Harvard Law School Forum on Corporate Governance

SPAC-Related Enforcement and Litigation: What to Expect in 2022

Posted by Alex Wyman, Colleen Smith, and Kristin Murphy, Latham & Watkins LLP, on Wednesday, April 13, 2022

Editor's note: Alex Wyman, Colleen Smith, and Kristin Murphy are partners at Latham & Watkins LLP. This post is based on their Latham memorandum. Related research from the Program on Corporate Governance includes SPAC Law and Myths by John C. Coates (discussed on the Forum here).

Key Points:

- The SEC has indicated that it will continue its focus on SPACs, including by proposing rules to further regulate SPACs this spring, which could lead to increased SEC enforcement activity involving SPACs and de-SPAC'ed public companies.
- Federal prosecutors, under directives from US Deputy Attorney General Lisa Monaco to invigorate efforts to combat corporate crime, are likely to increase their focus on SPAC-related securities matters, including on issues involving insider trading and investor fraud.
- Private securities class action lawsuits targeting SPACs, SPAC directors, and operating company executives are increasingly common in light of regulatory scrutiny and a proliferation of short seller attacks.
- Key court decisions are expected in early 2022 that may clarify or limit the application of *MultiPlan*'s entire fairness standard of review and resolve questions involving the application of the Investment Company Act of 1940 to certain SPACs.

SEC Enforcement Division Continues Focus on SPACs

The Securities and Exchange Commission (SEC or Commission) Chair Gary Gensler has signaled his desire to have the SEC propose rules in April 2022 to increase its scrutiny of special purpose acquisition companies (SPACs) and private companies that go public through de-SPAC transactions.

On December 9, 2021, Chair Gensler delivered public remarks before the Healthy Markets Association in which he expressed concerns about information asymmetries, the potential for misleading information and fraud, and conflicts of interest that he believes are inherent in de-SPAC transactions.[1]

[1] Gary Gensler, Chair, SEC, Remarks Before the Healthy Markets Association Conference (Dec. 9, 2021), *available at* https://www.sec.gov/news/speech/gensler-healthy-markets-association-conference-120921.

To mitigate these concerns, Chair Gensler announced that he has directed Commission Staff to develop proposed rules for the Commission's consideration to address SPAC-related disclosure requirements, marketing practices, and "gatekeeper obligations."

These rules are intended to achieve the following effects:

- Eliminate information asymmetries among investors—for example, between retail investors and PIPE (private investment in public equity) investors—by enhancing disclosure requirements at all stages of SPACs, including both the initial SPAC IPO and the de-SPAC transaction;
- Better guard against misleading information and fraud by regulating marketing practices in the de-SPAC process—for example, by restricting the level of "hype" permitted in connection with the de-SPAC transaction or by requiring more robust disclosures to the public to support any statements made in connection with a de-SPAC announcement; and
- Mitigate conflicts of interest by better aligning incentives between gatekeepers—which Chair Gensler defined as "potentially including directors, officers, SPAC sponsors, financial advisors, and accountants"—and investors, in order to prevent these gatekeepers from attempting to "arbitrage liability regimes" by avoiding the due diligence and other requirements that exist in more traditional funding routes such as an IPO.

In Chair Gensler's words, these efforts are designed to ensure that "like activities are treated alike," and to reflect his view that de-SPAC transactions—which have the effect of taking a private company public—should be treated with the same regulatory scrutiny and have the same disclosure and due diligence requirements as a traditional IPO.

Lastly, Chair Gensler emphasized that he intends for the SEC to fill the role of the "cop on the beat," signaling a continued emphasis on aggressive enforcement action related to SPACs.

Chair Gensler's remarks, which are the clearest indication to date of how the SEC intends to regulate SPACs and when companies can expect such regulations to be released, echo prior indications by the SEC that it intends to scrutinize SPACs. In December 2020, for example, the SEC issued guidance for best practices on making disclosures in connection with SPAC transactions, which highlighted concerns about disclosing conflicts of interest and differing incentives among SPAC sponsors and investors.[2] Similarly, in April 2021, then-Acting Director of the SEC's Division of Corporation Finance, John Coates, gave public remarks in which he discussed the "legal liability that attaches to disclosures in the de-SPAC transaction," and questioned whether the current regulatory framework and existing private liability provisions impose sufficient incentives to ensure proper due diligence and disclosures in de-SPAC transactions.[3] In November 2021, Chair Gensler delivered public remarks at the Securities Enforcement Forum in which he expressed the need for the Commission to focus on the

[2] SEC, Special Purpose Acquisition Companies, CF Disclosure Guidance: Topic No. 11 (Dec. 22, 2020), *available at* https://www.sec.gov/corpfin/disclosure-special-purpose-acquisition-companies.

