Delaware Court Holds de-SPAC Transaction Subject to Entire Fairness

January 14, 2022

Last week, in a case of first impression, the Delaware Court of Chancery declined to dismiss breach of fiduciary duty claims against a SPAC sponsor and the members of the SPAC's board of directors in connection with a "de-SPAC" transaction and the related redemption rights of the SPAC's public stockholders.[1] Notably, the court held that these claims were subject to entire fairness—the "most onerous standard of review" under Delaware law—because the interests of the sponsor and directors were adverse to those of the public stockholders. The fiduciary duty claims related primarily to the redemption rights of the public investors, rather than the de-SPAC merger itself. The principal fiduciary duty at issue was the duty of candor: the obligation of directors to disclose fully and fairly all material information within the board's control when submitting to stockholders a transaction requiring them to make an investment decision.

The case involved a SPAC that completed its initial public offering in February 2020, raising $1.1 billion by selling 110 million units (consisting of one common share and one quarter of a warrant to buy a common share at an exercise price of $11.50) at a price of $10 per unit. In July 2020, the SPAC agreed to acquire MultiPlan, Inc., which provided data-analytics and cost management services to the healthcare industry, pursuant to a merger in which the ultimate stockholders of MultiPlan would receive a combination of cash and stock valued (assuming a $10 per share value of the SPAC's shares) at $5.7 billion. As a result of the transaction, the SPAC's public stockholders had the right, exercisable by notice to the SPAC at least two days before the stockholder vote on the merger, to redeem their common shares for $10.04 per share, conditioned on the closing of the merger. The proxy statement for the merger was also the disclosure document the public stockholders relied upon in deciding whether to redeem.

On the record date for the stockholder vote (as well as on the closing date of the merger), the SPAC's shares closed at $11.09 per share. Holders of less than 10% of the SPAC shares sought redemption. A month later, however, the trading price of the shares of the surviving company (referred to in the opinion as "Public MultiPlan") had

---

[1] *In re MultiPlan Corp. S'holder Litig.*, C.A. No. 2021-0300-LWW (Del. Ch. Jan. 3, 2022).

declined to $6.27 per share, following the publication of a research report stating that UnitedHealth—by far MultiPlan's largest customer, representing about 35% of its revenues—was developing an in-house data analytics business that would both compete with MultiPlan and result in UnitedHealth's moving all of its business away from MultiPlan. UnitedHealth had publicly disclosed its intention to form the in-house data analytics group in June 2020. The SPAC's proxy statement had disclosed that MultiPlan depended on a single customer for 35% of its revenues, but it did not disclose this customer's identity or its intention to develop a competing business. Litigation naturally followed.

To understand why the court determined that plaintiffs' claims were subject to entire fairness rather than the business judgment rule, a short review of SPAC economics is helpful.

Generally, following a SPAC's initial public offering, the SPAC shares are owned 80% by the IPO investors and 20% by the sponsor (and friends of the sponsor). The IPO investors typically pay $10 for each unit in the IPO, and the sponsor typically pays for its shares . . . essentially nothing. The public investors have the right to redeem their shares for $10 per share plus interest when the SPAC completes an acquisition, and are automatically redeemed if no acquisition is completed by a specified deadline, generally two years after the IPO.

The SPAC puts the IPO proceeds in trust to secure the public stockholders' redemption rights. At the same time, though, the SPAC has to spend money to effect the IPO (filing fees, banker fees, accountant fees, lawyer fees, etc.) and to identify an acquisition target, perform due diligence and negotiate an acquisition (more advisor fees, etc.). Those costs are generally funded by the sponsor in return for SPAC warrants. Those warrants, like the sponsor's common shares, will expire worthless if the SPAC fails to complete a deal. As a result, while the SPAC is not a no-lose proposition for the sponsor, it is very much a one-sided bet.

