Brooklyn Journal of Corporate, Financial & Commercial Law

Volume 17 | Issue 2 Article 10

5-15-2023

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Recommended Citation

Nicole Lynch, *Entire Fairness or Bust: The Burst of the 2020-2021 SPAC Bubble*, 17 Brook. J. Corp. Fin. & Com. L. 179 (2023).

Available at: https://brooklynworks.brooklaw.edu/bjcfcl/vol17/iss2/10

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ENTIRE FAIRNESS OR BUST: THE BURST OF THE 2020-2021 SPAC BUBBLE

ABSTRACT

Special Purpose Acquisition Companies (SPACs) have skyrocketed in recent years as an alternative for taking private companies public through an initial public offering (IPO). SPACs are blank-check companies that raise capital through public exchanges for the "special purpose" of acquiring a privately held company. Once acquired, the private company will take the SPAC's place on the public exchange, effectively accomplishing the same thing as a traditional IPO but without all the onerous reporting requirements and upfront costs.

For these reasons, SPACs have become the next big thing in securities markets despite being around since the 1990s. Throughout 2020 and 2021, the market saw an unprecedented amount of SPACs go public, raising record amounts of cash. However, with all this newfound popularity also came greater scrutiny from SPAC shareholders, who slowly but surely began to see the inherent flaws in this seemingly successful investment vehicle. While much of the commentary and criticism surrounding SPACs has been primarily focused on federal securities laws, more focus ought to shift to the court's treatment of how traditional fiduciary duties apply to SPAC sponsors who execute the de-SPAC transaction with the private company target. This is because SPAC sponsors stand to benefit immensely from any acquisition of a target company, no matter how profitable the outcome is for their shareholders.

Recently, however, in this new wave of SPAC litigation, the Delaware Court of Chancery in In Re MultiPlan Corp. S'holders Litig., 268 A.3d 784 (Del. Ch. 2022) (MultiPlan) held that fiduciary principles and the entire fairness standard do, in fact, apply to shareholder claims. While the MultiPlan case surely opened the door to heightened fiduciary standards, greater clarity, protection, and uniformity are still needed.

INTRODUCTION

Special Purpose Acquisition Companies (SPACs) took Wall Street by storm in 2020 and early 2021 and were dubbed the hottest new investment vehicle.[1] SPACs are publicly traded entities created for the "special purpose" of acquiring an existing private company (target) and taking it public.[2] In its initial stages of formation, SPACs raise capital through an initial public offering (IPO) and are then traded on public exchanges, typically for around

1. Michael Klausner, Michael Ohlrogge & Emily Ruan, *A Sober Look at SPACs* (Eur. Corp. Governance Inst., Financial Working Paper No. 746, 2021), https://ecgi.global/sites/default/files/working_papers/documents/klausnerohlroggeruanfinal.pdf.

2. *Id.*

$10 per unit (similar to a share).[3] The proceeds of the offering are then pooled into a trust account that is intended to be used within a defined period of time to identify and acquire an existing private company.[4] Once this occurs and a deal is agreed upon, the parties affect a business combination through a reverse merger (a de-SPAC transaction), which essentially allows the target company to take the SPAC's place on a public exchange.[5]

SPACs are created and governed by initial investors called sponsors, who typically put a down payment of $25,000 into the SPAC in exchange for a 20% equity stake in the newly formed public company post-merger.[6] Generally, sponsors are people who have expertise in a particular industry, are successful investors, or who are just financial celebrities trying to hop on board the next big thing on Wall Street.[7] These sponsors will initially seek out investments from underwriters and institutional investors, including prominent banks, private equity funds, and also various retired senior executives.[8] However, after this initial round, SPACs are then listed on public exchanges for everyday retail investors to purchase.[9] Specifically, in 2020, these retail investors included people who were similarly trying to take advantage of this new, seemingly successful trend of investing while stuck at home during the COVID-19 pandemic.[10] In fact, several investors told Andrew Ross Sorkin, a columnist for The New York Times, that they "know more people who have a SPAC than have Covid."[11] The reason why SPACs may be appealing to everyday retail investors is because it gives them the

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3. *What You Need to Know About SPACs – Updated Investor Bulletin*, SEC (May 25, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin; *but see* Kenneth Squire, *Bill Ackman and Tontine Holdings rewrite the terms for SPACs*, CNBC (Jul. 22, 2021), https://www.cnbc.com/2020/07/22/bill-ackman-and-tontine-holdings-rewrite-the-terms-for-spacs.html (the recent IPO of Pershing Square Tontine Holdings, Ltd., Bill Ackman's most recent venture, had some unique terms; it was priced at $20 per share (instead of the regular $10 per share)).

4. Gary M. Lawrence, Ahmer Nabi & Kevin Gold, *A Bridge Over Troubled Waters: The Role of Due Diligence in Mitigating SPAC Litigation Risks*, AM. BAR ASSOC. (Aug. 13, 2021), https://businesslawtoday.org/2021/08/a-bridge-over-troubled-waters-the-role-of-due-diligence-in-mitigating-spac-litigation-risks/#:~:text=Through%20the%20first%20half%20of,13.6 %20billion%20in%2059%20IPOs.

5. Complaint at 12, *Kwame Amo v. MultiPlan Corp*. 268 A.3d 784 (Del. Ch. Ct.) (No. 2021-0258).

6. Duncan Lamont, *The pros, cons and incentives behind the SPAC-craze sweeping markets*, SCHRODERS (Mar. 31, 2021), https://www.schroders.com/en/us/insights/equities/the-pros-cons-and-incentives-behind-the-spac-craze-sweeping-markets/.

7. Klausner et al., *supra* note 1.

8. Julie Young, *Special Purpose Acquisition Company (SPAC) Explained: Examples and Risks*, INVESTOPEDIA (Dec. 22, 2022), https://www.investopedia.com/terms/s/spac.asp#:~:text =SPAC%20shares%20are%20structured%20as,must%20return%20funding%20to%20investors.

9. *Id.*

10. *Lawyers suing Bill Ackman's SPAC plan up to 50 more lawsuits against blank-check firms, sources say,* REUTERS (Aug. 26, 2021), https://www.cnbc.com/2021/08/26/lawyers-suing-bill-ackmans-spac-plan-up-to-50-more-lawsuits-against-blank-check-firms-sources-say.html.

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

unique opportunity to "partner" with investment professionals and venture capital firms who source and perform due diligence on privately held companies.[12]

SPACs have risen in popularity, in part, because of the relative simplicity of the SPAC process, including the limited disclosure requirements and low, upfront costs.[13] Achieving public company status through a de-SPAC transaction has become so popular among investors that it has reached record-breaking numbers.[14] In 2021 there were 613 SPAC IPOs totaling $160 billion, which far exceeded the total number of SPAC IPOs in 2020 and 2019 *combined* (in 2020, there was $83.4 billion raised in 248 IPOs, and in 2019 there was $13.6 billion in 59 IPOs).[15]

All of the enthusiasm surrounding SPACs, however, seemed to overshadow any discussions about the conflicts and risks that are inherent in the SPAC structure.[16] But, as more companies began to go public through de-SPAC transactions, it painted a clearer picture of the inherent risks they pose to investors, generating greater scrutiny and skepticism.[17] Accordingly, many shareholders have initiated lawsuits against SPAC management teams, and it is only getting worse. According to the Securities Class Action Filings 2021 Year in Review conducted by Cornerstone Research, the federal SPAC filings in 2021 by shareholders increased more than sixfold relative to 2020.[18] In response, the Securities and Exchange Commission (SEC), in a three-to-one vote of its commissioners on March 30, 2022, approved the issuance of proposed rules regarding disclosures, due diligence requirements, and accounting standards.[19] Current SEC Chairman, Gary Gensler, stated that the

12. *Stocks Investing in a SPAC*, FINRA (Mar. 29, 2021), https://www.finra.org/investors/insights/spacs.

13. Jamie Payne, *Market Trends: De-SPAC Transactions*, PRACT. GUIDANCE J. (Mar. 6, 2022), https://www.lexisnexis.com/community/insights/legal/practical-guidance-journal/b/pa/posts/market-trends-de-spac-transactions#:~:text=In%202021%2C%20SPAC%20IPOs%20and,than%20%24160%20billion%20in%202021.

14. *Id.*

15. *Id.*; Lawrence et al., *supra* note 4.

16. Christopher Kercher, Ellison Ward Merkel, Andrew Rossman & R. Brian Timmons, *Litigation Risk in the SPAC World*, JD SUPRA (Oct. 1, 2020), https://www.jdsupra.com/legalnews/litigation-risk-in-the-spac-world-88058/.

17. *Id*; Ivana Naumovska, *The SPAC Bubble Is About to Burst*, HARV. BUS. REV. (Feb. 18, 2021), https://hbr.org/2021/02/the-spac-bubble-is-about-to-burst.

