WOODRUFF SAWYER

Guide to D&O Insurance for SPAC IPOs

2022 EDITION

Table of Contents

3 SPAC Life Cycle

4 D&O Insurance for a SPAC IPO

- Six Forms of Litigation Against SPACs
- Regulatory Enforcement Against SPACs
- D&O Costs for SPAC IPOs Are Significant
- Risk Factors Examined by Insurance Underwriters
- The Process of Securing D&O Insurance for Your SPAC IPO
- Consideration for Limit Selection

9 Business Combination and D&O Insurance Logistics

11 Choosing the Right Insurance Broker: Questions to Ask

13 Contributing Experts

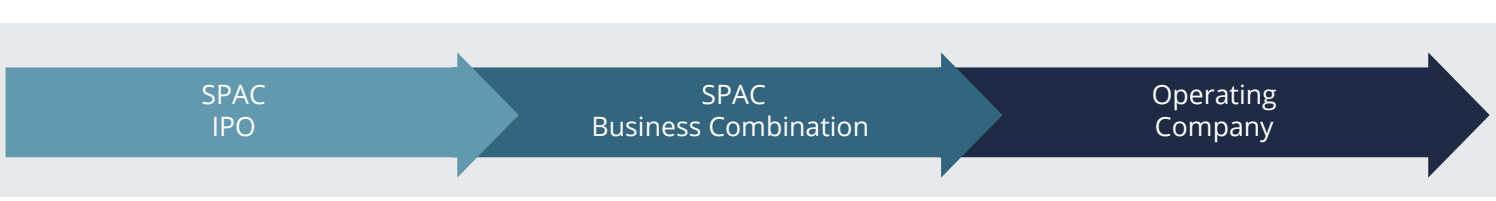
SPACs (special purpose acquisition companies) had a volatile year in 2021, raising more funds in the public market and doing more business combinations than ever before. After an extremely busy first quarter the pace of SPAC IPOs and SPAC business combinations (aka de-SPACs) slowed down largely as a result of an overheated market and increased attention from the regulators. The pace of new issuances and combinations picked back up towards the end of the year and will likely continue to be robust in 2022. Attention from regulators like the SEC and FINRA will also likely continue and we anticipate a number of new statements from the regulators as well as SPAC-related rule changes in 2022.

As they go through their IPO and the subsequent M&A process, SPACs face many regulatory, legal, and business hurdles, including obtaining the appropriate amount and type of insurance for each stage of their life cycle. However, with some smart preparation and the expertise of the right advisors, insurance can go from being a necessary burden to a strategic asset.

Woodruff Sawyer is a market leader for placing Directors and Officers (D&O) insurance for SPACs and SPAC targets that are going public through a de-SPAC. Woodruff Sawyer is also a nationally recognized leader when it comes to Representations and Warranties insurance (RWI), something that can play a critical role in the SPAC M&A process.

SPAC Life Cycle

When thinking about insurance for a SPAC, it is helpful to think in terms of the SPAC's life cycle. From an insurance perspective, there are three main phases:



Phase One:
SPAC IPO

- S-1 registration statement filed with SEC
- SEC approval is obtained
- SPAC's D&O policy is bound
- SPAC units begin trading on a public exchange

Phase Two:
SPAC Business Combination

- SPAC management identifies an M&A target
- SPAC's insurance broker conducts target company insurance due diligence and advises on Reps & Warranties insurance
- SPAC files S-4 Registration Statement and shareholder approval is obtained
- SPAC's broker consults on operating company D&O
- SPAC's tail policy goes into effect when M&A transaction closes

Phase Three:
New Public Company

- The combined company begins life as an operating company with publicly traded shares
- Operational strategy for the combined business is established
- Integration of board and/or management takes place
- Financial and other compliance processes are set

The insurance needs of the SPAC are different at each of these phases. This *Guide* focuses on the first phase of the cycle, the time period from a month or two prior to the SPAC IPO until the business combination closes. Read our SPAC insights for further analysis of all phases of a SPAC and our *Guide to Insurance for de-SPAC Transactions* for additional information on phases two and three of the cycle.

D&O Insurance for a SPAC IPO

As it goes through the IPO process, the main assets of a SPAC are its management team and directors as well as the management team's investment strategy.

