Clients&FriendsMemo

Delaware Chancery Court Signals Heightened Scrutiny of SPAC Boards and Sponsors

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The Delaware Chancery Court has issued a decision with major implications for sponsors and directors of Delaware incorporated special purpose acquisition companies (SPACs). *In re MultiPlan Corp. Stockholders Litigation*[1] is a suit arising from the purchase of healthcare-data company MultiPlan, Inc. by Michael Klein's $1.1 billion Delaware SPAC, Churchill Capital Corp. III. Shortly after the closing, the combined entity's share price plummeted when the market learned that MultiPlan's largest customer was building its own in-house data platform. Stockholders sued the SPAC's sponsor and board.[2]

Vice Chancellor Will largely denied motions to dismiss and held that the transaction will be subject to the rigorous "entire fairness" review.

I. <u>Facts</u>

Churchill's structure followed a typical blueprint for SPACs:

- Class A shares representing 80% of the SPAC's outstanding stock were sold for $10 per share in a $1.1 billion IPO.
- The sponsor paid $25,000 for "Class B founder shares" representing the other 20% of the stock—the so-called "promote." All of the SPAC's directors, in turn, were awarded in the sponsor.
- Public stockholders could opt out of any business combination by exercising pre-closing redemption rights.
- If no deal were closed during a 24-month "completion window," Churchill would refund all IPO proceeds plus interest to investors, and the promote would become worthless.

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[1] Cons. C.A. No. 2021-0300-LWW, 2022 Del. Ch. LEXIS 1 (Jan. 3, 2022).

[2] *Id.* at *4.

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Five months after the IPO, Churchill announced its agreement to acquire MultiPlan. The proxy touted the target's "attractive valuation" and growth prospects; it did not identify the target's largest customer or disclose that the customer had publicly announced a plan to launch a competing data platform. The stockholders overwhelmingly voted to approve the merger, which closed on October 8, 2020, and redemptions were low. Immediately following the merger, Mr. Klein's interests in the combined entity were worth roughly $230 million and all but one of the remaining directors each held interests worth at least $3 million.

After news of the customer's business plan broke, the company's share price fell more than 40%, from $11.09 per share to a low of $6.27. At that point the promote was still worth $108 million. Stockholders sued Mr. Klein and Churchill's other officers and directors, alleging breaches of fiduciary duty.

II. The Motion-to-Dismiss Decision

A. Claims Held Derivative, Not Direct

The Chancery Court held as a threshold matter that the stockholders' claims are direct, not derivative—meaning the plaintiffs are suing on behalf of themselves and other stockholders, not asserting the company's rights. The thrust of the complaint is that the defendants "impaired the public stockholders' informed exercise of their redemption rights"—a harm that could not have "run to the corporation."[3] That opens the door to class actions, which are more lucrative for the plaintiffs' bar than derivative cases.

B. Entire Fairness Test Held to Govern

The court held that the defendants' conduct must be judged under the "entire fairness test," Delaware's "most onerous standard of review."[4] That test is typically applied when the board is not entitled to the protections of the Business Judgment Rule. The board is not entitled to Business Judgment Rule protections if it hasn't complied with any of four fiduciary duties:

- Care
- Loyalty
- Good faith
- Candor

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[3] *Id.* at *24.

[4] *Id.* at *36.

Under the entire fairness test, the defendant must prove "fair dealing" and a "fair price" for stockholders. That framework applies, the court concluded, for two reasons:

1. The case involves a "conflicted controller transaction." Mr. Klein, through his control of the sponsor, was Churchill's controlling stockholder. The conflict arose because he stood to profit from *any* deal—and would lose everything without a deal—whereas public stockholders would have preferred liquidation over a bad deal. On top of that, Churchill was advised on the deal by Klein's investment bank, which was paid $30.5 million—a fact that "bolsters" the conclusion that this was a conflicted controller transaction.[5]

2. A majority of the directors were self-interested due to their ownership of founders' shares and/or conflicted because they were beholden to Mr. Klein due to other business ties.

Against the entire fairness backdrop, the court held that the plaintiffs pleaded viable claims against the director defendants and the controlling stockholder: "for purposes of the motions to dismiss, the alleged disclosure violations sufficiently give rise to a lack of overall fairness."[6]

The court's ruling on the standard of review substantially increases litigation risk. Churchill is not unusual for SPACs in either its structure or in the way it compensates its independent directors. The issues noted by Vice Chancellor Will will apply identically to virtually all other Delaware SPACs.

III. **Takeaways**

The Chancery Court's decision in *MultiPlan* counsels caution. In connection with their business combination transactions, Delaware SPACs should consider the following:

1. The board's process.

2. Should a financial advisor issue a fairness opinion?

3. Can the issue of interested independent directors be addressed?

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[5] *Id.* at *43.

[6] *Id.* at *52. A claim for aiding and abetting breach of fiduciary duty against the SPAC's financial advisor, The Klein Group, also survived, given allegations that it knew the undisclosed facts about the target. A claim against Churchill's CFO for breach of fiduciary duty, on the other hand, was dismissed for lack of supporting allegations.

If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

Stephen Fraidin	+1 212 504 6600	stephen.fraidin@cwt.com
Gregory Patti	+1 212 504 6780	greg.patti@cwt.com
Jonathan Watkins	+1 704 348 5129	jonathan.watkins@cwt.com
Aaron Lang	+1 704 348 5145	aaron.lang@cwt.com