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Delaware Corporation Law Is Amended to Expressly Permit Coverage of Directors and Officers by Captive Insurers

By John J. Paschetto and Kenneth L. Norton

Delaware law has long permitted a corporation to indemnify its directors, officers, employees, and agents against certain types of losses incurred in proceedings brought "by reason of" their service. To be lawful, the indemnification must meet the standards set forth in Section 145 of the General Corporation Law of the State of Delaware (the "**DGCL**")—for example, the indemnitee must have acted in good faith (8 *Del. C*. § 145(a)-(b)). But the DGCL also permits a corporation to buy insurance to cover losses to directors, officers, employees, and agents, including losses that the corporation itself would be barred from indemnifying.

Because of this distinction between the class of losses a corporation can indemnify and the larger class of losses it can insure against, there was some doubt among practitioners whether a corporation could cover non-indemnifiable losses using a captive insurance company, i.e., a separate legal entity created for the purpose of insuring the losses of the captive's parent corporation or its affiliates, or their directors, officers, employees, and agents. In other words, if the insurer is a captive of the corporation that the insured serves, would the insurance coverage therefore be treated as a form of corporate indemnification, with the result that the captive insurer could reimburse only for losses that are indemnifiable under Section 145 of the DGCL?

This uncertainty has been alleviated by an amendment to Section 145 that took effect on February 7, 2022. As amended, Section 145(g) now makes clear that the insurance contemplated by Section 145 "include[s] any insurance provided directly or indirectly . . . by or through a captive insurance company[,]" as long as certain requirements are met.

First, the captive insurance company must be "organized and licensed in compliance with the laws of any jurisdiction[.]" Second, the captive insurance must "exclude from coverage" any non-indemnifiable losses connected with claims based on "personal profit or other financial advantage to which [the insured] was not legally entitled[,]" a "deliberate criminal or deliberate fraudulent act" by the insured, or "a knowing violation of law" by the insured, in each case if "established by a final, non-appealable adjudication in the underlying proceeding[.]"

Third, the decision whether the captive insurance covers losses incurred specifically by a current director or officer must be "made by [an] independent claims administrator" or by a vote of directors who are not parties to the underlying proceeding, by "independent legal counsel in a written opinion[,]" or by a stockholder vote. And fourth, if a payment by the captive insurer is to be made in connection with the dismissal or compromise of a proceeding by or in the right of the corporation where stockholders must be given notice (as in the settlement of a stockholder derivative action), the notice must disclose the involvement of the captive insurer.

Corporate-Governance Claims Involving SPACs Come before the Delaware Court of Chancery

By John J. Paschetto, Lauren M. McCrery, and Sarah M. Hand

Although special purpose acquisition companies ("**SPACs**") are not new, deals employing them rose sharply in popularity during 2018-2021.[1] A typical SPAC is a shell corporation with publicly traded shares, formed by a "sponsor" for

the express purpose of acquiring an as-yet-unidentified target. One of the unusual features of a SPAC is that when the acquisition of a target ultimately occurs (a so-called "de-SPAC transaction"), each of the public stockholders is given the option of cashing out at the original issue price, plus interest, rather than holding shares in the post-SPAC entity.

In the first quarter of 2022, the Delaware Court of Chancery had occasion to address for the first time fiduciary-breach claims arising from de-SPAC transactions, along with several other issues related to SPACs. As the cases indicate, the court has recognized that SPACs raise novel questions about how established principles of Delaware law should apply to de-SPAC transactions.

The redemption feature of publicly held SPAC shares was central to the fiduciary-breach claims considered in the first two cases discussed below, *In re MultiPlan Corp. Stockholders Litigation* and *In re Lordstown Motors Corp. Stockholders Litigation*.[2] The remaining three cases discussed in this article involved transfer restrictions imposed through a de-SPAC transaction (*Brown v. Matterport, Inc.*), a side deal with a creditor as a condition to approval of a de-SPAC transaction (*Blue v. Fireman*), and advancement of expenses sought by a SPAC fiduciary following a de-SPAC transaction (*Krauss v. 180 Life Sciences Corp.*).[3]

***In re MultiPlan Corp.*: Fiduciary Conflicts Found to Be "Inherent" in a Common SPAC Structure**

The SPAC in *MultiPlan* demonstrates how SPACs typically operate.[4] The SPAC, Churchill Capital Corp. III ("**Churchill**"), was formed by its sponsor, a limited liability company controlled by Michael Klein. Klein served as the CEO and board chair of Churchill and selected its other directors, most of whom received equity in the sponsor.

Churchill was authorized to issue two classes of common stock—Class A, which was issued in an initial public offering, and Class B, all of which was acquired by the sponsor at a nominal price. The public acquired "IPO Units," each of which consisted of one Class A share and a warrant to acquire an additional fraction of a Class A share. The proceeds of the IPO were not available to Churchill but were instead held in a trust account.

