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Delaware Chancery Court Issues Highly-Anticipated SPAC-Related Decision

On January 3, 2022, the Delaware Court of Chancery issued a long-awaited and highly-anticipated decision arising out of a challenge to a transaction involving a special purpose acquisition company (SPAC) and addressing fiduciary duty claims in the context of a de-SPAC business combination/merger. *In re Multiplan Corp. Stockholders Litig., C.A. No. 2021-0300-LWW*), a dispute alleging conflicts of interests and disclosure failures relating to Churchill Capital Corp. III's ("*Churchill*") completed de-SPAC business combination transaction with target acquisition company, Multiplan, Inc., marks the first dispositive motion decided in the Delaware courts in a wave of recent SPAC litigation. The Court, applying "well-worn fiduciary principles" under Delaware law to the claims raised by the SPAC stockholder plaintiffs, denied a motion to dismiss, thereby allowing claims to proceed against a SPAC's sponsor and its directors, and held, in relevant part, that SPAC public stockholders' redemption rights can be undermined by inadequate disclosures regarding the transaction.

In light of the claims raised in *MultiPlan* relating to common features, practices and structural elements of SPACs and de-SPAC business combination transactions (including, in particular, the redemption rights feature that was designed to mitigate certain inherent conflicts of interests), the *MultiPlan* decision is significant and has some key takeaways for SPACs going forward. Although the Court clarified that its "conclusion does not address the validity of a hypothetical claim where the disclosure is adequate and the allegations rest solely on the premise that fiduciaries were necessarily interested given the SPAC's structure" and left open whether the redemption feature of SPACs may be an effective shield to fiduciary liability, the *MultiPlan* decision indicates that it will only be effective if stockholders are informed of all material information when making their decision whether to redeem. *MultiPlan* emphasizes the importance of robust corporate governance and related practices for SPACs, reinforces the need for comprehensive and rigorous deal processes and exacting documentation in connection with de-SPAC business combination transactions, and underscores how critical fulsome and robust disclosures are in the context of such transactions (just like in the traditional public merger context).

BACKGROUND

Churchill was a SPAC founded and controlled by Michael Klein through a sponsor entity (the Sponsor). As is typical practice for SPACs, Churchill was formed for the sole purpose of searching for, and consummating a business combination with, a target acquisition company, and Churchill completed its initial public offering ("IPO") without any business operations. Public investors participating in Churchill's IPO received, in exchange for a purchase price of $10.00 per unit, units comprised of one share of Class A common stock and one-fourth of a warrant to purchase one share of Class A common stock (exercisable at a strike price of $11.50 per share). Following consummation of the IPO, Churchill's capital structure consisted of the shares of Class A common stock (held by the investors that participated in the IPO) and "founder" shares or Class B common stock (purchased by the Sponsor for a nominal purchase price and convertible to shares of Class A common stock contingent upon the SPAC successfully closing a business combination transaction). The SPAC also made a private placement of warrants to the Sponsor, purchased at $1.00 each, with an exercise price of $11.50.

The funds received by Churchill in the IPO were customarily placed in a trust account and generally could only be released (i) upon successful completion of a business combination or, (ii) alternatively, in the event a business combination was not successfully completed within a 24-month period, upon liquidation of the SPAC, in which case, the public (Class A) stockholders would be returned their respective pro rata shares of the IPO funds (plus any interest earned thereon). In contrast, the "founder" shares or Class B common stock, as well as the warrants, held by the Sponsor would expire as worthless in the absence of a deal. As is a staple feature in de-SPAC transactions, prior to consummating any business combination, Churchill was also required to provide its public (Class A) stockholders an opportunity to redeem their shares of Class A common stock in connection with the consummation of such business combination at a price equal to the original $10.00 per-share IPO investment (plus any interest earned thereon) and such stockholders would retain their warrants, regardless of whether they voted in favor of the deal.

Following the IPO, Churchill identified MultiPlan, Inc. as a potential acquisition target and retained The Klein Group LLC, an entity controlled by Michael Klein, as its financial advisor in connection with the potential de-SPAC business combination transaction with MultiPlan, Inc. Following the eventual closing of the business combination, the stock price of the newly-public MultiPlan, Inc. dropped significantly based on a report from an equity research firm that its largest customer had formed a competitor entity, which was not a matter that was disclosed or discussed in any capacity within the proxy statement disseminated to Churchill's stockholders or otherwise. The complaint ensued, alleging direct, class-action breach of fiduciary duty claims against Michael Klein, The Klein Group LLC and Churchill's directors.

