

*Delaware Law Update Roundtable, March 23, 2022*

hosted by

John L. Weinberg Center for Corporate Governance at the University of Delaware

# *MultiPlan* and SPAC Litigation in Delaware

# Overview

- **2021 SPAC Activity**
- **SPAC Litigation Trends: Federal and Delaware**
- ***MultiPlan*: Chancery's 2022 Initial Guidance on SPACs**
- **Legal Market's Reaction to *MultiPlan***

# 2021 SPAC Activity

- **613 IPOs priced** Compared to 248 in 2020
  - 53 in December 2021 (compared to 47 in 12/2020)
  - \$162.4 billion IPO Gross Proceeds (compared to \$83 billion in 2020)
- **267 combinations announced** Compared to 96 in 2020
  - 30 in December 2021 (compared to 10 in 12/2020)
- **197 combinations completed** Compared to 64 in 2020
  - 42 in February 2021 (high) (compared to 0 in 2/2020)
  - 11 in October 2021 (low) (compared to 17 in 10/2020)
  - 30 in December 2021 (compared to 19 in 12/2020)
- As of February 2022, approximately 600 SPACs were reportedly looking for a target transaction

# SPAC Litigation Trends: Federal and Delaware

# SPAC Federal Securities Class Actions

- **Large Increase in Federal SPAC Filings in 2021**

- While M&A-related federal filings (Section 14 claims) fell 82%, SPAC federal securities class action filings increased six-fold from 2020 to 32 filings
- All but one federal SPAC filing in 2021 included Rule 10b-5 allegations
- Typical statutory-based claims:
  - Section 10(b) and Rule 10b-5 of the Exchange Act: Typically supplemented with control person claims brought directly against the individual officers and directors of the SPAC and/or target company under Section 20(a) of the Exchange Act
  - Section 14(a) and Rule 14a-9 of the Exchange Act: material misstatements or omissions in the proxy
  - Section 11 of the Securities Act: Frequently supplemented with control person claims brought under Section 15 of the Securities Act
- Target of Claims
  - SPAC entity; former directors and officers of SPAC; SPAC's sponsors; post de-SPAC company; current directors and officers of the company

# Delaware SPAC Litigation

## Types of Claims

- **Breach of Fiduciary Duty**
  - Directors and officers of SPACs (incorporated in Delaware) are fiduciaries, owing duties of loyalty and care (including disclosure obligations) to SPAC stockholders
  - So far, there is one opinion from the Court of Chancery, *MultiPlan*, that substantively addressed the fiduciary duties of SPAC directors and officers in connection with de-SPACing transaction
    - The Court permitted the SPAC-related lawsuit to survive a motion to dismiss, applying entire fairness, but suggested that the outcome might have been different if there had not been well-pled allegations about improper disclosures

# Delaware SPAC Litigation

- **Brophy**

- Recent complaints, piggybacking off of SEC investigations and federal securities actions, have alleged that directors and officers of post-SPAC public companies have sold millions of dollars worth of stock just months after the de-SPAC transaction and while in possession of material, non-public information
- The complaints allege that the stock was sold at inflated prices due to false and misleading statements both pre and post de-SPAC transaction that artificially inflated the value of the companies and which only came to light after reports by short sellers

- **Unjust Enrichment**

- Recent complaints also allege that the directors and officers of SPACs and the post de-SPAC public companies have been unjustly enriched through compensation, bonuses and other benefits obtained while the value of the companies was inflated due to the allegedly false and misleading statements

- **Section 242(b) DGCL (Voting by Class)**

- In late summer and early fall of 2021, several complaints filed alleging a violation of DGCL 242(b) due to SPAC sponsors soliciting a vote to increase the number of authorized Class A shares without holding a separate Class A vote; cases were mooted prior to the vote by providing for separate Class A vote

