

## **Quinn Emanuel Private Equity Litigation Practice Alert**

### **Recent SPAC Litigation Tied To Short Seller Scrutiny**

2020 was the year of the special purpose acquisition company (“SPAC”), with over \$ 70 billion raised in deal value, a five-fold increase over 2019.<sup>1</sup> SPACs are a large, growing and ebullient market. A SPAC is a shell company with no operations that raises capital in an initial public offering (“IPO”) for the purpose of merging with and taking public an unspecified existing company. SPACs can be a faster and more efficient method of going public, compared to the conventional direct or underwritten public offering, which has contributed to their increasing popularity.

But some see the boom in SPACs as a return to “speculation in all its glory”—and the possibility that the SPAC market is “frothy” is increasingly also attracting the attention of short sellers.<sup>2</sup> As a result of these factors, some short sellers are even using the pool of upcoming SPACs as a starting place for short opportunities.<sup>3</sup>

Having undertaken their analysis and taken a short position, short sellers may have an incentive to bring to light information that justifies their analysis that a stock is overvalued, and thereby catalyze the very market reactions that will reward their position. And because a SPAC vehicle is a shell company that has made minimal substantive disclosures, and the target is a private company that has not been subjected to full disclosure requirements prior to the merger transaction, there is almost inevitably less information available at the time of the de-SPAC than in a traditional IPO, as we highlighted in our Private Equity Litigation Practice Alert, “[Litigation Risk In The SPAC World](#).”<sup>4</sup> This means that the short seller’s release of information may have an unusually high impact on share price. As certain deals have recently demonstrated, this can lead directly to litigation.

In this Client Alert, we summarize recent litigation prompted by or correlated with short seller interest in a de-SPAC acquisition transactions, and examine the implications for our clients on all sides of the SPAC market.

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<sup>1</sup> See Mark DeCambre, “A surge in ‘blank check’ companies this year could drive \$300 billion in M&A in 2021–’22, forecasts Goldman,” Dec. 14, 2020, available at <https://www.marketwatch.com/story/a-surge-in-blank-check-companies-this-year-could-drive-300-billion-in-m-a-in-202122-forecasts-goldman-11607963956>.

<sup>2</sup> Jim Chanos, of Kynikos Associates, also said “the return of special purpose acquisition companies is not only bad relative to the stock market, it’s even worse than initial public offerings.” See Ilya Banares, “Blank-Check Company Deals Driven by Speculation, Chanos Says,” Oct. 20, 2020, available at <https://www.bloomberg.com/news/articles/2020-10-20/blank-check-company-deals-driven-by-speculation-chanos-says>.

<sup>3</sup> See Michelle Celarier, “The SPAC Short Boom Is on Its Way,” Dec. 18, 2020, available at <https://www.institutionalinvestor.com/article/b1pqwl3dm2dxgf/The-SPAC-Short-Boom-Is-on-Its-Way/>.

<sup>4</sup> See also Eliot Brown, “Startups Going Public Via SPACs Face Fewer Limits on Promoting Stock,” Jan. 3, 2021, available at <https://www.wsj.com/articles/startups-going-public-via-spacs-face-fewer-limits-on-promoting-stock-11609678800>.

## I. Recent SPAC Litigation Linked To Scrutiny By Short Sellers

A number of cases from 2020 have highlighted the interaction between short sellers' increased attention to the SPAC market, and the litigation that may be attendant on that attention.

**Nikola Corporation.** The zero-emissions vehicle company Nikola Corp. went public via a de-SPAC transaction in June 2020 after it merged with VectoIQ Acquisition Corp. VectoIQ reportedly vetted more than 100 clean transportation companies before reaching an agreement with Nikola.<sup>5</sup> Nikola's market capitalization more than doubled to \$30 billion the week after the de-SPAC transaction. Its share price moved around, but increased almost 40% after the company announced a partnership agreement with GM to produce an electric truck, on September 8, 2020. But only days later, the short seller firm Hindenburg Research announced it had taken a short position on Nikola's stock, describing it as an "intricate fraud."<sup>6</sup> Hindenburg Research alleged, among other things, that Nikola's partnerships had been induced by false information, that key claims about Nikola's technology, its ability to design components in-house, and ads about its vehicles' abilities were false, and that Nikola's reports of outstanding orders were overstated.<sup>7</sup>

After that report, multiple plaintiffs have filed securities fraud class actions against Nikola Corp., as well as directors and officers of Nikola and the pre-merger SPAC, asserting false statements claims under Section 10(b) and Rule 10b-5 of the Exchange Act, and claims against the individual directors and officers that they participated in making those false statements.<sup>8</sup> These complaints rely on and quote heavily from the report by short sellers Hindenburg Research.

