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SEC Speaks Out on SPACs, Highlights Legal Liability and Reporting Risks

By **Corey I. Rogoff** on April 19, 2021

Posted in **Securities Law, Securities Regulatory, SPAC**

SPACs seem to be having their moment in the financial world, especially in 2021. In less than three months, U.S.-based SPACs have raised more money – almost $88 billion – than all SPACs combined in 2020 (which held the previous high for SPAC investment by some margin). They have even reached a level of societal notoriety, as shown by this week's cover of New York Magazine. However, before SPACs and their supporters can carry this trend "to the moon," the SEC chose this week to release two notices bringing SPAC fans back to earth.

On April 8, Acting Director of the Division of Corporate Finance John Coates released a public statement titled "SPACs, IPOs, and Liability Risk under the Securities Laws." Coates notes that some commentators have argued SPACs present advantages over the traditional IPO process via "lesser securities law liability exposure for targets and the public company itself," specifically the Private Securities Litigation Reform Act's (PSLRA) safe harbor for forward-looking statements. While Coates admits projections are "woven into the fabric of business combinations," he is concerned that "participants may not have thought through all the legal implications" of such statements. Rather, these claims of SPACs as the safer option are overstated at worst and may in fact pose greater liability "due in particular to the potential conflicts of interest in the SPAC structure."

Under this approach on SPACs and their interaction with securities laws, Coates highlights that material misstatements or omissions in a registration statement are subject to liability under Section 11 of the Securities Act of 1933. Further, these types of classic securities missteps would also pose liability concerns when it comes to proxy solicitations and tender offers under Section 14 of the Exchange Act of 1934. These actions may also run afoul of state laws, which apply a duty of candor and fiduciary duties to these transactions when presented with potential conflicts of interest.

Notably, Coates explains how the PSLRA and its safe harbor may not be the shield its proponents expect it is. Excluded from this safe harbor are statements made in connection with a securities offering by a blank check company and those made in connection with an IPO. However, as the PSLRA does not define "IPO," Coates theorizes that the deSPAC transaction is the true introduction of the economically viable company to the market and therefore the safe harbor would not apply to statements about such a transaction. In fact, it may not be a stretch to consider the entire SPAC lifespan – from IPO to deSPAC transaction – as part of the IPO for the purposes of liability and regulatory purposes.

On April 12, the Division of Corporate Finance again roiled the SPAC world by releasing a staff statement on Accounting and Reporting Considerations for Warrants Issued by SPACs. In certain fact patterns examined by the Staff, the SEC found that SPACs may need to revise or restate historical financial statements with the SEC due to errors in the accounting treatment of warrants, a central feature of the SPAC structure. Warrants, commonly found in SPAC transactions, entitle a holder to purchase more stock at a later date (usually after the future SPAC target has been acquired). However, the SEC found several common practices – such as warrants that provided for potential changes to settlement amounts dependent on who held the warrant or scenarios whereby a tender offer would entitle warrant holders to cash while only certain common stock holders would be entitled to the same – would require the warrants not to be listed as equity but rather as "a liability measured at fair value." By suggesting such errors would require financial restatements, the SEC is effectively forcing SPACs and deSPAC companies to take a closer look at their warrant offerings and SEC filings.

* * *

In the coming days and weeks, we plan to post a deeper dive on these SEC statements and what they will mean for the SPAC litigation world. ***To stay up-to-date on events in the SPAC world, subscribe to Proskauer's Corporate Defense and Disputes blog and we will keep you appraised of the latest developments.***

TAGS: IPO, SPAC, SPECIAL PURPOSE ACQUISITION COMPANIES (SPACS), SPECIAL PURPOSE ACQUISITION COMPANY

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Post-SPAC Technology Company Hit with Securities Class Action

By **Corey I. Rogoff** on March 30, 2021

Posted in **Securities Class Action, SPAC**

Private companies with cutting-edge technology have become particularly attractive targets for special purpose acquisition companies (SPACs). These private companies may choose to go public via SPAC for a number of reasons that include the ability to share projections with investors, better valuation prospects and deal execution certainty. Much like companies that go public by way of a traditional IPO, however, companies that go public via SPAC can also become subject to Section 10(b) securities class actions. The risk for this type of company may be particularly acute given its high growth prospects or the volatility that may accompany its securities. An example of a company that went public via SPAC that was quickly confronted with this type of action is Velodyne.

In 1983, David Hall founded Velodyne as a company known for producing specialized audio equipment. However, in 2006, he patented an invention known as a multi-beam spinning LiDAR sensor that would become the backbone of his company. LiDAR sensors use light to determine an object's distance in the same way sonar sensors use soundwaves. LiDAR is thought to be key to the future of self-driving vehicles and how these vehicles can navigate obstacles and environments in real time.

A SPAC called Graf Industrial Corp. successfully completed its merger with Velodyne Lidar on September 29, 2020. Between November 2020 and February 2021, Velodyne made numerous public statements and SEC filings regarding its financial health and the goings-on of its Board.

