

CLIENT ALERT

Current Trends in SPAC Litigation and Regulatory Scrutiny

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AUTHORS

William J. Stellmach | A. Kristina Littman | Adam Aderton | Elizabeth P. Gray
Sean Sandoloski | Kristin E. Bender | Sophia Khorshad

SPACs, or Special Purpose Acquisition Companies, saw exponential growth in 2020 and 2021, with 861 companies raising \$246 billion on U.S. public markets—a tenfold increase in funding from the previous two-year period.¹ But so far this year (as of August 2023), just 22 SPACs have listed, raising around \$3 billion,² and it is clear that they have become less attractive to private companies and investors in recent months. In fact, as of September 2023, the number of SPACs searching for mergers is down 66% from the cycle high of 610 in March 2022. While enthusiasm for SPACs may have cooled for the time being, litigation and enforcement in the space have heated up, crystalizing trends in litigation risks and regulatory scrutiny.³

Background

SPACs, are publicly traded corporations formed with the purpose of effecting a merger, or “business combination,” with a privately held company to enable that company to go public.⁴ By raising money largely from public-equity investors,

¹ *Summary By Year*, SPAC Insider, <https://www.spacinsider.com/data/stats> (last visited Sept. 19, 2023); John Hyatt, *Why Dealmaker Betsy Cohen Believes SPACs Will Make A Comeback*, Forbes (June 1, 2023), <https://www.forbes.com/sites/johnhyatt/2023/06/01/why-dealmaker-betsy-cohen-believes-spacs-will-make-a-comeback/?sh=7a3488b67fce>.

² See Nasdaq US SPAC Monitor, SPAC Research (September 18, 2023); Nasdaq US SPAC Monitor, SPAC Research (March 28, 2022).

³ This is not the first time that we have issued an alert on SPACs. Our previous alert is available [here](#).

⁴ For a comprehensive overview of SPACs as a vehicle to bring companies to the public market, see *SPACs: What You Need to Know*, Harvard Business Review (August 2021), <https://hbr.org/2021/07/spacs-what-you-need-to-know>.

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rather than through a traditional initial public offering (“IPO”), SPACs have the potential to lessen the risks and shorten the process for their target companies to become publicly traded, often offering them better terms than a traditional IPO would. By the end of their lifespan, also called a “combination window”—typically around two years with a limited option to extend—if a SPAC has not successfully identified and combined with a potential target, it must wind up all operations and return the funds raised to its investors. Conversely, if a target is identified, a merger is proposed and investors vote on the proposed business combination.

The SPAC process is initiated by the sponsors: they invest risk capital in the form of nonrefundable payments to bankers, lawyers, and accountants to cover operating expenses. Sponsors do not have the “redemption right”—the choice afforded to original investors to receive an investment back with interest, once a merger agreement is announced—meaning they stand to lose their investment if a deal is not voted through. However, if a business combination is completed, sponsors may see substantial financial returns, often worth as much as 20% of the equity raised from the original investors.

SPAC proponents argue that SPACs offer investors and targets a new set of financing opportunities that compete with other vehicles, such as direct listings and the traditional IPO process, and that they expand funding avenues for start-ups and emerging companies.⁵ Critics, however, label SPACs as “black check companies” and maintain that the “merge-or-lose” dilemma faced by sponsors creates a significant conflict of interest that a shareholder’s redemption right alone cannot overcome,⁶ and that post-merger performance of SPACs exposes their chronic overvaluation.⁷

Litigation Trends

SPACs have generated substantial activity in civil litigation. 2021 saw 33 securities class actions related to de-SPAC transactions, and 2022 saw 24 such actions.⁸ Suits include securities class actions relating to “unsuccessful mergers,” and derivative and direct actions for breaches of fiduciary duties against SPACs’ directors and officers. A

⁵ *SPACs: What You Need to Know*, Harvard Business Review (August 2021), <https://hbr.org/2021/07/spacs-what-you-need-to-know>.

⁶ *The Special Purpose Acquisition Company Fallout Is Going To Be SPAC-tacular*, Financial Times (Jan. 11, 2023), <https://www.ft.com/content/65b96216-afc0-40c2-b763-da4f3ebd4535>.