The trust account funds would be disbursed under the following circumstances: If Churchill identified and proposed a de-SPAC transaction within two years, each Class A stockholder would have the choice of continuing to hold Class A shares or redeeming them at the original purchase price per IPO Unit ($10), plus interest. The warrants could be retained regardless of whether the holder redeemed shares. Redemption amounts would be paid from the trust account, with any funds left over becoming the property of Churchill. The Class B shares, meanwhile, would be converted one-for-one to Class A shares.

If, on the other hand, Churchill failed to acquire a target within two years, Churchill would be dissolved, the Class A shares would all be redeemed with the trust-account funds, and the Class B shares would be worthless.

Thus, absent a de-SPAC transaction, the sponsor's investment would be a total loss. Given that alternative, almost any de-SPAC transaction would be preferable from the sponsor's standpoint. For the public stockholders, however, a de-SPAC transaction would be preferable only if it resulted in a share value greater than the redemption amount.

The Churchill board ultimately determined to engage in a timely de-SPAC transaction by acquiring MultiPlan, Inc. ("**MultiPlan**"). In its proxy statement for the stockholder vote on the MultiPlan acquisition, Churchill disclosed that over a third of MultiPlan's revenues came from

a single customer. The proxy did not disclose, however, that this customer was UnitedHealth Group Inc. ("**UHC**"), or that UHC planned to develop technology that would enable it not only to dispense with MultiPlan's services but also to become a MultiPlan competitor.

The Churchill stockholders "overwhelmingly" approved the MultiPlan acquisition. *In re MultiPlan Corp*., 2022 WL 24060, at *6. On the record date for the stockholder vote, the closing price for the Class A shares was $11.09 per share, whereas redeeming stockholders were entitled to receive approximately $10.04 per share. Not surprisingly, then, less than 10% of Churchill's public stockholders chose to redeem.

Just over a month after the acquisition closed, the market learned about UHC's development of its competing technology. The next day, Churchill stock closed at $6.27 per share.

That the *Multiplan* SPAC's structure was in common use did not "cure it of conflicts."

Churchill stockholders filed a complaint alleging that the company's directors, officers, and controlling stockholder (the SPAC sponsor) "issued a false and misleading proxy that impaired" the public stockholders' exercise of their redemption rights. *Id*. at *7. The defendants moved to dismiss, and the court ruled on the motion in the present opinion.

The defendants argued, among other things, that the de-SPAC transaction should be reviewed under the deferential business-judgment standard. But the court held, instead, that the defendants would have to demonstrate the transaction's entire fairness, because of conflicts of interest "inherent" in the SPAC. *Id*. at *2.

The entire-fairness standard applied, first, because the de-SPAC transaction involved a conflicted controlling stockholder, Churchill's sponsor. Specifically, it was adequately alleged that the MultiPlan acquisition was a "value-decreasing" deal, after which Churchill shares would be worth less than the redemption amount. *Id*. at *18. Thus, as the trust account would be obligated to pay a redemption price greater than the shares' true post-SPAC value, Churchill's sponsor had an interest in seeing as few shares redeemed as possible. For the same reason, the public stockholders had an interest in choosing to redeem—although they were apparently not then aware of it.

Second, even if Churchill's sponsor was not a conflicted controlling stockholder, entire fairness applied because the complaint adequately alleged that a majority of the Churchill directors were "self-interested in the [de-SPAC transaction], not independent from Klein [the sponsor's controller], or both." *Id*. at *19. Since most of the Churchill directors had been issued equity in the sponsor, they stood to benefit from any transaction that gave value to the sponsor's holdings, even one that caused Churchill stock to be worth less than the $10.04 redemption amount available to the public stockholders. Separately, the complaint also adequately alleged that a majority of directors were "beholden to Klein because he had appointed them to serve as directors of other 'Churchill' SPACs, providing them founders shares with the potential for more 'multi-million-dollar payday[s]'" like that of the MultiPlan acquisition. *Id*. at *21.

Accordingly, as a consequence of the sponsor's and board's conflicts, the de-SPAC transaction was subject to the entire-fairness standard of review. The court further held that the plaintiffs stated a claim that the transaction did not meet this standard. Their complaint adequately alleged that Churchill issued a "false and misleading Proxy," which failed to disclose MultiPlan's impending loss of its main customer and gain of a strong new competitor. *Id*. at *22.

