Professional Perspective

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Special purpose acquisition companies, or SPACs, are popular new tools for raising capital that have garnered significant attention and momentum over the past year. In 2020, 248 SPAC initial public offerings raised over $83 billion in capital—more than quadrupling the number of such offerings from the previous year and eclipsing the amount of capital they raised in 2019 by $69 billion. The amount and value of such offerings is set to grow exponentially again in 2021; as of April 1, 2021, 298 SPAC initial public offerings raised over $97 billion and an additional 247 SPACs filed for an IPO that had yet to close.

There have been few fully litigated cases relating to SPACs. Although many of the cases that have been filed have focused on federal securities law, the nature of SPACs and so-called de-SPACing transactions also potentially implicate a host of state law issues, particularly in connection with the fiduciary duties of directors. This article addresses several issues under Delaware law and how the unique features of SPACs may have an impact on the applicability of those rules.

Characteristics of SPACs

A SPAC is a publicly traded company created for the sole purpose of finding and acquiring an existing (typically private) company. This is accomplished by raising capital from investors who fund the SPAC's IPO before the SPAC has identified a specific company to acquire. Because a SPAC is a new company with no operating business, its IPO process is considerably faster than the process for a traditional company and can be completed in as little as two to three months from the initial SPAC formation to its IPO closing.

Investors in a SPAC IPO generally receive a unit consisting of one share of redeemable voting common stock in the SPAC, as well as a fraction of a warrant to purchase common stock of the surviving public company if the SPAC achieves its goal of merging with or acquiring a private company. This de-SPACing typically results in the conversion of a private company—often a late-stage startup with limited stockholders—into a publicly traded company, thus taking the company public without undergoing a traditional IPO process.

This provides some assurance to investors that, upon a successful de-SPACing, the value of their original investment will increase as both the common stock and the warrant increase in value. The SPAC's founders, called its sponsors, contribute a modest amount of capital into the SPAC for working capital purposes and in return receive a so-called "promote," typically consisting of non-redeemable common shares worth 20% of the SPAC on a pro forma basis, along with additional warrants in the SPAC, which positions them to realize a substantial return upon the successful de-SPACing. In addition, SPACs will also frequently use third party PIPE transactions (private investment in public equity) as a means of raising additional capital to finance the de-SPACing.

The funds that a SPAC raises from its public investors through its IPO are held in a trust account. They can be released only to fund a de-SPACing, to be returned to investors upon the SPAC's liquidation if it has failed to consummate a de-SPACing within typically 18-24 months, or to be returned to investors who elect to redeem their shares and take their money back at either the time of the de-SPACing or if the SPAC asks its stockholders to extend its life beyond that 18-24 month period, if necessary.

If a SPAC finds a private company with which to merge or acquire, its public shareholders will vote on the de-SPACing pursuant to a proxy statement that sets forth relevant information about the proposed transaction. At that time, the shareholders will have an option that is entirely separate from their voting right: to remain invested in the transaction and/or redeem their investment from the trust in full, with interest. This is one of the defining features of today's SPACs.

SPAC investors retain the option of simply redeeming their shares and getting their initial investment back. They can do so even if they vote yes on the transaction in order to, for example, ensure that the de-SPACing closes and their warrants retain some potential upside value. If the de-SPACing fails to receive approval and the SPAC eventually liquidates, then those warrants would become worthless. Nevertheless, these transactions are typically structured as mergers, require shareholder approval, and can involve a "change of control" within the meaning of Delaware law at either the SPAC or the target level.

As such, they potentially raise issues about the traditional rules governing mergers—including the applicability of *Revlon*, what information needs to be provided to shareholders being asked to vote, and whether the merger agreements should include a "fiduciary out" for the target board.

Fiduciary Duties

Section 141(a) of the Delaware General Corporation Law vests directors with the exceptional authority to manage or direct the affairs of a corporation. As a result of this authority, a familiar and fundamental precept of Delaware corporate law is that a board of directors owes fiduciary duties to the corporation and its shareholders. See, e.g., *Aronson v. Lewis*, 473 A.2d 805, 810 (Del. 1984). Delaware courts sometimes describe the purpose of fiduciary duties as "maximizing the long-term value of the corporation" for the benefit of a corporation's shareholders. See, e.g., *In re Rural/Metro Corp. Stockholders Litig.*, 102 A.3d 205, 253 (Del. Ch. 2014).

