WHITE PAPER

1st Half 2022 SPAC and De-SPAC Litigation Update

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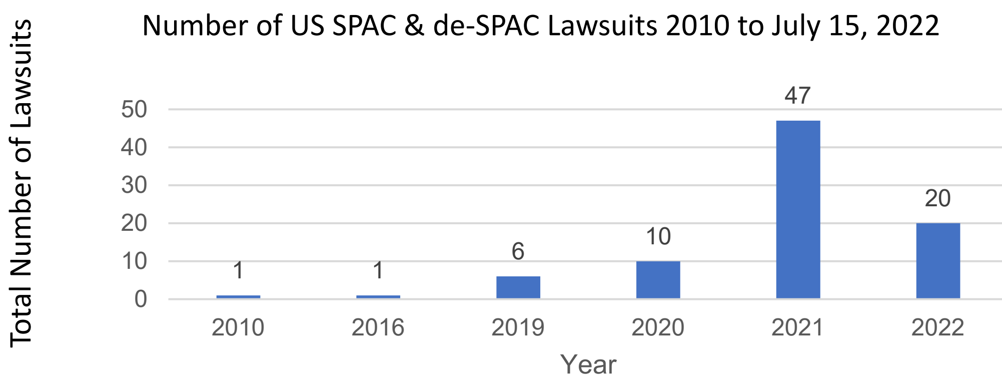
Introduction

If 2020 was the year of the Special Purpose Acquisition Companies (SPACs), and 2021 the year of SPAC litigation, 2022 is off to a slow start in terms of de-SPACs and related litigation. The number of traditional IPO filings and SPAC IPO filings fell to their lowest levels in the past seven quarters. As of March 31st, there was $183.5 billion in SPAC dry powder available to be invested. After Q1 of 2022, there were 604 priced SPAC IPOs actively seeking a target, representing $144.7B in gross proceeds, the highest number and dollar value on record at the end of any quarter.

The numbers speak for themselves as SPAC IPO and de-SPAC M&A activity dropped significantly in 2022.

- New SPAC IPOs fell from 163 in Q4 of 2021 to 55 in Q1 of 2022.
- Only 34 de-SPAC M&A deals were announced in Q1 2022, compared to 61 in Q4 2021.
- Withdrawn SPAC deals outnumbered priced SPAC IPOs 61 to 55 in Q1.
  - » This is a drastic increase from the 11 withdrawn SPAC IPOs in 2021.



New SEC Proposals

On March 30, 2022, the SEC commissioners issued a press release proposing new rules concerning SPACs. Chair Gary Gensler stated that the SEC must "treat like cases alike" when considering rules governing SPACs and IPOs. The proposed rules would strengthen disclosure, marketing standards, and gatekeeper and issuer obligations, helping to ensure that investors get protections similar to those granted when investing in traditional IPOs. Although these proposed rules cannot explain the decrease in de-SPAC activity in the beginning of Q1, it may explain the continued drop in SPAC IPO filings and de-SPAC mergers throughout 2022 and beyond.

The SEC proposals would: Add specialized disclosure requirements regarding SPAC sponsors, conflicts of interest, target IPOs and dilution; require non-financial disclosures about the target private company; require that disclosure documents in SPAC target IPOs be disseminated to investors at least 20 days before shareholders have to vote to approve the transaction; and align the financial statement requirements with those of traditional IPOs. This additional information would aid shareholders in making informed voting, investment, and redemption decisions.

The proposed changes would also affect marketing practices. The changes would dissuade parties from using overly optimistic language or over-promising by amending the definition of blank check company to encompass SPACs such that the Private Securities Litigation Reform Act safe harbor would not be available.

Furthermore, the proposed changes would affect gatekeeper and issuer obligations, specifically holding signing persons and blank-check underwriters liable for basic aspects of their work. The proposed rule is not intended to limit the definition of underwriter under Section 2(a)(11) but is meant to expand the scope of liability to those in connection with a de-SPAC transaction regardless of whether they acted as SPAC IPO underwriters.

