THE REVIEW OF
SECURITIES & COMMODITIES REGULATION
AN ANALYSIS OF CURRENT LAWS AND REGULATIONS AFFECTING THE SECURITIES AND FUTURES INDUSTRIES

Vol. 55 No. 4 February 23, 2022

SPAC LITIGATION: CURRENT STATE AND BEYOND

In this article the authors discuss the structural features and disclosure-related issues arising in SPAC transactions and in SPAC litigation. They begin with a discussion of SPAC structures and potential conflicts. They then turn to Delaware's approach to SPAC litigation, the SEC's approach to SPAC disclosures and conflict issues, and private plaintiffs' securities law actions to recover losses in SPAC investments. At two points they provide key takeaways and observations regarding this litigation. They close with notes on the new frontiers for SPAC trends.

By Jenny Hochenberg and Justin C. Clarke *

Recent years have witnessed a widely remarked increase in sponsor activity establishing special purpose acquisition companies (or "SPACs"). In 2021 alone, there have been over 600 initial public offerings of SPACs, which have raised in excess of $160 billion in funds. Of these, close to 500 are still seeking a merger partner.[1]

The SPAC boom has generated new opportunities for some start-ups and other high-growth companies to access the public equity markets before they might otherwise have been regarded as eligible candidates for an IPO. It has also given retail investors the chance to invest in companies that might otherwise be the exclusive domain of venture capital firms and professional investors. At the same time, investments in such early-stage companies can carry risks, and the performance of these companies after going public via a business combination with a SPAC (or a "de-SPAC" transaction) has been mixed and, in many cases, disappointing.

Adding to this dynamic is a SPAC structure that, from a litigation and regulatory perspective, contains an unusual variety of "threat surfaces." Depending on a particular SPAC's structural features and the particular details of its de-SPAC transaction, the sponsors, directors, and/or officers of the SPAC, as well as the controlling shareholders, directors, and/or officers of the company combining with the SPAC (or "target" company), may be subject to shareholder claims under core fiduciary-duty doctrines, as well as private causes of action arising under state and federal securities law. In addition, SPACs have drawn increased attention from regulators, including through enforcement actions by the Securities and Exchange Commission.

These factors have resulted in a dramatic increase in litigation involving SPACs – a trend that is not expected to abate anytime soon. In fact, novel and complex legal issues are almost certain to arise as newly formed SPACs enter the next phase of their lifecycle and undertake de-SPAC transactions and as previously de-

[1] *SPAC IPO Transactions: Summary by Year and SPAC Status by Year of IPO*, SPACINSIDER, *available at* https://spacinsider.com/stats. Data as of December 31, 2021.

* *JENNY HOCHENBERG and JUSTIN C. CLARKE are partners at Cravath, Swaine & Moore LLP's New York City office. Their e-mail addresses are jhochenberg@cravath.com and jcclarke@cravath.com.* *The authors would like to thank Caroline B. Shinkle and Meher Babbar for their vital contributions to the article.*

RSCR Publications LLC Published 22 times a year by RSCR Publications LLC. Executive and Editorial Offices, 2628 Broadway, Suite 29A, New York, NY 10025-5055. Subscription rates: $1,197 per year in U.S., Canada, and Mexico; $1,262 elsewhere (air mail delivered). A 15% discount is available for qualified academic libraries and full-time teachers. For subscription information and customer service call 609-683-4450; fax 609-683-7291; write Subscriber Services, RSCR Publications, PO Box 585, Kingston NJ 08528; e-mail cri.customer.service@comcast.net; or visit our website at www.rscrpubs.com. General Editor: Michael O. Finkelstein; tel. 212-876-1715; e-mail mofinkelstein@gmail.com. Associate Editor: Sarah Strauss Himmelfarb; tel. 301-294-6233; e-mail sarah.s.himmelfarb@gmail.com. To submit a manuscript for publication contact Ms. Himmelfarb.

SPACed companies begin once again to go "private" or are acquired.

This article discusses the structural features and disclosure-related issues arising in the context of SPAC transactions, as well as the primary litigation and regulatory implications generated by both.[2]

SPAC STRUCTURE AND POTENTIAL CONFLICTS

SPACs, also known as "blank check companies," have no initial assets or operations, and are established exclusively to identify and execute a business combination with a target company. They are formed by sponsors who purchase "founder shares" in the SPAC (commonly known as the "promote") for nominal consideration. In the typical SPAC structure, the sponsor pays $25,000 for founder shares representing 20% of the SPAC's equity. Sponsors also usually purchase warrants in the SPAC for an amount of cash (which represents the sponsor's "at risk capital") that covers the upfront IPO expenses and anticipated future expenses of the SPAC.

SPACs raise cash through an IPO, and the proceeds of the IPO are held in a trust account until the SPAC completes a business combination transaction or dissolves. In the IPO, the SPAC typically issues "units" to the public shareholders – which are comprised of (1) one common share (usually designated as a "class A" share) and (2) a warrant for a fraction of a common share (*e.g.*, one-half of a share, one-third of a share) – for $10 per unit. Thus, one important distinction between the founder shares and the public shares is that the sponsor purchases its shares for nominal consideration, whereas the public shareholders pay nearly $10 for theirs (with the remainder of the $10 per unit purchase price ascribed to the fractional warrant). In addition, the shares issued to the public shareholders are a different class from the founder shares (the latter are typically designated as "class B" shares) and may carry certain distinct rights.

The SPAC has a limited period of time after its IPO (typically 18-24 months) to find a merger partner and complete a business combination. If the SPAC does not consummate a de-SPAC transaction by that deadline, the SPAC must either obtain shareholder approval to extend the timeframe or liquidate and return the IPO proceeds (which until then were held in a trust account) to the public shareholders. The founder shares are not entitled to participate in the return of capital from the trust account. Therefore, if the SPAC does not complete a de-SPAC transaction, the founder shares and all the warrants expire worthless, whereas the public shareholders recover their investment in full, with interest from earnings in the trust account.

If the SPAC identifies a merger partner, the SPAC public shareholders (but not the sponsors) are typically entitled to make an election either (1) to redeem their shares for $10 per share (the amount for which they bought their units in the IPO), plus interest from earnings in the trust account, *and retain their warrants* or (2) to keep both their shares and their warrants. Thus, the first option gives the SPAC public shareholders an avenue to recover their investment in full, as well as any interest accumulated in the trust, and keep the upside associated with their warrants. In 2021, the average redemption rate for SPACs that completed a business combination was close to 45% – and increased nearly threefold from the first to the second half of 2021.[3] Some de-SPAC transactions experienced redemption rates in the vicinity of 90%.

Consummation of a de-SPAC transaction nearly always requires approval by the SPAC's shareholders, and the voting rights of the public SPAC shareholders are completely separate – and independent – from their redemption rights. A public SPAC shareholder can vote in favor of a transaction and, at the same time, elect to have its shares redeemed for cash and keep their warrants. This, combined with the fact that the founder

---

[2] Setting aside contractual disputes between deal parties, additional claims against SPACs have included claims that SPACs constitute "investment companies" under the Investment Company Act of 1940. These claims raise specialized issues that are beyond the scope of this article.

[3] SPACINSIDER, *available at* www.spacinsider.com/stats. Data as of December 31, 2021.

shares represent 20% of the vote, means that SPAC mergers are rarely (if ever) voted down by SPAC shareholders.

This structure has resulted in one common critique of SPACs – that they can give rise to inherent conflicts between SPAC sponsors and directors (who may be related to the sponsor and/or owners of founder shares and warrants), on the one hand, and public shareholders, on the other. The claims of conflict have tended to focus on the idea that SPAC sponsors (and, in some instances, directors) are better off completing a de-SPAC deal – *any* deal, even a *bad* deal – than not completing one. As a result, it is claimed, SPAC sponsors are more willing to overpay for a target in order to get a deal done before the liquidation deadline expires. In a much publicized study of the post-merger performance by SPACs, *A Sober Look at SPACs*, Professors Klausner of Stanford and Ohlrogge of New York University found that SPAC sponsors "profit handsomely" from SPAC mergers, whereas the SPAC shareholders who do not redeem their shares "experience steep post-merger losses."[4] Sponsors have responded to these claims in different ways, including in some instances subjecting some or all of their founder shares to a vesting schedule tied to the post-merger stock price of the SPAC to better show that the returns of the sponsor are indeed aligned with those of public shareholders in the combined company.

