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What SPAC Sponsors, Directors and Officers Can Do to Mitigate Their Litigation Exposure

The explosive growth in Special Purpose Acquisition Companies (“SPACs”)¹ is starting to generate significant amounts of litigation. Scores of civil lawsuits have been filed against SPAC sponsors and/or their directors and officers since the start of 2020, with more than 50 securities or stockholder cases filed in the federal courts alone. We expect this represents the tip of the iceberg. With intense public attention on SPACs, including from incoming SEC Chairman Gary Gensler,² acting Director of the SEC’s Division of Corporate Finance John Coates,³ and the SEC’s Office of Investor Education and Advocacy,⁴ as well as heightened enforcement under the Biden Administration generally, we expect regulatory scrutiny to increase as well.

This Client Alert surveys notable trends in these early days of the SPAC litigation boom. We review recent lawsuits filed against SPACs and related parties, most of which have either (i) challenged the de-SPAC transaction, or (ii) alleged fiduciary duty and securities law claims in connection with stock drops or other adverse events after the de-SPAC transaction. While many of the lawsuits filed to date against SPACs resemble claims brought against any public company, whether it became public through a SPAC or not, the plaintiffs’ bar is seizing on unique structural features of SPACs to plead aggressive new theories, to bolster allegations of scienter or to try to evade defenses such as the business judgment rule. Although each case will depend on its particular facts and circumstances, we suggest below what SPAC sponsors, directors and officers can do preemptively to minimize litigation exposure.

We are closely monitoring SPAC litigation and regulatory implications and will provide further updates as SPAC-related cases work their way through the courts and as regulatory inquiries emerge.

¹ In the first two months of 2021 alone, more than 225 SPACs have raised public funds at an average IPO size of over \$320 million. See [SPAC IPO Transactions](#), SpacInsider (last updated Mar. 7, 2021).

² See Chris Katje, [New SEC Chair Gary Gensler Could Push For SPAC Regulation](#), Yahoo! Finance (Jan. 20, 2021) (“New SEC Chairman Gary Gensler said his enforcement agenda will include heightened scrutiny of SPACs, fintech and cryptocurrency . . .”).

³ See Twitter.com, [@SEC_NEWS](#) (March 10, 2021) (“The rapid increase in the volume of SPACs represents a significant change and we are taking a hard look at the disclosures and other structural issues surrounding SPACs.”).

⁴ See SEC Office of Investor Education and Advocacy, [Celebrity Involvement with SPACs – Investor Alert](#) (March 10, 2021) (“It is never a good idea to invest in a SPAC just because someone famous sponsors or invests in it or says it is a good investment.”).

I. SPAC Litigation Trends & Notable Cases

SPACs are publicly listed “blank check” companies that go through an IPO process. They do not themselves operate a business. Instead, after they raise funds, they seek to acquire privately held target companies in a “de-SPAC” transaction. The SPAC has a set period of time—typically two years—in which to find and consummate a de-SPAC transaction with a target. If it fails to do so, the SPAC is unwound and the initial investment is returned to shareholders. If the SPAC completes an acquisition, the SPAC’s investors will be offered the opportunity to either redeem their investment or own stock of the target company. Investors enjoy the opportunity to acquire an ownership stake in a company that would not previously be available to the investing public. And the acquired company may avoid the ordinarily complex and lengthy IPO process required by the Securities Act of 1933 (“the Securities Act”).⁵

The advantages and potential drawbacks of SPACs have been the subject of intense debate.⁶ As set out below, the plaintiffs’ bar is homing in on certain structural features unique to SPACs—in particular the typical 20% of shares reserved for the sponsor, and the sponsor’s perceived incentive in some circumstances to complete a transaction rather than return funds to investors—to increase litigation opportunities.

Litigation Challenging the De-SPAC Transaction

A substantial number of lawsuits have been filed by SPAC shareholders seeking to contest the terms of, or disclosures surrounding, de-SPAC merger transactions. While shareholders and plaintiffs’ firms have long contested public company M&A transactions, and are bringing familiar challenges to de-SPAC merger transactions, certain structural features of SPACs have led shareholders to make new twists on those arguments.

