8-30-2023

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Karen Woody

Lidia Kurganova

Recommended Citation
Karen Woody & Lidia Kurganova, *The SEC's SPAC Solution*, 73 Emory L. J. Online 1 (2023).
Available at: https://scholarlycommons.law.emory.edu/elj-online/46

THE SEC'S SPAC SOLUTION

Karen Woody

Lidia Kurganova[*]

ABSTRACT

The SPAC craze has ebbed and flowed over the past few years, creating fortunes and ruining others. The SEC stepped into the mix in 2022 and proposed rules governing SPACs. The proposed rules artfully balance the interests of investor protection while retaining some of the featured characteristics of SPACs as innovative ways to take companies public. This Article details the history of SPACs, including their benefits and risks, and analyzes the SEC's proposed rules, arguing that the SEC is well within its Congressional authority to regulate SPACs, and that the proposed rules are both well-tailored and necessary.

INTRODUCTION

On March 30, 2022, the Securities and Exchange Commission ("SEC") proposed much-anticipated regulations related to Special Purpose Acquisition Companies ("SPACs").[1] SPACs provide an alternative route for a company to be traded on a national exchange, such as the New York Stock Exchange ("NYSE") and NASDAQ, without undertaking the cumbersome process of an initial public offering ("IPO").[2] Although SPACs have been around for decades, they spiked in popularity in recent years.[3] Between 2019 and 2021, the number of SPACs more than doubled in the United States,[4] becoming popular investment vehicles among private equity shops, technology start-ups, and even celebrities like tennis superstar Serena Williams and rapper Jay-Z.[5] In 2021, there were more SPAC deals than traditional IPOs, totaling 614 SPAC IPOs and raising

[*] Associate Professor, Washington and Lee University School of Law; J.D. 2023, Washington and Lee University School of Law.

[1] *See* SEC *infra* note 9.

[2] *See* Max H. Bazerman & Paresh Patel, *SPACs: What You Need to Know*, HARV. BUS. REV. (July–Aug. 2021), https://hbr.org/2021/07/spacs-what-you-need-to-know.

[3] *See* John C. Coates, *SPAC Law and Myths*, 78 AM. BAR ASS'N: BUS. LAW. 371, 371–72 (2022).

[4] *See SPAC and US IPO Activity*, SPAC ANALYTICS, https://www.spacanalytics.com/.

[5] *See* Usha Rodrigues & Michael Stegemoller, *Redeeming SPACs*, U. GA. SCH. L.: RSCH. PAPER SERIES, 2021, at 6, 7.

$162.4 billion.[6] Even in the bear market of 2022 that was caused in part by high inflation and a pandemic, SPACs raised more money than traditional IPOs.[7]

SPACs have been seen as a more desirable alternative to IPOs for some companies looking to go public because the timeline is often shorter and there were fewer rules and requirements involved.[8] Until now. The SEC's proposed regulation released in March 2022 introduced some long-overdue guardrails into the SPAC process.[9] These proposed regulations intend to promote transparency, enhance accountability, and increase investor confidence in SPACs as investment vehicles, while simultaneously protecting investors and the market.[10] In essence, the SEC's proposed rule would close the regulatory gap between SPACs and IPOs while providing maximum protection for investors.[11]

The over-300-page proposal includes regulations such as expanding disclosure requirements and clarifying the applicability of a safe harbor for forward-looking projections.[12] In addition, the proposed Securities Act Rule 140a ("Rule 140a") imposes underwriter liability in the de-SPAC stage, which is the topic of much debate and controversy regarding the Commission's authority to impose such liability.[13] This Article argues that beyond being vital and timely,[14] the Commission's proposal to impose underwriter liability in the de-SPAC stage[15] is likely to withstand judicial scrutiny under the Supreme Court's recent decision in *West Virginia v. EPA*[16] because the SEC has clear

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[6] *See* Preston Brewer, *Analysis: Bears Claw IPOs in 2022; New Rules for Direct Listings*, BLOOMBERG LAW (Jan. 5, 2023), https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-bears-claw-ipos-in-2022-new-rules-for-direct-listings (providing statistics on the US IPO market).

[7] *See id.* (stating that SPACs raised $13.4 billion as compared to $10.9 billion raised by traditional IPOs).

