An Investment Too Good to Be True No Longer: Are SPACs in the Clear from Security Class Action Litigation?

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SUMMARY

This paper examines the new Securities and Exchange Commission (SEC) special-purpose acquisition company (SPAC) legislation, Rule 1600 of Regulation S-K, implemented in June 2024. It argues that while the legislation enhances investor rights and protections in SPAC-related investments, it also compels corporate gatekeepers involved in these transactions to act in better faith. This shift arises from the elimination of safe harbour provisions as a liability defence. The paper explores SPACs and de-SPACs as investment vehicles, the history of securities class actions (SCAs), and emerging trends in SPAC-related litigation. It posits that although SCAs in SPAC and de-SPAC transactions were historically rare, the new legislation may lead to an increase in such actions.

KEYWORDS:

Special-Purpose Acquisition Company (SPAC), De-SPAC, Initial Public Offering (IPO), Security Class Action, Rule 10b-5, section 11, Private Securities Litigation Reform Act, Safe harbour

Throughout history, the stock market has been one of the most significant contributors to wealth creation and preservation for individuals, and a way for institutions and companies to hedge risk and profit. At its core, the stock market is a simple supply and demand model, with buyers deeming what they would pay (their bid) and what sellers are willing to sell for (their ask). Upon reaching an agreement, the security changes hands.[1] The stock market is comprised of publicly traded companies, bonds, commodities, and other securities that anyone registered in their respective countries can buy and sell. However, one of the more complex securities that are eligible to be bought and sold is a special-purpose acquisition company (SPAC), also referred to as a 'blank check' company, which is a shell company.[2] However, SPACs are one of if not the most scrutinized securities in the markets. They are not a typical publicly traded company and are less heavily regulated than a typical publicly traded company. This, in turn, has made SPACs face a lot more class-action litigation[3] and costly legal battles, resulting in new guidelines in the United States of America (USA) being implemented to try and make SPACs more regulated.[4] This paper aims to show how the new legislation passed in the USA will help SPACs become less likely to be the victims of class actions while simultaneously holding the institutions and key stakeholders in SPAC transactions more accountable in the legal and regulatory sphere. An overview of SPACs will be provided, followed by an overview and history of class action lawsuits will be provided; primarily in the scope of a security class action in the USA. Next an analysis of selected security class action lawsuits against SPACs in the market will be analysed and discussed. Upon the SPAC environment set relative to the class action litigation environment, an analysis and critique of how the new legislation will achieve safer investable security for individuals; while subsequentially ensuring that key actors in these transactions are under stricter regulations. Concluded by a brief discussion on how security class actions targeted against SPACs and de-SPACs could likely increase due to the enhancement of the legislation giving right to plaintiffs to sue under section 11 of Securities Act 1933.[5]

1 SPAC OVERVIEW

SPACs are an investable security; however, they are unique in the sense that they are not operating as a company as most publicly traded companies are. Rather, they are shell companies[6] that sit on an exchange and have the purpose of raising funds to merge with private companies, allowing the private companies to become publicly traded.[7] The merger of the SPAC and a private company, also known as a 'de-SPAC', is both an initial public offering (IPO) and a merger and acquisition (M&A) transaction wrapped together. The IPO itself is completed with an S1 Form (prospectus), which is required for any security to become publicly listed under the Securities Exchange Act 1934 and offers insight and transparency into the company itself.[8] However, the S1 is not filed like most IPOs as the company going public is not an ordinary company, as noted. Instead, it is a company with a broad investment target and hoping to find a company to take public. SPACs are headed by a 'sponsor someone highly creditable and experienced in the financial industry'.[9]

The nuance with this transaction, however, comes from the monetary proceeds that coincide with it. When a SPAC is formed, there must be a minimum of USD five million in shares (which are redeemable) along with warrants in accordance with section 12 (b) of the Securities Exchange Act 1934. A financial

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[1] Inyoung Hwang, *A Brief History of the Stock Market* (SoFi 27 Feb. 2024), https://www.sofi.com/learn/content/history-of-the-stock-market/?__cf_chl_tk=zf29IKcM2bn7UF5uD1Y_QLQknayytSpW61m78.0KW4w-1713959070-0.0.1.1-1621 (accessed 13 Apr. 2024).

[2] US Securities and Exchange Commission, *SEC.gov | What Are the Differences in an IPO, a SPAC, and a Direct Listing?* (Jul. 2013), www.sec.gov12, https://www.sec.gov/education/capitalraising/building-blocks/registered-offerings (accessed 13 Apr. 2024).

[3] Kevin LaCroix, *EV Company Hit With SPAC-Related Securities Suit* (The D&O Diary 28 Nov. 2023), https://www.dandodiary.com/2023/11/articles/securities-litigation/ev-company-hit-with-spac-related-securities-suit/#:~:text=With%20the%20filing%20of%20this (accessed 13 Apr. 2024).