18. Cornerstone Research & Stanford Law School Securities Class Action Clearinghouse, *Securities Class Action Filings 2021 Year in Review*, CORNERSTONE RESEARCH (2021), https://www.cornerstone.com/wp-content/uploads/2022/02/Securities-Class-Action-Filings-2021-Year-in-Review.pdf.

19. Jacqueline M. Vallette & Kathryne M. Gray, *US SEC's Climate Risk Disclosure Proposal Likely to Face Legal Challenges,* MAYER BROWN (Apr. 21, 2022), https://www.mayerbrown.com/en/perspectives-events/publications/2022/04/us-secs-climate-risk-disclosure-proposal-likely-to-face-legal-challenges; Gary Gensler, *Statement on Proposal on Special Purpose Acquisition Companies, Shell Companies, and Projections*, Exchange Act Release No. 33-11048 (Mar. 30, 2021), https://www.sec.gov/news/statement/gensler-spac-20220330. "The proposed new rules and amendments would require, among other things, additional disclosures about SPAC sponsors,

proposal "would strengthen disclosure, marketing standards and gatekeeper and issuer obligations by market participants in SPACs, helping ensure that investors in these vehicles get protections similar to those when investing in traditional IPOs."[20]

However, this same initiative to protect shareholders has not been adequately addressed at the state level, despite the fact that there were 245 lawsuits filed by shareholders in state courts, including in Delaware and New York, between 2020 and 2021.[21] This is especially concerning because most SPACs are formed as Delaware corporations.[22] Specifically, many of these lawsuits revolve around breaches of fiduciary duties, alleging several conflict of interest issues that incentivized the SPAC management team to get a merger deal done rather than take into account the shareholders' best interests.[23] However, with many suits being resolved by supplemental disclosures during the 2020-2021 SPAC bubble, few courts had the occasion to address whether or how traditional Delaware fiduciary duty laws apply to sponsors who effectuate the de-SPAC transactions.[24] This raises several concerns not only because SPAC shareholders are "putting their money and confidence behind the sponsor's ability to source and execute a deal," but also because inherent in the SPAC structure is misaligned economic incentives between sponsors and shareholders, and various situations that give rise to conflicts of interest between sponsors and the board of directors of the SPAC and private company.[25]

This Note explores the significant power sponsors are granted with little-to-no liability or consequences attached. This Note proposes that sponsors of

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conflicts of interest, and sources of dilution . . . . Further, the new rules would address issues relating to projections made by SPACs and their target companies, including the Private Securities Litigation Reform Act safe harbor for forward-looking statements and the use of projections in SEC filings and in business combination transactions." *Id.*

20. *Id.*

21. Amit Bubna & An Wang, *SPACS: MARKET OVERVIEW AND LITIGATION LANDSCAPE*, BATES WHITE ECON. CONSULTING (May 2022), https://www.bateswhite.com/newsroom-insight-Bubna-and-Wang-SPAC-market-overview-and-litigation-landscape-May-2022.html#:~:text=From%202020%20Q1%20through%202021,SPAC%2Drelated%20cases%2C%20respectively. Of the 245 lawsuits filed in state courts between 2020 and 2021, 85 of them were filed in Delaware and 83 of them were filed in New York. *Id.*

22. Ramey Layne & Brenda Lenahan, *Special Purpose Acquisition Companies: An Introduction*, HARV. L. SCH. F. ON CORP. GOV. (Jul. 6, 2018), https://corpgov.law.harvard.edu/2018/07/06/special-purpose-acquisition-companies-an-introduction/.

23. *SPAC Litigation and Enforcement Update: Spring 2021*, BAKER BOTTS (Apr. 23, 2021), https://www.bakerbotts.com/thought-leadership/publications/2021/april/spac-litigation-and-enforcement-update-spring-2021.

24. Jim Ducayet, Joshua G. Doclos & Rebecca B. Shafer, *SPACs and Delaware Fiduciary Duties*, SIDLEY (Apr. 19, 2021), https://ma-litigation.sidley.com/2021/04/spacs-and-delaware-fiduciary-duties/; Alison Frankel, *The new 'deal tax': SPAC defendants are paying plaintiffs lawyers to drop N.Y. state suits*, THOMSON REUTERS (May 5, 2021), https://www.reuters.com/business/legal/new-deal-tax-spac-defendants-are-paying-plaintiffs-lawyers-drop-ny-state-suits-2021-05-05/.

25. Lamont, *supra* note 6.

SPACs incorporated in Delaware, as controlling shareholders in the company, should owe the same fiduciary duties to their shareholders as do directors of any Delaware corporation. Declaring this heightened sponsor liability will give clarity and peace of mind to investors while quelling the SPAC bonanza that has escalated in recent years despite serious investor protection concerns.[26]

This Note will proceed in four parts. Following this introduction, Part I provides an overview of the structure of SPACs, including the features that inherently misalign sponsor incentives and shareholder interests. Part II details some of the suggestions investors and other professionals have proffered, noting the most obvious fix is to alter the SPAC structure in and of itself. This part also discusses the implications of each resolution, emphasizing the unrealistic and uncertain nature of their efficacy. Part III introduces a court-declarative solution that is a step in the right direction toward holding sponsors accountable and subject to the entire fairness standard of review. This section agrees, in part, that by defining sponsors as controlling shareholders, and thereby attaching them to a host of fiduciary duties to abide by, courts can clarify a murky field, more logically align shareholder protections with sponsors, and further protect the merged public company and its shareholders. However, at the same, simply attaching the entire fairness standard is not the end of the road. Rather, it still leaves open the possibility for sponsors to take shelter under the deferential business judgment rule despite the still-looming conflicting defects inherit in a SPAC's structure. The Note concludes by highlighting that while the litigation door may have been opened by declaring the entire fairness standard as the standard of review, greater clarity, protection, and uniformity are still needed. As a result, in the meantime, sponsors should consider implementing structural features to help mitigate the conflicts of interest that still persist in de-SPAC transactions.

I. AN INNOVATION WITH MISALIGNED INCENTIVES: REGULATIONS GOVERNING SPACS

A. THE SPAC PROCESS

SPACs are dubbed as blank-check companies that raise cash through the stock market in order to acquire enough capital to buy a private company to take public.[27] The initial stage of SPAC formation consists of the SPAC being

26. Kevin M. LaCroix, *SPAC-Related Class Action Breach of Fiduciary Duty Lawsuit Filed in Delaware Chancery Court*, THE D&O DIARY (Aug. 9, 2021), https://www.dandodiary.com/2021/08/articles/director-and-officer-liability/spac-related-class-action-breach-of-fiduciary-duty-lawsuit-filed-in-delaware-chancery-court/.

27. Ortenca Aliaj, Sujeet Indap & Miles Kruppa, *The Spac Sponsor Bonanza*, FIN. TIMES (Nov. 13, 2020), https://www.ft.com/content/9b481c63-f9b4-4226-a639-238f9fae4dfc.

listed on public exchanges to raise capital from everyday, public investors.[28] The investors in the SPAC, called shareholders, 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.[29] SPACs will generally sell these units for a set price, typically at $10 per unit.[30] The SPAC management team, led by the sponsor, has 12 to 24 months to find a worthy private company to merge with, but, if the management team is unable to do so, then the capital investments in the IPO trust account must be returned to the investors.[31] However, when the management team is lucky enough to identify a promising target, they must obtain approval from the shareholders before the SPAC can merge with the private company.[32] Accordingly, if a majority of shareholders vote in favor of the acquisition, the private company will merge with the SPAC and subsequently take its spot on the exchange as a publicly traded company. [33]

Compared to the traditional IPO process, SPACs seem to present investors with a faster timeline for going public, fewer reporting requirements, and an exciting new investment alternative.[34] And despite the recent buzz around SPACs in late 2020 as the hot, new investment vehicle on Wall Street, they have actually been around since the 1990s.[35] Originally, SPACs were invented to bypass the SEC's rule against blank-check companies, which were then known as penny stocks and experiencing "epidemic proportions" of "fraud and abuse."[36] By qualifying as mergers, SPACs were able to evade certain SEC hurdles, including the strict reporting requirements that prohibit traditional IPOs from making forward-looking projections.[37] There has been an unprecedented surge in SPACs as many

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28. Young, *supra* note 8.

29. Ducayet, *supra* note 24.

30. *What You Need to Know About SPACs – Updated Investor Bulletin*, *supra* note 3; *but see* Squire, *supra* note 3 (the recent IPO of Pershing Square Tontine Holdings, Ltd., Bill Ackman's most recent venture, had some unique terms; it was priced at $20 per share).