[8] *Recommendations of the Investor as Purchaser and Investors as Owner Subcommittees of the SEC Investor Advisory Committee Regarding Special Purpose Acquisition Companies* (Aug. 26, 2021), https://www.sec.gov/spotlight/investor-advisory-committee-2012/draft-recommendation-of-the-iap-and-iao-subcommittees-on-spacs-082621.pdf.

[9] *See* Special Purpose Acquisition Companies, Shell Companies, and Projections, Securities Act Release No. 11048, Exchange Act Release No. 94546, Investment Company Act Release 34549 (proposed Mar. 30, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 230, 232, 239, 240, 249 & 270) [hereinafter "Proposal"].

[10] *Id.* at 17–18.

[11] *See id.*

[12] *Id.*; *see also* 15 U.S.C. § 78u-5 (providing additional information on the safe harbor for forward looking projections).

[13] *See* discussion *infra* Sections II.B, II.C.

[14] 2021 was a banner year for SEC enforcement actions against SPACs, suggesting more clarity was necessary to preserve the industry. *See* Press Release, Sec. & Exch. Comm'n, SEC Announces Enforcement Results for FY 2021, (Nov. 18, 2021) https://www.sec.gov/news/press-release/2021-238.

[15] The SPAC process has three stages. *See* discussion *infra* Section I.

[16] 142 S.Ct. 2587 (2022).

Congressional authority under the Securities Act of 1933 and the Securities Exchange Act of 1934 to regulate SPACs.

This Article consists of four sections. Section I outlines the genesis of the SPAC craze and the procedural steps included in the SPAC process. Section II details the SEC's proposed regulation and the new risk of underwriter liability in the de-SPAC stage. This Section also discusses the opposing reactions to the SEC proposal from regulators, law firms, and other commentators. Section III discusses the *West Virginia v. EPA* decision and its applicability to SEC's congressional authority to impose underwriter liability. Finally, Section IV provides an analysis and prediction about the success and merit of the SEC proposal.

I. AN OVERVIEW OF SPACS

The immediate predecessor of SPACs emerged in the 1980s in the form of blank check companies.[17] Because mergers of these blank check companies resulted in market manipulation and fraud,[18] the SEC and other regulatory bodies pushed Congress to pass the Penny Stock Reform Act ("PSRA"),[19] as well as Securities Act of 1933 Rule 419 ("Rule 419").[20] With this additional authority, the SEC adopted new rules to help combat fraud associated with blank check companies, including overseeing disclosure of registration statements for blank check companies.[21]

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[17] *See* Bruce Rader & Shane de Búrca, *SPACs: A Sound Investment or Blind Leap of Faith?*, 6 J. TAX'N FIN. PRODS. 17, 17 (2006) ("Blank check companies have been around for years, the late 1980s was a heyday for such companies . . . but fraud became rampant as promoters only had to disclose that the company had no assets but hoped to build a business through a merger or acquisition."); *see also* Usha Rodrigues, *SPACs and the JOBS Act*, 3 HARV. BUS. L. REV. ONLINE 17, 18–19 (2012–2013) (providing a comprehensive overview of a SPAC and its origin).

[18] *See* Rodrigues & Stegemoller, *supra* note 5, at 22 (highlighting that blank check companies were "often associated with 'pump-and-dump schemes,' where an unscrupulous company would spread false reports about an upcoming merger . . . and then after the value had risen, abruptly sell," leaving investors with nothing).

[19] Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931 (1990); *see* Rader & de Búrca, *supra* note 17, at 17; (stating that Congress promulgated the Penny Stock Reform Act of 1990 and amended the Securities Act of 1933 to give the SEC power to regulate blank check companies, specifically to oversee disclosure of the registration statements of such companies).

[20] 17 C.F.R. § 230.419 (describing the general requirements of the offerings by blank check companies); *see* James Murray, *Innovation and Regulation in Finance: The Evolution of Special Purpose Acquisition Corporations*, 6 REV. INTEGRATIVE BUS. & ECON. RSCH. 1, 8 (2017) ("Holding funds in trust, time limits, stockholder voting on the business combination and providing conversion rights all emulate the provisions of Securities Act Rule 419.").

[21] *See* Rader & de Búrca, *supra* note 17, at 18 ("[The new regulations] gave investors certain protections by imposing obligations and restrictions upon issuers that are deemed to be blank check companies under applicable rules and regulations.").

