Blogs
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Delaware Chancery's First De-SPAC Decision: Four Take-Aways

In one of the first decisions to analyze fiduciary duty claims in the context of a SPAC merger, the Delaware Chancery Court recently sustained the legal viability of a putative shareholder class action brought against a SPAC's directors, officers, controlling shareholder, and financial advisor based on an allegedly false and misleading proxy statement. The court concluded that the plaintiffs had successfully pleaded "a reasonably conceivable impairment of public stockholders' redemption rights—in the form of materially misleading disclosures." As noted in this **client alert** that I penned along with Matt Riccardi and Arthur Greenspan, the decision—which marks the first time that the Chancery Court has applied Delaware law in the SPAC context—is important for several reasons and may provide a roadmap for plaintiffs' attorneys in crafting SPAC-related lawsuits that are sure to be filed in the coming months and years. Most notably, the decision suggests that the existence of the SPAC public shareholders' right of redemption prior to a de-SPAC transaction—often thought of as a key mitigating factor against conflict of interest claims—will not shield SPAC fiduciaries from liability where they have failed to disclose information to the public shareholders that is material to their decision of whether to redeem their SPAC shares or convert them to shares in the combined public company. Here are four take-aways from the decision: **1. Full and accurate disclosure of all material facts is key to mitigating liability -**In upholding the plaintiffs' fiduciary duty claims, the court made clear that its decision that the plaintiffs' claims are viable was "not simply because of the nature of the transaction or resulting conflicts"—which are inherent in most de-SPAC transactions—but "because the complaint alleges that the director defendants failed, disloyally, to disclose information necessary for the plaintiffs to knowledgeably exercise their redemption rights." Thus, the court's 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." Indeed, "one can imagine a different outcome" if public SPAC stockholders were given "all material information about the target, [and] had chosen to invest rather than redeem."

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2. Application of "entire fairness" in other cases is unclear -Given the fact-intensive nature of the court's decision—which is based almost entirely on the SPAC's alleged defective and misleading disclosures—it is too early to tell whether the onerous entire fairness standard applied by the court will apply to other fiduciary duty challenges to de-SPAC transactions. What is clear from the opinion, however, is that those involved in a de-SPAC transaction are well-advised to ensure robust and accurate disclosures. Plaintiffs' lawyers are likely to use the decision as a roadmap in crafting complaints going forward by, among other things, highlighting "material" disclosure violations and the various conflicts inherent in a de-SPAC transaction.

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3. Maximize director independence -To reduce the likelihood that the entire fairness standard of review will apply, and to increase the odds of a successful motion to dismiss, a majority of the SPAC board should be independent of the sponsor or controlling shareholder. In addition, the economic interests of the independent board members in the outcome of the de-SPAC transaction should be as closely aligned as possible with the interests of the SPAC's public shareholders.

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4. Use independent advisors where possible -The court's decision to uphold the aiding and abetting claim against the SPAC's financial advisor was clearly driven by the fact that the financial advisor was owned and controlled by the controlling stockholder of the SPAC. In light of this alleged conflict, the court concluded that it was "reasonably conceivable" that the financial advisor "participated" in the board's decision or "otherwise caused the board to make the decision" to "approve the merger while withholding material information from stockholders." To avoid such conflict claims, SPACs should consider engaging third-party advisors who are independent of the sponsor to provide valuation reports with respect to the target company. In addition to the engagement of an independent financial advisor, SPACs should consider adopting other procedural safeguards typically used in the traditional merger context to help mitigate risk, such as using an independent third-party advisor to conduct due diligence, obtaining a fairness opinion as to the value of the target company, and potentially creating an independent special committee to review the proposed transaction.

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