[4] US Securities and Exchange Commission, *SEC.gov | SEC Adopts Rules to Enhance Investor Protections Relating to SPACs, Shell Companies, and Projections* (8 Jan. 2024), www.sec.gov, https://www.sec.gov/news/press-release/2024-8 (accessed 13 Apr. 2024).

[5] Securities Act 1933, s. 77k(a).

[6] Defined in s. 15 (E) (V) of the Securities Exchange Act 1934 as: The term '"shell company"' means a company that at the time of a transaction with an eligible privately held company (1) has no or nominal operations; and (2) has (a) no or nominal assets; (b) assets consisting solely of cash and cash equivalents; or (c) assets consisting of any amount of cash and cash equivalents and nominal other assets.

[7] Julie Young, *Special Purpose Acquisition Company (SPAC)* (Investopedia 24 Nov. 2020), https://www.investopedia.com/terms/s/spac.asp.

[8] *US Securities and Exchange Commission* 2, https://www.sec.gov/files/formf-1.pdf> (accessed 13 Apr. 2024).

[9] Max H. Bazerman & Paresh Patel, *SPACs: What You Need to Know*, Harv. Bus. Rev. (1 Jul. 2021), https://hbr.org/2021/07/spacs-what-you-need-to-know#:~:text=The%20SPAC%20process%20is%20initiated (accessed 13 Apr. 2024).

firm underwrites these shares[10] and when the underwriting is completed, the shell company completes their IPO and the underwriters gain 5%–5.5% of the proceeds from the offering. However, 3% of those proceeds are usually contingent on the de-SPAC transaction.[11] Additionally, the sponsor of the SPAC will receive shares of the SPAC prior to the IPO, which are classified as 'founders shares' or 'promoter' shares. On average, they receive 20% of the total shares after the IPO, but the shares only hold value if the de-SPAC transaction is completed.[12]

With the sponsor raising the initial money for an IPO, they then seek out other investors to raise more capital for an M&A deal, with many investors being institutional funds. The first or 'original' investors are sold shares of the SPAC at USD ten a share in which those proceeds are put into escrow and usually bear interest, along with warrants – which entitles the investor to buy shares in the future at a specific price which is typically USD 11.50 a share.[13] However, the original investors do not know the potential targets for the SPAC, and have to rely on the sponsors' credibility and leadership for their investment.[14] With the investors' capital, the sponsor then seeks their target and aims to acquire them to bring them public within their governing documents' timeframe. If the SPAC fails to do so, it must either ask the shareholders to extend its time frame or liquidate and return all capital to its investors plus any interest earned.[15]

If and when the SPAC finds its target and the de-SAPC transaction is underway, it is required to file an 8-K or a 6-K if it is a foreign private issuer.[16] The purpose of these forms is to provide insight and material information on the agreement in place,[17] and offer some transparency of the target's operations. However, before the completion of the de-SPAC, the shareholders can demand the SPAC to redeem their shares and receive pro rata shares from the IPO proceeds or stay as shareholders of the company after the M&A transaction.[18] However, the de-SPAC transaction may force the SPAC to raise private investment in public equity (PIPE) if they need to offset the redemptions taking place or if the SPAC needs more money to fund the target for the de-SPAC.[19] Upon having all the capital in place, the SPAC still needs to have shareholder approval for any amendments or additional share issuance, which must be filed in a proxy statement under 14A[20] and 14C[21] of the Securities Exchange Act 1934.[22] The SPAC or target company must also file an S-4 or an F-4 (if they are a foreign private issuer) to issue more shares with the de-SPAC transaction.[23] The S-4 and F-4 are forms that the public company must file when an M&A transaction or offer occurs.[24] These forms offer the public and shareholders transparency into the deal and give risk factors, a summary of the deal, and questions and answers that shareholders would have about the deal.[25] After all regulatory forms are submitted and approved and the de-SPAC transaction is completed, the recently merged company must file an 8-K within four days and provide all information as if it is filing a Form 10.[26]

2 The history and overview of class action lawsuits

A class action lawsuit is a civil lawsuit that has more than one plaintiff accusing the defendant for the same proposed wrong doing, allowing the courts to not have to hear the same lawsuit more than one time. In order for a class action lawsuit and the 'class' itself to be certified in USA the plaintiffs must be able to satisfy Rule 23 of the Federal Rules of Civil Procedure.[27] Rule 23 states:

> One or more members of a class may sue or be sued as representative parties on behalf of all members only if: (1) the class is so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect the interests of the class.[28]

Once a class is certified the lead law firm then puts an induvial claimant as the 'lead claimant' who will represent the whole 'class' in court – there are various factors that go into making the decision of the lead claimant and not overly important to the purpose of this essay.

