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WHITE PAPER

2021 Year-End-SPAC and De-SPAC Litigation Update

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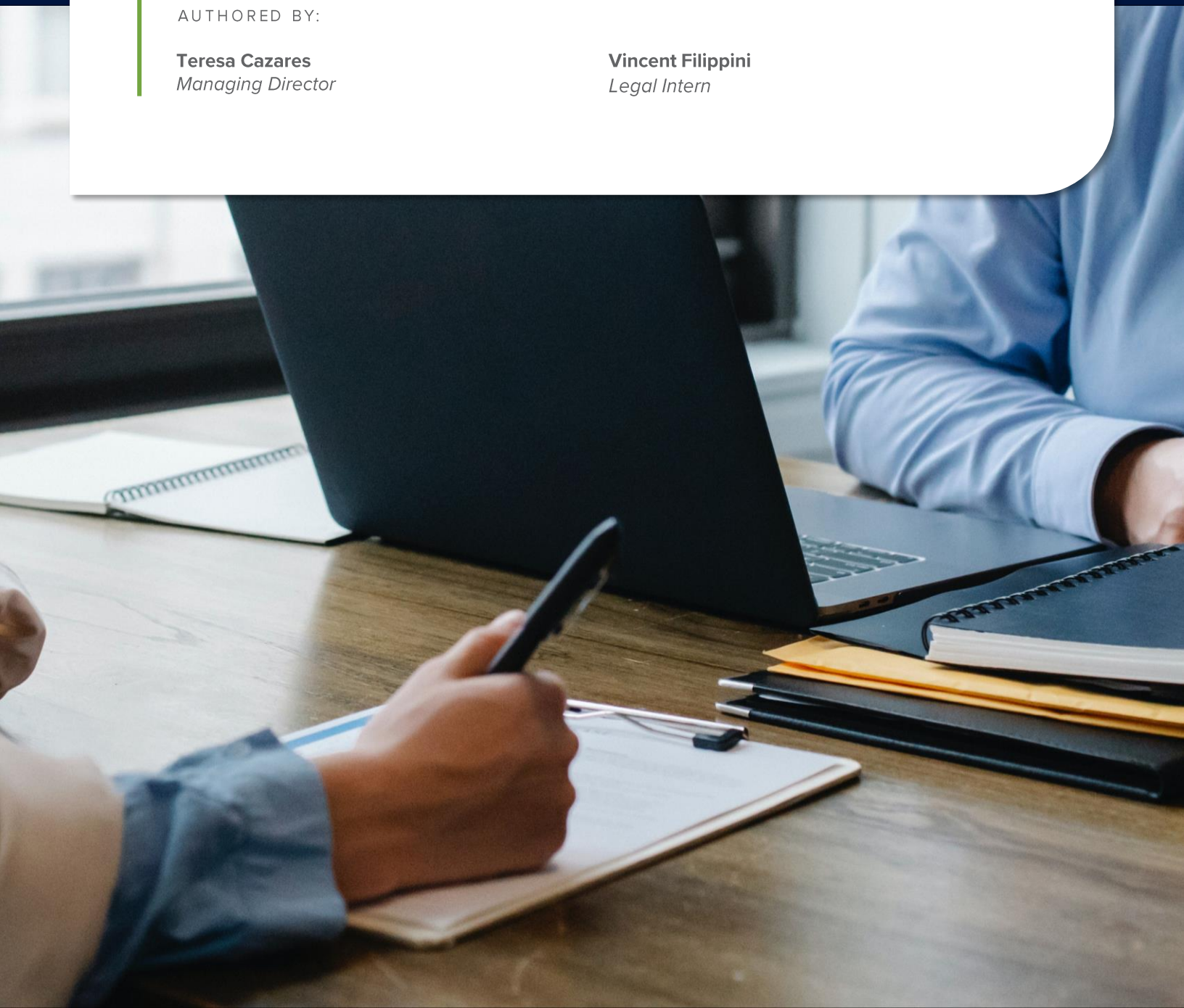
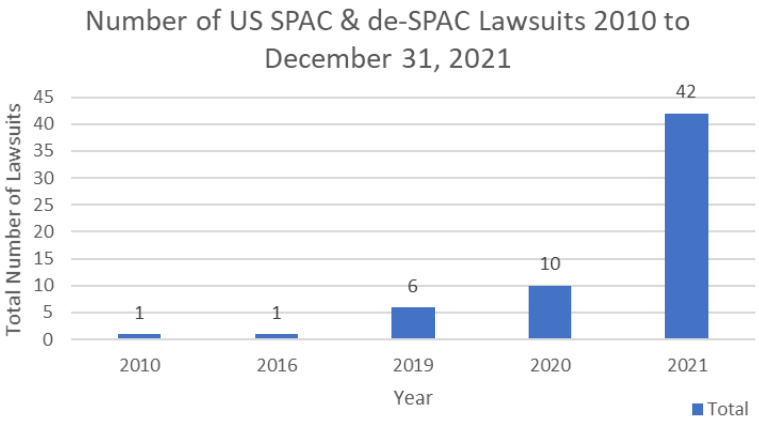