For example, shareholders in a SPAC called Acamar Partners Acquisitions Corp. recently sued in Delaware state court to enjoin a de-SPAC transaction with CarLotz, Inc., arguing that the SPAC directors and officers breached their fiduciary duties by rushing to sign a deal just before the time limit to return capital to investors expired.⁷ The plaintiffs argued that this time limit—a distinctive feature of SPACs—improperly incentivized the SPAC sponsor and directors and officers to select a de-SPAC target that was not in the best

⁵ For an overview of the structure and operation of SPACs, see generally Lamey Layne & Brenda Lenahan, [Special Purpose Acquisition Companies: An Introduction](#), Harv. L. Sch. F. on Corp. Governance (July 6, 2018).

⁶ See, e.g., Michael Klausner, Michael Ohlrogge & Emily Ruan, [A Sober Look at SPACs](#), Harv. L. Sch. F. on Corp. Governance (Nov. 19, 2020).

⁷ See *Laidlaw v. Acamar Partners Acquisitions Corp.* No. 2021-0016 (Del. Ch. filed Jan. 7, 2021).

interests of SPAC shareholders.⁸ The plaintiffs also alleged that several of the SPAC's managers lacked independence because they were promised board membership in the post-transaction company.⁹ The lawsuit was voluntarily dismissed after the SPAC issued additional disclosures.

Even more recently, shareholders in the SPAC FinTech Acquisition Corp., IV, sued in Delaware to enjoin the SPAC's merger agreement with Perella Weinberg.¹⁰ The plaintiff shareholders argued that FinTech's directors breached their fiduciary duties by signing a merger agreement that would give the current owners of Perella Weinberg voting control of the post-merger company, and also by waiving the corporate opportunity doctrine, which would allow the owners of Perella Weinberg to compete with the post-merger company.¹¹ According to the plaintiffs, the sponsors—despite maintaining a significant stake in target after acquisition—allowed these deal terms because they were more focused on their next SPAC than the future of the target company.¹² A motion to expedite those proceedings is currently pending.

Shareholders have also filed dozens of nuisance claims alleging misleading disclosures in proxy statements soliciting shareholder approval of de-SPAC merger transactions. These kinds of proxy statement challenges, which are common in the public M&A setting, are frequently brought under Section 14 of the Securities Exchange Act of 1934 (the “Exchange Act”) and SEC Rule 14a-9. In these actions, plaintiffs' lawyers threaten to enjoin a shareholder vote until the issuer releases supplemental information. These actions frequently settle or are voluntarily dismissed when the company issues additional disclosures, and plaintiffs' lawyers then seek a “mootness fee.”¹³ Commentators and courts have criticized this minuet on the ground that the supplemental disclosures confer no real benefits on shareholders.¹⁴ These criticisms have even more force in the context of de-SPAC transactions, where disclosure requirements are often different and SPAC shareholders may exercise redemption options if they are not satisfied with the target.¹⁵

⁸ See Compl. ¶¶ 35, 36, 39–40, *id.* Allegations concerning the time limit imposed on SPACs have appeared in several cases. See, e.g., Am. Compl. ¶ 89, *Welch v. Meaux*, No. 2:19-cv-01260 (W.D. La. Oct. 16, 2020) (alleging the rush to complete the de-SPAC transaction led to securities fraud by SPAC sponsors).

⁹ See Compl. ¶¶ 36–38, *Acamar Partners*, *supra*; see also Am. Compl. ¶¶ 37, 43, *Nguyen v. Colonnade Acquisition Corp.*, No. 650883/2021 (N.Y. Sup. Ct. Feb. 25, 2021) (alleging insiders are primary beneficiaries of the transaction, not stockholders).

¹⁰ See *Pels v. FinTech Acquisition Corp., IV*, No. 2021-0184 (Del. Ch. filed Mar. 2, 2021).

