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CD corporate disputes

SPAC-RELATED LITIGATION

REPRINTED FROM:
CORPORATE DISPUTES MAGAZINE
OCT-DEC 2022 ISSUE

www.corporatedisputesmagazine.com

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LOYENS & LOEFF
Law & Tax

Published by Financier Worldwide Ltd
corporatedisputes@financierworldwide.com

www.corporatedisputesmagazine.com

EXPERT FORUM

SPAC-RELATED LITIGATION

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CD: Reflecting on the last 12-18 months, how would you describe litigation activity arising in connection with special purpose acquisition companies (SPACs)?

Blake: There has been a significant volume of special purpose acquisition company (SPAC)-related litigation over the last 12 to 18 months, with a large number of securities and derivative lawsuits brought in federal courts as well as breach of fiduciary duty cases brought in Delaware or other state courts. SPAC litigation activity has slowed somewhat since the second half of 2021, as SPAC stockholder redemption rates have increased, and SPAC business combination volume has declined.

Loseman: With the proliferation of SPACs and de-SPAC transactions in the last few years, we are seeing not only an increase in related litigations but also creativity in the framing of claims. For example, many federal securities cases in 2021 and 2022 have asserted strict liability claims under the Securities Act based on registration statements filed in advance of the de-SPAC transaction. But that approach raises some interesting standing questions because SPACs are already public companies. For that reason, no stockholder who purchases on the open market following the de-SPAC transaction is likely to be able to trace their shares to the prospectus. Plaintiffs are also increasingly pursuing what amount to false statement theories in state court. For example, we have seen plaintiffs bring direct fiduciary duty claims against SPAC directors for alleged failures to disclose negative information causing the SPAC stockholders to not exercise their redemption rights.

Yoskowitz: SPACs are under increased scrutiny by the public and by regulators and subject to litigation risks on multiple fronts. In 2021, the number of suits involving SPACs increased from the prior years and that trend appears to be continuing in 2022. There have been securities class actions and SEC regulatory actions in addition to straightforward breach of contract claims. A few of these actions have resulted in significant decisions and liabilities for the sponsors and other SPAC participants, which has only fuelled the litigation boom. In addition, the current state of the financial markets generally means investors are losing money and may seek to recover their losses through the courts.

Sinninghe Damsté: While we have not yet seen SPAC-related litigation in the Netherlands, concerns in the market are rising in view of international developments. It is not uncommon for the Netherlands to lag some time behind the US, for instance, where it concerns these types of developments, although we tend to catch up quickly. Moreover, there are several factors that point to the Netherlands becoming a key jurisdiction for SPAC-related litigation in Europe. The Netherlands is

the premier jurisdiction for SPAC activity in the EU, outpacing London and Frankfurt and accounting for 16 out of a total of 39 European SPACs obtaining a listing on Euronext Amsterdam in 2021, raising approximately €4.4bn in total. In addition, Dutch entities are being used for de-SPAC transactions involving foreign SPACs. Historically, the Netherlands has been one of the primary hubs for class action securities litigation in Europe. The recent introduction of a new statutory class action regime, allowing monetary damages to be claimed, has only strengthened that position.

Gerber: SPACs have been a magnet for litigation activity over the last 12 to 18 months, and have faced litigation from all directions, including securities class actions when their stock prices decline, fiduciary duty litigation challenging potential conflicts of interest, merger litigation concerning the adequacy of de-SPAC disclosures, litigation under the Investment Company Act challenging the very structure of SPACs, and even criminal and regulatory proceedings in some extreme cases. While some of these filings can be seen as the type of routine litigation that is faced by all publicly traded companies, others likely reflect a strong sense of scepticism across regulators and the plaintiffs' bar about the value of SPACs and the companies that they have brought public.

CD: What factors typically drive a SPAC-related lawsuit? Are you seeing any common themes?

