint ‘allege[d] facts supporting a reasonable inference that there were not enough sufficiently informed, disinterested individuals who acted in good faith when taking the challenged actions to comprise a board majority.’”<sup>269</sup> Similar to the discussion concerning an independent committee above, it is in the best interest of SPAC directors to ensure an unaffiliated, disinterested board composition.<sup>270</sup> “A director ‘subject to the interested party’s dominion or beholden to that interested party’ lacks independence.”<sup>271</sup> Thus, to avoid entire fairness review, a prudent board will diversify its composition.<sup>272</sup>

For clarity, Delaware courts have instructed us on when a director is beholden to the controller:

A director may be considered beholden to (and thus controlled by) another when the allegedly controlling entity has the unilateral power (whether direct or indirect through control over other decision makers), to decide whether the challenged director continues to receive a benefit, financial or otherwise, upon which the challenged director is so dependent or is of such subjective material importance to him that the threatened loss of that benefit might create a reason to question whether the controlled director is able to

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<sup>267</sup> *In re SmileDirectClub*, No. 2019-0940-MTZ, 2021 WL 2182827, at \*12 (quoting *7547 Partners v. Beck*, No. 13252, 1995 WL 106490, at \*3 (Del. Ch. Feb 24, 1995)).

<sup>268</sup> *In re MultiPlan*, 268 A.3d at 792.

<sup>269</sup> *Id.* at 809.

<sup>270</sup> *See supra* IV.A.ii.0.

<sup>271</sup> *In re MultiPlan*, 268 A.3d at 814 (citing *In re BGC Partners, Inc.*, No. 2018-0722-AGB, 2019 WL 4745121, at \*6 (Del. Ch. Sept. 30, 2019)).

<sup>272</sup> *See id.*

consider the corporate merits of the challenged transaction objectively.<sup>273</sup>

In *MultiPlan*, the controlling stockholder appointed each of the directors to the board, with unilateral authority to remove them.<sup>274</sup> As discussed, five of these directors were also appointed to serve as directors of other SPACs, and one of these directors was the controlling stockholder's brother.<sup>275</sup> In *Beam v. Stewart*, the Court of Chancery found that a director has a "material interest in her own continued employment" and that the controller's ability to impact that employment can raise doubts about an appointed director's independence.<sup>276</sup>

However, the fact that a director has served in other related SPACs is not automatically damning. In *Zimmerman v. Crothall*, extensive shared work experience was insufficient to show a lack of independence.<sup>277</sup> Similarly in *Crescent/Mach I Partners v. Turner*, a "long-standing 15-year professional and personal relationship" between the director and CEO of the company were insufficient to show control.<sup>278</sup> The CEO in *Turner*, for example, could not retroactively effect the director's fifteen-year professional career.<sup>279</sup> In contrast, the controller in *MultiPlan* held in his hand "more 'multi-million-dollar payday[s],' " revocable at the drop of a hat.<sup>280</sup>

While less than ideal for SPAC directors, it is likely in their best interest to avoid appointing friends, family, and affiliates to join them on the board of directors. This does not mean every board must be made up of complete strangers. But when a director is "subject to the interested party's dominion or beholden to that interest party," such director lacks independence.<sup>281</sup>

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<sup>273</sup> *Orman v. Cullman*, 794 A.2d 5, 25 n.50 (Del. Ch. 2002).

<sup>274</sup> *In re MultiPlan*, 268 A.3d at 814.

<sup>275</sup> *Id.*; see also *supra* IV.A.ii.0. As far as the familial relationship goes, see *Marchand v. Barnhill*, 212 A.3d 805, 818 (Del. 2019) ("When it comes to life's more intimate relationships concerning friendship and family, our law cannot 'ignore the social nature of humans' or that they are motivated by things other than money, such as 'love, friendship, and collegiality.'" (quoting *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 938 (Del. Ch. 2003))).

<sup>276</sup> 833 A.2d 961, 977–78 (Del. Ch. 2003).

<sup>277</sup> No. 6001–VCP, 2012 WL 707238, at \*13 (Del. Ch. Mar. 27, 2012).

<sup>278</sup> 846 A.2d. 963, 980–81 (Del. Ch. 2000).

<sup>279</sup> See *id.*

<sup>280</sup> *In re MultiPlan*, 268 A.3d at 814 (alteration in original).

<sup>281</sup> *Id.* (citing *In re BGC Partners, Inc.*, No. 2018-0722-AGB, 2019 WL 4745121, at \*6 (Del. Ch. Sept. 30, 2019)).

### C. Protective Provisions.

Common to most financing agreements, protective provisions may be included as an incentive for performance and to stabilize the stock price. In the SPAC context, funds may provide for a “lock-up” provision or that certain sponsor shares will un-vest, requiring certain conditions before they re-vest.<sup>282</sup> These provisions will put a restriction on directors so that they are disincentivized from consummating a value-decreasing de-SPAC merger and immediately dumping their shares. Additionally, with a percentage of shares subject to vesting conditions, directors are incentivized to improve company performance post-merger.<sup>283</sup>

A lock-up provision prevents shareholders from selling their shares for a specified period of time—generally between six and thirty-six months.<sup>284</sup> With this restriction, shareholders are stuck with “bad shares” that are declining in value. This is particularly useful in the SPAC context, because the sponsor now has an incentive to identify a target that will have positive performance over the long term, rather than a target with fleeting value. This restriction, however, can be illusory. The shares were purchased for pennies on the dollar in the first place; therefore, waiting to liquidate at a lower price—while not ideal—may still lead to significant gains.