- **Section 228 DGCL (Availability of Written Consent)**

# Will 2022 Bring More SPAC Lawsuits?

## Considerations Potentially Impacting Filings

- **2021 Saw Increase in SPAC and De-SPACing Transactions**
  - Many, if not most, of the SPACs IPO'd in 2021 are still searching for de-SPACing transactions
    - Nearly all of the 2021 federal class action lawsuits related to SPAC IPOs from 2020
  - As de-SPACing transactions occur, courts may see more SPAC litigation
- **Performance of Company Post De-SPAC**
  - Many targets are early-stage start ups, capital intensive, whose businesses often have more risk than established businesses (*e.g.*, unproven technologies, forecasting financial performance difficult)
  - WSJ article (2/25/2022): half of start-ups with less than \$10 million in annual revenues that went public through SPACs have failed or are expected to fail to meet 2021 revenue or earnings targets given to investors (missing revenue projections by average of 53%)

# Will 2022 Bring More SPAC Lawsuits?

- **SEC Rule-Making and Guidance**

- The SEC is increasingly focused on SPACs and de-SPACing transactions, *e.g.*:
  - information asymmetries, accuracy of information, and mitigating conflicts
- Spring 2022 anticipated SEC pronouncements
  - SEC Chair (Dec. 2021):
    - “I’ve asked staff to serve up recommendations about how investors might be better informed about the fees, projections, dilution, and conflicts that may exist during all stages of SPACs, and how investors can receive those disclosures at the time they’re deciding whether to invest. I’ve also asked staff to consider clarifying disclosure obligations under existing rules.”
    - “[A]s SPAC target IPOs occur through a merger, who’s performing the role of gatekeepers — potentially including directors, officers, SPAC sponsors, financial advisors, and accountants?”

- **Future Judicial Decisions**

- Upcoming SPAC-related judicial rulings in Delaware and in federal courts likely will impact filings

*MultiPlan:*  
Chancery's 2022 Initial Guidance on SPACs

# *In re MultiPlan Corp. Stockholders Litigation: Overview*

Complaint filed April 9, 2021; Motion to Dismiss denied January 3, 2022

## ***“Crux” of Claims, according to Court:***

*“Viewing the Complaint in the light most favorable to the plaintiffs, the crux of the plaintiffs’ claims is that the defendants’ actions—principally in the form of misstatements and omissions—impaired [SPAC] public stockholders’ their redemption rights to the defendants’ benefit.” (Op. 22)*

## ***Court’s “Conclusion”:***

*“The plaintiffs have pleaded direct claims that center around the purported impairment of their redemption rights. The entire fairness standard of review applies due to inherent conflicts between the SPAC’s fiduciaries and public stockholders in the context of a value-decreasing transaction. And the plaintiffs have pleaded viable, non-exculpated claims against the SPAC’s controlling stockholder and directors.” (Op. 3)*

# *In re MultiPlan Corp. Stockholders Litigation: Overview*

Vice Chancellor Will:

*“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 plaintiff to knowledgeably exercise their redemption rights.” (Op. 55-56)*

*“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.” (Op. 55)*

# *In re MultiPlan Corp. Stockholders Litigation: Background*

- **October 2019: SPAC formed by Sponsor**
  - **Management of SPAC:** Michael Klein, CEO and Chairman
  - **Board of SPAC:**
    - Klein appointed and Klein could unilaterally remove
    - Directors had prior connections to Klein; most served on other Klein-related SPACs
    - Directors received indirect interest in promote / founder shares
  - **Financial Advisor of SPAC:** wholly owned subsidiary of another Klein business (M. Klein & Co.); retained when SPAC identified possible business combination; \$30.5 million fee for advisory services
- **February 2020: SPAC IPO -- \$1.1 billion**
  - **SPAC Equity: 20%:** promote or founder Shares, namely Class B shares acquired by Sponsor upfront for contribution of \$25,000; to convert into Class A shares in connection with de-SPACing transaction; option to acquire warrants (private placement warrants) **80%:** 110 million units at \$10 per unit; each unit was one share of Class A common stock and ¼ of warrant at exercise price of \$11.50
  - **24 months' completion window:** *If no transaction, then return IPO proceeds, plus interest, to Class A stockholders; wind up; sponsor and Class B stockholders receive nothing*