However, on February 22, 2021, Velodyne announced David Hall had been removed from his position as Chairman and his wife Marta Hall was removed from her role as Chief Marketing Officer following an Audit Committee investigation. The company disclosed the investigation concluded "Mr. Hall and Ms. Hall each behaved inappropriately with regard to Board and Company processes, and failed to operate with respect, honesty, integrity, and candor in their dealings with Company officers and directors."

Shortly thereafter, on March 2, 2020, a sole plaintiff filed a purported class action in the United States District Court for the Northern District of California against Velodyne Lidar, as well as two officers who served during the class period. In his complaint, the plaintiff alleges defendants made materially false or misleading statements regarding Velodyne's directors and the existence of the internal investigation during the class period (November 2020 to February 2021). Among these alleged misstatements is the company's February 18, 2021 announcement that a director linked with the SPAC vehicle resigned and that his "decision to resign was not a result of any disagreement with the Company." Notably, the complaint does not include any allegations relating to Velodyne's merger with Graf Industrial.

Velodyne has not yet filed its response to the complaint, and the Court has not made any statements about class certification. We will continue to monitor this case and actions facing de-SPAC public companies.

TAGS: CLASS CERTIFICATION, PRIVATE, PUBLIC COMPANIES, SEC FILING, SECTION 10(B), SECURITIES CLASS ACTIONS, SPAC, SPECIAL PURPOSE ACQUISITION COMPANIES (SPACS), UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA

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SPAC Securities Class Action Comes for Private Equity Sponsor

By **Corey I. Rogoff** on March 1, 2021

Posted in **Health Care, Securities Class Action, SPAC**

Pharmaceutical and biotech companies, with proprietary and potentially lucrative products, have been popular targets for SPAC sponsors. Unfortunately, one such private equity sponsor may have its hands full after its managing partner was publicly named in a securities class action.

Immunovant Sciences was a private clinical-stage biopharmaceutical company that develops treatments for autoimmune diseases. One of its promising drugs – IMVT-1401 – was in Phase II clinical trials for the treatment of Graves' ophthalmopathy and warm autoimmune hemolytic anemia. Dr. Roderick Wong, Managing Partner/Chief Investment Officer of RTW Investments and CEO of blank-check company Health Sciences Acquisitions Corporation ("HSAC"), must have liked what he saw, as Immunovant Sciences entered into a merger agreement with HSAC on September 29, 2019, after which the new company "changed" its name to Immunovant, Inc.

The merger was announced to the public three days later, in which Dr. Wong stated he "believe[d] IMVT-1401 is a uniquely compelling asset within the FcRn drug class" which he expected would become "a cornerstone therapy for treating many auto-antibody driven disease." Throughout the rest of 2019 and 2020, Immunovant, Inc. positively mentioned IMVT-1401 in public statements and SEC filings.

However, Immunovant Inc. changed its tune on February 2, 2021 when it announced a " voluntary pause of dosing in its ongoing clinical trials for IMVT-1401" as the company became aware of a "physiological signal consisting of elevated total cholesterol and LDL levels in IMVT-1401-treated patients in ASCEND GO-2, a Phase 2b trial in Thyroid Eye Disease (TED)."

On February 19, 2021, a sole plaintiff filed a purported federal securities class action against Immunovant, Dr. Wong, and its current CEO and CFO in the United States District Court for the Eastern District of New York. In her complaint, the plaintiff alleged the company and Dr. Wong's statements were materially misleading as, among other things, HSAC failed to perform adequate due diligence on Immunovant Sciences prior to the merger.

Immunovant, Inc. has not yet filed its response, and the Court has not made any statements about class certification.

TAGS: CLASS CERTIFICATION, PLAINTIFF, PRIVATE EQUITY SPONSOR, PURPORTED FEDERAL SECURITIES CLASS ACTION, SEC, SECURITIES CLASS ACTION, SECURITIES LAW, SECURITIES-FRAUD PLAINTIFF, SPAC, SPAC SPONSORS

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SPACs Explained, in Five Minutes or Less


By **Corey I. Rogoff** and **Julia Alonzo** on February 10, 2021

Posted in **Securities Regulatory, SPAC**

In the financial world, 2020 was the year of the SPAC. During the past few years, many Silicon Valley start-ups were chomping at the bit to get listed and cash out via initial public offering (IPO). And in 2020, over half of the companies that went public did so using a SPAC. Exchanges are also getting in on the fun, with at least three SPAC ETFs hitting the stock exchange in the past few months.

But what is a SPAC? Are they just the next financial fad, or are they here to stay? And what types of litigation risk does a company accept by taking the SPAC approach? If you take a few minutes to review our cheat sheet below, you should be able to speak *SPAC* fluently in no time:

What is a SPAC?

The SEC defines a SPAC as a company "created specifically to pool funds in order to finance a merger or acquisition opportunity within a set timeframe. The opportunity usually has yet to be identified." SPACs are a subset of "blank check" company and these terms are often used interchangeably in the media.