Vesting conditions are another way to promote performance. These provisions will impose conditions on company performance—or “milestones”—before they “vest,” meaning the shares are not actually held until the condition is satisfied.<sup>285</sup> The milestone is generally some metric of financial performance.<sup>286</sup> For example, the shares will vest once and if the company’s share price reaches \$X/per share. Because the sponsor will often hold a significant stake in the public company, they now have more incentive to improve value and satisfy these conditions.<sup>287</sup>

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<sup>282</sup> See, e.g., *In re MultiPlan*, 268 A.3d at 796–97.

<sup>283</sup> Notably, these protections, however, can only do so much. Even with a lock-up and vesting conditions, the sponsor can still see significant gains in a value-decreasing transaction.

<sup>284</sup> See Tim Castelli, *Not Guilty By Association: Why the Taint of Their “Blank Check” Predecessors Should Not Stunt the Growth of Modern Special Purpose Acquisition Companies*, 50 B.C.L. REV. 237, 255–56 (2009).

<sup>285</sup> See Shari A. Levitan et. al., *Realizing the Full Value of Hard to Value Assets*, 34 J. AM. ACAD. MATRIM. L. 133, 139 (2021).

<sup>286</sup> See *id.*

<sup>287</sup> This condition can likewise be deceiving—for similar reasons to the lock-up provision. Because only a certain percentage (40%, for example) are subject to vesting conditions, the sponsor

The *Lobell* court considered the potential for these provisions to save the SPAC from heightened fiduciary scrutiny:

[A]lthough defendants argue that the structure of the SPAC was such that the directors could not have approved the acquisition of Chem Rx without shareholder approval, they do not submit legal authority addressing the impact on directors' good faith decision-making of investor protections which may be adopted in connection with SPACs, including a requirement that a majority of IPO stockholders approve a business combination or that initial stockholders agree to a lock-up provision committing them to hold the stock for a fixed period.<sup>288</sup>

The court did not hear any argument concerning these provisions, but its note implies that they are of at least *some* significance.<sup>289</sup>

The *MultiPlan* SPAC provided both a lock-up provision and vesting conditions.<sup>290</sup> The sponsor's converted shares in the post-merger company were subject to an eighteen-month lock-up period.<sup>291</sup> Additionally, about 45% of the sponsor's share would unvest post-merger and re-vest if the public company's stock price exceeded \$12.50 for any forty trading days in a sixty-day period.<sup>292</sup>

While the lock-up and vesting conditions lower the value of a potential windfall for defendants, it is not guaranteed to negate a conflict—at least in the pleading stage.<sup>293</sup> As Vice Chancellor Will hypothesized, “[e]ven the vested 55% of those shares, if hypothetically valued at \$5 and discounted back 18 months at an aggressive 20% per year, are worth more than \$40 million.”<sup>294</sup>

We gather from *Lobell* and *MultiPlan* that protective provisions such as a lock-up or vesting conditions are not enough, standing alone, to save the

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still stands to recognize significant gains on the unhindered 60%, which was acquired for nominal consideration.

<sup>288</sup> AP Servs., LLP v. Lobell, No. 651613/12, 2015 WL 3858818, at \*1 n.1 (N.Y. Sup. Ct. June 19, 2015).

<sup>289</sup> *See id.*

<sup>290</sup> *In re MultiPlan Corp. S'holders Litig.*, 268 A.3d 784, 796–97 (Del. Ch. 2022).

<sup>291</sup> *Id.* at 796.

<sup>292</sup> *Id.* at 797.

<sup>293</sup> *Id.* at 811.

<sup>294</sup> *Id.*

day; however, they are significant enough to warrant discussion.<sup>295</sup> Prudent directors will continue to include these protective devices in an effort to show “good-faith decision-making” and prioritization of performance.<sup>296</sup> With more skin in the game, defendant-directors can point to these provisions as evidence that their incentives are aligned with those of other public shareholders.

