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Chancery Court Grants Rare Motion to Dismiss Suit Governed by Entire Fairness

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In Short

The Case: The electric vehicle company Canoo went public in a de-SPAC transaction in December 2020. After its stock price fell, a stockholder in the SPAC who chose not to redeem his stock sued the SPAC board and its controller for breaching their fiduciary duties.

The Outcome: In an unusual development, the Delaware Court of Chancery granted defendants' motion to dismiss, ruling that even though the transaction was subject to entire fairness review, the plaintiff had failed to plead that the defendants had impaired his right to choose whether or not to redeem his stock.

Looking Ahead: Pleading-stage dismissals of claims that are subject to the entire fairness standard are rare. The court's ruling, however, serves as a reminder that they are possible —and that, no matter what the standard of review, a stockholder plaintiff challenging a transaction must still plead a viable non-exculpated claim.

Hennessy Capital Acquisition Corp. IV, a special purpose acquisition company ("SPAC"), signed a merger agreement with Canoo in August 2020 and issued a proxy statement that described the company's business model. Unlike its competitors, Canoo's business focused on providing engineering services for other manufacturers, and a "subscription" model whereby consumers would effectively rent Canoo cars on a monthly basis. The merger was overwhelmingly approved, and almost no stockholders chose to redeem their stock.

Three months after the merger closed, Canoo announced that it was changing its subscription model to adopt a more traditional sales-based approach. The stock price fell sharply. After recovering, it fell again, and a plaintiff stockholder sued.

The suit came on the back of a wave of successful litigation challenging SPAC transactions that led to disappointing results. The first of these (as recounted in our prior Commentary) was *In re MultiPlan Corp. Stockholders Litigation*, 268 A.3d 784 (Del. Ch. 2022). There, the Court of Chancery ruled that the fiduciary duty claim was governed by the entire fairness standard, both

because the controller of the SPAC stood to gain a unique benefit from the transaction and because the board members were self-interested or lacked independence. The court went on to deny the motion to dismiss. The court noted, however, that the conflicts of interest present in SPACs are well known to investors, and its conclusion stemmed from the fact that the plaintiffs had alleged that the company had prevented them from exercising a free choice whether to redeem their stock by making misleading disclosures. The court emphasized that it was not addressing a situation where the disclosures were adequate, and that "[i]f public stockholders, in possession of all material information about the target, had chosen to invest rather than redeem, one can imagine a different outcome." Subsequent cases applied the same reasoning and had similar outcomes.

In *Hennessy*, the plaintiff argued that the directors and controlling stockholder had violated their fiduciary duties to the stockholders by failing to make adequate disclosures in the proxy statement related to Canoo's business plan. But the court ruled that there was no allegation that Canoo's business plan changed *before* closing, or that the acquiror—which issued the proxy statement—was aware of these facts.

The adequate disclosures meant that stockholders could make a fully informed decision to either redeem their stock or remain investors in the post-merger entity. Therefore, even though the entire fairness standard applied to the plaintiff's claims because of the conflicts inherent in the de-SPAC transaction, the suit still warranted dismissal because the plaintiff had not sufficiently alleged that the transaction was unfair.

The *Hennessy* decision is one of an extremely small number of cases in which the Court of Chancery has dismissed a suit that alleges a direct non-exculpated claim of breach of fiduciary duty that is subject to the entire fairness standard of review. The decision underscores that proxy statements will be deemed complete and non-misleading when they disclose all material information available at the time, notwithstanding future events. And, perhaps most welcome, the decision can be read as supporting the equitable principle that where stockholders have all relevant material information when making an investment decision, they may be barred from bringing suit later, notwithstanding the presence of conflicts of which they were aware.

Two Key Takeaways

1. Although disclosure requirements in Delaware remain rigorous, proxy statements will not be read with the benefit of hindsight. Courts will reject efforts by plaintiffs to cast doubt on proxy statements by pointing to events that happened only after the proxy was issued.
2. Even the application of the entire fairness standard does not inevitably signal that the defendants are consigned to protracted litigation. In some circumstances, it may still be possible for the defendants to obtain a pleading-stage dismissal.

Link to original piece can be found here.