31. *What You Need to Know About SPACs – Updated Investor Bulletin*, *supra* note 3; *Lawyers suing Bill Ackman's SPAC plan up to 50 more lawsuits against blank-check firms, sources say,* REUTERS (Aug. 26, 2021), https://www.cnbc.com/2021/08/26/lawyers-suing-bill-ackmans-spac-plan-up-to-50-more-lawsuits-against-blank-check-firms-sources-say.html; Derek Malmberg et al., *Private-Company CFO Considerations for SPAC Transactions*, DELOITTE (Sep. 2020), https://www2.deloitte.com/content/dam/Deloitte/us/Documents/audit/us-private-company-CFO-considerations-for-SPAC-transactions.

32. Layne & Lenahan*, supra* note 22.

33. *Id.*

34. *What You Need to Know About SPACs – Updated Investor Bulletin*, *supra* note 3.

35. Michelle Celarier, *The Big SPAC Crackdown*, N.Y. MAG. (Sep. 2, 2021), https://nymag.com/intelligencer/2021/09/the-big-spac-crackdown.html?utm_source =flipboard.com&utm_medium=social_acct&utm_campaign=feed-part.

36. Daniel S. Riemer, *Special Purpose Acquisition Companies: SPAC and SPAN, or Blank Check Redux?*, 85 WASH. & LEE L. REV. 931, 935 (Jan. 2007).

37. Michelle Celarier, *Free of IPO Constraints, SPACs Can Make 'Absurd' Financial Projections — And This Hedge Fund Manager Says The Fallout Is Coming*, INST. INV. (Feb. 26, 2021), https://www.institutionalinvestor.com/article/b1qqvy1pqh34s6/Free-of-IPO-Constraints-

seasoned investors have turned to them to avoid the market volatility amidst the pandemic as well as the traditional risk IPOs present.[38] In 2021, 613 SPACs raised nearly $160 billion in funding—jumping from the 248 SPACs that raised $83 billion in 2020 and the 59 SPACs that raised $13 billion in 2019.[39] Some of the most high-profile investors, including hedge fund billionaire Bill Ackman and sports executive Billy Beane, have sought out SPACs to "skip over the expensive and time consuming IPO process."[40] The social media buzz surrounding private companies in exciting spaces, including the sports betting arena and the electronic vehicle industry, makes it easy to sell the investment to everyday investors who are jumping at the chance to board the SPAC frenzy.[41] In fact, in January 2021, "small-time investors represented 46% of trading volume in SPACs on Bank of America's platform" alone.[42]

However, what many everyday investors do not realize is that SPACs were constructively built with features that promote sponsor interests over shareholders. The misaligned economic incentives and various conflicts of interest that are inherent in the SPAC structure are seemingly reminiscent of the time that penny stocks brought out "epidemic proportions" of "fraud and abuse."[43]

SPACs-Can-Make-Absurd-Financial-Projections-And-This-Hedge-Fund-Manager-Says-The-Fallout-Is-Coming.

38. Preston Brewer, *ANALYSIS: IPOs Fall to Earth; a Requiem for SPACs?,* BLOOMBERG (July 8, 2022), https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-ipos-fall-to-earth-a-requiem-for-spacs.

39. Payne, *supra* note 13; Carmen Reinicke, *A SPAC Frenzy Earlier This Year Could Lead to Riskier Deals Here's Why*, CNBC (June 2, 2021), https://www.cnbc.com/2021/06/02/a-spac-frenzy-this-year-could-lead-to-riskier-deals-heres-why.html.

40. Ortenca Aliaj, Sujeet Indap & Miles Kruppa, *Can Spacs shake off their bad reputation?*, FIN. TIMES (Aug. 13, 2021), https://www.ft.com/content/6eb655a2-21f5-4313-b287-964a63dd88b3.

41. Dane Bowler, *Beware The SPAC: How They Work And Why They Are Bad,* SEEKING ALPHA (Jan. 5, 2021), https://seekingalpha.com/article/4397498-beware-spac-how-work-and-why-are-bad; Pippa Stevens, *Nikola saga hits three speculative areas at once: SPACs, Robinhood traders and electric vehicles*, CNBC (Sep. 21, 2021), https://www.cnbc.com/2020/09/21/nikola-saga-hits-three-speculative-areas-at-once-spacs-robinhood-traders-and-electric-vehicles.html (reporting that the "apparent success" of electronic vehicle company "Nikola's debut—as evidenced by investors rushing into the stock and bidding shares higher," reaching $93.99, for a gain of more than 170% after a few days of being traded, was extremely short-lived as it was revealed that Nikola was "making false statements about its technology" and as a result, its shares "plunged more than 22%.").

42. Yun Li & Nate Rattner, *Meme stocks, SPAC craze and a $100 million deli: It was a wild year in the market,* CNBC (Dec. 23, 2021), https://www.cnbc.com/2021/12/23/meme-stocks-spac-craze-and-100-million-deli-2021-marks-a-wild-year-in-the-stock-market.html.

43. Riemer, *supra* note 36.

B. SPAC *PROMOTES* SPONSORS TO GET *ANY* DEAL DONE

Most SPACs are structured with incentives for sponsors to pursue business decisions that do not align with those of their shareholders.[44] For example, in a typical SPAC, sponsors receive Class B shares, called founder shares, in return for an initial nominal investment in the SPAC.[45] These founder shares give the sponsor the right to obtain 20% of the equity in the post-merger company.[46] This generous equity stake, called the promote, is to compensate the sponsor for their work in pinpointing a promising target and consummating a merger.[47] Accordingly, once a sponsor secures a business combination, the founder's shares convert into regular Class A common stock in the newly merged public company, which typically translates into an equity stake worth millions of dollars.[48] However, absent any deal within the completion window, usually set at 12-24 months, the sponsor's founder shares are essentially rendered worthless, and all the investments in the SPAC must be returned to the shareholders.[49] With this win-or-lose scenario, it is no wonder why sponsors are extremely incentivized to complete the deal during the allocated time frame—no matter how profitable it is for their shareholders.

Not only do sponsors reap significant rewards if and when the merger is accomplished, but they do so with little risk. The nominal investment sponsors typically put down is around $25,000, which raises several concerns since their stake of founder shares will likely be worth hundreds of millions of dollars provided that the SPAC successfully merges into a public company.[50] This remains true regardless of the amount of their initial investment or how well the company performs after the merger.[51] As such, sponsors are arguably given big stakes for free and, in this way, are betting on target companies almost entirely with "house money."[52] As the Muddy Waters Research investment firm reported, "[a] business model that incentivizes promoters to do *something – anything* — with other people's money is bound to lead to significant value destruction on occasion."[53] In fact, this is exactly the concern that was raised by SPAC shareholders of

44. Complaint at 15, Kwame Amo v. MultiPlan Corp., 268 A.3d 784 (Del. Ch. Ct. 2022) (No. 2021-0258).

45. Malmberg et al., *supra* note 31.

46. *Id.*

47. *Id.*

48. Complaint, *supra* note 44, at 16.

49. *Id.*

50. Lamont, *supra* note 6.

51. Andrew Ross Sorkin et al., *The Issues With SPACs*, N.Y. TIMES (Feb. 10, 2021), https://www.nytimes.com/2021/02/10/business/dealbook/spacs-blank-check-deals.html.

52. *Id.*; Lamont, *supra* note 6.

53. Muddy Waters Capital LLC, *MultiPlan: Private Equity Necrophilia Meets The Great 2020 Money Grab (MPLN US)*, MUDDY WATERS RSCH. (2020), https://www.muddywatersresearch.com/research/mpln/mw-is-short-mpln/.

GigCapital 3, Inc. (Gig3), a Delaware corporation formed as SPAC by Avi Katz.

In a complaint filed in the Delaware Court of Chancery, former stockholders of Gig3 alleged that the SPAC's sponsor, GigAcquisitions3, which was led by Katz, breached its fiduciary duty in its capacity as Gig3's controlling shareholder when merging with Lightning eMotors, Inc. (New Lightning), the private company target.[54] As the sponsor, Katz purchased five million initial shares of Gig3 for the nominal price of $25,000.[55] In return, he was issued 20% of Gig3's post-IPO equity.[56] Upon the completion of its IPO on May 18, 2020, Gig3 sold 20 million units to public investors for $10 per unit, raising proceeds totaling $200 million.[57] However, when it came time to get approval from the public shareholders to combine with New Lightning, Gig3 boasted "unrealistic production and financial projections."[58] As a result, unbeknownst to the investors, following through with the transaction would dissolve the amount of cash they held per share from the original $10 they invested down to approximately $6 per share.[59] Yet, as bad as this merger was for the Gig3 public shareholders, it was lucrative for the sponsor, Katz.[60] This is because when the merger with New Lightning closed, the initial five million founder shares, which Katz received in return for his mere $25,000 investment, were worth more than $39 million.[61] Even at the deflated share price of $6.57, his shares were still worth approximately $32.7 million.[62] But, had no merger occurred, Katz would have received nothing while the public stockholders would have received their initial investment back plus a small profit at around $10.10 per share.[63] Thus, inherent in this structure is the strong incentive for sponsors to complete a merger—*any* merger—rather than return funds to investors.

