Lowenstein Sandler's Insurance Recovery Podcast: Don't Take No For An Answer

Episode 16 -
Don't Step on a Crack in the SPAC/deSPAC Insurance Claim Process

By [Lynda A. Bennett](#)
Guests: Steve Shappell and Ron Borys

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Lynda Bennett: Hi, welcome to "Don't Take No for an Answer," I'm your host, Lynda Bennett, Chair of the Insurance Recovery Group at Lowenstein Sandler. And during a recent episode of don't take no for an answer, we discussed one of the hottest topics of 2021 in the D&O insurance space, that being securing D&O coverage for SPAC and De-SPAC transactions. Well, since airing that episode, the SPAC, De-SPAC market has remained active and is running at a frenzied pace. The level of available funding for SPACs is historic and eye-poppingly large. This phenomena has created a capacity squeeze in an already challenged D&O market where it's getting more and more difficult for players in the space to secure their coverage as premium pricing has skyrocketed, but that has not been the only rocket ride. The underwriting process for these policies has taken over a matter of days rather than the usual months-long process that typical D&O coverage entails.

Now, from my point of view, that's created a potentially interesting dynamic when we start to consider the next inevitable step in this process, namely will SPAC and De-SPAC claims actually be paid. Will the process be smooth or complex? And will there be unintended consequences flowing from the speed with which these complicated transactions has proceeded. To help probe what's coming around the corner when the claim process starts, I am pleased to welcome back Steve Shappell of Alliant Insurance Services.

Steve is the Specialty Claims and Practice Group Leader for Alliant, and also I'm pleased to welcome Ron Borys also of Alliant Insurance Services. He's a Senior Vice President and the Financial Institutions Practice Group Leader. And they're going to share their thoughts about what's going on in this particular market space. So Ron and Steve welcome, very happy to have you and look forward to discussing this topic. So let's start with what claims do you anticipate flowing from SPAC and De-SPAC transactions and where do you see the most likely coverage issues arising?

Steve Shappell: So I'll go first, Lynda, this is Steve Shappell. So where we've seen some SPAC claims, right? The SPACs on announcement of transaction, De-SPAC transactions, we've seen some merger objection like chutes come out where the shareholders of the SPAC securities, they are objecting to the transaction. Either they're making objections that there's not adequate disclosure, not enough details of the deal details and looking for seeking additional disclosure and or a better deal. So that's the first kind of claims that we're seeing and we're seeing those in state and federal court.

And then the other claims we're seeing and we're tracking these really carefully, and there's been nine of them so far in the last 12 months are after the De-SPAC and the now new public company that was a formerly a private company, starts to make SEC filings and disclosures. We're seeing some claims come out of those disclosures and those filings where the shareholders of the new co are seeking damages because of false representations, omissions, disclosures, and bringing kind of classic 10b-5 shareholder class action suits against the new public company that evolved from the private company.

Lynda Bennett: Let me just ask on the... You identified the disclosures and the quote unquote, it's a bad deal on the front end there. What are we talking about in terms of coverage? Because to my ear, that sounds like we're mainly looking for defense cost coverage and are the carriers going to press pretty hard if the focus of the dispute is on get a better deal. Are carriers ensuring the best deal?

Steve Shappell: It's a great question, right? And it's been a source of frustration forever, right? Cause in a vacuum it's easy to say insurance is not going to pay for a better deal, but that's in a vacuum because often these claims look a little different than that, right? And it's allegations of a breach of fiduciary duty that caused harm that would... Otherwise this deal would be worth X plus one versus now it's only worth X. So, for the most part, what we're seeing out of these merger objection cases, and because the D&O insurance marketplace is very mature on these claims, right? We see a lot of merger objection suits generally, and carriers get it, right. They are cost of defense and then maybe upon additional disclosures, a small fee for the corporate benefit that the plaintiffs conferred. So the good news is the D&O marketplace on these merger objection claims are responding very, very well and they get it and they're truly 100% behind the insurance on these. And so far none of them have evolved to a situation where there's... And asked for additional consideration in that merger objection suit.

Lynda Bennett: One of the things that I think is challenging with particularly the SPACs where frankly many of the companies are more a bet on future performance as opposed to actual value, you're really betting on projections of what this high flying company is going to look like when you take them public. Are you seeing any specific issues, either on the claim side or Ron, something that we can do on the underwriting side to just have greater alignment on what the intent of these policies are and what they're going to cover?

Ron Borys: Sure. So, let me start by saying everything Steve is saying, we've been tracking this stuff very carefully and that's where having someone like Steve

Shappell on our team really is a great benefit and sort of asset to ourselves as brokers, cause just following the trends and the litigation, as we know, I mean, this stuff could take years to play itself out. D&O claims by history and by nature are long tale claims. And I think that's what has the underwriter so concerned right now is just this fear of uncertainty. They don't like high profile things that are in the press every day.