⁷ Of the more than 400 de-SPACed companies that remain publicly traded, around 330 (almost 85%) are trading at or below \$10 (i.e., initial purchase price for investors), while nearly 95 are trading under \$1. *Acquiring a de-SPACed Company—Key M&A Considerations*, Business Law Today (Sept. 12, 2022), <https://businesslawtoday.org/2022/09/acquiring-de-spaced-company-key-ma-considerations/>.

⁸ *SPAC Litigation by the Numbers: Surprisingly Positive Trends in 2022*, American Bar Association (Jan. 24, 2023), https://www.americanbar.org/groups/business_law/resources/business-law-today/2023-february/spac-litigation-by-numbers-surprisingly-positive-trends-in-2022/.

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significant percentage of litigation challenging de-SPAC transactions is in Delaware and federal courts, and a majority of these suits have survived motions to dismiss.⁹

The fiduciary-duties litigation has created some SPAC-unfriendly precedent in the Delaware Court of Chancery—a forum that has been on the leading edge of class action litigation filed with respect to SPACs in recent years. The Delaware court has regularly indicated in its cases, such as *Multiplan*, *Gig2*, and *Gig3*, that a breach of fiduciary duty claim stemming from a de-SPAC transaction warrants application of the plaintiff-friendly “entire fairness” standard, as opposed to the “business judgment” rule, because of the potential misalignment of interests between SPAC sponsors and their shareholders.¹⁰ As a result of this precedent, in conjunction with recent dismissals of securities class actions, plaintiffs’ attorneys are trading in securities class action strategies for direct fiduciary-duty suits against Delaware SPACs.¹¹

Still, with SPAC-related litigation decreasing by 27% from 2021 to 2022,¹² defendants may view the landscape more positively than they did even a year ago. Defendant sponsors and targets have had several key victories, moreover, in the securities class actions arena. In January 2023, the Northern District of California granted the dismissal of a securities class action against Churchill Capital Acquisition Corporation IV and Lucid Motors on the grounds that the plaintiffs failed to plead materiality.¹³ In March 2023, the Southern District of New York dismissed an action against CarLotz and certain of its directors and officers for plaintiffs’ lack of standing related to pre-merger statements.¹⁴ And in January 2023, the Southern District of New York dismissed an action against Diamond Eagle Acquisition Corp. and DraftKings on the grounds that the plaintiffs’ suit relied entirely on a short-seller report with unknown and inadequate sources¹⁵—a particularly noteworthy

⁹ *Litigation & Enforcement Fallout of the SPAC Boom*, Bloomberg Law (Aug. 2022), https://www.rc.com/upload/ARTICLE_Litigation-and-Enforcement-Fallout-of-the-SPAC-Boom_Daniels-Zhou-Bradley-Scoville-8-2022.pdf; *SPAC Litigation: A Review of Recent Developments*, <https://www.jonesday.com/en/insights/2023/05/spac-litigation-a-review-of-recent-developments>.

¹⁰ See *In re MultiPlan Corp. S’holders Litig.*, 268 A.3d 784, 812 (Del. Ch. 2022); *Delman v. GigAcquisitions3, LLC*, 288 A.3d 692, 713 (Del. Ch. 2023); *Laidlaw v. GigAcquisitions2, LLC*, No. 2021-0821-LWW, 2023 WL 2292488, at *7 (Del. Ch. Mar. 1, 2023).

¹¹ *SPAC Litigation Mid-Year Update: Delaware Opens the Gates*, American Bar Association (June 23, 2023).

¹² *SPAC Litigation by the Numbers: Surprisingly Positive Trends in 2022*, American Bar Association (Jan. 24, 2023), https://www.americanbar.org/groups/business_law/resources/business-law-today/2023-february/spac-litigation-by-numbers-surprisingly-positive-trends-in-2022/; see also, e.g., *Securities Class Action Filings—2021 Year in Review*, Cornerstone (2022), <https://www.cornerstone.com/wp-content/uploads/2022/02/Securities-Class-Action-Filings-2021-Year-in-Review.pdf>.