Moreover, not only does the promote induce sponsors to pursue unfavorable deals, but the shareholders are the ones paying for it. While the target company nominally pays for the promote as part of the merger agreement with the SPAC, arguably, the cost is coming out of shareholder pockets. This is because since the promote is a known percentage at the time pricing is negotiated, it is essentially baked into the price at which the target

54. Complaint at 1, Delman v. GigAcquisitions3, LLC, 288 A.3d 692 (Del. Ch. 2023) (No. 2021-0679), 2023 WL 29325.

55. LaCroix, *supra* note 26.

56. *Id.*

57. Complaint, *supra* note 54, at 2.

58. LaCroix, *supra* note 26.

59. Complaint, *supra* note 54, at 2.

60. *Id.* at 22.

61. *Id*. at 10.

62. *Id.* at 38; *see also* Complaint, *supra* note 44, at 5 (finding that the founder shares held by the Sponsor, Michael Klein, cost him just $25,000 yet were worth over $300 million upon the merger's closing, representing a personal return on investment of 1,219,900%).

63. Complaint, *supra* note 54.

company will issue shares to the SPAC.[64] With this knowledge in mind, the shares are priced higher in the sense that the same number of shares are issued as if there was no promote.[65] So while the target company is giving the 20% equity promote to the sponsor, the existence of it in the first place dilutes the number of shares available to investors.[66] In this way, the negative consequences of the promote falls yet again on the shareholders.

C. TICKING TIME BOMB – ONLY 24 MONTHS TO FIND A TARGET

SPACs are similar to merger and acquisition (M&A) transactions in that they both have an accelerated financial, legal, and tax due diligence process. [67] However, a crucial distinction is that SPAC sponsors must identify a company to merge with, usually within 24 months, or else the SPAC will be wound up, and the IPO proceeds returned to investors.[68] Thus, in the event the SPAC strikes out during its two-year timeline for action, the sponsor's investment essentially becomes worthless.[69] Accordingly, there is a strong incentive to close deals, even if it means risking shareholder value.[70] And with so many SPACs flooding the market in the hopes of securing a target company, there is an even greater rush to complete the merger.[71] This is concerning because there are only so many quality targets to go around, and as a result, many SPACs end up with companies that are unfit to go public.[72]

64. Bowler, *supra* note 41.

65. *Id.*

66. *Id.*

67. Malmberg et al., *supra* note 31.

68. *Id.*

69. Corey I. Rogoff, *SEC Speaks Out on SPACs, Highlights Legal Liability and Reporting Risks*, PROSKAUER (Apr. 19, 2021), https://prfirmpwwwcdn0001.azureedge.net/prfirmstgacctpwwwcdncont0001/uploads/f9421b0f19f9d09ceef3844f8887ac6f.pdf. In "virtually no other public company merger setting (other than pending insolvency) is a person in the sponsor's position faced with a 'binary' result in which their vote can render their shares potentially valuable or condemn them to be worthless." Frank M. Placenti *Recent Claims SPAC Board Structures are a "Conflict-Laden" Invitation to Fiduciary Misconduct*, HARV. LAW SCH. F. ON CORP. GOV. (June 4, 2021), https://corpgov.law.harvard.edu/2021/06/04/recent-claims-spac-board-structures-are-a-conflict-laden-invitation-to-fiduciary-misconduct/.

70. Naumovska, *supra* note 17.

71. Complaint, *supra* note 44, at 14 (reporting that there are currently 551 SPACs actively seeking acquisition targets that need to pull off a merger or risk being liquidated); Therese Poletti, *SPACs aren't dead, but they don't look too healthy*, MKT. WATCH (July 10, 2021), https://www.marketwatch.com/story/spacs-arent-dead-but-they-dont-look-too-healthy-11625673320.

72. Naumovska, *supra* note 17; Stevens, *supra* note 41. For example, after Nikola went public through a de-SPAC transaction, it was revealed that it had not yet developed or even acquired the correct technology for the prototype it advertised to consumers. Thomas Franck & Michael Wayland, *SEC cracks down on SPAC claims as electronic truck maker Nikola agrees to pay $125 million to settle fraud charges*, CNBS (Dec. 21, 2021), https://www.cnbc.com/2021/12/21/nikola-to-pay-125-million-to-settle-fraud-charges-as-sec-cracks-down-on-spac-claims.html. As such, its shares sunk from nearly $100 down to $9.25 within one year. *Id.* Clearly, Nikola was at too early a stage of business to withstand the pressure of going public, however, with target companies

In this way, "the possibility for value destruction is only magnified by the sheer amount of SPAC capital—ticking time bombs of dry powder—chasing a limited universe of private targets."[73] With this massive demand-supply imbalance, SPACs seem to be "lowering the bar" for companies that they are partnering with.[74] Moreover, even the few private companies that are ripe to go public may not want to exit via a SPAC because they have "a range of funding options, from getting another round of financing, doing a traditional IPO, or proceeding through a direct listing."[75] As such, sponsors are growing increasingly desperate for acquisitions and, in response, are aggressively pursuing questionable transactions.[76]

This pressurized time feature has not gone unnoticed, as it has been the center of several lawsuits in Delaware state courts.[77] Specifically, shareholders of the SPAC FinTech Acquisition Corp. IV (FinTech) filed a claim against its sponsor in the Court of Chancery on March 2, 2021, alleging that FinTech "acted with lightning speed to find a business partner."[78] Only three months after FinTech's SPAC was listed on NASDAQ did the sponsor announce its business plan to merge with the target company Perella Weinberg.[79] Similarly, SPAC shareholders of Churchill Capital Corp III (Churchill) filed a verified class action complaint on March 25, 2021, also in the Delaware Court of Chancery, alleging the SPAC's sponsor, Michael Klein, breached his fiduciary duty "by rushing to sign a deal just before the time limit expired."[80] With respect to this deal, Klein was responsible for pinpointing, negotiating, and executing a business combination for Churchill by February 19, 2022, or else the founder shares would be forfeited, and the SPAC would be dissolved.[81] This conflict-laden timeline invited fiduciary misconduct when the SPAC managers conveniently left out of the proxy statement the fact that the target company was about to lose its largest client

dwindling left and right, the SPAC was incentivized to secure the deal before their timeline expired. *Id.*

73. Complaint, *supra* note 44, at 16.

74. Andrew Ross Sorkin, *Wall Street's New Favorite Deal Trend Has Issues,* N.Y. TIMES (Feb. 10, 2021), https://www.nytimes.com/2021/02/10/business/dealbook/spac-wall-street-deals.html; Bailey Lipschultz, *Why More Than 40% of Ex-SPACs Are Running Out of Cash*, BLOOMBERG (Oct. 5, 2022), https://www.bloomberg.com/news/articles/2022-10-05/doens-of-de-spacs-flag-severe-cash-problems-as-economy-weakens.

75. Poletti, *supra* note 71.

76. *Id.*

77. *The SPAC Litigation Boom: What SPAC Sponsors, Directors and Officers Can Do to Mitigate Their Exposure*, PAUL WEISS (Mar. 9, 2021), https://www.paulweiss.com/media/3980884/the_spac_litigation_boom_what_spac_sponsors_directors_and_officers_can_do_to_mitigate_their_exposure.pdf.

78. Julia L. Bensur & James Heyworth, *SPAC Litigation Accelerates in Delaware Courts*, SIDLEY (Apr. 8, 2021), https://ma-litigation.sidley.com/2021/04/spac-litigation-accelerates-in-delaware-courts/.

79. *Id.*

80. *The SPAC Litigation Boom, supra* note 77.

81. Complaint, *supra* note 44, at 19–20.

to its competitor.[82] Thus, Klein, as the sponsor responsible for sourcing this deal, prioritized his personal and financial interests in reaping over $300 million upon the merger's closing to the detriment of the shareholders.[83]

D. SPONSOR DE FACTO CONTROL OF SPAC BOARDS

A number of potential self-dealing issues may be orchestrated by the sponsor and also implicate the SPAC's board of directors.[84] For example, the sponsor may install their choice of directors and officers to the SPAC's board, which may result in a board with extensive familial, personal, or financial ties to the sponsor.[85] Another issue that could arise is if the sponsor promises incentives, in the form of founder shares or bonuses, to the directors and officers and makes them contingent upon closing the de-SPAC transaction.[86] This creates a conflict between the SPAC shareholders' best interest—not going through with a deal with an unprofitable target—and the management team's best interest—completing the de-SPAC transaction and obtaining the bonus awards.[87] Lastly, if the IPO fails to raise enough capital, the sponsor may seek out additional funds from Private Interest in Public Equity (PIPE) financing, often on especially favorable terms.[88] In doing so, the sponsors are essentially diluting the existing SPAC shareholders by allowing outside investors to acquire cheap post-deal equity.[89]

Sponsors invite misconduct when they personally select their choice of board members and richly compensate them upon the condition of closing any deal.[90] In fact, in *Kwame Amo v. MultiPlan Corp* and in *Delman v. GigAcquisitions3 LLC,* that is exactly what the shareholders alleged.[91] In *MultiPlan*, the SPAC's sponsor, Michael Klein, controlled nearly the entire board because not only had he chosen directors whom he had deep financial and personal ties with, but he also had the power to remove them at any time.[92] For example, one of the directors was Klein's brother, and two others worked at his affiliate company.[93] Additionally, Klein granted each of the

82. *Id.* at 30–31 (stating that the client the target was going to lose to its competitor provided 35% of the target's revenues in 2019).

