THE AMERICAN LAWYER
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June 1, 2022

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Settling SPAC Litigation: International SPAC Boom, SPAC Litigation and Best Practices for Resolving These Matters

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Over the last two years, special-purpose acquisition companies (SPACs) have grown exponentially, and this growth has triggered a wave of litigation. The unique nature of SPACs and the underlying drivers, as well as scrutiny related to these cases, demand a thoughtful approach when attempting to settle SPAC-related matters.

What is a SPAC?

Created by a sponsor for the sole purpose of raising capital through an initial public offering (IPO), a SPAC begins essentially as a shell, or "blank check," company, with funds but no actual operations. Within 18 to 24 months of formation, a SPAC acquires and merges with a target, typically a private company. This is known as a de-SPAC transaction. The target company is wedded to the capital of the SPAC, resulting in a single public entity.

Unlike a traditional IPO, a SPAC raises capital before identifying acquisitions. Initial investment windows open before the SPAC secures a target. Projected earnings are tied to the unknown acquisition, so the prospectus cannot offer much insightful information. Actual earnings may vary once the merger takes place. Steep post-merger losses invite scrutiny and litigation.

SPAC activity in the U.S., Europe, and Asia

Due to the market volatility partly caused by the pandemic, IPOs have become less popular. SPACs, which have been around since 1993, have quickly gained traction as a quicker and more certain path to a public offering. The general public's awareness of SPACs has been boosted by the endorsements of celebrities such as Jay-Z, Serena Williams and Martha Stewart.[1] Since 2020, U.S. SPAC activity has grown 300%, during which time SPACs have raised close to $250 billion. Similar trends are present in Europe,[2] and SPACs have made their debut in Asia.[3] Singapore and Hong Kong markets' interests in SPACs is growing. Europe's exchanges listed four SPACs in 2020 and 39 in 2021, a nine-fold increase.[4] The Netherlands leads this growth, with 16 of Europe's SPACs, raising $4.36 billion among them. Germany and France follow, with $1.11 billion and $1.06 billion in SPACs, respectively. The U.K. in 2021 has modified its listing rules to attract more SPACs.[5]

Why SPAC transactions are sensitive to litigation

SPACS have attracted attention, and with attention comes scrutiny. SPACs are subject to less regulatory oversight and less rigorous due diligence than traditional IPOs. Moreover, critics argue that SPACs' uncertainty and conflicts of interest expose investors to excess risk. A deal that hurts investors may yet benefit the sponsor. Because of this, they have attracted the attention of lawmakers and regulators, resulting in litigation and a call for measures which encourage sponsors to choose deals that benefit investors over the long run.

The current landscape of SPAC litigation

Investors, regulators and plaintiff's lawyers are currently focused on SPACs. The first wave of cases related to the explosion of SPACs is moving through U.S. courts now. If history is any indicator, a similar trend is in store for Europe and Asia. U.S. and European regulators are scrutinizing SPACs and pushing for regulations that increase transparency and protection for investors, and legislators are sharing their concerns.[6] Enforcement actions by the U.S. Securities and Exchange Commission (SEC) and investigations by the U.S. Department of Justice (DOJ) and the Financial Industry Regulatory Authority (FINRA), along with short sellers' reports, are triggering civil lawsuits.

Most of the SPAC-related claims are brought post-merger after a price-drop incident, but some even before de-SPAC.[7] The most common cases brought are merger objection lawsuits, followed by securities class actions, then breach of fiduciary duties suits and shareholder derivative suits. Thirty-seven securities class actions were filed in 2021, a 520% jump from 2020.[8] They are brought by plaintiffs after post-acquisition stock drops attributed to SPACs overpaying for target companies. A 4% stock drop has become the threshold for filing.[9]

These cases so far center on possible misrepresentations, disclosure failures, inadequate due diligence, questions about the independence of boards, misstatements, and omissions in disclosure or public statements. However, the novelty of SPACs is prompting plaintiffs' lawyers to be inventive in their approaches.

Targets of these claims have expanded beyond sponsors and directors. They now include target companies, their individual directors and officers, and investment banks. Even advisors and auditors may be liable. Settlements with regulators to date include a $38.8-million partial settlement with Akazoo S.A. and more than $8 million in regulatory fines levied against Stable Road/Momentus. And in December 2021, another action the SEC filed settled for $125 million.

With continuing enforcement and investigative actions and class action activity, more multimillion-dollar settlements are on the horizon.

Teeing up SPAC-related disputes for settlement

While SPAC cases are queuing up in the U.S. and internationally, the evolving landscape and their unique combination of characteristics are making it difficult to predict how civil cases will fare. A common way to manage the uncertainty brought about by novel financial instruments is to settle such matters. Past trends and experiences regarding settling disputes involving complex financial products, such as financial fraud litigation and securities class actions related to deal-litigation, offer directions on what is important in navigating and preparing for the resolution of these types of complex matters. Three best practices have proven themselves and will likely help parties successfully settle SPAC-related matters.

