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Delaware Court Applies Entire Fairness Standard to MultiPlan de-SPAC

The decision adopts enhanced scrutiny of director fiduciary duties for de-SPAC transactions, but suggests dismissal may be appropriate when stockholders exercise redemption rights on a fully informed basis.

On January 3, 2022, Vice Chancellor Lori Will of the Delaware Court of Chancery issued a much-anticipated ruling in the MultiPlan stockholder litigation.[1] This is the first time any court has addressed the applicable standard of review for breach of fiduciary duty claims in the context of a de-SPAC merger. The court focused primarily on the incentives associated with founder's shares — a common feature of SPACs through which SPAC sponsors, and often SPAC directors, receive economic benefits that are not shared by all SPAC common stockholders — and held that the transaction involved inherent conflicts that required the application of the heightened entire-fairness standard of review.

In reaching this conclusion, the court relied heavily on allegations that SPAC stockholders were deprived of "their right to make a fully informed decision about whether to redeem their shares."[2] The opinion suggests that notwithstanding the entire fairness standard of review, for de-SPAC transactions in which all material information relevant to the redemption decision — including the mismatched incentives created by the existence of founder's shares — has been disclosed, breach of fiduciary duty claims may be subject to dismissal at the pleading stage.

Background

The claims at issue arise from a business combination between Churchill Capital Corp. III, a special purpose acquisition company (SPAC), and MultiPlan, Inc., a healthcare industry-focused data analytics and cost management provider. Churchill's sponsor was Churchill Sponsor III, managed by an entity wholly owned by Michael Klein. Klein served as Churchill's Chief Executive Officer and Chairman and was involved in selecting the SPAC's directors. The board selected The Klein Group LLC, an affiliate of Klein, as its financial advisor with respect to a business combination.[3]

As is typical of the majority of SPACs, the sponsor purchased Class B founder's shares for an initial capital contribution of US$25,000. If a business combination was completed within the SPAC's two-year window, the founder's shares would convert into Class A shares in the combined company in an amount equal to 20% of the SPAC's outstanding Class A shares. But in the absence of a business combination, the founder's shares would expire worthless. Meanwhile, as with other de-SPAC mergers, the holders of Class A common stock sold in the SPAC's IPO had the option to convert those shares into Class A shares in the post-close combined company or to redeem them for the US$10 IPO price plus interest.[4]

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The business combination closed successfully. A few months later, a short seller published a report asserting that one of MultiPlan's major customers had developed its own in-house data analytics platform that would permit it to reduce its reliance on MultiPlan's services. MultiPlan's stock price dropped precipitously in response to this report.

The lawsuit followed. The plaintiffs, on behalf of a class of stockholders of the SPAC prior to the business combination who did not redeem their shares, allege breach of fiduciary duty claims against the SPAC sponsor, directors and certain officers, along with a claim that The Klein Group aided and abetted these purported fiduciary breaches.[5] Fundamentally, the plaintiffs allege that the defendants self-interestedly failed to disclose material information regarding the customer's plans to develop its own data analysis platform, and as a result of that failure, the SPAC's Class A stockholders were deprived of the ability to make a fully informed decision regarding whether to exercise their redemption rights.[6]

Analysis

The defendants moved to dismiss the complaint, arguing that the claims suffered from several threshold defects, including that the claims are derivative rather than direct, or if not derivative, that they should be treated as breach of contract claims rather than fiduciary duty claims, or as holder claims not recognized under Delaware law.[7] The court rejected each of these arguments, ruling that the claims involved direct and cognizable harm to SPAC stockholders arising from the alleged impairment of their redemption rights.[8]

Having declined the invitation to decide the case on these narrower threshold issues, the court had to grapple with the key question of the case — what standard of review should be applied to evaluate whether the plaintiffs' allegations, taken as true, had sufficiently alleged a breach of the fiduciary duty of disclosure: should it be the deferential business judgment standard[9] or entire fairness which requires a showing that the transaction was entirely fair to the corporation and its stockholders?[10] The answer to this question is critical, as the standard of review is often dispositive of whether a complaint will proceed into discovery or be dismissed at the pleading stage.[11]

At least for the *MultiPlan* case, the court's clear answer to this question was to apply the entire fairness standard of review. The court reached this conclusion for two independent reasons, each of which the court viewed as sufficient to require entire fairness review.

First, the court examined whether Klein individually and through his control of the sponsor received a "unique benefit" from the de-SPAC transaction such that he received "something uniquely valuable," to the detriment of the minority stockholders — even if he and the sponsor nominally received the same consideration as all other stockholders.[12] Examining the benefits associated with the founder's shares, the court concluded that Klein's and the sponsor's interests represented unique value that diverged from and were detrimental to the interests of the common stockholders. The court placed great weight on the fact that the founder's shares would provide a substantial return to Klein and the sponsor in almost any deal, even if the shares would be worth less than the US$10.04 per share redemption price, but would become worthless if no deal at all was made. In contrast, the common stockholders would benefit only from a transaction in which the combined company's value exceeded US$10.04 per share.[13] As the court explained:

> In brief, the merger had a value — sufficient to eschew redemption — to common stockholders if shares of the post-merger entity were worth US$10.04. For Klein, given the (non-)value of his stock and warrants if no business combination resulted, the merger was valuable well below US$10.04. This is a special benefit to Klein.[14]

The court further noted the inherent benefit to the sponsor resulting from low redemptions in a value-decreasing deal. The non-redeeming stockholders gave up US$10.04 (by declining to redeem for cash), in exchange for something less valuable (a share in the combined company), leaving more of the SPAC's trust account intact to the benefit of the sponsor. According to the court, "Klein effectively competed with the public stockholders for the funds held in trust," which gave the sponsor an incentive to discourage redemptions.[15] The court found that these unique benefits, bolstered by the fact that Klein caused the SPAC to retain The Klein Group as its financial advisor, resulting in additional alleged financial benefit to Klein, required entire fairness review.