The fact that the common stock of the SPAC is publicly traded after the IPO makes the SPAC management team and the SPAC's directors and officers vulnerable to lawsuits from investors as well as to SEC enforcement actions. D&O insurance, of course, is designed to mitigate the risk of these types of costs falling on individual directors and officers and the companies they serve.

In 2021, SPAC IPOs became a popular target for litigation and regulatory scrutiny. The number of securities class actions filed against SPACs and de-SPACs increased by 520% from 2020.

The vulnerabilities associated with being a public company create a need for D&O insurance coverage for the SPAC's management team and its board. Moreover, a majority of a SPAC's board must consist of independent board members to satisfy stock exchange listing rules. Business people who serve as independent board members typically do not accept a board appointment without the promise of good D&O insurance.

Six Forms of Litigation Against SPACs

We saw the following six types of SPAC-related litigation and enforcement in 2021. More types of lawsuits will likely be brought in 2022.

1. The Merger Objection Lawsuits

Merger Objection lawsuits are not new. In the SPAC context—much like in non-SPAC deals—as soon as a deal is announced, a plaintiff files a suit claiming that the deal is unsatisfactory in some way and should not proceed. The allegations usually revolve around insufficient disclosure about the upcoming merger. These kinds of lawsuits are typically mooted and dropped after additional disclosure is filed, and the plaintiff and their attorney walk away with a "mootness fee" of a few thousand dollars.

2. Securities Class Actions

Securities Class Actions are more serious in nature. These can be brought in federal or state court against the SPAC, its directors and officers, or the private company being acquired by the SPAC, and its directors and officers. In some cases, security class actions can be brought against SPAC sponsors and other related deal parties.

Depending on the fact pattern, allegations center around violations of the Securities Act or the Securities Exchange Act and their respective rules and typically focus on misstatements or omissions in the disclosure or public statements. These kinds of cases are typically brought post-merger, but some, like the Lucid Motors case, are filed prior to the merger.

3. Breach of Fiduciary Duty Suits

Several Breach of Fiduciary Duty lawsuits were filed in the Delaware Chancery Court in 2021, alleging that the SPAC structure creates an inherent conflict of interest between the SPAC's sponsor and its board and the SPAC's investors. The allegations are that this conflict of interest diminishes the rigor with which the SPAC's sponsor and its board consider a proposed merger, and that, as a result, the merger cannot meet the entire fairness test and the SPAC's board is in breach of its fiduciary duty to the SPAC's shareholders. An example of this kind of lawsuit is the Multiplan litigation.

The question in all of these lawsuits is whether the entire fairness standard should even apply or whether the actions of the SPAC sponsor and its board should be considered under the more deferential business judgment rule.

4. Shareholder Derivative Suits

Many shareholder derivative lawsuits have been filed in 2021 on behalf of SPACs against the SPACs' directors and officers. Typically, these lawsuits come on the heels of a securities class action already filed against the SPAC.

These cases typically allege harm to the SPAC from false statements made by the SPAC's directors and officers and serious breaches of fiduciary duties. Because Delaware corporations cannot indemnify derivative suit settlements, these suits can pose a serious personal financial risk to the individual directors and officers of the SPAC. For example, if the SPAC's D&O insurance policy does not have sufficient coverage under its "Side A," the individual directors and officers may need to cover the settlement costs out of pocket.

5. SPACs are Investment Companies Suits

An example of a shareholder derivative suit but also of a line of a new type of allegations directed against SPACs is the August 2021 lawsuit filed against Bill Ackman's Pershing Square Tontine. The allegations are that SPACs are investment companies and should register as such under the Investment Company Act of 1940. The same plaintiffs' attorney team, led by former SEC Commissioner Robert Jackson, brought two more suits with the same allegations against two other SPACs.

In an unprecedented move, more than 60 law firms published a statement in response to these lawsuits calling the assertion that SPACs are investment companies meritless. It remains to be seen whether these suits will move forward, or if the SPACs will be forced to settle.

6. Shareholder Voting Suits

Another type of common lawsuit against SPACs is a technical challenge to the manner in which SPAC shareholders are being asked to vote on a merger. Recent examples were filed in Delaware on behalf of investors of dMY Technology Group IV and Mudrick Capital Acquisition Corporation II. These suits allege that the SPACs' boards attempted to improperly force Class A shareholders to vote together with Class B shareholders in violation of Delaware General Corporation Law so that the SPAC could proceed with the merger.