#### *D. Exculpation Provisions.*

SPAC fiduciaries can mitigate litigation risks by including appropriate exculpatory provisions in the charter.<sup>297</sup> At the SPAC’s formation, sponsors should include exculpatory provisions in their charters and bylaws to shield directors from any additional liability. In many jurisdictions, these provisions can waive fiduciary duty claims other than those alleging disloyalty and bad faith.<sup>298</sup> The state of Delaware amended DGCL Section 102 to allow a corporation to eliminate the liability of directors for a breach of its duty of care in its certificate of incorporation.<sup>299</sup> Some liability is unwaivable, such as for breach of the duty of loyalty or actions not in good faith.<sup>300</sup> However, maximum protection is afforded to those corporations that avail themselves of all benefits the DGCL has to offer.<sup>301</sup>

#### *E. The Completion Window.*

Under the common SPAC structure, the entity will liquidate after a period of time—typically twenty-four months. As discussed, when this occurs, the promote is effectively worthless. The timing of the de-SPAC is not outcome determinative, but as we saw in *Lobell*, it can raise suspicion.<sup>302</sup> Shareholders may claim that the directors were incentivized to rush to the de-SPAC to protect their founder shares.<sup>303</sup> This is not to say that any de-SPAC occurring

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<sup>295</sup> *See id.*

<sup>296</sup> AP Servs., LLP v. Lobell, No. 651613/12, 2015 WL 3858818, at \*1 n.1 (N.Y. Sup. Ct. June 19, 2015).

<sup>297</sup> PAUL WEISS, *supra* note 216.

<sup>298</sup> *Id.*

<sup>299</sup> DEL. CODE ANN. tit. 8, § 102 (West 2020).

<sup>300</sup> *Id.*

<sup>301</sup> *See id.*

<sup>302</sup> *See* AP Servs., LLP v. Lobell, No. 651613/12, 2015 WL 3858818, at \*2 (N.Y. Sup. Ct. June 19, 2015).

<sup>303</sup> *See, e.g., id.*

close to the drop-dead date is inherently suspect, but management should be mindful of their timing.

While it should be a consideration, it is far from a safe harbor. Unlike the *Lobell* de-SPAC, Churchill had nineteen months left in its completion window to consummate a merger.<sup>304</sup> The defendants used this fact to argue that the directors would have pursued other deals if they truly believed that MultiPlan was a value-decreasing target.<sup>305</sup> While a helpful fact, the *MultiPlan* court was unconvinced.<sup>306</sup> “Time left in the completion window does not change the potential for misaligned incentives.”<sup>307</sup> In other words, what made MultiPlan a value-decreasing target for the public stockholders did not necessarily mean it was value-decreasing for the directors.<sup>308</sup> The argument may have been more convincing if it was value-decreasing for the directors—but such was not the case, and under the common SPAC structure, it almost never would be.<sup>309</sup>

Synthesizing *Lobell* and *MultiPlan*, it appears that the timing of the de-SPAC can only hurt directors.<sup>310</sup> Defendants cannot rely on the fact that they completed a merger early to save them from otherwise bad facts.<sup>311</sup> In contrast, a late merger can be a bad fact—evidencing a rushed de-SPAC and misaligned incentives.<sup>312</sup>

## V. CONCLUSION

“A business model that incentivizes promoters to do something—anything—with other people’s money is bound to lead to significant value

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<sup>304</sup> *In re MultiPlan S’holders Litig.*, 268 A.3d 784, 811 (Del. Ch. 2022).

<sup>305</sup> *Id.*

<sup>306</sup> *Id.*

<sup>307</sup> *Id.*

<sup>308</sup> *See id.* (“MultiPlan could have been viewed as an attractive target for [Sponsor] stockholders even if the resulting post-merger entity proved less valuable for [public] stockholders than if [the SPAC] had liquidated.”).

<sup>309</sup> *See id.* at 811; *id.* at 810 n.154 (citing Michael Klausner et al., *A Sober Look at SPACs* 13 (European Corporate Governance Inst., Working Paper No. 746, 2021), available at [http://ssrn.com/abstract\\_id=3720919](http://ssrn.com/abstract_id=3720919) (“While a SPAC sponsor and board would prefer a good deal over a bad deal, they can do very well in a value-decreasing deal—and they would lose everything in a liquidation.”)).

<sup>310</sup> *See, e.g., In re MultiPlan*, 268 A.3d at 811; *AP Servs., LLP v. Lobell*, No. 651613/12, 2015 WL 3858818, at \*2 (N.Y. Sup. Ct. June 19, 2015).

<sup>311</sup> *See, e.g., In re MultiPlan*, 268 A.3d at 811.

<sup>312</sup> *See Lobell*, 2015 WL 3858818, at \*2.

destruction on occasion.”<sup>313</sup> However, “some entities have more bespoke structures intended to address [these] conflicts.”<sup>314</sup> Under Delaware law, a “bespoke” SPAC structure may allow private companies to access the public markets in accordance with “well-worn fiduciary principles.”<sup>315</sup> Critical to this bespoke SPAC structure are comprehensive, objective, and particularized disclosures.<sup>316</sup> To assure protection of the business judgment rule, prudent directors should employ disinterested directors, protective and exculpatory provisions, and proper timing of the de-SPAC merger.<sup>317</sup> Only time will tell how Delaware courts will treat an entity with these characteristics, but well-worn fiduciary principles give us hope for the efficient and effective SPAC.

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<sup>313</sup>MUDDY WATERS RESEARCH, *supra* note 1, at 2.

<sup>314</sup>*In re MultiPlan*, 268 A.3d at 792.

<sup>315</sup>*See id.* at 792.

<sup>316</sup>*See id.* at 816.

<sup>317</sup>*See supra* Part IV.