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

**Episode 38 -
Has the SPAC Bubble Burst? Part 2:
The SEC's New Rules**

**By [Lynda A. Bennett](), [Jared Kelly](),
and Yelena Dunaevsky, Esq.**
APRIL 2022

Kevin Iredell: Welcome to the Lowenstein Sandler podcast series. I'm Kevin Iredell, Chief Marketing Officer at Lowenstein Sandler. Before we begin, please take a moment to subscribe to our podcast series at lowenstein.com/podcasts. Or find us on iTunes, Spotify, Pandora, Google podcast, and SoundCloud. Now let's take a listen.

Lynda Bennett: Welcome to "Don't Take No For An Answer". I'm your host, Lynda Bennett, Chair of the Insurance Recovery practice here at Lowenstein Sandler and I'm very pleased to welcome back Yelena Dunaevsky, a Vice President of Transactional Insurance with Woodruff Sawyer, as well as my partner, Jared Kelly, who is in our Capital Markets & Securities group. So thanks so much for coming back, Yelena and Jared.

Yelena Dunaevsky: Thank you, Lynda. Always a pleasure.

Jared Kelly: Thank you very much for having us.

Lynda Bennett: All right. Well last time we got together, we talked about SPAC mania and the incredible raise of capital, and then the difficulty in deploying it and the marketing conditions associated with that. And today, I wanted to pick up with the game changer of the SEC now wanting to get very involved in looking under the hood of all of these deals and having greater visibility and disclosures around exactly what's taking place in the SPAC and de-SPAC market. So Jared, why don't you just talk a little bit about what is it that the SEC, what are the proposed rules that the SEC put out there and what are the purpose of them?

Jared Kelly: Yeah. So bottom line on the rules is the chairman wants the de-SPAC process to look and feel and smell like a regular IPO. And that's the intention of the rules and that's what some of the bigger parts of the rules are really sinking teeth into the perceived problems with the SPAC market trying to fix those, which is two things mostly. Number one is disclosure. There's a lot of disclosure clarifications, which probably speaking to other practitioners and bankers I think are welcome because it adds some clarity to what it needs to be and included in an S-4 for a de-SPAC transaction. So most of the disclosure issues were fine. Number two is this extension of the underwriter liability to catch participants on the backend of these deals.

Jared Kelly: So if you were a bank who underwrote an IPO, you take 2% upfront and you defer three and a half percent to the backend. And 2% upfront being 2% of the IPO proceeds and then three and a half percent of the IPO proceeds are deferred to when you do a de-SPAC transaction. Now, that second portion of the fee, there's no underwriting liability for that second portion. The S-4 is not an initial issuance of securities that's underwritten by a bank like the IPO is. And so we have a situation where A, because it's a merger and a de-SPAC and there's projections created, those projections are included in the S-4 and that's required. In an IPO, you don't have that situation where you're required to include projections. So now, you have this document out there that's including projections or a go forward company.

And B, you don't have a high level of diligence on those numbers from third parties, you just have the target private company and its advisors creating these projections. They're diligenced a little bit by the lawyers and maybe the SPAC, but no third party bank or advisors is saying, "We looked at these numbers too and we can stand behind them." That's what the new SEC rules are attempting to do. They're attempting to place some responsibility on these third party participants, namely the banks who are underwriting the transaction on the backend. So if you're receiving fees in both stages, then you're responsible for what goes into the S-4 which is not currently the case.

Lynda Bennett: And what's the practical impact of that going to be? Does that mean less banks are going to be willing to underwrite these deals? Is it going to impact the investors? Where's the real pain going to be felt there?

Jared Kelly: Yeah. I think it could play out three different ways. The first is you just have the banks actually doing all the diligence and so it becomes a more costly process on the backend. And maybe you even have two different banks involved, you have a bank that's representing the target and a bank that's representing the SPAC and they're both going to share liability for underwriting what's in that S-4. Maybe that happens.

Lynda Bennett: By the way, that's a litigator's dream...

Jared Kelly: That's the point, right? That's the SEC's point because you're a shareholder, you're not going to sue the target company probably, right? Because that's where your investment is, you don't want to tank that. So you want to sue somebody else and try to recover that way. But anyway, the second part is you could see some bigger bulge banks like Citi and Barclays have already announced getting out of the front end of the IPO and not taking any fees up there and just taking maybe M&A advisory fees on the backend. And so far under the rules, it can be interpreted that you don't have underwriter liability if you do it that way, we'll see what the final rules say. Or number three is you just have the same participants come in, do the IPO, maybe take a higher fee up front, and then don't go into the backend and stay out of the backend.

