Katten Capital Markets Attorneys Speak Out After Releasing Joint Statement Alongside Over 60 Leading Law Firms

Published by *Capital Markets Compass* | Issue 1

October 14, 2021

On August 19, hedge fund magnate Bill Ackman released a letter to shareholders announcing plans to potentially unwind the SPAC he launched last year, Pershing Square Tontine Holdings, Ltd. (Tontine), in response to a shareholder derivative lawsuit that claimed Tontine was operating as an unregistered investment company in violation of the Investment Company Act of 1940, as amended (the Investment Company Act). Ackman's $4 billion investment vehicle was launched in June 2020 and remains the largest-ever SPAC raise by dollar size, but had trouble finding an acquisition target to match its substantial war chest.[I] Subsequent to the action against Tontine, several other similar suits were filed against additional SPAC vehicles, each making similar claims. In response to the lawsuits and in an unprecedented development, Katten and more than 60 other leading law firms released a joint statement condemning their merits.

Timothy J. Kirby, a partner in Katten's Capital Markets Group and Richard D. Marshall, a partner in Katten's Financial Markets and Funds practice, spoke with *The American Lawyer* regarding the suits, with Kirby noting: "A SPAC's primary goal is not to invest in securities [which is the focus of entities regulated under the Investment Company Act], but to buy an operating company. As SPACs went more mainstream, there has been more of an emphasis on transparency. You can go back and forth whether as a vehicle it is preferable to a traditional IPO, but the plaintiffs are trying to push through [this] Investment Company Act [claim]. That doesn't apply."

The lawsuit against Tontine, which was filed by former SEC commissioner Robert Jackson[II] and Yale Law School professor John Morley, claims Tontine is operating as an illegal investment company in violation of the Investment Company Act because, as is typical in the SPAC industry, it had invested its initial public offering (IPO) proceeds (which per SPAC regulations are kept in trust until an acquisition target is found) in short-term treasury bonds and money market funds, which invest in high-quality, short term debt securities. The Investment Company Act defines an "investment

company" as a company that "holds itself out as being primarily engaged, or proposes to engage primarily, in the business of investing, reinvesting or trading in securities"[III] and the plaintiffs suggest in the suit: "An investment company is an entity whose primary business is investing in securities. And investing in securities is basically the only thing that [Tontine] has ever done."

Although Katten and other leading law firms argued in their joint statement that such claims are without merit, the lawsuits are notable because the requirements of the Investment Company Act and the process of registering as an "investment company" are generally incompatible with the structure and operations of a SPAC vehicle, including certain fundamental elements such as the awarding of warrants to sponsors and directors, which under the Investment Company Act could be deemed "unlawful compensation." Further, operating as an unregistered investment company potentially renders any contracts such entity had entered into null and void - a dire consequence, which if realized, could call into question the legitimacy of everything from a SPAC's basic constitutional documents, to any agreements between the SPAC and its sponsor, and perhaps most significantly, any agreements the SPAC had entered into with an acquisition candidate related to a proposed business combination.

Regardless of the merits of the underlying claim,[IV] its potential chilling effects on SPAC market investors and potential deal partners wary of legal challenges is readily evident – including with respect to Ackman himself.[V] – In response to the lawsuit, Ackman announced he was shifting his focus to a new investment structure called a special-purpose acquisition rights company, or SPARC, which differs from a SPAC in that it does not take investor money upfront, but gives shareholders the right to buy into a deal when it is presented, and would not be subject to any time-based limitations on finding an acquisition target. Although Ackman noted Tontine is still searching for an acquisition candidate, he claimed that, if the SEC and New York Stock Exchange (NYSE) approve his new SPARC structure, which would require amending NYSE listing rules, he would dissolve Tontine and return investor funds (as well as provide them with a warrant to purchase shares in his new SPARC vehicle).

Read *Capital Markets Compass* | Issue 1.

I Notably, Pershing Square's bid to acquire a 10% stake in Universal Music Group was derailed by the SEC, which cited NYSE rules requiring a SPAC merger target to have "a fair market value equal to at least 80% of [its] net assets held in trust" - Ackman's bid for Universal utilized only ~74% of the SPAC's trust funds (with the rest rolling over for future acquisitions). See New York Stock Exchange Listed Company Manual Rule 102.06 and https://www.bloomberg.com/opinion/articles/2021-06-04/bill-ackman-s-spac-will-be-three-spacs?sref=1kJVNqnU#footnote-3.

II Ackman said of Jackson's involvement: "Notably, one of the professors who is leading the suit, Robert Jackson, served as an SEC Commissioner between January 2018 and February 2020. During his more than two-year term as Commissioner, the SEC reviewed and declared effective more than 100 SPAC IPO registration statements, and oversaw dozens of de-SPAC merger transactions. If Mr. Jackson is so sure that SPACs are in fact illegal investment companies, why didn't he take steps to shut them down while he was an SEC Commissioner?" https://www.businesswire.com/news/home/20210819005824/en/.

III See Section 3(a)(1) of the Investment Company Act.

IV Significantly, Tontine plaintiffs noted that part of their motivation in bringing the suit was general "reform" of the SPAC industry.

V Ackman noted: "While we believe the lawsuit is meritless, the nature of the suit and our legal system make it unlikely that it can be resolved in the short term. Even if the case were dismissed expeditiously, the plaintiff can then appeal. As a result, the mere existence of the litigation may deter potential merger partners from working with [Tontine] on a transaction until the lawsuit is finally resolved. Because the basic issues raised here apply to every SPAC, a successful claim would imply that every SPAC may also be an illegal investment company. As a result, the lawsuit may have a chilling effect on the ability of other SPACs to consummate merger transactions or to engage in IPOs until the litigation is resolved in [Tontine's] favor, as the consequences of being deemed an illegal investment company are extremely onerous."

CONTACTS

For more information, contact your Katten attorney or any of the following attorneys.

Timothy J. Kirby
+1.212.940.6494
tim.kirby@katten.com

Richard D. Marshall
+1.212.940.8765
richard.marshall@katten.com

Attorney advertising. Published as a source of information only. The material contained herein is not to be construed as legal advice or opinion.

©2026 Katten Muchin Rosenman LLP.

All rights reserved. Katten refers to Katten Muchin Rosenman LLP and the affiliated partnership as explained at katten.com/disclaimer.