NOT SO FAST, SPACS: DISLOYALTY, EMERGING DELAWARE CORPORATE LAW, AND HOW TO PROTECT SPAC MANAGEMENT AND SHAREHOLDERS ALIKE

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Abstract

Special Purpose Acquisition Companies, or SPACs, have existed in one form or another for about forty years. Such companies have historically strived to protect public shareholders from the inherent conflicts of interest created by SPAC organizers and sponsors. Their current form incentivizes unfair dealings that can leave unsophisticated shareholders unprotected and their interests abandoned. Securities regulations have been the primary tool to address these issues, but SPAC boards, officers, and sponsors are increasingly adroit at complying with legal technicalities while benefitting themselves to their shareholders' detriment. Thus, equitable principles embedded in Delaware fiduciary duties should take on increased importance. Moreover, as the Delaware Court of Chancery has recently issued its first ever SPAC ruling in a motion to dismiss, interested parties everywhere are eager to see how Delaware corporate law will shape the contours of fiduciary duties within the SPAC context. This Note reviews the Court's ruling and draws on precedent to propose how SPAC management and sponsors might "cleanse" a transaction to protect themselves from shareholder litigation in a way that preserves the shareholders' best interests.

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INTRODUCTION

In 2020, special purpose acquisition companies ("SPACs") quickly took center stage in the public markets, but their recent publicity has not been so flattering.[1] As their name suggests, SPACs are used to take private companies public through an acquisition or merger. If successful, SPACs essentially grant retail investors access to private investments, creating what some scholars have referred to as the "Poor Man's Private Equity."[2] However, it has largely been proven to be too good to be true for the retail investor. Multiple studies demonstrate that, in the long run, SPACs generally generate negative returns.[3] The SPAC literature has overwhelmingly attributed poor performance to structural deficiencies that create conflicts of interest not only between SPAC management, sponsors, and shareholders, but also among shareholders themselves.[4] SPAC sponsors have addressed these conflicts of

[1] Usha Rodrigues & Michael Stegemoller, *Redeeming SPACs* 6 (U. Ga. Sch. L. Legal Stud. Rsch. Paper Series, Paper No. 2021-09, 2021), https://ssrn.com/abstract=3906196 [hereinafter *Insider IPOs*] (citing JAY R. RITTER, INITIAL PUBLIC OFFERINGS: UPDATED STATISTICS (2021)); Amrith Ramkumar, *The SPAC Ship Is Sinking. Investors Want Their Money Back.* WALL ST. J. (Jan. 21, 2022, 5:30 AM), https://www.wsj.com/articles/the-spac-ship-is-sinking-investors-want-their-money-back-11642761012?st=6axr24qfmxj99xc&reflink=desktopwebshare_permalink ("SPACs . . . burst onto the scene in 2020 as the hip way to take Silicon Valley's hottest startups public. . . . Now, the hype is giving way to reality.").

[2] Lora Dimitrova, *Perverse Incentives of Special Purpose Acquisition Companies, the "Poor Man's Private Equity Funds"* 63 J. ACCT. & ECON. 99 (2017); Jim Fink, *Special Purpose Acquisition Companies (SPACs): Will Investors Live Long and Prosper?*, INVESTING DAILY (Apr. 10, 2012), http://www.investingdaily.com/10914/special-purpose-acquisition-companies-spacs-will-investors-live-long-and-prosper; Steven M. Davidoff, *Black Market Capital*, 1 COLUM. BUS. L. REV. 172, 225 (2008) ("SPACs are a species of private equity").

[3] Dimitrova, *supra* note 2, at 99 ("I find that, on average, SPACs perform extremely poorly, whether measured by long-run stock abnormal returns or operating performance."); Fink, *supra* note 2 (SPACs that have completed an acquisition "have an average annual excess return of -36.5% per year.") (quoting Stefan Lewellen, SPACs as an Asset Class (Mar. 24, 2009) (unpublished manuscript), https://ssrn.com/abstract=1284999); Snehal Banerjee & Martin Szydlowski, Harnessing the Overconfidence of the Crowd: A Theory of SPACs (Aug. 4, 2022) (unpublished manuscript), https://ssrn.com/abstract=3930346. *But see Insider IPOs*, *supra* note 1, at 43 (finding a few outliers that delivered excellent returns, including one over 1000%).

[4] *E.g.*, Mira Ganor, *The Case for Non-Binary, Contingent, Shareholder Action*, 23 U. PA. J. BUS. L. 390 (2021); *Insider IPOs*, *supra* note 1, at 19–20; Usha Rodrigues & Michael Stegemoller, *Exit, Voice, and Reputation: The Evolution of SPACs*, 37 DEL. J. CORP. L. 849, 894 (2013) [hereinafter *The Evolution of SPACs*]; Michael Klausner, Michael Ohlrogge, & Emily Ruan, *A Sober Look at SPACs*, 39 YALE J. ON REG. 228,

interests differently. Some disclose conflicts to shareholders,[5] but most ignore disclosure as sponsors secure insiders to ensure they come out on top.[6] Thus, the "Poor Man's Private Equity" exposes retail investors to subtle opportunism by sophisticated players.[7]

To date, most academic papers and professional proposals that address SPAC structural deficiencies have strongly advocated for SEC regulatory solutions.[8] Enhanced regulatory structures are necessary because they attempt to protect the public market and economy from information asymmetry and disparities of bargaining power—a veritable issue in the context of SPACs, as will be shown below. For example, penny stock companies, an infamous predecessor to the SPAC that threatened public investors up through the 1980s,[9] were strangled[10] by strict federal code[11] and regulations promulgated

289 (2022); John C. Coates, SPAC Law and Myths, 9–10 (Feb. 2, 2022) (unpublished manuscript), https://ssrn.com/abstract=4022809 (referring to SPAC mergers and then "other conflict of interest deals"). *Contra* Daniel S. Riemer, *Special Purpose Acquisition Companies: SPAC and Span, or Blank Check Redux?*, 85 WASH. U. L. REV. 931, 960 n.189 (2007) (arguing that SPAC sponsor and shareholder interests are aligned); Sebastian Gryglewicz, Barney Hartman-Glaser, & Simon Mayer, PE for the Public: The Rise of SPACs 3 (Oct. 21, 2021) (unpublished manuscript), https://ssrn.com/abstract=3947368.

[5] *Insider IPOs*, *supra* note 1, at 7 n.22 (SPAC disclosed conflict of interest in proxy to its shareholders); *Schedule 14A: Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934, Churchill Capital Corp. III*, U.S. SEC. & EXCH. COMM'N 15 (Sept. 18, 2020), https://www.sec.gov/Archives/edgar/data/0001793229/000110465920106245/tm2025258-5_defm14a.htm#tQAAA ("The Sponsor and Insiders may have interests . . . that may conflict with your interests as a stockholder.") [hereinafter *Churchill Capital Corp. III Proxy Statement*].

[6] Tim Jenkinson & Miguel Sousa, *Why SPAC Investors Should Listen to the Market*, 21 J. APPLIED FIN. 38, 50 (2011) (finding evidence that SPAC sponsor affiliates engage in "tactics" to approve mergers).

[7] William W. Clayton, *The Private Equity Negotiation Myth*, 37 YALE J. ON REG. 67, 110–11 n.176 (scholars have "argu[ed] that [existing investor protection standards] leave room for opportunism against unsophisticated investors.").

[8] *E.g.*, Klausner et al., *supra* note 4, at 299; *Insider IPOs*, *supra* note 1, at 5–6.

[9] Riemer, *supra* note 4, at 935 ("By the end of the 1980s, fraud and abuse in the penny stock market had reached 'epidemic proportions.'") (citing *Telemarketing Fraud: Hearing Before the Subcomm. on the Consumer of the S. Comm. on Commerce, Science, and Transportation*, 101st Cong. 25 (1989) (statement of Sen. Richard Bryan, Member, S. Comm. on Commerce, Science, and Transportation)).

[10] *Id.* at 943 ("The onerous requirements of Rule 419 made it nearly impossible for a blank check company to complete an acquisition."). Penny stock companies defrauded people through "pump-and-dump" schemes. *Id.* at 943–44.

[11] Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, § 508, 104 Stat. 931 (1990), 956–57.

by the U.S. Securities and Exchange Commission (SEC).[12] The SEC has shown that it can regulate opportunistic security schemes out of the public market. Yet, it has particularly struggled to regulate SPACs, only recently proposing enhanced, yet potentially condemning,[13] disclosure obligations.[14]

Though a derivative of penny stock companies,[15] SPACs have been able to operate relatively free of SEC regulation because they circumvent penny stock regulations, known as Rule 419, by not issuing penny stock.[16] Notwithstanding that fact, SPACs have gained the public's trust by voluntarily complying with some aspects of Rule 419.[17] As William K. Sjostrom explains, SPACs have chosen to comply with at least three Rule 419 requirements: (1) hold 90-percent of net IPO proceeds in an escrow or trust until an acquisition is completed, (2) ensure that the fair market value of any acquired company or assets equals or exceeds 80-percent of the IPO offering proceeds, and (3) return all offering proceeds to investors if an acquisition is not completed within eighteen months.[18] Thus, SPACs have partly followed Rule 419 without being incapacitated by it. In addition, SPACs also subject themselves to rigorous requirements the SEC imposes on publicly traded companies.[19] These investor

[12] Blank Check Offerings, Securities Act Release No. 6,891, Exchange Act Release No. 29,096, 48 SEC Docket 962, 1962 (Apr. 17, 1991).

[13] *See generally*, Minor Myers, The Corporate Law Reckoning for SPACs 64 (Aug. 2, 2022) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4095220 ("The SPAC at the moment is squarely in the crosshairs of federal officials. Some federal responses to SPACs might encroach on the domain of corporate governance that has long been left in the hands of Delaware and other states.").

[14] SEC Proposes Rules to Enhance Disclosure and Investor Protection Relating to Special Purpose Acquisition Companies, Shell Companies, and Projections, Press Release 2022-56, U.S. SEC. & EXCH. COMM'N (Mar. 30, 2022), https://www.sec.gov/news/press-release/2022-56.

[15] *The Evolution of SPACs*, *supra* note 4, at 875–77 (explaining that, though blank check companies like penny stock companies, SPACs were developed to satisfy Rule 419 requirements); Riemer, *supra* note 4, at 932 ("SPACs are direct descendants of the corrupt blank check companies that plagued the securities markets in the 1980s.").

[16] DAVID N. FELDMAN, REVERSE MERGERS: TAKING A COMPANY PUBLIC WITHOUT AN IPO 44 (2006) ("[SPACs] . . . are exempt from Rule 419 because they raise more than $5 million."); William K. Sjostrom, Jr., *The Truth About Reverse Mergers*, 2 ENTREPRENEURIAL BUS. L.J. 743, 757 (2008).

[17] Sjostrom, *supra* note 16, at 757–58.

[18] *Id. See* Riemer, *supra* note 4, at 946 ("However, in contrast to the Rule 419 requirements, SPAC managers had two years, as opposed to the Rule 419 limit of eighteen months, to complete an acquisition.").

[19] *The Evolution of SPACs*, *supra* note 4, at 854.

protections have largely remained consistent[20] throughout the various versions of the SPAC.[21] These regulatory protections partially explain why, in 2020, the public market invested in SPACs more than in traditional IPOs.[22]

More recently, however, the public has recognized the danger the SPAC structure poses for unsophisticated investors.[23] Despite SPAC compliance with Rule 419 and SEC regulations applicable to publicly traded companies, SPACs are still able to take advantage of unsuspecting and ill-equipped investors. The proposed SEC regulations may resolve these issues,[24] but even if they did, sophisticated market actors may yet again engineer the SPAC to benefit management and sponsors at the expense of unsophisticated shareholders.[25] In other words, experience shows that regulatory solutions are likely not enough to protect shareholders. Other bodies of law are needed to fill in the gaps.

As scholars and practitioners continually strive to improve regulations to protect the market from SPACs, they should also focus on enhancing fiduciary duties to protect SPAC shareholders for two primary reasons. First, fiduciary duties are needed to defend corporate democracy and, specifically, the mechanics of the shareholder vote. As this paper will explain, sponsors are heavily incentivized to govern their SPACs in ways that improve their own financial position but significantly harm the company and its shareholders in the long run.[26] In the past, SPAC sponsors prevented these incentives by endowing their shareholders with enhanced voting protections.[27] However, since 2010, shareholders have been able to hedge their financial position[28] because SPAC sponsors have allowed them to lock in the value of their original investment regardless of how they vote.[29] By assuaging shareholders' economic concerns, SPAC sponsors have persuaded many shareholders to vote

[20] Coates, *supra* note 4, at 3; Klausner et al., *supra* note 4, at 11 (explaining that SPACs place IPO proceeds in a trust and that most will liquidate within two years if they do not consummate a merger).