While Rule 23 first took its footing in 1938, as the Federal Rules of Civil Procedure was approved by congress in September 1938,[29] *Amchem Products, Inc. v. Windsor*[30] provided the precedent and road map in which class action lawsuits have formed going forward. *Amchem*[31] concerned numerous asbestos manufactures (defendants) who were facing litigation from individuals who were or could be suffering from various health and illnesses due to the asbestos product.[32] Various individuals were filing cases in the East District of Pennsylvania for pretrial; however, there was a global settlement offered, and accepted which included all current plaintiffs and future plaintiffs who could make the same claim.[33] The purpose of this settlement was to find an administrative path to set the compensation for all asbestos related health issues.[34] However, The Third

[10] US Securities and Exchange Commission, *SEC.gov | SEC Adopts Rules to Enhance Investor Protections Relating to SPACs, Shell Companies, and Projections* (8 Jun. 2024), www.sec.gov, https://www.sec.gov/news/press-release/2024-8 (accessed 13 Apr. 2024).
[11] *Ibid.*
[12] *Ibid.*, at 10.
[13] *Ibid.*, at 9.
[14] Bazerman & Patel, *supra* n. 9.
[15] US Securities and Exchange Commission, *supra* n. 10, at 10.
[16] Foreign Private Issuer [Regulation C, Rule 405 and Exchange Act Rule 3b-4]: 'The term foreign private issuer means any foreign issuer other than a foreign government except an issuer meeting the following conditions: More than 50% of the outstanding voting securities of such issuer are directly or indirectly owned of record by residents of the United States; and Any of the following: The majority of the executive officers or directors are United States citizens or residents; More than 50% of the assets of the issuer are located in the United States; or The business of the issuer is administered principally in the United States'. US Securities and Exchange Commission, *SEC.gov | Financial Reporting Manual* (www.sec.gov 18 Nov. 2020) <https://www.sec.gov/corpfin/cf-manual/topic-6 (accessed 13 Apr. 2024).
[17] US Securities and Exchange Commission, *FORM 8-K* 1.01(a)(1) (2012), https://www.sec.gov/files/form8-k.pdf (accessed 13 Apr. 2024).
[18] US Securities and Exchange Commission, *supra* n. 10, at 11.
[19] *Ibid.*
[20] Securities Exchange Act 1934, Subpart 240.14a-101.
[21] *Ibid.*, Subpart 240.14c-101.
[22] Securities Exchange Act 1934.
[23] *Ibid.*, s. 5.
[24] Cornel takes placel Law, *Form S-4* (LII / Legal Information Institute Jan. 2022), https://www.law.cornell.edu/wex/form_s-4 (accessed 7 May 2024).
[25] *Ibid.*
[26] US Securities and Exchange Commission, *FORM 8-K* 2.01(f), https://www.sec.gov/files/form8-k.pdf (accessed 13 Apr. 2024).
[27] Federal Rules of Civil Procedure 2023.
[28] *Ibid.*, Rule 23.
[29] Federal Rules of Civil Procedure, *Federal Rules of Civil Procedure* (United States Courts 2018), https://www.uscourts.gov/rules-policies/current-rules-practice-procedure/federal-rules-civil-procedure (accessed 26 Oct. 2024).
[30] 521 US 591 (1997).
[31] *Ibid.*
[32] *Ibid.*
[33] *Ibid.*
[34] *Ibid.*

Circuit Court of Appeals overturned the class certification, as it did not meet requirements of 23(b)(3).[35] The plaintiffs petitioned to the Supreme Court which was granted, however, the Supreme Court affirmed the Court of Appeals decision in not certifying the class.[36] However, what did come from this ruling was that subclasses could be a 'appropriate' when a single class cannot satisfy all interests of the members in the class.[37] The importance of *Amchem*,[38] is the fact that the Supreme Court made it clear that Rule 23[39] is to be interpreted in a strict and narrow approach; however, there are ways in which all those who are or will be affected are given a method to claim damages while not undermining the law at hand.

3 History and overview of security class action lawsuits

While a general class action lawsuit offers a strategic and powerful option and right for individuals to seek damages against any company, a securities class action lawsuit (SCA) in the USA is a power right that all security holders have, but must follow slightly different rules. Evidently, the biggest difference from a class action and a SCA is the claim comes from holders of a security.[40] However, unlike general class actions which are formed for any potential wrong doing, SCA claims arise from fraudulent or material misrepresentation made by a company to entice the purchase or a sale of a security that resulted in a financial loss. These statements, omissions and or claims are often made in prospectuses – S1 or S4/ F4, however any other U.S Securities and Exchange Commission (SEC) disclosure form required that offer material information that may cause the security to change in price are still eligible to be the basis of an SCA. While the change in price to the upside is not a 'trigger' event, the change in price to the downside is more often than not the 'trigger' for a SCA claim to be brought forward as the damages can be traced back to the original statement or misrepresentation made. Upon a claimant finding a materially false or misleading statement that resulted in a financial loss due to the security price drop the claimant can sue under the applicable United States securities law, and must file their case in a district court.[41]