Lynda Bennett: So Yelena, one aspect that Jared mentioned about these proposed rules by the SEC is to increase disclosure requirements, particularly with respect to sponsors' conflict of interest and dilution for SPACs and for de-SPACs requiring disclosures of fairness determinations and an outside report opinion or appraisal. Will these enhanced disclosure requirements have an impact on how insurers perceive the risk associated with these transactions?

Yelena Dunaevsky: Well so certainly if you have more disclosure, the better it is for an insurance underwriter, they see obviously less risk. The more there is disclosed, the less likelihood of someone coming along and saying, "Well you didn't tell me." That problem was afoot and less likelihood of a litigation happening. On the flip side, I've been watching the market and the market has been moving towards better disclosure independently of these SEC rules over the last few months. And the reason for that is simple. They were watching all that same litigation that the insurers are watching and they're thinking we don't want to be in the middle of that. So we'd like to disclose everything we can disclose. So certainly, there's just been a correction in the market in that sense even before the SEC came out with these proposed rules.

The more we're seeing of this, perhaps folks trying to fit into the parameters that SEC is laying out, the better it is on the insurance side. The one thing that I worry about is that aside from the disclosures, the rest of the rules seem to be little bit heavy handed in the way that they're approaching the market. There are a lot of nuances and very delicate issues in how the market is currently structured with the underwriters, their participation with projections going into the merger. And I feel like the SEC's rules are just too blunt of an instrument, too much hacking going on there.

Lynda Bennett: All right. Yelena, are you starting to see any meaningful trends with respect to claims involving SPAC or de-SPAC transactions?

Yelena Dunaevsky: That's a good question, Lynda. So we saw an increase in activity or lawsuit securities, class actions definitely jumped last year. We saw 30 plus of them as opposed to just a handful or even less in the previous years, and that's a function of just how many SPACs are in the market or enter the market. But these things take a really long time. So lawsuits are still very much inching along. There's really not that many that we've been able to see come to completion or to a stage where it's a good idea to draw any conclusions around trends. What is happening right now on the insurance side is a lot of conversations around allocation issues. And I'm sure you know, many of these lawsuits bring in multiple parties that are involved.

So usually, they pull in the SPAC, the SPAC directors and officers, the go forward company and its directors and officers, and perhaps even the directors and officers of the company prior to the merger. And all of these are covered by various insurance policies. And so then the question becomes which of these insurance policies should respond? Or how much of the defense costs or potential settlements will be allocated to each? So that's where we're having a lot of conversations.

Lynda Bennett: Yeah, that's interesting. So it's allocation and it's also capacity, right? When some of the board members in the initial IPO are then going to come out on the other side of the transaction, which hat are they wearing, right, when they're engaged in certain conduct? Are you seeing in a lot of these deals that there's any overlap among the insurers? In other words, is the same insurer ensuring the SPAC and then at least even appearing in the tower in the de-SPAC transaction?

Yelena Dunaevsky: Well yeah, that's exactly right. And that's a great point. There is such a small number of these insurers that are out in the market that are providing capacity, that with the number of deals that are out there, you're bound to see an insurer being on both sides of the coin, so to speak. And that's an aggregation issue that a lot of the insurers that are currently looking at deals are very cognizant of. And they're trying to pull back from that and try to figure out where they should play. But yes, that's definitely something that is out there and we're going to just keep seeing more of it.

Lynda Bennett: And I think that's an important point for our listeners to understand if and when you find yourself in a lawsuit, understanding that carrier that may be on both sides of the transaction may have more flexibility to pay under one policy to save the limits on the other, right? So there's some broader strategy issues that people need to be thinking about when they're presented with claims there. So Yelena, another question for you, how do you anticipate the insurers reacting to the SEC's state and intention to remove the safe-harbor provision for blank check companies?

Yelena Dunaevsky: Yeah. I can tell you that's been a sore point.

