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

Episode 91:
Current State of Play with SPAC Litigation and Available Insurance Coverage

By Lynda Bennett, Heather Weaver, Yelena Dunaevsky

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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. Today, I'm very pleased to be joined by Yelena Danaevsky, a Senior Vice President and Partner at Woodruff Sawyer. As well as my colleague, Heather Weaver, who is Counsel in the Insurance Group here at Lowenstein as well. Today we've gathered to talk about the current state of SPAC related litigation and its impact on the insurance market.

Yelena, you recently published an interesting article on this topic and we thought it would be fun to have you come on back on the show. You're a repeat guest and we're pleased to have you. We wanted to flesh out some of the details of your report with you live. Thanks for joining us today, Yelena.

Yelena Dunaevsky: Yeah, pleasure to be here. Thanks for having me back.

Lynda Bennett: Heather, thank you for joining us as well. Always fun to pair up with one of my insurance recovery group. Thanks for joining.

Heather Weaver: Hi Lynda. It's nice meet you Yelena.

Lynda Bennett: Why don't we start by, Yelena, you telling our listeners what that SPAC acronym stands for and how SPACs are used in corporate transactions, such as mergers and acquisitions?

Yelena Dunaevsky: Sure, sure. SPAC stands for special purpose acquisition company. What it really does is it's a team of folks with financial expertise that get together and essentially raise funds for a future acquisition of an operating company. It is a blank check company, in a sense, that for typically two years, has a two-year search period, at the end of which they find a suitable target operating company and merge with it. And through this process, take that private company.

Lynda Bennett: I want to portal us back to 2020, when we were all thinking about the pandemic, and lockdown, and social distancing, and all of those phrases that we were very familiar with. SPAC has been around for quite a long time, but it seems like that's when it really splashed across the headlines. There was an awful lot of money floating around for these types of special organizations, as you just described.

What's happened since 2020, when there was a lot of money sloshing around, and we had a lot of celebrities throwing their names behind some of these SPACs? What's happened since then? What happened to all the money? What happened to the groups that got together to look at these new business models?

Yelena Dunaevsky: Yeah. There's definitely been a shift in the market. But I want to point out that SPACs have been around for a much longer time than 2020. They've actually been around for at least a couple of decades and have gone through a couple of cycles where they were popular, and then unpopular. But 2020, '21, that's when the frenzy that you mentioned, is what we witnessed. I think it was driven a lot by some of the more household names that entered the SPAC market and took some targets private. One of them was Virgin Atlantic. It caused an interest in the space. Then the general market conditions were such, there was interest from sponsors to get these kinds of vehicles together, interest from investors to get them together. Celebrities got involved. It really went a little too crazy. Many of the veterans in the SPAC world that I talk to and have been in the SPAC world since the beginning, they all admit to it. It just went wild. It was a wild, wild West.

I think a portion of it was driven by the fact that this vehicle is essentially an alternative to the traditional IPO. It was sold, at some point, as an easier, or maybe shorter, or less contentious way to get to a public company space. That's what happened. "This is an easy to get to an IPO and I'm going to do it this way." Of course, as a result, some of the teams that chose this-

Lynda Bennett: It became a lawyer's dream. You had money sloshing around, you had a lot of people doing a lot of things quickly, looking for ways around regulations. This sounds like a plaintiff's lawyer absolute dream.

Yelena Dunaevsky: Yeah.

Lynda Bennett: The lawsuit's filed.

Yelena Dunaevsky: There were a few bad apples, absolutely. Some of those companies that went public shouldn't have gone public. They were just not ready for it. That's true.

Lynda Bennett: Money gets put out there, not a lot of regulation around it. Now the plaintiff lawyers. A number of these SPAC transactions failed, right?

Yelena Dunaevsky: Right. A number of them did fail. Sponsors lost millions of dollars because they put up considerable, 2, 3, 4, $5 billion to get these vehicles going. Investors, I want to point out, didn't really lose any money because the way that the SPAC vehicle works is if the deal doesn't go forward, they get their shares back. There's a redemption mechanism.

But there was frenzy around trading, and obviously there was room for lawsuits. We did see a number of securities class actions that came out of the space. Happy to talk about what we're seeing right now. But the situation has changed. You asked where we are in connection with 2021. That frenzy had died in 2022. '23 was very, very quiet.

Lynda Bennett: Nobody could get money, right?

Yelena Dunaevsky: The SPAC sponsors got so burned and lost so much money that no one wanted to launch new vehicles, new SPAC IPOs, and they were all still trying to get their deals done and ran out of viable targets to buy so '23 was very, very quiet.