The claimant often sues the company, the previous and current board members and certain key executives for the fraudulent or material misleading statements made often falling under Rule 10b-5[42]–Rule 10b-5 prohibits any act in which there is fraud, misrepresentation or deceit where there is a proof and or a connection of purchasing or selling of a security.[43] Since 2014 there have been 1672 SCA lawsuits filed under section 10b-5[44] which makes up 56% of SCA lawsuits in the same time period.[45] However, securities are often not held by a sole individual as these companies are publicly traded on exchanges, meaning there are a number of investors who faced the same financial loss, allowing there to be a class formed as long as it satisfies Rule 23[46] just as a general class action lawsuits must. Although, for an SCA to form under a breach of Rule 10b-5[47] the claimants must prove they either bought or sold the security as *Blue Chip Stamps v. Manor Drug Stores*[48] provides authority for. Additionally, the claimant will have to have bought or sold the security is a specific time frame to be eligible to be part of the class, which can vary depending on when the materially false or misleading statement was made to the time of the security price drop took place as the Private Securities Litigation Reform Act (PSLRA)[49] provides clear legislation for. For example, if a company which traded at USD 10 a share disclosed knowingly fraudulent financials on 1 May 2023 and traded up to USD thirty by 30 April 2024, but the fraudulent financials were discovered on 1 May 2024 and the shares dropped to USD two all shareholders who bought between 1 May 2023 and 30 April 2024 would be eligible for the 'class' and have the right to seek damages. While Rule 10b-5[50] is the most common SCA filing, claimants have also been suing under section 11,[51] which is similar to Rule 10b-5[52] but allows and gives a right to the purchaser of the security to sue a corporate gatekeeper in the registration of an IPO as well as the company, board and key executives. Another law claimants are filing under is section 12,[53] which holds any person accountable for selling securities without proper registration or make false and or misleading statements in their prospectuses.[54]

Just as a general class action lawsuit, there must be a lead claimant or plaintiff that represents the whole 'class'. However, unlike a general class action where the lead plaintiff firm chooses, the court chooses for an SCA as the PSLRA states that the lead plaintiff is decided by the court overseeing the case.[55] Once a plaintiff (which is often a plaintiff law firm) files the complaint they must publicly announce the claims they are making, with the time period with who is eligible.[56] After the publication, the plaintiff law firm has ninety days to send and file a lead plaintiff application.-[57] The PSLRA does state the lead plaintiff should be the individual with the greatest financial loss,[58] however, there is not a clear calculation provided to the courts which allows for anyone to apply to be the lead if they meet the requirements of the class.

4 SPAC class action lawsuit analysis

While SPACs are complex, the public market has seemingly opted for, accepted, and profited from them. Figure 1[59] shows the last fifteen years of SPAC activity and the key financial metrics of SPACs.

[35] Federal Rules of Civil Procedure, 2023 states 23(b)(3) states: the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy. The matters pertinent to these findings include: (1) the class members' interests in individually controlling the prosecution or defence of separate actions; (2) the extent and nature of any litigation concerning the controversy already begun by or against class members; (3) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and (4) the likely difficulties in managing a class action.

[36] 521 US 591,1997.

[37] *Ibid.*, at 641.

[38] *Ibid.*

[39] Federal Rules of Civil Procedure 2023.

[40] Security is defined as a form of an investment, commonly share(s) of a company.

[41] Federal Rules of Civil Procedure, Rule 23, 2023.

[42] Securities Exchange Act 1934, 17 C.F.R. s. 240.10b-5.

[43] *Ibid.*

[44] *Ibid.*

[45] Edward Flores & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2023 Full-Year Review* 3 (2024), https://www.nera.com/content/dam/nera/publications/2024/PUB_2023_Full-Year_Sec_Trends_0123.pdf (accessed 10 May 2024).

[46] Federal Rules of Civil Procedure, Rule 23, 2023.

[47] Securities Exchange Act 1934, 17 C.F.R. s. 240.10b-5.

[48] 421 US 723, 1975.

[49] Private Securities Litigation Reform Act 1995.

[50] Securities Exchange Act 1934, 17 C.F.R. s. 240.10b-5.

[51] Securities Act 1933, s. 77k(a).

[52] Securities Exchange Act 1934, 17 C.F.R. s. 240.10b-5.

[53] Securities Act 1933.

[54] *Ibid.*

[55] Private Securities Litigation Reform Act 1995.