The notion that fiduciary duties serve to protect a corporation's long-term value is based on the assumption that every corporation has a "perpetual life in which the residual claimants have locked in their investment." *Frederick Hsu Living Tr. v. ODN Holding Corp.*, No. CV 12108-VCL, at *18 (Del. Ch. Apr. 14, 2017), as corrected (Apr. 24, 2017).

But this assumption is not fully applicable to a SPAC, whose existence is limited to the discrete timeframe in which investors typically retain the right to exit at their investment price plus interest. Few courts have had occasion to address whether or how traditional rules concerning fiduciary duties under Delaware law apply to SPACs. The courts that have done so, however, have not applied a different or modified set of fiduciary duty rules to SPACs. Nevertheless, courts recognize that "fiduciary duties of directors have context-specific manifestations." In re *PLX Tech. Inc. Stockholders Litig.*, No. CV 9880-VCL, at *29 (Del. Ch. Oct. 16, 2018), aff'd, 211 A.3d 137 (Del. 2019). The remainder of this article analyzes these rules in the context of SPACs and discusses how they might or should be applied to the directors of SPACs or targets.

Application of Specific Issues Under Delaware Law

Revlon and Standards of Review

One context-specific question is what standard of review courts will apply in considering whether directors have breached their fiduciary duties when engaging in a de-SPACing. Delaware courts considering whether directors have breached their fiduciary duties generally apply the deferential business judgment rule. E.g., *Firefighters' Pension Sys. of the City of Kansas City v. Presidio, Inc.*, No. CV 2019-0839-JTL, at *16 (Del. Ch. Jan. 29, 2021).

But when directors engage in certain types of merger transactions, Delaware courts scrutinize the directors' actions by applying a heightened standard of review. See *Revlon, Inc. v. MacAndrews & Forbes Hldgs., Inc.*, 506 A.2d 173, 179–82 (Del. 1986). *Revlon* traditionally applies when a corporation actively seeks to engage in a transaction that would result in "the break-up of the company" or when directors approve a transaction that "results in a sale or change of control." *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59, 71 (Del. 1995).

When *Revlon* applies, the relevant time horizon shifts because there is "'no tomorrow' for stockholders," *McGowan v. Ferro*, 859 A.2d 1012, 1032 n.97 (Del. Ch. 2004). *McGowan v. Ferro*, 873 A.2d 1099 (Del. 2005), and the transaction may represent the last opportunity for shareholders to realize a control premium. *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 45 (Del. 1994) (*Revlon* applies where "an asset belonging to public stockholders (a control premium) is being sold and may never be available again").

As such, the board's duty shifts to an obligation to obtain the best price reasonably available for the company's shareholders and to "exercise their fiduciary duties to further that end." The rationale behind *Revlon* is that courts should apply heightened scrutiny to transactions with significant consequences for shareholders, particularly where directors' personal motivations, financial and otherwise, might depart from the interests of the corporation and its shareholders.

From the perspective of a SPAC investor, a de-SPACing does not fall neatly into any of the circumstances where *Revlon* applies. *Revlon* does not typically apply to a transaction in which stockholders of a widely traded public company exchange their stock for the stock of another widely traded public company. See, e.g., *Arnold v. Soc'y for Sav. Bancorp, Inc.*, 650 A.2d

1270, 1290 (Del. 1994); *In re Smurfit-Stone Container Corp. S'holder Litig.*, No. CIV.A. 6164-VCP, at *12 (Del. Ch. May 20, 2011), as revised (May 24, 2011). In these types of stock-for-stock transactions, there is effectively no change in control, because the target's stockholders retain voting power and still have the opportunity to get a controlling share in a future transaction.

Thus, if the de-SPACing transaction is one where the SPAC is a publicly traded company without a controlling shareholder, as long as the resulting company is likewise a publicly-traded company without a controlling shareholders, investors retain the opportunity to obtain a control premium later on. Note that if the post-SPAC entity ends up with a controlling stockholder, it may be necessary to consider whether *Revlon* might apply from the perspective of the SPAC, although the redemption feature provides a means of "exit" should the SPAC investor not wish to remain an equity investor in the new combined company.