The critiques against SPACs have gone hand-in-hand with a significant increase in shareholder litigation, resulting in a dramatic rise in Directors and Officers ("D&O") liability insurance rates for SPAC IPOs and de-SPACed merged companies in the last 18 months.[5] Carriers often charge meaningfully higher premiums for de-SPACing companies relative to a traditional IPO.[6] Between the first quarter of 2020 and the second quarter of 2021, some insurance brokers have seen SPAC D&O premiums increase as much as fivefold.[7] Carriers also typically impose higher self-insured retentions in the context of a SPAC – for companies purchasing D&O insurance coverage upon a de-SPAC transaction, retentions can range in the neighborhood of $5 million to $20 million, depending on the risk.[8] D&O policies may also have limited or no coverage when the target company is affiliated with the sponsor and therefore the perceived risk of a conflict is higher.

DELAWARE'S APPROACH TO LITIGATION SURROUNDING SPAC STRUCTURE AND CONFLICTS OF INTEREST

The increase in SPAC activity over the past couple of years has led to a significant number of new case filings in the Delaware Court of Chancery, where most U.S. incorporated SPACs are domesticated.[9] In that court alone, there are over a half-dozen significant challenges to SPAC transactions currently pending.[10] The recent wave of fiduciary-duty suits tends to focus on *structural* features of SPACs and alleged *disclosure deficiencies* which impair the shareholders' redemption rights – in particular (1) the role that the sponsor plays in SPAC governance; (2) alleged conflicts of interest between the SPAC board and management, on the one hand, and its public shareholders, on the other; and (3) the role played by the public shareholders' redemption right. Courts are currently in the early stages of assessing whether, and in what circumstances, these structural features of SPAC

[4] Michael D. Klausner, Michael Ohlrogge, and Emily Ruan, *A Sober Look at SPACs* (October 28, 2020), YALE J. REG. 14, 19 (forthcoming), *available at* https://ssrn.com/abstract=3720919.

[5] Andrew Pendergast and Jonathan Abbott, *NFP's SPAC Securities Litigation Update: Has Growth in the Number of SPAC IPOs Led to an Increase in the Frequency of Litigation?* (Dec. 15, 2021), *available at* https://spacinsider.com/wp-content/uploads/2021/12/NFPs-SPAC-Securities-Litigation-Update.pdf.

[6] Woodruff Sawyer, *Looking Ahead to 2022* (Sept. 21, 2021) 32, *available at* https://woodruffsawyer.com/wp-content/uploads/2021/09/DO-Looking-Ahead-to-2022.pdf.

[7] *Id.* at 7.

[8] Roger E. Barton & Carrie O'Neil, *D&O Insurance for SPACs: Differentiating the Risk*, REUTERS (Oct. 28, 2021), *available at* https://www.reuters.com/legal/legalindustry/do-insurance-spacs-differentiating-risk-2021-10-28/.

[9] A significant number of SPACs are incorporated in foreign jurisdictions, most commonly the Cayman Islands. This discussion is focused on SPACs incorporated in Delaware, as Delaware courts generally are viewed as the leading authority in developing U.S. corporate law.

[10] *Delman v. GigAcquisitions3 LLC*, No. 2021-0679 (Del. Ch. Oct. 19, 2021); *Anthony Franchi v. MultiPlan Corp.*, C.A. No. 2021-0300 (Del. Ch. Apr. 9, 2021); *Cody Laidlaw v. XL Fleet Corp.*, C.A. No. 2021-0424 (Del. Ch. May 13, 2021); *Joel Newman v. GS Acquisition Holdings Corp II* (GSAH), C.A. No. 2021-0760 (Del. Ch. Sept. 3, 2021); *Evan Umbright v. Khosla Ventures Acquisition Co. II*, C.A. No. 2021-0762 (Del. Ch. Sept. 3, 2021); *Cody Laidlaw v. Jonathan J. Ledecky*, C.A. No. 2021-0808 (Del. Ch. Sept. 20, 2021); *Cody Laidlaw v. GigAcquisitions2, LLC*, C.A. No. 2021-0821 (Del. Ch. Sept. 23, 2021); *Anthony Franchi v. dMY Tech. Group, Inc. IV*, C.A. No. 2021-0841 (Del. Ch. Sept. 30, 2021); *Anthony Franchi v. CM Life Scis. III, Inc.*, C.A. No. 2021-0842-KSJM (Del. Ch. Sept. 30, 2021); *Irfan Janmohamed v. Jonathan J. Ledecky*, C.A. No. 2021-0906 (Del. Ch. Oct. 19, 2021).

transactions merit enhanced judicial scrutiny, such as Delaware's entire fairness standard of review. In instances when enhanced judicial scrutiny is triggered, the next question will become whether courts will recognize any cleansing doctrine or other similar safe harbor for SPACs that adopt appropriate procedural protections.

Fiduciary Duties and Standard of Judicial Review

Delaware's baseline standard of review is the business judgment rule, which "presumes that in making a business decision, the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company."[11] However, this default presumption is set aside in transactions involving conflicts of interest, such as those involving a controlling shareholder who receives benefits that are not shared proportionately with the company's common shareholders (often referred to as "non-ratable benefits").[12] In such circumstances, the Delaware courts will apply "entire fairness review," which requires the defendant to prove that the transaction was both procedurally and economically fair to the public shareholders.[13] Where entire fairness review applies, it is generally difficult for a defendant to succeed on a motion to dismiss, as "fairness" is often regarded as a question of fact that is not amenable to decision at the motion-to-dismiss stage. Notwithstanding this difficulty, the Delaware courts have recognized a variety of "cleansing" doctrines that are available to parties who adopt appropriate procedural protections in a variety of transactional settings, including those found in *Corwin* (holding that in the absence of a conflicted controlling shareholder, a fully informed vote of disinterested, uncoerced shareholders will cleanse the transaction of fiduciary-duty breaches by the board and afford it business judgment review)[14] and *M&F Worldwide* (holding that a going-private merger by a controlling shareholder can obtain business judgment review if both a duly empowered independent special committee acted with due care to negotiate a fair price and the transaction was approved by a fully informed, uncoerced majority-of-the-minority vote).[15]

The prototypical fiduciary-duty claims challenging SPAC transactions tend to make a similar set of allegations: they generally allege that the SPAC sponsor selected and controls the SPAC directors and management; that the sponsor made a modest upfront investment in the SPAC in exchange for its valuable founder shares; that the proxy statement on the basis of which public shareholders decide whether to exercise their redemption rights and whether to vote in favor of the de-SPAC transaction was deficient; and that the 18- to 24-month window to complete a de-SPAC transaction under the SPAC charter created a strong incentive for the sponsor to ensure that any deal – even one that was bad for the public shareholders – was completed, or otherwise the SPAC would liquidate and the sponsor's investment would be worthless. Plaintiffs typically allege that the sponsor then dominated or controlled negotiations with the target, causing the SPAC to enter into an unfair deal that was favorable to the sponsor (because it avoided a liquidation and permitted the sponsor to retain its valuable founder shares) but not the public shareholders. Plaintiffs argue that this structure calls for entire fairness review because the sponsor is a controller and stands to receive benefits from the transaction that are not shared ratably with other shareholders.

This set of allegations highlights three important issues: (1) whether SPAC sponsors should necessarily be regarded as "controllers" in all circumstances; (2) whether the founder shares and deal timeline in fact give rise to a misalignment of interests; and (3) whether public shareholders' redemption rights and shareholder approval rights provide a structural remedy for any of these perceived issues.

Control. To decide whether a shareholder is a controller, courts engage in a fact-intensive inquiry that looks beyond the level of stock ownership[16] to whether the shareholder controls the board of directors and

[11] *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 52 (Del. 2006) (internal quotation marks omitted).

