

## Practice Update

# SPACs Face Enhanced Scrutiny for Fiduciary Duties in de-SPAC Transactions

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The Delaware Court of Chancery recently issued a significant ruling involving common special purpose acquisition company (SPAC) practices and disclosures that occur when a business combines with a SPAC. *See In re MultiPlan Corp. Stockholders Litigation*, C.A. No. 2021-0300-LWW (Del. Ch. Jan. 3, 2022). The stockholder plaintiffs alleged that the SPAC's sponsor and directors failed to disclose material information and breached their fiduciary duties by prioritizing their own interests when approving an unfair merger, and that the stockholders were deprived of the right to make a fully informed decision about whether they should exercise their rights of redemption. Plaintiffs' claims are based in part on alleged inadequate disclosures about the value of MultiPlan's business, and the failure to disclose that MultiPlan's largest customer was creating an in-house product that would make MultiPlan's services unnecessary.

The court denied defendants' motion to dismiss, and held that the plaintiffs' claims involved direct and cognizable harm to SPAC stockholders from the alleged damage to their redemption rights, and could go forward. In reaching its conclusion, the court had to determine which standard of review was appropriate to analyze whether the plaintiffs had properly alleged a breach of the fiduciary duty of disclosure: was it the deferential business judgment

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standard, which establishes a presumption that directors' decisions are based on sound business judgment, or the entire fairness standard, which places the burden on the defendants to prove that the challenged transaction was entirely fair to the company's stockholders?

In *MultiPlan*, the court determined that the entire fairness standard of review applied for two separate reasons. First, the SPAC's CEO and Chairman, Michael Klein, controlled the SPAC through his relationship with the Sponsor, and he would receive a "unique benefit" from the de-SPAC transaction. Specifically, the court noted that Klein's stocks and warrants had value if the merger resulted in a share price well below \$10.04; the common stockholders, however, only received value if the shares were worth \$10.04 or more. The court said that this constituted a "special benefit." Second, each of the directors held founder's shares, and would enjoy unique benefits different from other stockholders. Importantly, the court found that this was true even though the founder's shares were converted in the de-SPAC transaction to the same consideration as the public shareholders' shares. Because of this, the court found that a majority of the SPAC directors could not independently consider the de-SPAC transaction because they were self-interested in the business combination.

Significantly, the court reached this conclusion while acknowledging that the structure of the de-SPAC and the directors' incentives and benefits had been properly disclosed to SPAC stockholders, and that the SPAC shareholders understood the general structure of the transaction. The court found that the shareholders "did not, however, agree that they did not require all material information" to decide whether to redeem or accept post-closing public shares. Specifically, the court held that plaintiffs properly alleged that the definitive merger proxy contained false and misleading disclosures because it did not disclose that MultiPlan's largest customer was developing in-house technology that would

eliminate the need for MultiPlan's services, and ultimately, would be a competitor of MultiPlan. The court noted that their analysis and outcome may have been different if the de-SPAC disclosures had been "adequate," suggesting that shareholder claims arising from a fully-informed decision to redeem in a de-SPAC may be dismissed.

## Key Takeaways and Things to Consider

While the Delaware Chancery Court's decision reinforces the importance of full and adequate disclosure of the details of a de-SPAC transaction, like in the context of traditional mergers, the court left many unanswered questions for another day.

- Will other courts adopt the "entire fairness" standard of review to challenge de-SPAC transactions, or will this standard will be limited to fact patterns similar to *MultiPlan*?
- What disclosures are adequate to address the court's concern about founder's shares?
- Are there specific fact patterns for de-SPAC transactions that could invoke the business judgment standard of review?
- When will plaintiffs be able to successfully challenge a de-SPAC based on the board's actions, and when will they be able to successfully challenge the disclosures?

Each of these questions is important to consider in future structuring and transactional decisions for SPACs.

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