Loseman: What motivates litigation in the SPAC space does not seem to be all that different from other securities litigation. If the emerging public company struggles following the de-SPAC transaction, it is more likely to draw a suit. The stock performance of companies that go public through a de-SPAC transaction can be more volatile. This volatility may increase the likelihood of a stock drop catching plaintiffs' counsel's attention, but it can also result in fewer reflexive case filings because of the likelihood that the stock price rebounds quickly.

Yoskowitz: The most common themes are allegations of breaches of fiduciary duty and misrepresentations. In a typical class action, plaintiffs assert that defendants misled the investing public, or omitted material information, which inflated the price of the shares. Misrepresentations normally concern the private company with which the SPAC is combining. Usually, a failure to disclose certain information like an SEC investigation or loss of major customer is alleged to have resulted in a decline in the price of shares post the merger. The underlying claims are that the SPAC sponsors failed to do their due diligence, rushed a deal to market, or simply lied about the underlying company. In other instances, sponsors are alleged to have breached

their contractual duties by, for example, not using their best efforts to file a registration statement for the registration of the common stock. Finally, there are sometimes pre-merger lawsuits brought alleging that the disclosures are inadequate.

Sinninghe Damsté: In Dutch SPAC-related litigation, we expect to see investors bring claims on allegations of breaches of disclosure obligations and director duties. Much like in the US, securities fraud litigation in the Netherlands typically concerns alleged breaches of disclosure obligations. Especially in stock drop litigation, claimants will often fabricate allegations of securities fraud when certain announcements trigger a drop in share price, arguing that such drop is the result of an inflated share price caused by late, incorrect or misleading disclosures. Given the nature of the SPAC lifecycle, we also expect litigation on breaches of director duties. SPACs typically have an 18 to 24-month timeframe to enter into a business combination. Management may be under pressure to get a deal done despite suboptimal market conditions. Investors may try to bring director liability claims, arguing that the SPAC directors breached their fiduciary duties by failing to observe appropriate standards of diligence and care, for example rushing into a transaction while failing to conduct sufficient due diligence investigations into the target.

> **"Much of the focus of this first wave of SPAC-related litigation has been on alleged conflicts of interest involving so-called sponsor or founder shares."**
>
> *Stephen P. Blake, Simpson Thacher*

Gerber: Two factors that have been prominent in SPAC-related lawsuits are projections and the potential for conflicts of interests. With respect to projections, a large number of suits have challenged disclosures about the anticipated timeline for companies taken public by SPACs to develop new products and reach revenue milestones. These suits reflect stated concerns that SPACs may have an ability to present optimistic projections given that their disclosures, unlike ones in connection with initial public offerings (IPOs), are subject to the Private Securities Litigation Reform Act (PSLRA) safe harbour for forward-looking statements. With respect to conflicts of interests, a number of suits have raised issues with the potential incentives that

sponsors and other entities have to find targets and close de-SPAC transactions that may not be in the best interests of other stakeholders. However, these potential conflicts are regularly disclosed by SPACs and investors retain the ability to redeem their shares if they are unhappy with any proposed transaction.

Blake: Much of the focus of this first wave of SPAC-related litigation has been on alleged conflicts of interest involving so-called sponsor or founder shares. Plaintiffs have alleged that the SPAC compensation structure creates differing incentives for the sponsor and public stockholders. Lawsuits have also focused extensively on disclosure, including traditional M&A disclosure issues such as providing a fair summary of financial analysis and more SPAC-specific issues, like the use of forward-looking financial projections.

CD: Have there been any particular SPAC-related cases worth highlighting? How would you characterise their impact?