The more interesting question concerns shareholders of the SPAC target. In some instances, the SPAC target may be a company in which there is already a controlling shareholder, such as a private equity firm, or an affiliated group comprised of founders and early investors. As such, *Revlon* as such would not normally apply, since the non-controlling target shareholders are not entitled to a control premium, and the transaction does not result in a "change of control" from that perspective.

Moreover, on both the SPAC and target side, stockholders will receive a stake in the resulting, publicly traded company, and so the concern about "end stage" situations discussed above has less force. Nevertheless, the Delaware courts have scrutinized transactions in which a control group sells to an unaffiliated third party, particularly where the control block receives "differential consideration."

In that situation, courts have applied the so-called "entire fairness" doctrine, requiring the seller to establish both a fair process and a fair price, unless there are procedural steps, including the delegation of the decision to an independent special committee of the board, a non-waivable requirement for approval by a majority of the disinterested and fully informed stockholders, and the absence of threats or coercion. See, e.g., *In re Martha Stewart Living Omnimedia, Inc. Stockholder Litigation*, (Del. Ch. Aug. 18, 2017); *In re John Q. Hammons Hotels Inc. Shareholder Litigation*, at *10 (Del. Ch. Oct. 2, 2009). And the recent *Presidio* case suggests that a court may apply enhanced scrutiny even where the controller receives the same consideration as other shareholders.

It appears that no de-SPACing has yet been challenged by a seller stockholder on these grounds, and it is not common for SPAC targets to establish such procedures such as independent committees or majority-of-the-minority provisions. To the contrary, as discussed below, transactions are often structured through use of support agreements to secure the requisite shareholder approval. Of course, most SPAC targets are start-ups in which investors other than employees or "friends and family" are sophisticated venture capital firms with preferred stock, warrants, or other instruments that provide protection in the event of a public offering or transformational event and therefore lack a widely-dispersed unaffiliated stockholder base that might yield a plaintiff willing to assert such a claim. But just because it hasn't happened yet doesn't mean it won't, and advisors should be alert to the possibility of such claims.

State-Law Disclosure Obligations

Another context-specific question is what state-law disclosure obligations SPACs owe their investors. When directors seek or recommend shareholder action, they have an affirmative duty to disclose all information material to the action being requested and "to provide a balanced, truthful account of all matters disclosed in the communications with shareholders." *Malone v. Brincat*, 722 A.2d 5, 12 (Del. 1998). This is a judicially created fiduciary duty aimed at promoting informed decision-making by stockholders, not "a full-blown disclosure regime like the one that exists under federal law." *In re Micromet, Inc. Shareholders Litig.*, No. CIV.A. 7197-VCP, at *10 (Del. Ch. Feb. 29, 2012). However, under the *Corwin* case, the ability to establish that shareholders were fully informed of all material facts will provide an additional defense in situations in which heightened scrutiny, such as *Revlon*, might otherwise apply. *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 312 (Del. 2015).

When it comes to financial data, directors must provide stockholders with material financial information but not "all of the financial data" needed to make "an independent determination of fair value." See, e.g, *McMullin v. Beran*, 765 A.2d 910, 925 (Del. 2000). That said, Delaware courts have been reluctant to require directors in all cases to disclose information about financial projections or trends because that information is viewed as less probative of a transaction's value. See, e.g., *In re Oracle Corp.*, 867 A.2d 904, 938 n.149 (Del. Ch. 2004), *aff'd sub nom. In re Oracle Corp. Derivative Litig.*, 872 A.2d 960 (Del. 2005).

In the context of cash-out mergers, where shareholders receive cash for their shares, courts have found that financial projections can be considered material information that must be disclosed. See, e.g., *In re Netsmart Techs., Inc. Shareholders Litig.*, 924 A.2d 171, 203 (Del. Ch. 2007). This is because the stockholders of the target company must decide whether to give up an interest in the company's future cash flows, and projections of future cash flows would be important to that decision. The same considerations obviously do not apply to stock-for-stock mergers such as de-SPACing transactions.

Further, while companies generally do not disclose financial projections in connection with an IPO because of potential federal securities law liability concerns on the part of IPO underwriters, those concerns do not apply to a de-SPACing, even though it involves taking a private company public. As a result, another unique feature of a de-SPACing is that target companies can and often do disclose financial projections in connection with the transaction, and those projections are frequently included in PIPE marketing materials that are eventually filed by the SPAC and in proxy statements provided to SPAC investors.