83. Lawrence et al., *supra* note 4; Complaint, *supra* note 44, at 4–5.

84. Varant Yegparian, *How to Prepare for the Deluge of SPAC Litigation*, SCHIFFER HICKS JOHNSON PLLC (Apr. 22, 2021), https://shjlawfirm.com/2021/04/22/how-to-prepare-for-the-deluge-of-spac-litigation/.

85. *Id.*; *See* Complaint, *supra* note 44, at 4.

86. Yegparian, *supra* note 84.

87. *Id.*

88. *Id.*; Jonathan (Yoni) Schenker & H. Gregory Baker, *Delaware Court Holds that SPAC Sponsor's "Founder Shares" Created a Conflict of Interest with Public Stockholders*, PATTERSON BELKNAP (Feb. 1, 2022), https://www.pbwt.com/securities-litigation-insider/delaware-court-holds-that-spac-sponsors-founder-shares-created-a-conflict-of-interest-with-public-stockholders.

89. Complaint, *supra* note 44, at 17–18.

90. *Id.*

91. *Id.* at 3; Complaint, *supra* note 54, at 3.

92. Complaint, *supra* note 44, at 21.

93. *Id.*

directors' founders shares worth millions of dollars, which of course, they could retain only if the Churchill SPAC completed an acquisition.[94] Similarly, in *Gig3*, the sponsor, Avi Katz, "Packed the Board With Loyalists and Ensured That Their Financial Interests Were Aligned With His."[95] He elected board members who had pre-existing and continuing loyalties to him as current board members of other deals he was sponsoring at the time.[96] As such, all of the directors had a strong interest in maintaining their lucrative relationship with Katz and, when presented with a merger deal, "simply rubberstamped what Katz requested."[97] Looking at all of the connections together, these sponsors essentially neutered the board's ability to act independently and "'say no.'"[98]

Moreover, the process by which a conflict-laden board negotiates PIPE funding is severely flawed.[99] For example, in *Gig3*, Katz orchestrated a deal with an outside PIPE investor, but the terms of the deal made it "a far worse alternative" for the shareholders, with each share valued at less than $6.00 per share, rather than going through with a liquidation in which the shareholders would simply receive their initial $10 investment back.[100] However, the board failed to consider this and instead turned "a blind eye to the dilution of Gig3's shares and the dissipation of its cash."[101] The agreement to this huge undercut shows just "how determined the Board and the Sponsor were to see the Merger occur," no matter the cost to the shareholders.[102]

Overall, this aspect of a SPACs' structure presents a "central governance challenge" for SPACs—the conflict between the sponsor controlled board and the shareholders.[103] While "shareholders can be protected if the merger decision is in the hands of independent directors," most of the time, this is not the case.[104] As mentioned above, many sponsors design their SPAC's governance so that the directors have a strong connection to the sponsor or a significant financial interest in the founder shares in the post-merger company.[105] In this way, a SPAC governed by directors linked to the sponsor

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94. *Id.* at 22.
95. Complaint, *supra* note 54, at 17.
96. *Id.* at 6–7.
97. *Id*. at 9.
98. Complaint, *supra* note 44, at 22.
99. Yegparian, *supra* note 84.
100. Complaint, *supra* note 54, at 7.
101. *Id.* at 26.
102. *Id.* at 20.
103. Kevin M. LaCroix, *SPACs' Structural Conflicts, Shareholder Litigation, and Judicial Review*, THE D&O DIARY (Dec. 6, 2021), dandodiary.com/2021/12/articles/director-and-officer-liability/spacs-structural-conflicts-shareholder-litigation-and-judicial-review/; Michael Klausner & Michael Ohlrogge, *SPAC Governance: In Need of Judicial Review* (Stan. L. Sch., Working Paper No. 564, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3967693.
104. LaCroix*, supra* note 103.
105. *Id.*

or who are generously rewarded with equity in the form of founder shares is "'the epitome of bad governance.'"[106] In the words of Stanford Law Professor Michael Klausner and NYU Law Professor Michael Ohlrogge, it is "a loyalty breach waiting to happen."[107]

Overall, SPACs are essentially a way for financial celebrities to get significant equity in public companies in exchange for a mere $25,000 investment.[108] And even if these sponsors are unsuccessful in merging with a target company—banks still collect their fees, but shareholders get nothing except for their initial investment back, which is likely worth less because by the time of the merger deadline, it has depreciated.[109] Also, SPACs allow sponsors to take private companies public without the normal regulatory oversight that is required for IPOs, so there is little risk or accountability there.[110] With IPOs, in contrast, the incentives are clearly disclosed, and there are no hefty promotes that result in giving away huge equity stakes in a company for virtually nothing.[111] And with venture capitalists or hedge funds, the investments are backed not only by teams of professional investors with expertise in certain industries, but also by those who have skin in the game—whereas sponsors put in an insignificant amount compared to the total value of the company they are going to acquire.[112] Despite this potential for misconduct, SPACs are still Delaware corporations governed by the State's fiduciary duty laws—a core concept that sponsors seem to have forgotten.

E. REDEMPTION RIGHT

Another conflict-ridden feature of SPACs is the incentive to dissuade public shareholders from redeeming their shares. SPACs include the option for shareholders to withdraw from the deal if they do not like the target company the sponsor proposes to merge with.[113] If so, they can choose to pull out their initial investment before the merger and redeem their shares for cash plus interest.[114] It is only after all the redemption requests have been satisfied

106. *Id.*
107. Klausner, *supra* note 103 at 6.
108. Aliaj et al., *supra* note 27.
109. Klausner et al., *supra* note 1 at 32 (noting that the median SPAC holds cash of just $6.67 per share (compared to the initial $10 share value)).
110. Aliaj et al., *supra* note 27; *What are the differences in an IPO, a SPAC, and a direct listing?*, SEC (Aug. 5, 2022), https://www.sec.gov/education/capitalraising/building-blocks/registered-offerings#:~:text=By%20going%20public%20via%20a,that%20the%20SPAC's%20sponsors%20put.
111. *Id. What are the differences in an IPO, a SPAC, and a direct listing?*, SEC (Aug. 5, 2022)].
112. *Id.*; Mergers & Inquisitions / Breaking Into Wall Street, *The Great SPAC Scam: Why SPACs Are Terrible for Most Investors*, YOUTUBE, https://www.youtube.com/watch?v=jaQ_73c7qMY&lc=UgzTz284x4k6H92JGOx4AaABAg.
113. Max H. Bazerman & Paresh Patel, *SPACs: What You Need to Know*, HARV. BUS. REV. (Aug. 2021), https://hbr.org/2021/07/spacs-what-you-need-to-know.
114. Klausner, *supra* note 103.

that the remaining cash in the trust can be used in the merger.[115] In this way, the more cash that remains available to fund the merger after all redemption rights have been exercised, the more valuable the post-merger company will be for the sponsor.[116] Therefore, a sponsor has a strong incentive to dissuade as many of the public shareholders from redeeming their shares.[117]

While a SPAC's sponsor and board must provide the public shareholders with all information material to their redemption decision, they often do not do so.[118] Rather, they tend to sway or mislead shareholders to vote in favor of the merger so the sponsors and directors can reap their financial reward.[119] This is exactly what the Gig3 shareholders claimed in their suit. In addition to breaching its duty of loyalty, the shareholders alleged the management team "breached its duty of candor to Gig3's stockholders by withholding critical information" about the level of share dilution as a result of the merger.[120] The merger agreement valued the Gig3 shares at $10.00 per share, but in reality, there was less than $6.00 in cash underlying those shares.[121] Additionally, the management team included materially misleading revenue projections.[122] In its proxy statement, the management team stated that the post-merger company would "increase its revenues more than 200-fold in just five years;" however, "[l]ess than a month after the share redemption deadline," Gig3 revealed that "the nature of [New] Lightning's business model would be extremely difficult to scale up."[123] This is exactly the type of information that should have been disclosed to Gig3 shareholders because it was not only material to their decision on how to vote their shares for the merger, but also to their decision on whether to redeem their shares after the vote.[124] The failure of their management team to inform the shareholders of the true nature of the merger deprived them of their interest and resulted in an economic loss.[125]