Regulatory Enforcement Against SPACs

SEC, FINRA, and the DOJ are likely to continue to focus on the SPAC market. In 2021 they brought several enforcement and investigative actions against SPACs, their directors and officers, their sponsors, the targets, and the targets' directors and officers. Enforcement actions like the one the SEC brought against Stable Road, which resulted in an $8 million fine, and the FINRA-initiated investigation into Digital World Acquisition were heavily covered in the media and closely followed by most SPAC market participants.

Considering the enormous numbers of SPACs that went public and announced or completed mergers in 2021, additional lawsuits and enforcement actions are virtually guaranteed in 2022.

D&O Costs for SPAC IPOs Are Significant

As a general matter, the cost of D&O insurance has been on the rise for the last few years. While SPAC IPOs have a very different profile than operating company IPOs, there is significant overlap in the carriers that write D&O insurance for these types of risks. Indeed, the group of carriers willing to write D&O insurance for SPACs is a subset of those willing to write insurance for the broader D&O market. The 2021 surge of SPAC IPOs and SPAC business combinations, and the scarcity of insurers willing to write D&O coverage for SPACs has pushed up SPAC IPO D&O premiums significantly: SPAC D&O premiums increased four to five times between Q1 of 2020 and Q1 of 2021 and continued to grow moderately through the end of 2022.

Positive litigation outcomes in the Delaware Supreme Court case, *Sciabaccuchi*, as well as in critical state court cases such as Restoration Robotics, Sonim, Dropbox, Uber and Domo, may bring comfort to some insurance carriers that multiple concurrent lawsuits will not be brought in both federal and state courts. However, this will only be true for companies that have federal choice of forum provisions (aka the "Grundfest Clause") in their charter documents. Be sure to discuss this with your securities counsel.

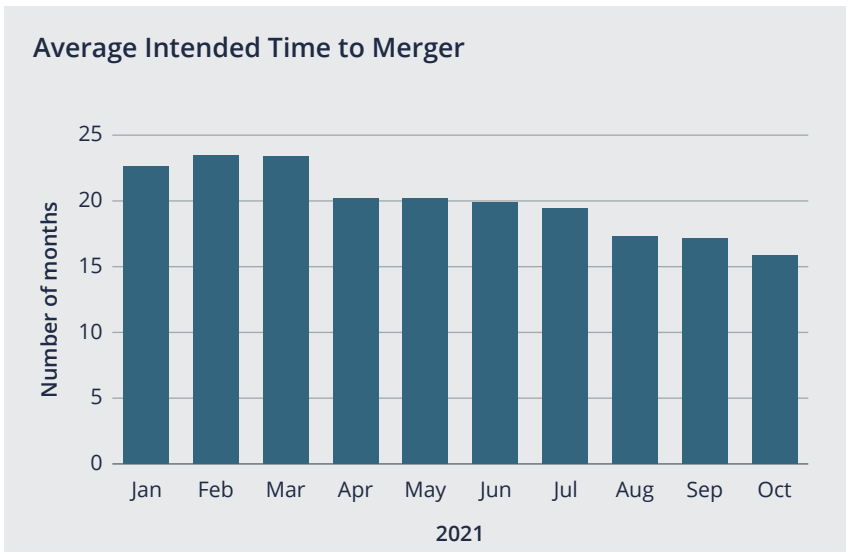
Given how dynamic the current D&O insurance market is, you will want to be sure to talk to your insurance broker to get an indication of current pricing sooner than later. A broker that specializes in SPACs will also be able to suggest ways to reduce premium costs. It has to be said: If you are asking these questions of someone who does not place a lot of D&O insurance for SPACs, you are at risk for having asked for pricing and program structure information from someone who does not realize that they do not know the answers to your questions.

Given the dynamic D&O insurance market, talk to a SPAC-specialty insurance broker to understand current pricing sooner rather than later.

