Green Light On SPAC Deal Suit Puts Fiduciary Duty In Context

By **Edward Micheletti, Susan Saltzstein and Sarah Runnells Martin**

The Delaware Court of Chancery issued a novel decision on Jan. 3 arising from a challenge to a transaction involving a special-purpose acquisition company in In re: MultiPlan Corp. Stockholders Litigation.

Edward Micheletti

Applying "well-worn fiduciary principles," under Delaware law to the claims raised by stockholder plaintiffs, the Delaware chancery denied a motion to dismiss, **allowing claims to proceed** against a SPAC's sponsor and its directors, as well as an aiding and abetting claim against its financial adviser.

Given the scope of the ruling, and the fact that the challenges raised in MultiPlan arise from common SPAC structures, practices and disclosures, the decision is a must-read for anyone focused on SPACs.

Susan Saltzstein

Background

According to the decision, Churchill Capital Corp. III was a SPAC founded and controlled by Michael Klein, the former investment banking chief of Citigroup Inc., through a sponsor entity. The SPAC's directors were allegedly hand-picked by Klein and given economic interests in the sponsor.

Churchill's 2020 initial public offering was priced at $10 per unit — consisting of one share of Class A stock and a quarter of a warrant with an exercise price of $11.50.

Sarah Runnells Martin

After the IPO, Churchill's equity structure consisted of Class A shares and Class B founder shares — with Class A shares held by public stockholders and the Class B shares purchased by the sponsor for a nominal capital contribution and convertible to Class A shares if the SPAC closed a transaction; and representing 80% and 20%, respectively, of the SPAC's outstanding equity.

The SPAC also made a private placement of 23 million warrants to the sponsor at $1 each, with an exercise price of $11.50. In the event that a transaction was not accomplished within 24 months, the SPAC would liquidate, and Class A shareholders would receive their pro rata share of the amount from the IPO plus interest — equal to $10.04.

In contrast, the sponsor's Class B shares would expire as worthless absent a deal. The warrants held by both Class A and Class B stockholders would also be worthless if there were no deal. However, if the SPAC proposed a business combination, Class A stockholders could choose to exercise a redemption right for their Class A shares for $10.04, and would retain their warrants, regardless of whether they voted in favor of the deal.

The SPAC identified MultiPlan as its acquisition target and retained The Klein Group LLC, an entity controlled by Klein, as its financial adviser. The SPAC did not obtain an independent third-party valuation of MultiPlan or a fairness opinion. The merger proxy statement sought

stockholder approval and also informed Class A stockholders about their ability to redeem their shares. Stockholders overwhelmingly approved the deal, and less than 10% of the Class A stockholders opted to exercise their redemption rights.

After the merger closed, the newly public MultiPlan's stock dropped significantly based on a report from an equity research firm about MultiPlan's largest customer forming a competitor entity, which was not disclosed in the proxy. The complaint followed, asserting class claims for breach of fiduciary duty against the SPAC directors, Klein, the SPAC's chief financial officer and The Klein Group.

Court's Analysis on the Motion to Dismiss

Preliminary Defenses

The complaint at its core generally challenged the structure of the SPAC as creating a divergence of interests between Class A and Class B stockholders, and specifically alleged that the defendants prioritized their personal interests above the Class A stockholder interests in completing the merger and issued a false and misleading proxy that harmed Class A stockholders when making their redemption decision.

As an initial matter, the court held that the claims raised were direct, not derivative — as they involved the redemption right, not a right that belonged to the SPAC, and impacted the Class A stockholders' right to redeem. The court also rejected the argument that fiduciary duty claims were foreclosed because the redemption rights arose contractually from the company's charter, and that the claim was a holder claim that could not be asserted on behalf of a class under Delaware law.

Entire Fairness Review

The court then turned to the substance of the claims, concluding that the entire fairness standard of review applied for two reasons.

First, the court held that it was reasonably conceivable that the de-SPAC merger was a conflicted controller transaction. The parties agreed that Klein, through the sponsor, controlled the SPAC, and the court concluded that "[t]he well-pleaded allegations in the Complaint highlight a benefit unique to Klein," emphasizing that on the date the merger closed, the sponsor's investment was worth $356 million, which represented "a 1,219,900% gain on the Sponsor's $25,000 investment."

However, "[t]hese figures would have dropped to zero absent a deal," the court said.

In contrast, Class A stockholders would have received $10.04 per share if the SPAC failed to consummate a transaction and liquidated, or if they had redeemed their shares. Thus, the court concluded that there was a "potential conflict between Klein [and the sponsor] and public [Class A] stockholders resulting from their different incentives in a bad deal versus no deal at all."

According to the court, the Class B stockholders were incentivized to support any deal, even if the resulting post-merger entity proved less valuable for Class A stockholders than if Churchill had liquidated.

The court also dismissed concerns about this ruling's impact on other SPACs, concluding that just because "this structure has been utilized by other SPACs does not cure it of its

conflicts. Nor does the technical legality of the de-SPAC mechanics."

The court quoted Delaware law principle that "Corporate acts must be 'twice-tested' — once by the law and again in equity.'"

Second, the court held that there were reasonably conceivable allegations that the SPAC board was conflicted because the SPAC's directors, through their economic interests in the sponsor:

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.

The court also held that a majority of the board was conflicted because they were not independent from Klein. Notably, he had appointed many of them to other SPAC boards — in some cases, at least five other SPACs — and it was conceivable, therefore:

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.

Disclosure Claims

The court then held that the proxy contained false and misleading disclosures. The proxy:

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.

Claims Against Defendants

Finally, the court held that the complaint alleged nonexculpated claims for breach of fiduciary duty against the SPAC's directors. In doing so, the court stated:

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.

The court also sustained claims against Klein in his capacity as the SPAC's controlling stockholder and as CEO of the SPAC. However, the court dismissed claims against the SPAC's CFO. The court also sustained an aiding and abetting allegation against The Klein Group, the SPAC's financial adviser.

Takeaways

The case involves a novel application of traditional fiduciary duty principles in the SPAC context, and as such, it will generate a significant amount of discussion and debate among SPAC participants and their advisers.

The MultiPlan opinion is a pleadings-stage decision, and the court's consideration of the facts was limited essentially to the complaint's allegations. Factual developments in the case going forward may provide additional guidance about the merits and invite a more refined analysis from the court.

It remains to be seen whether the decision will spur additional litigation and whether the court's analysis of the disclosures at issue, the potential conflicts identified and the court's view of the alignment of economics will impact the approach taken among SPAC market participants.

At a minimum, MultiPlan highlights that courts will parse proxy statements issued in connection with SPAC transactions and demonstrates the importance of robust disclosures in a context where a court could apply an entire fairness standard of review. Parties should give careful consideration to disclosures and risk factors issued in connection with any SPAC transaction.

Ultimately, the court in MultiPlan acknowledged that the decision turned on the court's view that the defendants made misleading disclosures that were, at the pleadings stage, conceivably the result of disloyal motivations. This suggests that, going forward, particularized disclosures may be one way to mitigate risk of a similar result.

Edward B. Micheletti and Susan L. Saltzstein are partners, and Sarah T. Runnells Martin is counsel, at Skadden Arps Slate Meagher & Flom LLP.

Skadden partners Howard L. Ellin and Gregg A. Noel contributed to this article.

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