[3] John Coates, Acting Director, Division of Corporate Finance, SEC, SPACs, IPOs and Liability Risk under the Securities Laws (Apr. 8, 2021), *available at* https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws.

"economic realities" of a transaction and to pursue what he termed "high-impact" cases, naming SPACs as the first example.[4]

Although it will be some time until the SEC's proposed rules or guidance is issued, and even longer until any rules are officially adopted and enforced, regulatory action could move quickly, which would lead to increased enforcement activity involving SPACs in the near term. Chair Gensler is moving rapidly to pass rule proposals for his top-priority agenda items, which has already sparked criticism by congressional lawmakers for his adoption of what they are calling "unreasonably short comment periods."[5]

In the meantime, the SEC has been engaged in significant enforcement activity involving SPACs and de-SPAC mergers. For example:

- In July 2021, the SEC announced that it had filed charges against a SPAC called Stable Road Acquisition (SRAC); SRAC's sponsor and CEO; SRAC's proposed merger target, Momentus Inc.; and Momentus' founder and former CEO, Mikhail Kokorich, for allegedly misleading claims about Momentus' technology and about national security risks associated with Kokorich.[6]
- On December 3, 2021, electric car maker Lucid Motors announced that it had been subpoenaed by the SEC and that the SEC's investigation "appear[ed] to concern" the de-SPAC transaction that took the company public earlier in 2021, along with "certain projections and statements."[7]
- The very next day, Digital World Acquisition Corp. (DWAC)—the SPAC set to merge with former President Donald Trump's media venture—announced that it, too, was under investigation by the SEC and that it had received a request seeking documents and information related to the anticipated de-SPAC transaction.[8]
- In December 2021, the SEC reached a settlement with Nikola, a publicly traded company taken public through a de-SPAC transaction, under which Nikola agreed to pay US$125 million to settle charges that it defrauded investors by misleading them about its products, technical advancements, and commercial prospects.[9] The SEC also sued Nikola's founder and former CEO, Trevor Milton, for fraud associated with those statements.[10]

These efforts are expected to continue in 2022. The SEC reportedly has signaled a willingness to "regulate by enforcement"—that is, to use enforcement cases as an expression of regulatory policy rather than wait to bring enforcement cases until regulations have been passed—

---

[4] Gary Gensler, Chair, SEC, Prepared Remarks at the Securities Enforcement Forum (Nov. 4, 2021), *available at* https://www.sec.gov/news/speech/gensler-securities-enforcement-forum-20211104.

[5] Tom Zanki, Republicans Slam Gensler for Limiting SEC Comment Periods, Law360 (Jan. 10, 2022), *available at* https://www.law360.com/securities/articles/1453897/republicans-slam-gensler-for-limiting-sec-comment-periods.

[6] SEC, Press Release, SEC Charges SPAC, Sponsor, Merger Target, and CEOs for Misleading Disclosures Ahead of Proposed Business Combination (July 13, 2021), *available at* https://www.sec.gov/news/press-release/2021-124.

[7] SEC Form 8-K, Lucid Group, Inc. (Dec. 3, 2021), *available at* https://ir.lucidmotors.com/static-files/d5cfaaaa-1258-41ab-a347-7a3cd6172ad5.

[8] SEC Form 8-K, Digital World Acquisition Corp. (Dec. 4, 2021), *available at* https://sec.report/Document/0001193125-21-348593.

[9] SEC, Press Release, Nikola Corporation to Pay $125 Million to Resolve Fraud Charges (Dec. 21, 2021), *available at* https://www.sec.gov/news/press-release/2021-267.

[10] SEC, Press Release, SEC Charges Founder of Nikola Corp. With Fraud (July 29, 2021), *available at* https://www.sec.gov/news/press-release/2021-141.

suggesting that the SEC could bring aggressive enforcement cases involving SPACs based on the concerns identified by Chair Gensler even before formal rules are adopted or proposed.[11]

Likely Uptick in Criminal Enforcement Activity

This year is also likely to see an increase in criminal enforcement activity involving SPACs. As described in this Latham Client Alert, Deputy Attorney General Monaco gave a speech last fall in which she announced the Department of Justice's (DOJ's) intent to "invigorate" its efforts to combat corporate crime. As a result, companies should expect a higher degree of scrutiny from federal prosecutors across corporate transactions generally.