I think CNBC spends at least 5 to 10 minutes a day talking about SPACs and the valuations of SPACs and everything around that. And that's just not something insurance carriers generally get very comfortable with but I do think that if the contract is tailored appropriately, there can be a lot of challenges down the road that can be avoided by just making sure the work, the time, the effort and the resources put in on the front end to make sure you have a good solid contract that will respond the way you expected to respond in the event of a claim.

Lynda Bennett: Well, are there any specific modifications you think that need to be made and I always focus on the definition of securities claim, or again, the definition of loss. Is there a need to start tweaking and modifying those two definitions in particular to make sure that there's alignment and understanding as to where the coverage is going to sit?

Ron Borys: I think what we've been focusing predominantly on are the entities that are involved in this back transaction. I think at this point we're pretty comfortable. There's always opportunities to expand definitions and limit exclusions. And we've certainly been taking advantage of doing that where the market will allow us to do so, but-

Lynda Bennett: Yeah. I was just going to say in this market, probably a little bit of a challenge, but yeah.

Steve Shappell: Yeah. I think the bigger issue that, and in many cases is not being carefully reviewed enough is just the entities involved. There's a sponsor organization that essentially launches the SPAC and it's still not very clear what the liabilities are of the sponsor. Obviously the sponsor once the SPAC goes public essentially dissolves and goes away cause it's fulfilled its obligation and purpose. But the question becomes what can come back after the fact, right? What was done during the road show process? What was done during the sort of preparing process? So just making sure continuity is there, making sure that the right entities are covered. We're hearing a lot about individuals who are not necessarily serving in a capacity as a director or officer, but more as a special advisor or on some type of other committee. They're in many cases being offered indemnification.

So making sure that those physicians are not necessarily excluded, even though they may not fall within the traditional definition of director or officer. Those are really the things that we're trying to focus on from a minutia perspective. And then to your point, I mean, the market is very challenged right now. There's a very limited number of insurers who are willing to consider primary on these types of transactions so leverage is not at it's best in the form of pushing carriers to broaden certain areas of coverage. But I think generally speaking, we've found the participants who are willing to consider these opportunities are fairly flexible and willing to work with us.

Lynda Bennett: Ron, just one quick follow-up on that. When you say that there aren't a lot of carriers that are willing right now to be primary, are they communicating that through a straight up declanation or are they communicating that through offering something, but at an extremely high price or with an extremely high self-insured retention? How is that messaging being communicated to the market?

Steve Shappell: Sure. I think it's a combination of both. I think there are certainly markets who are acting what I'll call as opportunistic. And they're basically saying we don't love this risk, but here are the terms, right. A really low limit, a really high retention and in some cases, what many may view as an offensive premium and if they like it, or if they have no other options, they'll bind it otherwise... You're to your point, it's essentially a declanation. There are plenty of markets who have essentially said, "We're just not in the game right now. Our management has put a moratorium on it." In some cases we're following up with those markets daily to see if the moratorium has been lifted.

I think there are a lot of different ways that these deals can be structured. And I think one of the things that we owe it to our clients, right? Both us and you all at Lowenstein is just to be creative, right. And try to find ways to make it work. Every board is different. They have their own sense of concerns with regards to protecting their assets and I think there are a lot of different ways to solve problems in this market. We just need to challenge ourselves to do so.

Lynda Bennett: Indeed. One of my favorite questions is how much limit should I have? I always respond by saying, what's your appetite for risk? Right, cause it's not a mathematical equation here. All right. Well so, what are some of the things that policy holders can do to best protect themselves? We've sort of touched on this and Steve, I know this is a pet issue of yours. A kind of don't step on the cracks or you'll break your mom's back, how are we going to not be on the cracks in between the SPAC and the De-SPAC? What are the things that policy owners need to do on the front end and on the back end to make this all flow properly and as expected?

Steve Shappell: Yeah. It's a great question, Lynda. And as you and I know, right, again, we've been dealing with transaction insurance for a long time. So we have some experience, right? This De-SPAC, the pace and volume is unique for the SPAC, De-SPACs. But, kind of the notion of entities kind of merging and creating a new go-forward entity is not new. So, what we need to do is really drill down into the nuances of the potential claims here, right? And fact patterns. Because you have the SPAC that is going to need to go into runoff, right? By tail insurance. You have the target company that is now going to be a new public company, completely different with a whole bunch more capital dumped in on it in addition to the SPAC. And so that policy needs to run off, and then you have the new public go forward.

And the devil is in the details, right. If you allow carriers right, to pick language in that scenario, they'll risk adverse and they'll have language in there where they won't cover any wrongful acts which occurred prior to the magic date of the combination and the go-forward won't cover, or the runoff won't cover anything after the date. And the challenge as we're seeing from some of these claims, and we've seen from combination claims over the years is... The world's not black and white, right? So you'll get these claims come in and we call them straddle claims, which will allege wrongful acts which started years ago, right. Misrepresentations about the nature and the quality of contractual relationships that the private company may have. And then it continues, right, and they learn about it, and they don't make disclosures. And for four or five, six months into the new public company.

