

Southern District of Texas: Denies Dismissal of Class Action Alleging Defendants Made Misrepresentations to Obtain Shareholder Approval for a De-SPAC Transaction

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On April 14, 2021, the Southern District of Texas denied the dismissal of a securities fraud class action alleging that defendants made a series of misrepresentations to induce plaintiff investors to vote for a de-SPAC transaction. [Camelot Event Driven Fund v. Alta Mesa Res., 2021 WL 1416025 \(S.D. Tex. 2021\) \(Hanks, J.\)](#). The court held that plaintiffs pled sufficient facts to establish claims under Sections 10(b), 14(a) and 20(a) where the company formed by the SPAC disclosed a \$3.1 billion write-down less than one year after its first 10-K was filed. Notably, the court denied the dismissal as to all defendants, including executives and directors of the post-merger company, two executives at the SPAC that became the post-merger company, and four business entities, including the SPAC sponsor, which were alleged to be control entities.

Background

After its IPO in March 2017, the SPAC in this case identified two oil-and-gas companies, an upstream company and a midstream company, for acquisition. The target companies, though nominally separate, were “deeply intertwined” with overlapping owners and interconnected operations. The SPAC’s stockholders voted to approve the merger in February 2018 and the merger closed.

Plaintiffs’ Allegations

Plaintiffs alleged that, prior to the merger, defendants intentionally overstated the value of the assets that were acquired in the merger. Plaintiffs alleged that defendants used misleading reserve and financial projections to overstate the value of the target companies to secure the SPAC shareholders’ approval of the merger.

The Court’s Findings

After a lengthy recitation of the events following the merger, the court found that the company’s SEC filings and other disclosures “indisputably show that [the company] experienced a massive drop in value during its brief time on the NASDAQ, to the point where the

company wrote down over 80% of its market value after its first year in existence and where assets valued at \$3.8 billion at the time of the special purpose acquisition company merger sold for, at most, \$320 million in a bankruptcy proceeding two years afterward.” The court found that it was “also indisputable that, toward the end of its short lifespan, [the company] acknowledged serious, systemic deficiencies in its financial reporting that created a reasonable possibility that a material misstatement of the company’s annual or interim financial statements would not have been prevented or detected on a timely basis.” Additionally, these reporting deficiencies triggered an ongoing SEC investigation.

Sufficient Facts Pled to Establish Claims Under Sections 10(b), 14(a) and 20(a)

The court stated that plaintiffs have “detailed numerous statements by various defendants from SEC filings, press releases, conferences, and earnings calls[,]” and determined that the “circumstances surrounding the company’s financial reporting . . . are alone enough to entitle [p]laintiffs to discovery.” In support of holding that plaintiffs pled sufficient facts to establish a Section 10(b) claim, the court noted that the 12 executive and director defendants all signed its first 10-K, which was filed less than two months after the SPAC merger closed. The court observed that less than a year after that 10-K was filed, the company disclosed a \$3.1 billion dollar write-down and that it was unable to file its annual report on time because it expected to report material weakness in its internal control over financial reporting in the 2018 Form 10-K. The company also “confirmed that it expected to report a net loss of \$3.1 billion for the year ended December 31, 2018 because of the write-down.” The court held that “[u]nder the circumstances, the enormity of the write-down over such a short period of time is enough for the case against these defendants to proceed.” The court further determined that plaintiffs “have pled facts sufficient to show that the defendants who signed the March 29, 2018 10-K acted with the requisite severe recklessness under Section 10(b). The same circumstances also satisfy the pleading standard for claims related to the [p]roxy under Section 14(a)[.]”

Further, the court concluded that plaintiffs pled sufficient facts to establish a claim under Section 20(a), where plaintiffs alleged “a complex web of securities ownership, contracts, business relationships, interlocking directors, and other factors that satisfies the ‘relaxed and lenient pleading standard for evaluating whether a plaintiff has sufficiently alleged a claim for control person liability.’” Quoting *One Longhorn Land I, L.P. v. Defendant FF Arabian, LLC*, 2015 WL 7432360 (E.D. Tex. 2015).

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