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ALERT MEMORANDUM

# Delaware Chancery Court Allows SPAC Merger Challenge to Proceed

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In one of the first opinions addressing fiduciary duty claims in the context of a transaction involving a special purpose acquisition company ("SPAC"), the Delaware Court of Chancery determined that the SPAC shareholders' right to redeem can be undermined by insufficient disclosures regarding the transaction and allowed class-action claims to continue against a SPAC's controlling shareholder and directors.[1] This decision is important because it addresses some of the unique features of SPACs designed to mitigate inherent conflicts of interest in the SPAC structure, particularly the redemption feature. While this opinion leaves open that the redemption feature of SPACs may be an effective shield to fiduciary liability, as some have suggested, it will only be effective to the extent the stockholders are informed of all material information when deciding whether to redeem. In short, full disclosure in the de-SPAC context (just like in the traditional merger context) is critically important.


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[1] *In re Multiplan Stockholders Litigation*, No. 2021-0300-LWW, Del. Chancery Court, January 3, 2022.


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**Background**

SPACs generally allow their shareholders to redeem their shares at the SPAC's initial public offering price if the SPAC identifies a target company with which to complete a business combination transaction, and a shareholder would rather receive its money back than shares in the to-be public company after closing. SPAC "sponsors" are charged with identifying a target company, and generally receive both "founder shares" and warrants, which have value only if the SPAC completes a business combination transaction. If no transaction is completed, the sponsor's shares are worthless, and the public shareholders of the SPAC receive their money back.

Consequently, SPAC sponsors have disparate interests because they receive founder shares and warrants that are valuable only if the transaction is completed, regardless of the post-closing trading price of the combined enterprise. This is in contrast to the public shareholders who must choose, on the basis of the disclosures regarding the target company's business in the proxy statement, between a certain cash value upon redemption or shares in the target company's business, which could be worth more or less than the redemption value—but who also receive their money back if no deal is ever completed.

**The Decision**

In an opinion denying defendants' motion to dismiss, the Court in *In re Multiplan Stockholders Litigation* determined that the plaintiffs' class-action claims of breach of fiduciary duty due to inadequate proxy disclosures regarding the business combination between Churchill Capital Corp. III ("Churchill") and MultiPlan, Inc. ("MultiPlan") could proceed. In essence, plaintiffs' claim is that inadequate disclosures about the value of MultiPlan's business did not allow them to make a fully informed decision about the value of the shares they would hold in MultiPlan after closing, versus the value of the cash they could receive by electing to redeem before closing. Further, plaintiffs claim that the SPAC sponsors prepared inadequate disclosures to induce shareholders to accept public shares rather than cash to facilitate a business combination from which the sponsors would receive a unique, personal benefit. The alleged harm to the public shareholders is receiving less valuable shares in MultiPlan than the cash that they could have received upon redemption.

The Court recited several of plaintiffs' allegations of inadequate disclosure, which it assumed to be true at this stage of litigation, including that MultiPlan's largest customer was considering an in-house alternative that would eliminate its need for MultiPlan's services in the near term. Indeed, following closing of the transaction, research analysts discussed the customer issue, and MultiPlan's stock closed at a low of $6.27 per share just over a month after the closing, as compared to the $10.04 per share plaintiffs could have received upon redemption.[2]

The Court allowed the claims to proceed beyond a motion to dismiss on a class-wide, as opposed to a derivative, basis because plaintiffs were allegedly harmed personally in making a choice whether to redeem absent adequate information. In addition, the Court noted that the entire fairness standard would apply both because the sponsor was a "conflicted controller" and because the director-defendants of Churchill stood to receive a unique benefit through the founder shares and warrants that had value only if a business combination closed. The Court rejected defendants' arguments that in fact they received the same consideration as the public shareholders and should be entitled to business judgment rule deference.

