

# Client Alert

Corporate and Securities Litigation

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## Delaware Chancery Court Issues Precedential Decision Dismissing Claims Challenging “De-SPAC” Merger Disclosures

The Delaware Court of Chancery’s recent decision in *In re Hennessy Capital Acquisition Corp. IV Stockholder Litigation*,<sup>i</sup> marks the Chancery Court’s first total dismissal of a complaint alleging breaches of fiduciary duties in connection with disclosures relating to a merger transaction involving a special purpose acquisition company (SPAC) and establishes precedent that should aid the defense of future claims.

### BACKGROUND

A string of early pleading stage successes, and several eight-figure settlements, have encouraged a wave of lawsuits challenging the accuracy and sufficiency of public disclosures surrounding transactions in which private companies come public by merging with SPACs—“blank check” public companies without commercial operations formed to raise capital to fund a business combination with an existing operating company.

In the seminal SPAC case, *In re MultiPlan Corp. Stockholders Litigation*, the Court of Chancery held that claims alleging misleading proxy disclosures impaired SPAC stockholders’ ability to decide whether to redeem their shares and recoup their initial investment or hold the shares and become stockholders in the acquired company are direct, rather than derivative claims.<sup>ii</sup> Accordingly, motions to dismiss such claims must be analyzed under the plaintiff-friendly 12(b)(6) standard and are not subject to the heightened requirements to plead the futility of a pre-litigation demand on the board of directors that apply to derivative claims. The *MultiPlan* decision also rejected defense arguments that claims alleging breaches of fiduciary duties in connection with stockholder redemption rights should be (i) barred as contractual in nature and (ii) deemed “holder” claims not properly litigated as class actions due to individualized



questions of reliance on the challenged disclosures.<sup>iii</sup> Finally, the Chancery Court held the *MultiPlan* plaintiffs adequately pled that structural elements of the transaction (that are common to many SPAC deals) created conflicts of interest between the SPAC fiduciaries and stockholders necessitating review of the claims under the onerous “entire fairness” standard under which defendants bear the burden of proving that the challenged act or transaction was entirely fair to the corporation and its stockholders.<sup>iv</sup>

The *MultiPlan* plaintiffs defeated defendants’ motion to dismiss and later settled the case for \$33,750,000.<sup>v</sup> Since the *MultiPlan* ruling, SPAC cases have proliferated and plaintiffs have largely succeeded in avoiding pleading stage dismissals. The Court of Chancery’s ruling dismissing the *Hennessy* case with prejudice represents the Court’s first full dismissal of claims challenging a SPAC transaction under the entire fairness doctrine and establishes useful precedent that may help defendants stem the SPAC litigation tide in future cases.

### THE COURT’S RULING

The *Hennessy* case arose from the SPAC’s December 21, 2020 merger with Canoo Holdings Ltd. (“Legacy Canoo”), an electric vehicle (EV) start-up company.<sup>vi</sup> Legacy Canoo’s business was built around its “skateboard” EV chassis designed to support multiple vehicle cabin configurations.<sup>vii</sup> Hennessy’s proxy statement recommending stockholder approval of the merger with Legacy Canoo discussed opportunities associated with Legacy Canoo’s contract engineering services segment and business-to-consumer subscription model, both of which plaintiffs alleged the proxy suggested were expected to contribute meaningfully to the company’s future financial performance.<sup>viii</sup>

At a meeting held approximately three months after the merger closed, Canoo’s board received a management presentation discussing the company’s transition from a “3-year-old private company into a public company” which included a slide titled “Canoo’s Business Model Needed a Reboot.”<sup>ix</sup> The board also received a presentation from McKinsey & Company which noted that, in “September to October 2020, McKinsey had begun to “[a]ssess [Legacy] Canoo’s initial economic model,” and in “October to November 2020, it [i]dentified [the] most attractive segments to focus on.”<sup>x</sup> McKinsey’s presentation also stated that “[c]ritical changes were made to Canoo’s business model” based on McKinsey’s “subscription model insights,” including “[d]eemphasiz[ing] [the] role of [lifestyle vehicle] subscription[s]” and “[p]ivot[ing] from [a] subscription-led sales model to [an] outright sale led sales model.”<sup>xi</sup>

During a quarterly earnings call a few days later, Canoo’s Executive Chairman reported that the board had decided to “deemphasize” the company’s subscription model and engineering services business line.<sup>xii</sup> After some analysts expressed surprise at the shift, the Executive Chairman noted that “the study we did” led him to want to move “in a different direction” and that the “[b]oard’s help and observations . . . kind of solidified that.”<sup>xiii</sup> After the earnings call, Canoo’s stock price declined more than 21%.<sup>xiv</sup>