[12] *In re Viacom Inc. S'holders Litig.*, No. CV 2019-0948-JRS, 2020 WL 7711128, at *16 (Del. Ch. Dec. 29, 2020), *as corrected* (Dec. 30, 2020).

[13] *In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 44 (Del. Ch. 2013).

[14] *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 312 (Del. 2015).

[15] *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 645 (Del. 2014).

[16] *In re Crimson Expl. Inc. S'holder Litig.*, No. CIV.A. 8541-VCP, 2014 WL 5449419, at *10 (Del. Ch. Oct. 24, 2014) ("a larger share percentage [does not] make[] it substantially more likely that the court will find the stockholder was a controlling stockholder. Instead . . . [prior] holdings highlight[] the importance and fact-intensive nature of the actual control factor").

management – either formally or informally.[17] In arguing that SPAC sponsors should be treated as controlling shareholders, plaintiffs attempt to paint a picture of a close relationship between the sponsor and the SPAC directors.[18] SPAC organizational documents may grant the sponsor, via its ownership of the class B shares, the unilateral power to appoint and replace the SPAC directors, and SPAC sponsors are often alleged to pack the board with "loyalists."[19] Plaintiffs argue that sponsors appoint directors with whom they have long-standing personal relationships, offer directors membership interests in the sponsoring entity and/or founder shares in the SPAC, and/or otherwise work to structure the SPAC in a manner that aligns the interests of sponsors and directors.[20] Consequently, SPAC boards are alleged to be "beholden" to the sponsor, affording the sponsor the type of influence a controlling shareholder typically possesses.[21] By virtue of this alleged control over the SPAC board, plaintiffs argue that SPAC sponsors owe the remaining shareholders fiduciary duties of care and loyalty. Embedded in those duties is the duty of disclosure, which is an "'application of the fiduciary duties of care and loyalty' implicated when fiduciaries communicate with shareholders."[22]

Defendants in SPAC litigation have often rejected the premise that directors are beholden to the sponsor. They note that the power of sponsors to appoint and remove directors "is insufficient by itself to reasonably doubt a director's independence because that is the usual way a person becomes a corporate director."[23] Under Delaware law, directors can be independent of the shareholders who select and nominate them,[24] even if they share a personal friendship or prior business relationship.[25] Being a director nominee of a particular shareholder does not render a director automatically controlled or dominated by that shareholder. Rather, the court would look at whether the relationship between the shareholder and the director is such that the director would be more willing to risk their reputation than their relationship with the shareholder, and whether the financial benefits received by the director are material enough in the context of the director's economic circumstances such that the director would be influenced by overriding personal interests when discharging his or her fiduciary duties.[26]

Conflicts. The Delaware Court of Chancery considers a conflicted controller transaction generally to be one where either the controller stands on both sides of the transaction (*i.e*., when a parent acquires its subsidiary) or the controller stands on just one side of the transaction but "competes with the common stockholders for

[17] *In re Ezcorp Inc. Consulting Agreement Derivative Litig*., No. CV 9962-VCL, 2016 WL 301245, at *9 (Del. Ch. Jan. 25, 2016) ("Delaware corporate decisions consistently have looked to who wields control in substance and have imposed the risk of fiduciary liability on that person."); *FrontFour Cap. Grp. LLC v. Taube*, No. CV 2019-0100-KSJM, 2019 WL 1313408, at *21 (Del. Ch. Mar. 11, 2019) ("In determining whether a minority stockholder is a controller, the level of stock ownership is not the predominant factor, and an inability to exert influence through voting power does not foreclose a finding of control.").

[18] *See, e.g.*, Complaint at ¶ ¶ 6, 116–17, *Delman v. GigAcquisitions3 LLC*, No. 2021-0679 (Del. Ch. Aug. 4, 2021); Complaint at ¶ 35, *In re Multiplan S'holders Litig*., No. 2021-0300 (Del. Ch. Aug. 10, 2021); Complaint at ¶ 6, *Laidlaw v. Ledecky*, No. 2021-0808 (Del. Ch. Sept. 20, 2021).

[19] Complaint, *Multiplan*, *supra* note 18, at ¶ 117.

[20] Complaint, *Delman*, *supra* note 18, at ¶ 6; Complaint, *Ledecky*, *supra* note 18, at ¶ 6.

[21] *See, e.g.*, Complaint, *Multiplan*, *supra* note 18, at ¶ ¶ 80, 118.

[22] *In re Multiplan S'holders Litig.*, No. 2021-0300 (Del. Ch. Jan. 3, 2022) (quoting *Dohmen v. Goodman*, 234 A.3d 1161, 1168 (Del. 2020)).

[23] Opening Brief in Support of Defendants' Motion to Dismiss at 37, *In re Multiplan S'holders Litig*., No. 2021-0300 (Del. Ch. Aug. 10, 2021) (quoting *McElrath v. Kalanick*, 224 A.3d 982, 995 (Del. 2020) (quotation marks and alterations omitted).

[24] Reply Brief in Support of Defendants' Motion to Dismiss at 14–15, *In re Multiplan S'holders Litig*., No. 2021-0300 (Del. Ch. Aug. 10, 2021). *See also McElrath*, 224 A.3d at 996 (holding that an individual appointing a director who may be loyal to the individual "without more does not allow a reasonable inference that [their] relationship was of a 'bias-producing nature'") (internal citation omitted).

[25] *See, e.g., Litt v. Wycoff*, No. CIV.A. 19083-NC, 2003 WL 1794724, at *4 (Del. Ch. Mar. 28, 2003). *See also* Opening Brief in Support of Defendants' Motion to Dismiss, *supra* note 23, at 37 (contending that to be seen as controlled, "the nature of the relationships between [an interested controlling stockholder and a director] must demonstrate that the director is beholden to the stockholder") (quoting *Beam v. Stewart*, 845 A.2d 1040, 1054 n. 37 (Del. 2004) (alteration in original)).

[26] Opening Brief in Support of Defendants' Motion to Dismiss, *supra* note 23, at 37 (arguing that "the alleged benefit [must be] significant enough in the context of the director's economic circumstances, as to have made it improbable that the director could perform her fiduciary duties to the shareholders without being influenced by her overriding personal interest") (quoting *Orman v. Cullman*, 794 A.2d 5, 23 (Del. Ch. 2002)) (internal quotation marks omitted).

consideration."[27] A controlling shareholder competes with common shareholders for consideration when the controller receives more consideration for its shares than the minority common shareholders; receives different consideration for its shares than the minority common shareholders; or "extract[s] something uniquely valuable" to the controlling shareholder, even if the controller nominally receives the same consideration as the other shareholders.[28]

Plaintiffs alleging conflicted de-SPAC transactions generally argue that sponsors, by virtue of the substantial financial gains they seek to obtain from their founder shares if a business combination is completed, receive different consideration than public shareholders for their shares. Plaintiffs claim that sponsors have tremendous upside, with very little downside, if their SPAC completes a de-SPAC transaction – even a de-SPAC transaction in which the target company is significantly overvalued. At the same time, sponsors receive nothing if the SPAC liquidates without finding a target. Public shareholders, however, are in a very different position. While they are fully protected if the SPAC does not complete a business combination, according to the plaintiffs, they bear the downside risk and, as studies have shown, the brunt of losses if the SPAC makes a bad investment decision and public shareholders continue to hold their shares post-merger.[29]

SPAC sponsors are not the only parties alleged to be facing this "structural" conflict of interest, as plaintiffs have argued SPAC directors are similarly compromised because they often own founder shares and/or warrants. As a result, when directors evaluate business combination transactions, they are said to do so through the same risk/reward calculus as the sponsor.