I'm just back from the annual SPAC conference from a couple weeks ago, and I can tell you that the mood is very, very positive. There's a lot of buzz about mostly experienced SPAC sponsors coming back into the market. The reason that's happening is also wider economic change in the market, where the interest rates are not where they used to be. There's some tweaks to the SPAC structure. Not huge tweaks, but enough to cause sponsors to come back to the table and investors to come back to the table.

You have to also look at SPACs as a subset of the general IPO market. The IPOs, generally as you know, have been very, very few and far between. That's what's happening right now.

Lynda Bennett: Your article talks about it's not gloom and doom, you just laid the groundwork for that. You think that the SPAC market's going to come back. People are going to take some lessons learned, but come back and continue to use that vehicle.

Yelena Dunaevsky: Yes, I think so. When done correctly, and not being abused, and done with the disclosure that its required to have, with the sophisticated advisors that are required for this process, taking a company public, it is a very good alternative to a traditional IPO and it works very, very well for some of the industries.

Also, a lot of the people have learned from previous mistakes. They've seen how the litigation played out in the securities class action, some of the fiduciary duty cases in Delaware. Happy to talk about those as well. That's a trend that we noted in the SPAC Notebook, that's a monthly blog post that I write focused on SPAC risks. People have learned from those mistakes and I think they're going to be able to do things better great forward.

I'm not anticipating the same numbers as we saw in 2021 going forward, but I think there's going to be a healthy market in the SPAC vehicle from now on. I can tell you, the last couple of weeks, I got eight, nine calls about D&O coverage for new SPAC IPOs, compared to almost no calls over the last year, year-and-a-half.

Lynda Bennett: Well, that is good news because when there's D&O coverage in place and lawsuits follow, what happens? That's when we need you to come in.

Before we dive into the coverage that'll be available, and Heather will take us through that, just give us an idea of the kind of lawsuits that you've seen over the last couple of years. What are the nature of the claims? You mentioned a couple of important decisions out of Delaware. Give us the overview of when the transaction goes wrong, what's the nature of the relief that's being sought? What are you seeing the courts doing there, the keep appropriate guardrails up?

Yelena Dunaevsky: Yeah, that's an excellent question. We saw securities class actions, not as many as you would think. Actually, the number has steadied around 20, 24, 27 over the last three years. We're likely to see more of them. What I thought was really interesting, especially this past year, is a focus on fiduciary duty cases in Delaware. We saw an uptick in those. They're a progeny of multi-plan, which essentially is a case that Delaware decided against the SPAC, and a lot of similar kinds of complaints followed. This was in '21, '22, so now there's a whole slew of these multi-plan progeny cases out in Delaware.

That one has been fairly negative in its treatment of SPACs. A lot of the plaintiffs decided to switch gears and go from filing securities class actions into doing fiduciary duty cases in Delaware. Which is, interestingly enough, has now pushed a lot of the new SPACs out of Delaware. None of them are now incorporating in Delaware, they're all going to Cayman. Market conditions are different.

But the kinds of cases, and I have some data here that we keep at Woodruff Sawyer, 86% are centered around misleading or fraudulent disclosures about a product. 59% are misrepresentation of revenue or growth. 40% deceptive or fraudulent disclosures. 36% accounting issues. And 16%, lowering of guidance or outlook. Those are the types of claims that come through. Of course, the D&O policy would respond to these kinds of claims.

Lynda Bennett: Yeah, heather, why don't you comment on that? When we get the lawsuit in, D&O is obviously the main policy. But what are some of the things that folks need to be thinking about when they get that lawsuit and how are the insurance companies going to respond?

Heather Weaver: Well, I think there's a few considerations to think about here. As always, whether your actual policy will cover a particular lawsuit or investigation will of course depend on the terms of your policy and the claim at issue. In this area in particular, I think it's important to work with an experienced broker or coverage counsel, because of the complexities of SPAC transactions. I think it's created the need to better understand the intricacies of D&O coverage and what a particular company might need.

For example, my understanding is typically D&O insurance will be needed for the different entities involved in this lifecycle of SPAC. The original SPAC shell company, coverage there in connection with rates in capital and acquisition activities. Then you want to make sure there's adequate coverage for the private target company, that mergered SPAC. Then, the surviving post-merger company.