[21] Riemer, *supra* note 4, at 944–47; *The Evolution of SPACs*, *supra* note 4, at 889; *see generally* Davidoff, *supra* note 2.

[22] *Insider IPOs*, *supra* note 1 (60% of IPOs were performed by SPACs in 2020).

[23] Ramkumar, *supra* note 1.

[24] SEC Proposes Rules to Enhance Disclosure and Investor Protection Relating to Special Purpose Acquisition Companies, Shell Companies, and Projections, *supra* note 14.

[25] This assumes that such regulations will not regulate SPACs out of the market, like Rule 419 regulated out penny stock companies.

[26] Jenkinson & Sousa, *supra* note 6, at 41 ("Given the apparent conflicts of interest facing the founders . . . .").

[27] *Id.*

[28] *See infra* Part II.B.3.

[29] *See infra* Part II.A.

in favor of the sponsors' best interests rather than their own. This strategy "creat[es] a close analogue of 'empty voting[,]'" since shareholders' votes do not affect their economic position.[30] While some might argue that empty voting is voting nonetheless and reflects the shareholders' true intent just like any traditional vote,[31] unsophisticated investors who necessarily rely on the votes of sophisticated investors suffer when they vote in favor of a merger but do not redeem their shares.[32] While empty voting may not be scrutinized under federal securities regulation, it is scrutinized under Delaware corporate law, which prioritizes the alignment between "share voting and the financial interest of the shares."[33] Thus, Delaware corporate law can condemn SPAC sponsor conduct that, though legal under federal securities regulations, is obviously problematic. "[I]nequitable action does not become permissible simply because it is legally possible."[34]

Second, where many of the threats that SPACs pose derive from the backstage dealings between sponsors and select shareholders, such dealings raise equitable concerns that securities regulations may be inadequately suited to curtail. While some scholars argue for more disclosure than current securities laws require,[35] others conclude that "disclosure is not enough."[36] Moreover, at least three scholars have argued that, in the SPAC context, "securities laws facilitate sponsors painting a rosy picture of the mergers they propose."[37] On the other hand, "[e]quitable principles act . . . to protect [stockholders] who are not in a position to protect themselves[,]" such as unsophisticated investors, and fiduciary duties create causes of action grounded in such principles.[38] Thus, fiduciary duties require more from sponsors and leave less room for opportunism by scrutinizing fair dealing in conflicted transactions, which evaluates "how the approvals of the directors

[30] Coates, *supra* note 4, at 9 (citing Henry T.C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811, 835 (2006)).

[31] *Insider IPOs*, *supra* note 1, at 27 ("[T]he new SEC regulations permitted shareholders to 'vote with their feet.'").

[32] *Id.* at 30–31 ("Decoupling voting and economic interests poses particular danger to retail investors if we presume that the public markets are largely driven by big players like hedge funds and institutional investors. Typical market functioning allows smaller investors to ride the coattails of large investors.").

[33] Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377, 388 (Del. 2010).

[34] Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971).

[35] *Id.* at 290.

[36] *Insider IPOs*, *supra* note 1, at 44.

[37] Klausner et al., *supra* note 4, at 234.

[38] Malone v. Brincat, 722 A.2d 5, 9 (Del. 1998).

and the stockholders were obtained."[39] In other words, even if SPAC boards, officers, and sponsors technically comply with federal securities regulations, Delaware corporate law provides a necessary backstop. As Vice Chancellor Will reiterated in the Court of Chancery's first ever SPAC ruling in January of this year: "Corporate acts must be twice-tested—once by the law and again in equity."[40]

Until recently, despite the intrinsic conflict of interest in the SPAC context and the need for Delaware corporate law,[41] very little literature has been published about the role fiduciary duties can play in protecting SPAC shareholders from SPAC management and sponsors. Premier law firms even seem unsure about how to talk about fiduciary duties and SPACs.[42] At a time when shareholders are increasingly seeking protection from SPAC founders under fiduciary duties,[43] ascertaining the contours of SPAC sponsors', board members', and officers' fiduciary duties is as relevant as ever.

The paper will proceed as follows. In Part II, the structural features and incentives of a SPAC will be described to explain the conflicts of interest inherent in SPACs. In Part III, I will provide a comprehensive review of the Court of Chancery's first SPAC ruling, *In re Multiplan*, and explain its serious implications for SPAC boards, sponsors, officers, and shareholders everywhere. Part IV will contain a proposal for the Court of Chancery and SPAC proponents to "cleanse" SPAC mergers so management and shareholders can be protected from litigation and economic harm, respectively. Part V will conclude.

[39] Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983) (explaining the duty of loyalty).

[40] *In re* Multiplan Corp. S'holders Litig., 268 A.3d 784, 812 (Del. Ch. 2022).

[41] *See generally*, Myers, *supra* note 13; *see* Coates, *supra* note 4, at 7–8 (this article cited only one academic paper when discussing fiduciary duties). Moreover, other papers are expectedly coming in response to *In re* Multiplan Corp. S'holders Litig.

[42] *See* Jim Ducayet, Joshua G. Duclos, & Rebecca B. Shafer, *SPACs and Delaware Fiduciary Duties*, SIDLEY (Apr. 19, 2021), https://ma-litigation.sidley.com/2021/04/spacs-and-delaware-fiduciary-duties/ (despite the duty of loyalty concerns inherent to SPACs, the article mentions the business judgment rule and entire fairness standard of review only once and does not elaborate on either. With that said, as a change in corporate control is typical, the article discusses SPAC boards' *Revlon* duties from Revlon, Inc. v. MacAndrews & Forbes Hldgs., Inc., 506 A.2d 173, 179–82 (Del. 1986), which are triggered under a change of corporate control under Paramount Commc'ns v. QVC Network, 637 A. 2d 34 (Del. 1994)).

[43] *See generally*, *id.*

I. The Conflicts of Interest Inherent to the SPAC

A. Basic SPAC Procedures

As its name suggests, the SPAC, or special purpose acquisition company, is a public company created specifically to acquire, or merge with, private companies and bring them to the public market. SPACs are generally organized by private equity or hedge funds,[44] which normally pay the initial underwriting, legal, and accounting fees involved in preparing the SPAC to issue public shares.[45] SPAC sponsors are compensated primarily by a "'promote' of 20% of the SPAC's post-IPO shares for a nominal price."[46] SPAC investors at the time of IPO—i.e., IPO investors—generally purchase SPAC "units" for $10 each, usually including one share, one warrant, and sometimes a right to acquire a fraction of a SPAC share for no additional cost when a merger occurs.[47] Warrants are normally exercised at a price $1.50 higher than the unit price.[48]

SPACs are referred to as "blank check" companies because SPAC founders and managers, usually known as "sponsors,"[49] use broad discretion in spending the money received in exchange for the SPAC's public shares. [50] Generally, SPAC sponsors are required only to direct such funds towards merging with a private company within a specified period, which is usually between eighteen to twenty-four months.[51] Thus, SPAC sponsors have one

[44] Klausner et al., *supra* note 4, at 236. Also, sometimes celebrities endorse SPACs to attract investor attention—a phenomenon about which the SEC has become considerably concerned. "Celebrity Involvement with SPACs—Investor Alert," SEC Investor Alerts and Bulletins, Mar. 10, 2021, https://www.sec.gov/oiea/investor-alerts-and-bulletins/celebrity-involvement-spacs-investor-alert.

[45] *The Evolution of SPACs*, *supra* note 4, at 921 ("SPAC sponsors now pay for the funds' operating expenses, allowing the trust account to grow to ever higher levels.").

[46] Klausner et al., *supra* note 4, at 232. A promote is an equity interest given to founders in exchange for a nominal price. Frantz Jacques, *The Evolving Landscape of SPACs*, Am. Bar Ass'n (Feb. 7, 2022), https://www.americanbar.org/groups/business_law/publications/blt/2022/02/spacs1/.

[47] *Id.* at 236.

[48] *Insider IPOs*, *supra* note 1, at 19.

[49] Riemer, *supra* note 4, at 950.

[50] *Id.*, at 932 n.6 ("The name 'blank check' is derived from the fact that investors in this type of offering entrust their capital to the fund's management to use at its discretion.") (citing N. Am. Sec. Adm'rs Ass'n, The NASAA Report on Fraud and Abuse in the Penny Stock Indus. (Part 1 of 2) 44 (1989), *reprinted in Penny Stock Market Fraud: Hearings Before the Subcomm. on Telecommunications and Finance of the H. Comm. on Energy and Commerce*, 101st Cong. 198 (1989)).

[51] *Id.* at 946; *Insider IPOs*, *supra* note 1, at 39.

responsibility: find a private company to merge with. All mergers, however, are contingent on a majority, and sometimes supermajority, stockholder vote.[52] In 2021, stockholder votes occurred nearly six months, on average, following merger announcements.[53] Transactions in which a SPAC merges with a private company are often referred to as "de-SPACs."[54] If a merger is ultimately approved by a shareholder majority, dissenting shareholders may nevertheless "redeem" their shares for cash value. If SPAC sponsors do not merge with a private company within the specified period, they may often either extend their search by receiving board recommendation to such effect and subsequent shareholder approval,[55] or they must liquidate.[56] Until SPAC funds are used in either a merger or liquidation, they are maintained in an interest-bearing escrow account. This ensures that either redeeming shareholders or shareholders of a liquidating SPAC will be refunded the entire amount of their investments adjusted for the time value of money.[57]

Of particular importance is the feature that SPAC sponsors do not receive any value in a liquidation event. Herein lies the most troubling feature of the SPAC structure. It creates enormous potential for a conflict of interest because unless a merger occurs, SPAC sponsors' "entire investment is lost."[58]

B. Conflicts of Interest Between SPAC Sponsors and Shareholders

1. The Dangers of the Promote

The SPAC structure effectively raises capital from SPAC sponsors and public investors alike by promising, or at least touting the possibility of, lucrative returns. However, conflicts of interest set SPAC sponsors against unsophisticated investors in many ways. SPAC sponsors only receive the benefit of their 20% promote if the SPAC consummates a merger. Consequently, they are incentivized to do so even if it destroys or reduces stockholder value. As one seminal paper found in a study of forty-seven SPACs that de-SPAC'd ("post-merger companies"), the post-merger companies with shares underperforming the market twelve months after the de-SPAC produced "average sponsor returns [of] . . . over $100 million."[59] The

[52] Ganor, *supra* note 4, at 396.

[53] Minmo Gahng, Jay R. Ritter, & Donghang Zhang, SPACs (Oct. 10, 2022) (unpublished manuscript), https://site.warrington.ufl.edu/ritter/files/SPACs.pdf.

[54] *Id.* at 4; *Insider IPOs*, *supra* note 1, *passim*.

[55] *Insider IPOs*, *supra* note 1, at 10.

[56] *Id.* at 40; *The Evolution of SPACs*, *supra* note 4, at 877 ("Funds must be returned if no acquisition occurs within eighteen months.").

[57] Ganor, *supra* note 4, at 408.

[58] Klausner et al., *supra* note 4, at 290.

[59] *Id.* at 234.

paper concluded that, "[f]or most sponsors, even a merger worth one penny per share would be more attractive than a liquidation in which their entire investment is lost."[60] Of particular concern is the fact that SPAC officers and directors ("SPAC management"), "as a formal matter[,]"[61] "often overlap with the individuals that control the entity that is the SPAC's sponsor."[62] Therefore, when the SPAC board puts the merger proposal before its shareholders, it is encouraged to "sell" the proposal rather than merely describe it for informational purposes. SPAC boards may be unable to adequately look out for the stockholders' and companies' best interests because they are strongly incentivized to advance their own interests.