II. PROPOSED SOLUTIONS TO CURTAIL MISALIGNED SPAC INCENTIVES

A. SEC INTERVENTION: CRACKING DOWN ON SPACS

The aforementioned Delaware complaints are part of a disruptive trend of SPAC transactions in which good corporate governance is overshadowed

115. *Id.*
116. LaCroix, *supra* note 103.
117. *Id.*
118. *Id.*
119. *Id.*
120. Complaint, *supra* note 54, at 9.
121. *Id.*
122. *Id.* at 10.
123. *Id.*
124. *Id.* at 9.
125. *Id.* at 42–43.

by the financial conflicts of sponsors.[126] The SEC has already begun to take action as it approved the issuance of proposed rules on March 30, 2022.[127] If adopted, the SEC believes it "could help the SPAC market function more efficiently by improving the relevance, completeness, clarity, and comparability of the disclosures…and by providing important investor protections to strengthen investor confidence in this market."[128] The issuance of these proposed rules is no surprise considering there was more than double the number of federal SPAC class actions filed in 2021 as there was in 2020.[129]

Although many of the complaints that have been filed have focused on a host of federal securities law issues, the nature of SPACs also implicate several state law issues, "particularly in connection with fiduciary duties."[130] But, there is much less clarity here because there have been few fully litigated cases at the state level relating to SPACs because the majority of suits thus far are either pleading-stage opinions or have been resolved with supplemental disclosures, cutting short any further inquiry or court analysis.[131] In fact, prior to 2022, "Delaware courts had not previously had the opportunity to consider the application of Delaware law in the SPAC context."[132] It was not until January 3, 2022, when Vice Chancellor Will issued a novel decision in *In re MultiPlan Corp. Stockholders Litigation*, which gave investors and shareholders an inkling into the intersection of Delaware fiduciary duty principles and SPACs.[133] Yet the legal uncertainty continues to persist at the state level as to whether shareholders can hold sponsors accountable for creating and perpetuating a flawed SPAC structure.[134]

B. REDEFINING THE SPAC STRUCTURE

In order to better align sponsor incentives with those of shareholders,

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126. Ann Lipton, *Another SPAC legal development*, BUS. L. PROF. BLOG (Aug. 7, 2021), https://lawprofessors.typepad.com/business_law/2021/08/another-spac-legal-development.html.

127. Kevin M. LaCroix, *SEC Proposed New SPAC-Related Disclosure Rules and Investor Protections*, THE D&O DIARY (Mar. 31, 2022), https://www.dandodiary.com/2022/03/articles/securities-laws/sec-proposed-new-spac-related-disclosure-rules-and-investor-protections/.

128. *Id.*

129. Bubna & Wang, *supra* note 21 (noting there were 122 federal SPAC cases filed in 2021 compared to the 43 filed in 2020).

130. Ducayet et al., *supra* note 24.

131. *Id.*; Frankel, *supra* note 24.

132. Cydney Posner, *Fiduciary duty claims against SPAC sponsor survive dismissal in Delaware under entire fairness standard,* JD SUPRA (Jan. 10, 2022), https://www.jdsupra.com/legalnews/fiduciary-duty-claims-against-spac-1095428/.

133. Howard L. Ellin et al., *Court of Chancery Issues SPAC-Related Decision of First Impression*, SKADDEN (Jan. 6, 2022), https://www.skadden.com/insights/publications/2022/01/court-of-chancery-issues-spac-related-decision.

134. LaCroix, *supra* note 103.

Andrew Ross Sorkin, a columnist for the *New York Times*, suggested the idea that sponsors be "required to hold their shares, including any investments they made at the time of the deal, for the full duration of the financial projections that helped sell the merger" to the SPAC shareholders.[135] The rationale for such a solution is to lock sponsors into the deal they sourced so they cannot jump ship the minute a merger deal proves unprofitable.[136] As it stands now, many sponsors will typically exit the SPAC right after the merger because, from their perspective, it is better for them to cut their losses sooner, especially given the fact that they did not invest much of their own money in the first place.[137] In this way, sponsors are basically jumping ship on their own proposed investment, allowing them to profit and cash out before the newly formed company even becomes an operational success or failure.[138] This is yet again another example of where the interests between sponsors and shareholders do not align.[139]

To combat this problem, Sorkin proposed that sponsors be restricted from selling their shares for the duration of their financial projections.[140] For example, if a company makes financial projections for five years ahead, the sponsor should be locked up from selling for five years.[141] In his view, this rule "would align sponsors' interests directly with what they are selling to the public—a future vision of the company."[142] It would not only attach sponsors to the future of the merged company, but it would also "open them up to liability from shareholders if the de-SPAC transaction include undisclosed dilution or fraudulent statements."[143] In support, former SEC chief accountant Lynn E. Turner called the proposed fix "an excellent idea," emphasizing that sponsors should be the ones locked into deals they are advertising.[144]

However, Chamath Palihapitiya, a billionaire venture capitalist, SPAC sponsor, and benefactor, pointed out several flaws in Sorkin's fix.[145] First, "why would a sponsor agree to a five-year lockup when management

135. Andrew Ross Sorkin, *How to Fix SPACs: Keep Their Backers Locked in Longer*, N.Y. TIMES (Mar. 31, 2021), https://www.nytimes.com/2021/03/31/business/dealbook/spac-sponsors.html.
136. *Id.*
137. *Id.*
138. Office of Sen. Elizabeth Warren, *The SPAC Hack: How SPACs Tilt the Playing Field and Enrich Wall Street Insiders* (May 31, 2022), https://www.warren.senate.gov/imo/media/doc/SPACS.
139. Sorkin, *supra* note 135.
140. *Id.*
141. *Id.*
142. *Id.*
143. Office of Sen. Elizabeth Warren, *supra* note 138.
144. Sorkin, *supra* note 135.
145. *Forbes Profile Chamath Palihapitiya,* FORBES (last updated Apr. 6, 2021), https://www.forbes.com/profile/chamath-palihapitiya/?sh=3cb14981316b; Sorkin, *supra* note 135.

wouldn't, nor would other investors including PIPE investors?"[146] Also, Palihapitiya questioned Sorkin's solution further, stating, "what if the management team [or the target company directors] lied [about the financial projections]?" If so, "should the sponsor now be on the hook for bad behavior of management?"[147] While shareholders may demand more from their sponsors, in the end, it does not seem likely that mandating sponsors to commit to their own deals will come to fruition.

C. CREATING A NEW INVESTMENT VEHICLE: SPECIAL PURPOSE ACQUISITION *RIGHTS* COMPANIES (SPARCS)

Alternative structures similar to SPACs have recently come to light. In launching his own blank-check company, Pershing Square Tontine Holdings Ltd. (PSTH), sponsor and billionaire investor Bill Ackman proposed to his shareholders a "better structured vehicle," which he dubbed a Special Purpose Acquisition Rights Company (SPARC).[148] The SPARC structure would give shareholders "the right to invest in a merger with a private company once the target has been announced—unlike a SPAC, where investors tie up their money while the sponsor searches for a suitable target."[149] In this way, because the SPARC does not require investors to put up any money until it has identified a merger target, there is no two-year time limit.[150] Moreover, the SPARC introduces a new form of promote: the sponsor will receive around a 6% equity stake in the combined public company post-merger, "but only after investors have received a 20% return."[151] In this way, Ackman's promote structure "creates a scenario in which the sponsor is rewarded handsomely in a fixed post-merger equity stake, but only after the transaction has been successful from an equity valuation standpoint."[152] If successful, Ackman assures it will provide "a clear path to mitigate the harm that SPAC litigation has and will continue to cause" shareholders.[153]

146. Sorkin, *supra* note 135 (noting that at the time of the de-SPAC merger deal, institutional investors are often invited to buy shares with favorable terms through what's called a private investment in public equity, or PIPE).

147. *Id.*

148. Svea Herbst-Bayliss, *Ackman seeks SPAC relaunch to fix lawsuit's 'harm'*, REUTERS (Aug. 19, 2021), https://www.reuters.com/business/ackman-seeks-spac-relaunch-fix-lawsuits-harm-2021-08-20/.

149. *Id.*

150. Michelle Celarier, *Bill Ackman Wants to Dissolve His Beleaguered $4 Billion SPAC*, INST. INV. (Aug. 20, 2021), https://www.institutionalinvestor.com/article/b1t76m3xxr0smc/Bill-Ackman-Wants-to-Dissolve-His-Beleaguered-4-Billion-SPAC.

151. *SPACs Are Booming – So What Does the Future Hold?*, SIDLEY (Dec. 2020), https://www.sidley.com/en/us/ourstory/ourstorieslanding/spacs/.