¹¹ Compl. ¶¶ 3, 6, *id.*

¹² See *id.* ¶¶ 2, 41

¹³ See generally Matthew D. Cain, et al., *The Shifting Tides of Merger Litigation*, 71 Vand. L. Rev. 603 (2018).

¹⁴ See, e.g., *In re Walgreen Co. Stockholder Litig.*, 832 F.3d 718, 721, 725–26 (7th Cir. 2016) (Posner, J.)

¹⁵ For example, in many of the merger objection suits filed to date, plaintiffs seek information regarding the financial advisors to both the SPAC and the target, demanding information about those advisers' relationships with the SPAC sponsors and the target as well as the financial advisors' compensation. See, e.g., Compl. ¶ 67, *Watkins v. Vesper Healthcare Acquisition Corp.* No. 1:21-cv-00713 (S.D.N.Y. Jan. 26, 2021). In doing so, plaintiffs often claim disclosure is required by Item 1015 of Regulation

Nevertheless, we expect plaintiffs' securities law firms to continue to file these claims in connection with most, if not all, de-SPAC merger transactions.

Litigation After the De-SPAC Transaction

The second major category of SPAC litigation, filed after the de-SPAC transaction closes, consists of fiduciary duty and securities law claims against SPAC sponsors, directors or others, alleging the defendants misrepresented material facts about the target company, or breached their fiduciary duties in a way that caused the value of the post-merger company to decline. While these kinds of claims are familiar to public companies, for SPACs, plaintiffs are playing up the fact that a company went public through a SPAC to enhance their allegations regarding supposed conflicts of interest, misaligned incentives or ineffective due diligence.

The recent complaint in *Pitman v. Immunovant, Inc.* is illustrative. After Health Sciences Acquisition Corp. ("HSAC"), a SPAC, completed its acquisition of Immunovant, Inc., a pharmaceutical company, the post-SPAC company issued a press release announcing that it had paused the clinical trial of a pharmaceutical product; its stock dropped more than 40% in the following days.¹⁶ Shareholders filed a putative class action alleging that HSAC had made materially false and misleading statements in its proxy statement soliciting votes for the merger by failing to disclose that it "ha[d] performed inadequate due diligence . . . prior to the [SPAC] [m]erger, and/or ignored or failed to disclose safety issues with [the product]."¹⁷

Plaintiffs' law firms are closely monitoring the performance of companies after their de-SPAC transactions. As with all issuers, material declines in share price, or other significant adverse events, may give rise to claims under various legal theories.

Recent cases against SPACs have asserted state law fiduciary duty claims, as well as claims alleging violations of Sections 10(b)¹⁸ and 14(a) of the Exchange Act. Section 14(a) claims—which several courts have held are subject to only a negligence standard—have been asserted against not only SPAC sponsors and managers, but also against officers of *target companies* who put their "reputation in issue" in the proxy

M-A, which governs disclosures required for organizations or persons that issue fairness opinions. Given the redemption feature in SPACs, however, fairness opinions have been less common in de-SPAC transactions, which generally do not trigger the disclosure requirements of Item 1015.

¹⁶ Compl. ¶¶ 32–33, *Pitman v. Immunovant, Inc.*, No. 1:21-cv-00918 (E.D.N.Y. filed Feb. 10, 2021).

¹⁷ *Id.* ¶ 31.

¹⁸ These claims are more challenging to plead successfully than Section 14(a) claims, particularly because they require plaintiffs to plead a strong inference that defendants acted with fraudulent intent. Notably, at least one court has previously ruled that the time-limited structure of SPACs, by itself, is insufficient to plead a strong inference that a defendant acted with fraudulent intent. *In re Stillwater Capital Partners Inc. Litig.*, 858 F. Supp. 2d 277, 288 (S.D.N.Y. 2012).

materials.¹⁹ If new shares are issued in connection with a de-SPAC transaction, plaintiffs may also assert claims against the SPAC or its directors under Section 11 of the Securities Act, alleging misstatements or omissions in the accompanying registration statement.²⁰