With that said, SPAC boards might argue their interests are aligned with shareholders because their promote is often "locked up" for some time following the de-SPAC and possibly even contingent on some earnout provision, though earnouts are often used to shorten the lock-up period.[63] In addition, the promote is often so lucrative that the prospects of the diminished time value of money and a substantially lower enterprise value do not seriously reduce SPAC sponsors' strong incentive to approve the de-SPAC. Thus, even though a majority of stockholders must approve a de-SPAC before it is consummated and SPAC sponsors may not obtain the benefit of their promote for over a year, SPAC boards are often heavily incentivized to manipulate the de-SPAC vote, even when the de-SPACs are prospectively more damaging than beneficial.[64] Before exploring how SPAC sponsors have influenced the de-SPAC vote, understanding SPAC payment structures will provide the necessary context to understand how shareholders may be harmed.

2. SPAC Payment Structures

As mentioned above, SPAC sponsors place IPO investor funds into an interest-bearing escrow account so original investments can be returned to either redeeming shareholders in the event of an acquisition, or all shareholders

[60] *Id.* at 290.

[61] *Id.* at 234 n.12.

[62] *Id.* at 236. For the remainder of this paper, I will use "SPAC sponsors" and "SPAC boards" interchangeably, unless otherwise specified.

[63] *E.g.*, *Churchill Capital Corp. III Proxy Statement*, *supra* note 5, at F-12 (notice how the earnout provision is actually not a condition to receive the promote ever; its only function is to "unlock" the promote before the end of the stated lockup period).

[64] As a side note, underwriters are also incentivized to push the deal through, since a portion of their own compensation is contingent on the completion of a de-SPAC. Gahng et al., *supra* note 53, at 29 ("For underwriters, it is common for them to receive 2% of the 5.5% underwriting commission at the time of the IPO for all shares sold, but the remaining 3.5% is deferred until the business combination.").

(except SPAC sponsors) in the event of liquidation. But what happens to stockholder shares that are not redeemed in the event of a merger ("non-redeemed shares")? This is the question that Michael Klausner, Michael Ohlrogge, and Emily Ruan answer in *A Sober Look at SPACs*, an empirical study of forty-seven SPACs that underwent a de-SPAC.[65] Even though SPAC sponsors purported that IPO investor units (i.e., one share, one warrant, and sometimes a right) were worth $10 per unit immediately before each de-SPAC, many expenses placed such units at a significantly lower value, leaving non-redeeming shareholders with shares worth a median of $5.70 per share immediately before the de-SPAC. [66] These expenses include the SPAC sponsors' essentially free 20% promote, the fees paid to IPO underwriters and other IPO professionals (e.g., accountants and lawyers), redemptions by redeeming shareholders, and IPO investors' free warrants and rights extracting significant value from SPACs ("SPAC Expenses").[67] In other words, after (i) sponsors' 20% promote and shareholders' warrants and rights dilute the value of unredeemed SPAC shares, (ii) underwriting, accounting, and legal fees from the IPO are paid, and (iii) redeeming shareholders receive back their original investments, non-redeeming shareholders would have received a median of $5.70 per share if their companies had liquidated immediately before their de-SPACs. The average, or mean, share value immediately before each of the forty-seven companies' de-SPACs was even lower, resting at $4.10 per share.[68]

Recognizing that not all SPACs are created equal, the authors distinguished the value impact in high-quality SPACs—i.e., those led by high-profile private equity funds or former senior officers of Fortune 500 companies—from value impact in non-high-quality SPACs. The median and mean share values immediately preceding de-SPACs in high-quality SPACs were $7.00 and $5.80, respectively; and such values immediately preceding de-SPACs in non-high-quality SPACs were $2.70 and $2.30.[69] In both cases, SPACs prove to be very expensive, but SPACs may be especially costly depending on how boards structure their SPACs and subsequent de-SPACs. For instance, Klausner et al. suggested that non-high-quality SPACs were much more costly than high-quality ones because they gave away about twice as many warrants and rights per unit, experienced about 70% more redemptions, and secured about 83% less private investments in public equity (i.e., PIPE investments) to replace value lost to dilution and redemption.[70] Returning to SPAC sponsors' self-interested motive to obtain majority

[65] *See generally*, Klausner et al., *supra* note 4.

[66] *Id.* at 253.

[67] *Id.* at 246.

[68] *Id.*

[69] *Id.* at 252.

[70] *Id.* at 245.

stockholder approval for a merger, Klausner et al.'s insight suggests that, although redeeming stockholders can safely walk away with their original investments, non-redeeming shareholders can be significantly harmed by warrants and rights, fees to underwriters and other IPO professionals, the sponsor's 20% promote, and redemptions.[71] Although warrants, rights, and the unconditional choice for redemption appeal to investors, too many of these can harm non-redeeming shareholders. By offering these features and others, SPAC sponsors facilitate obtaining majority approval for their proposed de-SPACs.

3. *Manipulating the De-SPAC Vote*

Generally speaking, sponsors design SPACs so that IPO investors want to vote in favor of a de-SPAC even where the de-SPAC would likely lower shareholder value; that is, even further beneath the share price prior to the de-SPAC. Although enticing, SPAC units often harm more than enhance shareholder welfare. SPAC units come with warrants and rights that, after some time, trade separately from investors' SPAC shares.[72] As a result, even where a de-SPAC would decrease shareholder value, investors are incentivized to redeem their shares yet vote in favor of the de-SPAC, which de-SPACs allow.[73] This allows investors to recoup their entire original investment while also receiving the benefit of their warrants and rights.[74]

Allowing investors to redeem their shares even when they vote in favor of a de-SPAC substantially separates their financial interests from their vote, creating what is called the "empty vote."[75] By decoupling shareholders' economic interests from their vote, the only loss they risk is not cashing out on their warrants and rights, which such shareholders can do only if they vote in favor of a de-SPAC. Thus, this voting structure almost always encourages shareholders to vote in favor of the de-SPAC and "is the most common way that modern SPACs have effectively neutered the shareholder vote . . . ."[76] So,

[71] Whether the non-redeeming SPAC shareholders, or the target shareholders, bear the costs described herein might depend on the merger agreement between the SPAC and the target company, but it also might inevitably fall on the SPAC shareholders depending on post-merger performance. *Id.* at 254–55, 259.

[72] *Id.* at 248.

[73] *E.g.*, *Churchill Capital Corp. III Proxy Statement*, *supra* note 5, at 29 (redeeming one's shares is not contingent on voting for or against the de-SPAC).

[74] Ganor, *supra* note 4, at 412 (warrants in a SPAC "will be worthless if the SPAC does not consummate the De-SPAC transaction.").

[75] Coates, *supra* note 4, at 9 (citing Henry T.C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811, 835 (2006)).

[76] *Insider IPOs*, *supra* note 1, at 28.

in transactions where sophisticated investors generally expect the de-SPAC to further decrease shareholder value, SPAC boards allow redemptions and incentivize approving the de-SPAC through giving warrants and rights. To illustrate, if only 10% of shareholders believe a de-SPAC would increase the value of their shares, the other 90% would normally not vote to approve it. However, with redemptions, warrants, and rights, the other 90% recognizes that they can receive back their original $10 per share investments while voting in favor of the de-SPAC. This gives their warrants and rights a chance to become valuable. Far from a gamble—they will receive back their original investments—many if not most of the remaining 90% of shareholders would approve the de-SPAC in the off-chance they were wrong, and their warrants and rights would become valuable. Yet, such redemptions, warrants, and rights decrease value for non-redeeming shareholders by simultaneously (i) draining resources from the SPAC and (ii) diluting their shares.

Not leaving anything to chance, SPAC sponsors pursue additional strategies to obtain de-SPAC approval. In addition to offering warrants and rights, SPAC boards have begun to vote in favor of the de-SPAC regardless of whether the majority votes against it—betraying long-standing practice.[77] Since SPAC sponsors generally hold a 20% promote, only a little more than 30% of stockholders need to vote in favor of the de-SPAC to obtain majority approval.[78] Current practice suggests that obtaining 30% stockholder approval should be an easy undertaking.

Put simply, SPAC sponsors rely heavily on securing the votes of sophisticated investors by giving them terms that are more favorable[79] than the terms they give other shareholders. SPAC sponsors commonly purchase votes from private, institutional or accredited investors who agree to purchase

[77] *Churchill Capital Corp. III Proxy Statement*, *supra* note 5, at 65 ("Unlike many other blank check companies in which the initial stockholders agree to vote their founder shares in accordance with the majority of the votes cast by the public stockholders . . . the [SPAC sponsors] have agreed to vote any shares of common stock by them in favor of the business combination proposal"); *see also* Jenkinson & Sousa, *supra* note 6, at 44 (demonstrating that founders historically have voted their shares—generally 20% of outstanding shares—with the majority).

[78] *See, e.g.*, *Churchill Capital Corp. III Proxy Statement*, *supra* note 5, at 65.

[79] *Insider IPOs*, *supra* note 1, at 21 ("PIPE investors may negotiate terms that are more favorable than those of SPAC holders, who can suffer considerable dilution. PIPE investors also receive bargained-for registration rights, and there is no guarantee they will continue to hold shares of the de-SPAC'd, newly public company for long. But once a PIPE investor is secured, then inevitably it too is pushing to get a deal done—on its own terms.").

publicly traded stock directly from issuers,[80] such that these investors make private investments in public equity ("PIPE investors").[81] SPAC sponsors even incentivize PIPE investors to enter into forward purchase agreements at the time of IPO by discounting SPAC units by at least 10% and occasionally transferring PIPE investors "their own shares or warrants."[82] One study found that SPAC sponsors give nearly 34% of their shares to attract PIPE investors, "and these inducements are larger when there are more redemptions."[83] In sum, SPAC sponsors often improve the economic deal for PIPE investors because sponsors need more votes in value-decreasing transactions and PIPE investors are too sophisticated to purchase and hold SPAC shares through a de-SPAC otherwise. In addition, SPAC sponsors provide PIPE investors with exclusive details about the prospective de-SPAC, thereby giving them an informational advantage over other investors.[84] As a result, PIPE investors are treated as insiders much like certain sophisticated investors in a private equity fund negotiate better terms than other investors through side agreements.[85] This tactic is empirically supported, too, as Klausner et al. found that PIPE investors replaced on average up to 70% of IPO proceeds of high-quality SPACs.[86] Where the average redemption rate in such SPACs was just 43%,[87] SPAC sponsors were evidently seeking to buy more than enough votes to secure de-SPAC approval.

SPAC sponsors use at least two other strategies to obtain majority approval for the de-SPAC. First, they will sometimes spend their own money to purchase additional shares that they will use to vote in favor of the de-SPAC.[88] So, where SPAC sponsors already plan to cast the votes from their 20% promote in favor of the de-SPAC, they have purchased additional SPAC shares to secure even more voting power. If a de-SPAC was approved by 51% of SPAC shareholders, SPAC sponsors alone may comprise 50% or more of such shareholders—an alarming possibility where the sponsors are motivated

[80] Anna T. Pinedo & James R. Tanenbaum, *Frequently Asked Questions About PIPEs*, U.S. Sec. & Exch. Comm'n (Last accessed June 1, 2022), sec.gov/info/smallbus/gbfor25_2006/pinedo_tanenbaum_pipefaq.pdf.

[81] Klausner et al., *supra* note 4, at 238.

[82] *Id.* Moreover, because some de-SPACs are contingent on the SPAC having a minimal amount of capital, some SPAC sponsors enter non-redemption agreements with third-party PIPE investors to ensure they do not redeem their shares; *see, e.g.*, *Churchill Capital Corp. III Proxy Statement*, *supra* note 5, at 65.

[83] Banerjee & Szydlowski, *supra* note 3, at 33.

[84] Klausner et al., *supra* note 4, at 273 ("PIPE investors are 'brought over the wall' and given confidential information on which to make an investment decision.").

[85] Clayton, *supra* note 7, at 91.

[86] Klausner et al., *supra* note 4, at 253.

