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Chancery Court Applies "Well-Worn Fiduciary Principles" to Address "Novel Issues" Presented by SPAC Disclosure Litigation

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DELAWARE CORPORATE LAW BULLETIN

CHANCERY COURT APPLIES "WELL-WORN FIDUCIARY PRINCIPLES" TO ADDRESS "NOVEL ISSUES" PRESENTED BY SPAC DISCLOSURE LITIGATION

Applying entire fairness due to "inherent conflicts" in SPAC structure, Court refuses to dismiss claims that Sponsor and SPAC directors omitted material information from disclosures to public investors

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INTRODUCTION

In *In Re MultiPlan Corp. S'holders Litig.*, 268 A.3d 784 (Del. Ch. 2022) ("*MultiPlan*"), the Delaware Court of Chancery ("*Chancery Court*") confronted—for the first time—litigation over one of the most popular devices currently available to privately-held businesses seeking "to access the public markets": the "special purpose acquisition company," or "*SPAC*." A SPAC's primary function is to raise financing through an initial public offering ("*IPO*") of shares in a shell company, and then, within a prescribed time horizon, combine the shell company with a private operating company via a so-called "de-SPAC merger." As compensation for its efforts in identifying a suitable merger candidate, the SPAC's sponsor receives "founder shares" at a "nominal price," plus other considerations. If the SPAC cannot complete a de-SPAC merger within the time horizon, the funds raised in the IPO are returned to the public SPAC investors, thereby rendering the founder shares worthless. But, if a de-SPAC merger is timely completed, the founder shares automatically convert into shares of the combined company. The value of these newly-converted shares is "pure upside" to the sponsor.

The SPAC at issue in *MultiPlan* "was formed in the midst of a SPAC boom" in early 2020. As noted by the *MultiPlan* Court, a total of ten SPACs closed their IPOs in 2013, "raising a total of $1.4 billion," followed by fifty-nine the following year "with $13.6 billion raised." By 2020, deal volume exploded, increasing to "248 SPAC IPOs rais[ing] a total of $83.4 billion."

In *MultiPlan*, unhappy IPO investors ("*Plaintiffs*") brought breach of fiduciary duty claims against the SPAC sponsor and members of its board of directors (collectively, "*Defendants*"), alleging that Defendants "—motivated by financial incentives not shared with public stockholders—impaired the public stockholders' right to divest their shares" before the ensuing de-SPAC merger. Specifically, Plaintiffs claimed Defendants failed to disclose a material risk to the acquired business that, soon after completion of the de-SPAC merger, triggered a sharp decline in the SPAC's public trading price.

Vice Chancellor Lori W. Will, noting that "Delaware courts have not previously had an opportunity to consider the application of our law in the SPAC context," applied "well-worn fiduciary principles" to "the novel issues presented." At the outset of her analysis, the Vice

Chancellor rejected various "threshold" arguments—unique to the SPAC structure—raised by Defendants to facilitate pleading-stage dismissal of Plaintiffs' claims. Next, recognizing that SPAC transactions are, by their very nature, rife with potential conflicts of interest, the Vice Chancellor opted to apply the entire fairness standard of review to assess Plaintiffs' claims. Applying entire fairness, she then determined Plaintiffs adequately pleaded that the public stockholders effectively were "robbed of their right to make a fully informed decision" whether to divest their interests or remain invested following the de-SPAC merger. On this basis, the Vice Chancellor denied Defendants' motions to dismiss.

I. Factual Background

Churchill Capital Corp. III ("*Churchill*") was the "third . . . of at least seven" SPACs sponsored by financier Michael Klein ("*Klein*") and affiliated entities (collectively with Klein, "*Sponsor*"). In addition to Klein and his brother, Churchill's board of directors (the "*Board*") consisted of individuals "hand-picked by Klein." These other Board members "were compensated with membership interests in the Sponsor," giving them potentially valuable indirect interests in Churchill once the IPO and a de-SPAC merger were completed. Several of the directors had additional connections with Klein, including "serv[ing] on the boards of multiple other SPACs that Klein launched," both preceding and following the Churchill SPAC. According to Vice Chancellor Will, the structure and terms of Churchill's SPAC were "market standard."