Risk Factors Examined by Insurance Underwriters

When deciding premium and retention (similar to a deductible) for a SPAC IPO D&O policy, insurers typically examine the following factors, among others:

1. Whether the SPAC sponsor team has successfully executed previous SPAC IPOs, has relevant public company experience, and has expertise in the industry of the target company it plans to acquire. Premiums are higher for more inexperienced sponsor teams that lack a substantial track record, public company knowledge or familiarity with raising money for SPACs, and for teams that are seeking targets outside of their area of expertise.
2. Jurisdiction of the SPAC entity and the potential target. If the SPAC is based outside of the United States or aims to acquire targets in riskier markets, the premium pricing can go up considerably.
3. Size of IPO raise. The larger the SPAC IPO, the riskier it is from an insurer's perspective, thereby resulting in higher D&O premiums.
4. The SPAC's plans with respect to the redemption of shares. Towards the end of 2021, some SPACs saw redemptions as high as 90%. Insurers have started asking SPACs to outline their plans for counteracting a potentially deal-breaking number of redemptions.
5. Length of the SPAC's investment period. Many SPACs now allocate only 18 months or 15 months as their period to find a suitable merger target. This contrasts with the typical 24-month period that was standard during most of 2021. Considering the dearth of private target companies, the increases in the length of time the SEC has been taking to approve pre-merger filings and the number of lawsuits brought against SPACs that are close to their deal deadlines, insurers are becoming increasingly weary of artificially short investment periods.



Source: WS graphic based on data from SPACInsider.com

Read more about risk factors examined by SPAC IPO insurance underwriters and their latest areas of concern.

There is no doubt that the main driver of increased prices in the SPAC D&O market is the unprecedented demand for D&O insurance for SPAC IPOs and SPAC business combinations. There are two vectors to this price increase: (1) the supply of D&O insurance for SPACs is not increasing at the same rate as the demand; and (2) insurance carriers are concerned that the sheer number of SPAC deals will lead to increased risk of litigation and enforcement. Both vectors, predictably, are keeping the cost of D&O insurance for SPAC IPOs elevated.

A few new insurer entrants into the SPAC market in early 2022 and the decreased volume of SPAC IPO activity in Q4 of 2021 and beginning of 2022 as compared to Q1 of 2021 are pointing towards a stabilization and slight improvement in D&O insurance pricing. However, considering the substantial increase in the number of lawsuits and enforcement actions being brought against SPACs in 2021 as compared to previous years (e.g., 31 securities class actions in 2021 compared to five in 2020 and two in 2019), it is unlikely that D&O insurance pricing will decrease significantly in the beginning of 2022. Indeed, D&O insurance carriers may even increase pricing again as the year progresses.

The Process of Securing D&O Insurance for Your SPAC IPO

The process of securing D&O insurance for your SPAC begins with choosing the right D&O insurance broker. (See Choosing the Right Insurance Broker: Questions to Ask). Ideally, in advance of the first filing of your confidential Form S-1 registration statement, your broker will launch the process by sending non-disclosure agreements to the relevant insurance carriers. Once your S-1 has been filed with the SEC (confidentially or otherwise), your broker will send the S-1 registration statement to insurance carriers. The S-1 registration statement will serve as the insurance underwriters' primary underwriting document. Your broker will then negotiate with the insurance carriers on your behalf while keeping you informed and updated.

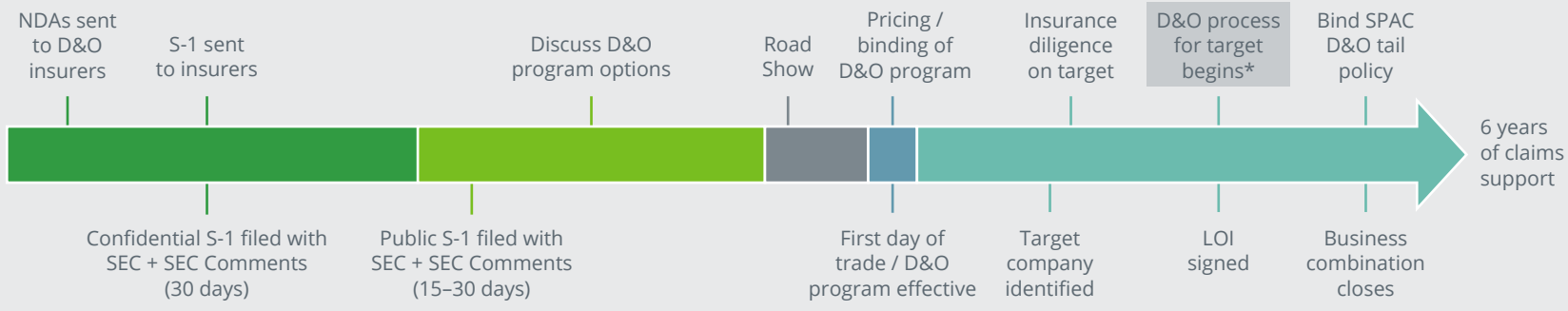
Critical decisions you will make with your broker's guidance will include:

- The total D&O insurance limit
- The structure of the program (the break-down between traditional "ABC" insurance versus "Side A" insurance)
- The amount of the self-insured retention (like a deductible)

The duration of the D&O insurance policy for a SPAC's IPOs will match the duration of the investment period of the SPAC. In addition, at the time you place the D&O insurance for your SPAC IPO, your broker will negotiate the terms of the six-year tail (also referred to as "runoff") policy. (More on this below)

Once your broker has presented you with options and you have made your choices, the broker will wait to hear from you that your deal has priced. If your deal might be delayed, upsized, or downsized, be sure to tell your broker in case there is a need to refresh your insurance carriers' quotes. Above all, remember to call your broker on the day of pricing, confirm the price, and instruct your broker to bind your D&O program so that it is active before your first trade the next day.

SPAC IPO Milestones Timeline for D&O Insurance



D&O Insurance Process

PREPARE

- Implement carrier NDA
- Discuss preferred D&O insurance program structure and limits
- Broker sends S-1 to D&O insurance market
- Organize insurance underwriting call if appropriate

LAUNCH

- SPAC provides updated S-1 to broker
- Broker and SPAC discuss results of insurance market negotiations
- SPAC makes final decisions on D&O insurance program structure and limits

FINALIZE

- Keep broker updated on any significant SEC comments, changes to the S-1 or changes to the pricing date
- Broker finalizes D&O insurance program

IMPLEMENT

- Give bind order upon pricing
- Policy is in place before the first trade the next day

ON-GOING SUPPORT

- Keep broker informed about any potential de-SPAC transactions
- Broker conducts insurance diligence on target, as requested
- Implement SPAC's tail policy at the close of the de-SPAC transaction
- 6 years of claims support
- Broker assists with placement of reps and warranties policy ahead of the de-SPAC
- Broker assists in placement of the D&O policy for the combined entity

Source: Woodruff Sawyer

* Read more in our *Guide to D&O Insurance for De-SPAC Transactions*

Your D&O program will remain active from the IPO date until the closing of the business combination. At that time, the policy will go into "runoff" (aka a "tail" policy will be put into place). This means the policy will continue to respond for the rest of its policy term, but only for claims related to events that took place before the closing of the business combination.

Consideration for Limit Selection

We observed a gradual decrease in the coverage limits chosen by SPAC IPO teams in 2021. At the beginning of 2021 many teams that were raising between $100 million and $500 million in their IPO gravitated towards limits of $10 million to $20 million in coverage. As the pricing of D&O insurance increased sharply and continued to stay high through Q2 and Q3 of 2021, new and repeat SPAC teams started purchasing total limits of between $5 million and $10 million.

Many SPACs raising between $100 million and $250 million now chose no more than $5 million in total coverage. Exact structuring of these programs (e.g., whether they chose $5 million in ABC coverage or supplement ABC layers with Side A only coverage) varies according to the preferences and circumstances of each team. It is important to get the advice and guidance of a knowledgeable SPAC D&O broker to find the right limit and structure for your deal.

Business Combination and D&O Insurance Logistics

At the time of the business combination, there are at least five D&O insurance-related considerations to keep in mind:

1. Insurance Diligence on the Target Company
2. Claims Handling
3. Tail Policy
4. Reps and Warranties Insurance
5. D&O Insurance for the Target Company

1. Insurance Diligence on the Target Company

One of the benefits of working with a full-service retail broker is being able to have your broker conduct insurance diligence on your target. You will want to know if there are gaps in coverage that need to be fixed before your transaction closes. Depending on the amount of work involved, most brokers will charge a small fee for this diligence work.