Yoskowitz: In 2022, the Delaware Chancery Court issued a well-reasoned decision of first impression in *MultiPlan Corp. S'holders Litig.* The Court of Chancery denied for the most part motions to dismiss claims challenging a de-SPAC merger. The court found that the claims of shareholders were direct claims, not derivative, and also that the more onerous entire fairness standard of review applied, rather than the lesser business judgment rule. The decision highlighted the conflicts inherent in a SPAC transaction between sponsors who receive 'founder' shares versus regular shareholders. After the merger, the market price of the post de-SPAC shares dropped significantly. Plaintiffs alleged that the SPAC's fiduciaries failed to disclose information that one of MultiPlan's larger customers was moving all of its accounts in-house. On the regulatory front, in July 2021, the SEC announced charges against a SPAC, Stable Road Acquisition Company, its sponsors and chief executive, and the SPAC target and the target's founder for misleading claims around the target's technology and about national security risks

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Jack Yoskowitz, Seward & Kissel LLP

associated with the founder. Parties, for the most part, settled the claims with total penalties of more than $8m. The target company apparently misled the SPAC, but the SPAC and its sponsors were still alleged to have conducted inadequate due diligence. The settlement highlighted a very large danger for SPAC sponsors that they can be misled but also be liable.

Sinninghe Damsté: A number of high-profile securities fraud cases may give an indication of what to expect from SPAC-related litigation. Notable examples include the following. Alongside a US class action, there is a Dutch class action pending against Airbus and a number of its current and former directors and auditors for alleged securities fraud, seeking compensation for a multibillion European market cap loss. The Airbus litigation perfectly embodies the way that claimant firms try to use the new Dutch statutory class action regime to their benefit in securities fraud litigation. In the recent past, a Dutch class action was threatened against certain banks involved in a €500m notes issuance, accusing such banks of not observing applicable standards of care when performing their due diligence into the issuer. We expect similar such claims to be brought in SPAC-related litigation. I also refer to the 2018 Fortis settlement, representing €1.3bn in value. This is the largest court-approved collective settlement in Dutch securities fraud litigation to date, demonstrating the potential of the Dutch statutory collective settlement regime to achieve finality for all parties involved and accommodate for complex and high-value cases.

Blake: The vast majority of SPAC-related litigation cases are federal securities lawsuits and those are still largely in their early stages. On the regulatory side, Securities and Exchange Commission (SEC) enforcement actions, such as those against Nikola and Momentus over claims made about technology, have been closely watched. In Delaware, the *MultiPlan* case found that SPAC shareholders could proceed with a putative class action over disclosure issues affecting their redemption rights under Delaware's searching entire fairness standard. There

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have also been a number of innovative lawsuits, including cases in state court about SPAC voting rights and in federal court over whether SPACs should be regulated under the Investment Company Act.

Gerber: The most high-profile litigation arising out of the SPAC world may have been the criminal, regulatory and related civil proceedings concerning electric truck company Nikola. The allegations in those actions exemplify many of the concerns raised regarding SPACs over time, including pre-revenue companies allegedly overstating the state of development of their products, misleading the public about the demand for those products, and targeting unsophisticated retail investors through social media. The sensational nature of the claims at issue in the case have likely contributed to or further reinforced the negative view of the SPAC market held by certain regulators and market observers.

CD: How would you characterise current regulation of the SPAC market? In terms of the obligations placed on SPACs, and scrutiny of both SPAC and de-SPAC processes, what are the main areas of concern for regulators?

Gerber: SPACs have received extraordinarily close scrutiny from regulators. Regulators have also been particularly focused on whether there

are so-called 'gatekeepers' in the SPAC process to the same extent that there are in IPOs. In IPOs, it is generally thought that underwriters – who face potential liability under the Securities Act, subject to an affirmative due diligence defence – serve as gatekeepers on behalf of investors by conducting due diligence concerning the disclosures made by the issuer. In SPACs, however, the potential absence of such Securities Act liability for participants in connection with de-SPAC disclosures has given rise to regulatory concern. The SEC's recent rules attempt to respond to this perceived shortcoming by purporting to extend Securities Act liability to underwriters of the original SPAC offering that participate in the de-SPAC transaction.