In short, a SPAC is a publicly traded pile of money waiting to be used to acquire a private company.

How do SPACs work?

The SPAC process has many of the same steps as a traditional IPO, but SPACs typically get to market much faster.

A sponsor, seeking to acquire or merge with an existing private company or asset, goes through the process of getting the SPAC underwritten, registered, and traded publicly. Prior to the SPAC's IPO, the sponsor owns 100% of the SPAC. During the roadshow, the sponsor seeks investors to purchase common stock and warrants, which entitle the buyer to purchase more stock at a later date (typically once the future target has been acquired). During the IPO, the SPAC will sell these units (containing a share and a portion of a warrant) for a set price, typically at $10 per unit. Given the dearth of historical data or audited financial statements for the newly formed SPAC, this process can be completed more quickly than a more traditional IPO.

Once the SPAC IPO is completed and the sponsor's ownership stake is diluted (typically to 20%), the search for the intended target begins. Up until this point, the SPAC cannot know for certain what company it will acquire or merge with. During the search (which usually takes between 12 and 24 months), the funds raised through the IPO are held in a trust account that the sponsor cannot access until they are used for their intended purpose (an acquisition or combination).

The SPAC, however, can also raise additional funds in support of the potential business combination. PIPEs (Private investments in public equity) have become a significant piece of the SPAC business combination formula allowing SPACs to take on larger targets than they otherwise would be able to with the amounts raised in the IPO and held in trust. The PIPE also provides the target company with certainty in the face of potential public SPAC shareholder redemptions.

If the SPAC finds its target and signs a merger agreement (what is sometimes called a "de-SPAC transaction"), it will announce the planned acquisition and file the necessary documents with the SEC. The transaction is then put to a shareholder vote, where investors can approve or vote down the deal. As part of the shareholder vote, shareholders can elect to have the SPAC redeem (often whether or not they vote for or against the transaction) the shares of the SPAC they purchased in the IPO (and can keep the warrants). Following shareholder approval, the deal closes.

However, if the SPAC strikes out during its stated timeline for action, it returns the money from the trust account to the public investors on a pro rata basis. In such an event, the sponsor's investment in the SPAC becomes worthless.

Are SPACs new?

No, SPACs have been around in some form or another since the 1990s.

However, they have recently seen a resurgence. In 2013, $1 billion in funds were raised through SPACs, or less than two percent of the total capital raised through IPOs. Even in 2019, SPACs only accounted for less than one-fourth of the market. 2020 was the first time that more money was raised through SPACs than through traditional IPOs.

Why would a company choose to use a SPAC?

Traditional IPOs are costly and take time. The Corporate Finance Institute has a good explainer on this topic, but in short, IPOs require negotiating with banks and investors while filing complex documents with federal regulators. There can be significant scrutiny on a company's actual financials or business model during this roadshow. Even well-known and promising companies have fallen flat when gearing up for an IPO.

SPACs, on the other hand, typically operate on a much quicker timeline, and involve fewer parties. In this environment, it is not surprising that investors have looked to other means to shepherd more "unicorns" into the market.

Do SPACs risk litigation?

SPACs bear many of the same risks that plague newly public companies. However, with their newfound popularity, SPACs have not yet faced a breadth of legal challenges. As SPACs continue to be used in the market, they may face two buckets of potential challenges: failing to act in the best interests of shareholders due to conflicts of interest, and failing to disclose material information.

- **Conflicts of Interest**: SPACs can have different incentives than traditional IPOs, as a SPAC may rely more heavily on PIPE financing. Directors and officers, while still bound by stock exchange listing requirements for corporate governance, may have ties to PIPE financers or the sponsor. Furthermore, SPACs may also produce profits for interested parties in a manner different than IPOs. For example, a SPAC sponsor vests their shares upon the closing of the merger. As sponsors and investors may have different motivations and sources of profit, there will always be concerns about conflicts of interest when it comes to SPACs and mergers.
- **Disclosure**: Once the de-SPAC transaction has occurred, the new company still must make the same SEC filings and disclosures that are required of public companies created through an IPO. Failing to properly alert the market to material findings could prompt actions brought under

Sections 10(b), 14(a), and 20 of the Securities Exchange Act of 1934 due to alleged false or misleading statements in their public disclosures.

The SEC issued two documents in December 2020 – a notice for investors and disclosure guidance from the Division of Corporate Finance – on SPACs, and more guidance may come in 2021. Unsurprisingly, the SEC appears focused on disclosures, and specifically on potential conflicts of interest.

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More Questions?

Please contact your Proskauer lawyer(s) or any member of the Securities Litigation group with any of your SPAC litigation questions.

Stay up-to-date on all things SPAC by subscribing to Proskauer's Corporate Defense and Disputes blog.

TAGS: CONFLICTS OF INTEREST, DISCLOSURES, INVESTORS, IPO, PIPE, PRIVATE INVESTMENTS IN PUBLIC EQUITY, SEC, SPAC, SPECIAL PURPOSE ACQUISITION COMPANY