NFP's SPAC Securities Litigation Update

Has growth in the number of SPACs IPOs led to an increase in the frequency of litigation?

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Introduction

In this first edition of our SPAC Securities Litigation Update, we seek to answer whether SPACs are being targeted with securities litigation more frequently now than they have been historically, or if the percentage of SPACs being sued has remained relatively constant while the number of IPOs has increased. When we update this report on a semi-annual basis we will include settlement data as it becomes available and compare class action trends within the SPAC sector to the traditional IPO market.[1]

With Directors and Officers liability insurance rates for special purpose acquisition company (SPAC) initial public offerings (IPOs) and De-SPAC'ed merged companies increasing dramatically over the past 18 months, we focused our analysis on any change in frequency of the two types of allegations most frequently made against SPACs and De-SPACs via securities class action litigation:

1) Violations of § 14 (a) of the Securities Exchange Act of 1934 that allege SPAC teams made material misrepresentations and/or omissions within the proxy statements sent to stockholders in connection with a proposed business combination.

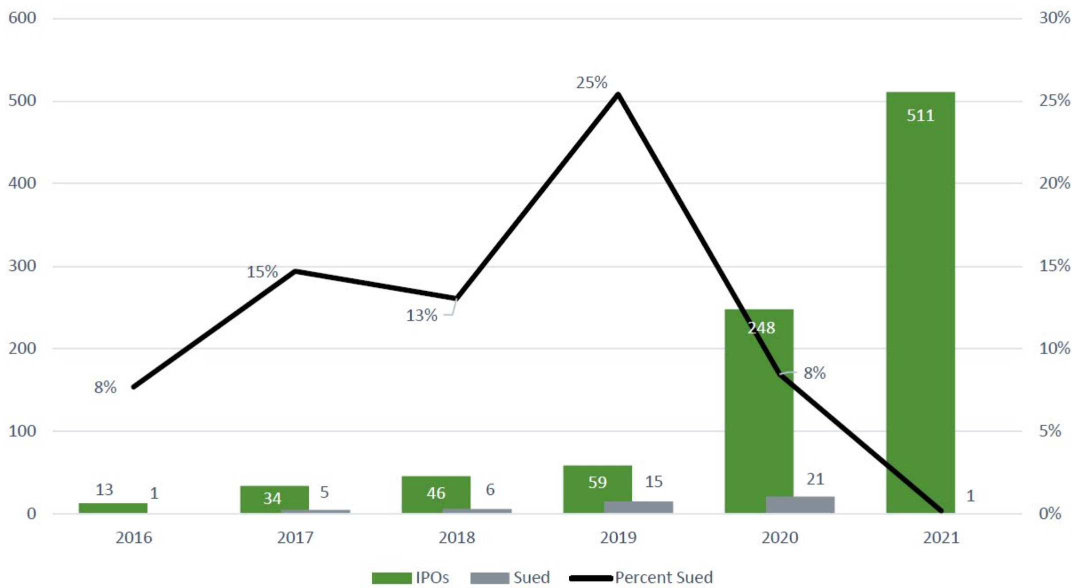
2) Violations of Rule 10b-5 of the Securities Exchange Act of 1934 that allege securities fraud in connection with a completed business combination. These claims can be far more severe as investor losses are alleged during the class period.

We begin by analyzing how frequently SPACs that IPO'd in a given year have been sued by connecting any 14 (a) or 10b-5 litigation back to the year of the SPAC IPO. Then we connect 10b-5 litigation back to the year the business combination was completed to analyze how many of these deals have been targets of material litigation in the years following the close of the merger or combination. We believe that this is a more meaningful approach to analyzing 10b-5 claims as it better reflects the current litigation environment in the year the business combination occurred.