Among the defense arguments rejected by the court was that the "structural feature" giving rise to the sponsor's (and the directors') conflicts of interest "would appear in '*any* de-SPAC transaction[.]'" *Id*. at *19. But the popularity of the structure did not change the court's analysis: "That this structure has been utilized by other SPACs does not cure it of conflicts." *Id*. Nevertheless, the court also made clear that the plaintiffs' claims did not survive merely because of the complaint's well-pleaded conflict allegations. Rather, the claims survived because the plaintiffs *also* alleged that "the director defendants failed, disloyally, to disclose information necessary for the plaintiffs to knowledgeably exercise their redemption rights." *Id*. at *22. The outcome could be different, the court allowed, in a case where public stockholders chose not to redeem their SPAC shares while "in possession of all material information about the target[.]" *Id*.

In re Lordstown Motors Corp.: Fiduciary-Breach Claim against SPAC Sponsor and Directors Not Stayed in Favor of Earlier-Filed Federal Securities Action

The plaintiffs in *In re Lordstown Motors Corp. Stockholders Litigation* were similarly situated to those in *MultiPlan* and brought similar claims in the Court of Chancery. The *Lordstown* plaintiffs held publicly traded shares in a SPAC, DiamondPeak Holding Corp. ("**DiamondPeak**"). Like the plaintiffs in *MultiPlan*, these plaintiffs had an opportunity to redeem their shares when a de-SPAC transaction was consummated. And as happened in *MultiPlan*, information made public after the de-SPAC transaction caused the post-SPAC entity's stock price to drop below what stockholders would have received had they chosen to redeem their shares. The plaintiffs therefore brought claims in Delaware against certain DiamondPeak directors and its sponsor, alleging that the defendants "breached their fiduciary duties by failing to disclose" information about problems with the target company's operations. *In re Lordstown Motors Corp*., 2022 WL 678597, at *2.

The defendants moved to stay the Court of Chancery action "pending the resolution of a federal securities class action" that arose from the same de-SPAC transaction. *Id*. at *1. The federal action consolidated several complaints, the first of which was filed in March 2021, some nine months before the action in Delaware commenced.

Declining to stay the later-filed Delaware action, the _Lordstown_ court noted its interest in passing upon corporate-law questions in "emerging" areas.

The Court of Chancery declined to grant the stay. As the court explained, although the federal action was filed well in advance of the Delaware action, and both involved examination of DiamondPeak's proxy disclosures, there were significant differences in the actions' parties, claims, and remedies. Importantly, the court also emphasized its interest in resolving novel corporate issues governed by Delaware law: "This Action concerns allegations that the defendants breached their fiduciary duties of loyalty and impaired the exercise of stockholders' redemption rights in the context of a de-SPAC transaction. . . . The Court of Chancery has long been chary about deferring to a first-filed action pending elsewhere when a case involves important questions of our law in an emerging area." *Id*. at *3 (internal quotation marks omitted).

Brown v. Matterport, Inc.: Lockup Imposed through De-SPAC Transaction Did Not Apply to Certain Post-SPAC Shares

The claims in *Brown v. Matterport, Inc*. were brought by a holder of target shares converted in a de-SPAC transaction into shares of the post-

SPAC entity ("**Matterport**"). Leading up to the de-SPAC transaction, the SPAC amended its bylaws (which would subsequently be the Matterport bylaws) to impose a 180-day lockup on any Matterport shares held by certain individuals "immediately following the closing" of the de-SPAC transaction. *Brown*, 2022 WL 89568, at *2. The plaintiff sought a declaratory judgment that the lockup did not apply to his shares and also asserted claims for breach of fiduciary duty. The Court of Chancery held an expedited trial solely on the applicability of the lockup, reserving the fiduciary-duty issues for later proceedings.

The court held that the lockup did not apply to the plaintiff's Matterport shares because he did not hold those shares "immediately following" the de-SPAC transaction's closing. Under the terms of the transaction, the target's shares were automatically converted into "only the right to receive" Matterport shares if and when the former target stockholder submitted a properly completed transmittal letter to Matterport's transfer agent. *Id*. at *4 n.38. While the de-SPAC transaction closed in July 2021, the plaintiff did not submit his transmittal letter until the following November. As the court concluded, "[o]btaining shares over 100 days after closing is not 'immediately.'" *Id*. at *4.

Blue v. Fireman: Former Stockholders of Target Had Standing to Assert Claim against Creditor Based on Side Deal

Blue v. Fireman also involved claims brought by stockholders of a target company acquired in a de-SPAC transaction. The complaint here alleged that the target was controlled by a creditor that also designated a majority of the directors and had an irrevocable proxy to cast a supermajority of the stockholder votes. According to the complaint, this creditor indicated that it would not vote for the de-SPAC transaction unless the target board agreed to "a series of favorable amendments to debt and warrant agreements" that "diverted approximately $40 million of would-be merger consideration out of the stockholders' pockets and into the creditor's." *Blue*, 2022 WL 593899, at *1. The defendants moved to dismiss.