2. Claims Handling

It is not unusual for SPAC shareholders to file suit against the SPAC directors and officers at the time a merger is announced. It is important to send any litigation (or threats of litigation) to your insurance broker along with instructions to "notice the claim" to your D&O insurance carriers. Remember that insurance carriers have to approve your choice of defense counsel. You will want to coordinate with your broker in order to maximize any available recovery from your D&O insurance policies. This is where choosing a broker that has a robust claims advocacy practice is important.

3. Tail Policy

Contact your SPAC insurance broker around the time you are close to signing of your Letter of Intent (LOI) and plan to announce your proposed merger transaction. This gives your broker time to prepare to place a tail on your D&O insurance program.

What is a Tail Policy? Recall that your D&O insurance policy was likely a two-year policy. What happens if you are sued after the policy expires for something that took place before the business combination (e.g., an allegation of inadequate diligence on the target by the SPAC directors and officers)? Unless special steps are taken, there would be no D&O insurance response. To avoid this gap in coverage, brokers arrange to put a "tail" on the D&O insurance policy. This tail takes the form of an endorsement that will hold the policy open, typically for six years, in exchange for additional premium. Your insurance broker will pre-negotiate the amount of the additional premium when the IPO policy is placed, but you only pay the additional premium at the time the business combination closes.

4. Reps and Warranties Insurance

For a relatively low premium, RWI provides an insurance backstop to the buyer if the seller's representations and warranties turn out to be flawed, or worse fraudulent. What's even more important, the diligence review the insurance underwriters and their counsel conduct as part of the placement of the RWI policy provides a written trail of issues that were known and unknown ahead of the merger. More and more SPACs are folding RWI into their acquisition strategies. With more private equity (PE)-backed SPACs coming to market and more lawsuits alleging insufficient or rushed due diligence, SPACs' use of reps and warranties insurance in 2022 is bound to increase. (RWI is used in about 95% of PE transactions and is considered market standard in the PE world). With more than 20 insurers competing against each other in the RWI market, a good broker who specializes in SPAC RWI will be able to find several attractive options for coverage.

For a SPAC, a RWI policy can offer protection against seller fraud and can be an important differentiator for a SPAC that is courting a reluctant private company or a private company with multiple suitors. For a SPAC that is competing against private equity firms or other SPACs for the same target, not offering the benefits of a RWI policy may mean a failed acquisition attempt and costly time delays. Since SPACs are under extra pressure to close their acquisition transactions before their combination deadline, having management spend time and effort on a failed auction process can be fatal.

For SPACs competing against PE firms, not having an RWI policy may result in a failed acquisition attempt and costly time delays.

Read our Guide to R&W Insurance to navigate the complex space of reps and warranties.

Consider as well that that many of the recent lawsuits brought against SPACs center around insufficient diligence performed prior to the business combination. The RWI process can serve as a kind of safety net for anything the SPAC's diligence team could have missed while reviewing the target's business and operations, which can go a long way to counteract allegations of shoddy due diligence and can help to ring-fence potential litigation exposure.

5. D&O Insurance for the Target Company

Typically, one or more of the SPAC board members will join the board of the target company, which, of course, will be a publicly traded company at the conclusion of the merger transaction. The target company will have to significantly up-level its D&O insurance since its private company D&O insurance policy will no longer be sufficient.

Details on how to obtain D&O insurance for the new public company are covered in our *Guide to D&O Insurance for De-SPAC Transactions*. Note that the private company's process for obtaining D&O insurance for itself as a public company typically starts with the S-4 filed by the SPAC in connection with the merger transaction.

Choosing the Right Insurance Broker: Questions to Ask

Given the rapidly changing nature of the D&O insurance market and the peculiarities of SPAC IPO companies, your choice of insurance broker is consequential.

A quirk of the insurance market is that, to optimize your result, you must choose one insurance broker to approach all the viable insurance markets on your behalf. Sending multiple insurance brokers into the market will lead insurance carriers to conclude that you do not know what you are doing and that you are not a serious candidate for their insurance capacity. For this reason, if you are interviewing D&O insurance brokers, be sure to instruct them to refrain from sending your name into the market until you have actually informed them that you have chosen them to be your broker.