THE DECISION

The SPAC stockholder plaintiffs generally claimed that the structure of the SPAC created a conflict of interests between the public stockholders owning Class A shares and the Sponsor and SPAC insiders holding Class B shares and specifically asserted that the defendants prioritized their personal interests over the public stockholders' interests in completing the business combination and issued a materially misleading proxy statement that impaired the ability of the public stockholders to make the decision as to whether to redeem. The complaint, boiled down, turned on the claim that inadequate disclosures about the value of MultiPlan's business did not allow the public (Class A) stockholders to make a fully-informed decision about the value of the shares they would hold in MultiPlan following the closing of the business combination, relative to the value of the cash they could have received by electing to redeem prior to the closing of the business combination. The complaint further alleged that such inadequate disclosures were prepared by the Sponsor and SPAC directors to induce public (Class A) stockholders to accept Multiplan shares (instead of electing to redeem their shares of Class A common stock for cash) in order to facilitate a business combination.

As an initial matter, the Court held that the nature of the claims asserted by the public (Class A) stockholder plaintiffs were properly pleaded as direct, as opposed to derivative, claims, finding that the allegations impacted the stockholders' personal redemption right/decision (not a right that belonged to the SPAC) and centered around the purported impairment of such redemption rights due to materially misleading disclosures. The claims therefore represented an alleged personal harm to the SPAC public stockholders in making their decision as to whether to redeem without being fully informed—such alleged harm being receiving less valuable shares in MultiPlan than the cash they could have received upon electing to redeem.

In turning to the substance of the claims, the Court noted that the more stringent “entire fairness” standard of review would apply because (i) it was reasonably conceivable that the Sponsor was a “conflicted controller” (given that Klein, through the Sponsor, controlled the SPAC, and in light of the “potential conflict between Klein and public stockholders resulting from their different incentives in a bad deal versus no deal at all”) and (ii) the SPAC’s director-defendants, through their economic interests in the Sponsor (i.e., the SPAC founder shares and warrants), stood to receive a unique benefit only if a business combination closed (noting such directors “would benefit from virtually any merger — even one that was value diminishing for Class A stockholders — because a merger would convert their otherwise valueless interests in Class B shares into shares of Public MultiPlan.”). Furthermore, the Court determined that a majority of Churchill’s board of directors were conflicted because they were not independent from Klein. Notably, Klein had appointed many of these directors to other SPAC boards (in some cases, at least five other SPACs), and the Court therefore deemed it “conceivable that those directors would ‘expect to be considered for directorships’ in future Klein-sponsored SPACs and that the founder shares they would receive from those positions were material to them.”

The Court then held that the proxy statement contained, as alleged in the complaint, false and misleading disclosures, given that it “did not disclose that MultiPlan’s largest customer was UHC and that UHC was developing an in-house alternative to MultiPlan that would both eliminate its need for MultiPlan’s services and compete with MultiPlan. … Based on the plaintiffs’ allegations, it is reasonably conceivable that a Class A stockholder would have been substantially likely to find this information important when deciding whether to redeem her Churchill shares.”

Finally, the Court held that the complaint alleged non-exculpated claims for breach of fiduciary duty against the SPAC’s directors. Many SPAC industry experts and participants, including the defendants here, have argued and/or long thought of the redemption right feature—whereby a public stockholder affirmatively chooses to invest in the de-SPAC company or get his or her investment back separate from voting for or against the transaction—as a mitigant for liability for alleged breaches of fiduciary duties or conflict of interest issues. That argument appeared to fail in the *MultiPlan* decision due to the allegations of inadequate disclosure—that is, the Court found that Churchill’s public stockholders were not fully informed in making their decision as to whether to exercise redemption rights, noting:

> Critically, I note the plaintiffs’ claims are viable not simply because of the nature of the transaction or resulting conflicts. They are reasonably conceivable because the Complaint alleges that the director defendants failed, disloyally, to disclose information necessary for the plaintiffs to knowledgably exercise their redemption rights. This conclusion does not address the validity of a hypothetical claim where the disclosure is adequate and the allegations rest solely on the premise that fiduciaries were necessarily interested given the SPAC’s structure. The core, direct harm presented in this case concerns the impairment of stockholder redemption rights. If public stockholders, in possession of all material information about the target, had chosen to invest rather than redeem, one can imagine a different outcome.

