The Ripples Behind the SPAC Wave

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The past year saw a burst in popularity of SPACs. More than half of companies that went public in 2020 did so using a SPAC on their way to raising over $80 billion in proceeds, and so far in 2021 SPAC offerings far outpace traditional IPOs. SPACs allow companies to go public with greater speed and with fewer hurdles than a traditional IPO. These innovations combined with unprecedented deal volume may signal an increased risk for disputes, especially where the SPAC process and structure can present unique pitfalls.

For example, SPACs must issue registration statements and proxies in advance of acquiring a target company, which require compliance with Sections 11 and 14(a) of the Securities Exchange Act. But unlike in traditional IPOs, SPAC target companies may disclose projections of future performance before shareholders vote on whether to move forward with a merger, and failure to meet those projections could lead to litigation by shareholders or the SEC. The SEC has issued guidance on the types of disclosures that SPACs specifically should keep in mind, including disclosures pertaining to sponsors', officers' and directors' financial incentives, prior SPAC experience, and conflicts of interest with other entities to which they owe fiduciary duties. SPACs also often raise money through PIPE (private offering in public equity) transactions, which allow for private investment on special terms, but those require separate disclosures and result in an additional set of shareholders who could later bring claims. By their nature, SPACs also present a number of other regulatory risks, including risks relating to MNPI, valuation, and conflicts of interest.

SPAC officers and directors may also face individual liability in connection with both the acquisition of a target company as well as their management of operations. As a potential harbinger of things to come, a 2015 New York state court decision suggested that SPAC directors might not be protected by the business judgment rule in connection with a merger where they are incentivized to consummate a transaction before the drop-dead date. And if a combined company struggles after a merger, officers and directors could face allegations that they inadequately managed the company or did not exercise sufficient oversight. The latter, known as a *Caremark* claims, have been gaining increasing traction in the courts in recent years after a 2019 Delaware Supreme Court decision.

Sponsors should be particularly vigilant in assessing legal and regulatory risks involving SPACs because a significant number of private equity-backed companies have been acquired by SPACs. Between January 1, 2021 and March 12, 2021, SPACs have acquired, or announced an agreement to acquire, 78 different private equity-backed portfolio companies. If there is litigation involving a SPAC concerning the acquisition of a portfolio company, the funds and their sponsors are at increased risk of being dragged into the litigation. Funds are typically significant shareholders in portfolio companies, and often hold or control board seats. As we have described in our parallel series, ***The Portfolio Company Playbook,*** these indicia of control create litigation risk for the entire fund complex (individual sponsors, board directors, and funds). The same risk persists, post-acquisition, if the fund retains a board seat. Therefore, while SPACs are an innovative and efficient path to liquidity, they are not risk-free.

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