Following the passage of the Penny Stock Reform Act and the promulgation of related SEC regulations, there was a concerted effort by those in the financial services community to develop a new mechanism that would circumvent some of the more onerous disclosure requirements of the IPO yet avoid the pitfalls of the blank check company.[22] What evolved from this process was the SPAC. It is an attractive option for smaller private companies that are less seasoned, "particularly in younger emerging industries like electric vehicles and cryptocurrencies."[23] Tech start-ups have benefited greatly from SPAC mergers and see many advantages for their industry.[24] It does not come as a surprise that many SPAC mergers involve companies with little or no revenue, as these companies' "primary sales proposition to investors is that the business being acquired has a revolutionary technology that will change their industry or even the world."[25] This makes SPACs somewhat risky for investors and underscores why certain measures should be in place to allow for investor protection.

What exactly is a SPAC? The SPAC process involves three steps.[26] First, a SPAC entity, formed by SPAC sponsors, raises funds as a "blank check" or shell entity through an IPO.[27] Shares of the shell entity SPAC are held by SPAC shareholders. Second, the SPAC entity pursues a target company, with a deadline to complete a merger within approximately two years, otherwise it fails and liquidates.[28] The initial SPAC shareholders must vote and approve of the merger.[29] In addition to looking for a suitable business to acquire, a SPAC conducts due diligence on the potential target.[30] Similarly, a SPAC target

[22] *See id.*

[23] Paul R. La Monica, *IPO vs SPAC vs Direct Listing: Explaining Wall Street's Hot Trends*, CNN (Apr. 13, 2021, 10:46 AM), https://www.cnn.com/2021/04/13/investing/ipo-spac-direct-listing-new-stocks/index.html.

[24] *See* Tim McDonnell, *The Climate Tech Boom is Just Beginning*, QUARTZ (July 22, 2021), https://qz.com/2036760/the-climate-tech-spac-boom-is-just-getting-started/ ("But the companies—which are designed to merge with or acquire a promising startup that needs quick access to a lot of capital without the expense, time, and regulatory hassle of a traditional initial public offering—are well suited to tackling the climate change crisis.").

[25] Peter Eavis & Lauren Hirsch, *After Failed I.P.O., WeWork Will Go Public Through a Merger*, N.Y. TIMES (Mar. 26, 2021), https://www.nytimes.com/2021/03/26/business/WeWork-Spac-ipo.html.

[26] *See* Ramey Layne & Brenda Lenahan, *Special Purpose Acquisition Companies: An Introduction*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 6, 2018), https://corpgov.law.harvard.edu/2018/07/06/special-purpose-acquisition-companies-an-introduction/.

[27] *See* Zac McGinnis, *SPAC Phases: Ensuring Successful Financial Reporting*, RIVERON (May 4, 2021), https://riveron.com/posts/spac-phases-ensuring-success/.

[28] *See* Layne & Lenahan, *supra* note 26.

[29] *See id.*

[30] *See* McGinnis, *supra* note 27 ("Activities typical for this stage are ongoing SEC reporting maintenance and related officer certifications, public company readiness for the target company and financial and other organizational diligence on any target companies the SPAC seeks to acquire.").

company goes through a "SPAC-off," where it looks for the right SPAC to merge with and also conducts financial due diligence.[31] The "target search and negotiation phase" can take up to nineteen months.[32] Finally, in the "de-SPAC" process, the SPAC and the target company merge, allowing the target company to be publicly traded on a national exchange.[33]

Figure 1. Three-Phase Lifecycle of a SPAC[34]

The three-stage process of a SPAC is similar to a traditional IPO,[35] although a SPAC merger takes less time and is subject to lessened regulatory scrutiny.[36] Moreover, "the decision to merge [via a SPAC] rather than undertake a traditional IPO obviates the need for conventional underwriters, largely

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31 *See id.*
32 *See* Layne & Lenahan, *supra* note 26.
33 *See* John Coates, Acting Director of the SEC's Corporate Finance Division, *Statement on SPACs, IPOs and Liability Risk under the Securities Laws* (Apr. 8, 2021).
34 *See* Layne & Lenahan, *supra* note 26.
35 The SEC defines a traditional IPO as the following:

> Traditionally, a company starts and develops a business. Eventually, that company may grow to a scale that it determines that it has the resources and structures in place for the IPO process as well as the subsequent SEC reporting requirements and elects to seek to raise capital in the public markets, thereby becoming a public company. Public companies may list their securities on an exchange.