[87] *Id.*

[88] *Id.* at 247.

by benefits that the majority of shareholders will not enjoy. Second, at least one SPAC decided to cast all unvoted shares in favor of its proposed de-SPAC.[89] Thus, as an example, if shareholders who collectively hold 31% of SPAC shares fail to vote for or against a proposed de-SPAC, SPAC sponsors may consider all such votes in their favor and use their own 20% voting portion to secure de-SPAC approval. It may be unlikely that shareholders who collectively own 31% of voting shares would fail to vote for or against a de-SPAC transaction, but this is nevertheless a frighteningly relentless approach when used alongside the others mentioned herein. Clearly, SPAC sponsors pull out all the stops to make obtaining de-SPAC approval "a foregone conclusion."[90]

As one recent article put it, "The shareholder franchise once provided a market check on the pressure to close a deal. That check is now gone."[91] Though present in form, the stockholder vote is substantively absent. Thus, de-SPAC approvals for value-decreasing de-SPACs are a virtual certainty, causing non-redeeming shareholders to hold shares that are expected to reduce in value. Moreover, in the context of a value-decreasing transaction, PIPE investors' favorable treatment harms *unsophisticated* investors who, unlike *sophisticated* investors, cannot protect themselves. Additionally, because SPAC Expenses only increase as sponsors incentivize PIPE investors with additional warrants and rights,[92] unsophisticated investors' economic interests are injured even further. Clearly, although such dealings may not violate current securities regulations, they veritably raise equitable concerns. One might retort, however, asking why unsophisticated investors do not simply redeem their shares. That question will be addressed next.

4. *Why Unsophisticated Investors Do Not Redeem*

Non-redeeming unsophisticated shareholders are often harmed by SPAC sponsors' actions because they mistakenly rely on institutional, or sophisticated, investors. The vast majority of IPO investors in a SPAC are hedge funds and other large institutional investors, colloquially known as the "SPAC Mafia."[93] These players rarely if ever stay with the SPAC through the

[89] *Churchill Capital Corp. III Proxy Statement*, *supra* note 5 ("If you return your proxy card without an indication of how you wish to vote, your shares will be voted in favor of each of the proposals.").

[90] *Insider IPOs*, *supra* note 1, at 28.

[91] *Id.* at 30.

[92] Banerjee & Szydlowski, *supra* note 3, at 30.

[93] Klausner et al., *supra* note 4, at 242 (citing Patrick Jenkins, Opinion, *The Twisted Logic of Reverse Listings*, FIN. TIMES (Aug. 3, 2020), https://www.ft.com/content/7501e978-2a62-4a5c-bf94-aaacf2ce40f2 [https://perma.cc/HM9Q-6UJ6].").

completion of a de-SPAC. SPAC Mafia members are aware that the value of their shares is decreasing and plan to exit pre-merger, not through redemption, but through selling their shares to unsophisticated (often retail) investors.[94] Surprisingly, unsophisticated investors choose to buy shares from the exiting SPAC Mafia even when the Mafia's exit indicates that the sophisticated investment decision is to avoid the SPAC altogether. Yet the decision of these investors buying into a low-quality SPAC may not be so surprising after all. Often, unsophisticated prospective investors purchase SPAC shares from SPAC Mafia members, and existing unsophisticated investors choose not to sell or redeem their shares because they see PIPE investors flooding into the SPAC.[95] Therefore, PIPE investments support SPACs in two ways: in addition to providing their own affirmative votes for the de-SPAC, they give the de-SPAC a "stamp of approval" and thus persuade unsophisticated investors that it is a sound investment.[96] As one scholar noted, "Typical market functioning allows smaller investors to ride the coattails of large investors" since "retail investors do not consult [SPAC SEC filings], let alone pour over them" like large investors.[97] However, SPACs are not the "[t]ypical market." Unlike in the typical market where the interests between large investors and small investors are aligned,[98] SPAC sponsors give large investors—i.e., PIPE investors—terms more favorable than those given to small investors, as discussed above. Plainly, "unsophisticated investors . . . may misinterpret the approval of the [de-SPAC] by the majority of the shareholders' vote as a sign that the sophisticated investors support the transaction because they believe it is in their best interest as shareholder . . . ."[99] As a result of this "misinterpretation," though investment prudence would dictate that unsophisticated investors should redeem or sell their shares, they often retain them in reliance on large, sophisticated investors who hold their shares, not because of promising post-merger performance but because insider terms cause PIPE investor "[r]eturns [to be] higher than returns to public

[94] *Insider IPOs*, *supra* note 1, at 34.

[95] Gahng et al., *supra* note 53, at 26–27.

[96] *Id.*; Banerjee & Szydlowski, *supra* note 3, at 5 ("[M]any sponsors argue that participation by such investors can act as a 'stamp of approval' for the proposed deal, since PIPE investors tend to be sophisticated and well informed.").

[97] *Insider IPOs*, *supra* note 1, at 31.

[98] *Id.* ("[S]ophisticated third parties . . . naturally protect[] the smaller investors because the economic incentives of the big players and retail investors are usually aligned.").

[99] Ganor, *supra* note 4, at 21; *see also Insider IPOs*, *supra* note 1, at 20 ("The participation of a sophisticated institutional player thus can serve as a stamp of approval for the SPAC, indicating that the target is a viable public company."); Banerjee & Szydlowski, *supra* note 3, at 32.

shareholders."[100] In these situations, unsophisticated investors are indubitably harmed by holding shares in post-merger companies that de-SPAC'd contrary to sound business judgment. Sometimes, these investors are harmed unnecessarily as SPAC sponsors may not have even needed their continued shares to approve the de-SPAC but wanted them to further avoid diluting the 20% promote.[101] Thus, the use of PIPE investors harms unsophisticated shareholders' voting interests by impairing their ability to determine whether the de-SPAC is a poor investment decision. PIPE investors incidentally lead unsophisticated shareholders to hold shares in a less valuable enterprise. A valid argument in some areas of law, SPAC sponsors may claim that they are only ensuring that unsophisticated investors do not lose out on a lucrative de-SPAC.[102]

5. Paternalism is a Nonstarter

Unfortunately, SPAC sponsors are not acting out of paternalistic concern for unsophisticated investors, as if they were trying to approve the de-SPAC so that shareholders can reap the post-merger benefits that they are too naïve to see. Quite the contrary, for the reasons explained above, SPACs often stoop to acquire subpar companies they know will only further harm shareholder value.[103] In one study wherein SPACs were deemed "bad" if their share prices on the day of the de-SPAC vote were below their respective escrow trust values, the authors found that "bad" SPACs produced "average cumulative returns of -39% within six months [of the de-SPAC], rising to -79% after a year."[104] Moreover, out of forty-seven companies that de-SPAC'd within 2019 and 2020, Klausner et al. found that the mean and median returns within twelve months were 19.1% and -19.3%, respectively.[105] Compared to the IPO Index, NASDAQ, and Russell 2000, the average returns twelve months after the de-SPAC were, respectively, -50.9%, -17.9%, and -4.4%.[106] Another study found

[100] Klausner et al., *supra* note 4, at 259.

[101] *E.g.*, *In re* Multiplan Corp. S'holders Litig., 268 A.3d 784, 797 (Del. Ch. 2022) (due to PIPE investors entering non-redemption agreements, "the merger could be completed even if all public shareholders chose to redeem.").

[102] *See generally* Air Prod. & Chemicals, Inc. v. Airgas, Inc., 16 A.3d 48 (Del. Ch. 2011) (affording directors considerable latitude in defending their corporation from a takeover threat against shareholders' wishes because the board had a more complete and accurate understanding of the corporation's long-term potential).

[103] Gahng et al., *supra* note 53, at 9 ("Sponsors are often willing to invest in merging companies at $10 per share, even when they are of the opinion that the correct value is, say, $6 per share.").

[104] *Id.* at 39.

[105] Klausner et al., *supra* note 4, at 256.

[106] *Id.*

that average returns within one-year of a de-SPAC were -5.4% for eighty-four companies with sales exceeding $100 million and -18.6% for sixty-eight companies with sales below $100 million.[107] SPAC sponsors are not acting in the unsophisticated shareholders' best interests by recommending they vote in favor of a de-SPAC and not redeem their shares in value-decreasing transactions. SPAC sponsors are acting in their own best interests.

6. *Why De-SPACs Continue Receiving Majority Approval*

SPACs do not consistently offer lucrative returns for shareholders, so why have they continued receiving investments? There are three possible answers. First, some post-merger SPACs are enormously successful, generating returns of over 1000%.[108] Understandably, some unsophisticated investors purchase a $10 "lottery ticket" and thereby knowingly take a large risk of failure. However, in light of the insider practices reviewed herein, unsophisticated investors do not "knowingly" take such a risk since they are unaware of how they are harmed by SPAC sponsors acting out of self-interest.

A second reason why unsophisticated investors may retain their shares in a de-SPAC is because of continued trust in the SPAC sponsors' judgment. This reason is empirically supported by the findings of one Yale finance scholar who concluded that SPACs that have found a target but not yet merged with it have an average "annualized excess return of approximately 11%."[109] In other words, the public has confidence in the SPACs' future prospects and this confidence manifests in increased share prices. After all, if SPAC sponsors or boards are bound by fiduciary duty to act in shareholders' best interests, should shareholders not trust them? Unfortunately, for the reasons discussed, unsophisticated investors who trust their SPAC sponsors may do so at their own peril. Many sponsors manipulate the de-SPAC approval vote, even when the de-SPAC would destroy the company and significantly lower shareholder value. In addition to the statistics listed above, according to the same finance scholar, post-merged SPACs "have an average annual excess return of -36.5% per year."[110] Put another way, although the public's pre-de-SPAC confidence inflated SPAC share prices to what the public believed the post-de-SPAC share value would be, such post-de-SPAC share values were drastically lower. Consequently, unsophisticated investors should not readily place their trust in their SPAC sponsors.

[107] Gahng et al., *supra* note 53, at 44.

[108] *Insider IPOs*, *supra* note 1, at 43.

[109] Stefan M. Lewellen, SPACs as an Asset Class 11 (Mar. 24, 2009) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id =1284999.

[110] *Id.*

The last reason why unsophisticated investors do not redeem or sell their shares prior to a de-SPAC has already been explained: they are deceived into believing that the de-SPAC is a wise investment since sophisticated PIPE investors do not redeem or sell their shares. The average unsophisticated investor does not know that PIPE investors choose to retain their shares through the de-SPAC only because they have obtained favorable terms that make their investments financially sensible. Without being on the "inside," unsophisticated investors face considerable threats from those who are legally obligated to look after their best interests.

7. The Role of Reputation in SPACs

Informal incentives, like the role of reputation, often exist in the marketplace to police opportunistic behavior that is not otherwise legally prohibited. Yet, the reputation of SPAC management and sponsors—who lead unsophisticated investors[111] into unprofitable de-SPAC transactions—has apparently remained unscathed, or at least functional, since investors have not altogether avoided SPACs.[112] This begs the question, why? Two scholars addressed the role that reputation plays in SPACs, concluding that it is not a factor because of SPACs' "publicly traded one-shot" nature, which inherently eliminates the "long-term relationships between investors and managers" traditionally seen in private equity.[113] Accordingly, the authors believe that "reputation does not constrain managers."[114] While true in some regards, this finding might not hold up against the fact that many SPAC managers and sponsors are repeat players, coming to the market under the same name that investors can recognize.[115] So, if the market truly abhorred how particular management and sponsors treated their investors in a prior de-SPAC, the opportunity to shun them exists but is simply not taken. Although not empirically supported, the reason why reputation has not halted SPAC

[111] *The Evolution of SPACs*, *supra* note 4, at 849, 853 n.24 (citing Ronald J. Gilson, Charles F. Sabel, & Robert E. Scott, *Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice, and Doctrine*, 110 COLUM. L. REV. 1377, 1379 (2010)) (concluding that reputational harm, caused by breaching non-legal but social expectations, limits future opportunities).

[112] Crystal Kim, *Serial SPAC Sponsors Hunt Bigger Game, Draw Greater Confidence*, BLOOMBERG QUINT (Sept. 21, 2020), https://www.bloombergquint.com/business/serial-spac-sponsors-hunt-bigger-game-draw-greater-confidence ("Of the more than 100 SPACs to debut on U.S. exchanges this year, five of the largest 10 have been part of a growing *series*.") (emphasis added). Series of SPACs are very unlikely to form but for a public market willing to invest.

[113] *The Evolution of SPACs*, *supra* note 4, at 849, 853.

[114] *Id.* at 920.

[115] Kim, *supra* note 112.

managers' and sponsors' opportunistic behavior may be as straightforward as it is disheartening. Unsophisticated investors are often the only SPAC investors who are harmed, but they are also the only SPAC investors with negligible market influence.