Introduction

While many refer to 2020 as the year of the SPAC (special purpose acquisition company), it seems lesser known that 2021 has been the year of SPAC litigation. In 2021, the number of SPACs continued to grow to over 500 SPAC IPOs. With $182 billion in "dry powder" waiting to be deployed by SPACs looking for a target company, it is likely we will continue to see a high volume of SPAC activity.[1] At the same time, the amount of SPAC & de-SPAC-related litigation in 2021 nearly quadrupled in number from 2020.

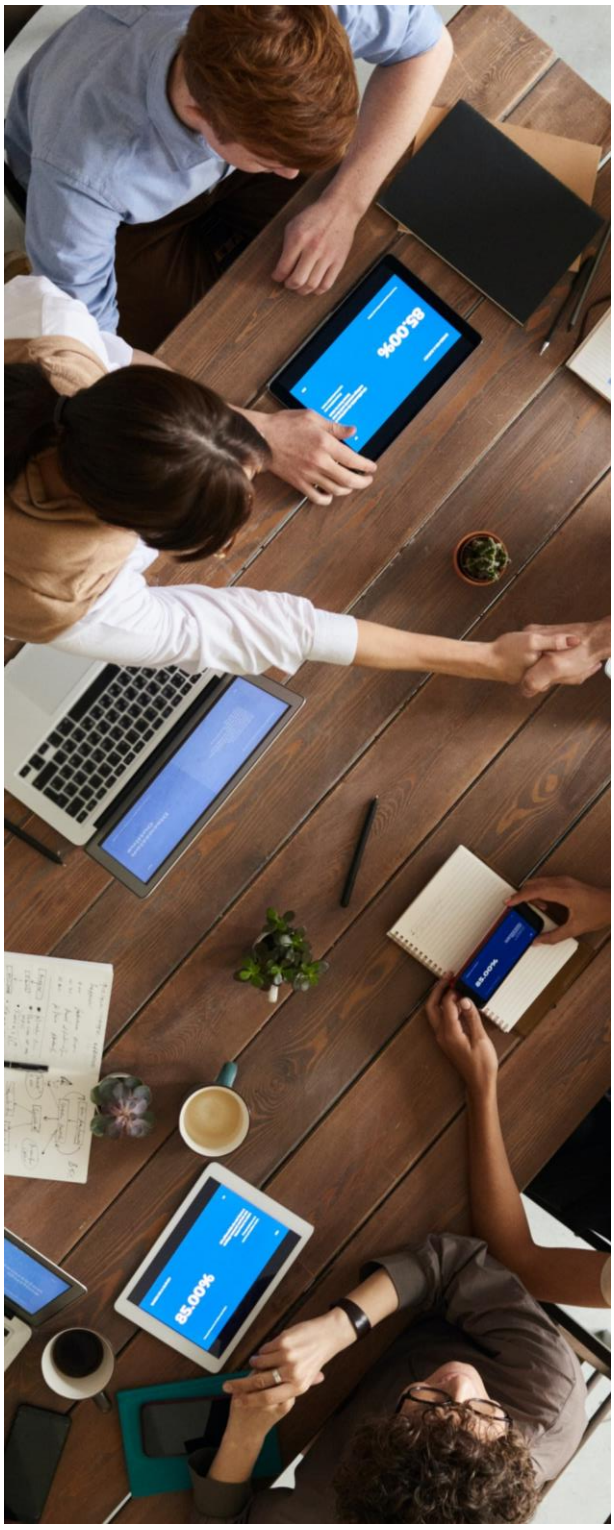
We saw 42 total lawsuits, including security class actions and derivative suits, filed against SPACs and de-SPACs through the end of 2021. This is a dramatic rise from 10 lawsuits in 2020 and 6 in 2019. Some trends have emerged as we continue to track this litigation. It is most common that these suits occur within the first six months after the de-SPAC or merger date. We have also seen many cases filed even before a de-SPAC merger is announced and others filed two years into the future and beyond.



1 https://www.dealpointdata.com/res/dpd_spac_study_%20q3_update_oct_2021.pdf

Why the Increase in Litigation?