# *In re MultiPlan Corp. Stockholders Litigation: Background*

- **July 13, 2020: de-SPAC merger announced**

- **Target:** MultiPlan; healthcare industry-focused data analytics and cost management solutions provider. MultiPlan enterprise value of \$11 billion
- **Restrictions on Sponsor:**
  - Investor Rights Agreement: Sponsor's converted Class A subject to 18-month lockup
  - Sponsor Agreement: ~45% of Sponsor's converted Class A shares and ~21% of Private Placement Warrants *unvest* post-merger (and revest if stock price exceeds \$12.50 for 40 trading days in a 60-day period between 1-5 years after merger)

- **September 18, 2020: SPAC issued definitive proxy for vote of SPAC stockholders**

Proxy Statement disclosed:

- “attractive valuation”; “opportunities for growth” in revenues, adjusted EBITDA and free cash flow
- “extensive due diligence” by SPAC board and management
- dependent on single customer (largest) for 35% of revenues
  - No mention of United Healthcare Group (UHG) or that it intended to create in-house data analytics platform
- No independent third-party valuation
- No fairness opinion

# *In re MultiPlan Corp. Stockholders Litigation: Background*

- **Anticipated ownership following de-SPACing transaction**
  - 4.2%: sponsor and affiliates (after Class B converts to Class A)
    - Valued at record date as ~\$305 million
    - Klein's interest ~\$230 million; each other director at least \$3 million
  - 60.5%: prior owners of MultiPlan
  - 16%: public Class A of SPAC
  - 19.2%: PIPE investors (some affiliated with Klein). Bought \$1.3 billion in shares; assume \$1.3 billion of debt
- **October 7/8, 2020: SPAC stockholders overwhelmingly approved; merger closed**
- **November 2020: post-closing, stock price fell on analyst report**
  - Equity research firm published report on November 11, 2020
    - Discussed UHC's formation of Naviguard and other matters
    - On November 12, 2020, stock price closed at \$6.27
- **April 8, 2021: day before complaint filed, price at \$6.27**

# *In re MultiPlan Corp. Stockholders Litigation: Court's Analysis*

## **Four Counts**

- **Counts 1-3: breach of fiduciary duty** against SPAC directors, officers and controlling stockholder for issuing false and misleading proxy that impaired Class A SPAC stockholders' informed exercise of redemption and voting rights
- **Count 4: aiding and abetting** against financial advisor affiliated with Klein

## **Court Rejected Defendants' Argument that Claims Are Derivative**

- Derivative claims would be subject to pre-suit demand on *new* board of post-SPAC entity; potentially result in dismissal of lawsuit
- Court found board allegedly impaired informed exercise of redemption right, which is a personal injury to stockholders (Op. 25-26)

# *In re MultiPlan Corp. Stockholders Litigation: Court's Analysis*

## **Court Applied Entire Fairness**

### **Entire fairness applies because well-pled allegations:**

- (A) controller received unique benefit, and
- (B) conflicted board

### **A. Parties Agreed Klein Was “Controlling Stockholder” (through control of Sponsor)**

- allegedly competed with common stockholders for consideration held in trust; extracted a unique benefit to minority's detriment
- alleged misalignment of interests:
  - Sponsor allegedly would take any deal (even a bad deal) over no deal
  - *If no deal, then Sponsor's investment worth zero. In contrast, if no deal, Class A common stockholders would receive IPO money plus interest, \$10.04 per share*

# *In re MultiPlan Corp. Stockholders Litigation: Court's Analysis*

- **Court Rejected Defendants' Arguments**

- **Estoppel.** Court rejected argument that plaintiffs should be estopped from challenging economic incentives because they were disclosed to them before they invested in the SPAC