At the same time, the Department of Justice opened an investigation,<sup>9</sup> and the Chairman of the SEC, Jay Clayton, said that the SEC will look to examine "incentives and compensation to SPAC sponsors" to make sure that "investors understand those things," both at the time of the initial SPAC offering, and at the time of the de-SPAC transaction.<sup>10</sup>

**Multiplan Corp.** In October 2020, Multiplan Corp. went public via a de-SPAC transaction after it merged with Churchill Capital Corp III. Multiplan is a healthcare cost management company that provides access to networks and services to medical plans to reduce costs, and takes a percentage of the savings. The transaction was one of the largest SPAC deals of 2020, worth approximately \$ 11 billion. Before it closed, a class action litigation alleging false statements in the proxy statement under Section 14

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<sup>5</sup> See Todd Maiden, "Fast track to public listings dealt a blow amid Nikola fallout," Sept. 22, 2020, available at <https://www.freightwaves.com/news/fast-track-to-public-listings-takes-a-blow>.

<sup>6</sup> See <https://hindenburgresearch.com/nikola/>.

<sup>7</sup> *Id.*

<sup>8</sup> See *Borteanu et al. v. Nikola Corp. et al.*, No. 2:20-cv-01797-JZB (D. Ariz., Sept. 15, 2020), now consolidating *Salem v. Nikola Corp., et al.*, No. 2:20-cv-02374-SPL (D. Ariz., Sept. 16, 2020); *Wojichowski et al. v. Nikola Corp. et al.*, No. 2:20-cv-01819-DLR (D. Ariz., Sept. 17, 2020); *Malo et al. v. Nikola Corp., et al.*, No. 2:20-cv-02237-SPL (D. Ariz., Oct. 16, 2020); *Holzmacher et al. v. Nikola Corp. et al.*, No. 2:20-cv-02123-JJT (D. Ariz., Nov. 3, 2020); *Eves et al. v. Nikola Corp. et al.*, No. 2:20-cv-02168-SPL (D. Ariz., Nov. 10, 2020).

<sup>9</sup> See Kelly Anne Smith, "Nikola Corp Versus Hindenburg Research: Who Should You Trust?" Sep. 21, 2020, available at <https://www.forbes.com/sites/advisor/2020/09/21/nikola-corp-versus-hindenburg-research/?sh=7063bbfa19b8>. Nikola Corp. later confirmed it had received a Grand Jury subpoena from the Dept. of Justice: Claire Bushey and Peter Campbell, "Nikola and founder Trevor Milton subpoenaed by US justice department," Nov. 9, 2020, available at <https://www.ft.com/content/51c9de3f-7e08-4740-8a50-4f301d8ca9ae/>.

<sup>10</sup> Chairman Clayton did not name Nikola specifically. See <https://www.cnbc.com/video/2020/09/24/sec-chairman-jay-clayton-on-disclosure-concerns-surround-going-public-through-a-spac.html>.

sought to block the merger.<sup>11</sup> But shortly after the de-SPAC deal closed, Carson Block of the short seller firm Muddy Waters released a report that alleged, among other things, that Multiplan’s business model was weak, and that as a result it was on the brink of losing its largest client, UnitedHealth. Muddy Waters also alleged that Multiplan’s private equity owners, Hellman & Friedman—the third PE firm to hold Multiplan—had made the SPAC deal as the last available exit, having extracted what value it could and otherwise taken much of its investment out of the company.

Multiplan stock dropped 20% on the release of the Muddy Waters report, and at least two plaintiff firms are investigating the claim that Multiplan made materially false or misleading statements to investors, with a view to filing class action lawsuits.<sup>12</sup>

**Akazoo S.A.** In September 2020, shareholders filed an amended consolidated securities class action in the Eastern District of New York against Akazoo S.A., which operates a music streaming platform, and against a number of officers and directors. Akazoo was the product of a September 2019 SPAC merger with Modern Media Acquisition Corp. Shareholders allege there were numerous false statements as to Akazoo’s financial results, the size and scope of the available market, the number of subscribers to the service.

The lawsuit—which is currently stayed for mediation—directly credits the roadmap of its claims to an April 2020 investigative report issued by short sellers Quintessential Capital Management, which supplied both the underlying information as well as a fall in the share price that served as a convenient early marker for damages.<sup>13</sup> Akazoo was subsequently delisted in June 2020. In September 2020, the SEC also filed a civil case against Akazoo, alleging fraud and misleading statements and omissions, which credits the Quintessential Capital Management report with bringing the fraud to light.<sup>14</sup>

**Triterras Inc.** The most recent example we have observed is of Triterras, Inc., a fintech company that operates a blockchain-enabled commodity trading platform known as Kratos. Triterras went public on November 11, 2020, via a de-SPAC transaction with Netfin Acquisition Corp. On December 17, 2020, Rhodium Resources Pte Ltd—a related party to Triterras that Triterras relied on for the majority of its referrals to the Kratos platform—sought a moratorium on creditor actions to restructure its own debt. Short sellers pointed out ties between Rhodium and the CEO of the SPAC that merged with Triterras, and that Rhodium was controlled by Triterras’ CEO. Short sellers alleged that, particularly given the close ties