A. Churchill Completes IPO

Churchill completed its IPO in February 2020, raising $1.1 billion by selling units at $10 per unit ("*IPO Price*"). Each unit consisted of one share of Class A common stock ("*Class A Stock*") plus a fractional warrant to purchase additional shares. Class A Stock represented 80% of Churchill's outstanding shares, with the remaining 20% consisting of shares issued to Sponsor for minimal consideration ("*Founder Shares*"). Founder Shares would convert (on a share-for-share basis) into shares of Class A Stock upon completion of a de-SPAC merger.

The IPO proceeds were placed in trust ("*Trust*") while Churchill searched for a suitable de-SPAC merger candidate. Any de-SPAC merger would require approval not only by the Board, but also by "[t]he affirmative vote of a majority of Churchill's stockholders." Churchill

retained a Klein affiliate as a financial advisor to assist with the de-SPAC merger, contracting to pay "$30.5 million for its advisory services."

The Trust could distribute IPO proceeds only "in one of three ways":

- If a de-SPAC merger was not completed within a two-year window period ("*Window*"), the IPO proceeds would be returned to the holders of Class A Stock ("*Class A Stockholders*"), leaving nothing for Sponsor as owner of Founder Shares.
- If a merger candidate was identified within the Window, then, in accordance with Churchill's certificate of incorporation (the "*Charter*"), each Class A Stockholder would have the opportunity to redeem its shares at the IPO Price rather than remain as an investor in the combined enterprise following the de-SPAC merger.
- Any funds remaining after the redemption "could be used 'as consideration to complete [the] initial business combination' or 'as working capital to finance the operations of the target business.' "

B. De-SPAC Merger with MultiPlan

Within a couple months following the IPO, Churchill identified MultiPlan, Inc. ("*Target*"), "a healthcare industry-focused data analytics and cost management solutions provider," as a suitable candidate for a de-SPAC merger. Following a period of negotiations, on July 12, the Board approved a merger agreement with Target ("*Merger Agreement*"). Churchill publicly announced the transaction the following day.

The Merger Agreement provided for the issuance of a mixture of cash and Class A Stock "valued at $10 per share" to Target stockholders "worth $5.678 billion." Churchill financed the cash portion of the merger consideration from (i) IPO proceeds remaining in the Trust after payment of any required redemptions, plus (ii) proceeds from a private placement to institutional investors ("*Private Investors*"), including Klein affiliates and certain Board members. The purchase price and related financing "implied" a post-de-SPAC merger "enterprise value of $11 billion." Assuming no Class A Stockholders would demand redemption of their shares, ownership of the merged entity following closing of the de-SPAC merger would be allocated as follows:

- former Target stockholders—60.5%;
- Class A Stockholders—16.0%;

- Sponsor and affiliates (including Board members) upon conversion of Founder Shares—4.2%; and
- Private Investors—19.2%.

Churchill distributed a proxy statement ("*Proxy Statement*") to Class A Stockholders on September 18 to solicit their votes in favor of the de-SPAC merger. The Proxy Statement explained that each stockholder could either (i) elect redemption of Class A Stock in exchange for the IPO Price or (ii) vote in favor of the de-SPAC merger and remain invested in the post-merger entity. The Proxy Statement not only touted "the 'attractive valuation' and 'opportunities for growth' "offered by the transaction, but also "described the 'extensive due diligence' conducted by the Board and Churchill management, including communications with 'senior leaders of several large customers of [Target].' " Among other disclosures, the Proxy Statement revealed Target's dependence on a single customer, which accounted "for 35% of its revenues." However, the Proxy Statement "did not disclose that the customer was UnitedHealth Group Inc. ("*UH*") or that UHC intended to create an in-house data analytics platform called Naviguard" to "both compete with [Target] and cause UHC 'to move all of its key accounts from [Target] to Naviguard by the end of 2022.' " In fact, "UHC had publicly discussed its plan for Naviguard by June 2020."