Whereas sophisticated investors can buffer the effects of dilution, unsophisticated investors are left without protection. And yet, for the reasons described in this Part II, de-SPAC approval is almost independent from the vote of unsophisticated investors. Thus, even if all unsophisticated investors in the market did not participate in SPACs, they would be unharmed, and SPACs would likely still be able to push through their proposed de-SPACs. In other words, if reputation became an issue, SPACs would likely not mind. But, due to the "insider" nature of SPAC management and sponsor dealings, reputation is not an issue for SPACs and unsophisticated investors accordingly fail to recognize just how threatened they actually are when they bid for a piece of the "Poor Man's Private Equity." Consequently, because the dealings of SPAC management and sponsors are not more salient, reputation appears to be a nonfactor and unsophisticated investors will only continue participating in SPACs.

In summary, SPACs provide a unique and powerful combination of features to raise capital. They offer SPAC sponsors, boards of directors, and officers (many of which overlap) a 20% stake in the company's equity post-IPO for a nominal price and they grant unsophisticated investors access to what is essentially private equity, an extremely lucrative prospect. Since the 20% promote is available only upon the consummation of a merger which is the completion of a de-SPAC, it incentivizes SPAC sponsors and management to ensure that the de-SPAC is approved by a majority of the company's shareholders. Specifically, sponsors and management (i) often vote their 20% of shares in favor of the de-SPAC instead of with the shareholder majority; (ii) decouple share redemption from voting in favor of the de-SPAC, so shareholders may vote in favor of even a prospectively poor de-SPAC; (iii) give warrants and rights to shareholders so they are incentivized to approve the de-SPAC; (iv) give PIPE investors favorable terms unavailable to other investors in exchange for PIPE investors' vote for the de-SPAC; (v) purchase additional shares to increase their own voting stake beyond 20%; and (vi) vote undecided shares in favor of the de-SPAC. Taken together, these practices have the effect of (i) decreasing shareholder value, (ii) deterring redemption when that would be the correct investment decision, and (iii) manipulating non-redeeming unsophisticated investor votes in favor of the de-SPAC even when it is not in their best interests. Next, this paper will address the relevant fiduciary concerns apparent in the SPAC (and subsequent de-SPAC) context and briefly explore how SPACs can protect themselves from litigation by protecting unsophisticated investors from economic injury. To set us in that direction, Part III will summarize and analyze the Delaware Court of Chancery's first two fiduciary duty rulings arising from the SPAC context.

II. The Delaware Court of Chancery Grapples with the SPAC

Despite the SPAC existing in one form or another for about forty years, the Delaware Court of Chancery, corporate law's most influential judicial body, had never applied the "well-worn fiduciary principles" of loyalty and care until early January of 2022.[116] Two months later, the Court offered another SPAC ruling.[117] The first ruling was on a motion to dismiss[118] and the second was on a move to stay on the basis that federal securities claims involving the same facts were moving through another court.[119] The second ruling lacked the legal analysis provided in the first, and for our purposes, its contribution to this paper can be summarized in one line: defendant SPAC sponsors and management may breach their fiduciary duty of loyalty by impairing the informed exercise of stockholders' redemption rights to defendants' benefit.[120] Though a significant holding, it is picked up in the Court of Chancery's first SPAC ruling. As a result, Part III will primarily provide a comprehensive review of the facts and legal analysis in that ruling, *In re Multiplan Corp. Stockholders Litigation*, to demonstrate how the Court of Chancery has applied Delaware corporate law to a SPAC with most of the characteristics described in Part II. We will first discuss the facts of *In re Multiplan* and then move on to the legal analysis.

A. The Facts of In re Multiplan

The SPAC and de-SPAC involved in this case were structured similarly to those described in Part II. Before the Court of Chancery was a motion to dismiss particular claims brought by stockholder plaintiffs against SPAC fiduciaries for failing to disclose material facts prior to the vote to merge with Polaris Parent Corp. ("Multiplan"), the parent company of Multiplan, a "data analytics and cost management solutions provider" focused on the healthcare industry.[121] The SPAC was called Churchill Capital Corp. III ("Churchill"), and its sponsor was a corporation named Churchill Sponsor III, LLC ("Sponsor") that was managed by Michael Klein ("Klein"), a sophisticated

[116] *In re* Multiplan Corp. S'holders Litig., 268 A.3d 784, 792 (Del. Ch. 2022).

[117] *In re* Lordstown Motors Corp. S'holders Litig., No. 2021-1066-LWW, 2022 WL 678597 (Del. Ch. March 7, 2022).

[118] *In re Multiplan*, 268 A.3d at 792.

[119] *In re Lordstown*, 2022 WL 678597, at *1.

[120] *Id.* at *4.

[121] *In re Multiplan*, 268 A.3d at 796.

businessman and serial SPAC sponsor.[122] With control over Sponsor, Klein "had the exclusive power to appoint Churchill's board of directors[,]" (the "Board") virtually all of which had previous connections to Klein.[123] With one exception, all members on the Board, including Klein himself, received a portion of the 20% promote that Sponsor purchased for just $25,000.[124] Moreover, Sponsor purchased 23 million SPAC warrants for $1 each, which had an exercise price of $11.50.[125]

On February 19, 2020, Churchill raised $1.1 billion in an initial public offering (IPO), selling 110 million units for $10 each. Churchill shares and warrants could then be traded separately after a specified time.[126] Investors who purchased Churchill's IPO shares were Class A stockholders.[127] Among those Class A stockholders were those who brought this action ("Plaintiffs"). Churchill held the $1.1 billion in a trust while it sought a private target. The funds could only leave Churchill's trust account in the event of (i) liquidation, (ii) share redemption, or (iii) the consummation of a de-SPAC.[128] Nearly six months after Churchill's IPO, the Board announced and, shortly thereafter, approved a de-SPAC with Multiplan (the "Multiplan Merger"). [129] Moreover, the Board hired The Klein Group LLC ("The Klein Group") as its financial advisor, which later received over $30 million in compensation.[130] Importantly, as part of the merger agreement, 45% of Sponsor's promote and 21% of its warrants would "unvest" until Multiplan's stock price exceeded a certain price for forty days within any sixty-day period between one and five years after the de-SPAC.[131]

To help finance the Multiplan Merger, the Board recruited PIPE investors to purchase Churchill shares and warrants, many of which were affiliated with the Board.[132] Assuming no redemptions, Multiplan's prior owners would own 60.5% of the post-merged entity ("Public Multiplan"), Churchill's shareholders would own 16%, Sponsor would own 4.2%, and the PIPE investors would own 19.2%.[133] When the Board recruited the PIPE investors, the parties entered non-redemption agreements which allowed

[122] *Id.* at 793.

[123] *Id.* at 794–95.

[124] *Id.* at 794.

[125] *Id.*

[126] *Id.* at 794.

[127] *Id.* at 795.

[128] *Id.* at 795–96.

[129] *Id.* at 796.

[130] *Id.*

[131] *Id.* at 796–97.

[132] *Id.*

[133] *Id.* at 797.

approval for the Multiplan Merger "even if all [other] public stockholders chose to redeem."[134]

Two months after the announcement date, Churchill held the vote for the Multiplan Merger.[135] Through its proxy statement (the "Proxy"), the Board disclosed the prospective earnings, cash flow, and the due diligence it conducted for the Multiplan Merger.[136] The Board also disclosed that Multiplan was dependent on a customer ("Client") that made up more than a third of its revenues. However, it failed to mention that Client planned to remove all its accounts from Multiplan and compete with Multiplan by the end of the next year.[137] Notably, the information in the Proxy was primarily gathered through Sponsor's own efforts and by The Klein Group; it was not valuated by an independent third-party nor assessed by a fairness opinion.[138] As of the voting date, the Proxy stated that each share was worth about $10.04, and Sponsor's promote was worth about $305 million.[139] "Churchill shareholders overwhelmingly voted to approve the business combination."[140] Less than two months after the Multiplan Merger was completed, an analyst report publicly revealed Client's plans, and Public Multiplan's public stock dropped to $6.27 the next day and was valued identically five months later.[141]

B. The Court of Chancery's Legal Analysis

Plaintiffs sued Sponsor and the Board for "putting their own interests above their own—Churchill Class A stockholders—interests" by issuing a materially misleading proxy statement that "impaired [the] informed exercise of [the stockholders'] redemption and voting rights."[142] At the heart of the motion to dismiss was whether Plaintiffs stated a "reasonably conceivable" claim that the Board breached its duty of loyalty through breaching their duty of disclosure, acting with lack of good faith, or by issuing materially false and misleading disclosures for Sponsor's own benefit.[143]

[134] *Id.*

[135] *Id.*

[136] *Id.*

[137] *Id.*

[138] *Id.* at 798.

[139] Klein's personal stake was worth about $230 million. *Id.*

[140] *Id.*

[141] *Id.*

[142] *Id.* at 799.

[143] *Id.* at 799–800 (citations omitted).

1. Preliminary Items

Before addressing the fiduciary principles underlying the plaintiffs' claims, the Court of Chancery took up three preliminary items. Two of these items will not be elaborated on here,[144] but one of the preliminary items elucidated the harm that SPAC sponsors can cause by deciding whether the plaintiffs' claims were direct or derivative. The Court of Chancery determined that plaintiffs' claims were direct.[145] Simply put, the Court found that the plaintiffs suffered "personal injury" caused by the purposeful, "wrongful impairment by fiduciaries of stockholders' voting power or freedom." [146] In this case, "wrongful impairment" took the form of a board issuing materially false and misleading disclosures that allegedly caused stockholders to uninformedly forego exercising their redemption rights. In sum, the Court concluded, "it is reasonable to infer . . . that the defendants' disloyal conduct impaired stockholders' redemption rights, giving rise to individual claims."[147] At the motion to dismiss stage, the non-redeeming shareholders in this case were held to have been directly harmed by the Board's decision to issue material misstatements or omissions in the Proxy. The Board interfered with the shareholders' ability to make an informed decision on whether to exercise their redemption rights.

2. Fiduciary Claims

a. The Proper Standard of Review. Before the Court of Chancery could scrutinize the Sponsor and Board's actions, it needed to determine the proper level of scrutiny to apply to them, i.e., the standard of review.[148] As the Court explained, boards are generally entitled the highest level of deference—or, the lowest level of scrutiny—known as the business judgment rule, which presumes that directors have "acted on an informed basis, in good faith and in the honest belief that the action was taken in the best interests of the

[144] First, the Court of Chancery held that the plaintiffs' fiduciary claim for impaired redemption rights was not preempted by contract law since Churchill's certificate of incorporation did not dictate that the board must respect those rights through disclosing all material information. Second, the Court found the plaintiffs' claims were not "holder" claims—defined as when stockholders are wrongfully induced to hold stock instead of to sell it—because the claim is based on *inaction*, yet the board's disclosure veritably required shareholder action in two ways: decide whether to redeem and whether to approve the Multiplan Merger. *Id.* at 806–08.

[145] *Id.* at 802–03.

[146] *Id.* (quotation marks omitted).

[147] *Id.* at 803.

[148] *Id.* at 809.

company."[149] However—to prevail against the Sponsor and Board—Plaintiffs wanted to, and did, invoke entire fairness—or "Delaware's most onerous standard of review."[150] Fortunately for Plaintiffs, the Court held that such standard should apply because Plaintiffs "pleaded facts supporting a reasonable inference that" the Multiplan Merger was a conflicted controller transaction and that the Board lacked independence. [151] This determination carries serious implications for SPACs everywhere. Accordingly, the reasons for the Court's findings will be explained below.

The Court of Chancery's rationale is so broad that it is hard to imagine a SPAC that would not be subjected to the entire fairness standard. First, the Court held that the Multiplan Merger was a conflicted controller transaction because Klein, who controlled Churchill through the Sponsor competed against Plaintiffs, i.e., the Class A stockholders, to "receive[] a unique benefit," or "something uniquely valuable to the controller, . . . to the detriment of the minority."[152] Specifically, the Court held that Klein competed against Plaintiffs for their original investments held in Churchill's trust account: if the Multiplan Merger failed and Churchill liquidated, Plaintiffs would receive back their original investments plus interest—i.e., $10.04—and the Sponsor's "1,219,900% [prospective] gain on [its] $25,000 investment . . . would have dropped to zero."[153] Klein and Plaintiffs were after the same funds, i.e., the trust funds. The benefit of such funds was unique to Klein. While the Class A stockholders would, through redemption, draw from the trust funds if the Public Multiplan shares were worth less than $10.04. Klein—due to his nominal consideration in exchange for the promote and warrants—would cause such shareholders to not redeem even if the Public Multiplan shares were worth "well below $10.04."[154] Moreover, the Court held that the value-decreasing nature of the Multiplan Merger conferred a benefit upon Klein to the non-redeeming shareholders' detriment. By persuading shareholders to retain rather than redeem their shares, Klein would be protecting Public Multiplan's assets while encouraging Class A stockholders to "giv[e] up $10.04 for something less valuable."[155] In sum, the Multiplan Merger was controller conflicted because the value of the Sponsor's promote relied on Class A stockholders not exercising their redemption right, even though such exercise was in the stockholders' best interests because the Multiplan Merger was a value-decreasing transaction.