Investor Alerts and Bulletins: What You Need to Know About SPACs—Updated Investor Bulletin, SEC. & EXCH. COMM'N (May 25, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin.
36 *See* Rader & de Búrca, *supra* note 17, at 18.

removing the threat of Section 11 liability from investment banks."[37] As further discussed in the next section, one major goal of the SEC's Proposal is to impose liability on underwriters in a SPAC merger similar to the liability faced by underwriters in IPOs.

The first official SPAC was filed in 2003 by EarlyBirdCapital.[38] However, the apparent similarities between the SPAC and the now-disfavored blank check company meant these efforts were met with skepticism by regulators and industry watchdogs.[39] In fact, before 2008, both the NYSE and NASDAQ prohibited SPACs from being listed on their exchanges.[40] Some SPAC organizers nonetheless pushed regulators to "loosen their grip to allow SPACs to IPO."[41] These efforts successfully convinced the SEC to allow such offerings to go through because, according to the SPAC proponents, investors were afforded numerous protections, especially at the acquisition stage.[42] The SEC gave the green light to the NYSE and NASDAQ to change their rules regarding SPAC permission to list in 2008,[43] emphasizing the shareholders' voting power in approving or disapproving the ultimate acquisition.

In this original SPAC structure, SPAC managers were subject to the "market test" in which "a SPAC's managers had to convince the market of the proposed deal's merits," and if the majority of shareholders voted down the deal, "bad deals could be halted before they reached the market."[44] These safeguards were designed to protect retail investors and the market as a whole.[45] The ability for sophisticated investors to redeem their shares—thereby "voting with their wallets to exit the transaction"—shielded downstream investors.[46] It signaled

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37 Andrew F. Tuch & Joel Seligman, *The Further Erosion of Investor Protection: Expanded Exemptions, SPAC Mergers, and Direct Listings*, 108 IOWA L. REV. 303, 306 (2022). Section 11 of the Securities Act of 1933 imposes broad liability on underwriters and issuers for errors in the documentation sent to the SEC in the registration process. *Id.* at 313.

38 *See* Milan Lakicevic & Milos Vulanovic, *A Story on SPACs*, 39 MANAGERIAL FIN. 1, 12 (2013), https://ssrn.com/abstract=1958238 ("The first modern-era SPAC, which completed an IPO in August 2003, created the underwriter EarlyBirdCapital.").

39 *See* Tuch & Seligman, supra note 37, at 306.

40 *See* Lakicevic & Vulanovic, *supra* note 38, at 7 (explaining that the two public stock exchanges prohibited SPACs from listing largely because of similar rules prohibiting blank check companies from listing on NYSE or NASDAQ).

41 Rodrigues & Stegemoller, *supra* note 5, at 23.

42 *See id.* ("SPAC shareholders could 1) vote on the deal and 2) redeem their shares—that is, get most of their money back from the company if they voted against the business combination").

43 SEC application SR-NASDAQ-2008-13; SEC application SR-NYSE-2008-17.

44 Rodrigues & Stegemoller, *supra* note 5, at 32.

45 *Id.* at 27.

46 *Id.* at 24.

that such bad deals were a poor investment for the rest of the SPAC shareholders and simultaneously disallowed fraudulent companies from becoming publicly traded.

SPAC founders saw these shareholder approval provisions as a liability to the SPAC process due to a large number of SPACs liquidating, thereby failing to reach the market.[47] Subsequently, SPAC founders started to modify the terms of their deals to ensure a successful business combination and to avoid a liquidation.[48] In response, in 2010, the SEC eliminated many investor protections requirements in the SPAC process, such as the conversion threshold and the requirement of a shareholder vote.[49] With this shift away from shareholders having a say in the SPAC's acquisition process and with the initial voting protections virtually gone, savvy investors—*i.e.*, those who tend to be professional or institutional investors with time and capital to conduct their own due diligence—who are skeptical of the deal can cash out before the merger. However, despite the "savvier" investors cashing out before the merger, the deal nevertheless would survive and enter the public market. Without "the market test of the original SPAC mechanism" or the scrutiny that comes with going public via an IPO, retail investors in SPACs are the most vulnerable to suffer the financial consequences if bad deals reach the public market.[50] The investor protections that distinguished the SPAC and provided its investors with necessary safeguards have been eroded, leaving SPAC investors—and particularly retail investors—weakened and vulnerable to risky investments. This prompted the SEC to act.