Before the October 8 completion of the de-SPAC merger, with "[f]ewer than 10% of Churchill's public investors opt[ing] to exercise their redemption rights," "Churchill stockholders overwhelmingly voted to approve the business combination." The euphoria over the de-SPAC merger was short lived, however, as a little over one month later, on November 11, "an equity research firm published a report about MultiPlan discussing . . . UHC's formation of Naviguard." Realizing this report signaled that Target not only would be losing its largest customer, but also would be gaining a new, deep-pocketed competitor, wary investors drove Churchill's trading price "to a then-closing low of $6.27." As a result, the de-SPAC merger became, in the words of Vice Chancellor Will, "value-decreasing" for any Class A Stockholder who did not elect redemption.

C. Litigation Ensues

In early April 2021, with Churchill's stock price still trading at its "then-closing low," Plaintiffs brought a class action lawsuit in Chancery Court. Among other things, Plaintiffs claimed that Defendants breached their fiduciary duties by "putting their own interests above Churchill Class A [S]tockholders' interests" by

"issu[ing] a false and misleading proxy that impaired Class A [S]tockholders' informed exercise of their redemption and voting rights." Defendants moved to dismiss. Following briefing and oral argument, Vice Chancellor Will denied Defendants' motions.

II. VICE CHANCELLOR WILL'S ANALYSIS

At the outset, Vice Chancellor Will explained "[t]here is no dispute that Churchill's directors, officers, and controlling stockholder owed fiduciary duties of care and loyalty to stockholders." And given that Plaintiffs' claims rested principally on allegedly misleading disclosures in the Proxy Statement, she added that "[t]he duty of disclosure is an 'application of the fiduciary duties of care and loyalty' implicated when fiduciaries communicate with stockholders."

Defendants sought to secure a procedural advantage at the pleading stage by asking the Vice Chancellor to segment Plaintiffs' claims into several discrete issues. Plaintiffs "reject[ed] that characterization of their claims," arguing instead they had asserted "a holistic claim for breach of fiduciary duty." The Vice Chancellor, attributing this difference in approach to "the distinctive features of a SPAC," adopted a "plaintiff-friendly construction" of Plaintiffs' complaint to "underpin[ ] [her] analysis of the breach of fiduciary duty claims." As such, she explained, "the crux of the [P]laintiffs' claims is that [D]efendants' actions—principally in the form of misstatements and omissions—impaired Churchill public stockholders' redemption rights to the [D]efendants' benefit."

A. Threshold Issues

Before turning to the substance of Plaintiffs' claims, Vice Chancellor Will tackled three "threshold issues" raised by Defendants in support of their motions to dismiss. Each of these issues arose from the litigants' competing characterizations of Plaintiffs' claims and, in siding with Plaintiffs on each, the Vice Chancellor remained true to her view of "the crux of [P]laintiffs' claims" described above.

1. Plaintiffs' Claims Direct Rather Than Derivative

First, Defendants argued that Plaintiffs' claims were *derivative* in nature because the gravamen of the dispute was that Churchill "overpaid" for Target, causing a loss to the corporation rather than any individual Class A Stockholder. If the claims were considered derivative, to avoid dismissal, Plaintiffs would have been required to

either demand that the Board investigate their claims or plead "demand futility." The Vice Chancellor rejected this argument, concluding instead that the claims were *direct* in nature and should be allowed to proceed on that basis.

In so ruling, the Vice Chancellor focused on two factors:

- *Who Suffered the Harm*? Rather than asserting a claim that Churchill overpaid for Target, as Defendants argued, Plaintiffs' claim actually stemmed from Class A Stockholders' inability to "make 'a fully informed decision [on] whether to redeem their shares ahead of the [m]erger.' " As such, Class A Stockholders were *directly* "harmed through the impairment of their redemption rights," causing them "personally" to lose "the opportunity to recover" repayment of the IPO Price "before the merger closed and any reduction in enterprise value occurred."
- *Who is Entitled to Recovery*? Similarly, because "the option to make an informed redemption decision had a value to [Class A S]tockholders independent of any injury to the Company . . . . [d]amages for impairment of the redemption right flow to the [Class A S]tockholder[s]—not Churchill" as would be the case in a derivative claim.