Defendant sponsors and directors, however, have strongly argued that the alleged conflicts of interest inherent in a SPAC's structure are disclosed to shareholders when they invest in the SPAC. Because investors purchase stock in a SPAC with full knowledge of these terms, the structure, it is argued, should not be subject to heightened scrutiny. Further, defendants have also asserted that any compensation arrangements with directors who serve on the SPAC board do not generally rise to the level of materiality required under Delaware law to influence a director's decision-making.[30]

Redemption Rights. Shareholders' redemption rights, which allow shareholders to redeem their shares in lieu of rolling them into a de-SPACed company, can be viewed as a means to help remedy potential conflicts of interest because they grant shareholders the option of not participating in any deal they consider harmful to their interests.[31] Therefore, the argument goes, redemption rights are a mitigating factor when evaluating whether a transaction suffered from a flawed process due to conflicts. Conversely, plaintiff-shareholders typically argue that they were harmed by false or misleading proxy statements that misled them into not exercising their redemption rights.[32]

The Multiplan Litigation and Application of Entire Fairness

One of the most significant cases alleging fiduciary-duty breaches by the sponsor and the directors of a SPAC is *In re Multiplan Corp. Stockholders Litigation*, currently proceeding in the Delaware Court of Chancery.[33] In an opinion dated January 3, 2022, Vice Chancellor Will denied the defendants' motions to dismiss the case and found that the entire fairness standard of review applied to the merger due to "inherent conflicts between the SPAC's fiduciaries and the public stockholders in the context of a value-decreasing transaction."[34] In doing so, the court "emphasiz[ed]" that its "conclusions stem from the fact that a reasonably conceivable impairment of public stockholders' redemption rights ─ in the form of

[27] *Larkin v. Shah*, 2016 WL 4485447, at *8 (Del. Ch. Aug. 25, 2016) (quoting *In re Crimson Expl. Inc. S'holder Litig.,* No. CIV.A. 8541-VCP, 2014 WL 5449419, at *12 (Del. Ch. Oct. 24, 2014)).

[28] *Crimson*, 2014 WL 5449419, at *12–13.

[29] Klausner, et al., *supra* note 4, at 36, 54.

[30] Opening Brief in Support of Defendants' Motion to Dismiss, *supra* note 23, at 37, 40–41.

[31] Michael Klausner & Michael Ohlrogge, *SPAC Governance: In Need of Judicial Review* (Nov. 19, 2021) 7, *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3967693.

[32] *See, e.g.,* Complaint, *Multiplan*, supra note 18, at ¶ 83 ("Crucially, the Proxy and other public disclosures by Churchill insiders contained material omissions or were materially misleading, such that Class A stockholders were not provided with a fully informed decision whether to redeem their shares ahead of the Merger."); Complaint, *Delman*, *supra* note 18, at ¶ 86 ("This was a material omission that violated the Board's duty of candor and prevented the stockholders from making informed decisions in voting their shares or exercising their redemption rights.").

[33] No. 2021-0300 (Del. Ch. Aug. 9, 2021).

[34] *In re Multiplan S'holders Litig.*, No. 2021-0300, slip op. at 3 (Del. Ch. Jan. 3, 2022).

materially misleading disclosures — has been pleaded in the case" and suggested that the outcome might be different if the stockholders had been in possession of all material information at the time they made their redemption decision.[35] This is the first case in which the court considered the application of Delaware's fiduciary-duty doctrines and the appropriate standard of judicial review in the SPAC context.

The case arose from the October 2020 merger of Multiplan, a data analytics provider to healthcare companies and consumers, with Churchill Capital Corp. III, one of several SPACs formed by Michael Klein. The plaintiffs, purported shareholders of Multiplan Corp. (formerly SPAC Churchill Capital Corp. III), asserted that the merger merits entire fairness review on the grounds that the "massive windfalls" available to the sponsor and board, based on their ownership of founder shares, created a clear conflict of interest, and the de-SPAC merger constituted a conflicted controller transaction.[36] The plaintiffs noted that the founder shares, which cost only $25,000 to acquire when the SPAC was formed, became worth over $300 million at the closing of the Multiplan acquisition.

The plaintiffs also claimed that the SPAC board was not independent because the directors were "self-interested" and/or were "beholden" to Klein. According to the plaintiffs' complaint, Klein, through his control of the sponsor, had the exclusive power to appoint the whole SPAC board. Each director was "hand-picked" by Klein, with whom they had extensive familial, personal or financial ties, and received (directly or indirectly via ownership of equity interests in the sponsor) economic interests in a significant number of founder shares. Many directors also allegedly served on the boards of one or more of Klein's other SPACs where they held lucrative founder shares. Taken together, the plaintiffs argued that the directors lacked the incentive or power to act independently from Klein.

The plaintiffs also argued that the merger transaction suffered from a "deeply flawed and unfair process" that did not satisfy the entire fairness standard. For one, the plaintiffs maintained that the board did not engage an independent financial advisor to evaluate the deal and specifically the consideration to be paid for the target company. Instead, the board retained one of Klein's own firms and paid it an advisory fee of $30.5 million. Second, the plaintiffs asserted that the board did not perform adequate due diligence on the target company. It allegedly did not uncover (or worse, concealed) crucial facts about the value of the target company's business, including that its largest customer intended to create its own competing data analytics platform that would render its relationship with Multiplan redundant. Third, and of particular significance to the court's ultimate ruling, the disclosures included in the merger proxy statement allegedly contained affirmatively misleading information, both with respect to the "extensive due diligence" performed by the board, and the health and viability of Multiplan's business.

By contrast, the *Multiplan* defendants argued that the transaction was not a conflicted controller transaction because the SPAC sponsor did not receive special consideration from the deal. The defendants noted that the SPAC acquired Multiplan, not the other way around, and that the shares held by the sponsor participated in the acquisition on the *same terms* as all other shares. As a result, "[n]one of the [d]efendants received any greater or different consideration than other Churchill stockholders in the [a]cquisition."[37] The defendants also advanced an overarching equitable argument, namely that the plaintiffs should not be allowed to challenge the SPAC economics and incentives, as they were disclosed to them before they invested in the SPAC at the time of its IPO. Finally, the defendants argued that the SPAC board was disinterested and independent with respect to the merger, but that even if it were not, the business judgment rule should apply because the SPAC shareholders approved the transaction in a fully informed vote.[38]

The court in *Multiplan* sided with the plaintiffs and found, on the basis of the allegations in their complaint, that the SPAC sponsor had a "special benefit" not shared with the public shareholders arising from the "(non-)value of his stock and warrants if no business combination resulted."[39] The merger was valuable to the sponsor even if the shares of the post-merger company were worth less than $10.04 (4¢ being accrued interest on the trust funds); for the public shareholders, however, the merger was valuable only if the shares of the post-merger company were worth more than $10.04. As such, the court concluded that the de-SPAC transaction was a conflicted controller transaction, and entire fairness was the appropriate standard of review.

[35] *Id*. at 3, 55.

[36] Complaint, *Multiplan*, *supra* note 18 at ¶ 7.

[37] Brief in Support of Defendants' Motion to Dismiss at 29, *In re Multiplan S'holders Litig.*, No. 2021-0300 (Del. Ch. Aug. 10, 2021).

[38] Opening Brief in Support of Defendants' Motion to Dismiss, *supra* note 23, at 13.

[39] *In re Multiplan*, No. 2021-0300, slip op. at 43.

The court further found, based on the allegations in the plaintiffs' complaint, that a majority of the SPAC's board was conflicted because they were self-interested with respect to the de-SPAC transaction (by virtue of their economic ownership of founder shares) and, in addition, were not independent from Klein given the scope of their economic, personal, and employment relationships with him and vehicles controlled by him. According to the court, these conflicts at the board also separately justified the application of entire fairness review.

The court observed that even though the structure of the SPAC and the sponsor's incentives were disclosed in the offering materials for the SPAC's IPO, certain material details of the de-SPAC transaction were not disclosed either there or in the proxy materials for the merger with Multiplan. In particular, the court credited the plaintiffs' factual allegation that the SPAC's proxy statement failed to disclose that a significant Multiplan customer was in the process of developing its own competing solution in-house. The court concluded that the failure to disclose this information inappropriately deprived the SPAC's public shareholders of the opportunity to make a fully informed decision as to the exercise of their redemption rights.