Percentage of SPACs Targeted by 14 (a) and 10b-5 Securities Litigation by Year of IPO (2016-2021)

Figure 1 shows the number of SPAC IPOs for each year between 2016 and 2021, the number of lawsuits targeting each year's SPAC IPOs, and the percentage of SPAC IPOs targeted by lawsuits. 18% of all SPACs that IPO'd between 2016 and 2019 have been the target of securities class action litigation, with that figure peaking at 25% for those that IPO'd in 2019. Only one SPAC within this set has yet to announce a transaction and only 3 have announced deals which are yet to close. The percentage of SPAC IPOs targeted with litigation increased significantly from 2016 to 2019. It is reasonable to assume that this trend will continue for those SPACs that IPO'd in 2020 and 2021, though the data is immature (there are over 538 SPACs still seeking targets and 112 SPACs that have announced a deal but not yet closed their business combinations). Regarding timing of the litigation, note that 14 (a) litigation does not typically occur until a proxy has been filed, and the average time between a business combination closing and a 10b-5 lawsuit filing is approximately 13 months according to our study.

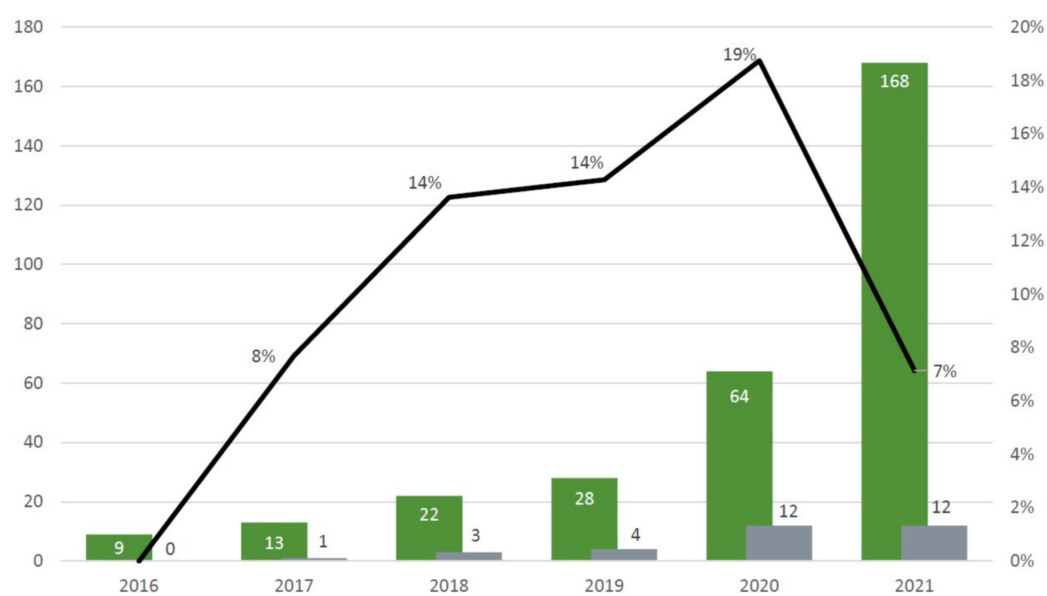
Figure 1



Percentage of Closed Business Combinations Targeted by 10b-5 Securities Litigation by Year of Business Combination Close (2016-2021)

Figure 2 shows the number of SPAC IPOs that have completed a merger for each year between 2016 and 2021, the number of 10b-5 lawsuits targeting each year's completed mergers, and the percentage of SPAC IPO completed mergers targeted by 10b-5 lawsuits. Our analysis shows a steep increase in the percentage of targeted closed business combinations from 2016 to 2020, with 2020 likely still not at its ultimate frequency. As noted above, from 2012 to 2019, the average time between a business combination close and a 10b-5 lawsuit filing is about 13 months, with the largest gap at 21 months (AdaptHealth Corp). If one assumes that 19% of the business combinations closed in 2021 will be the target of 10b-5 litigation, the current value of the class of 2020, we can reasonably expect 32 of these combinations will see litigation. However, if the trend of increasing frequency of 10b-5 litigation year over year continues, we expect the percent of merged businesses sued will be above 20%.