Blake: Over the past 18 months, the SEC review process has become more intensive and the SEC has been increasing its rulemaking activity. The SEC's recently proposed SPAC rules enhance disclosure requirements, eliminate the PSLRA's safe harbour for forward-looking statements, impose new registration and liability requirements, and create a new safe-harbour for Investment Company Act status. These rules, once finalised later this year, will impose further oversight on SPACs, and the market has already begun shifting practices in the expectation of their promulgation.

Loseman: The SEC has shown tremendous interest in SPAC and de-SPAC activity, likely due to

what some in the markets perceived to be a less burdensome way of going public. Gary Gensler, chair of the SEC, has made clear his support in seeing the same tools the SEC uses to regulate traditional IPOs to address information asymmetry, misleading information, and conflicts of interest apply equally to SPAC and de-SPAC transactions. In March 2022, the SEC issued proposed rules that would bring what many describe as significant changes to the regulatory requirements for both SPAC and de-SPAC transactions. The proposed rules seem to have already put a bit of a damper on the volume of SPAC transactions.

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Monica K. Loseman, Gibson Dunn

Sinninghe Damsté: Generally speaking, the European Union (EU) regulation of SPACs is lagging behind the US. In particular, the EU lacks a current set of overarching, European SPAC rules as well as clarifications as to where a SPAC stands within existing European regulation. This also means that, in the Netherlands, there is no specific regulatory framework for SPACs or de-SPAC transactions, including no requirement to obtain a fairness opinion in respect of the target. Dutch SPACs are in principle subject to the same rules and requirements as other listed or to be listed companies. These rules and requirements can roughly be broken down into three categories. First, prospectus requirements. SPACs looking to list on Euronext Amsterdam or another regulated market within the EU need to publish an approved prospectus. An approved prospectus may also be required when the SPAC, although not listed on a regulated market in the EU, offers securities to investors in the EU. Second, transparency obligations. After listing, a SPAC, like any other listed company, has ongoing transparency obligations. This means, for example, that a SPAC must publish inside information under the EU Market Abuse Regulation as soon as possible, which is particularly relevant in connection with a potential business combination. Finally, product governance. Whereas listed Dutch companies are generally expected to be structured as public limited liability companies, Dutch SPAC companies are typically structured as private limited liability companies. A consequence thereof is that Dutch BV SPACs typically offer lower standards of

product governance and investor protection than is generally expected of listed Dutch companies.

Yoskowitz: The regulatory world is still very much developing. As SPACs became more popular, regulators began to sit up and take notice – as evidenced by the SEC announcing in March 2022 that it was proposing new rules that would, among other things, impose additional disclosure requirements on SPACs. It would also make clear that the safe harbour for forward-looking statements does not apply to SPACs. The main concerns for regulators are the inherent conflicts between the sponsors and the investors, whether adequate and robust due diligence is being performed, and the adequacy of disclosures. At the IPO stage, regulators want to see that the sponsors are disclosing risks and conflicts. During the investment process, the concern is that the deal may be rushed to market with either inadequate due diligence by the sponsors or by omissions or misrepresentations by the target companies.

CD: As regulatory scrutiny intensifies, how likely is this to translate into increased enforcement activity? To what extent will this scrutiny focus on behaviour such as insider trading, investor fraud and short seller attacks?

Blake: I expect to continue to see regulatory enforcement activity on all fronts. Investigations and enforcement actions have focused on accounting, disclosure, insider trading and other issues. Short sellers have been active among post-SPAC companies, triggering stock drops and leading to lawsuits and enforcement questions. The SEC and other regulators will continue to review SPAC transactions closely and aggressively utilise the broad array of enforcement tools available to them.