Moreover, while the SEC and DOJ are commonly aligned in their interests, here they appear to be directly aligning their positions. In her remarks from October 2021, Deputy Attorney General Monaco indicated that the DOJ would evaluate a company's "historical misconduct" when considering potential corporate resolutions—including with civil authorities—stating that "prosecutors will be directed to consider the full criminal, civil and regulatory record of any company when deciding what resolution is appropriate for a company that is the subject or target of a criminal investigation."[12]

Less than a week later, Chair Gensler stated in public remarks that Deputy Attorney General Monaco's comments were "broadly consistent with [his] view of how to handle corporate offenders," and promised to "make war without quarter on any who sell securities by fraud or misrepresentation."[13]

Federal prosecutors have the authority to criminally prosecute violations of the rules promulgated by the SEC,[14] as well as violations of the federal criminal securities fraud statute,[15] and the SEC commonly refers securities matters to the DOJ for potential criminal prosecution if the Commission believes criminal prosecution—a much bigger hammer than civil enforcement—is warranted.

As the SEC prioritizes enforcement actions involving SPACs—and in particular allegations of misleading information and fraud in connection with SPACs and de-SPAC transactions—companies can expect a correspondingly higher number of criminal referrals involving SPACs and potentially a higher level of interest by criminal authorities in SPACs generally.

Notably, federal criminal investigations take longer to become public than SEC investigations because of the secrecy and non-disclosure requirements of grand jury investigations.[16] Given the sharp increase in SPAC activity in 2020 and 2021, it is possible that there has already been an

---

[11] *See* Richard Satran, U.S. SEC embraces "regulation by enforcement" as securities industry morphs beyond rulebooks, Reuters (Nov. 12, 2021), https://www.reuters.com/article/bc-finreg-sec-regulation-by-enforcement/u-s-sec-embraces-regulation-by-enforcement-as-securities-industry-morphs-beyond-rulebooks-idUSKBN2HX1OR.

[12] Lisa O. Monaco, Deputy Attorney General, DOJ, Remarks prepared for the ABA's 36th National Institute on White Collar Crime in Washington, DC (October 28, 2021), *available at* https://www.justice.gov/opa/speech/deputy-attorney-general-lisa-o-monaco-gives-keynote-address-abas-36th-national-institute.

[13] Gensler, Prepared Remarks at the Securities Enforcement forum, *supra* n.4.

[14] 15 U.S.C. § 77f(a).

[15] 18 U.S.C. § 1348.

[16] *See generally* Fed. R. Crim. P. 6(e).

increase in SPAC-related criminal enforcement activity that will become public in the coming months.

Indeed, de-SPAC transactions implicate a variety of issues that commonly prompt federal criminal investigations. For example:

- **Insider Trading:** As with any corporate transaction involving a publicly traded company, the de-SPAC process involves insider trading concerns. Unlike in a traditional IPO, in which the company being taken public is not yet publicly traded, in a de-SPAC transaction the SPAC is publicly traded prior to the business combination that takes a private company public. Information that the SPAC is pursuing a business combination agreement with a target, before that agreement is announced, could constitute material non-public information (MNPI) in some circumstances, and conducting trading in the SPAC based on that information could be considered insider trading. Insider trading concerns are particularly acute in SPACs due to the common practice of securing commitments for PIPE investments leading up to the de-SPAC transaction, in which PIPE investors are often provided with details about the expected business combination agreement. Dissemination of MNPI to potential PIPE investors increases the risk of tipper/tippee insider trading liability.
- **Investor Fraud:** As Chair Gensler outlined in his December 2021 remarks, individuals involved in a de-SPAC transaction may face possible exposure for committing investor fraud if, in connection with raising investments, they either make false or misleading statements to the investors or fail to make adequate disclosures regarding material information concerning the SPAC investment. Whether SPAC directors and sponsors will also face a corresponding increase of scrutiny is unclear. But as the SEC places more emphasis on disclosures—or lack thereof—in connection with de-SPAC transactions, it is safe to assume that federal prosecutors will as well.

