

Alert

SPAC Litigation Alert: CEO of Acquisition Target Charged in First Criminal Indictment Connected to a De-SPAC Transaction

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After a period of unparalleled growth, Special Purpose Acquisition Companies (“SPACs”) have recently come under significant additional regulatory scrutiny, both with respect to the mechanics of their structure, as well as the subsequent business combination (“de-SPAC”) process.¹ As a result, SPAC initial public offerings (“IPOs”) have dropped significantly from their peak, as market participants continue to process the impact of the evolving regulatory environment.² While SPACs will continue to play an important role in providing an alternative method for private companies to access the public markets, the near-term pressure on the SPAC market is likely to continue. A new indictment unsealed by the U.S. Department of Justice (“DOJ”), with a parallel action by the SEC, suggests that criminal authorities are ready to take action if they believe fraudulent conduct is serious enough to merit criminal charges.

On July 29, 2021, the DOJ unsealed an indictment for securities fraud and wire fraud against Trevor Milton, the founder and former-CEO of the Nikola Corporation (“Nikola”), a green technology vehicle company that went public via merger with a SPAC. While the SEC has been actively scrutinizing SPACs, *U.S. v. Milton* is the first criminal indictment brought in connection with a de-SPAC transaction.³ The SEC also filed a civil complaint against Milton on the same day, suggesting that Milton’s conduct was determined to warrant both criminal and civil liability.⁴ This follows two weeks after the SEC filed a civil complaint in *SEC v. Kokorich*, which itself was the second SPAC-related lawsuit filed by the SEC.⁵ However, unlike in *Kokorich*, the DOJ indictment and parallel SEC action against Milton are replete with allegations detailing an intent to defraud investors.⁶

The charges in *Milton* arose from a series of allegedly false or misleading statements designed to persuade investors to acquire Nikola securities. The indictment lays out a series of alleged misrepresentations and false statements extending to virtually every part of the nascent green energy

¹ Please see SRZ’s prior SPAC Litigation Alert for more details, available [here](#).

² In 2020, SPACs raised more money than in the entire preceding decade — and more in 1Q2021 than all of 2020. Since 1Q2021, there has been a precipitous drop in new SPAC offerings. See, e.g., Kevin Dowd, “‘A Perfect Storm’: Record-Breaking M&A, A SPAC Slowdown, Antitrust Action, Media Mega-Mergers And More From A Frantic First Half Of Deals In 2021,” *Forbes*, July 4, 2021, available [here](#) (last accessed Aug. 2, 2021).

³ In addition to the indictment brought against Milton, the existence of at least one other active DOJ investigation into SPAC participants has been disclosed since the start of 2021. See *Lordstown Motors Corp.*, Post-Effective Amendment No. 2 to Form S-1 Registration Statement, 16 (Filed July 15, 2021).

⁴ *SEC Charges Founder of Nikola Corp. With Fraud*, SEC Press Release No. 2021-141 (July 29, 2021), available [here](#).

⁵ In connection with the complaint filed against Kokorich, the SEC announced a settlement order against the other SPAC participants which, *inter alia*, contained claims brought under Exchange Act Section 14(a) for failing to conduct adequate due diligence of a target company, allegedly resulting in material misstatements being incorporated into proxy material. Please see SRZ’s prior SPAC Litigation Alert for more details, available [here](#).

⁶ See generally *U.S. v. Milton*, 23 Crim 478 (S.D.N.Y. 2021).

startup’s ambitions to produce electric- and hydrogen-powered vehicles, and the fuel and batteries to power them. The lengthy indictment includes details such as Milton allegedly assuring the public that a previously announced vehicle (“Nikola One”) was not “vaporware, i.e., a product that is marketed but does not yet exist,” while it purportedly did not yet have a motor, gears or any type of system that would allow for a driver to direct the vehicle.⁷ Nevertheless, the indictment claims that Milton attended the filming of a commercial celebrating innovation in which the Nikola One was repeatedly towed to the top of a hill where its driver released the brakes in order to simulate driving.⁸ Further allegations of Milton promoting unsubstantiated claims include Milton allegedly researching the phrase “can you drink water from a fuel cell,” days after allegedly claiming on social media that an electric truck would provide passengers with clean drinking water produced as the hydrogen byproduct from the vehicle’s hydrogen fuel cell.⁹