Loseman: Enforcement staff are always laser-focused on signs of fraud, manipulation or insider trading. There seems to be a perception that some market participants pursued opportunities to go public outside of a traditional IPO not merely because it might be a more efficient form of transaction, but also to avoid regulatory scrutiny. Whether that perception is right or wrong, the SEC will be motivated to ensure every market participant knows it will not tolerate wrongful, fraudulent conduct anywhere in the public markets.

Sinninghe Damsté: A number of issues related to SPACS have raised the concerns of regulators and investors alike and led to an increase of regulatory scrutiny in the Netherlands and in the EU more broadly. In the context of product governance, the Authority for the Financial Markets (AFM) in the Netherlands has publicly expressed concerns on the 'atypical and complex capital structures' of

many SPACs and the level of investor protection they tend to offer. As such, the AFM has stated that it expects SPACs to be suitable only for a very limited group of retail investors prior to a de-SPAC. The AFM's scrutiny so far has mainly focused on the protection of the retail investors against certain SPAC-related risks, including conflict of interests and PIPE finance issues. This may be an indication of enhanced AFM scrutiny of SPACs. Another point to note is that on 15 July 2021, the European Securities and Markets Authority (ESMA) published a non-binding disclosure and investor protection guidance on SPACs. Additional guidance may follow, also in view of international regulatory developments. Such concerns and guidance may very well translate into enhanced scrutiny and increased risk of enforcement actions by supervising authorities.

Yoskowitz: Increased scrutiny always results in increased enforcement activity. In the US, that may be doubly true because the public and media have shown such an interest in SPACs and bigger and more well-known players have become involved. We have also seen the SEC bring its first major cases involving SPACs in the last year or so with the Stable Road settlement in June 2021 and the $38.8m settlement in October 2021 against Akazoo, S.A. This enhanced review will undoubtedly lead to settlements and actions involving fraud and other illegal behaviour. It will touch all players in the SPAC market. Institutional investors in SPACs, like traditional investment managers, have received and will continue to receive subpoenas in SEC investigations where the focus will be not only on the SPAC process itself, but in traditional areas of review like insider trading and lack of disclosures.

Gerber: I would expect continued enforcement activity in connection with SPACs, as they represented a significant percentage of securities offerings over the last two years and have been a frequent target of such activity to date. However, to the extent that some prior regulatory actions with respect to SPACs may have reflected an attempt to put the brakes on the SPAC market at a time when it was at its height, the recent decrease in SPAC market activity may impact the number and types of cases pursued in the future.

CD: What advice would you offer to SPACs, their investors and their acquisition targets, in terms of managing and mitigating potential litigation?

Loseman: SPACs should hire counsel with deep experience to advise on going-public alternatives. Given that the likelihood of litigation is so heavily tied to a company's stock performance, it is nearly impossible to prevent entirely the risk of shareholder litigation for any public company. Someone with a breadth of experience can advise on the relative risks inherent in each alternative.

Sinninghe Damsté: Litigation risks likely cannot be mitigated entirely, as the bear market arguably both increases risks while incentivising investors to recover losses through litigation. To limit such risks, however, I have two main points of advice for Dutch SPACs. First, Dutch SPACs should be mindful of conflict-of-interest rules and their disclosures, ensuring fair, timely and accurate disclosures. Accusations of promises or commitments that were not met, including greenwashing allegations, pose a material threat to SPACs. Second, management should duly document their conduct and – if necessary – have this supported by external financial and legal advice, especially where it concerns considerations whether to enter into a business combination. In managing such processes, early involvement of litigation counsel will help anticipate potential claimant action, helping to ensure that relevant risks are identified and that a clear and consistent strategy is in place to help mitigate such risks.

Yoskowitz: For investors, the advice is to read the documents with a particular eye toward the disclosures but also the contractual obligations themselves. Too often investors think they know how a transaction 'should work' or what 'generally happens'. But when the process breaks down, those underlying documents are what controls. For sponsors and the targets, they should understand that they are under tremendous scrutiny by both regulators and the traditional class action players that will bring a litigation pre or post-merger if they can allege any kind of wrongdoing. It is very important to ensure disclosures are adequate and that due diligence is done correctly.