According to the SEC's enforcement numbers for fiscal year 2021, the agency's enforcement increased by seven percent, in part due to more aggressive oversight of SPACs.[51] Notably, the SEC filed an enforcement action against an electric vehicle start-up Nikola, a company promising zero-emission trucks that

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47 *See* Thomas Freidman & D. Chad Larson, *Special Purpose Acquisition Companies: A SPAC Evolution*, HEDGE FUND J. (May 2008), https://thehedgefundjournal.com/special-purpose-acquisition-companies/ (explaining that early SPACs attracted hedge fund investors who intended to profit through arbitrage trading strategies and did not intend to become long-term investors).

48 *See id.* (providing an example of Liberty Lane's modification of its unit structure in order to make its common stock more attractive to prospective business targets).

49 *See* Rodrigues & Stegemoller, *supra* note 5, at 24 (stating that the SEC, ironically, eliminated the safeguards that were put in place initially to persuade the two national exchanges to allow SPACs to list). In practice, a conversion threshold equals twenty percent, meaning that the deal would fail if that number of shareholders asked for a return of their money. *Id* at 23.

50 *Id.* at 32.

51 *SEC Announces Enforcement Results for FY 2021*, SEC. & EXCH. COMM'N, https://www.sec.gov/news/press-release/2021-238 (Nov. 18, 2021).

went public via a SPAC in 2020.[52] The SEC and Nikola reached a $125 million settlement for false statements made to investors about the company and the capability of its vehicles.[53] After filing more enforcement actions in 2021 against public companies that went public via a SPAC, the SEC took a step further to protect investors in SPAC deals.[54]

II. THE SEC PROPOSAL

On March 30, 2022, the SEC voted 3 to 1 to approve its long-awaited proposal to regulate SPACs.[55] The proposal would render the process for SPACs similar to the process for IPOs, in many ways. In his statement to the Commission, Chair Gary Gensler outlined the goals of the proposal which would "strengthen disclosure, marketing standards, and gatekeeper and issuer obligations by market participants in SPACs, helping ensure that investors in these vehicles get protections similar to those when investing in . . . IPOs."[56] While the proposal covers a wide array of issues related to SPACs, there is one that stands out—underwriter or "matchmaker" liability.

In the traditional IPO process, which is subject to stringent SEC regulations,[57] underwriters are deemed to be "crucial players in conducting a successful offering."[58] Taking a closer look at the underwriter's role in an IPO

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52 Press Release, Nikola Corporation to Pay $125 Million to Resolve Fraud Charges, SEC. & EXCH. COMM'N (Dec. 21, 2021), https://www.sec.gov/news/press-release/2021-267.

53 *See* Dean Seal, *Electric Truck Co. Nikola To Pay $125M To End SEC Probe*, LAW360 (Dec. 21, 2021, 11:28 AM), https://www.law360.com/articles/1450654?e_id=a889bf43-e083-45c9-9e4bc679c86ea64b&utm_source=engagement-alerts&utm_medium=email&utm_campaign=similar_articles ("Nikola Corp. has reached a $125 million agreement with the U.S. Securities and Exchange Commission to resolve allegations that its embattled former CEO deceived investors about the SPAC-born company's ability to build electric- and hydrogen-powered trucks."). The company released a promotional video that was allegedly staged to show Nikola's semi-truck having autonomous capabilities and driving at very high speeds. *Id.*

54 Proposal, *supra* note 9.

55 *Id.* The proposed rules were originally available for public comment until June 13, 2022. *Id.* However, the SEC reopened the comment period in October 2022 due to a technical glitch. Carolyn Frantz, J.T. Ho, et al., *Comment Period Reopened for Climate and Cybersecurity Proposals, Among Others*, ORRICK HERRINGTON & SUTCLIFFE (Oct. 17, 2022), https://www.orrick.com/en/Insights/2022/10/Comment-Period-Reopened-for-Climate-and-Cybersecurity-Proposals-Among-Others. The finalized rules have not been issued to date.

56 Gary Gensler, Chairperson, Statement on Proposal on Special Purpose Acquisition Companies (SPACs), Shell Companies, and Projections (Mar. 30, 2022), https://www.sec.gov/news/statement/gensler-spac-20220330.