In the lawsuit that followed, the plaintiff alleged that Hennessy’s board and sponsor breached their fiduciary duties by failing to disclose McKinsey’s engagement and the changes to Legacy Canoo’s business model.<sup>xv</sup> Before analyzing the sufficiency of plaintiff’s allegations, the Chancery Court paused to discuss the explosion of SPAC litigation following the *MultiPlan* decision, noting in particular that “[r]emarkably similar complaints accuse SPAC directors of breaching their fiduciary duties based on flaws in years-old proxy statements that became problematic only when the combined company underperformed.”<sup>xvi</sup> Such “[p]oor performance,” the Court continued, “is not, however, indicative of a breach of fiduciary duty. Conflicts are not a cause of action. And pleading requirements exist even where entire fairness applies.”<sup>xvii</sup>



Examining the complaint's allegations, the Chancery Court found them wanting, as the disclosure claims relied entirely on "post-closing developments"—namely, the presentations at the post-merger Canoo board meeting and ensuing changes to the company's business model.<sup>xviii</sup> The Court contrasted plaintiff's allegations with those in *MultiPlan* and other SPAC cases denying motions to dismiss, noting that the complaints in those cases pled "concrete facts about the merger target's prospects" that were "known or knowable" by the defendants *prior stockholders' approval of the challenged mergers*.<sup>xix</sup> The Court found that "[n]o such material facts that were known or knowable by the defendants" were pled in the *Hennessy* complaint, which "instead addresses actions by Canoo's post-closing board."<sup>xx</sup>

In so finding, the Chancery Court rejected plaintiff's arguments that "use of the past tense" in some portions of the cited board presentations supported an inference that the decision to revamp Canoo's business model preceded the merger.<sup>xxi</sup> The Court cited the Executive Chairman's statement on the post-merger earnings call that the decision to "deemphasize the originally stated contract engineering services lines" was made with the input of Canoo's board, which input presumably was supplied at or following the post-merger board meeting.<sup>xxii</sup> While plaintiff's allegations, taken as true, supported an inference that "McKinsey may have reached early recommendations about aspects of the company's business" prior to the stockholder meeting, the Court noted that "Delaware law does not . . . require the disclosure of preliminary analyses and discussions" and that "[t]o require an unadopted, interim analysis to be disclosed would invite speculation about matters that may never solidify."<sup>xxiii</sup> The Court also held that plaintiff's claim that Hennessy's engagement of McKinsey was material information that defendants were required to disclose lacked support in Delaware law.<sup>xxiv</sup>

Finally, the Chancery Court observed that "[e]ven if I credited the bare allegation that Legacy Canoo's business shifted pre-closing, there are no facts from which I could fairly infer knowledge by Hennessy's Board."<sup>xxv</sup> In light of plaintiff's failure to "sufficiently allege that Legacy Canoo decided to materially reconfigure its business model before the merger closed and that the decision was knowable by Hennessy's Board," the Chancery Court dismissed with prejudice plaintiff's breach of fiduciary duty claims and related claims alleging aiding and abetting and unjust enrichment as to certain defendants.<sup>xxvi</sup>

### KEY TAKEAWAYS

As the first total pleading stage victory for defendants in SPAC-related fiduciary duty litigation under the entire fairness standard, *Hennessy* is a noteworthy ruling and a potential arrow in the quivers of defendants in future SPAC cases. In a litigation arena in which claims frequently challenge disclosures bearing on companies' *future*, post-closing business prospects, the Chancery Court's ruling that plaintiffs must plead "material facts that were known or knowable by the defendants" pre-merger in order to survive dismissal is an important and likely to be often-cited precedent. At the very least, the Chancery Court's reminder that "pleading requirements exist even where entire fairness applies," and its dismissal ruling giving those words real teeth, marks a significant moment in the development of this still-nascent genre of stockholder litigation.



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<sup>i</sup> C.A. No. 2022-0571-LWW, 2024 WL 2799044 (Del. Ch. May 31, 2024).

<sup>ii</sup> 268 A.3d 784, 802-05 (Del. Ch. 2022).

<sup>iii</sup> *Id.* at 805-08.

<sup>iv</sup> *Id.* at 810-12, 815.

<sup>v</sup> See <https://www.multiplanstockholderslitigation.com/>.

<sup>vi</sup> *Hennessy*, 2024 WL 2799044, at \*3.

<sup>vii</sup> *Id.*

<sup>viii</sup> *Id.* at \*4-5.

<sup>ix</sup> *Id.* at \*5.

<sup>x</sup> *Id.* at \*6.

<sup>xi</sup> *Id.*

<sup>xii</sup> *Id.*

<sup>xiii</sup> *Id.*

<sup>xiv</sup> *Id.*

<sup>xv</sup> *Id.* at \*11.

<sup>xvi</sup> *Id.* at \*1.

<sup>xvii</sup> *Id.*

<sup>xviii</sup> *Id.* at \*1 & \*11

<sup>xix</sup> *Id.* at \*12.

<sup>xx</sup> *Id.* at \*13.

<sup>xxi</sup> *Id.*

<sup>xxii</sup> *Id.*

<sup>xxiii</sup> *Id.* at \*14.

<sup>xxiv</sup> *Id.*

<sup>xxv</sup> *Id.* at \*15.

<sup>xxvi</sup> *Id.* at \*15-18.