I think one thing to keep in mind for policyholders is to make sure that there's adequate D&O coverage for alleged wrongful acts occurring up until the closing. Then once the merger takes place, you'll want to make sure that SPAC has a tail or runoff policy to cover claims made during the time period following the transaction for wrongful acts that took place before the transaction closed. And making sure that there's go-forward coverage for the surviving entity.

I'd love to hear from you, Yelena, what types of exclusions you're seeing. But I would that it would be important to look for securities exclusions, prior acts exclusions, things like that, things to be aware of when purchasing D&O insurance. I'm sure, as the risk of these SPAC litigations go up, insurers are looking to include more and more exclusions. But perhaps, if things are looking up as you suggest, maybe the market will soften in that regard a little bit.

Yelena Dunaevsky: Yeah. Also, that's absolutely important to look at, I totally agree. I just also want to point out that, while it is important to make sure that the tail coverage is there, there's been a new structure in the market that we've actually used at Woodruff Sawyer and we pioneered, where we have coverage where we call a combined policy for post-merger, all of the entities involved, which creates a prior acts coverage for the D&Os of the original SPAC, thereby eliminating the need for the tail. While that coverage still needs to be in place, you need coverage for those Ds and Os, there's different ways of approaching it, through either a tail separately, or through a prior act with a combined entity. I have more information on that, if anyone's interested.

In terms of exclusions, I am not seeing really exclusions. These policies are looking very much like a traditional public company D&O policy would. While it's definitely important to make sure that you don't have exclusions for security issues and things like that, the structuring element of it, it takes more time than worry about the kinds of exclusions that are being imposed. Except for one element, which I've seen in my practice, where some of the companies, foreign companies coming from different jurisdictions, sometimes work with brokers who are insurers that are not US based or not knowledgeable in US SPAC world. Sometimes I've seen securities exclusions in those. Essentially, that's incredibly problematic and I feel like that's something that non-knowledgeable players in this market are doing, and are hurting their insureds and their clients who are not aware that securities matters are what needs to be covered by these policies.

Lynda Bennett: Yeah. It's music to our ears that you've got the combined policy because what we've seen in some of these SPAC, is you've got two or three different carriers. When you get the claim in, you get the finger pointing game that, with capacity issues and all of that. Good on Woodruff Sawyer for coming up with the hack around that.

Before we wrap up, let's just touch on, as you said, the market is starting to come back. People are dipping their toe back in the water on these SPAC transactions. The D&O insurers are going to be happy to jump in and issue policies, collect premiums there. What are we looking at, in terms of pricing? And perhaps, is it the usual suspects in the market or do you have new entrants into this market? Why don't you touch on that, before we wrap up?

Yelena Dunaevsky: Yeah, that's a great question. As you probably know, the general public company D&O market has softened considerably over the last year or so. We're definitely not seeing the pricing that we were seeing in '21, which was exorbitant and ridiculous, if you ask me. That was really hard conversations to have with my clients. Now the market has done 180-degree flip, which is excellent for my clients. Much lower pricing and the insurers are fighting for those premium dollars, so we're seeing that reflected not only in the traditional D&O public company space, but also in SPACs.

There are a few carriers are the ones that have been in the market forever, and they are able to offer primary coverage. Some new entrants into the market, but I haven't dealt with them recently. My sense is that they don't really understand the SPAC dynamics yet very well, based on the questions that they're asking. I think they need a little bit of time to get up to speed on how this actually works. But once they get there, there's going to be additional capacity in the market.

But generally speaking, the D&O market right now, it's very favorable for SPACs. The pricing is somewhere for, doing five million coverage for the SPAC IPO, somewhere in the 200, 250, 270 range for a Side A only. Again, that goes into how you structure, and what you should be doing, and how the SPAC risk is looking. But it's very, very different from the numbers that we were seeing, which were four, five, six times that in 2021.

Lynda Bennett: Well, one thing has come through loud and clear to me in today's episode, which is you need to have a specialized broker who really knows the SPAC market inside and out. You certainly are someone that, if I were in the market looking, I'd give a call to because you have your thumb on the risk that's out there and how to beat up those insurance companies to get good coverage at the right price.

I want to thank you very much for joining us today. Interesting to watch this market continuing to evolve. We'll be very happy to have you come on back and give us your next update. But in the meantime, thanks for coming on today and sharing your knowledge. It's really appreciated.

Yelena Dunaevsky: Thank you so much, Lynda and Heather. Absolutely, I would love to update you on how this develops down the road, and would love your expertise once we get to those claims because you are the best in market. Thank you.

Heather Weaver: Appreciate that.

Lynda Bennett: Thank you so much.

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