[56] *Ibid.*, 3(a)(i)(I).

[57] *Ibid.*, 3(a)(i)(II).

[58] *Ibid.*, 3(a)(iii).

[59] SPAC Insider, *SPAC Statistics/SPAC Insider* (7 May 2024), www.spacinsider.com, https://www.spacinsider.com/data/stats (accessed 7 May 2024).

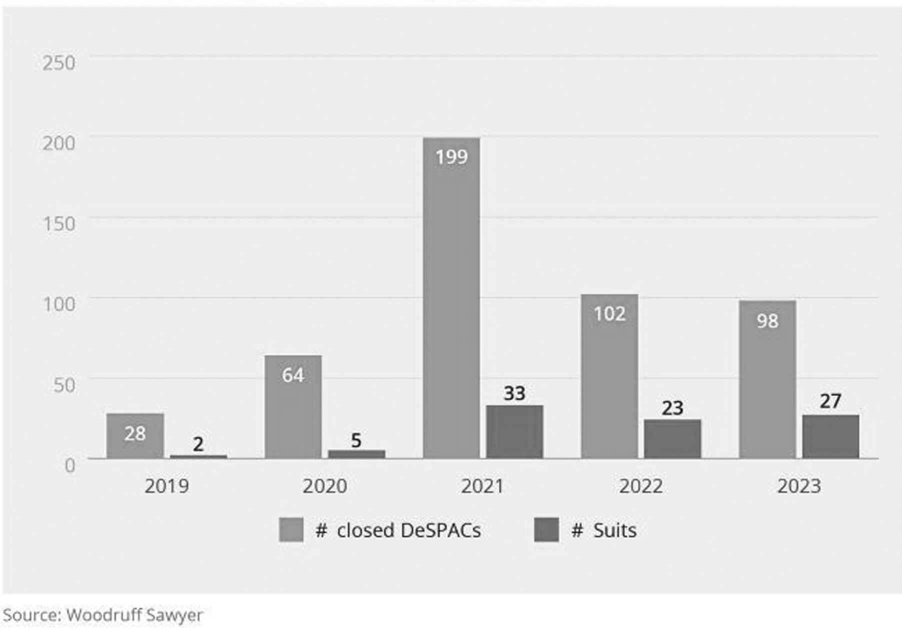
Figure 1 [60] *Fifteen Year History of SPACs*

IPO Year	IPO Count	Gross Public Proceeds USD ($mm)	Avg IPO Size USD ($mm)
2024	7	945.75	135.11
2023	31	3,847.96	124.13
2022	86	13,430.70	156.17
2021	613	162,502.57	265.09
2020	248	83,379.52	336.21
2019	59	13,608.31	230.65
2018	46	10,751.94	233.74
2017	34	10,048.46	295.54
2016	13	3,499.16	269.17
2015	20	3,902.45	195.12
2014	12	1,749.75	145.81
2013	10	1,455.27	145.53
2012	9	490.50	54.50
2011	15	1,081.53	72.10
2010	7	502.52	71.79
2009	1	36.00	36.00

The data shows a clear trend: Over the past fifteen years, SPACs have become increasingly popular within the public markets. However, the height of SPAC transactions came from 2020 to 2022, when, on average, they made up 64% of the IPOs in the USA markets and 43% of IPOs in the USA in 2023.[61] Relative to proceeds in the USA IPO market, 51% of total proceeds from 2020 to 2022 were SPACs; however, by 2023, only 15% were from SPACs.[62] While the SPAC market has seen a decline in the past year, during the SPAC boom from 2020 to 2022, SCA lawsuits also saw a spike, which is not a coincidence. In 2021, thirty-three SCAs were filed against SPACs; in 2022, twenty-three SCAs were filed; and in 2023, twenty-seven SCAs were filed.[63]

While these numbers seem low, they are high in comparison to the number of de-SPACs closed in each of their respective years. The percentage of SCAs relative to the total number of closed transactions, is seen in Figure 2[64] below.

Figure 2 [65] *Number of DeSPAC transactions v. Number of Suits from 2019–2023*



[60] US Securities and Exchange Commission, *supra* n. 10, at 14.
[61] US Securities and Exchange Commission, *supra* n. 10, at 14.
[62] *Ibid*.
[63] Yelena Dunaevsky & Teresa Milano, *SPACs Poised to Turn a Corner in 2024: Annual Risk Update | Woodruff Sawyer* (woodruffsawyer.com 22 Feb. 2024), https://woodruffsawyer.com/insights/spac-year-in-review-2024 (accessed 2 May 2024).
[64] *Ibid*.
[65] *Ibid*.