The Court of Chancery first rejected the defense's argument that the claim was derivative and therefore the plaintiffs' standing was extinguished in the merger that formed part of the de-SPAC transaction. Applying established principles of Delaware law, the court held that the claim was direct because the side deal with the creditor had the following characteristics: It "divert[ed] merger consideration from stockholders, rather than from the acquirer"; it was "'improper,' that is, the product of misconduct by the defendants"; and it "materially affect[ed] the merger's process or price, calling the merger's fairness or validity into question." *Id*. at *11. The court then found that the complaint adequately alleged the creditor to be the target's controller, and that the entire-fairness standard would apply.

Krauss v. 180 Life Sciences Corp.: SPAC Fiduciary Entitled to Advancement of Expenses in Responding to SEC Subpoena and Defending Delaware Fiduciary-Breach Action

Marlene Krauss was a director and the CEO of a SPAC until she resigned at the time of its de-SPAC transaction. The Securities and Exchange Commission thereafter began investigating the de-SPAC transaction and served Krauss with a subpoena seeking documents concerning the transaction and certain securities filings by the SPAC. Some months later, the post-SPAC entity ("**180 Life Sciences**") initiated a fiduciary-breach action in the Delaware Court of Chancery against Krauss, the SPAC's sponsor, and a related entity. In addition, a contract-breach action was brought by 180 Life Sciences in New York state court against yet another entity, which then asserted third-party claims against Krauss.

Krauss sued 180 Life Sciences after it failed to respond to her demand for advancement of the expenses she was incurring in the above investigation and lawsuits. In the present opinion, the Court of Chancery ruled on her motion for summary judgment. The defense arguments were not peculiar to the SPAC setting. They included that (except as to certain claims in the Delaware suit) Krauss was not subpoenaed or sued by reason of her capacity as an officer or director of the SPAC, and that under provisions in the SPAC's charter, her counterclaims and third-party claims in the Delaware suit were "advanceable" only if approved by the 180 Life Sciences board. *Krauss*, 2022 WL 665323, at *7. Applying settled Delaware law, the court held that Krauss was entitled to advancement regarding the SEC subpoena, her defenses and affirmative defenses in the Delaware suit, and one of her counterclaims in the Delaware suit. In other respects, her motion was denied.

As regards SPACs, *Krauss* is perhaps primarily of interest for the glimpse it provides of the pending Delaware suit. In it, 180 Life Sciences—the post-SPAC entity—sued a fiduciary of the SPAC, "alleg[ing], among other things, that Krauss intentionally failed to disclose information that rendered certain [of the SPAC's] disclosures materially false and misleading." *Id.* at *3. Other allegations against Krauss in the Delaware complaint "concern her alleged . . . self-dealing monetary transfers, improper redemption of [SPAC] shares before the closing of the [de-SPAC transaction], and improper issuance of shares to an investment bank for services rendered to [the SPAC]." *Id*. at *8. All of these allegations "stem[med] from events taking place" around the time of the de-SPAC transaction. *Id*. Proceedings in the Delaware suit may therefore prove instructive if they result in opinions discussing fiduciary-duty principles as applied to officers and directors of SPACs.

* * *

Now that issues involving SPAC governance and de-SPAC transactions have been squarely presented to the Court of Chancery, Delaware law as applied to this popular tool is beginning to develop. It is yet to be seen what effects, if any, the above decisions—particularly the finding of inherent conflicts in *MultiPlan*—may have on the structure and use of SPACs.

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[1] Michael Klausner et al., *A Sober Look at SPACs*, 5 (ECGI Finance Working Paper No. 746/2021 Jan. 2022), https://ssrn.com/abstract=3720919.

[2] *In re MultiPlan Corp. S'holders Litig*., Consol. C.A. No. 2021-0300-LWW, 2022 WL 24060 (Del. Ch. Jan. 3, 2022); *In re Lordstown Motors Corp. S'holders Litig*., C.A. No. 2021-1066-LWW, 2022 WL 678597 (Del. Ch. Mar. 7, 2022).

[3] *Brown v. Matterport, Inc*., C.A. No. 2021-0595-LWW, 2022 WL 89568 (Del. Ch. Jan. 10, 2022); *Blue v. Fireman*, C.A. No. 2021-0268-MTZ, 2022 WL 593899 (Del. Ch. Feb. 28, 2022); *Krauss v. 180 Life Sciences Corp*., C.A. No. 2021-0714-LWW, 2022 WL 665323 (Del. Ch. Mar. 7, 2022).

[4] *See, e.g*., Klausner et al., *supra*, at 9-14 (describing standard SPAC features).

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