This case is important because the SPAC phenomenon has exploded in popularity. SPACs combine elements of both an M&A transaction and an IPO, but have inherent complexity and structural features that appear to distinguish them from traditional public companies. Yet Delaware courts have not had an opportunity to weigh in on several issues that traditional public companies have dealt with for years in the dealmaking environment. The case illustrates that while many SPAC commentators have pointed to the unique

[2] Slip Op. at 15, 17, 55.

structural features and IPO-related disclosures as mitigating factors to fiduciary duty liability, Delaware law does not view these features as a shield in the face of an alleged breach of fiduciary duties, at least where plaintiffs can plead inadequate disclosures.

**Takeaways:**

— The Court analogized the alleged interference with the SPAC shareholders' redemption rights to the shareholders' right to vote.[3] The right to vote is among the most sacrosanct shareholder rights under Delaware law, and to the extent redemption rights are viewed this way, courts will likely be vigilant in reviewing these claims. Among other things, Delaware courts will want to ensure that SPAC shareholders are provided with all material information in deciding whether to redeem, just as Delaware courts place a premium on providing shareholders with all material information when they are asked to vote. But just as full disclosure has a cleansing effect in a traditional merger (see *Corwin*), the Court in this case hinted, though did not decide, that full disclosure to SPAC shareholders may preclude claims that they were prevented from exercising redemption rights.

— The Court determined that the entire fairness standard applies to these claims against Churchill's sponsor because of a "unique benefit" received in the form of founder shares, which are valuable only if a business combination is completed, whereas the public shareholders had to choose between cash and shares of the combined entity.[4] This was the case even though the founder shares were converted in the transaction to the same consideration as the public shareholders' shares.

— The Court rejected the claim that because the alleged conflicts of interest and incentives were disclosed at the time of the SPAC's initial public offering, there was no basis for an inadequate disclosure claim on the facts of this case. The Court instead stated that the SPAC shareholders, while understanding the general structure, "did not, however, agree that they did not require all material information"[5] to determine whether to accept post-closing public shares or redeem. This leaves open the possibility that in a fully informed redemption decision in a de-SPAC transaction, shareholder claims would be subject to dismissal because shareholders would have a (fully informed) choice whether to redeem or keep their shares.

— The Court determined that because the breach of fiduciary duty claims would accrue to each shareholder's direct economic benefit, the claims are properly made as direct, not derivative claims, removing procedural barriers to such claims. The Court rejected defendants' argument that the claim is akin to a classically derivative "overpayment" claim that would accrue to the benefit of the company as a whole, since the right to redeem was specific to each shareholder.[6]

— Some SPAC industry observers have suggested that unique structural elements of SPACs, and specifically the redemption feature, can ameliorate fiduciary issues and conflicts of interests—the idea being that since shareholders have a contractual right to opt out, there is no harm even in the face of a conflict. However, this case indicates that even knowledge of a conflict cannot cleanse a process that is not fully informed, and the directors' duties still apply to require disclosure that allows shareholders to determine whether to exercise their rights on a fully informed basis.[7]

— SPAC sponsors and directors should consider, like controlling shareholders and directors of any other Delaware corporation, appropriate procedural steps to mitigate risk in a business combination transaction. These can include full disclosure of due diligence findings on the target company, re-examining the independence and compensation of non-sponsor directors, and third-party valuation reports or fairness opinions as to the value of the target business. However, there is inherent tension in the use of at least one such risk mitigation strategy—a special committee

[3] Slip Op. at 27.
[4] Slip Op. at 42-43.
[5] Slip Op. at 46.
[6] Slip Op. at 29.
[7] Slip Op. at 35.

of independent directors—since SPAC shareholders buy SPAC shares on the basis of the expertise and connections of the SPAC's sponsor, and a committee could divest the sponsor from involvement in the process. As noted above, the opinion in this case indicates that certain fiduciary liabilities can be mitigated so long as all material information is disclosed, regardless of whether a committee is employed.

— Many recent SPACs have been organized in jurisdictions outside of Delaware. The *Multiplan* decision may reinforce that trend.

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