152. *Id.*

153. Herbst-Bayliss, *supra* note 148.

Ackman proposed the SPARC idea to PSTH shareholders after a lawsuit was filed against certain directors of PSTH and others on August 17, 2021.[154] The lawsuit alleged that a SPAC is an investment company and therefore should be subject to the Investment Company Act of 1940 (ICA), which would expose them to stricter oversight.[155] The plaintiffs, former SEC Commissioner Robert Jackson, an NYU law professor, and John Morley, a Yale law securities professor, reasoned that because investing in securities is all the SPAC does until its IPO, it is operating as an investment fund, thereby qualifying it as an investment company.[156] However, Kirkland & Ellis, along with other major national law firms, banded together in a counterattack against this suit, arguing that it was "without any factual or legal basis."[157] These firms deemed the claims frivolous because a SPAC's primary purpose is to acquire an operating company—not to invest in securities.[158] Ackman also responded to the lawsuit by writing a letter to shareholders assuring them of the meritless claims.[159] But, he also contended that the uncertainty surrounding the lawsuit would scare off potential merger candidates such that the best course of action, in Warren Buffett's words, was to jump ship rather than patch up leaks to complete the mission.[160] In Ackman's mind, jumping ship meant buying into his SPARC.[161]

On paper, the SPARC route seems to resolve many of the issues facing SPACs. However, "the SPARC structure, devised by Ackman and never before tested on Wall Street, would have to be approved by the SEC as well as the New York Stock Exchange (NYSE)."[162] And while Ackman has an impressive track record, one of the biggest challenges of SPACs is finding a top-tier company to merge with, which will remain to be seen with SPARC structure as well.[163] As a result, putting too much weight behind this solution is not only time consuming, but also unreliable.[164] While these proposed ideas target the root of the misaligned incentives inherent in the SPAC structure, they fail to offer a sustainable solution and direct route for holding SPAC

154. Shareholders Foundation, Inc., *NYSE: PSTH Investor Notice: Lawsuit against directors of Pershing Square Tontine Holdings, Ltd. announced by Shareholders Foundation*, GLOBENEWSWIRE (Aug. 24, 2021), https://www.globenewswire.com/news-release/2021/08/24/2285422/12089/en/NYSE-PSTH-Investor-Notice-Lawsuit-against-directors-of-Pershing-Square-Tontine-Holdings-Ltd-announced-by-Shareholders-Foundation.html.

155. *Id.*

156. *Id.*; Andrew Ross Sorkin et al., *A SPAC Counterattack*, N.Y. TIMES (Aug. 30, 2021), https://www.nytimes.com/2021/08/30/business/dealbook/spac-lawsuits.html.

157. Sorkin et al*., supra* note 156.

158. *Id.*; Shareholders Foundation, Inc., *supra* note 154.

159. Herbst-Bayliss, *supra* note 148.

160. Nicholas Jasinski, *Bill Ackman Wants to Liquidate His SPAC. Hello, SPARC*, BARRON'S (Aug. 21, 2021), https://www.barrons.com/articles/bill-ackman-spac-51629477062.

161. *Id.*

162. Herbst-Bayliss, *supra* note 148.

163. Jasinski, *supra* note 160.

164. Herbst-Bayliss, *supra* note 148.

sponsors accountable. Instead, a more effective alternative could be found at the state level.

III. A STEP IN THE RIGHT DIRECTION

A. DELAWARE COURT OF CHANCERY HOLDING SPONSORS TO THE ENTIRE FAIRNESS STANDARD OF REVIEW

Under Delaware law, directors owe a fiduciary duty of loyalty to the corporation and its stockholders, which requires that a director act in good faith and in the best interest of the corporation, rather than in the director's own interests or "the interests of someone who the director is beholden to, controlled by, or otherwise dependent on."[165] Because there are many instances in which a director may be incentivized to breach this duty, including when a change in control threatens their position or when a transaction involves a conflict of interest, a court may apply the exacting entire fairness review rather than the deferential business judgment rule.[166] The rationale for such heightened review is to afford greater protection to shareholders when "there is a controlled board—either by a third party or the directors' self-interest."[167]

Along these same lines, Delaware courts also apply enhanced judicial review in the presence of controlling shareholders, who owe fiduciary duties much like directors because their tremendous voting power gives them the ability to effectuate significant changes in the company in the same way as director decisions.[168] However, the presence of a controlling stockholder (i.e., the sponsor), without more, does not "automatically" trigger the entire fairness review.[169] Rather, Delaware courts will use entire fairness in one of two situations with controlling shareholders: (1) "where the controller stands on both sides" and (2) "where the controller competes with the common stockholders for consideration."[170] Within the SPAC environment, the second category is common because, given the SPAC structure, the incentives of sponsors are almost always at odds with those of its shareholders.[171] Specifically, a controlling sponsor competes with common

165. *Controller Confusion: Realigning Controlling Stockholders And Controlled Boards*, 133 HARV. L. REV. 1706 (2020); *See also* Del. Code Ann. 8, § 102(b)(7) (West 2019).

166. *Controller Confusion: Realigning Controlling Stockholders And Controlled Boards*, *supra* note 165.

167. *Id.*

168. *Id.*

169. *See* IRA Tr. FBO Bobbie Ahmed v. Crane, 2017 WL 7053964, at *6 (Del. Ch. Dec. 11, 2017, revised Jan. 26, 2018) (explaining that the presence of a controller, without more, does "not automatically subject [the controller's conduct] to entire fairness review"); *In re* Crimson Expl. Inc. S'holder Litig., 2014 WL 5449419, at *12 (Del. Ch. Oct. 24, 2014) ("Entire fairness is not triggered solely because a company has a controlling stockholder.").

170. *In re Crimson Expl. Inc. S'holder Litig.*, 2014 WL 5449419, at *12.

171. Sorkin, *supra* note 74.

stockholders when the controller is given a unique benefit to the detriment of minority shareholders.[172] With respect to SPACs, sponsors are given a unique benefit via the promote that allows them to convert their founder shares into a 20% equity stake following the merger.[173] This benefit is often to the detriment of the public shareholders because this same reward is present for the sponsors even if the value of the public shareholder's shares drops below par value as a result of the merger.[174] Thus, given the control-ridden advantages sponsors have over public shareholders, the entire fairness standard should apply, and sponsors ought to be held accountable for not acting in their best interest.

Now, that ideal solution is becoming reality. For the first time in this new wave of SPAC litigation, the Delaware Court of Chancery held that fiduciary principles and the entire fairness standard do, in fact, apply to shareholder claims against sponsors.[175] In the case *In re MultiPlan Corp. Stockholders Litigation,* as noted in Part I, the shareholders in the Churchill SPAC (the Plaintiffs) claimed that the SPAC sponsor, Michael Klein, and the board members (the Defendants) "disloyally impaired the plaintiffs' rights to redeem their SPAC shares prior to consummation of the de-SPAC transaction by breaching their fiduciary duty to disclose to the plaintiffs material information about the de-SPAC target company."[176] Despite the novel issues that this claim presents, Vice Chancellor Will, in a detailed 61-page opinion, held that "entire fairness standard of review applies due to inherent conflicts between the SPAC's fiduciaries and public stockholders."[177] The conclusion that "the 'entire fairness standard' applies, rather than the business judgment rule, is significant because the 'entire fairness' standard is Delaware's 'most onerous standard of review.'"[178] And with this heightened standard of review, Vice Chancellor Will noted, it will be "rare that a court will dismiss a fiduciary duty claim."[179]

Specifically, the court held that because the sponsor-controlling shareholder Michael Klein "stood to receive a 'unique benefit' from the transaction, he 'effectively competed' with the public shareholders and was incentivized to discourage redemptions" through misleading proxy statements.[180] This is because almost any deal would have been a good deal

172. *IRA Tr.*, 2014 WL 5449419, at *6 (quoting *In re Crimson Expl.*, 2014 WL 5449419, at *13).

173. Lamont, *supra* note 6.

174. Kevin M. LaCroix, *Del. Court Dismissal Denial Has Important SPAC-Related Litigation Implications*, THE D&O DIARY (Jan. 5, 2022), https://www.dandodiary.com/2022/01/articles/director-and-officer-liability/del-court-dismissal-denial-has-important-spac-related-litigation-implications/.

175. Posner, *supra* note 132.

176. *Id*.

177. *In re* Multiplan Corp. S'holder Litig., 268 A.3d 784, 792 (Del. Ch. 2022).

