

Franchi highlights potential conflict issues with SPAC transactions



Ilirjan Pipa, Christopher Hawley | Wednesday, July 7, 2021

Special Purpose Acquisition Companies (SPACs) have seen a widespread acceptance and exponential level of usage these past two years. Though we are only halfway through 2021, \$98.9 billion has already been raised by SPACs, surpassing the total amount raised in 2020, which was already a record-breaking \$83.4 billion.

The prevalence of this structure has brought its organizational issues to the forefront, notably in the recently filed *Franchi v. Multiplan Corp.*, a class action complaint filed in Delaware Chancery Court on April 9, 2021 (the Complaint), which contends that the structure of the SPAC board “practically invites fiduciary misconduct.”

How are SPAC directors compensated?

Most SPAC directors are compensated with founders’ shares, which are either granted or purchased for a nominal amount. If the de-SPAC transaction - which is where the SPAC acquires another company and is merged with it - is successful, the shares are often worth millions of dollars. If the de-SPAC transaction is not completed within the required two-year period, then the SPAC is dissolved and the directors’ shares are worthless. According to the complaint, beyond just creating an incentive to complete the deal, this structure creates a binary where either a director receives a windfall of cash, or essentially nothing.

Franchi v. Multiplan Corp.

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At issue in the Complaint are the actions of Michael Klein, the CEO, President and Chairman of the Board of Churchill Capital Corp III (Churchill), which is the SPAC. Both Klein and Churchill are defendants in this case. The directors of Churchill, each of whom was selected by and had extensive familial, personal or financial ties to Klein, received a large number of founder shares. The value of these shares were conditioned on the closing of *any* deal. According to the Complaint, even in a “bad” deal for public SPAC investors (i.e., where the post-transaction company's stock trades at less than \$10 per share, as the SPAC investors committed money at the typical price of \$10/share), completion of a business transaction would exponentially increase the value of the founder shares. The founder shares, held mainly by Klein, cost him \$25,000 yet were worth over \$300 million upon the closing of the de-SPAC transaction, representing a personal return on investment of 1,219,900%.

Franchi also shows some of the issues surrounding disclosure and diligence, as companies that go public via the de-SPAC process do not disclose the same amount of information to the SEC as they would with a traditional IPO. The corporation that Churchill chose to merge with, MultiPlan, had several concerning elements that were not appropriately disclosed to investors. Pre-deal MultiPlan depended on UnitedHealth Group Inc. (UHC) for about 35% of its revenues. Well before the deal to buy MultiPlan was even announced, UHC had disclosed its intention to create its own data analytics platform to provide services duplicative of those provided by MultiPlan, which would likely render its relationship with MultiPlan obsolete and create an additional competitor. In addition to this impending conflict, MultiPlan’s earnings were not performing well. Investors have a right to redeem their shares if they do not support a proposed deal. According to the Complaint, disclosures surrounding the deal were not done with the rigor of the usual IPO process, depriving investors of critical information they would need to exercise their redemption rights.

Fewer than 10% of Churchill’s outside investors redeemed their shares before the merger closed on October 7, 2020. Following the closing, a research report disclosing the loss of UHC’s business and the precariousness of MultiPlan’s financial position was published, and the combined companies’ stock price plummeted. The combined companies’ shares had traded around \$10 (and actually represented \$10 per share, plus interest, of cash) before the Complaint was filed. The shares closed at just \$6.27 per share the day prior to the filing of the *Franchi* complaint. In other words, according to the Complaint, a pool of approximately \$1 billion of cash pre-deal is now only worth \$627 million, reflecting the loss of over \$370 million of stockholder value.

SPAC structure does retain special risks for investors

This unfortunate situation now holds only the possibility of being resolved through litigation, and it shows a worst-case scenario for investors in other SPACs. *Franchi* alleges that, due to the novel popularity of this structure, the regulation and oversight is not yet up to par. Until further precedence is developed and guidance is released, the SPAC structure does retain some special risks for investors that are not as present in the traditional IPO process.

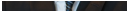
We will keep you updated on any new developments related to the *Franchi* Complaint. In the meantime, if you have any questions, please do not hesitate to contact our attorneys listed below.



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