[149] *Id.*

[150] *Id.* (quotation marks omitted).

[151] *Id.*

[152] *Id.* at 810 (quotation marks omitted).

[153] *Id.* at 810–11.

[154] *Id.* at 811.

[155] *Id.*

The Court's responses to the Sponsor's rebuttals were insightful and precedential. First, the Sponsor argued that the lockup provision and "unvestment" of 45% of Promote Interests cured any conflict of interest.[156] The Court of Chancery, however, was not persuaded, reasoning that, "[e]ven the 55% of [Sponsor's] shares, if hypothetically valued at $5 and discounted back 18 months at an aggressive 20% per year, are worth more than $40 million."[157] Without considering the return on the Sponsor's warrants, a $40 million return on the original $25,000 investment constitutes a 1,599% gain. The Sponsor also argued estoppel on the grounds that Plaintiffs knew before investing that the Sponsor had an economic incentive to consummate a merger.[158] The Court agreed that Plaintiffs knew about the Sponsor's economic incentive before investing in Churchill, but nevertheless held that estoppel was inappropriate because Plaintiffs did not know about the Multiplan Merger when they purchased their Class A shares.[159] On the contrary, Plaintiffs invested in Churchill only because they were given a redemption right and believed the Board would disclose "all material information when the time came to" approve or disapprove of the proposed de-SPAC.[160] The Court dismissed the Sponsor's other rebuttals, holding that the presence of a promote in all other SPACs and the "technical legality of the de-SPAC mechanics" "do[] not cure it of conflicts."[161] Although these holdings were given at the motion to dismiss stage under a "reasonably conceivable" standard, the Court of Chancery thus far has dealt SPACs a heavy hand. Using the Court's rationale, most if not all SPACs with the characteristics listed in Part II will implicate conflicted controller transactions.

The second reason Plaintiffs' argue why the entire fairness standard should apply is because there is a conflicted board. The Court's findings are equally detrimental for SPAC sponsors and boards. Plaintiffs alleged that the Board was conflicted because (i) all of its members, except one, were self-interested in the Multiplan Merger and (ii) the Board lacked independence. Regarding the Board's self-interest, the Court of Chancery first explained that entire fairness applies whenever the majority of a board "labors under actual conflicts of interest," such as the expectation to receive "any [material] personal financial benefit from [a transaction] in the sense of self-dealing."[162] Drawing upon these principles, the Court of Chancery held that, despite the Board's compensation being based in stock—and thus company success—all

[156] *Id.*

[157] *Id.*

[158] *Id.* at 811–12.

[159] *Id.* at 812.

[160] *Id.*

[161] *Id.*

[162] *Id.* at 813 (quotation marks omitted; citations omitted).

of the directors could stand to gain over $500,000 even if the post-merger stock price dropped to $5 per share, in which case Class A stockholders would lose half of their original investment.[163] Regarding Plaintiffs' claims that the Board was conflicted because it lacked independence, the Court held that the members on the Board were beholden to Klein.[164] Klein possessed "unilateral power to remove [Board members,]" compensated all of them with extremely lucrative interests in the current SPAC, and offered some of them the possibility of receiving similar compensation in future ones.[165] Because of the Board's self-interest in the Multiplan Merger and a lack of Board independence, the Court of Chancery held that the Board was conflicted and thus that the entire fairness standard should apply. [166]

In sum, the Court ruled that both the conflicted controller transaction and conflicted board individually warranted applying the entire fairness standard to the Board and Sponsor, although the Court continually qualified its holdings by clarifying they were made only at the motion to dismiss stage. In order to defeat the motion to dismiss, the Board and Sponsor were each required to demonstrate that their actions were entirely fair to Churchill and plaintiff-shareholders, beyond Plaintiffs' ability to prove that it could be reasonably conceived otherwise. [167] To do this, Board and Sponsor would need to show both fair price—i.e., "economic and financial considerations of the proposed merger"—and fair dealing—i.e., the timing, initiation, structure, negotiation, director disclosures, and approval-seeking processes involved in the merger.[168]

b. Scope of Conduct Under the Duty of Loyalty. Turning now to Plaintiffs' fiduciary duty claims, the Court of Chancery first addressed their claim that the Board breached its duty of loyalty and duty of disclosure, which implicates the duty of loyalty. The Court found that Plaintiffs' complaint contained "well-pleaded allegations that false and misleading disclosures impaired [the] exercise of their option to redeem."[169] Specifically, it held that the Proxy was one-sided and tampered largely because it did not disclose Client's plans to remove its accounts from and compete against Multiplan.[170] The Court held it was "reasonably conceivable" that, a plaintiff "would have been substantially likely to find this information important when deciding whether to redeem her shares."[171] The Court accordingly concluded that this

[163] *Id.* at 813–14.

[164] *Id.* at 814.

[165] *Id.*

[166] *Id.* at 814–16.

[167] *Id.* at 815.

[168] *Id.*

[169] *Id.* at 816.

[170] *Id.*

[171] *Id.*

first claim survived the motion to dismiss because, with the duty of disclosure integrated into the fair dealing,[172] the Board's failure to disclose Client's plans was not entirely fair to Plaintiffs.[173]

The Court next assessed Plaintiffs' fiduciary claim against the Sponsor, or Klein more specifically. Plaintiffs alleged that Klein and other members of the Sponsor breached their fiduciary duties by agreeing to the Multiplan Merger "without ensuring that it was entirely fair" to the Class A stockholders.[174] In response, the Court concluded that Plaintiffs made it reasonably conceivable for the Court to find that Klein had the power to, and actually did, "control, influence, and cause" Churchill to enter in the Multiplan Merger.[175] As a result, Plaintiffs' fiduciary claim against the Sponsor survived the motion to dismiss.

Plaintiffs brought two other claims in this action, one against Klein acting in his capacity as an officer and one other officer, and the second as an aiding and abetting claim against The Klein Group.[176] Briefly put, the Court upheld the first of these claims against Klein but dismissed it against the other officer because Plaintiffs failed to plead sufficient facts to suggest that he breached his fiduciary duties.[177] Regarding the aiding and abetting claim, the Court of Chancery held that it was reasonably conceivable that The Klein Group—Churchill's financial advisor controlled by Klein—knowingly participated in the Board's and Sponsor's fiduciary duties breaches because of Klein's highly involved relationship in all three entities. For these reasons, Plaintiffs' fiduciary breach claim against Klein and their aiding and abetting claims against The Klein Group survived the Sponsor's and Board's motions to dismiss.

C. *Implications of* In re Multiplan

The above review of *In re Multiplan* reveals it significantly influences SPACs in at least four ways. First, because Churchill's structure almost identically resembles the general SPAC structure described in Part II, involving a 20% promote, redemption rights, stockholder warrants and rights, sponsor-appointed board members and officers, and PIPE investors who

[172] *Id.* (citing Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983)).

[173] *Id.* at 816–17 ("[F]or purposes of the motions to dismiss, the alleged disclosure violations sufficiently give rise to a lack of overall fairness."). *But see In re Multiplan*, 268 A.3d at 817 n.196 (stating that the Board presented evidence that the report revealing Client's plans but that the Court could not evaluate such evidence at the motion to dismiss stage).

[174] *Id.* at 817.

[175] *Id.*

[176] *Id.* at 817–18.

[177] *Id.* at 817.

entered in non-redemption agreements, *In re Multiplan* provides extremely applicable precedent for future fiduciary breach claims in SPACs.

Second, *In re Multiplan* facilitates (potentially frivolous) SPAC litigation because it reveals that Plaintiffs can easily bring direct rather than derivative claims against SPAC sponsors and management. Specifically, the Court of Chancery made it clear that plaintiffs in de-SPAC transactions suing for the impaired exercise of their redemption and voting rights suffered direct harm.[178] In a post-*In re Multiplan* world, every SPAC holding a de-SPAC vote should feel threatened because shareholders do not need to clear the hurdles of derivative litigation to sue SPAC sponsors and managers for impairing the informed exercise of their redemption rights and votes. In light of sponsors' and managers'—i.e., those who hold interests in the SPAC promote ("Promote Holders")—inherent conflict of interest, plaintiffs' direct claims might be further facilitated, which leads to *In re Multiplan*'s third takeaway.

Third, because the Churchill SPAC was not especially different from the majority of SPACs, the Court of Chancery's first SPAC ruling implies that the entire fairness standard would apply to many if not most SPAC defendants for duty of loyalty claims, at least at the motion to dismiss stage.[179] There, the Court applied entire fairness to the Board and the Sponsor because the Multiplan Merger constituted a conflicted controller transaction and the majority of the Board was conflicted, being both self-interested in the Multiplan Merger and beholden to Klein.[180] Like the Churchill SPAC, most if not all SPACs are controlled by their sponsors—a fact that defendants and plaintiffs alike embraced in *In re Multiplan*.[181] Moreover, like the Sponsor in *In re Multiplan*, many SPAC sponsors in value-decreasing de-SPACs may be conflicted since they, by virtue of their 20% promote, stand to gain a benefit unique to them,[182] competing against SPAC shareholders with redemption rights for it. Also, most of the members of the Board and the Sponsor were

[178] It might go without saying that plaintiffs might still sue SPAC sponsors and boards derivatively, such as for harming the corporate enterprise by entering in a value-decreasing merger. But, derivative claims are difficult to successfully bring because suing shareholders would need to (i) show that they demanded suit, or that demand was futile, and (ii) plead with particularity on the corporation's behalf that the de-SPAC was not in its best interests. United Food and Com. Workers Union v. Zuckerberg, 250 A.3d 862, 875–76 (Del. Ch. 2020).

[179] Other scholars beginning to write in this area agree. *See* Myers, *supra* note 13, at 28 ("Under existing law, the entire fairness test very likely applies to the SPAC's business combination.").

[180] *In re Multiplan*, 268 A.3d at 809–15.

[181] *Id.* at 809 ("The parties agree that Klein, through his control of the Sponsor, was Churchill's controlling stockholder.").

[182] *See supra* Part III.B.2.a (summarizing the Court of Chancery's explanation for why the Sponsor stood to gain a unique benefit).

conflicted because their promote and warrants incentivized self-interested behavior to Plaintiffs' detriment, most SPACs offer their own Promote Holders the same economic incentives, which harm SPAC stockholders in the context of value-decreasing de-SPACs.[183] Lastly, because many SPAC sponsors are repeat players like Klein,[184] future courts may readily conclude as they did in *In re Multiplan* that SPAC boards are beholden to SPAC sponsors. This is not only because the sponsors can terminate board member employment but because they can involve them in future, lucrative deals. For all these reasons, SPAC boards and sponsors should consider alternative structures or practices to inoculate SPAC conflicts of interest and lack of independence and thus to avoid scrutiny under the entire fairness standard.

The fourth way that *In re Multiplan* is highly influential is the Court of Chancery's rationale for finding that it was reasonably conceivable that the Board and Sponsor breached their duties of loyalty to Plaintiffs. Like how the Board may have breached its duty of loyalty by impairing Plaintiffs' informed exercise of their redemption rights and not proving that its actions were entirely fair to them, many if not most SPAC boards might be doing the same to their own stockholders. To illustrate, numerous scholars have called for increased SPAC disclosures,[185] including the need to inform stockholders of their decreased share values immediately before a de-SPAC,[186] the nature of the sponsor's interest in the de-SPAC,[187] possibly even their return on investment, SPAC management's confidence in the post-merged company, and other information generally only conveyed to PIPE investors.[188] Implicit in these calls to action is the belief that investors are not adequately informed of all the material information they need either when exercising their redemption rights or voting for or against proposed de-SPACs, or both. Consequently, the argument might be made that, because thousands of shareholders may have chosen to not redeem their SPAC shares or to approve de-SPACs on the basis of directors' failure to disclose all material information such as that described

[183] As explained in *In re Multiplan*, non-redemption in value-decreasing de-SPACs preserves SPAC boards and sponsors lucrative returns but only harms non-redeeming SPAC shareholders, since they exchange the option of receiving back their original investments plus interest for "something less valuable." *Id.* at 811.