Not unlike bankers, lawyers, and accountants, different insurance brokers bring with them varying levels of experience and resources. You want to be sure to work with a broker who places a significant amount of premium with the major insurance carriers.

To get the optimal D&O insurance coverage at the best possible price, here are some questions to ask potential D&O insurance brokers before you choose one.

1. What level of experience does the particular brokerage team you are talking to (not just the brokerage firm, but your particular team) have when it comes to placing D&O coverage for SPACs?

   It is critical that your D&O insurance broker has extensive and current experience working with SPACs, IPO companies, private equity firms, mature public operating companies, and RWI deals. The market for SPAC-related insurance changes very rapidly. Unless your broker is in the market every day, you will miss out on the latest developments in the terms and conditions of your policy, which are critical elements of your negotiated, customized D&O insurance program.

2. What reach does the brokerage team have in the D&O and RWI markets?

   Ask whether the brokers on your team have extensive and long-term relationships within the SPAC D&O and RWI underwriters. Having a broker with years of experience and rapport built into their underwriter relationships can make a significant difference in the terms and pricing of your policies and the speed with which they can be placed.

3. Will the broker be using a wholesaler, or making a direct placement?

   Many brokers only do a limited amount of SPAC / IPO / RWI / public company D&O business. These brokers may be excellent in other areas but will inevitably have to use a "wholesale" broker to work on your business if they do not transact a large volume of this business routinely. That can be a big negative for you, especially if there is a claim, because the person you are talking to will have no relationship with the insurance carrier that will be deciding whether to pay or deny your claim. Choose a broker who accesses the insurance market directly.

4 Can your broker clearly articulate the business and legal risks you face?

There is little chance your D&O or RWI insurance broker will do a good job of ensuring you have insurance coverage for critical risks if your broker cannot clearly articulate them. If your broker is not an expert in understanding the risks you face, you are talking to the wrong person.

5 What experience does your broker have in terms of advocating for coverage payments with carriers on behalf of clients with complex claims?

Many brokers have an anemic claims function at best, and often the same claims person who handles client auto or workers' compensation claims is also being asked to handle your difficult D&O insurance or RWI claims. Given the complexity of D&O insurance and RWI claims, this is a mistake. Find out if your broker has specialists who can swing into action on your behalf.

It is in your best interest to choose a broker that has the experience and expertise to be able to recommend the most strategic insurance program placement options, as well as one with extensive experience managing SPAC-related claims.

For More Information Please Contact:

Dan Berry
Senior Vice President, Private Equity & Venture Capital Group Leader, Management Liability
dberry@woodruffsawyer.com
415.399.6473
View Bio • LinkedIn

Yelena Dunaevsky, Esq.
Vice President, Transactional Insurance Group
ydunaevsky@woodruffsawyer.com
949.435.7398
View Bio • LinkedIn

Emily Maier
Senior Vice President, National Group Leader, M&A Insurance
emaier@woodruffsawyer.com
949.435.7378
View Bio • LinkedIn

Priya Cherian Huskins, Esq.
Senior Vice President, Management Liability
phuskins@woodruffsawyer.com
415.402.6527
View Bio • LinkedIn

About Woodruff Sawyer

As one of the largest insurance brokerage and consulting firms in the US, Woodruff Sawyer protects the people and assets of more than 4,000 companies. We provide expert counsel and fierce advocacy to protect clients against their most critical risks in property & casualty, management liability, cyber liability, employee benefits, and personal wealth management. An active partner of Assurex Global and International Benefits Network, we provide expertise and customized solutions to insure innovation where clients need it, with headquarters in San Francisco, offices throughout the US, and global reach on six continents.

For more information

Call 844.972.6326, or visit woodruffsawyer.com

Find out why clients choose to work with Woodruff Sawyer

Subscribe for Expert Advice and Insights

Sign up to receive expert advice, industry updates and event invitations related to Employee Benefits and/or Business Risks.

Additional Resources

SPAC Resources >>

SPAC Notebook Blog Series >>

Guide to D&O Insurance for IPOs and Direct Listings >>

D&O Notebook Blog Series >>

D&O Looking Ahead 2022 >>

M&A Notebook Blog Series >>

Cyber Notebook Blog Series >>

Cyber Looking Ahead 2022 >>

P&C Looking Ahead 2022 >>

Woodruff Sawyer Events >>