In just the past six months, plaintiff shareholders have filed lawsuits following de-SPAC transactions, alleging that SPACs and their managers:

- Misrepresented the stability of the target company's customer base by failing to disclose that the target's biggest client was on the verge of leaving and developing a competing product²¹;
- Misrepresented growth possibilities by failing to disclose that the target, a commodities trading platform, relied heavily on a single referrer of clients, which was on the verge of bankruptcy²²;
- Inadequately described the de-SPAC target search process by failing to disclose the extent of negotiations with 13 potential targets in similar industries²³; and
- Misrepresented the target company's compliance efforts by failing to disclose a fleet of luxury cars used by target executives and a series of related-party transactions involving family members of the target executives.²⁴

In each of these cases, plaintiffs sought to recover investment losses by alleging that the SPAC misrepresented the quality of its diligence efforts, which failed to discover defects in the target company's products, management teams or controls.²⁵ Because de-SPAC transactions typically require shareholder approval, plaintiffs frequently pair Section 10(b) securities fraud claims with Section 14(a) claims for misleading proxy statements.

Plaintiffs are pursuing SPACs not just with alleged fraud or disclosure claims, but using multiple other legal theories under the federal securities laws as well. At least one recent suit has accused SPAC sponsors of

¹⁹ See, e.g., *SEC v. Hurgin*, 484 F. Supp. 3d 98 (S.D.N.Y. 2020).

²⁰ Section 11 claims are subject to a strict liability standard, but are available against fewer potential defendants than Section 10(b) and 14(a) claims.

²¹ See, e.g., *Srock v. Multiplan Corp.*, No. 1:21-cv-01640 (S.D.N.Y. filed Feb. 24, 2021) (notice of voluntary dismissal filed Mar. 15, 2021).

²² See, e.g., *Ferraiori v. Triterras, Inc.*, No. 7:20-cv-10795 (S.D.N.Y. filed Dec. 21, 2020).

²³ See, e.g., *Martinez v. Tortoise Acquisition Corp.*, No. 1:20-cv-07595 (S.D.N.Y. filed Sept. 16, 2020).

²⁴ See, e.g., *Mendoza v. HF Food Group*, No. 2:20-cv-02929 (C.D. Cal. filed Mar. 15, 2020).

²⁵ See also Heather Perlberg, ["Hey, Hey, Money Maker": Inside the \\$156 Billion SPAC Bubble](#), Bloomberg News (Mar. 8, 2021) (reporting view of private equity executive that diligence is sometimes abbreviated in the SPAC context).

obtaining short-swing trading profits in violation of Section 16 of the Exchange Act. In *Calenture, LLC v. Eos Energy Enterprises, Inc.*, shareholders of a post-merger SPAC alleged that the SPAC sponsors had realized over \$430,000 in short-swing profits from a series of trades that straddled the de-SPAC transaction.²⁶ After the sponsors disgorged the profits—purportedly in response to plaintiffs’ demand letters—plaintiffs filed suit to recover 25% of the disgorged funds as “attorneys’ fees.”

II. What SPAC Sponsors, Directors and Officers Can Do to Mitigate Their Exposure

SPAC sponsors, directors and officers may consider proactive steps to mitigate litigation risks, including:

- From the Outset, Include Appropriate Exculpatory Provisions in Charters and Bylaws. At formation, SPAC sponsors should consider including exculpatory clauses in their charters; in many jurisdictions, such provisions can shield directors from liability for fiduciary duty claims other than those alleging disloyalty and bad faith. SPACs should also include appropriate forum selection provisions.²⁷
- Closely Review SEC Guidance on SPAC IPOs. In addition to its guidance on de-SPAC merger transactions, discussed below, the SEC’s Division of Corporate Finance issued guidance regarding 14 SPAC IPO disclosure considerations. The guidance focuses on disclosures regarding the economic interests of SPAC sponsors, directors and officers, and ways in which their interests may differ from other shareholders.²⁸ For example, the guidance recommends disclosing whether (i) outside business interests of SPAC sponsors, directors and officers may influence their efforts to find an acquisition target, and (ii) the economic and reputational harm management might suffer if the SPAC does not complete an acquisition within its prescribed time limit. The SEC also recommends disclosures regarding how shares held by management may differ from shares offered in the IPO, and the material terms of any convertible debt held by management.²⁹ SPAC sponsors, directors and officers should carefully review the latest guidance from the SEC and ensure robust disclosures in the offering documents.
- Engage in Robust and Well-Documented Due Diligence on De-SPAC Targets. Shareholder complaints in SPAC litigation frequently allege that SPAC sponsors, directors and officers selected