TAKEAWAYS

- Given the specific alleged conflicts of interests in *MultiPlan*, where members of the SPAC’s board of directors and the SPAC’s financial advisor were closely affiliated to and/or controlled by Klein, along with the allegations of material disclosure failures in the proxy statement, the Court’s decision should not necessarily be viewed as outcome-determinative or a pillar for all future SPAC litigation. Ultimately, the Court in *MultiPlan* acknowledged that the decision turned on the determination that the defendants issued materially misleading and/or inadequate disclosures that were, at the pleadings stage, conceivably the result of disloyal motivations. Because *MultiPlan* is a pleadings-stage decision and the Court’s consideration of the “facts” was thereby limited to the allegations of the plaintiffs, factual developments in the case going forward may inevitably provide additional guidance and refined legal analysis.

- It has been suggested by many in the SPAC industry that certain unique structural elements of SPAC transactions—most notably, the redemption feature whereby a stockholder effectively has a right to opt out—effectively provides a shield to claims and liability related to fiduciary duties and conflicts of interests. However, the decision in *MultiPlan* indicates that, even up-front knowledge of a potential conflict of interest and different stakeholder interests (here, by virtue of disclosures disseminated to the public stockholders in connection with the SPAC’s IPO) will not cleanse a process that is not fully informed, and SPAC directors’ fiduciary duties still apply to require adequate disclosure that enables shareholders to decide whether to exercise their redemption rights on a fully-informed basis. That being said, the Court, at a minimum, leaves open the possibility that, in a fully-informed redemption decision in a de-SPAC transaction, stockholder claims could be subject to dismissal because stockholders would have been afforded the (fully informed) choice to opt out. As further discussed below, structural elements of SPACs designed to mitigate inherent conflicts of interest such as the redemption rights feature may therefore ultimately prove to effectively ameliorate and mitigate fiduciary claims and liability, albeit only if a SPAC provides adequate disclosure of all material information such that stockholders can make a fully-informed redemption decision.

- In its analysis, the Court compared the alleged interference with the redemption rights of the SPAC's public stockholders to a public stockholders' right to vote – a hallmark principle of shareholder rights protected under the principles of Delaware corporation law. Assuming SPAC redemption rights are viewed this way, courts will be watchful in reviewing these claims going forward and will closely dissect the disclosures provided in the proxy statement disseminated to the public stockholders. In particular, akin to the significance of providing public corporation stockholders with all material information relevant to a vote in favor of a particular matter, Delaware courts will be careful to ensure, among other things, that a SPAC adequately discloses in the proxy statement, and its stockholders are therefore provided with, any and all material, pertinent and relevant information in making the decision as to whether to exercise redemption rights. Notably, similar to the cleansing effect that full disclosure has in a traditional merger context, the Court suggested that adequate, fulsome, robust and particularized disclosures may effectively preclude claims and any liability on the part of SPAC sponsors, directors, management or insiders relating to impairment of redemption rights. The decision in *MultiPlan* therefore emphasizes the importance of adequate, fulsome and robust disclosures and parties should give careful consideration to the contents of the proxy statement (including, in particular, the factual disclosures and risk factors) issued in connection with any SPAC transaction.

- SPAC sponsors and directors looking to avoid entire fairness review in the future should consider, like controlling shareholders, directors and/or insiders of any other Delaware public corporation, the feasibility of adopting and implementing appropriate procedural deal process safeguards to mitigate risk in a de-SPAC business combination transaction. In addition to and aside from ensuring full disclosure of all material facts and information in the proxy statement, certain safeguards that have historically been utilized in the traditional merger context—such as independent special committees, independent financial advisors, and third-party valuation reports or fairness opinions as to the value of the target business—may be helpful tools for reducing exposure in the context of de-SPAC deals going forward.