The Delaware Court of Chancery's holding that the fiduciary duty claims of Public MultiPlan stockholders were subject to entire fairness review was premised on the divergent economic interests of the sponsor and the public investors. Under Delaware law, a transaction by a controlled company is subject to entire fairness if the controller either stands on both sides of the transaction or competes with the public stockholders for consideration. A controller competes with the other stockholders if it receives a larger share of the consideration (*i.e.*, a control premium), a different form of consideration (*e.g.*, shares in the surviving company rather than cash) or otherwise "receives a unique benefit by extracting something uniquely valuable to the controller

even if the controller nominally receives the same consideration as all other stockholders to the detriment of the minority."[2]

In this case, the court determined that the economics of the sponsor shares resulted in the sponsor receiving a "unique benefit" from the de-SPAC merger. For a SPAC sponsor, almost any deal is a good deal. Here, the sponsor (and friends) paid $25,000 for the 20% sponsor interest, which, at the closing price on the date of the merger, was worth over $300 million.[3] For the public investors, on the other hand, the deal would be profitable only if Public MultiPlan shares continued to trade above the $10.04 redemption price. The court also found that the sponsor had an incentive to discourage redemptions. *First*, a sufficiently high level of redemptions would have imperiled the completion of the de-SPAC merger; *second*, to the extent Public MultiPlan was expected to be worth less than $10.04 per share, a decision of public investors not to redeem at that price would be value-enhancing to the sponsor.

The court held that the SPAC's directors had the same conflict as the sponsor, albeit with much lesser economic interests. All of the directors (excluding the sponsor's brother, who presumably participated in the sponsor economics directly), owned common shares acquired at the (nominal) sponsor price. At the record date price of $11.09, the value of those shares—all of which would expire worthless if the SPAC did not complete a transaction—ranged from $3.3 million to $43.6 million for each director. The court held that the fiduciary duty claims against the directors were not subject to exculpation because the claims invoked both the duty of loyalty and disclosure duties implicating director loyalty.

It is worth noting that, in connection with the MultiPlan merger, the sponsor agreed to arrangements that modified the economics described above. Those included an 18-month lockup on the sponsor shares, and the "unvesting" of about 45% of the sponsor shares, which shares were subject to "re-vesting" if Public MultiPlan's shares traded above $12.50 for any 40 trading days in a 60-day period between one and five years after the merger. Although the court acknowledged that these arrangements would lower the value of the sponsor's windfall if the deal turned out poorly for the public stockholders, they would not—at least for purposes of a motion to dismiss—negate it. The same was true for the directors. The court observed that if Public MultiPlan's shares ultimately turned out to be worth just $5 per share, and one applied a significant discount because of the lockup and accounted for the shares that would remain unvested, the director who held the fewest number of sponsors shares would still have an interest worth over

---

[2] *MultiPlan* at 41.

[3] In addition, the sponsor's warrants, for which it had paid $23 million and which would have also expired worthless in the absence of a deal, were then worth about $50 million.

half a million dollars—an amount the court said "is presumptively material at the motion to dismiss stage."

Does the *MultiPlan* decision mean that every de-SPAC transaction is potentially subject to entire fairness review? On the one hand, the court did not dismiss the claim that the sponsor and the directors "breached their fiduciary duties by prioritizing their own personal, financial and/or reputational interests and approving the Merger, which was unfair to the public stockholders." On the other hand, the court took pains to tie its ruling primarily to the redemption rights, rather than to the merger itself:

> 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 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.

Despite the court's caveats, it is hard to avoid the conclusion that, given prevailing SPAC structures, the sponsor and the public stockholders are in a conflicted position in almost any de-SPAC transaction, with the result that such transactions are by their nature potentially subject to the test of entire fairness. However, the court left open the possibility that – absent material disclosure issues in the proxy statement that the stockholders relied upon in making the investment decision whether to redeem, as were alleged by the *MultiPlan* plaintiffs – SPAC stockholders might be estopped from challenging de-SPAC transactions on the basis of economic incentives of the sponsor that were disclosed to them in the SPAC's IPO prospectus. [4]

Moreover, assuming adequate disclosure, it seems difficult to identify how the "unique benefit" derived by the holders of the sponsor shares results in any damage or loss to the public stockholders given their redemption rights. Full disclosure—relating both to the sponsor economics (disclosed in the IPO prospectus) and to the de-SPAC transaction

---

[4] "The defendants also advance an overarching equitable argument: That the plaintiffs should be estopped from challenging the same economic incentives that were disclosed to them [in the IPO prospectus for the SPAC]. . . . The Defendants' argument might be persuasive if it had been made about the Proxy and the plaintiffs had opted not to redeem despite adequate disclosures—but that is not the universe alleged in the Complaint." *MultiPlan* at 45-46.