Importantly, the court left open the possibility that it might have reached a different outcome if the proxy statement had disclosed all material information related to the de-SPAC transaction. On the one hand, the court noted that just because the sponsor promote is utilized in "*any* de-SPAC transaction," that does not cure it of conflicts.[40] At the same time, however, the court acknowledged that "[t]he mismatched incentives relevant here were known to public stockholders who chose to invest in the SPAC."[41] And it explained that its ruling did

> 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.[42]

In summary, the court found that the plaintiffs had pleaded viable claims for breaches of the duty of loyalty as a result of both the allegedly misleading proxy statement, which impaired the public shareholders' informed exercise of their redemption rights and because of the conflicts involved in the transaction structure. Whether the same outcome would result in the case 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 structure will have to await further development in future cases.

Key Takeaways and Observations

- Courts' analysis of the alleged conflicts involved in the SPAC structure may be influenced by the quality of the disclosures surrounding the de-SPAC transaction. Comprehensive and accurate disclosures may aid in mitigating not only the risk of securities liability (discussed in more detail below), but also fiduciary-duty claims.

- Obtaining one or more fairness opinion(s) from independent financial advisors in connection with a de-SPAC transaction may be beneficial.[43] Fairness opinions are one way a board can demonstrate both fair price and fair process in the event an entire fairness standard of review is applied.

- SPACs can mitigate allegations of conflict by ensuring that their board includes a sufficient number of independent directors. SPACs should therefore weigh the benefits of allowing sponsors with deal expertise to negotiate the de-SPAC transaction against the importance of independence at the board. SPACs may consider cash compensation for independent directors in lieu of the SPAC issuing, or the sponsor transferring, founder shares for nominal or no consideration to directors.

- Conducting thorough due diligence and ensuring full disclosure are key. A failure to conduct adequate due diligence could be relevant to a court applying entire fairness review, as it indicates an unfair

[40] *Id*. at 46.

[41] *Id*. at 3.

[42] *Id*. at 55 (emphases added).

[43] Fairness opinions associated with de-SPAC transactions have been relatively rare. As of December 31, 2021, of the transactions completed since 2019, approximately 11% had fairness opinions from the SPAC's financial advisor. DEAL POINT DATA, *available at* www.dealpointdata.com.

process and calls into question whether the SPAC ultimately received a fair price for the transaction. Inadequate due diligence also heightens the risk of claims alleging misleading disclosure.

- Breaches of non-exculpated duties of loyalty by SPAC sponsors, directors, and officers can be grounded in the failure to provide adequate disclosure about a de-SPAC transaction. Therefore, it is very important that the merger proxy disclose all material facts about the de-SPAC deal, the target company, the sponsor's incentives, and compensation payable to the sponsor and the SPAC's fiduciaries.

THE SEC'S APPROACH TO SPAC DISCLOSURES AND CONFLICT ISSUES

Over the last two years, SPACs have come under increased scrutiny by the SEC, in particular with respect to conflicts of interest disclosure and anti-fraud enforcement. The SEC has pursued a number of means to advance investor protections, including disclosure guidance, cease-and-desist orders, and enforcement litigation. In recognition of the pace and volume at which SPACs have been raising and deploying IPO proceeds in de-SPAC transactions, the SEC has sought to impose more rigor around disclosures for both SPAC IPOs and de-SPAC transactions. The SEC's disclosure guidance focuses on enhanced disclosure of potential conflicts of interest, the nature of sponsors' and directors' interests in SPAC IPOs and de-SPAC transactions, and the factors the board considered in approving a de-SPAC transaction. The SEC has also relied on enforcement actions and cease-and-desist orders to enforce the anti-fraud and proxy solicitation provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934.

Disclosure Guidance Regarding Conflicts of Interest

In December 2020, the SEC issued disclosure guidance for SPACs in connection with IPOs and subsequent de-SPAC transactions.[44] The SEC noted that the economic interests of SPAC sponsors, directors, and officers often differ from those of public shareholders, which may lead to conflicts of interest. According to the SEC, "[c]lear disclosure regarding these potential conflicts of interest and the nature of the sponsors', directors' [and] officers'. . . economic interests in the SPAC is particularly important because these parties are generally responsible for negotiating the SPAC's business combination transaction" and "for deciding how to value the private operating company and how much the SPAC will pay for it."[45] The SEC's guidance specifically called for disclosure of the material factors the SPAC board considered in approving a de-SPAC transaction and how it evaluated the interests of the SPAC sponsor, directors, and officers in that context. It also asked for detailed information on how the SPAC sponsors, directors, and officers will benefit from the transaction, as well as their continuing relationship with the combined company.

Anti-Fraud Enforcement

SEC v. Hurgin. In June 2019, before the SPAC boom took off, the SEC brought one of its seminal cases in the SPAC space in connection with the December 2015 de-SPAC merger of Cambridge Acquisitions Corporation.[46] The case, which alleged fraud and violations of the proxy solicitation rules, served as an early blueprint for some of the "stock drop" federal securities class action litigation involving SPACs that has since become common (discussed in Section IV of this article).

The defendant in the case was Ability Computer & Software Industries Ltd., an Israeli private company that sold cell phone and satellite interception products, which merged with Cambridge. Also named as defendants in the SEC's complaint were the publicly listed company that resulted from the merger, and Anatoly Hurgin and Alexander Aurovsky, Ability's two co-founders and co-owners, who became co-controlling shareholders, directors, and senior executives of the surviving company.

In its complaint, the SEC alleged several material misstatements and omissions regarding the company and its business in the proxy materials relating to the merger, which came to light not long after the transaction closed. In particular, the SEC asserted that Ability misled shareholders into believing that it owned a new "game-changing" cellular interception product for mobile devices, which would generate significant and recurring revenues. However, according to the SEC's complaint, Ability was merely a reseller of the product under an undisclosed reseller agreement. Further, while Ability claimed to have an impressive backlog of existing customer orders and a pipeline of probable future orders

[44] SECURITIES & EXCHANGE COMM'N, *Corporate Finance Disclosure Guidance: Topic No. 11* (Dec. 22, 2020), https://www.sec.gov/corpfin/disclosure-special-purpose-acquisition-companies.

[45] *Id*.

[46] *Sec. & Exch. Comm'n v. Hurgin*, 484 F. Supp. 3d 98 (S.D.N.Y. 2020).

to support its projected revenue growth, the SEC alleged that a majority of Ability's backlog was not supported by actual, signed purchase orders. Finally, the SEC claimed that a significant portion of Ability's backlog was attributable to Ability's largest customer – a Latin American police agency – and was based only on oral agreements with management who had been terminated as a result of a notorious international narcotics trafficker's prison escape.

In connection with the merger, Cambridge retained a financial advisor to issue a fairness opinion, as well as an additional advisor to prepare a "quality of earnings" report. Unlike the financial advisor, who relied on management forecasts without independent verification, the second advisor conducted its own due diligence review of Ability's revenues and found that only about one-third of Ability's backlog was supported by actual purchase orders. While the proxy statement attached the fairness opinion as an exhibit, it did not include the "quality of earnings" report commissioned by the SPAC and it did not disclose the undocumented nature of Ability's purported orders.

