Clients&FriendsMemo

Interest in SPACs—Special Purpose Acquisition Companies—is booming…and so is the risk of litigation. Following these ten steps will prepare SPAC boards, sponsors, and advisors for the likely shareholder suits and potential regulatory investigations that are increasingly becoming part of the SPAC landscape.

March 31, 2021

If 2020 was the "year of the SPAC," 2021 may be the year of SPAC litigation. SPACs—Special Purpose Acquisition Companies—are publicly traded companies launched as vehicles to raise capital to acquire a target company. Often called blank-check companies, SPACs are companies in which shareholders buy shares without knowing which company the SPAC will target and acquire. Investors place their faith in the sponsor: the entity or management team that forms the SPAC. The SPAC generally has around twenty-four months to seek out and acquire a target, or else must liquidate and return the capital.

Hundreds of new SPACs were launched in 2020 alone. Booming M&A or other transactional activity in any sector can invite litigation driven by plaintiffs' attorneys, and SPACs are no exception. In just the first three months of 2021, more than 40 suits targeting SPACs have been filed. The nature of these claims evidence growing sophistication, as lawyers used to challenging traditional M&A transactions begin to tailor their claims to the unique characteristics of the SPAC lifecycle. And with SPACs going mainstream—and attracting attention from outside the usual financial circles—regulators are closely examining transaction disclosures and other aspects of SPAC deals.[1]

Preparing in advance—throughout the SPAC transaction cycle—for the prospect of litigation or regulatory scrutiny could make the difference between a quick resolution and an existential threat. Following these ten steps will provide SPACs, their boards, their sponsors, and their advisors the edge in future litigation or regulatory inquiries.

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1 *See* Jody Godoy & Chris Prentice, *Exclusive: U.S. Regulator Opens Inquiry into Wall Street's Blank Check IPO Frenzy – Sources*, Reuters (Mar. 24, 2021), https://www.reuters.com/article/us-usa-sec-spacs-exclusive-idUSKBN2BH09F.

1. Document all board meetings in formal minutes—and make sure they are approved.

The typical public company has a corporate secretary who takes minutes at each board and committee meeting. The typical SPAC has no such employee and corporate housekeeping is sometimes delayed in the urgency to secure a binding acquisition transaction. Nevertheless, formal minutes, formally approved, are important and this detail should not be ignored or delayed unreasonably. Accurate, complete, contemporaneous, and board-approved minutes are important in demonstrating the board's compliance with its fiduciary duty of due care. The absence of board minutes unfortunately can demonstrate the reverse.

2. Carve out time at each board meeting for private, executive sessions of independent directors—without the sponsor—and document in the minutes that these sessions occurred.

There have been persistent concerns about conflicts between SPAC sponsors and public investors. Plaintiffs' attorneys are targeting these potential conflicts—arguing that sponsors have wielded their influence to push through deals on terms that favor their own interest in consummating a transaction within the required timeframe at the expense of other shareholders. To guard against the appearance that a SPAC board was captive to the sponsor, boards should reserve time for private deliberation by independent directors, free of the sponsor's watchful eye, and board members should carefully evaluate the performance by sponsors.

3. Provide SPAC boards detailed due diligence reports before deal approval.

Rare is the SPAC litigation that does not claim the SPAC hastily agreed to a deal without adequate diligence. There are multiple ways to mitigate these claims—adopting exculpatory charter provisions can help—but there is no substitute for a well-informed board. Even if fulsome diligence, financial analyses or other assessments were performed, that information must be communicated to the board with adequate time for board review to put directors in the best position to argue that the transaction is the product of informed deliberation and that the board was afforded adequate time to review and sign off on the accuracy of the deal disclosures.

4. Make a record of looking for initial business combination opportunities.

The objectives of a SPAC are to identify a partner for an initial business combination and to complete that transaction. The sponsor should aggressively seek out these opportunities. The sponsor should also periodically inform the board of its efforts in this regard, and that should be reflected in the minutes. If an initial business combination is completed and the board is sued, it will be helpful if the minutes reflect efforts to identify a partner. The absence of that record could make it appear that what was being sought was *any* business combination, but not necessarily the *best* one.

5. The audit committee should scrutinize the target's financials.

For the target company, the requisite disclosures that must be made to complete the de-SPAC transaction are more akin to an IPO than a typical acquisition by an existing, public operating company. Extensive, detailed audited financials are required, and the review of these disclosures by the SPAC board should be performed in consultation with competent advisors and/or delegated to the experts on the audit committee.

6. Consider obtaining a fairness opinion—and/or a formal presentation from the financial advisor.

Fairness opinions tend to be the province of target companies, not buyers. But the SPAC's very existence centers around this acquisition, and a fairness opinion, like proper deal diligence, can bolster the board's decision-making process—particularly if the target company has connections to the SPAC or the sponsor. Obtaining the opinion is not a mere box to check on the closing checklist. Regardless of whether a fairness opinion is obtained, the board should consider whether a financial advisor presentation is desirable.

7. The merger proxy statement should be carefully prepared.

The merger proxy statement for the initial business combination should be as scrupulously prepared as an IPO prospectus. So, for example, if the target company relies heavily on one customer or supplier, or if major competition is expected to be faced, or if its products are relatively untested, it is not enough to mention that in boilerplate "risk factors." And if potential business issues have been identified by consultants or in due diligence, those should be fully disclosed. Finally, it is often the case that forecasts will be included in the proxy statement for the business combination. Are those the only forecasts the SPAC has seen? If not, you should consider what you should do about the other set of forecasts.

8. All public statements should be closely scrutinized for accuracy—including social media posts.

Rule 10b-5 does not contain a social media exception. High-profile leaders of public companies are finding themselves on the receiving end of securities fraud claims and enforcement actions for statements made on Twitter and other platforms. SPAC boards should have policies in place to guard against these missteps, which should include a process to review, identify and correct potentially misleading claims or risky puffery.

9. Beware the late-stage deal.

The appearance of potential conflicts between SPAC sponsors and ordinary shareholders approaches its zenith as the deadline for liquidation looms. SPAC leadership should be aware that multiple suits have been filed against SPACs that embraced a deal target at the eleventh hour, claiming that the SPAC sponsors and boards put their interest in closing a deal ahead of the SPAC and its investors.

10. Disclose, disclose, disclose.

Plaintiffs' lawyers use the SEC's guidance on disclosure considerations for SPACs like a playbook. SPAC boards should carefully review disclosures that touch on the topics flagged by the SEC, particularly disclosures relating to conflicts (such as interlocks between the sponsor, the SPAC, and the target; the liquidation timeline; and underwriting fee structures) and details about how the SPAC board settled on the acquisition target.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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