Setting aside any federal securities law issues, which are outside the scope of this article, Delaware courts do not appear to have addressed how disclosure requirements will apply to de-SPACing transactions. Many recent de-SPACing transactions have been accompanied by disclosure lawsuits filed by SPAC investors using the traditional M&A disclosure template—i.e., seeking additional information about granular details of the financial information provided by the SPAC, often in the hope of securing additional "mooting" disclosures and the payment of a mootness fee. But there is an important difference.

The projections are those of the target business, not the SPAC, and accordingly, the inclusion of such financial information raises potential fiduciary duty questions relating to the extent of the SPAC board's due diligence and the extent to which claims might be made for a failure to provide a full and accurate picture of the target company. Such concerns may counsel SPAC sponsors to document their due diligence efforts, cast a critical eye on projections furnished by the target to the extent they are included in the proxy statement, and ensure that the proxy materials contain all appropriate cautionary language and disclaimers regarding the sources of the information and the limitations of the SPAC's review of that information.

Omnicare and Fiduciary Duties Following Announcement of De-SPACing

A final context-specific question is what fiduciary duties will apply to directors after they enter into a merger agreement to accomplish a de-SPACing. The Delaware Supreme Court has stated that "directors of a Delaware corporation have a continuing obligation to discharge their fiduciary responsibilities, as future circumstances develop, after a merger agreement is announced." *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 938 (Del. 2003).

To fulfill that obligation, it is common to include a "fiduciary out" clause in the merger agreement—essentially, a provision by which they retain the ability to terminate the deal if a better offer emerges prior to the shareholder vote. This provides a means for directors to ensure that the minority is not irrevocably locked into a transaction that turns out to be against their interests.

Omnicare was controversial at the time, and, while never overruled, has been whittled away in subsequent Chancery Court decisions and by workarounds such as "sign and consent" structures in which the signing of a merger agreement is quickly followed, often within hours or minutes, by written consents from stockholders sufficient to approve the transaction.

Practitioners have become comfortable with these structures, but SPACs present a problem: under the current federal securities laws, given the use of a Form S-4 registration statement to register the shares issued to target company shareholders in many de-SPACing transactions, it is not currently possible to solicit written consents from target stockholders until the Form S-4 is declared effective by the SEC, months after the signing of the merger agreement. Thus, from the perspective of a target, the structure of de-SPACing transactions seems reminiscent of the deal structure at issue in *Omnicare*.

De-SPACing agreements typically do not have "fiduciary out" clauses, so they may not require the target's board to consider other, higher bids. As a result, the target may become "locked" into an agreement to complete the transaction. What happens if a deal is locked up with a SPAC but another SPAC (or any other potential buyer) makes a higher bid prior to closing?

Resolution of this issue may require guidance from the U.S. Securities and Exchange Commission, which could make clear that the federal securities laws do not prohibit the practice, common in private transactions, of entering into written consents with shareholders around the same time the merger agreement is signed. However, this may require a rule change regarding the use of Form S-4. Until that happens, there remains some risk of litigation in the event of a "topping" bid.

On the one hand, as in *Omnicare*, courts could find that the absence of an effective "fiduciary out" clause undermines directors' obligations by making them obligated to complete a transaction that may not be the best deal. On the other hand, all of the arguments marshalled against *Omnicare* since it was decided would apply in full force here, as measures to lock up a transaction can provide shareholders with a substantial benefit by facilitating a potentially lucrative de-SPACing. And, of course, if target shareholders end up with widely traded public stock following the de-SPACing with no controlling shareholder, this would seem to mitigate some of the equitable concerns that animated the *Omnicare* court.

Conclusion

As more SPACs are formed and more de-SPACing transactions completed, there is likely to be a corresponding increase in litigation concerning those transactions. That litigation could raise novel questions about the application of state-law rules, particularly as they pertain to fiduciary duties overall and in the contexts of *Revlon*, state-law disclosure obligations, and *Omnicare*. Although courts have not yet had the occasion to address how those rules apply to SPACs and de-SPACing transactions, the analysis provided above can help the directors of SPACs and their target companies determine and assess their legal obligations in connection with de-SPACing transactions.