From 2021 to 2023, the average SCAs against de-SPACs were 22%. However, it is imperative to note that, on average, there is a nine-month lag between the de-SPAC transaction and an SCA being filed, which may cause some spillover in the data.[66] Nonetheless, the settlement amounts are still quite large, with 2023 recording just under USD ninety-four million with the ten settlements made public.[67] However, it is essential to note that the median time to resolve a class action lawsuit from the first complaint is 2.1 years, indicating the data still needs to catch up to the SPAC boom seen in previous years.[68]

The SEC is another factor of SPACs potential legal issues as the SEC can launch investigations and enforce regulatory actions.[69] XL Fleet[70] is a crucial example of the SEC enforcing regulatory actions; this case concerns XL Fleet going public via SPAC in 2020, later acquiring Spruce Power in 2022, and changing its name to Spruce Power.[71] However, during the SPAC and de-SPAC transaction, XL Fleet filed an 8-K stating that they had USD 220 million in their sales pipeline based on their probability metric inside their CRM (customer relationship management) system and were projected USD seventy-five million in revenue for 2021.[72] Upon more due diligence, the SEC found that USD 133 million of the pipeline had a 5% chance of closing and USD sixty-one million had a 25% chance of closing, meaning the revenue projections provided by XL Fleet were misleading to investors.[73] The SEC charged XL Fleet for misleading revenue projections ahead of their SPAC merger under 17(a)(2), 17(a)(3) of the Securities Act 1933,[74] rule section 14(a) and 14a-9 of the Securities Exchange Act 1934,[75] and rules 13a-11 and 12b-20 under the Securities Exchange Act 1934.[76] With these charges, Spruce Power was ordered to pay USD eleven million in a civil money penalty.[77]

While the above case illustrates the SEC's strong and diligent approach to projections and statements made by public or soon-to-be-public entities, many believe that SPACs need to be regulated more and, at times, take advantage of the law. Dambra, Even-Tov and George argue that the loophole SPACs use to issue forward-looking statements[78] (FLS) and projections is by seeking safe Harbour under the PSLRA.[79] The loophole with FLS being protected for a SPAC is that the PSLRA excludes IPOs and their S-1s. However, due to the public company going public via the merger with the SPAC, the proxy statements required to be filed are arguably protected under safe harbour law. The benefit of being protected under Safe harbour allows the SPAC and target companies to release projections at what they deem as 'reasonable' and not have the same liability that a normal IPO would have.

Additionally, with there being no named underwriter, there is no gatekeeper in a de-SPAC transaction, implying there is no liability under section 11 (issuers, underwriters, directors and officers, or any other professional/ expert involved that helped prepare the registration statement are strictly liable for any omission or misrepresentation of material information in their registration statement) of the Securities Act 1933,[80] and therefore, are not required to perform the same due diligence an IPO requires. Corporate gatekeepers, such as lawyers, bankers, auditors, and credit rating agencies, are corporations or individuals who are third parties to a corporation and are meant to oversee and ensure that the company is being regulated, managed, and compliant with all laws and regulations.[81] As noted, however, de-SPACs transactions do not have named gatekeepers, meaning no real third-party actors are working to ensure the deal is compliant, safe, and by the originally filed prospectus. *Slack Technologies, LLC v. Pirani*,[82] is a 2023 Supreme Court case that concerned Slack becoming publicly traded through a direct listing, and both registered and unregistered shares were eligible to be bought by the public.[83] Shortly after, a shareholder filed a SCA lawsuit against Slack under section 11 and section 12 of the Securities Act 1933 because he could not determine whether the shares he bought were registered under the registration statement.[84] The trial court certified its decision for an interlocutory appeal but denied Slack's argument to dismiss, and the Ninth Circuit, on a divided panel, affirmed the trial court's decision. However, the US Supreme Court reversed the decision in a unanimous ruling and deemed that in order to prove a suit under section 11, the plaintiff must be able to prove the securities they hold are traceable to a false or misleading statement in a registration statement.[85] This ruling upheld precedent law, and the Supreme Court further clarified the test for section 11.[86]

Regarding SPACs specifically, another recent case from March 2023, *In re CarLotz, Inc. SCA*,[87] which concerned CarLotz becoming a publicly traded company via a de-SPAC transaction in 2021 from Acamar Partners Acquisition Corporation (the SPAC).[88] The plaintiffs bought shares in

[66] *Ibid*.
[67] *Ibid*.
[68] Flores & Starykh, *supra* n. 45, at 13.
[69] Securities Exchange Act, s. 202.5.
[70] *United States of America Before the Securities and Exchange Commission in the Matter of Spruce Power Holding Corporation* (2023).
[71] *Ibid*., at 2.
[72] *Ibid*., at 5.
[73] *Ibid*., at 7.
[74] Securities Exchange Act 1933.
[75] Securities Exchange Act 1934.
[76] *Ibid*.
[77] *United States of America, supra* n. 70, at 8.
[78] Section 27A of Private Securities Litigation Reform Act 1995 defines forward looking statements as: '(i) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward looking statement'; or '(ii) immaterial'; or '(B) the plaintiff fails to prove that the forward-looking statement' '(i) if made by a natural person, was made with actual knowledge by that person that the statement was false or misleading'; or '(ii) if made by a business entity'; was '(I) made by or with the approval of an executive officer of that entity', and

'(II) made or approved by such officer with actual knowledge by that officer that the statement was false or misleading'.