1 https://www.dealpointdata.com/res/dealpointdata_spac_study_q1_update_2022.pdf
2 https://www.dealpointdata.com/res/dealpointdata_spac_study_q1_update_2022.pdf
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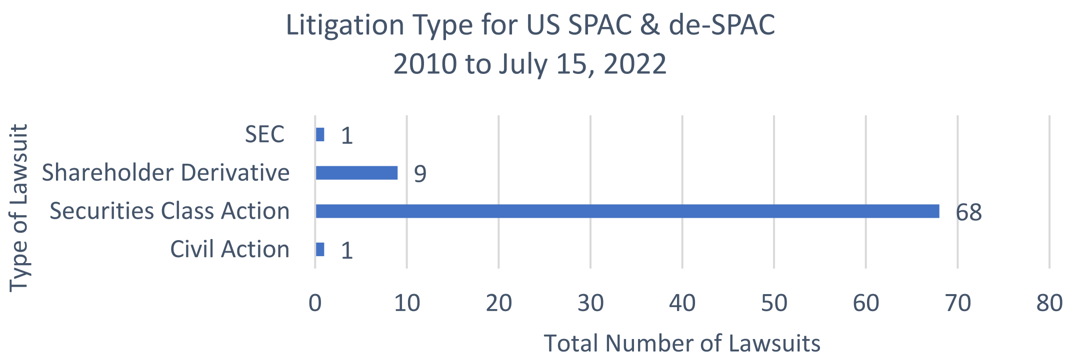
6 https://www.dealpointdata.com/res/dealpointdata_spac_study_q1_update_2022.pdf
7 https://www.sec.gov/news/statement/gensler-spac-20220330

Trends in 2022

In Q1 of 2022, the healthcare industry emerged as the largest target sector for de-SPAC transactions as measured by volume and value in the U.S., as opposed to the technology sector that dominated 2021. Delaware remained the primary jurisdiction for SPAC IPOs but only by a slim margin over the Cayman Islands. Additionally, there was an increase in the use of Termination Fees on de-SPAC M&A deals. For example, 17.6% of all Q1 2022 de-SPAC M&A deals had Target Termination Fees, compared with only 4.5% of de-SPAC deals in 2021.



In addition to SEC guidance, court decisions are shaping the boundaries of fiduciary duties in de-SPAC transactions. On January 3, 2022, the Delaware Court of Chancery issued its anticipated ruling in the *MultiPlan Corp* stockholder litigation and enhanced scrutiny of fiduciary duties for de-SPAC transactions. The court focused on the incentives associated with founder's shares and held that "the transaction involved inherent conflicts that required the application of the heightened entire-fairness standard of review." This may have far-reaching implications concerning the entire fairness standard of review applying to de-SPAC transactions; however, this issue may be interpreted differently by other courts.

Post-*MultiPlan*, shareholders are likely to plead for an entire fairness standard of review because the challenges raised in *MultiPlan* are common in SPAC transactions. We are already seeing this transpire in *Hyzon* where, on March 18, 2022 a shareholder filed a fiduciary duty claim against former directors of Decarbonization Plus Acquisition Corporation, a SPAC that merged with Hyzon Motors USA. The *Hyzon* case makes similar allegations to *MultiPlan* and even quotes the court's denial of the defendant's motion to dismiss. *Hyzon's* complaint alleges that the court should apply the entire fairness standard of review, citing *MultiPlan* for support. These lawsuits may indicate the direction future SPAC litigation may follow.

D&O Market Update

Despite the uncertainty of the above noted litigation, D&O rates have improved markedly for buyers. Since the turn of the calendar in 2022, and most notably Q2 2022, D&O insureds renewing have experienced drastic rates cuts, particularly on excess layers. Increased competition from new entrants coupled with many "blue-chip" insurers trying to preserve their books, has resulted in excess D&O rates dropping anywhere from 10%-40%. This rapid "softening" of the D&O market has also permeated into the SPAC/de-SPAC market, and insureds are reaping the benefits of multiple competitive primary options (as opposed to just a few options 1-2 years ago). While limits deployed by insurers are still hovering around $5M, retentions have been reduced to $5M along with premiums that are well below the $1M sticker price of just last year. Further, excess rates continue to drop with first excess Rate-on-Line (ROL) as low as 50% of the primary layer. While proposed SEC rules changes and SPAC/de-SPAC litigation may have tempered new transactions for the time being, the D&O market remains increasingly competitive as SPACs look to consummate their business plan by merging with target companies. However, it remains to be seen how long this current market lasts and whether it is sustainable.

11 https://www.whitecase.com/publications/insight/us-spacs-data-hub
12 https://www.dealpointdata.com/res/dealpointdata_spac_study_q1_update_2022.pdf
13 https://www.dealpointdata.com/res/dealpointdata_spac_study_q1_update_2022.pdf

About the Authors

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With over 25 years of experience, Jane is the Head of Executive Line Brokers and is responsible for consulting, program design, program implementation and negotiating of directors and officers liability, employment practices liability, fiduciary liability, fidelity and other related insurances. Internally, Jane is a member of the internal audit committee and leads the continuing education and onboarding of new hires within the Executive Liability Practice.

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