²⁶ See Compl. ¶ 22, *Calenture, LLC v. Eos Energy Enterprises, Inc.*, No. 1:21-cv-01416 (S.D.N.Y. Feb. 17, 2021).

²⁷ See [A Second California State Court Enforces Federal Forum Provision and Dismisses Securities Act Claims Against All Defendants—including Underwriters](#), Paul, Weiss, Rifkind, Wharton & Garrison LLP (Nov. 23, 2020); [Adopting & Enforcing Effective Forum Selection Provisions in Corporate Charters & Bylaws](#), Paul, Weiss, Rifkind, Wharton & Garrison LLP (Jan. 8, 2015).

²⁸ See, e.g., [Special Purpose Acquisition Companies](#), S.E.C. Corp. Fin. Disclosure Guidance: Topic No. 11 (Dec. 22, 2020).

²⁹ See *id.*

a poor de-SPAC target and/or failed to conduct adequate due diligence and uncover supposed red flags in a de-SPAC target. While experiences can vary from one situation to another, these types of allegations could be addressed by ensuring that diligence findings are appropriately documented and communicated to the board of directors. Disclosure of diligence efforts should generally conform to standard M&A disclosure practices.

- **Consider Conflicts of Interests in any De-SPAC Transaction.** Special care should be taken regarding any potential conflicts of interest or related-party transactions. Information about potential conflicts should be disclosed in de-SPAC filings, including proxy statements.
- **Closely Review SEC Guidance on Proxy Statements for De-SPAC Transactions.** The SEC's Division of Corporate Finance issued guidance on nine separate disclosure considerations for de-SPAC transactions, including disclosures regarding how SPAC management evaluated the target company and other potential targets, the material factors considered in approving the transaction, conflicts of interest and the terms of any additional financing necessary to complete the de-SPAC transaction.³⁰ More guidance is likely forthcoming, including on projections specifically, and should be reviewed closely.
- **Employ Appropriate Cautionary Language in Disclosures.** SPAC management should also make sure that any financial projections or forward-looking statements included in SEC filings are accompanied by meaningful cautionary language and qualify for the safe harbor protections afforded by the Private Securities Litigation Reform Act.

Given the intense public attention on SPACs, it is no surprise that plaintiffs' law firms have been scouring the more than 400 SPACs launched in the last year for litigation opportunities. One law firm has published an article setting out a theory for how the business judgment rule may potentially not apply to actions taken by SPAC directors, or why SPAC targets may potentially be liable for the disclosures made by the SPAC itself.³¹ While many of the lawsuits against SPAC-related entities to date have been traditional merger objection claims, or securities claims that could be filed against any public company, not just a SPAC, the plaintiffs' bar is already calling out the unique structural features of SPACs in order to enhance their allegations. Plaintiffs are making particular use of allegations that SPACs have failed to conduct adequate due diligence on the de-SPAC target, and that SPACs have rushed to complete a transaction before the redemption window. We expect the plaintiffs' bar to expand these areas of focus as more lawsuits are filed. SPAC sponsors, directors and officers can mitigate litigation exposure at each stage of the SPAC lifecycle, through considered disclosures, effective and well-documented diligence and other risk-reducing strategies.

³⁰ See *id.*

³¹ See, e.g., [Litigation Risk in the SPAC World](#), Quinn Emanuel Urquhart & Sullivan, LLP (last accessed Mar. 7, 2021).

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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