2. Plaintiffs' Claims Not Solely Governed by Contract

Second, Defendants argued that because the redemption right was contained in, and governed by, the Charter, Plaintiffs' "fiduciary duty claims would be subsumed within a contractual claim." In rejecting this approach, the Vice Chancellor explained that Plaintiffs were not making a contract claim inasmuch as "Churchill *met* its contractual obligation and stockholders had the chance to redeem." Rather, the essence of Plaintiffs' claims was that Defendants "disloyally impaired th[e] [redemption] right by breaching their duty to disclose." Quoting from an earlier Chancery Court decision, the Vice Chancellor explained "that a corporation is bound by its valid . . . fiduciary duties when considering how to handle[ ] those contractual obligations" reflected in a corporate charter. Because "[a] fiduciary duty claim . . . is not foreclosed simply because the source of the right being exercised is contractual," Defendants were not entitled to dismissal on this basis.

3. Plaintiffs' Claims Not Holder Claims

Third, Defendants argued that Plaintiffs' claims were so-called "holders claims" which, by "requiring proof of causation, reliance, and

damages," rendered class action status inappropriate. The Vice Chancellor also rejected this contention, explaining that Plaintiffs "have not advanced a holder claim." To the contrary, the "dispute is not about whether the alleged omissions induced Class A [S]tockholders to hold on to their stock," but rather, "whether to exercise their redemption right and whether [to] approve the merger." In essence, "an active and affirmative choice around which the SPAC structure revolved." Class action status, therefore, was not foreclosed.

B. Breach of Fiduciary Duty Claims

Turning to the substance of Plaintiffs' claims, Vice Chancellor Will considered, *first*, the applicable standard of review and, *second*, whether Plaintiffs' allegations were sufficient to survive Defendants' motions to dismiss.

1. Standard of Review

Defendants sought application of the "Delaware[ ] default standard of review . . . the business judgment rule," with its deferential presumptions in favor of a board of directors' business decisions. Plaintiffs, on the other hand, asserted "two independent—and individually sufficient—reasons" in favor applying "entire fairness, Delaware's 'most onerous standard of review.' " Specifically, Plaintiffs argued that, *first*, "the de-SPAC merger, including the opportunity to redeem, was a conflicted controller transaction" and, *second*, "a majority of the . . . Board was conflicted either because the directors were self-interested or because they lack[ed] independence from Klein." Once again, the Vice Chancellor concluded Plaintiffs had the better of these arguments and deemed entire fairness the appropriate standard of review.

a. Conflicted Controller Allegations

Because there was no dispute that Klein controlled Churchill, the operative question was whether Klein had "engaged in a conflicted transaction." In this connection, because Klein did not stand on both sides of the transaction, Vice Chancellor Will was required to determine whether Klein "compete[d] with the common stockholders for consideration" under any of three potential scenarios. While Defendants focused on the *first two scenarios*—arguing Klein neither "receive[d] greater monetary consideration" nor "a different form of consideration" than the Class A Stockholders—the Vice Chancellor focused on the *third scenario*: whether Klein "receive[d] a 'unique

benefit' by extracting 'something uniquely valuable to the controller' . . . to the detriment of the minority." In this vein, the Vice Chancellor explained that while the de-SPAC merger would have value for Class A Stockholders "sufficient to eschew redemption" *only* if the de-SPAC merger delivered value exceeding the IPO Price. Klein, who paid only a nominal price for Founder Shares, would receive a "special benefit" so long as the de-SPAC merger had *any* value. Accordingly, the Vice Chancellor found that "Klein effectively competed with the public stockholders for the funds held in trust and would be incentivized to discourage redemptions if the deal was expected to be value decreasing," as it ultimately proved to be.