Second, the court considered whether a majority of the SPAC directors were self-interested in the business combination such that they could not independently consider the de-SPAC transaction. The court answered this question in the affirmative as well, holding that because each of the directors also held founder's shares, they similarly enjoyed unique benefits and would derive material personal benefits that diverged from other stockholders in a value-decreasing business combination.[16] While this fact alone was sufficient to render a majority of the board interested and lacking in independence, the court noted that the directors also lacked sufficient independence based on their alleged personal and financial relationships with Klein, including appointments to other Churchill SPAC boards.[17]

In reaching these conclusions the court acknowledged that the structure of the SPAC — and Klein's (and the other directors') incentives — were disclosed to SPAC stockholders in connection with the SPAC IPO, yet rejected the argument that those disclosures estopped them from pursuing breach of fiduciary duty claims based on these incentives.[18] But the court noted that this disclosure argument "might be persuasive" if the disclosures regarding the proposed de-SPAC merger had been "adequate."[19]

Finally, having identified entire fairness as the relevant standard of review, the court applied that standard to the breach of fiduciary duty claim, which in this case was based on the allegation that the directors prioritized their own interests in approving an unfair merger and failing to disclose information regarding the development of a competing platform by one of MultiPlan's largest customers.[20] The court concluded the complaint had adequately alleged material omissions, and that those omissions were directly relevant to the overall economic fairness of the transaction. The court left open the possibility that the entire fairness standard might not be met under other alleged facts. The court observed:

> Critically, I note that 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 knowledgeably 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.[21]

If stockholders had been in possession of all material information and opted under those circumstances not to redeem, the court observed, "one can imagine a different outcome."[22]

Implications

The *MultiPlan* ruling may have far-reaching implications for de-SPAC transactions in that it suggests the entire fairness standard of review will apply by virtue of the existence of founder's shares and the benefits that structure creates. It remains to be seen, however, whether this issue will be viewed differently or more narrowly by other courts, and whether *MultiPlan* will be limited to its specific alleged facts. Indeed, a

handful of pending cases presenting similar issues may resolve this question and other open questions, including:

- To what extent do the specific nature and value of the alleged unique benefits require entire fairness review? Are there circumstances in which the mere existence of founder's shares, with full disclosure, do not implicate heightened scrutiny?
- Can an estoppel argument be successful if there is full disclosure of the lack of alignment on incentives?
- Even with entire-fairness review, will the standard of review dictate the outcome at the motion to dismiss stage, or will courts conclude in some cases that the entire fairness standard is satisfied on the pleadings, thus supporting dismissal?
- Could parties to a de-SPAC transaction apply the MFW framework to shift the standard of review back to business judgment?[23] And if so, what steps are required to meet the MFW standard?
- Does the court's denial of an aiding and abetting claim against the financial advisor have implications for such claims against financial advisors in other de-SPAC transactions?
- What are the damages, and what do they add, if anything, on top of the remedies available in private securities class actions involving similar disclosure claims? In *MultiPlan*, the redemptions were relatively low. How attractive these types of claims will be for more recent de-SPAC mergers that have experienced high redemptions is unclear.

Perhaps the biggest question left unanswered is whether, and on what basis, a plaintiff may challenge the board's decision to acquire the target, as opposed to challenging the disclosures about that decision. Normally a challenge to an acquisition is a derivative claim, and is subject to the business judgment rule absent conflicts or other circumstances that would justify a heightened standard of review. It remains to be seen whether courts will allow plaintiffs to argue for heightened scrutiny based on the sponsor's incentives that were disclosed to them at the time they invested in the SPAC.

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Endnotes

[1] *In re Multiplan Corp. Stockholder Litigation*, C.A. No. 2021-0300-LWW (Del. Ch. Jan. 3, 2022).

[2] *Id.* slip op. at 3.

[3] *Id.* at 4-9.

[4] *Id.* at 6-7, 10.

[5] *Id.* at 17-18.

[6] *Id.* at 22-23.

[7] *Id.* at 23.

[8] *Id.* at 24-39.

[9] *Solomon v. Armstrong*, 747 A.2d 1098, 1111 (Del. Ch. 1999) (quoting *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984)), aff'd, 746 A.2d 277 (Del. 2000).

[10] *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 52 (Del. 2006); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).

[11] *Hamilton P'rs, L.P. v. Highland Cap. Mgmt., L.P.*, 2014 WL 1813340, at *12 (Del. Ch. May 7, 2014) ("The possibility that the entire fairness standard of review may apply tends to preclude the Court from granting a motion to dismiss under Rule 12(b)(6) . . . ."); *see also Emerald Partners v. Berlin*, 787 A.2d 85, 89 (Del. 2001) ("The applicable standard of judicial review often controls the outcome of the litigation on the merits.").

[12] *Id.* at 40 (quoting *In re Crimson Expl., Inc. Stockholder Litig.*, C.A. No. 8541–VCP, 2014 WL 5449419, at *13 (Del. Ch. Oct. 24, 2014)).

[13] *Id.* at 42-43.

[14] *Id.* at 43.

[15] *Id.* at 44.

[16] *Id.* at 48-50.

[17] *Id.* at 50-53.

[18] *Id.* at 46.

[19] *Id.*

[20] *Id.* at 53-58.

[21] *Id.* at 54-55.

[22] *Id.* at 55.

[23] *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).