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Underperforming SPAC Still Subject to Federal Claims in Securities Class Action

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If 2020 was the "Year of the SPAC," 2021 may be turning into the year of the SPAC class action. We have already followed numerous cases where recently formed SPACs have been challenged in federal court for alleged violations of federal securities laws. Although those cases are still pending, a district court recently delivered a notable ruling on a SPAC created far in the distant past, as far as SPACs are concerned: 2017.

The SPAC in question in this suit, then known as Silver Run Acquisition Corporation II, went public through an IPO and searched for an acquisition in the energy sector. Silver Run's management highlighted Alta Mesa Holdings, LP, an oil and gas company, as a potential target. Alta Mesa is known as an upstream oil-and-gas company which focuses on acquiring and developing unconventional hydrocarbon resources. Such companies often have symbiotic relationships with a midstream company, which produces, gathers, processes, and markets oil and gas. While upstream and midstream companies are separate entities, they often generate revenue from the same wells and leases. Silver Run sought to take advantage of synergies by combining these types of companies and announced a preliminary agreement to merge with Alta Mesa and its midstream colleague in late 2017 while also planning for a potential spin-off of the midstream company.

In support of the preliminary agreement, in early 2018, Silver Run issued a proxy statement, which recommended its shareholders approve the merger. The proxy statement indicated positive financial indicators from Alta Mesa and the midstream firm and stated these companies were poised for accelerating growth upon completion of the business combination. However, after the business combination closed in March 2018, Alta Mesa made its first SEC filings, which disclosed expected EBITDA nearly 50 percent below similar projections included in the proxy statement. Alta Mesa continued to present financials below its initial projections for the remainder of 2018.

In early 2019, Alta Mesa announced a $3.1 billion write-down and that its 2018 annual report would be delayed. This sizeable impairment represented the vast majority of the company's value, which was calculated to be $3.8 billion only one year earlier. In addition to drawing a reaction from financial markets, this announcement drew delisting warnings from the Nasdaq Stock Market. After numerous extensions, Alta Mesa filed its annual report, along with a statement from its independent accounting firm stating Alta Mesa failed to maintain control over financial reporting through 2018. Finally, in September 2019, Alta Mesa filed for Chapter 11 bankruptcy protection.

Prior to the bankruptcy filing, plaintiffs – numerous investors in Alta Mesa –filed a complaint in the United States District Court for the Southern District of Texas. This complaint, which was subsequently amended in March 2020, alleged the failure of Alta Mesa's business was the product of improprieties that resulted in false and misleading statements being made to the investing public. As such, Plaintiffs brought fraud claims under section 10(b) and 20(a) of the Exchange Act and proxy claims under section 14(a) and 20(a) of the Exchange Act.

On June 30, 2020, more than eighteen named defendants (most of whom are affiliated with Alta Mesa) filed eight separate motions to dismiss the action. On April 14, 2021, the Court denied the motion to dismiss in a brief opinion. The Court focused on the size of the write down, writing that "the enormity of the write-down over such a short period of time is enough for the case against these defendants to proceed." Given that the write down constituted over 80% of Alta Mesa's value less than one year after Alta Mesa filed its first 10-K and the company delayed its announcement by several months, the Court viewed the plaintiffs as having pled facts sufficient to sustain their action. Furthermore, the Court noted the allegations and SEC filings were sufficient to show that the lawsuit was not a "strike suit," and the plaintiffs were therefore entitled to discovery.

With the recent notoriety of SPACs, along with the plethora of actions challenging them under the federal securities laws, this brief analysis from the Court may provide some guidance on what type of alleged facts could withstand a motion to dismiss an action against a post-SPAC company. We will continue to monitor this case and provide updates as they occur.

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