The SEC's complaint also alleged that, contrary to statements made in the merger proxy statement that the SPAC had conducted "thorough" due diligence on Ability, it had not done independent diligence on the ownership of its purportedly "game-changing" product or its backlog and pipeline revenue figures.[47]

The SEC eventually entered into consent decrees with Ability and the post-merger company.[48] The case against the two co-founders, Hurgin (Ability's CEO, who would become CEO and chairman of the resulting company) and Aurovsky (Ability's Chief Technology Officer who would continue in that role post-closing and also serve on the board of the resulting company), is still pending before the U.S. District Court for the Southern District of New York following an unsuccessful motion to dismiss by the defendants, which was denied in September of 2020.[49]

In its decision denying Hurgin's motion to dismiss, the court rejected his arguments that he could not be held liable for alleged misleading statements because he "did not make or supply" those statements. The court noted that for purposes of Section 10(b) of the Exchange Act and its implementing regulation Rule 10b-5 – which contain the general anti-fraud provisions of the Exchange Act – "the maker of the statement is the person or entity with ultimate authority over the content of the statement and whether and how to communicate it."[50]

Similarly, in rejecting Aurovsky's motion to dismiss, the court observed that for purposes of Section 14(a) of the Exchange Act and its implementing regulation Rule 14d-9 – which establish liability for material misstatements and omissions in proxy materials – when individuals listed in a proxy "hav[e] put their reputations in issue, [they] cannot divorce themselves from improper actions taken in the proxy battle by the participants acting under the banner of their names."[51] The court found that the SEC had adequately alleged that Aurovsky put his reputation in issue in the proxy materials, noting that he had consented to the use of his name to solicit proxies; that his "qualifications and continued participation in the newly formed public company were essential to soliciting Cambridge shareholders to vote in favor of the merger"; and that the proxy materials contained information about his background and assured shareholders that he was a "highly talented. . . industry professional" who would bring his skills to the company after the merger.[52]

Charges Against Stable Road Acquisition Corp. On July 13, 2021, the SEC announced charges against the SPAC Stable Road Acquisition Corp., its sponsor, its CEO, the SPAC's proposed merger target Momentus, Inc., an early-stage space transportation company, and Momentus' founder and former CEO Mikhail Kokorich. The charges were for misleading claims about Momentus' technology and about national security risks associated with Kokorich. According to an SEC official, the action was the first of its kind, targeting all sides of the SPAC transaction and filed after an investigation that took under a year.[53]

[47] Complaint at ¶ 179, *Sec. & Exch. Comm'n v. Hurgin*, No. 1:19-cv-05705 (S.D.N.Y. June 18, 2019).

[48] In the consent decrees, neither Ability nor the post-merger company admitted or denied any of the allegations, but they were permanently restrained and enjoined from committing further violations of the federal securities laws, and they agreed to civil penalties and the disgorgement of gains.

[49] *Hurgin*, No. 1:19-cv-05705.

[50] *Hurgin*, 484 F. Supp. at 112 (quoting *Janus Cap. Grp., Inc., v. First Derivative Traders*, 564 U.S. 135, 142 (2011)).

[51] *Id.* at 117 (quoting *In re Bank of Am. Corp. Sec., Derivative, & Emp. Ret. Income Sec. Act (ERISA) Litig*., 757 F. Supp. 2d 260, 294 (S.D.N.Y. 2010)).

[52] *Id*. at 26.

[53] Chris Prentice, *U.S. SEC Charges Blank Check Firm Stable Road, Space Startup Momentus With Misleading Claims*, REUTERS (July 13, 2021), https://www.reuters.com/business/us-

All parties other than Kokorich settled with the SEC, with terms including total penalties of more than $8 million, tailored investor protection undertakings, and the SPAC sponsor's forfeiture of shares in Momentus.[54] The SEC has filed litigation in the U.S. District Court for the District of Columbia against Kokorich, in which a motion to dismiss is currently pending.[55]

According to the SEC's settled order, Kokorich and Momentus misrepresented to Stable Road's investors that Momentus had "successfully tested" its propulsion technology in space, when in fact the technology had failed to satisfy Momentus' own public and internal pre-launch criteria for success.[56] In addition, they made misleading disclosures regarding the extent to which national security concerns involving Kokorich undermined Momentus' ability to secure required governmental licenses essential to its operations. Stable Road repeated those misrepresentations and omissions in the registration/proxy statement it filed in connection with the proposed business combination with Momentus.

Importantly, the SEC's order found that Stable Road had failed to conduct adequate due diligence by not sufficiently reviewing the results of Momentus' in-space tests or following up on red flags concerning the national security and foreign ownership risks associated with Kokorich. According to SEC Chair Gary Gensler, "[t]he fact that Momentus lied to Stable Road does not absolve Stable Road of its failure to undertake adequate due diligence to protect shareholders."[57] Gensler further stated that the case "illustrates risks inherent to SPAC transactions, as those who stand to earn significant profits from a SPAC merger may conduct inadequate due diligence and mislead investors."[58] The SEC's actions against all parties involved in the Stable Road de-SPAC transaction, noted Gensler, aimed to help "better align the incentives of parties to a SPAC transaction with those of investors relying on truthful information to make investment decisions."[59]

HOW PRIVATE PLAINTIFFS ARE SEEKING REDRESS FOR LOSSES SUFFERED IN SPAC INVESTMENTS

Federal securities litigation involving SPACs, in particular class action filings, increased dramatically during 2021. Between January 1, 2019 and December 31, 2021, there were 45 federal securities class action filings involving SPACs, with 32 of these filed in 2021 alone.[60] As SPAC federal securities lawsuits more than doubled, the time period between the closing of de-SPAC transactions and the filing of litigation shrank in half, narrowing to a median of approximately four-and-a-half months in 2021.[61] This may be attributable, at least in part, to the growing number of de-SPACed companies that are underperforming the broader stock market. With respect to de-SPAC transactions completed in 2021, as of December 31, approximately 80% of de-SPACed companies were trading below their deal price.[62]

Potential Causes of Action

The federal securities laws provide several avenues pursuant to which private parties can seek redress for material misstatements and omissions in connection with the formation and listing of the SPAC, its de-SPAC transaction, and the resulting company's subsequent life as a publicly traded entity with ongoing reporting obligations.

Section 10(b) claims: Section 10(b) of the Exchange Act and Rule 10b-5 thereunder contain the general anti-fraud provisions of the Exchange Act. To state a Section 10(b) claim, a plaintiff must typically allege that a

footnote continued from previous page…

sec-charges-blank-check-firm-stable-road-space-startup-momentus-over-2021-07-13/.

[54] Press Release, SEC, *SEC Charges SPAC, Sponsor, Merger Target, and CEOs for Misleading Disclosures Ahead of Proposed Business Combination* (Jul. 13, 2021), https://www.sec.gov/news/press-release/2021-124.

[55] *Sec. & Exch. Comm'n v. Kokorich*, No. 1:21-cv-01869 (D.D.C. July 13, 2021). Kokorich has filed a motion to dismiss, the SEC has filed an opposition brief, and Kokorich, in turn, has filed a reply to the opposition as of November 11, 2021.

[56] Sec. Act Rel. No. 10955 (2021); Ex. Act Rel. No. 92392 ¶ 4 (2021).

[57] SEC, *supra* note 54.

[58] *Id*.

[59] *Id*.

[60] Stanford Securities Class Action Clearinghouse, *available at* https://securities.stanford.edu/index.html.

[61] CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS 2021 MIDYEAR ASSESSMENT, *available at* https://securities.stanford.edu/research-reports/1996-2021/Securities-Class-Action-Filings-2021-Midyear-Assessment.pdf (reflecting data for H1 2021).

[62] Includes deals completed between January 1, 2021 and December 31, 2021. Post-merger stock price corresponds to the surviving company's stock price as of the de-SPAC transaction completion date. FACTSET, *available at* www.factset.com.

defendant made a material misstatement or omission in connection with the purchase or sale of securities and that the defendant acted with *scienter*. Scienter, in the context of Section 10(b) claims, means either intent to deceive or reckless disregard for the truth. Section 10(b) may be based on *any* of the company's public statements, including statements in earnings calls and press releases, among other sources.

Section 14(a) claims: Section 14(a) of the Exchange Act and Rule 14a-9 thereunder establish liability for material misstatements or omissions in *proxy materials* in connection with a merger. In contrast to Section 10(b) claims, which require a showing of scienter, Section 14(a) claims generally require only a showing of *negligence*. In the context of a de-SPAC transaction, Section 14(a) claims attach to statements made in the SPAC's proxy statement and related proxy solicitation materials utilized in connection with soliciting the SPAC's shareholders' approval of the transaction.