*"In this case, the structure of the SPAC – and Klein's incentives – were disclosed in the prospectus but the transaction at issue was not." "[Public stockholders] did not ... agree that they did not require all material information when the time came to make that choice."*

- **"All SPACs are structured like this."** Court rejected argument that sponsor's promote could not trigger entire fairness because this "structural feature" is not unique and appears in any de-SPAC transaction
- **Lockup/Unvest.** Court could not conclude on MTD that sponsor lockups and unvestment of 45% of founder shares lowered value of "windfall" such as to negate it (Op. 44)
- **24-Month Completion Window.** Court could not conclude that simply because there was time left in the 24-month completion window, SPAC would have pursued other deals if they believed the MultiPlan merger would be value-decreasing. Court said this "does not change the potential for misaligned incentives." (Op. 45)

# *In re MultiPlan Corp. Stockholders Litigation: Court's Analysis*

## **B. Conflicted Board**

- Even if no interested controller, Court found well-pled allegations of conflicted board, also requiring application of entire fairness
  - **Interested.** Board members allegedly interested in a merger by virtue of their economic interests in the Sponsor and, derivatively, Class B shares; Class B shares are *valueless* without a merger that converts those shares to Class A shares (Op. 48)
    - Noting the diverging interest between Class A and Class B stockholder, Court indicated that directors were allegedly interested in achieving a de-SPAC transaction and payout: *“A greater than half-million-dollar payout is presumptively material at the motion to dismiss stage.”* (Op. 50)
  - **Not Independent.** Board members allegedly not independent from Klein. Klein appointed directors and had unilateral power to remove them. Also, many directors served as directors on other Klein-related SPACs, with founder shares (Op. 51)

# *In re MultiPlan Corp. Stockholders Litigation: Court's Analysis*

## **Breach of Fiduciary Duty Claim Survived Dismissal**

- **Well-Pled Allegations of False / Misleading Disclosures**

- The Court found well-pled allegations of false and misleading disclosures that impair Class A stockholders' exercise of their option to redeem (Op. 55)

*“Proxy did not disclose that MultiPlan’s largest customer was UHC and that UHC was developing an in-house alternative to MultiPlan that would both eliminate its need for MultiPlan’s services and compete with MultiPlan.”*

- **Defendants refuted that disclosures were false; challenged short seller report**

- maintained that the analyst report regarding UHC was “shown to be false” and the firm that issued report has been accused of market “deception.” But Court ruled these arguments relied on documents beyond complaint and were not appropriate for MTD (Op. 56 n.196)

# Legal Market's Reaction to *MultiPlan*

# Legal Market's Reaction to *MultiPlan*

Following *MultiPlan*, the legal community reacted by proffering various considerations or “takeaways” for clients contemplating a de-SPACing transaction

Depending on the circumstances of each SPAC and de-SPACing transaction, some of these considerations may be relevant or prudent, some not

Future rulings from the Court of Chancery may shed further light on “best practices” in this area

# Legal Market's Reaction to *MultiPlan*

- ✓ Rigorous Due Diligence on Target
- ✓ Comprehensive Disclosure of Material Information
- ✓ SPAC Board Composition and Compensation
- ✓ Formation of Special Committee
- ✓ Retention of Independent Financial Advisor

# Legal Market's Reaction to *MultiPlan*

## ✓ Rigorous Due Diligence on Target

- Assist with disclosure of material information (for informed investment decision by Class A stockholders)

## ✓ Disclosures

*Note: Disclosure claims against directors may not be exculpated*

*Non-Exhaustive (and as applicable):*

- potential conflicts
- any additional financing necessary to complete the de-SPAC transaction
- information about how the target was identified, who initiated contact and why the target was selected
- material terms of the transaction
- material factors considered by the board of directors
- information as to how the sponsors, directors, officers or their affiliates will benefit
- total ownership interest in the SPAC
- fees