Three strategies for resolving SPAC disputes

1. Timing is everything. A question in novel matters is when is the best time for settlement discussions? Moving too soon or waiting too long can reduce the likelihood of a quick settlement. In the U.S., many securities class actions related to SPACs are filed quickly after a post-merger stock drop. A shareholder derivative suit may soon follow. A possible settlement can be explored in an early mediation setting shortly after filing, or parties may decide to wait until they have some additional direction.

While waiting provides additional clarity, it may also mean missed opportunities. As similar cases work their way through the courts and standards evolve and become stricter, certain case types may be found to be frivolous. Similarly, if a case survives the motion-to-dismiss stage, its value tends to increase. Conversely, an adverse ruling may decrease a case's value.

For example, a settlement before or after the recent decision, such as when Delaware Vice Chancellor Lori Will rejected a plea from SPAC directors for application of the business judgment rule, will not be the same.[10] Will chose to apply the more demanding entire-fairness standard of review, making it more difficult for directors to meet it. Parties should carefully consider whether time is likely to be on their side or a quick settlement allowing for more creativity may be the right course.

2. Educate through the brief. SPAC litigation is new. SPACs have been around for many years in the U.S., yet only recently have they gained traction by bringing startups to market. In order to prevent a neutral jumping to conclusions based on incomplete information, education is essential. Use the briefing to fill in the background and bring the court or mediator up to speed on trends. Having a thorough insight into the evolution of SPACs

is essential to mediation and resolution. Information enables a neutral to build a clear picture of what a SPAC does.

Understanding SPACs' dynamics and conflicts of interest helps build a standard for evaluating directors' and others' behavior.

Depending on the jurisdiction, regulation may not exist, so any guidance on lawmakers' and regulators' current thinking is welcome. Provide insight regarding where the case stands in the jurisdiction and how it may likely evolve given the direction of investigations and other trends. Brief the neutral on key rules that apply. Explain what Delaware and New York courts are saying, where SEC or local regulators are in their thinking and what European regulators are currently thinking.

All of this information will help the neutral place these matters in context and gauge how they may fare as they move through the courts. It may also illuminate the best alternative to a negotiated agreement in mediation terms.

3. Select the right mediator. When choosing a mediator, style, expertise and experience matter. You have limited control over which judge you get, but you can select your mediator. Sometimes a more facilitative style is the best way to go; other times a more hands-on approach is preferred. An active mediator style is often appreciated in getting novel cases settled, particularly as there is lots of room for different views and liability theories. An understanding of financial instruments can give mediators a perspective on SPACs. Experience in the relevant sector provides an edge. It enables mediators to play an active role and better identify and evaluate the real driving forces. Those who have previously worked on similar cases will likely make better decisions.

Key takeaways

As SPAC litigation grows in the U.S. and around the world, these three strategies should help manage the uncertainty. When applied effectively, these approaches can help resolve SPAC cases more quickly. Attention to timing ensures that cases are initiated and settled at the most advantageous times. Educating participants and neutrals, as well as sharing background and other information, ensures that all parties are better equipped to set standards and expedite decisions. Consciously choosing a mediator with specific characteristics and experience, such as one who has relevant industry expertise, can ensure active, informed engagement in the process.

Footnotes

1. "SPACS – what are they and why are they a source of non-financial risk" (blog post), *Risk-Business*, Feb. 7, 2022.

2. "SPAC momentum continues in Europe" (blog post), Harvard Law School Forum on Corporate Governance, Oct. 3, 2021

3. Daga, Anshuman, "Singapore lists first SPAC as Asia investors warm up to blank check firms," *Reuters*, Jan. 20, 2022.

4. "European SPAC and de-SPAC data and statistics roundup," White & Case European SPACs Data Hub, Jan. 2022.

5. *Id*.

6. "FCA publishes final rules to strengthen investor protections in SPACs," FCA News, July 27, 2021.

7. "SPACs Remain in the SEC's Crosshairs" (blog post), Harvard Law School Forum on Corporate Governance, April 24, 2022.

8. See, e.g., *Assad v. Pershing Square Tontine Holdings, Ltd.*

9. Stanford Law School Securities Class Action Clearinghouse, available at **https://securities.stanford.edu/current-trends.html#collapse2.**

10. SEC Charges SPAC, Sponsor, Merger Target, and CEOs for Misleading Disclosures Ahead of Proposed Business Combination, SEC press release, available at **https://www.sec.gov/news/press-release/2021-124.**

11. See *In re Multiplan Corp. Stockholders Litig.*, C.A. No. 2021-0300-LWW.

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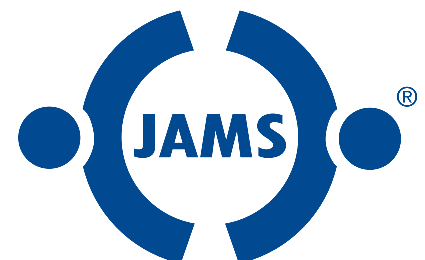

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