(disclosed in the merger proxy)—coupled with the right of any public stockholder that disfavors the de-SPAC transaction to redeem its shares, should ultimately be sufficient to render the transaction entirely fair.

SPAC sponsors and their appointed directors may nonetheless reasonably be concerned about the risk that de-SPAC transactions will be subject to greater litigation risk as a result of the entire fairness frame set forth in the *MultiPlan* decision. There are a number of steps sponsors might take to manage that risk:

- While a sponsor necessarily controls a SPAC prior to its initial public offering, the sponsor will normally own less than 20% of the SPAC's shares following the IPO. Usually, the sponsor will retain control between the IPO and the de-SPAC transaction through a separate class of voting shares. However, this need not be the case. If a sponsor has no more than a 20% voting interest in the SPAC following the IPO, it is substantially less likely that it would be deemed to be a controller—and therefore to have fiduciary duties to the public stockholders in connection with the de-SPAC transaction.

- As for the SPAC directors, in the *MultiPlan* case, their purported conflicts stemmed both from their relationships with the sponsor and their ownership of sponsor shares. Each of the directors also served on the boards of other SPACs formed by the sponsor or had other business relationships with the sponsor—relationships that were themselves sufficient, at the motion to dismiss stage, to support the assertion that they were not independent of the sponsor. However, if the sponsor does not control the SPAC, those relationships should not themselves give rise to a conflict with the public stockholders.

- That leaves the sponsor shares and the "unique benefit" they provide to the directors. This conflict can be reduced, but not eliminated, either by giving the directors fewer sponsor shares or by constraining the value of those shares in circumstances where the de-SPAC transaction proves to be unprofitable for public stockholders who do not exercise redemption rights. At some level, the interest of the directors in consummating *any* de-SPAC should be sufficiently immaterial that a court could conclude that it does not render them self-interested, although it is not yet clear what that level might be.[5]

- Finally, a risk-adverse SPAC sponsor could consider whether the controller conflict could be addressed in a manner consistent with the Delaware Supreme Court's *Kahn v. M&F Worldwide Corp.* decision: ensure that the SPAC has a sufficient number of

---

[5] As noted above, the court in this case determined that "a greater than half-million-dollar payout is presumably material at the motion to dismiss stage." *MultiPlan* at 50.

disinterested directors to form a special committee with the authority to hire its own advisors to review and negotiate the de-SPAC transaction, and condition the transaction on the approval of that committee and the affirmative vote of a majority of the disinterested common shares. There are a couple of significant challenges, though, to the application of *MFW* in this context. *First*, the fact that the closing of the de-SPAC merger is a condition to the redemption right means that redeeming stockholders invariably vote to approve the merger, which may call into question whether that vote has the cleansing effect contemplated by *MFW*. *Second*, because much of the de-SPAC litigation risk relates to the adequacy of the merger disclosures, and inadequate disclosures prevent the application of the *MFW* protections, putting *MFW* protections in place may not help in the circumstances where it is most desirable.

Of course, each of the above steps would require the sponsor to give up some significant degree of control over the de-SPAC transaction, which in many cases may be viewed as inconsistent with the investment thesis for buying SPAC shares, namely to have access to the deal identification and execution skills of the sponsor. And none of them by themselves ensure full and fair disclosure to the public stockholders. Nonetheless, instituting some or all of these may protect the SPAC's sponsor and directors from personal liability for disclosure claims, by reducing the risk that the sponsor will be deemed to be a controller with fiduciary duties and by increasing the likelihood that the directors will have the benefit of the exculpation provisions of the SPAC's charter.

* * *

Please do not hesitate to contact us with any questions.

NEW YORK

Christopher Anthony
canthony@debevoise.com

Gregory V. Gooding
ggooding@debevoise.com

Maeve O'Connor
mloconnor@debevoise.com

William D. Regner
wdregner@debevoise.com

Zachary H. Saltzman
zhsaltzman@debevoise.com

Shannon Rose Selden
srselden@debevoise.com