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Liability Risk in De-SPAC Transactions

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Material Misstatements or Omissions

Mr. Coates emphasizes that "going public" through a de-SPAC transaction in lieu of a conventional IPO does not sidestep liability for material misstatements or omissions. Indeed, both the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act) may impose liability for material misstatements or omissions in connection with a de-SPAC transaction. Mr. Coates also reminds SPAC participants that state law can impose liability for material misstatements and omissions.

- *Liability under the Securities Act*. Mr. Coates notes that when a de-SPAC transaction involves an effective registration statement under the Securities Act (i.e., a Form S-4), such registration statement is subject to Section 11 of the Securities Act. Section 11 provides investors with the ability to hold issuers, officers, underwriters and others liable for damages caused by untrue statements or material omissions of fact within the registration statement at the time it becomes effective.
- *Liability under the Securities Exchange Act.* Additionally, even if the SPAC does not file a registration statement in connection with the de-SPAC transaction, the SPAC will have to solicit proxies in connection with the approval of the de-SPAC transaction. Any material misstatement or omission contained in proxy solicitation materials subjects the SPAC participants to potential liability under Section 14(a) and Rule 14a-9 of the Exchange Act. Mr. Coates points out that courts and the SEC generally apply a lower negligence standard under these provisions, which actually increases potential liability exposure for material misstatements and omissions in these materials.

- *Liability under State Law*. Mr. Coates also notes that de-SPAC transactions could give rise to liability under state law. For example, Delaware corporate law applies the duty of candor and fiduciary duties more strictly when conflicts of interest exist (which is often the case in a de-SPAC transaction) in the absence of procedural safeguards, which could also be a source of liability.

Private Securities Litigation Reform Act

Mr. Coates notes that some commentators have relied on the PSLRA's safe harbor for certain forward looking statements to support the assertion that de-SPAC transactions expose SPAC participants to less liability than a conventional IPO. Mr. Coates counters this argument by noting the following limitations to the PSLRA safe harbor:

- *Private Litigation Only*. The PSLRA only applies in private litigation and does not prevent the SEC from taking action to enforce the federal securities laws.
- *No Protection for Knowingly False or Misleading Statements*. The PSLRA does not protect against false or misleading statements made with actual knowledge that the statements were false or misleading. Mr. Coates illustrates this point with the example of a company in possession of multiple sets of projections, each of which may be based upon reasonable assumptions but reflect different outcomes. According to Mr. Coates, the company would be on "shaky ground" if the disclosure in connection with the de-SPAC transaction only contained the favorable projections and omitted the unfavorable ones.
- *Information Must Be Forward-Looking*. The PSLRA safe harbor is not available if the statements are not actually forward-looking. Mr. Coates cites instances where courts have found statements about current valuation or operations outside the scope of the safe harbor, even when based upon forward-looking projections or statements.
- *Meaningful Cautionary Language Required.* To benefit from the PSLRA safe harbor, meaningful cautionary language must accompany the forward-looking statements, identifying important factors that could cause actual results to differ materially from those in the forward-looking statements.

The PSLRA specifically excludes IPOs from the safe harbor, but not de-SPAC transactions. Mr. Coates argues, however, that "initial public offerings" is a phrase that "may include de-SPAC transactions." Mr. Coates's interpretation relies on what he calls the "economic essence" of an IPO: the introduction of a new company to the public. Mr. Coates concedes that an IPO "is generally understood to be the *initial* offering of a company's securities to the public, and the

SPAC shell company *initially* offers redeemable equity securities to the public when it first registers to raise funds in order to look for and later acquire a target." He explains, however, it is "commonly understood that it is the de-SPAC—and not the initial offering by the SPAC—that is the transaction in which a private operating company itself 'goes public,' i.e., engages in **its** initial public offering." Under Mr. Coates's interpretation, a de-SPAC transaction—whether or not a Securities Act registration statement is involved and regardless of the de-SPAC transaction structure utilized—would constitute an IPO for purposes of the PSLRA. As a result, the PSLRA's safe harbor would not cover forwarding-looking statements made in connection with de-SPAC transactions.

Looking Ahead

Mr. Coates urges all SPAC participants to understand the limits of any alleged liability differences between de-SPAC transactions and conventional IPOs. Mr. Coates cautions that SPAC sponsors, targets, and their affiliates and advisors should already be providing the public with the information material to the investment opportunities a de-SPAC transaction represents regardless of the ultimate outcome of the liability analysis. At the same time, Mr. Coates acknowledges that there could be advantages of providing SPAC participants with greater clarity regarding the scope of the PSLRA safe harbor. Mr. Coates suggests that the SEC could use its rulemaking process to reconsider and recalibrate the applicable definitions or the SEC Staff could provide guidance on its views regarding the application of the PSLRA safe harbor to de-SPAC transactions. In closing, Mr. Coates emphasizes the economic equivalency between de-SPAC transactions and conventional IPOs, stating "[i]f we do not treat the de-SPAC transaction as the 'real IPO,' our attention may be focused on the wrong place, and potentially problematic forward-looking information may be disseminated without appropriate safeguards."

Steps to Mitigate Liability Exposure

Regardless of any actions the SEC or its Staff take to clarify the scope of liability in a de-SPAC transaction, SPAC participants should consider the following steps to mitigate liability risks associated with a de-SPAC transaction:

- *Due Diligence of Private Company Target*. Many stockholder complaints relating to de-SPAC transactions allege that the SPAC selected a poor private company target and/or failed to conduct adequate due diligence to uncover any red flags. A SPAC should appropriately document its due diligence of any private company target and create a written record that its due diligence findings were adequately communicated to the SPAC's board of directors.

- *Conflicts of Interest.* Conflicts of interests often arise in de-SPAC transactions and become the basis of de-SPAC litigation. SPACs should identify any potential conflicts of interests, employ a process that prevents these potential conflicts from compromising decisions regarding the de-SPAC transaction, and disclose such conflicts and processes in any proxy statement or registration statement filed in connection with the de-SPAC transaction.
- *SEC Guidance on Disclosure about De-SPAC Transactions*. As evidenced by Mr. Coates's statement, the SEC's Division of Corporation Finance continues to prioritize de-SPAC transactions. In December 2020, the Division of Corporation Finance issued CF Disclosure Guidance: Topic No. 11 on disclosure considerations for de-SPAC transactions. In particular, the SEC Staff emphasized disclosures relating to the financing of the de-SPAC transaction; background information about the de-SPAC transaction (including communications among the parties to the de-SPAC transaction and alternatives considered); material factors considered by the board of directors; and conflicts of interest and information regarding any special interests (including material payments or other compensation) that certain SPAC participants will receive as a result of the de-SPAC transaction. To mitigate lawsuits relating to disclosures in SEC filings, SPAC participants should analyze existing and future guidance from the SEC and its Staff relating to de-SPAC transactions.
- *Cautionary Language*. Notwithstanding Mr. Coates's view regarding the scope of the PSLRA, any financial projections and other forward-looking information contained in de-SPAC disclosures should be accompanied by meaningful cautionary language. SPACs should go beyond boilerplate language and tailor disclaimers so that they identify specific risks relating to the private company target and its industry.
- *Exculpatory Provisions in Governing Documents*. To preempt any claims associated with a later de-SPAC transaction, SPACs should consider including exculpatory clauses in governing documents at the time of formation that will limit liability for directors for fiduciary duty claims in connection with de-SPAC transactions.

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