Section 11 claims: Section 11 of the Securities Act establishes liability for material misstatements or omissions in *registration statements*. Section 11 imposes strict liability on the company, as well as its directors and officers, that issues securities pursuant to a misleading registration statement – a plaintiff need not establish either scienter or negligence.[63]

In the case of a SPAC, the registration statement for its IPO is usually a relatively bare-bones document, given that the SPAC is a newly formed blank check company with no operations and does not contain much business disclosure that can give rise to Section 11 claims.[64] Therefore, Section 11 claims are usually pursued only if there is an issuance of securities, and a related registration statement filing, in connection with the de-SPAC transaction (thus containing essentially the same information as the merger proxy). Not all de-SPAC transactions involve the filing of a registration statement.

Section 20(a) claims: Section 20(a) of the Exchange Act extends liability to individuals who exert control, whether directly or indirectly, over another person or entity (a "primary violator") that violates the federal securities laws. The statute makes a controlling person jointly and severally liable with and to the same extent as the controlled person.[65] As such, Section 20(a) claims are common against SPAC directors and officers, but they do not constitute a free-standing cause of action. A plaintiff must also plead a valid cause of action under another provision of the securities laws, such as Section 10(b) or Section 14(a), against a primary violator. Section 20(a) may then be available to extend liability to individuals who might not otherwise be proper defendants.

Litigation Trends

The early stages of SPAC litigation were heavily driven by the same sorts of strike suits that attend most public company mergers. SPACs found themselves the target of Section 14(a) claims challenging the adequacy of proxy statements issued in connection with de-SPAC transactions.[66] These claims were often resolved through the issuance of mooting disclosures, rather than litigation on the merits, and therefore resulted in very little published case law.

Over time, the law firms that frequently file merger strike suits began gravitating towards individual claims and away from class action suits. Meanwhile, the first wave of de-SPACs closed and began reporting financial results. In some instances, new disclosures led to significant stock drops, which have triggered a surge in Section 10(b) claims. Nowadays, Section 10(b) claims are the most common avenue for SPAC-related securities class action litigation and nearly all federal

[63] Section 15 of the Securities Act extends Section 11 liability to "control persons." 15 U.S.C. § 77o.

[64] The SPAC financials included in its registration statement may be subject to additional litigation. On April 12, 2021, the SEC staff released a statement on accounting and reporting considerations regarding the classification of warrants issued by SPACs as liabilities on their balance sheet rather than as equity. SEC, *Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies ("SPACs")*, (Apr. 12, 2021), https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs. Following that announcement, shareholder class action lawsuits have been filed challenging SPAC disclosures in connection with their accounting for warrants. *See, e.g., Lavin v. Virgin Galactic Holdings*, 1:21-cv-03070 (E.D.N.Y. May 28, 2021). These lawsuits are beyond the scope of this article.

[65] If the controller acted in good faith, however, and did not directly or indirectly induce the act or acts constituting the violation, the controller may raise such facts as a defense. 15 U.S.C. § 77t(a).

[66] A number of Section 14(a) suits have been voluntarily dismissed. *See, e.g., Kaul v. Clover Health Investments, Corp.*, 3:21-CV-00101 (M.D. Tenn. Feb. 5, 2021); *Hutchings v. Churchill Cap. Corp. III*, 20-CV-06318 (S.D.N.Y. Aug. 11, 2020).

SPAC-related securities class actions commenced in 2021 contained Section 10(b) claims.[67]

While some SPAC filings have included allegations under Section 11, those claims have been less common than suits under Sections 10 and 14.[68] There are a few possible explanations as to why Section 11 claims are relatively less common. First, Section 11 claims can typically be maintained only where the allegedly false statement occurred in the registration statement itself, which is normally carefully drafted by experienced deal counsel. By contrast, Section 10(b) claims look to *all* of the company's public statements, including statements in earnings calls and press releases, among other sources, as the basis for suit. Second, not all de-SPAC transactions include a registration statement in connection with the merger. Finally, Section 11 claims are subject to a damages cap and the shares held by the plaintiff shareholders must be "traceable" directly to the offering in respect of which the registration statement was filed. Damages are measured as the difference between the purchase price and either the sale price or the price of the security at the time of suit. Depending on the circumstances, this may result in a lower recovery than might otherwise be available under other causes of action. By contrast, in a typical "plaintiffs-style" damages analysis under Section 10(b), the plaintiff will seek recovery based on the amount by which the public stock price was "inflated" due to the allegedly false or misleading statements. Plaintiffs will often attempt to measure this inflation based on the amount by which the stock price dropped once the "corrective" disclosure was made to the market. Depending on the size of the stock drop and the number of shares traded during the class period, such damages figures can be quite large.

One of the early SPAC-related securities class action cases was *In re Akazoo S.A. Securities Litigation*.[69] The case – which asserted the full array of Section 10(b), Section 14(a), and Section 11 claims, as well as Section 20(a) claims – was brought against Akazoo, an on-demand music, audio streaming, media, and AI technology company that went public via a SPAC merger in September 2019, and several of its pre- and post-merger directors and officers.[70] The plaintiffs alleged that Modern Media Acquisition Corp. ("MMAC"), the SPAC which combined with Akazoo, was under immense time pressure to consummate a business combination transaction, having extended the deadline to do so twice. In order to obtain shareholder approval for the Akazoo merger, MMAC and its board allegedly touted Akazoo's "profitable and scaleable" business model, its strong and experienced management team, and the extensive, industry-specific background of Akazoo's founder.[71] MMAC's directors and officers emphasized their professional and educational backgrounds, and described in detail the rigorous due diligence they had conducted on Akazoo's business.

After the merger, the company continued to present an optimistic picture of its business until a short seller report in April 2020 asserted that Akazoo had overstated its users, subscribers, revenues, profits, and geographic presence. The publication of the report caused Akazoo's stock price to drop significantly, and Akazoo appointed a special committee to investigate the issues raised by the report. Following the conclusion of the investigation, the company terminated Akazoo's founder and CEO for cause, determined that its previously filed financial statements were false and misleading, and announced that it would seek to unwind the business combination as "members of Akazoo's management team and associates defrauded investors. . . as part of a multi-year fraud."[72] In September 2021, the case partially settled for $35 million.[73]

A similar fact pattern emerged in the *Hyzon Motors* litigation,[74] a more recent SPAC-related federal securities class action. The plaintiffs alleged that Hyzon Motors, a company focused on expanding fuel cell electric mobility in the commercial vehicle market, as well as the company's pre- and post-merger officers, misrepresented the nature of its customer contracts and made false or misleading statements about its deals and partnerships with customers.[75] The plaintiffs brought claims against the defendants under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. In particular, it appeared that of Hyzon's two largest customers, one had not been a customer at all and the other was a fake Chinese shell-entity formed three days before the deal

[67] Stanford, *supra* note 60.

[68] CORNERSTONE RESEARCH, *supra* note 61.

[69] No. 20-cv-1900 (E.D.N.Y. Sept. 8, 2020).

[70] There were also separate filings bringing claims under the Securities Act in Georgia state court. *Pareja v. Apostolos N. Zervos*, Case No. 2020CV337418 (Superior Court for the State of Georgia, Fulton County).

[71] Complaint at ¶ 14, *In re Akazoo* (No. 20-cv-1900).

[72] *Id*. at ¶ 26.

[73] Final Order and Partial Judgment, *In re Akazoo* (No. 20-cv-1900).

[74] *Jan Kauffmann v. Hyzon Motors Inc.*, No. 6:21-cv-06612 (W.D.N.Y. Sept. 30, 2021).

[75] Complaint at ¶ 2, *id*.

announcement. In addition, over the course of several months in 2021, Hyzon had removed the names of numerous blue chip customers from its investor decks without similarly modifying its financial projections. As of December 2021, the court overseeing the litigation has consolidated similar cases against Hyzon and approved the selection of a lead plaintiff and counsel.[76]

Other Litigation

Federal securities claims challenging SPAC transactions frequently allege overly optimistic revenue guidance and other financial projections for the target (as well as failure to disclose important underlying assumptions), false representations of historical financial data, and false claims about the target's business, internal controls, products, customers, and other business partners.[77] Plaintiffs also commonly allege that the sponsor conducted inadequate due diligence on the target company and did not appropriately disclose red flags uncovered during diligence. Because SPAC targets frequently include start-ups, cash flow negative companies, and other pre-IPO entities, they may lack some of the features that characterize more mature public companies – such as a strong internal financial planning and analysis group, or robust disclosure controls. Thus, even in the absence of egregious misconduct, SPACs are an attractive target for private securities plaintiffs.