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<sup>11</sup> Suits of this kind were described in our recent Private Equity Litigation Practice Alert. *See* “Recent Cases Highlight Supply and Demand Imbalance in the SPAC Market,” available at <https://www.quinnemanuel.com/the-firm/publications/recent-cases-highlight-supply-and-demand-imbalance-in-the-spac-market/>. *See also*, *Hutchings et al. v. Churchill Capital Corp. III, et al.*, No. 1:20-cv-06318 (S.D.N.Y., Aug. 11, 2020); *Feges et al. v. Churchill Capital Corp. III, et al.*, No. 1:20-cv-06627 (S.D.N.Y., Aug. 19, 2020); *Noor et al. v. Churchill Capital Corp. III, et al.*, No. 1:20-cv-06686-KPF (S.D.N.Y., Aug. 20, 2020); *Greenman et al. v. Churchill Capital Corp. III, et al.*, No. 1:20-cv-07466-UA (S.D.N.Y., Sep. 11, 2020).

<sup>12</sup> *See* <https://www.businesswire.com/news/home/20201112006123/en/EQUITY-ALERT-Rosen-Law-Firm-Announces-Investigation-of-Securities-Claims-Against-MultiPlan-Corporation-%E2%80%93-MPLN/>; <https://www.globenewswire.com/news-release/2020/11/17/2128405/0/en/INVESTOR-ALERT-Kirby-McInerney-LLP-Announces-an-Investigation-of-Shareholder-Claims-Against-MultiPlan-Corporation.html/>.

<sup>13</sup> *See In re Akazoo S.A. Securities Litigation*, No. 20-cv-1900, Dkt. No. 15 at ¶¶ 19, 20, 27, 85 (E.D.N.Y. 2020).

<sup>14</sup> *See SEC v. Akazoo Akazoo S.A.*, No. 20-cv-8101, Dkt. No. 1 at ¶¶ 24-25 (S.D.N.Y. 2020).

in management of Triterras and the SPAC, it was suspicious that investors were not told about the precarious financial position of an important related party.<sup>15</sup>

Only days later, on December 21, 2020, a shareholder had filed a class action alleging violations of Section 10(b) and Rule 10b-5 of the Exchange Act, and claims against the CEOs of Triterras and the SPAC that acquired it that they participated in those violations.<sup>16</sup>

## II. What You Should Be Doing—And How We Can Help

As the recent cases summarized above demonstrate, litigation may follow a well-publicized SPAC short. Although the examples above may appear to be outliers, this is a risk that will be important for SPAC sponsors and target companies to bear in mind when negotiating deal terms and drafting their disclosures. Sophisticated clients are increasingly getting litigation counsel involved early on as the potential for dispute first becomes apparent in a particular deal. As we have noted in other contexts, getting litigation counsel involved can provide fresh thinking and prophylactic insights alongside the client's deal lawyers who drafted the documents and lived through the deal, while helping clients to establish a thoughtful record and game plan in the event that litigation ensues.<sup>17</sup>

Moreover, while the examples we cited primarily featured securities plaintiffs borrowing from the publicized work of short sellers, litigation may ultimately prove to be a tool for short sellers. By focusing on the content of the SPAC transaction proxy statement, for example, a short seller may telegraph potential litigation claims to securities plaintiffs. A well-thought-out litigation strategy may be an important component of a short seller's strategy—though, retaliatory litigation or counterclaims from the SPAC sponsor or target company may follow. Quinn Emanuel has extensive experience representing clients on both sides of these disputes, and can help map out a litigation strategy to navigate the rapidly changing market for SPACs.

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If you have any questions about the issues addressed in this Client Alert, or if you would like a copy of any of the materials we reference, please do not hesitate to contact us:

**Ellison Ward Merkel**

Email: [ellisonmerkel@quinnemanuel.com](mailto:ellisonmerkel@quinnemanuel.com)

Phone: +1 212-849-7362

**Christopher Kercher**

Email: [christopherkercher@quinnemanuel.com](mailto:christopherkercher@quinnemanuel.com)

Phone: +1 212-849-7263

**Andrew Rossman**

Email: [andrewrossman@quinnemanuel.com](mailto:andrewrossman@quinnemanuel.com)

Phone: +1 212-849-7282

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<sup>15</sup> See Michelle Celarier, "The SPAC Short Boom Is on Its Way," Dec. 18, 2020, available at <https://www.institutionalinvestor.com/article/b1pqwl3dm2dxgf/The-SPAC-Short-Boom-Is-on-Its-Way/>.

<sup>16</sup> See *Ferraiori et al. v. Triterras, Inc. et al*, No. 1:20-cv-10795 (S.D.N.Y. Dec. 21, 2020).

<sup>17</sup> See Brian Timmons and Meredith Mandell, "Think Twice Before Using Deal Counsel as Litigation Counsel," LAW360, April 17, 2020, available at <https://www.law360.com/articles/1261252/think-twice-before-using-deal-counsel-as-litigation-counsel>.

**Brian Timmons**

Email: [briantimmons@quinnemanuel.com](mailto:briantimmons@quinnemanuel.com)

Phone: +1 213-443-3221

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