178. LaCroix, *supra* note 174 (discussing *In re* Multiplan Corp. S'holder Litig., 268 A. 3d 784, 809 (Del. Ch. 2022)).

179. *Id.*

180. *Id*.

for Klein so long as the merger went through. Here, Klein stood to see his $25,000 initial investment in founder shares turn into approximately $300 million upon the completion of the merger.[181] This remained true whether or not the share price decreased as a result of the merger.[182] In contrast, the public shareholders only stood to see a profit if the MultiPlan shares continued to trade above the $10.04 redemption price, which, as it turns out, was not going to be the case.[183] In this way, the merger was significantly more valuable to Klein than if no business combination resulted, even if the share price post-merger dropped below $10.04 for the public shareholders.[184] Thus, given the incentive to pursue a deal that was directly in competition with the best interests of the public shareholders, the court not only found that the public shareholders pleaded viable claims against the SPAC sponsors, but also that the entire fairness standard is required to review such claims.[185]

Overall, in reaching these conclusions, Vice Chancellor Will created the ultimate roadmap for allowing claims for breach of fiduciary duty to survive against a SPAC's sponsor and its directors and officers. However, in the greater SPAC environment, will *all* claims of fraudulent misrepresentation and omission become claims of breach of fiduciary duty under Delaware law—and reviewed under the entire fairness standard?

B. FURTHER CLARIFICATION NEEDED: WHERE DOES THIS LEAVE SPAC SPONSORS?

While the *MultiPlan* case involved a novel application of traditional fiduciary duty principles in the SPAC context, the opinion seemed to only momentarily diffuse the ticking time-bomb looming over them. First and foremost, *MultiPlan* is a pleadings-stage decision, and the court's consideration of the facts was essentially constrained to the complaint's allegations.[186] So, it is important to understand that the court did not make any ruling on the merits of the alleged claims, meaning that the court did not, in fact, find that the sponsors breached their fiduciary duties.[187] Rather, in ruling on a motion to dismiss, the court merely "accepted as true the factual

181. *Muliplan Corp. S'holder Litig.*, 268 A.3d at 810–11; Christopher Anthony et al., *Delaware Court Holds de-SPAC Transaction Subject to Entire Fairness*, DEBEVOISE & PLIMPTON (Jan. 14, 2022), https://www.debevoise.com/insights/publications/2022/01/delaware-court-holds-despac-transaction.

182. *Id.*

183. *Id.*

184. *Muliplan Corp. S'holder Litig.*, 268 A.3d at 811; Posner, *supra* note 132.

185. *Multiplan Corp. S'holder Litig.*, 268 A.3d at 792; LaCroix, *supra* note 174.

186. Ellin et al., *supra* note 133.

187. Alexander Gendzier et al., *SPAC Redemption Rights—Panacea or Achilles Heel? Delaware Court Denies Defendants' Motion to Dismiss in MultiPlan Litigation*, ARNOLD & PORTER (Feb. 11, 2022), https://www.arnoldporter.com/en/perspectives/advisories/2022/02/spac-redemption-rights-panacea-or-achilles-heel.

allegations of the plaintiffs and determined that, as a matter of law, the claims could stand."[188]

Second, Vice Chancellor Will noted that what made the SPAC shareholders' claims viable was "*not* the mere conflict inherent in the SPAC structure but rather the omission of information that impaired the stockholders' redemption rights."[189] So, even though a common feature among SPACs is the supposed conflict of interest between a sponsor and its public shareholders, this court decided that the structural incentive embedded in SPACs, alone, is not sufficient to bring a claim or even support the entire fairness standard in Delaware courts.[190] As a result, "it is not going to be every SPAC-related breach of fiduciary duty claim that will survive dismissal based on the standards Vice Chancellor Will applied; only those cases with sufficient allegations will survive."[191] Thus, it remains to be seen how the entire fairness standard declared in the *MuliPlan* decision will be applied to similar alleged breaches of fiduciary duties or if it will give rise to any supplemental SPAC litigation, "including in situations where plaintiffs cannot allege a material disclosure claim."[192]

For example, it seems difficult to pinpoint how the "unique benefit" derived by the sponsor's founder shares would result in any harm or economic loss to the public shareholders if there is adequate disclosure with respect to their redemption rights.[193] This is because shareholders would still have the independent right to redeem their shares for the same amount they would receive in liquidation whether or not the merger was rejected or accepted by shareholders.[194] In either case, disclosure, relating to sponsor economics and the de-SPAC transaction, coupled with the right of any public stockholder that disapproves of the de-SPAC transaction merger to redeem their shares, "should ultimately be sufficient to render the transaction entirely fair."[195]

However, is this really fair? Even with all the proper material disclosures, the stockholder vote in de-SPAC transactions is not completely free from coercion because of the feature that allows SPAC shareholders to redeem their shares regardless of their vote to approve or disprove the merger.[196] In other words, a shareholder could vote yes on the proposed merger yet still

188. *Id.*
189. *Multiplan Corp. S'holder Litig*., 268 A.3d at 816; LaCroix, *supra* note 174.
190. LaCroix, *supra* note 174.
191. *Id.*
192. Edward B. Micheletti et al., *Delaware Courts Simplify Rules for Derivative Actions, Analyze SPAC Fiduciary Duty Review and Clarify Books-and-Records Obligations*, SKADDEN (Jan. 19, 2022), https://www.skadden.com/insights/publications/2022/01/2022-insights/litigation/delaware-courts-simplify-rules.
193. Anthony et al., *supra* note 181.
194. *Id.*
195. *Id.*
196. Gendzier et al., *supra* note 187.

redeem their shares.[197] This result seems odd—it allows shareholders "to support the de-SPAC transaction but exit the investment [just] before the closing of the transaction."[198] As a result, it creates an "unusual separation of ownership and control," and, in a sense, "exposes [the other] retail investors to a misleading signal when making the decision about redemption of their shares."[199] In this way, the majority shareholders will not always be putting their money where their vote is, and so, any majority vote in favor of a proposed merger will not necessarily mean that it is a good deal.[200] This is because "if a large percentage of shareholders choose to exercise their redemption rights—which has been the case for several SPACs as of late—this can drastically reduce the cash proceeds that the combined company will have available for its future operations."[201] Accordingly, "it is questionable whether a court would find that the majority-of-the-minority approval achieves the necessary sanitizing effect to rescue the SPAC sponsor from having to prove entire fairness."[202]

So, while the *MultiPlan* decision might seem to solve the long-winded problem between SPAC sponsors and shareholders, Vice Chancellor Will's careful language and narrow application surely insulated its impact. The opinion left open the possibility for sponsors to escape the onerous entire fairness standard and instead take shelter under the deferential business judgment rule despite the still-looming conflicts inherit in a SPAC's structure.[203] Also, it left open the question of "whether courts will recognize any cleansing doctrines or other similar safe harbors for SPACs to adopt appropriate procedural protections."[204]

CONCLUSION

While the litigation door may have been opened by *MultiPlan*, greater clarity, protection, and uniformity are still needed. Perhaps in the meantime, SPAC sponsors should consider implementing structural features to help

197. *Id.*; Mira Ganor, *The Case for Contingent Shareholder Action*, THE CLS BLUE SKY BLOG (Aug. 6, 2020), https://clsbluesky.law.columbia.edu/2020/08/06/the-case-for-contingent-shareholder-action/.

198. Ganor, *supra* note 197.

199. *Id.*

200. *Id.*

201. Roger E. Barton, *High redemption rates see SPACs relying on alternative financing*, REUTERS (Jan. 14, 2022), https://www.reuters.com/legal/transactional/high-redemption-rates-see-spacs-relying-alternative-financing-2022-01-14/ (noting that "[f]rom January to July, the average monthly SPAC redemption rate ranged from 7%-43%. From July to November, however, this range jumped to 43%-67%, with the average SPAC seeing approximately a 60% redemption rate during these four months.").

202. Gendzier et al., *supra* note 187.

203. Logan A. Krulish, *Defending the De-Spac Merger: What Standard of Review Applies?*, 74 BAYLOR L. REV. 491, 514 (2022).

204. Jenny Hochenberg & Justin C. Clarke, *SPAC Litigation: Current State and Beyond*, 55 THE REV. OF SEC. & COMMODITIES REGUL., 33, 36 (Feb. 23, 2022).

mitigate the conflicts of interest that still persist in de-SPAC transactions. For example, sponsors could implement a special committee of disinterested and independent directors to value the transaction and render an opinion based on the de-SPAC transaction's fairness to the shareholders. While this would take away some of the sponsor's control in pinpointing a target company and perhaps undermine their ability to impart their expertise on a transaction, it may nevertheless serve as a middle ground in keeping the SPAC structure relatively the same without impeding too much on the sponsor's role. After all, the special committee would not deliberate on the viability of a target until after the sponsor submits it for consideration. If the sponsor and committee are willing to cooperate, then this could provide a simple and effective solution to conflicted transactions.

"A business model that incentivizes promoters to do something—anything—with other people's money is bound to lead to significant value destruction on occasion."[205] As we head into the future, investors, sponsors, and their directors should recognize that the *MultiPlan* decision is just the first ripple in the wave of litigation and scrutiny that will follow.

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205. Complaint, *supra* note 44, at 16.

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