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Judge Rules SPAC Trust Account Sacred for Public Shareholders and Not Property of the Estate

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In an important win for SPAC investors, the U.S. Bankruptcy Court for the Eastern District of Texas (the "Court") recently held that the express terms of a SPAC's trust agreement control whether a SPAC trust account is "property" of a debtor's estate.[1]

SPACs are engaged primarily in identifying and consummating a business combination with one or more operating companies within a specified period of time. In connection with an initial business combination, SPAC investors may elect to remain invested in the combined company or get their money back. If a business combination is not completed in a specified period of time, investors also get their money back. Pending the earlier to occur of the completion of a business combination or the failure to complete a business combination within a specified time frame, almost all of a SPAC's assets are held in a trust account for the benefit of its investors.

Prior to filing for Chapter 11 relief on December 6, 2023,[2] the debtor SPAC known as Financial Strategies Acquisition Corp. ("Financial Strategies") failed to consummate a business combination transaction within the time frame required under its underlying SPAC trust agreement, resulting in the termination of the trust account and necessitating the distribution of the funds held therein to its investors.

In January 2023, Financial Strategies filed a motion requesting that the Court compel the turnover of the funds held in a trust account for the benefit of its investors.[3] Financial Strategies intended to use its bankruptcy to circumvent the trust agreement and pay creditors — primarily insiders and other creditors that waived their rights to collect against the trust account — in full using the funds from the trust account at the expense of its investors.

As is typical in the industry, under the trust agreement, Financial Strategies' interest in the funds in the trust account was limited to:

- the ***interest*** on the principal of the trust account to (a) pay certain income and other taxes, upon written request of the SPAC, and (b) pay certain liquidation expenses (to the extent actually incurred, up to $100,000); and
- the ***principal*** of the trust account solely to effectuate an investor approved business combination (to the extent the trust account had not terminated pursuant to the trust agreement).

Based on the terms of the trust agreement, the Court denied Financial Strategies' motion to compel and held that Financial Strategies had (a) no interest in the principal of the trust account and (b) a limited interest in the interest on the principal, solely to the extent provided in the trust agreement. At the hearing, the Court specifically found that "the debtor's rights in and to the funds that are being held are limited to those rights that are outlined in . . . the trust agreement" and because "the debtor does not appear to have rights in and to those funds . . . the Court will not compel . . . the turnover of those those funds to the debtor."[4]

In addition to its motion to compel turnover of the trust funds, Financial Strategies also filed a motion to convert its case from Chapter 11 to Chapter 7, which was heard in conjunction with the motion to compel. Due in large part to Financial Strategies lacking an interest in the principal of the trust account, the Court denied Financial Strategies' motion to convert and dismissed its Chapter 11 case (with prejudice and barring refiling for 30 days once the order became final and non appealable).[5] Specifically, the Court justified its dismissal of the case based on Financial Strategies' "unreasonable delay of these proceedings and the lack of any significant assets for a Chapter 7 trustee to administer."[6]

The Court's holding protects a preeminent investor protection in the SPAC industry, the SPAC trust account, recognizing that a debtor can only access funds in a SPAC trust account to the extent expressly enumerated in the underlying trust agreement — otherwise, such funds are not property of a debtor's estate.

This case of first impression establishes a precedent that SPACs cannot use bankruptcy to invade SPAC trust accounts and deprive their investors of their investments.

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1. *In re Fin. Strategies Acquisition Corp.*, No. 23 42345 (BTR) (Bankr. E.D. Tex. May 17, 2024) [Docket No. 115].↩

2. *In re Fin. Strategies Acquisition Corp.*, No. 23-42345 (BTR) (Bankr. E.D. Tex. Dec. 6, 2023) [Docket No. 1].↩

3. *In re Fin. Strategies Acquisition Corp.*, No. 23 42345 (BTR) (Bankr. E.D. Tex. Jan. 12, 2024) [Docket No. 12].↩

4. *Transcript of Proceedings, In re Fin. Strategies Acquisition Corp.*, No. 23 42345 (BTR), Hr'g Tr. at 69:3-16 (Bankr. E.D. Tex. May 7, 2024).↩

5. *In re Fin. Strategies Acquisition Corp.*, No. 23 42345 (BTR) (Bankr. E.D. Tex. May 17, 2024) [Docket No. 117].↩

6. *Id.*↩

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