¹³ *In re CCIV/Lucid Motors Sec. Litig.*, No. 4:21-CV-09323-YGR, 2023 WL 325251 (N.D. Cal. Jan. 11, 2023); *SPAC-Related Securities Suit Dismissals Could Be Significant for Other Cases*, The D&O Diary (Jan. 16, 2023), <https://www.dandodiary.com/2023/01/articles/securities-litigation/spac-related-securities-suit-dismissals-could-be-significant-for-other-cases/>.

¹⁴ *In re CarLotz, Inc. Sec. Litig.*, No. 21-CV-5906 (RA), 2023 WL 2744064, at *1 (S.D.N.Y. Mar. 31, 2023).

¹⁵ *In re DraftKings Inc. Sec. Litig.*, No. 21 CIV. 5739 (PAE), 2023 WL 145591 (S.D.N.Y. Jan. 10, 2023); *SPAC-Related Securities Suit Dismissals Could Be Significant for Other Cases*, The D&O Diary (Jan. 16, 2023), <https://www.dandodiary.com/2023/01/articles/securities-litigation/spac-related-securities-suit-dismissals-could-be-significant-for-other-cases/>.

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development as nearly 21% of federal SPAC class action suits involved or relied upon a short-seller report.¹⁶ Each of these cases sheds light on available potential avenues toward obtaining dismissal of SPAC securities class actions.

When civil litigation has settled, however, the figures have been substantial, often multimillion-dollar propositions. Among them:

- **Akazoo:** Akazoo, a music-streaming service specializing in emerging markets, merged with the SPAC Modern Media in 2019.¹⁷ A securities class action followed, alleging insufficient due diligence and fraud, and the suit was eventually settled in October 2021 for \$35 million.¹⁸
- **Triterras:** Triterras, a global fintech company, merged with SPAC Netfin Acquisition Corp. in 2020.¹⁹ A securities class action followed, alleging inadequate disclosures about a related party, and the suit was eventually settled in April 2022 for \$9 million.²⁰
- **Multiplan:** Multiplan, a healthcare industry-focused data analytics and cost management solutions provider, merged with the SPAC Churchill Capital Corp. III in October 2020.²¹ Plaintiffs pursued a direct-action breach of fiduciary duty suit alleging inadequate disclosures about a main customer, and the suit was eventually settled in November 2022 for \$33.75 million.²²
- **TradeZero:** TradeZero, a commission-free stock and options broker, was hit with a private action alleging fraud after its proposed merger with the SPAC Dune Acquisition Corp. fell apart.²³ Parties reached a \$5 million settlement in December 2022.²⁴

¹⁶ *Securities Class Action Filings - 2021 Year in Review*, Cornerstone (2022), <https://www.cornerstone.com/wp-content/uploads/2022/02/Securities-Class-Action-Filings-2021-Year-in-Review.pdf>.

¹⁷ *In re Akazoo S.A. Sec. Litig.*, No. 1:20-CV-01900-BMC, Class Action Complaint (E.D.N.Y. April 24, 2020), ECF No. 1.

¹⁸ *In re Akazoo S.A. Sec. Litig.*, No. 1:20-CV-01900-BMC, 2022 WL 14915876, at *1 (E.D.N.Y. Oct. 7, 2022); *In re Akazoo S.A. Sec. Litig.*, No. 1:20-CV-01900-BMC, Stipulation and Agreement of Partial Settlement (E.D.N.Y. Apr. 23, 2021), ECF No. 32.

¹⁹ *Erlandson v. Triterras, Inc.*, 7:20-cv-10795-CS, 2021 WL 4737633 (S.D.N.Y. July 6, 2021).

²⁰ *Erlandson v. Triterras, Inc.*, 7:20-cv-10795-CS, Stipulation and Agreement of Settlement (S.D.N.Y. May 13, 2022), ECF No. 57.

²¹ *In re MultiPlan Corp. S'holders Litig.*, 268 A.3d 784, 798 (Del. Ch. 2022).