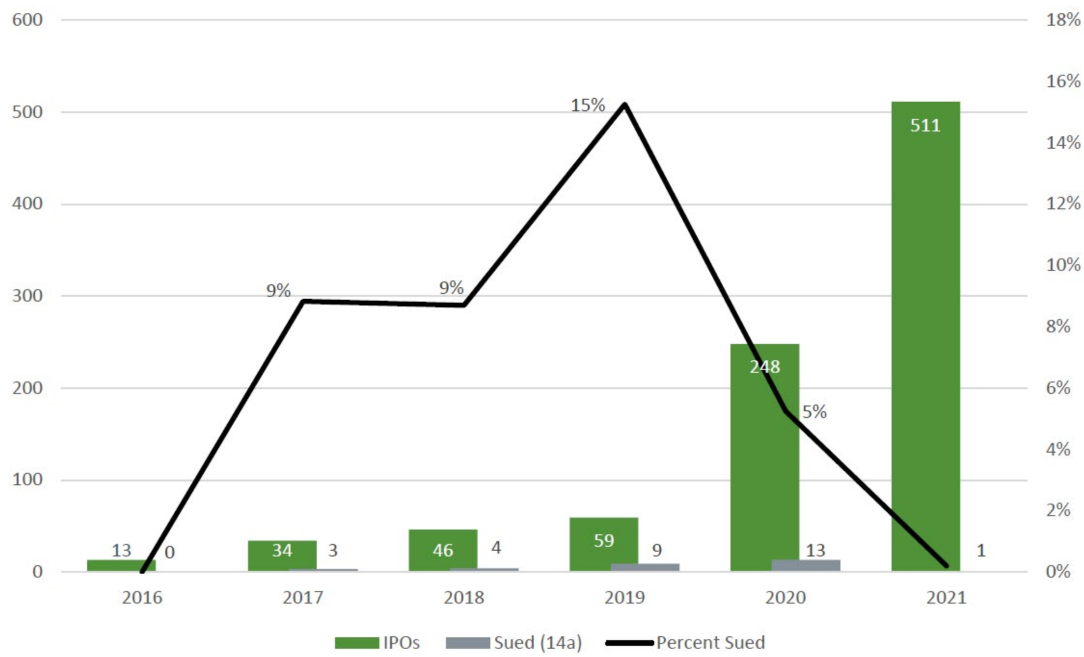
Figure 2



SPAC IPO 14a Related Lawsuits Since 2016

Figure 3 shows the number of SPAC IPOs for each year between 2016 and 2021, the number of lawsuits alleging 14 (a) violations targeting each year's SPAC IPOs, and the percentage of SPAC IPOs targeted by 14 (a) lawsuits. The percentage of SPAC IPOs targeted has similarly increased steeply from 2016 to 2019, and as with 10b-5 lawsuits, we expect the trend to be increased frequently for 2020 and 2021.

Figure 3



Conclusion

Along with the growth in SPACs IPOs over the past five years, an increase in the frequency of securities litigation has followed, so that the absolute numbers of lawsuits is magnified further. The percentage of closed business combinations targeted by 10b-5 lawsuits is currently at 19% for 2020, as seen in Figure 2, with this number likely to increase over the next 12 months as the 86 SPACs seeking targets file their proxies and the 36 SPACs that have announced deals close. Depending on how the frequency of litigation evolves and how many of the 511 SPAC IPOs (so far) in 2021 find merger partners, the number of SPAC securities litigation suits could be amplified further still.

Sources

[1] Litigation data from Stanford Securities Litigation Analytics database and Zywave D&O Loss Insights database and SPAC IPO data from SPACInsider.com SPAC IPO Universe.

About NFP

NFP is a leading insurance broker and consultant that provides employee benefits, specialized property and casualty, retirement, and individual private client solutions through our licensed subsidiaries and affiliates. Our expertise is matched by our commitment to each client's goals and is enhanced by our investments in innovative technologies in the insurance brokerage and consulting space.

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About Our SPAC Practice

NFP's SPAC Practice is comprised of a dedicated team of specialists focused on assisting SPAC teams throughout their lifecycle from Initial Public Offering (IPO) to initial business combination. We work closely with our SPAC clients and their advisors to provide tailored insurance solutions making certain that their personal assets, balance sheet and target are adequately covered against loss.

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