The Use of Social Media to Defraud Retail Investors

In addition to the proliferation of SPACs, social media-driven retail investing has surged over the last year. Social media now provides retail investors with unprecedented access to information about companies interested in availing themselves of the public markets. Regulators have repeatedly expressed concern¹⁰ about the potential for social media-fueled retail investors to become the target of potential fraudsters. These concerns appear to partially underlie the allegations against Milton, as the indictment expressly opines on the importance of SEC rules regarding the IPO “quiet period,” and draws a connection between direct access to retail investors through social media and Milton’s ability to carry out his alleged scheme.

Specifically, the indictment comparatively frames the IPO and de-SPAC processes, stating that the purpose of the federal securities laws’ mandated IPO quiet period is to create “a level playing field by ensuring that all investors have the same access to information at the same time and to prevent executives from hyping or inflating the stock price”¹¹ By contrast, de-SPAC combinations, which also result in a private company becoming publicly traded, are not subject to quiet period restrictions. The DOJ alleges that Milton used social media to capitalize on the lack of quiet period restrictions, pumping Nikola’s stock price by disseminating numerous false claims directly to retail investors. The SEC similarly focuses on Milton’s use of social media to establish his scienter.

According to the indictment, Milton’s goal was to “communicate with the market,” and ensure that Nikola had “retail investors on [its] side ... to [prevent the stock from being sold short].”¹² To accomplish this, Milton allegedly used various social media outlets such as Twitter and podcasts to disseminate false

⁷ *U.S. v. Milton*, 23 Crim 478 at ¶¶28-30.

⁸ *Id.* at ¶35.

⁹ *Id.* at ¶55.

¹⁰ See e.g., Securities and Exchange Commission, Office of Investor Education and Advocacy, *Celebrity Involvement with SPACs — Investor Alert* (March 10, 2021), available [here](#). Note that the SEC has issued similar warnings focused on celebrity promotions associated with cryptocurrency offerings, resulting in enforcement actions being brought against certain celebrity promoters. See e.g., Securities and Exchange Commission, Division of Enforcement and Office of Compliance Inspections and Examinations, *SEC Statement Urging Caution Around Celebrity Backed ICOs* (Nov. 1, 2017) available [here](#); *Two Celebrities Charged With Unlawfully Touting Coin Offerings*, SEC Press Release 2018-268 (Nov. 29, 2018), available [here](#).

¹¹ *Milton*, Crim 478 at ¶¶ 9-12.

¹² *Id.* at ¶24.

and misleading statements to retail investors to combat share price declines.¹³ Tying Milton's ability to promote his alleged scheme to the lack of a quiet period for de-SPAC transactions and his use of social media targeted at retail investors, may suggest that the criminal authorities are signaling that deal structures and communication methods are important factors in determining when false and misleading statements in connection with a securities offering rise to the level of criminal fraud. Such a move would also be in line with statements previously made by SEC Chair Gensler, who has specifically questioned the use of projections as part of the de-SPAC process, when their use would normally not be permitted in connection with an IPO.

Conclusion

The allegations in *Milton* follow a flurry of activity suggesting that SPACs are currently top of mind for regulators. As more regulatory scrutiny and additional criminal actions may follow, SPACs and their sponsors should ensure that their targets are carefully considering representations made to investors. As part of their due diligence, SPAC sponsors should judiciously screen the social media presence of their targets and ensure that target company executives, or promoters, are not disseminating unsupported claims. Finally, when negotiating with targets, SPACs and their sponsors should consider addressing pre-merger public communications by the target, including the timing and methods of delivery. In particular, negotiating strict controls over the timing and content of target-related disclosures may be warranted as one means to permit proper vetting of any public representations.

This is part of a series of SRZ Alerts regarding SPAC litigation. In addition to our robust SPAC transactions practice, which advises clients on SPAC IPOs and business combination transactions, SPAC sponsor investments, SPAC PIPEs and trading in SPACs generally, SRZ has a SPAC litigation task force advising, monitoring and advocating on SPAC litigation and regulatory developments. If you have any questions, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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¹³ See *id.* at ¶¶ 22-40.