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Delaware Court of Chancery Applies Entire Fairness to De-SPAC Transaction in First Major Decision Involving SPAC Litigation

In *In re Multiplan Corp. Stockholder Litigation*, C.A. No. 2021-0300-LWW (Del. Ch. Jan. 3, 2021), Vice Chancellor Lori Will of the Delaware Court of Chancery issued the first major decision applying Delaware law to de-SPAC transactions, holding that Delaware's entire fairness standard of review applies to a de-SPAC transaction challenged on the basis of misleading statements or omissions in the SPAC's proxy statement. In denying defendants' motions to dismiss, the court found that the entire fairness standard of review "applies due to the inherent conflicts between the SPAC's fiduciaries and public stockholders in the context of a value-decreasing transaction."

The court found that the SPAC's sponsor and directors, who owned founder shares, obtained a unique benefit in the de-SPAC transaction because absent a merger, the founder shares are worthless, while the SPAC's public shares are worth their trust value of $10 plus interest. Therefore, the price per share at which a merger is valuable for the SPAC's sponsor and directors differs from that for the public. The court held that given the SPAC's structure, the sponsor "would be incentivized to discourage [stockholder] redemptions" even "if the deal was expected to be value decreasing." Accordingly, plaintiffs sufficiently "pleaded viable, non-exculpated claims against the SPAC's controlling stockholder and directors." However, the court noted 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 that "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."

The decision underscores numerous considerations for SPACs and their targets moving forward, including:

- The need for complete and accurate disclosures in a SPAC's proxy statement regarding: (i) the target's business and risks to that business; and (ii) the sponsor's financial incentives to complete any transaction, including a transaction that may trade below $10 per share;
- The need for thorough due diligence to identify business risks;
- That directors and officers holding founders are subject to liability for being interested in a de-SPAC transaction;
- That actions of the directors may be subjected to higher scrutiny under the "entire fairness" standard of review;
- There may be a different outcome for a Cayman domiciled SPAC than for a Delaware SPAC;

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- This may lead to even higher costs for D&O insurance than what we have seen to date, which should be figured into the amount of risk capital that a SPAC should raise;
- The receipt of founder shares may cause otherwise independent directors to be conflicted if the value of the shares is deemed material to the directors; and
- SPACs should seek independent advisors and avoid engaging advisors that are related to the sponsor or may appear conflicted in any manner

The decision is described in more detail below, including the court's additional conclusions that such claims are direct, not derivative; the claims are fiduciary, not contractual; and the claims are not "holder" claims.

BACKGROUND

The action stems from Churchill Capital Corp. III's business combination with Multiplan Inc. Following the merger, an equity research firm published a report describing purported issues with Multiplan's business. Thereafter, plaintiffs filed a class action complaint against Churchill's sponsor (an alleged controller) and its directors and officers. The complaint alleged that the defendants breached their fiduciary duties, including the duty of disclosure, by failing to disclose material details in Churchill's proxy statement regarding Multiplan's business—namely, that Multiplan's largest customer was developing an in-house alternative to Multiplan that would both eliminate the customer's need for Multiplan's services and compete with Multiplan. Plaintiffs claimed that such omissions impaired public stockholders from exercising their redemption rights to receive $10.04 per share instead of shares in the combined de-SPAC entity.

The defendants moved to dismiss, raising numerous arguments including: (1) the proper standard of review; (2) the claims were derivative in nature and plaintiffs failed to allege demand futility; (3) the claims stemmed from contract; and (4) the claims were "holder" claims, which are not subject to class treatment. On January 3, 2022, the court issued its opinion, denying the motions to dismiss as to the SPAC's sponsor, directors, and CEO.

THE COURT'S OPINION

At the outset, the court noted that "distinctive features of a SPAC" do not change applicable principles of Delaware law or the standard under Court of Chancery Rule 12(b)(6). The court characterized "the crux" of plaintiffs' claims as defendants, "principally in the form of misstatements and omissions," impairing Churchill public stockholders' "redemption rights to the defendants' benefit." Because "public stockholders were allegedly not fully informed of all material information about MultiPlan, they exchanged their right to $10.04 per share—held in a trust for their benefit—for an interest in Public MultiPlan." Thereafter, the court addressed the defendants' arguments.

(1) THE STANDARD OF REVIEW: ENTIRE FAIRNESS

The court held that plaintiffs sufficiently raised two independent reasons for why entire fairness applies: (i) the "de-SPAC merger, including the opportunity to redeem, was a conflicted controller transaction;" and (ii) "a majority of the Churchill Board was conflicted because the directors were self-interested or because they lack independence from [Michael] Klein."

(i) Conflicted Controller: Conflicted controller transactions are subject to entire fairness review in two situations: "where the controller stands on both sides;" and "where the controller competes with the common stockholders for consideration." The court acknowledged that the first situation was not relevant to this case as the de-SPAC merger was an arm's-length transaction. However, the court

held that the second situation applied because the sponsor received a "'unique benefit' by extracting something uniquely valuable to the controller, even if the controller nominally receives the same consideration as all other stockholders."