Defendants argued there was no disabling conflict because, among other reasons, (i) the transaction structure was typical of "*any* de-SPAC transaction," and (ii) any potential conflicts were disclosed to, and implicitly accepted by, Class A Stockholders in the IPO. The Vice Chancellor rejected this contention: "That this structure has been utilized by other SPACs does not cure it of conflicts," particularly in light of Plaintiffs' well-pleaded allegation that Defendants failed to disclose "all material information when the time came" for Class A Stockholders to elect whether or not to redeem. This conclusion was "bolster[ed]" by the Board's retention of a Klein affiliate for the lucrative financial advisory role. Moreover, the Vice Chancellor explained, "the technical legality of the de-SPAC mechanics" did not absolve Defendants: "Under Delaware law, '[c]orporate acts must be 'twice-tested'—once by the law and again in equity.' "

b. Conflicted Board Allegations

Vice Chancellor Will also credited Plaintiffs' allegations concerning conflicts that disabled a majority of the Board. *First*, she found it "reasonably conceivable" that a majority of the Board members, by virtue of "their economic interests in the Sponsor," were "self-interested" in "virtually any merger—even one that was value diminishing to Class A [S]tockholders." Rather than parsing the materiality of such interest to any individual Board member, the Vice Chancellor recognized that "[a] greater than half-million-dollar payout is presumptively material at the motion to dismiss stage." *Second*, she found it "reasonably conceivable" that a majority of the Board members "were not independent from Klein." Foremost among the considerations supporting this conclusion was that a majority of the Board members served on boards of SPACs previously organized by the Sponsor and could be expected to serve on boards of Sponsor-organized SPACs in the

future, in either case reaping "lucrative" benefits. At the pleading stage, "the existence of these interests and relationships is enough to defeat a motion to dismiss."

2. Breach of Fiduciary Duty

Next, applying the entire fairness standard of review, Vice Chancellor Will refused to dismiss Plaintiffs' fiduciary breach claims against either the Board members or Sponsor. With the burden on Defendants "to demonstrate that the challenged act or transaction was entirely fair to the corporation and its stockholders," the Vice Chancellor observed that "[b]ecause the inquiry is fact intensive, 'it is rare the court will dismiss a fiduciary duty claim . . . when entire fairness is the governing standard of review.' This case is no exception."

Against this backdrop, Vice Chancellor Will found that Plaintiffs' claims were "viable" not due solely to "the nature of the transaction or related conflicts" but, more to the point, due to Plaintiffs' "reasonably conceivable" claims that Defendants "failed, disloyally, to disclose information necessary for the [Class A Stockholders] to knowledgeably exercise their redemption rights." At this stage of the proceedings, it was

> reasonably conceivable that a Class A [S]tockholder would have been substantially likely to find [the omitted information concerning UHC's plans] important when deciding whether to redeem her Churchill shares. . . . [F]or purposes of the motion to dismiss, the alleged disclosure violations sufficiently give rise to a [finding of] lack of overall fairness.

CONCLUSION

Although the *MultiPlan* litigation presented "novel issues" not previously considered by the Chancery Court, Vice Chancellor Will applied "well-worn fiduciary principles" to address the potentially conflicting relationships among the various parties to the SPAC transaction. Defendants asked the Vice Chancellor to ease their burden by segmenting the various aspects of the overall transaction. The Vice Chancellor, rejecting this approach, instead adopted a "plaintiff-friendly construction" focusing on the ultimate choice given to Class A Stockholders: (i) redeem your shares at the IPO Price or (ii) vote in favor of the de-SPAC merger and remain invested in the new enterprise. In addition, the "inherent conflicts" presented by the SPAC structure led the Vice Chancellor to apply the "onerous" entire fairness standard of review in her examination of the SPAC transaction. Finally, the substance of Plaintiffs' claims—failure by Defendants to disclose all material information necessary for Class A Stockholders to make an informed decision whether to redeem their shares or remain invested—

presented issues of fact compelling denial of a pleading-stage dismissal. While SPAC sponsors may not welcome Vice Chancellor Will's traditional approach, going forward, her reliance on well-established fiduciary principles offers M&A practitioners a familiar set of guidelines for addressing complex SPAC relationships and issues.