Most recently, SPACs are routinely facing claims related to Section 14(a) and Section 10(b) of the Securities Exchange Act of 1934. Section 14(a) prohibits material misrepresentations and omissions, while Section 10(b) of the act prohibits manipulative or deceptive device or contrivance in contravention of rules and regulations prescribed by the Securities Exchange Commission (SEC). Other claims that frequently appear include a breach of fiduciary duty and, more recently, claims relating to the Fraud-on-the-market Doctrine. Both claims center on the idea that stock prices are a function of all material information about a company, that information has been made available to investors and it has been presented in a legal/ethical manner to the investors.



In April of 2021, the SEC released guidance on accounting regulations for SPACs. The SEC said that "the warrants included provisions that provided for potential changes to the settlement amounts dependent upon the characteristics of the holder of the warrant. Because the holder of the instrument is not an input into the pricing of a fixed-for-fixed option on equity shares, OCA staff concluded that, in this fact pattern, such a provision would preclude the warrants from being indexed to the entity's stock, and thus the warrants should be classified as a liability measured at fair value, with changes in fair value each period reported in earnings.[2]" This accounting change forced many SPACs to issue restatements regarding a company's financials.

The SEC continued to issue guidance on SPAC accounting regulations in November 2021. The new guidance will require SPACs to treat Class A shares as temporary equity instead of permanent equity.[3] Because Class A shares can be redeemable for cash if investors do not want to continue as shareholders of the target company, they are not permanent equity. SPACs that counted Class A shares as permanent equity must issue a restatement reporting that investors cannot rely on previous financial disclosures.

2 https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs?utm_medium=email&utm_source=govdelivery
3 https://cooleypubco.com/2021/11/17/more-spac-restatements/

Trends in 2021

2021 had already been a record-breaking year for SPAC-related securities litigation when the SEC gave its accounting guidance for SPACs. In the nine months since we have continued to see SPACs and de-SPAC companies face litigation relating to a change in the value of the company because of this accounting rules change. The complaints continue to allege violations of the same provisions of the Exchange Act of 1934 as before but have a newfound focus because of financial amendments that have been released since April.

Though these lawsuits are being filed at a record pace, we have not seen many cases settled. One settlement between the SEC and Stable Road Acquisition Company, Momentus Inc. and Stable Road's CEO Brian Kabot resulted in a total Settlement amount of $8,040,000.[4] Another recent settlement in 2021 was in a securities class action case where Akazoo, S.A, settled with the plaintiffs for $35,000,000.[5] Finally, Nikola Corporation and the SEC agreed to the largest settlement in SPAC-related securities litigation history when Nikola agreed to a $125,000,000 settlement.[6]

We have recently seen new claims being made that many SPACs are not SPACs and therefore should be regulated under the Investment Company Act of 1940 and the Investment Advisors Act of 1940. This could lead to a change in the regulatory landscape that would potentially impact many SPACs seeking a target company. While we do not know the outcome of these cases, it is certainly something to watch and be aware of going forward.

Implications of Purchasing D&O Insurance

SPACs in the market to purchase Directors and Officers (D&O) insurance will continue to face premium pressures in 2022. We have seen the number of insurance carriers willing to write primary D&O business for U.S.-listed companies decrease to a handful across the U.S., Bermuda, London and Asia. Reinsurance pressure allowing D&O markets to offer D&O capacity to SPACs, increase in litigation and SEC scrutiny has limited the insurance carriers' appetite to grow their SPAC D&O business. A "good risk" SPAC should budget around $600,000 premium for a $5M limit of liability in 2022 for a two-year policy. While a SPAC pursuing challenging industries (i.e., tech, biotech, health care) can pay up to $800,000 premium for a $5M limit of liability for a two-year policy.

4 https://www.sec.gov/news/press-release/2021-124
5 https://www.dandodiary.com/wp-content/uploads/sites/893/2021/04/Akazoo-settlement-stipulation.pdf
6 https://www.sec.gov/news/press-release/2021-267

About the Authors

Teresa Cazares, *Managing Director*

With 20 years of industry experience, Teresa is responsible for the account team oversight and overall service level for customers. She works with service teams to develop and validate corporate insurance programs, helping ensure they align with customers' financial strategies. Teresa specializes in the design, development and execution of customers' directors & officers liability, cyber, employment practices/wage & hour liability, fiduciary liability, professional liability, crime, and kidnap & ransom programs.

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Vincent Filippini is a Legal Intern in the Executive Liability practice in New York. he is currently a rising second-year student at New York Law School. Vincent has a Bachelor of Arts from Bucknell University in Political Science.

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