²² *In re MultiPlan Corp. S'holders Litig.*, 268 A.3d 784, 798 (Del. Ch. 2022); *Multiplan Corporation Announces Settlement of Delaware Litigation*, MultiPlan (Nov. 17, 2022), <https://investors.multiplan.us/latest-news/news-details/2022/MultiPlan-Corporation-Announces-Settlement-of-Delaware-Litigation/default.aspx>.

²³ *Dune Acq. Corp. v. Pipitone*, No. 2022-0304-LWW, 2022 WL 1062415 (Del. Ch. Apr. 6, 2022).

²⁴ Settlement Agreement and Release, Ex. 99.1 (Dec. 28, 2022), https://www.sec.gov/Archives/edgar/data/1817232/000121390022084108/ea171078ex99-1_duneacq.htm.

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Regulatory Trends

Since September 2020, the U.S. Securities and Exchange Commission (“SEC”) has signaled its interest in more tightly regulating the SPAC market.²⁵ More recently, it has made good on its promise. In March 2022, the agency proposed a new set of rules and amendments that would, *inter alia*: mandate new disclosure requirements including with regard to sponsor economics, potential conflicts of interest, dilution to shareholders, and projects; define requirements for fairness opinions; and eliminate safe harbor protections for forward-looking statements.²⁶ In October 2022, the SEC reopened the comment period for the proposed rules and amendments after a technological error prevented it from receiving public comments.²⁷ It is unclear when these rules will be adopted by the SEC and whether they will change materially in light of the voluminous and strident critiques of the proposed rules received through comments.²⁸

Additionally, similar to civil litigation, the SEC has pursued enforcement actions and settlements in relation to SPACs—again for hefty sums. For example:

- *Momentus*: Momentus, a space infrastructure company, agreed to settle an enforcement action in July 2021 for a total of \$8.04 million after the SEC alleged that (i) the Company and its founder misled the SPAC with which it planned to merge about technology and national security issues, and (ii) the SPAC failed to perform its due diligence to identify those issues.²⁹

²⁵ See, e.g., *Blank Check Firms Offering IPO Alternative Are Under Regulatory Scrutiny*, The Wall Street Journal (Sept. 24, 2020), <https://www.wsj.com/articles/blank-check-firms-offering-ipo-alternative-are-under-regulatory-scrutiny-11600979237>; *SEC Chairman Jay Clayton’s Statements on CNBC* (Sept. 24, 2020), available at <https://www.youtube.com/watch?v=vD6mtQSfIPc>.

²⁶ *SEC Proposes Rules to Enhance Disclosure and Investor Protection Relating to Special Purpose Acquisition Companies, Shell Companies, and Projections* (March 30, 2022), <https://www.sec.gov/news/press-release/2022-56>; *What Will the SEC’s New SPAC Rules Bring to the Troubled SPAC Market?*, Woodruff Sawyer (April 13, 2022) <https://woodrufflaw.com/spac-notebook/sec-spac-rules-troubled-market/>; *The SPAC Rollercoaster – Is A Renaissance Coming?*, Mizuho Group (last visited Sept. 19, 2023), <https://www.mizuhogroup.com/americas/beyond-the-obvious/markets-mindset/the-spac-roller-coaster---is-a-renaissance-coming.html>.

²⁷ *SEC Reopens Comment Periods for Several Rulemaking Releases Due to Technological Error in Receiving Certain Comments*, SEC Press Release (Oct. 7, 2022), <https://www.sec.gov/news/press-release/2022-186>.

²⁸ *Proposed Rule: Special Purpose Acquisition Companies, Shell Companies, and Projections*, <https://www.sec.gov/rules/2022/03/special-purpose-acquisition-companies-shell-companies-and-projections>; *Litigation & Enforcement Fallout of the SPAC Boom*, Bloomberg Law (Aug. 2022), https://www.rc.com/upload/ARTICLE_Litigation-and-Enforcement-Fallout-of-the-SPAC-Boom_Daniels-Zhou-Bradley-Scoville-8-2022.pdf.