Specifically, the court held that the "unique benefit" was the difference in value of the merger (or non-merger) to the sponsor compared to public stockholders. The merger only had value to public stockholders if the post-merger entity was worth more than $10.04 a share, but the merger had value to the sponsor and directors "well below" that price. The court held that given the SPAC structure, the sponsor "would be incentivized to discourage redemptions" even "if the deal was expected to be value decreasing."

The court rejected defendants' argument that the founder shares' lock-up and "unvestment" (*i.e.*, founder shares that are unvested or subject to forfeiture) of 45% of the founder shares undercut plaintiffs' claim. The court noted that "even the vested 55% of those shares, if hypothetically valued at $5, and discounted back 18 months at an aggressive 20% per year, are worth more than $40 million dollars." In discussing the sponsor's private placement warrants, the court focused on the fact that the warrants would "expire worthless" absent a transaction, but did not seem to consider that the warrants have little value in a downside transaction.

The court also rejected the argument that the sponsor's promote cannot trigger entire fairness because it would appear in any de-SPAC transaction and was not unique to the Multiplan acquisition. The court held that the fact that "this structure has been utilized by other SPACs does not cure it of conflicts."

(ii) Conflict Board: The court found that Churchill's directors were conflicted because they all held founder shares. The court pointed out that even at $5 a share, the director holding the fewest shares would still own over $500,000 of stock, which is "presumptively material at the motion to dismiss stage." The court did not comment on if lesser grants would be presumptively material at the motion to dismiss stage and left open the question of if $500,000 was actually material to any director, noting that "defendants may ultimately be correct that" the issuance of founder shares "was not material to the directors."

Finally, the court also found that the board was conflicted because the directors were controlled by the sponsor. The court noted that plaintiffs had sufficiently alleged that the directors were "all beholden" to the sponsor because the sponsor "had appointed them to serve as directors" for other related SPACs, "providing them founders shares with the potential for multi-million-dollar paydays."

(2) DIRECT OR DERIVATIVE CLAIMS: DIRECT

In determining that the claims were properly brought as direct claims, the court applied the Tooley test, which asks: (i) who suffered the alleged harm; and (ii) who would receive the benefit of any recovery or other remedy?

(i) Who Suffered the Harm: The court held that the "Complaint centers around the allegation that the Board impaired the public stockholders' informed exercise of their redemption right," and this harm could not have run to the corporation because "Churchill had no such redemption rights" and the trust funds "did not belong to Churchill until those stockholders opted not to redeem." Therefore, "the stockholders suffered a harm independent of and not shared with Churchill." In making this ruling, the court rejected defendants' argument that the case was "a typical overpayment or dilution case."

(ii) Who Would Receive the Benefit of Any Recovery: The court held that Class A stockholders "harmed through the impairment of their redemption rights personally lost the opportunity to recover $10.04 before the merger closed and any reduction in enterprise value occurred. Fully informed public stockholders could have exercised their redemption rights." Accordingly, stockholders "rather than the Company, would receive the benefit of that recovery."

Because the stockholders suffered the harm and would receive the benefit of any recovery, the claims were direct, not derivative.

(3) CONTRACTUAL OR FIDUCIARY CLAIMS: FIDUCIARY

The court rejected the defendants' argument that plaintiffs' claims were governed by contract. The court held that while the company's certificate of incorporation provided the stockholder redemption right, the case was not about whether stockholders received such an opportunity. Instead, the case was about the defendants "disloyally impair[ing] that right by breaching their duty to disclose." The court held that the redemption right was an "investment decision" and analyzed it to "purchasing and tendering stock or making an appraisal election," to which "Delaware courts have applied the duty of disclosure."

(4) HOLDER CLAIMS: NOT HOLDER CLAIMS

The court also rejected the defendants' argument that plaintiffs' claims were holder claims. A holder claim is a "cause of action by persons wrongfully induced to hold stock instead of selling it." According to the court, "holder claims are predicated on stockholder inaction." The court held that the "dispute is not about whether the alleged omissions induced Class A stockholders to hold on to their stock." Rather, "Churchill's public stockholders were faced with two choices: whether to exercise their redemption right and whether to approve the merger." The court found that the redemption right was "a call for stockholder action in the form of an 'investment decision,' not unlike purchasing and tendering stock or making an appraisal election." Stockholders had to choose between "divest[ing] or invest[ing] in the post-merger entity" and "approv[ing] or disapprov[ing] the merger." These decisions were "active and affirmative choice[s] around which the SPAC structure revolved."

In addition to the above, the court also allowed an aiding and abetting claim against the SPAC's financial advisor, the Klein Group, to go forward because the Klein Group is an entity related to the sponsor. The court did dismiss the complaint against the CFO due to lack of specific allegations, and the complaint against the company (Churchill) because it was not named in any specific cause of action.

Winston and Strawn will continue to monitor the action and provide further updates as they occur. If you have any questions, comments, or would like to discuss, please reach out to Jeffrey Steinfeld at jlsteinfeld@winston.com or (213) 615-1960, the contributors below, or your regular Winston contact.

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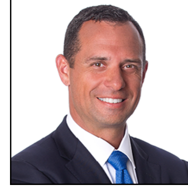

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