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Cleary Gottlieb Steen & Hamilton LLP

Gerber: Although the frequency and diversity of SPAC-related litigation over the last two years has been notable and unique, advice for managing and mitigating potential litigation largely remains the same as for other offerings: accurately disclose all material issues, include robust risk warnings and disclaimers where appropriate, and consider providing the key assumptions and limitations underlying any disclosed opinions and projections. Individuals and non-issuers involved in the SPAC

process should also consider performing the type of due diligence investigation done in connection with IPOs to the extent possible.

Blake: Litigation is a fact of life for many SPACs. I would recommend they consult with their counsel early and often on how to prepare for litigation, mitigate it and defend against it when it arises. Key issues to consider are structuring sponsor incentives, the use of special committees and fairness opinions, disclosure, particularly of projections, and methods for implementing robust compliance and due diligence processes.

CD: What are your predictions for SPAC-related litigation over the coming months? To what extent do you expect to see an uptick in activity?

Sinninghe Damsté: Over the coming months, the expiry of the timeframe to enter into a business combination will come near for a number of Dutch SPACs. This, combined with the current bear market and the large number of SPACs relative to the limited number of eligible targets, significantly increases the risk of de-SPAC deals going sour. This in turn will greatly enhance SPACs' exposure to litigation risk, which is only exacerbated by increased regulatory scrutiny. While the Netherlands is lagging some time behind the US, in view of all the foregoing, I expect that we will quickly catch up in view of current market conditions. As such, besides the expected de-SPAC transactions in 2022 we also expect to be at the dawn of Dutch SPAC-related litigation.

Yoskowitz: In a down market, litigation risks generally increase. Therefore, I would expect to see a continued uptick in post-merger litigation where the share price has fallen. Separately, I would expect to see announcements by the SEC and other regulators of settlements and complaints filed involving inadequate disclosures and misrepresentations. Announcements of any rule changes by the SEC will obviously be significant and will result in both increased compliance costs and ensuing investigations and lawsuits. It will be interesting to see how the SPAC markets absorb all of these litigation risks. Moreover, there was a large amount of short selling involving SPACs in 2022. This can potentially result in investigations by the government into that short selling itself. Short selling also may translate into litigations against the SPACs based on the analysis of the short sellers who often publish those analyses through blogs or chat rooms.

Blake: Given SPAC deal volume, I do not expect to see a meaningful uptick in litigation filing activity. However, I do expect a number of currently pending lawsuits to reach decision points, and ongoing investigations to result in enforcement activity, which will continue to shape the landscape for years to come.

Gerber: SPAC-related litigation will continue to be a prominent fixture of the securities litigation area in the coming months as existing litigations continue to progress and new litigations concerning companies taken public during the prior SPAC boom continue to be filed. These cases will raise interesting and novel issues concerning the applicability of the safe harbour for forward-looking statements, the scope of underwriter liability under the Securities Act, and the extent to which claims can be based on allegations advanced by interested short sellers. A further wave of litigation can be expected as previous SPACs enter into merger agreements before their expiration, including the fiduciary duty area. However, given the cooling of the SPAC market, it remains to be seen how long this litigation will continue.

Loseman: The volume of SPAC litigation is unlikely to be sustained at the levels we have seen in recent years. For one thing, increased regulatory scrutiny is expected to lead to a reduced number of SPACs. That reduction in the universe of SPACs will mean a reduction in potential litigation targets, but the number of filings may not decrease on pace. The de-SPAC entity's stock price performance will continue to be the biggest driver of litigation risk. And if regulators make those claims easier to bring – like the SEC's proposed rule eliminating application of the PSLRA's safe harbour for forward-looking statements to the target's projected financial performance in de-SPAC transactions – these entities will only become increasingly attractive targets for false statement cases. CD