²⁹ *SEC v. Kokorich*, No. CV 21-1869 (ACR), 2023 WL 2610641, at *1 (D.D.C. Mar. 23, 2023); *Stable Road and Momentus Reach SEC Settlement Over False Claims*, Space News (July 13, 2021), <https://spacenews.com/stable-road-and-momentus-reach-sec-settlement-over-false-claims/>.

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- *Nikola*: Nikola, a manufacturer of heavy-duty commercial battery-electric vehicles, agreed to settle an enforcement action in December 2021 for a total of \$125 million after the SEC alleged the Company made misleading statements about its products, technical advancements, and commercial prospects.³⁰
- *Perceptive Advisors*: Perceptive Advisors, an investment advisor providing investment advisory services to pooled investment vehicles, was the first target of a series of enforcement actions taken against investment advisors stemming from alleged conflicts of interest in connection with SPAC activity.³¹ Perceptive Advisors agreed to settle the enforcement action in September 2022 for a total of \$1.5 million.³²
- *Digital World Acquisition Corp. and Truth Social*: Digital World Acquisition Corporation (“DWAC”) agreed to settle charges that it had formulated a plan to acquire Trump Media & Technology Group Corp. (“TMTG”), the parent company for Truth Social, prior to DWAC’s IPO.³³ Further, three individuals have been charged with insider trading violations arising from trading in advance of DWAC’s October 2021 announcement that it had reached an agreement to acquire TMTG;³⁴ no settlement has yet been reached and the case is ongoing.

With the SEC’s fiscal year coming to a close at the end of September, this list may grow in the coming weeks.

Conclusion

There are 344 actively trading SPACs as of September 18, 2023.³⁵ An estimated 300 of those SPACs, with \$700 billion in trust, have combination deadlines in 2023.³⁶ While no one can predict what will happen for those de-SPAC transactions yet to close, what is certain is that sponsors and targets alike continue to be best served by understanding and containing the emerging litigation risks and regulatory trends.

³⁰ Nikola Corporation to Pay \$125 Million to Resolve Fraud Charges, SEC Press Release (Dec. 21, 2021), <https://www.sec.gov/news/press-release/2021-267>.

³¹ See *In the Matter of Corvex Management LP*, SEC Release No. IA-6284 (Apr. 14, 2023) (settling an enforcement action for \$1 million in civil penalties); *In the Matter of RTW Investments, LP*, SEC Release Nos. 34-97622, IA-6318 (May 30, 2023) (settling an enforcement action for \$1.4 million in civil penalties); *In the Matter of Monroe Capital Management Advisors, LLC*, SEC Release No. 97957 (July 20, 2023) (settling an enforcement action for \$1 million in civil penalties).

³² SEC Charges Perceptive Advisors for Failing to Disclose SPAC-Related Conflicts of Interest, SEC Press Release (Sept. 6, 2022), <https://www.sec.gov/news/press-release/2022-155>.

³³ SEC Charges Digital World SPAC for Material Misrepresentations to Investors (July 20, 2023), <https://www.sec.gov/news/press-release/2023-135>.

³⁴ *SEC v. Bruce Garelick, Michael Shvartsman, Rocket One Capital LLC, and Gerald Shvartsman*, SEC Release No. 25760 (June 29, 2023).

³⁵ Nasdaq US SPAC Monitor, SPAC Research (September 18, 2023).

³⁶ *The Special Purpose Acquisition Company Fallout Is Going To Be SPAC-tacular*, Financial Times (Jan. 11, 2023) <https://www.ft.com/content/65b96216-afc0-40c2-b763-da4f3ebd4535>.

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If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

William J. Stellmach

202 303 1130

wstellmach@willkie.com

A. Kristina Littman

202 303 1209

aklittman@willkie.com

Adam Aderton

202 303 1224

aaderton@willkie.com

Elizabeth P. Gray

202 303 1207

egray@willkie.com

Sean Sandoloski

202 303 1047

ssandoloski@willkie.com

Kristin Bender

44 203 580 4833

kbender@willkie.com

Sophia Khorshad

212 728 3437

skhorshad@willkie.com

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