[79] Michael Dambra, Omri Even-Tov & Kimberlyn George, *Should SPAC Forecasts Be Sacked?*, SSRN Electronic J. 11 (2021).
[80] Securities Act 1933, s. 77k(a).
[81] Sugata Roychowdhury & Suraj Srinivasan, *The Role of Gatekeepers in Capital Markets*, SSRN Electronic J. 1–2 (2019), doi: 10.2139/ssrn.3352046.
[82] No. 22–200, 2023 WL 3742580 (US 1 Jun. 2023).
[83] *Ibid*.
[84] *Ibid*.
[85] *Ibid*.
[86] Securities Exchange Act 1933, s. 77k(a).
[87] 2023 WL 2744064 (S.D.N.Y. 31 Mar. 2023).
[88] *Ibid*.

Acamar prior to the de-SPAC transaction and also bought shares in *CarLotz* post-de-SPAC transaction. They later filed claims stating that Acamar made materially false and misleading statements regarding CarLotz's business model.[89] The plaintiffs argued that due to these statements, they were in breach of sections 10(b) and 20(a) of the Securities Exchange Act 1934,[90] and sections 11, 12(a)(2) and 15 of the Securities Exchange Act 1933.[91] However, the court rejected all these claims and made it clear that section 10(b)[92] must be narrowly applied and that the plaintiff did not satisfy the 'purchaser-seller rule'.[93] Regarding section 11, the court again took a narrow approach to section 11[94] and found that the plaintiff's stock purchase was not traceable to the challenged registration statement.[95] section 12(a)(2)[96] which concerns oral statements, was also dismissed as it only applies to IPOs, and since the plaintiff bought in the secondary market, their claim had no merit.[97]

5 New SPAC legislation

SPACs bypass some securities laws and regulations, given the way in which the companies go public by a merger and are not under the same legal scrutiny as a standard IPO. However, on 24 January 2024, in a 3–2 vote, the SEC adopted new rules for SPACs and de-SPACs to comply with that came into force on 1 July 2024.[98] These new rules are under subpart 1600 to regulation S-K,[99] and while intensive can be summarized in four main points. First, it heightens investor protection and demands more disclosure in SPAC and de-SPAC transactions. [100] In section 1603 (a),[101] sponsors must now disclose their compensation; any conflict of interest between the SPAC sponsor, the SPAC itself and any of the SPAC sponsor affiliates; and disclosure of material lock-up agreements tabularly.[102] Second, business combinations involving shell companies will not qualify to be protected under safe harbour and the PSLRA[103] as the definition for 'blank check' companies are amended under Rule 145a.[104,105] Thirdly, projections under 10b and 1609 of Regulation S-K[106] regarding only de-SPAC transactions were added.[107] The de-SPAC must state who prepared the projections, all assumptions and bases for the material projections must be explained and must state if the reflections are views of the board or management of the SPAC or target company or both (either at the date of filing or a statement to disclose the projections and the reason for reliance by the board or management).[108] Finally, the status of SPACs under the Investment Company Act,[109] which some SPACs may meet the standard and definition under section 3(a)(1)(A) or 3(a)(1)(C) (or both),[110] and if the SPAC does, it must comply with the Investment Company Act[111] or may face litigation.[112]

With these four key takeaways, the liability landscape heavily shifts in the realm of SPACs. With no PSLRA[113] protection SPACs can no longer make projections that are 'too good to be true', as the enhanced disclosure requirements also require assumptions to be backed by evidence and facts, which enhances the protection of the investor to the same level as a traditional IPO. Additionally, liability under section 11[114] is now imposed as the co-registrant liability is now required by both the SPAC directors and officers and the private companies' directors and officers in their respective S-4.[115] By having section 11[116] liability relevant, it now puts disclosures under strict scrutiny on both ends of the deal, which again enhances the protection of investors. Prior to these new rules, the SPAC was only required to sign for the projections and disclosures, but having the de-SPAC also now sign means they must also perform their own due diligence on the projections being made.