And so, that is the detail, right? We've got to make sure that these policies are crafted to address that situation. And they're paying for that part of the loss that is that of the entity, the SPAC, right, before De-SPAC, right? So the representations they made in the roadshow and the private company, the representations they made. So it's not easy, it's super complex and trying to make it simple is not the answer. Right. We do an injustice to our clients to make this simple, because it's not, it's very complex and the claims coming out, which are the straddle claims, right? They're just proving the point that this is complicated and we got to make sure the underwriters and the clients understand the complex nature of this placement.

Lynda Bennett: Well, and both Ron and Steve, you touched on this, and that is the importance of the team that's in there representing you. A lot of our clients, I'm still surprised to learn a lot of our clients don't understand that this language is negotiable. It's not take it or leave it. And frankly, you've got to have a team like Alliant there who really is living and breathing these policies every day. We've worked very closely with you as outside coverage counsel. We put the whole team together, and frankly, when you do the work on the front end, then there's a lot fewer surprises and discontentment and denials on the backend. So, spending that time and effort and money on the front end definitely pays dividends. Sorry Ryan, you wanted to-

Ron Borys: Yeah. I was just going to say, I mean, the one thing we have to keep in mind is in many cases, the folks that are sourcing this transaction and the board that's signing off on these transactions may not be the board that ultimately runs the company, right. And considering the fact that claims can come a year, two years, three years down the road, we have to make sure we're clear today. What the expectation is if who's going to be covered where, what limits they're going to have available to them. There's a lot of different sort of varying opinions out there in the market right now about ways in which to structure these programs. And while many of our clients in the financial institution space have stated that their expectation is they want to stay involved with the company.

Well, that's because in many cases they have a... That's their business, right? They're investors. They have a history of doing these types of transactions and staying involved. But there's a lot of out there right now where it literally is solely for the purpose of creating the business combination. And then the expectation is that they may not be involved with the company going forward. So you just got to make sure those interested parties are really... The alignment and the risks and the exposures are all being addressed on the front end.

Lynda Bennett: So we have just a couple of minutes, but Ron, that actually segues beautifully into one of the concerns that I have on the claims side, which is, are we going to see a heightened risk of the conduct exclusions playing more of a prominent role in the SPAC and De-SPAC transactions due to potential conflicts of interest of the insiders, of financial gain for successful sponsors. So let's just touch on that in the couple of minutes that we've got left here.

Ron Borys: Sure. Well, I think that's the easiest one for the plaintiffs bar to sort of try to bring right is folks knew about something prior to either the announcement or the transaction and they didn't adequately or thoroughly disclose it. And unfortunately, almost every single one of those claims is going to involve some allegation of fraud. And it is incredibly important to not only make sure that that exclusion is kept as narrow as possible so that it's not prematurely triggered, but that there's also appropriate severability for other individuals who may not have been sort of implicit in that behavior. Particularly folks who may be running the company a year or two down the road when they weren't even there, presumably while the failure to disclose, or the alleged fraud is occurring. So, yes, I think you've hit on a very important point there, Lynda, that people just need to be extra careful and vigilant about, because I do think that that could potentially be a challenge at some point down the road.

Steve Shappell: Yeah. I agree with you, Ron, right? Cause by the very nature, right, these 10b-5 suits that are coming out, they're fraud suits, right? They have to plead and allege [inaudible 00:17:36], right. The mental state to commit fraud. So, your question's a great one, Lynda, right? The spotlight will be on these conduct exclusions and the property advantage exclusion because the plan smart loves to allege the motive, right. Self-dealing huge profits, that's why you are motivated to not make disclosures and you shouldn't make disclosures. So, it really does highlight the critical importance of making sure we continue to be vigilant on the conduct of exclusions.

Lynda Bennett: And we got to read those policy language, the words matter, another theme here at don't take no for an answer. All right. Well, in the last 30 seconds we have left here, quick question. Where's reps and warranties insurance fitting within here? Are you seeing that used and combined as part of these transaction and if not, should it be?

Ron Borys: Yeah, listen, rep and warranty insurance has evolved. It's area that every major broker, private equity firm, and major law firms are focused on. As we've learned rep and warranty insurance has many different tentacles. We have some real sort of solid experts in the area of tax, which is a big one for these types of business combinations, because you just don't necessarily know how certain tax were filed or tax liabilities that can ensue as a result of certain individuals or things that were done. So, I think that's a big one.

Obviously there's really no buyer or seller so I think some of the traditional rep and warranty products may not be as applicable. But again, the thing that people don't really understand entirely about rep and warranty insurance is it's not an off the shelf product. It's a product that is negotiated very specific and tailored to the unique characteristics of the M&A transaction. So, I do think the rep and warranty industry has potential to solve some problems for folks here. I just think it depends on the specific area of concern and how the policy is going to be addressed to tailor.

Lynda Bennett: That was the creativity I think, that you were talking about earlier. Well, Ron and Steve, I want to thank you very much for your time today. I think this is a topic that's certainly going to remain top of mind. You are knee deep, shoulder deep in all of it, and certainly a resource for myself and for our listeners. So thank you so much today for joining us, and we'll look forward to seeing you all on a future episode. Thanks so much.

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