Lynda Bennett: I bet. I bet

Yelena Dunaevsky: With all of my contacts in the SPAC market. So I think that the removal of the safe-harbor for projections and the underwriter liability, which by the way if you read the rules, the proposed rules can extend much further than just the bankers underwriting the deal. It depends on how we're going to interpret it in the future and what the final rules will be. But some have posed the question of whether that extends to the attorneys that are involved for example. So good question. But going back to the projections. So from the insurer's perspective, right, the fewer projections you have, the better, right? If you don't go out there and you say you're going to make a trillion dollars next year, there are not going to be a whole bunch of people suing you for not doing that next year.

So it's definitely a plus. What I worried about is that the whole mechanism of a SPAC, which in my opinion is tied very, very closely to a merger transaction versus a straight IPO despite what SEC likes to go out into the market with, how do you sell a merger when there are no projections or extremely limited projections? How do you make a decision on whether or not this is going to be a good thing to invest in? So while it's great for the insurers that there might be fewer projections in the future or no projections, will there be any deals to ensure?

Lynda Bennett: Great question. And just on that point of projections and public facing statements, we're seeing a great deal of focus in the broader D&O insurance market on ESG consciousness right now. Is that focus bleeding into the SPAC and de-SPAC space whereby certain insurers want to see SPAC sponsors focused on DEIs when targets are being identified and combinations are taking place?

Yelena Dunaevsky: I haven't really seen it so much, but maybe only to the extent that the stated purpose or goal of a particular SPAC was to be very DEI focused or focused on ESG. Otherwise, the insurers, that is not the priority that they have. But of course, if the SPAC is going out there and saying, "This is what our purpose is," and then at the end of the day is not realizing that purpose, then that could be grounds for a lawsuit. So yes.

Lynda Bennett: Right. Great. Well we're just about to wrap up. So Jared and Yelena, I'd love for you to polish up your crystal ball and tell me what you think the balance of 2022 holds for SPACs and de-SPACs and the litigation that may flow from those transactions. So Jared, why don't you go first and tell us what you see in the future?

Jared Kelly: Sure. I see a rush to try to get deals done in the next two months. And before these final rules go into effect, whenever they might go into effect, maybe third quarter, I see a mad rush of M&A transactions that are going to happen and maybe an increase in the IPO market, although probably, people just will stay out of the IPO market until the rules are final. And then I see after the rules go into effect just a re-tampering of how the final documents look in the de-SPAC market. And the back half of this year, I think we're going to see a lot of redemption and see as many deals get done and probably some companies go public that shouldn't have been public. And so then for the next year or so, there might be some unwinding of these investments.

Lynda Bennett: And that's when the litigators are going to show up on the scene, so thanks for that. We need some work to do, right? Yelena, what do you see when you look into the future?

Yelena Dunaevsky: Very similar thoughts to Jared's. I think right now, many people are going to maybe try to go out and get that deal done. But I do want to point out that these rules, we don't know whether they're going to make them retroactive. So not sure if we need to rush that much, but I'm not expecting to see many new IPOs enter the market. Deals will try to get done just because they have to, I think there's 609 of them sitting there waiting to get done. Many of them unfortunately won't and I'm really looking forward to everyone digesting the final rules when they come out and adjusting the market so that we can move forward with a clean slate in '23.

Jared Kelly: If they try to make them retroactive, then litigators will be in involved there too because-

Yelena Dunaevsky: Oh, absolutely. Lynda, you've got to get ready for that.

Lynda Bennett: We want to invite everybody to the party, guys. Well I really would like to thank both of you for coming on for this episode as well as our last one. I think you gave a really wonderful overview of where we're at in SPAC mania and where we are headed. And we'll really look forward to having you come back in 2023 and we can all find out whether we got it right, wrong, or otherwise. So thanks for coming on today. Appreciate you sharing your insights and wisdom.

Yelena Dunaevsky: Thank you so much.

Jared Kelly: Yeah. Thank you for having me.

Kevin Iredell: Thank you for listening to today's episode. Please subscribe to our podcast series at lowenstein.com/podcasts, or find us on iTunes, Spotify, Pandora, Google podcasts, and SoundCloud. Lowenstein Sandler podcast series is presented by Lowenstein Sandler and cannot be copied or rebroadcast without consent. The information provided is intended for a general audience. It is not legal advice or a substitute for the advice of counsel. Prior results do not guarantee a similar outcome. The content reflects the personal views and opinions of the participants. No attorney client relationship is being created by this podcast and all rights are reserved.