6 Are SPACs less likely to be victims of SCA lawsuits?

When looking at the new rules in place, there is no denying that shareholders are given much more protection with SPACs and de-SPAC transactions, as there is now seemingly an additional set of eyes and approval for all disclosures and projections. However, this extra liability also means that both sides of the transaction have to comply and agree with all disclosures and projections being made. In contrast, prior to this regulation, it was unknown if they were agreed upon in many ways. Although investors are given more protection and rights to file claims against these transactions, the narrowness and strictness that the courts have upheld previously should not be discredited in any way. While in theory, it would make sense that SPACs and de-SPACs are more likely to be sued as there are clear regulations that must be followed, the likelihood of a case actually being settled or even being allowed is in favour of these transactions given the litigation trends in the market since 2020, with 18% of M&A cases being dismissed and 50% of standard cases being dismissed excluding M&A cases while only 1% of M&A cases being settled.[117] However, this does not mean the trends will stay in favour, given that these transactions are no longer able to hide behind PSLRA,[118] and the courts will no longer need to interpret who is liable as both sides of these transactions are now equal in the eyes of the regulation. With this loophole closed the key actors in these transactions should become

89 *Ibid.*, at2.
90 Securities Exchange Act 1934, 17 C.F.R. s. 240.10b-5.
91 Securities Exchange Act 1933.
92 Securities Exchange Act 1934.
93 2023 WL 2744064 (S.D.N.Y. 31 Mar. 2023), at 6–10.
94 Securities Exchange Act 1933, s. 77k(a).
95 2023 WL 2744064 (S.D.N.Y. 31 Mar. 2023), at 11–13.
96 Securities Exchange Act 1933, s. 12(a)(2).
97 *Ibid.*, at 16.
98 US Securities and Exchange Commission, *supra* n. 10, at 14.
99 Securities Exchange Act 1933, Subpart 229–1603.
100 US Securities and Exchange Commission, *supra* n. 10, at 4041.
101 Securities Exchange Act 1933, Subpart 229–1603(a).
102 *Ibid.*
103 Private Securities Litigation Reform Act 1995.
104 Securities Exchange Act 1933, Rule 145a.
105 US Securities and Exchange Commission, *supra* n. 10, at 294295.
106 Securities Exchange Act 1933 Subpart 229–1609.
107 US Securities and Exchange Commission, *supra* n. 10, at 344345.
108 *Ibid.*
109 Investment Company Act of 1940.
110 *Ibid.*
111 *Ibid.*
112 US Securities and Exchange Commission, *supra* n. 10, at 370.
113 Private Securities Litigation Reform Act 1995.
114 Securities Exchange Act 1933, s. 77k(a).
115 US Securities and Exchange Commission, *supra* n. 10, at 179.
116 Securities Exchange Act 1933, s. 77k(a).
117 Flores & Starykh, *supra* n. 45, at 13.
118 Private Securities Litigation Reform Act 1995.

much more diligent, which should result in less misrepresentation in their regulatory filings.

However, in many ways this new legislation makes SPACs and de-SPACs very similar to traditional IPOs, given the heightened discloser requirements regarding all regulatory filings and also disclosing all corporate gatekeepers making them all liable and vulnerable to SCAs. While Rule 10b-5[119] lawsuits will always be a relevant risk for any public company and be the largest number of claims made in a SCA, section 11[120] claims will become the sore spot for SPACs. Historical data shows that 66% (Federal and State court) of section 11[121] claims were made against IPOs since 2019.[122] Indicating that plaintiffs will not just investigate the board and key executives but will also investigate the corporate gatekeepers involved in the disclosures as they are now given the right to with the new legislation. While one cannot predict the number of SCA claims to come froward, there is strong conviction from historical data and trends that there will be a rise in SCA claims for SPACs and de-SPACs primarily under section 11[123] as it has now become relevant for SPACs and de-SPACs as all corporate gatekeepers must be disclosed. As noted earlier however, this legislation should force the disclosures to undergo a lot more due diligence prior to them being publicly disclosed on the gatekeeper's end. Although, this does not mean that claims will be less, as evident with the IPO litigation data (as noted above) there are still many SCA claims brought forward under section 11.[124]

7 Conclusion

The new regulations made the SPAC and de-SPAC transaction package more in line and level with a traditional IPO by mandating enhanced disclosures and increasing the liability requirements on both companies' directors and officers. While the SEC's attempt to regulate SPACs and de-SPACs to ensure investors protection is not without merit, it was undoubtably meant to force the key actors in these transactions to make realistic projections and close safe harbour loopholes which many SPACs and de-SPACs used. This paper has examined and analysed the SPAC and de-SPAC transactions, along with the new regulation that came into force on 1 July 2024.[125] The new strict regulation should, in theory, prevent SPACs and de-SPAC transactions from being victims of SCA lawsuits while upholding investors' rights and ensuring greater transparency in the public markets. While the discourse requirements are strengthened, this new legislation now opens up and the opportunity and gives the right for plaintiffs to sue under section 11,[126] which in turn could start the next wave of SCA suits being brought forward in the near future.

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