[184] Kim, *supra* note 112.

[185] Banerjee & Szydlowski, *supra* note 3, at 2 ("This recent boom in SPAC deals and their severe under-performance for buy-and-hold investors has led to scrutiny by regulators and calls for changes to disclosure requirements and investor protection.").

[186] Klausner et al., *supra* note 4, at 287.

[187] *Id.*; *Insider IPOs*, *supra* note 1, at 46 ("Particularly in need of attention are disclosures surrounding the nature of the sponsors' investment in the SPAC. Sponsors sometimes invest mere thousands of dollars in exchange for 20% of the shares, but they contribute millions of dollars in warrants in order to build up the trust amount.").

[188] Klausner et al., *supra* note 4, at 273.

above, directors have impaired the informed exercise of shareholder redemption and voting rights. Fiduciary duties within the SPAC context require significant development before confidently making any reliable inference,[189] and the entire fairness test "is fact intensive."[190] SPAC boards would be wise to consider increasing their disclosures in de-SPAC proxy statements to avoid breaching their duty of loyalty to shareholders, or at least their "disclosure duties implicating director loyalty."[191]

Fifth, the Court of Chancery's choice to deny defendants' motions to dismiss plaintiffs' claims against the Sponsor, the officers, and The Klein Group are equally if not more concerning. The Court denied dismissing the claim against the Sponsor because Plaintiffs proved it was reasonably conceivable that the Sponsor controlled or at least influenced Churchill's entry in the Multiplan Merger without regard to Plaintiffs' welfare. This is a probable occurrence in other SPACs, especially since sponsors, who are compensated by the promote, often comprise SPAC management.[192] Regarding Plaintiffs' claims against the officers in *In re Multiplan*, the Court's response threatens litigation against other SPAC officers for many of the reasons that might implicate SPAC board fiduciary liability: SPAC officers may often approve and prioritize value-decreasing de-SPACs if they are Promote Holders, since they would stand to gain unique benefits. Lastly, the Court's finding in *In re Multiplan* is concerning for professionals assisting SPACs in a de-SPAC if such professionals have knowledge of SPAC managements' and sponsors' fiduciary misconduct. Although this paper does not address the extent to which SPACs use the financial services controlled by any members of management or the sponsor (like The Klein Group in *In re Multiplan*) SPACs should evaluate which professionals they contract when investigating de-SPAC transactions, especially since many SPAC sponsors are financial institutions.

In re Multiplan at last initiated how the contours of Delaware corporate law will influence SPAC management and sponsors everywhere. Like how federal securities regulation might consider requiring greater disclosure from SPACs in the context of a de-SPAC, or at least a value-decreasing de-SPAC, Delaware corporate law will have a similar but more comprehensive effect. Unlike how SPAC management and sponsors may ingeniously comply with federal securities regulations yet harm shareholders to obtain unique benefits, Delaware corporate law seeks to prevent such inequitable outcomes. Of course,

[189] *In re* Lordstown Motors Corp. S'holders Litig., No. 2021-1066-LWW, 2022 WL 678597, at *1 (Del. Ch. 2022) (denying a motion to stay because of Court's "essential role of providing guidance in developing areas of [Delaware corporate] law[,]" referring to SPACs).

[190] *In re* Multiplan Corp. S'holders Litig., 268 A.3d 784, 815 (Del. Ch. 2022).

[191] *Id.*

[192] Klausner et al., *supra* note 4, at 289.

how and under which circumstances Delaware corporate law will protect non-redeeming shareholders remains in question. For example, Delaware has precedent requiring harmed shareholders seeking appraisal rights to have voted against the relevant merger to recover their damages.[193] But, if the nature of SPAC shareholders' harm is democratic, meaning the SPAC management and sponsor impaired their ability to informedly exercise their redemption and voting rights, must non-redeeming SPAC shareholders prove they voted against the de-SPAC? This is only one of the many questions that remain to be answered. Delaware corporate law, flexible and adaptable as it is, has begun and will continue to provide necessary support to federal securities regulation in protecting unsophisticated shareholders from opportunistic SPAC management and sponsors, especially (if not exclusively) in the context of value-decreasing transactions. Acknowledging shareholders' (or class action plaintiff attorneys') inclination to incite litigation, however, the Court of Chancery and SPAC proponents alike should consider how they might "cleanse" their SPACs and de-SPACs to protect themselves by adequately recognizing and safeguarding shareholder interests.

III. In Search of a Cleansing Procedure

"Cleansing" corporate transactions is hardly a new concept. Put simply, boards cleanse transactions by adequately safeguarding their shareholders' interests while subduing their own. The effect of cleansing is to offer shareholders protection in normally conflicted transactions in exchange for managerial protection under the business judgment rule, rather than the strict scrutiny that board's actions would expectedly face under the entire fairness standard. In this way, cleansing a transaction focuses not on the scope of conduct, i.e., the fiduciary duty, but on the standard of review that courts will apply when evaluating such conduct.

A. Freezeout Cleansing Procedures

Perhaps the most well-known instance of corporate cleansing, *Kahn v. M & F Worldwide Corp.*,[194] involved a freezeout wherein stockholder, MacAndrews & Forbes ("M&F"), took M&F Worldwide Corp. ("MFW") private and in so doing eliminated unwanted shareholders from MFW.[195] M&F controlled MFW and three of M&F's directors were among MFW's thirteen

[193] *Insider IPOs*, *supra* note 1, at 30 (citing *In re* Appraisal of Dell, Inc., No. CV 9322-VCL, 2016 WL 3186538, at *31 (Del. Ch. May 31, 2016)).

[194] Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014).

[195] *Id.* at 638.

directors.[196] M&F was on both sides of the freezeout, and it thus constituted a conflicted controller transaction.[197] Accordingly, without additional law, the MFW board had the burden of proving that the freezeout was entirely fair to its stockholders, "sufficient to pass the test of careful scrutiny by the courts."[198] However, consistent with being a court of equity, the Supreme Court of Delaware abstained[199] from scrutinizing the MFW board's actions because the structure of the freezeout possessed "the shareholder-protective characteristics of third-party, arm's length mergers, which are reviewed under the business judgment standard."[200] Specifically, the controlling shareholder, M&F, conditioned the completion of its freezeout on two procedural protections: (1) the approval of an independent special committee that was empowered to act and acted with due care; and (2) the approving vote of a majority of minority stockholders, which stockholders were uncoerced and which vote was fully informed.[201] The Supreme Court of Delaware applied the business judgment rule to M&F board's actions in lieu of the entire fairness standard because the procedural protections (i) removed the controller from "the negotiations and shareholder vote," (ii) "optimally protect[ed] the minority stockholders in controller buyouts," (iii) encouraged future controller stockholders to "accord minority investors . . . the best protection," and (iv) ensured that stockholders obtain an adequate price just as the entire fairness standard would have.[202]

De-SPACs are not freezeouts. Indeed, they have nearly the opposite effect. Instead of controlling shareholders using their own private company to take the controlled public company private, they use their controlled public company to make a private company public. In other words, whereas controlling shareholders in freezeouts take public companies private, controlling shareholders in de-SPACs make private companies public. In so doing, controlling shareholders in freezeouts expand their shares in the target whereas those in de-SPACs dilute their shares therein. Another difference between de-SPACs and freezeouts is that the latter are conflicted controller

[196] *Id.* at 640.

[197] *In re* Crimson Expl., Inc. S'holder Litig., No. 8541-VCP, 2014 WL 5449419, at *12 (Del. Ch. Oct. 24, 2014) (explaining conflicted controller transactions occur "where the controller stands on both sides.").

[198] Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983).

[199] Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 Vand. L. Rev. 83, 96 (citing Shlensky v. Wrigley, 237 N.E.2d 776, 778 (Ill. App. Ct. 1968) (applying Delaware law), Bainbridge explains that the court "asserted a strong version of the abstention conception of the business judgment rule, arguing 'that the courts will not step in and interfere with honest business judgment of the directors unless there is a showing of fraud, illegality or conflict of interest.'").

[200] *Kahn*, 88 A.3d at 644.

[201] *Id.*

[202] *Id.* at 644–45 (citations omitted).

transactions because the controlling shareholder is on both sides of the transaction, but—according to the rationale in *In re Multiplan*, which is likely applicable to most SPACs for the reasons explained in Part III.C—de-SPACs are conflicted controller transactions because the controlling shareholder competed against the shareholders for a unique benefit to the shareholders' detriment. Lastly, one especially prominent practitioner and scholar, John Coates, has argued that "SPAC[s] lack[] the usual, central element of a board with discretionary business judgment over an operating company[,]" instead relying on its charter and bylaws[203]—unlike companies that are frozen out. Although these differences markedly distinguish de-SPACs from freezeouts, my view is that the dual-procedural protections in *Kahn v. MFW* should nevertheless cleanse de-SPAC transactions.

B. *Applying* Kahn*'s Dual-Procedural Protections to SPACs*

The fundamental justification for granting conflicted fiduciaries business judgment rule protection in exchange for offering shareholders dual-procedural protection is that shareholders' interests are adequately safeguarded from and prioritized above controlling fiduciary interests. Applying *Kahn*'s procedural protections to de-SPACs can also safeguard and prioritize unsophisticated shareholders' interests, although I argue such protections merit minor modification. Very few sources have referred to limiting SPAC liability by providing such protections, but they have not articulated how such protections would protect shareholders.[204] In very brief terms, a modified version of *Kahn*'s dual-procedural protections could both inoculate, or at least significantly reduce, the heavy incentives of the promote and provide minority shareholders a fully informed vote. In turn, this could serve the dual purpose of immunizing (i) sponsors—i.e., controlling shareholders—from being conflicted and (ii) management from being self-interested and lacking independence.

[203] Coates, *supra* note 4, at 49.

[204] *Id.* at 9 ("[T]he fiduciary duties of care and loyalty are conventionally applied more strictly in conflict of interest transactions, particularly if they involve control shareholders, absent special procedural steps, which themselves may be a source of liability risk."); Frank M. Placenti, *Recent Claims SPAC Board Structures are a "Conflict-Laden" Invitation to Fiduciary Misconduct*, Harv. Law Sch. F. on Corp. Governance (June 4, 2021), https://corpgov.law.harvard.edu/2021/06/04/recent-claims-spac-board-structures-are-a-conflict-laden-invitation-to-fiduciary-misconduct/.

1. Securing "Clean" Board of Approval

The approval of an independent special committee that is empowered to act and that acts with due care would ensure that SPAC boards who approve, recommend, and disclose the de-SPAC to shareholders do so without the promote contaminating their judgment and consequent actions. First, addressing independence, *In re Multiplan* explains what an independent board member does not look like: board members (i) who hold an interest in the promote and investigate a value-decreasing de-SPAC, or (ii) whose board position can be unilaterally terminated by the sponsor and restored in a future SPAC by the same. Therefore, members of a special committee may be independent if their compensation does not include interests in the promote ("Promote Interests") (convertible to common stock only upon consummation of a de-SPAC) and if they have no reasonable expectation of being compensated by Promote Interests in future transactions. Such independence would sufficiently align the special committee's interests with those of the common stockholders, such that the decisionmakers would not be incentivized to approve any "bad deal," unlike management and sponsors who hold Promote Interests.[205]

Moreover, the special committee must be empowered to act. Specifically, it must possess the ability to "freely select its own advisors and to say no definitively."[206] Without the ability to select its own advisors, the board—which presumably lacks independence—could appoint biased financial and legal counsel for the special committee, thereby polluting the committee's independence. Also, without the power to say "no" definitively, the special committee could easily become a mere formality to SPAC boards, only to afterwards "bypass the committee."[207] By empowering a special committee with these two abilities, it could conduct a proper investigation to ascertain whether consummating the de-SPAC would be in the shareholders' and SPAC's best interests—an investigation that Promote Holders might be entirely unable to conduct. If the special committee learned that the de-SPAC was in neither the shareholders' nor company's best interests, it could definitively reject such transaction without first consulting the board.