As an example of recent criminal interest in companies taken public by de-SPAC, the US Attorney's Office for the Southern District of New York indicted Nikola founder and former CEO Milton for violations of the federal securities fraud and wire fraud statutes in connection with substantially the same conduct that led the SEC to charge both Milton and Nikola—namely, defrauding investors "through false and misleading statements regarding Nikola's product and technology development."[17]

Key Issues in Private Securities Class Actions

As many have predicted, private securities class action lawsuits targeting SPACs and the companies they have taken public through de-SPAC mergers are on the rise. According to one database, a total of 50 securities class action cases have been filed involving de-SPAC public companies, with 37 of those filed in 2021 alone.[18] These cases point to a few issues to watch in the coming year.

---

[17] U.S. Attorney's Office, S.D.N.Y., Press Release, Former Nikola Corporation CEO Trevor Milton Charged In Securities Fraud Scheme (July 29, 2021), *available at* https://www.justice.gov/usao-sdny/pr/former-nikola-corporation-ceo-trevor-milton-charged-securities-fraud-scheme.

[18] Stanford Law School Securities Class Action Clearinghouse, a collaboration with Cornerstone Research, *available at* https://securities.stanford.edu/current-trends.html#collapse2.

Heavy Focus on Short Seller Attacks

Many of these cases have followed on the heels of public announcements of SEC investigations or other enforcement activity. Notably, a substantial portion of these cases have been filed in the wake of stock price declines connected to short seller attacks. Indeed, of the cases filed to date, 18 of them, or approximately 36% of cases, involve such attacks, and a disproportionate number of those are focused in the electric vehicle and autonomous vehicle space.

While many of these cases remain in their early stages, at least some courts have permitted claims based on short seller attacks to proceed past the motion to dismiss stage.[19] In a case involving electric vehicle battery manufacturer QuantumScape, for example, two short seller reports issued in the months following the de-SPAC alleged that the company's batteries still confronted significant hurdles before they could be scaled, and one of the reports pointed to information purportedly provided by undisclosed former company employees.[20] A court declined to dismiss claims based on statements contradicted by these reports, finding they were not entirely based on information that was otherwise already public (and therefore available to investors), and their sources were sufficiently described to be credited.[21]

The Applicability of the PSLRA Safe Harbor

Despite speculation in 2021 that the safe harbor provision of the Private Securities Litigation Reform Act of 1994 (PSLRA) may not apply to SPACs, so far industry participants and courts continue to consider that safeguard to be intact. The safe harbor provision protects forward-looking statements such as financial projections or predictions of future achievements when those statements are accompanied by sufficient risk warnings.[22] There are, however, exceptions to the safe harbor provision, which include IPOs and "blank check" companies.[23] In his April 2021 public remarks regarding SPACs, Mr. Coates commented that SPACs have typically failed to meet the definition of "blank check" companies under the PSLRA, and then noted that "[t]he Commission has not substantively amended the definition of 'blank check company' since the passage of the PSLRA, but of course, it could consider doing so in the future."[24]

Following these comments, the US House Financial Services Committee in May 2021 released draft legislation that sought to prevent SPACs from invoking the PSLRA's safe harbor provision by amending the Securities Act of 1933 and the Securities Exchange Act of 1934 to replace the term "blank check company" with a definition that encompasses SPACs.

In his December 2021 remarks, Chair Gensler expressed support for the notion that SPACs should not qualify for the safe harbor provision—which also does not apply to IPOs—through his messaging that "[f]unctionally, the [de-SPAC transaction] is akin to a traditional IPO" and that (to quote Aristotle) "like should be treated alike."[25]

---

[19] *See, e.g.*, *Bond v. Clover Health Investments Corp.*, No. 3:21-CV-00096 (M.D. Tenn. Mar. 1, 2022); *In re Quantumscape Sec. Litig.*, No. 21-CV-00058-WHO, 2022 WL 137729 (N.D. Cal. Jan. 14, 2022).

[20] *Quantumscape*, 2022 WL 137729, at *5-6, *9-10.

[21] *Id.* at *9-10.

[22] 15 U.S.C. § 77z-2(c).

[23] 15 U.S.C. § 77z-2(b)(1)(B), (b)(2)(D).

[24] Coates, SEC, SPACs, IPOs and Liability Risk under the Securities Laws, *supra* n.3.

[25] Gensler, Remarks Before the Healthy Markets Association Conference, *supra* n.1.