# Legal Market's Reaction to *MultiPlan*

## ✓ **SPAC Board**

- Consider independent SPAC directors
- Consider appointing different directors for different affiliated SPACs (not interlocking)
- Consider compensation for SPAC directors
  - Consider connection of compensation to de-SPAC, or not
  - Compare compensation to other independent directors; market?
  - Consider detailed disclosure of compensation

## ✓ **Consider creation of Special Committee** (prior to price discussions)

- How might this impact sponsor involvement and process?
- Sponsor experience and know-how might be the reason why stockholders invested

## ✓ **Independent Financial Advisor and Fairness Opinion**

- Consider retention of financial advisor to assess fairness of the de-SPAC terms, from a financial perspective, to the SPAC's Class A stockholders
- Consider fairness opinion
- Consider any relationships with sponsor or other conflicts

# Pending Delaware SPAC Litigation

The Court of Chancery likely will rule on other SPAC-related cases soon, providing further guidance for sponsors, directors, officers and stockholders

For example:

- ***Delman v. GigAcquisitions3, LLC, et al., 2021-0679-PAF***
  - Complaint alleges breach of fiduciary duty against the SPAC directors, including for false and misleading disclosures, breach of fiduciary duty by the SPAC sponsor as an alleged controller, and unjust enrichment
  - In their reply brief, filed after *MultiPlan*, defendants attempted to distinguish their case from *MultiPlan*
  - On February 28, 2022, Court granted plaintiff a sur-reply (filed March 1, 2022)
- ***In re XL Fleet (Pivotal) Stockholder Litigation, 2021-0808-KSJM***
  - Complaint alleges breach of fiduciary duty against the SPAC directors and officers, including for misleading disclosures, breach of fiduciary duty by the SPAC sponsor as an alleged controller, and aiding and abetting breach of fiduciary duty against both the SPAC sponsor and two officers of the post-merger company who were formerly officers of the pre-SPAC legacy private company
- ***In re P3 Health Group Holdings, LLC, 2021-0518-JTL***
  - Complaint filed by minority investor in LLC that was taken public through transaction with SPAC, alleging that through the de-SPAC transaction, contractual rights were violated by the LLC and its controller
  - Briefing on a motion to dismiss expected to be completed by mid-May 2022

# Pending Delaware SPAC Litigation

- ***In re Nikola Corp. Derivative Litigation, 2022-0023-KSJM***

- Derivative complaint filed by three stockholders of Nikola challenging what they allege was a “pump and dump scheme” by the company founder, largest stockholder and CEO
- Plaintiffs allege that in the period leading up to the de-SPAC transaction and for some time thereafter, the CEO engaged in an ongoing criminal fraud involving the dissemination of materially false and misleading statements to stockholders and the public that artificially inflated the value of the company. According to plaintiffs, the fraud was exposed by a short seller’s report that caused the company’s stock price to drop, injuring stockholders
- Plaintiffs plead claims for breach of fiduciary duty against the founder/CEO, the board, several of the company’s officers and the pre-merger SPAC board of directors, as well as claims for insider trading, aiding and abetting insider trading, aiding and abetting breaches of fiduciary duty against the legacy company’s board, unjust enrichment and waste

- ***In re Lordstown Motor Corp. Stockholders Litigation, 2021-1066-LWW***

- Complaint alleges breach of fiduciary duty against the SPAC directors for false and misleading disclosures and breach of fiduciary duty by the SPAC sponsor as an alleged controller
- On March 7, 2022, Court denied a motion to stay the action in favor of a first-filed federal securities actions in part because “this case raises emerging issues of Delaware law” in applying principles of fiduciary duty law to the context of SPACs
- Briefing on the pending motion to dismiss will be completed in late April with a hearing on the motion to dismiss on May 10, 2022

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