The last way to ensure that SPAC board approval is uncontaminated, or "cleansed," is by requiring the special committee to act with due care. In *Kahn v. MFW*, the Supreme Court of Delaware held that the special committee there exercised due care when, among other things, it requested the "most up-to-date, and presumably most accurate" projections, and required that they were prepared and provided by independent officers; consequently hired its financial

[205] *In re* Multiplan Corp. S'holders Litig., 268 A.3d 784, 813 (Del. Ch. 2022).

[206] *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 645 (Del. 2014).

[207] *Id.* at 650.

counsel to build a valuation model based on such updated data "using a variety of accepted methods"; adequately "investigated the possibility of other buyers"; and rejected a low purchase offer.[208] In sum, the special committee in *Kahn* ensured that the best interests of MFW's shareholders were safeguarded. A special committee that investigates a de-SPAC with due care could likewise safeguard SPAC shareholders' best interests by, for instance, ascertaining the "most up-to-date" share value after considering the SPAC Expenses and discussed in Part II; employing financial counsel to value the post-merged entity "using a variety of accepted methods"; and investigating the possibility of merging with other targets. Moreover, unlike the SPAC in *In re Multiplan*, a special committee could obtain a fairness opinion.[209] Although fairness opinions are often employed to ensure that target shareholders are adequately compensated, a fairness opinion could serve SPAC shareholders by determining whether the structured de-SPAC consideration causes them or the target shareholders to bear the costs of warrants and rights, fees to underwriters and other IPO professionals, the sponsor's 20% promote, and estimated redemptions. Clearly, a special committee that acts with due care can prioritize shareholder interests to at least match the priority management and sponsors place on their own. Taken together, special committees that are independent and empowered to act, and that act with due care, can ensure that SPAC board approval is not conflicted but, as the duty of loyalty requires, made in the SPAC's and shareholders' best interests.

2. *Ensuring that Shareholders are Uncoerced and Informed*

De-SPAC approval by the majority of the minority shareholders who were uncoerced and have made a fully informed vote would increase the likelihood that the shareholders were not deceived but entered in the merger fully aware of the post-merger risks.[210] As explained in Part II, SPAC boards will often incentivize PIPE investments with warrants, rights, and discounted share prices, and boards will similarly incentivize such investors to enter non-redemption agreements. SPAC boards have essentially purchased votes that, due to PIPE investors' size, guarantee shareholder approval when combined with the board's own 20% vote in favor of the de-SPAC. As a result, when

[208] *Id.* at 651–52.

[209] *See* Placenti, *supra* note 204.

[210] For clarity, the "minority" shareholders in SPACs often if not always possess more than 50% of voting shares in the SPAC, but they are considered "minority" shareholders because it is readily accepted that the sponsor is a controlling shareholder. *In re Multiplan*, 268 A.3d at 810 (referring unquestioningly to all shareholders other than the sponsor who owned no more than 20% of the SPAC's voting shares as minority shareholders).

incentivized PIPE investors "vote" on a de-SPAC, they are not assessing its merits the same way that other shareholders should yet do not because of their lack of sophistication.[211] PIPE investors have likely bargained themselves out of a loss.[212] Thus, I argue that, in order for the majority of the minority vote to have any meaning at all, in the sense that it reflects the non-PIPE shareholders' desires to enter the de-SPAC, *materially incentivized* PIPE investors must not be included in such count. This proposal avoids being draconian by allowing PIPE investors to vote generally, excluding those that enter the de-SPAC on favorable terms that enable them to overlook material deficiencies in proposed de-SPACs—i.e., those that are "materially incentivized." PIPE investors are important generally because SPACs often have capitalization requirements,[213] so providing a cleansing procedure that does not eliminate all PIPE investors from the de-SPAC vote would only be fair to those PIPE investors who are not materially incentivized. Discerning between incentivized and non-incentivized PIPE investors should be straightforward because SPAC management and sponsors must disclose insider treatment in their de-SPAC proxy statements.[214]

Though PIPE investors who are not materially incentivized can still participate in a de-SPAC vote under this proposal, it may nevertheless place a consequential portion of the de-SPAC vote into the hands of non-PIPE shareholders, many of whom are retail investors[215] and lack the necessary expertise to interpret proxy statements. SPAC boards must be prepared to provide materials that will reasonably inform such shareholders. Some scholars perpetuate the notion that most retail shareholders no longer hire intermediaries to "assimilate [disclosure] information," such as proxy statements.[216] Such persons believe this leaves retail investors with no other option than "investing the time to pore over the filings—filings which . . . suffer greatly from a lack

[211] Ganor, *supra* note 4, at 414 ("[T]he retail shareholders who need to decide whether to redeem their shares are left vulnerable and ill-equipped.").

[212] *Insider IPOs*, *supra* note 1, at 21 ("[O]nce a PIPE investor is secured, then inevitably it too is pushing to get a deal done—*on its own terms*.") (emphasis added).

[213] *Churchill Capital Corp. III Proxy Statement*, *supra* note 5, at 32 (Churchill must have "at least $5,000,001 of net tangible assets after redemptions by Churchill stockholders" to de-SPAC).

[214] *E.g.*, *id.* at 21, 30.

[215] Banerjee & Szydlowski, *supra* note 3, at 2–3 (quoting *Letter Urging Congress to Address Risks in Growing SPAC Mania*, AMS. FOR FIN. REFORM (Feb. 16, 2021), https://ourfinancialsecurity.org/2021/02/letters-to-congress-letter-urging-congress-to-address-risks-ingrowing-spac-mania/ ("These investors, many of whom are retail investors . . . .").

[216] *Insider IPOs*, *supra* note 1, at 47 ("With the advent of zero-cost trading, and the democratization of investing that has accompanied it, fewer and fewer retail investors are using intermediaries.").

of clarity and cohesion."[217] Other academics believe that current disclosures are difficult to understand.[218] However, intelligible current disclosures influence shareholder behavior.[219] Accordingly, this leaves SPAC boards with two options: (1) give non-PIPE shareholders[220] more time between merger announcement and de-SPAC vote, so as to avoid coercing them to make an uninformed vote; or (2) present disclosures in a digested form that such shareholders can understand and provide a link to the actual proxy statement for them to follow if they want more information.

Because of the complexity of de-SPAC proxy statements, I propose boards choose the second option. As explained in Part II, the average time between the merger announcement and de-SPAC vote in 2021 was nearly six months, so boards might simply make that the standard interlude. Six months is generally one-fourth of the time SPACs have to consummate a transaction, and that does not consider the time required to line up a merger announcement. Shareholders might not reasonably be able to read the convoluted, lengthy proxy statement within six months or longer. Consequently, boards would be wise to fully inform non-PIPE investors of the de-SPAC by providing a digested version of the proxy statement. Instead of requiring the shareholders to purchase the services of intermediaries, de-SPAC boards can purchase them—just as they do when they purchase PIPE votes—and provide the finished product to non-PIPE shareholders with a link to or copy of the actual proxy statement. At least one prominent law firm, post-*In re Multiplan*, has voiced a similar approach, advocating that, "going forward, *particularized* disclosures may be one way to mitigate risk . . . ."[221]

[217] *Id.*; *see generally*, *Churchill Capital Corp. III Proxy Statement*, *supra* note 5 (Churchill's proxy statement is several hundreds, if not a couple thousand, of pages long).

[218] Klausner et al., *supra* note 4, at 288 ("[P]roviding . . . raw [proxy] data is a far cry from providing shareholders with a statement of how much net cash underlies each of their shares.").

[219] *Id.* ("[R]esearch has shown that providing investors, particularly retail investors, with more transparent information on transaction costs can benefit investors."); Banerjee & Szydlowski, *supra* note 3, at 3 ("[M]andatory disclosure and transparency can have different effects on investor returns.").

[220] I recognize that some PIPE investors may not enter non-redemption agreements and that some may be investing at the same rate as other investors, but for simplicity, I will assume that only non-PIPE investors do not receive preferential treatment.

[221] Howard L. Ellin, Edward B. Micheletti, Gregg A. Noel, Susan L. Saltzstein, & Sarah Runnells Martin, *Court of Chancery Issues SPAC-Related Decision of First Impression*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP & AFFILIATES (Jan. 6, 2022), https://www.skadden.com/insights/publications/2022/01/court-of-chancery-issues-spac-related-decision.

As important, if not more important, is the content that SPAC boards include in such digested disclosures. SPAC boards should disclose to non-PIPE shareholders the information they provide to PIPE investors because PIPE investors are already receiving an economic premium. If such information is material to PIPE investors' decision to purchase SPAC stock and enter non-redemption agreements, it is material to non-PIPE shareholders' decision to not redeem their shares. Also mentioned earlier, a SPAC board should disclose the estimated share value immediately before the de-SPAC, the estimated share value after the de-SPAC, and the nature of the board's compensation. In addition, SPACs tend to be secretive about "the sponsor's relationship with affiliates that make PIPE investments, ownership interests in the sponsor, and how the sponsor divides the promote among different individuals and institutions[,]"[222] but they should disclose this information because it could inform non-PIPE shareholders the extent to which sophisticated investors feel they need to be compensated in order to make entering the de-SPAC worthwhile. I also argue that SPAC boards should disclose how many warrants and rights and how much of a discount they are giving PIPE investors. According to Delaware corporate law, PIPEs' choices to not redeem are unreliable indicators of the quality of a de-SPAC for unsophisticated investors because, for reasons discussed in Part II, they constitute "bought shareholder votes [that] may not reflect rational, economic self-interest arguably common to all shareholders."[223] Therefore, the disclosure of such information to the common shareholders could provide a proxy for how valuable and promising sophisticated investors believe the de-SPAC is, thereby restoring unsophisticated shareholders' reliance on sophisticated ones.

Obtaining an informed and uncoerced vote from the majority of the minority shareholders carries unfavorable consequences. For example, two scholars allege that SPAC boards prefer to issue non-redeemable shares when they perceive that unsophisticated investors pay closer attention to disclosures.[224] If SPAC management realizes that it can no longer opportunistically deceive unsophisticated shareholders and still receive business judgment rule protection, then it may decide to issuer fewer redeemable shares. But owning fewer redeemable SPAC shares is a low price to pay for fair shareholder treatment. In the alternative, if boards are unwilling to cleanse a de-SPAC through securing an informed and uncoerced majority of the minority shareholder vote, they will have to pass the stricter entire fairness standard. Implementing this procedural protection for shareholders is optional,

[222] Klausner et al., *supra* note 4, at 289–90.

[223] Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377, 388 (Del. 2010) (citing In re IXC Commc's, Inc. S'holders Litig., 1999 WL 100974 at 8, (Del. Ch. Oct. 27, 1999).

[224] Banerjee & Szydlowski, *supra* note 3, at 13.

but it would ensure that a majority of non-PIPE, minority shareholders have made an uncoerced and informed vote.

As a result of these procedural protections, SPAC board approvals could be void of sponsor-conflicted interests and self-interest, and they could be made by independent board members. Moreover, the power of a fully informed, uncoerced shareholder vote could be restored within the SPAC context, thereby protecting shareholders' redemption and voting rights and, thus, their economic interests. Just as the original dual-procedural protections in *Kahn v. MFW* provided minority shareholders in a freezeout with "the shareholder-protective characteristics of third-party, arm's length mergers,"[225] a SPAC-modified version of such protections can do the same for minority shareholders in a de-SPAC. Consequently, SPAC boards who properly implement such protections should avoid the harsh scrutiny under the entire fairness standard and receive business judgment rule protection even in the context of value-decreasing transactions.

CONCLUSION

Though formally giving shareholders control over whether a de-SPAC will occur, SPACs are designed to substantively eliminate that control. Securities regulation attempts to remedy this issue through mandating disclosure to SPAC shareholders, but savvy SPAC founders and managers may learn to technically comply with such disclosure while robbing unsophisticated shareholders of their original investments. Delaware fiduciary duties, however, may—and are beginning to—draw on equitable principles to stomp out such opportunism. Though only a motion to dismiss ruling, Court of Chancery's recent holdings are enlightening for all and particularly frightening for SPAC proponents. Notwithstanding that fact, just as Delaware corporate law protects corporate boards from freezeout claims when they have provided shareholders dual-procedural protections, it should consider protecting boards from de-SPAC claims when they provide shareholders a SPAC-modified version of the same. As fiduciary duty analyses are highly contextual and only just being performed within the SPAC context, only time will tell how exactly Delaware corporate law will shape SPAC fiduciary duties and affect SPAC sponsors, managers, and shareholders alike.

[225] Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014).