These remarks notwithstanding, courts evaluating motions to dismiss in private securities class actions involving de-SPAC public companies have continued to apply the safe harbor to qualifying forward-looking statements. Absent amendment to the PSLRA, that trend seems likely to continue in 2022.

Court Decisions to Watch

MultiPlan's Application of Entire Fairness Review

Many questions remain regarding the expected application of the Delaware Chancery Court's opinion in *MultiPlan*, in which the court applied the heightened entire fairness standard of review to claims that a SPAC board breached its fiduciary duties in connection with alleged disclosure claims arising from a short seller attack.[26] (For information on that decision and the key questions it left unanswered, see this Latham Client Alert.)

In the meantime, a handful of cases presenting similar claims are at the motion to dismiss stage, including a case filed against the directors of SPAC GigCapital2, Inc., in connection with its June 2021 acquisition of UpHealth Holdings, Inc. and Cloudbreak Health, LLC.[27] The plaintiffs allege—much as they did in *MultiPlan*—that the SPAC directors breached their fiduciary duties in connection with the de-SPAC transaction by failing to make sufficient disclosures, in this case in connection with the company's post-close capital structure. While the claims are similar, some key differences exist, including a less well-defined disclosure claim and the absence of the types of alleged conflicts that existed in *MultiPlan*, which may lead to a different outcome. This and other cases like it will provide guidance on some of the questions *MultiPlan* left open, such as whether board compensation with founder's shares will always trigger entire fairness review, whether the MFW framework can ever be applied to a de-SPAC transaction (and if so, under what circumstances), and whether an estoppel argument can be successful when there is full disclosure of misaligned incentives, to name a few.[28]

Investment Company Act Cases

Stockholder plaintiffs have also filed a handful of lawsuits against SPACs alleging they are investment companies that are subject to the requirements of the Investment Company Act of 1940. The most notable of these are claims pending against Pershing Square Tontine Holdings, in which a stockholder asserts that because the Pershing Square SPAC has done nothing but invest in and hold securities, it is subject to the '40 Act.[29] The claims focus in substantial part on an abandoned effort by the SPAC last year to acquire equity ownership in Universal Music Group, which the plaintiffs point to in support of their argument that the SPAC's purpose is to invest in securities rather than become an operating company. A few other, similar cases are pending against more traditional SPACs that have raised proceeds to conduct a single business combination with a target.[30] While an overwhelming number of law firms that practice in this area

---

[26] *In re MultiPlan Corp. Stockholders Litig.*, 2022 WL 24060 (Del. Ch. Jan. 3, 2022).
[27] *Laidlaw v. GigAcquisitions2*, LLC, C.A. No. 2021-0821-PAF (Del. Ch.).
[28] *See also Yu v. RMG Sponsor, LLC*, C.A. No. 2021-0932-SG (Del. Ch.).
[29] *Assad v. Pershing Square Tontine Holdings, Ltd*., No. 21-CV-1:21-CV-06907-AT-BCM, (S.D.N.Y. Aug. 17, 2021)
[30] *See, e.g*., *Assad v. E.merge Tech. Acquisition Corp.*, No. 21-CV-07072 (S.D.N.Y. Aug. 20, 2021); *Assad v. Go Acquisition Corp*., No. 1:21-cv-07076 (S.D.N.Y., Aug. 20, 2021).

have expressed the view that SPACs are not subject to the '40 Act,[31] suggesting these cases are vulnerable to dismissal on legal grounds at the pleading stage, this issue has not yet been addressed by the courts. A ruling may come within the next few months in connection with the pending motions to dismiss in these cases.

Conclusion

SPACs remain a key feature of the capital markets and M&A landscape as a means for private companies to go public through business combinations. Nevertheless, clients engaging in de-SPAC transactions should consider taking certain preventive measures to mitigate the heightened risk of criminal and civil enforcement and of private litigation impacting SPACs and their acquisition targets, as Latham has outlined. In addition, companies should consider taking additional steps to avoid regulatory scrutiny, including undergoing a thorough due diligence process, bolstering disclosures made in connection with the de-SPAC transaction, and putting careful restrictions in place regarding the dissemination of MNPI. Robust due diligence and disclosures in particular will help mitigate the risks of enforcement activity in de-SPAC transactions.

[31] Law360, *Forty-Nine Law Firms Push Back Against Litigation Targeting SPACs*, *available at* https://www.law360.com/articles/1416888/49-law-firms-push-back-against-litigation-targeting-spacs.