Many SPAC-related class action suits have been triggered by the publication of short-seller or analyst reports after the closing of the de-SPAC transaction, which publicize previously undisclosed alleged problems with the company's business and financial health.[78] Another frequent trigger point of litigation is when de-SPACed companies retract previous financial guidance or revisit their financial statements, especially in close proximity to the closing of the de-SPAC transaction.[79] In those instances, plaintiffs usually claim that misleading statements by the SPAC artificially inflated the price of its securities until the "truth" came to light – at which point the SPAC's stock price plummeted and investors suffered massive losses.

Key Takeaways and Observations

- Defendants in federal securities class actions suits challenging SPAC transactions can often include a combination of the SPAC itself, the SPAC sponsor, the directors and officers of the SPAC who take leadership roles post-merger, and the directors and officers of the target company.

- Even in extreme circumstances where SPAC directors and officers may have been misled by the target company and its founders or executives, this does not entirely protect the SPAC directors and officers from potential liability.

- Directors and officers may be found liable for misleading statements or omissions even if they did not personally make them or personally prepare the materials that contain them. Liability may extend to individuals who are deemed to have ultimate authority over the content of a statement or who are found to have put their reputation at issue in the documents containing the statement.

- Statements in a wide array of public disclosures, including investor road shows, earnings call transcripts, and other similar public statements, can serve as the basis of litigation and, potentially, liability.

- Companies undergoing a merger with a SPAC should work to develop robust disclosure controls and a disciplined financial planning and analysis function to seek to minimize disclosure deficiencies that can give rise to litigation and liability.

- Disclosure relating to financial forecasts, which are permitted in SPAC merger proxies, but generally not included in IPO registration statements, is often central to SPAC-related federal securities litigation. Thus, SPACs should be cautious about over-

[76] Order Appointing Lead Plaintiff and Approving Selection of Lead Counsel, *Jan Kauffmann v. Hyzon Motors Inc.*, No. 6:21-cv-06612, Dkt. No. 22 (W.D.N.Y. Dec. 14, 2021).

[77] *See, e.g.*, *Jensen v. GigCapital3, Inc*., 1:21-cv-00649 (S.D.N.Y. Jan. 25, 2021); *Pitman v. Immunovant, Inc.*, 1:21-cv-00918 (E.D.N.Y. Feb. 2, 2021); *Suh v. XL Fleet Corp.*, No. 21-cv-02002 (S.D.N.Y. Mar. 8, 2021); *Welch v. Meaux*, No. 2:19-cv-1260 (W.D. La. Dec. 17, 2019).

[78] *See, e.g*., *In re Akazoo*, No. 20-cv-1900; *In re Multiplan S'holders Litig*., No. 2021-0300 (Del. Ch. Jan. 3, 2022); *Borteanu v. Nikola Corp.*, No. 2:20-cv-01797 (D. Ariz., Sept. 15, 2020); *Ferraiori v. Triterras, Inc.*, No. 1:20-cv-10795 (S.D.N.Y. Dec. 21, 2020).

[79] *See, e.g.*, *Shafer v. Lightning eMotors, Inc.*, No. 1:21-cv-02774 (D. Colorado Oct. 15, 2021); *Ragan v. AppHarvest, Inc*., No. 1:21-cv-07985 (S.D.N.Y. Sept. 24, 2021); *McIntosh v. Katapault Holdings, Inc.*, No. 1:21-cv-07251 (S.D.N.Y. Aug. 27, 2021); *Burbige v. ATI Physical Therapy, Inc*., No. 1:21-cv-04349 (N.D. Ill. Aug. 16, 2021); *Lavin v. Virgin Galactic Holdings, Inc.*, 1:21-cv-03070 (E.D.N.Y. May 28, 2021).

optimistic business projections that may not materialize.

- Failure to conduct robust due diligence in connection with a de-SPAC transaction and misleading statements about the rigor or extent of due diligence can form a basis for federal securities class action litigation. This raises important questions as to how much due diligence a SPAC should conduct when evaluating a potential merger partner, considering the associated costs and the competitive dynamics of sales processes.

- Shareholder-plaintiffs may attempt to use alleged conflicts of interest as a basis for pleading scienter.[80] For example, a SPAC sponsor's incentives to complete a merger (or else risk the SPAC's liquidation), as well as the benefits associated with founder shares, have been cited as evidence of scienter.

- The increase in litigation has also had the effect of making D&O insurance more challenging and costly to obtain for SPACs. Therefore, SPAC directors and officers may be not only at greater risk of litigation, but also less well protected by, and/or less favorably positioned to obtain, D&O coverage than directors of other public companies.

THE NEW FRONTIERS OF SPAC TRENDS

The abundant capital that SPACs have attracted in recent years may well taper off going forward. Raising IPO capital may become more difficult due, in part, to general declines in SPAC returns, more competition for suitable merger targets, and additional regulatory scrutiny. The market for PIPE financing of de-SPAC transactions has already weakened due to oversaturation of de-SPAC transactions and lackluster returns. As SPACs continue to fall out of favor, SPAC-related litigation is likely to continue and probably grow.

SEC Chair Gensler revealed in a December 2021 interview that tougher rules for SPACs may be proposed as soon as early 2022.[81] The rules are expected to enhance investor protections by focusing on tougher disclosure requirements, new standards for marketing practices, and liability obligations for SPAC "gatekeepers," which could include financial advisors. Gensler specifically noted that he is interested in ensuring that investment banks provide the proper amount of scrutiny to SPAC deals. Investment banks earn significant fees for their services in a variety of stages of a SPAC's lifecycle (*i.e.*, as IPO underwriters, PIPE transaction placement agents, and financial and capital markets advisers in de-SPAC transactions). This makes them a prime target for future SPAC-related regulatory scrutiny, especially in light of the SEC's forthcoming rules.

Elected officials are taking an increased interest in SPACs as well. In September 2021, a group of Senate Democrats sent open letters to a number of serial investors in SPACs. The letters noted growing concerns with SPAC sponsors' actions, allowing them to profit even when investors suffer, and noted that this may "reveal significant market dysfunction, with insiders taking advantage of legislative and regulatory gaps at the expense of ordinary investors."[82]

An additional area ripe for future litigation involves a stage of the SPAC lifecycle poised to experience an uplift in activity going forward. As de-SPACed companies mature (and, if SPACs continue to trade at prices that do not generate robust yields), sponsors and other anchor investors are likely to seek to realize returns by looking to have the company be acquired by a buyer willing to pay a control premium. However, given the structural features of de-SPACed companies discussed above – including the fact that SPAC sponsors, directors, and officers may have financial incentives that are not shared equally with public shareholders – such deals can be expected to attract the attention of shareholder-plaintiffs.

Finally, while SPACs have been considered primarily a U.S. phenomenon, they are becoming popular in foreign markets as well, both as a result of SPACs incorporating in foreign jurisdictions and due to the fact that SPACs listed in the U.S. are increasingly pursuing foreign companies. Divergent legal and regulatory frameworks across jurisdictions could create novel and complex legal and regulatory challenges for SPACs. ■

---

[80] *See, e.g.*, *In re Stillwater Cap. Partners Inc. Litig*., 858 F. Supp. 2d 277, 288–89 (S.D.N.Y. 2012).

[81] NPR, *SEC Chair Gary Gensler Says Tougher Rules for Hot, Buzzy SPACs Are Coming Soon* (Dec. 7, 2021), https://www.npr.org/2021/12/07/1062004006/sec-chair-gary-gensler-says-tougher-rules-for-hot-buzzy-spacs-are-coming-soon.

[82] Elizabeth Warren, et al., United States Senate, Letters to SPAC Investors (Sept. 22, 2021), *available at* https://www.warren.senate.gov/imo/media/doc/SPAC%20letters%20%5bCombined%5d.pdf.

The Review of Securities & Commodities Regulation