57 Kate Ashford & John Schmidt, *What Is an IPO?*, FORBES ADVISOR, https://www.forbes.com/advisor/investing/initial-public-offering-what-is-an-ipo/.

58 LATHAM & WATKINS, US IPO GUIDE (Aug. 25, 2021, 6:00 PM), https://www.lw.com/admin/upload/SiteAttachments/lw-us-ipo-guide.pdf; *see* Shobhit Seth, *IPOs vs. Direct Listing: What's the Difference?*, INVESTOPEDIA (Apr. 10, 2021),

can help demonstrate why the SEC has Congressional authority to subject underwriters in a SPAC to underwriter liability in the de-SPAC stage.

A. Underwriters: The Quarterbacks of Deals

For almost a century, companies wishing to take their business public via a traditional IPO "have relied on firm-commitment underwriters to act as intermediaries between themselves and investors."[59] Underwriters are banks or financial organizations that evaluate and assume risk of another party for a fee in the form of a commission or interest.[60] The SEC refers to underwriters as "gatekeepers to the public markets" that serve a vital role in the securities offering process.[61] Underwriters have oversight and a significant amount of control over deals, playing a vital role in the success—or failure—of offerings.[62] They are present from the genesis of a public offering until its completion, ensuring proper due diligence.[63] Underwriters take the process of due diligence seriously for both reputation and regulatory reasons. With Section 11's imposition of near-strict liability, "underwriters certify to investors the accuracy of corporate disclosures and reduce the extent to which investors, fearing they will be sold 'lemons,' discount the value of newly issued securities."[64]

B. Securities Act Rule 140a

Under the current SPAC rules, underwriters involved in the initial SPAC IPO have avoided liability in the de-SPAC stage.[65] This means that underwriters can

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https://www.investopedia.com/investing/difference-between-ipo-and-direct-listing/ ("The underwriter works closely with the company throughout the IPO process, including deciding the initial offer price of the shares, helping with regulatory requirements, buying the available shares from the company, and then selling them to investors via their distribution networks.").

[59] Tuch & Seligman, *supra* note 37, at 305 ("The close relationship between IPOs and underwriting, governed in part by Section 11 of the Securities Act of 1933, is implicit in a regime that has proven enormously successful over the years.").

[60] *See* Caroline Banton, *Underwriter in Finance: What Do They Do, What Are Different Types?*, INVESTOPEDIA (Jan. 8, 2022), https://www.investopedia.com/terms/u/underwriter.asp (defining the term underwriter).

[61] *See* Proposal, *supra* note 9, at 20.

[62] *See generally* LATHAM & WATKINS, US IPO GUIDE, *supra* note 58.

[63] *See id.* at 5 ("The due diligence process starts with a detailed management presentation about the business (usually at the org meeting) and continues through all of the drafting sessions and right up to the closing.")

[64] Tuch & Seligman, *supra* note 37, at 313.

[65] Letter from Skadden, Arps, Slate, Meagher & Flom LLP to Vanessa Countryman, Sec'y of Sec. & Exch. Comm'n, Sec. & Exch. Comm'n 2 (June 13, 2022), [hereinafter, Letter from Skadden] https://www.sec.gov/comments/s7-13-22/s71322-20131124-301316.pdf.

take a SPAC public, and then bow out of the remainder of the SPAC process, thereby not having any liability exposure to the merger and de-SPAC process.[66] Practically, this means that underwriters are not exposed to liability, even if a SPAC does minimal due diligence on the merger target.[67] The proposed rule, Rule 140a, changes that.

> [The proposed rule w]ould deem anyone who has acted as an underwriter of the securities of a SPAC and takes steps to facilitate a de-SPAC transaction, or any related financing transaction or otherwise participates (directly or indirectly) in the de-SPAC transaction to be engaged in a distribution and to be an underwriter in the de-SPAC transaction [within the meaning of Section 2(a)(11) of the Securities Act].[68]

Rule 140a attaches liability to the initial SPAC underwriters for the merger stage, meaning that banks that help SPACs find initial shareholders will be required to facilitate the transition of the SPAC target going public via the merger.[69] The SEC's hope is that the proposed rule "should better motivate SPAC underwriters to exercise the care necessary to ensure the accuracy of the disclosure in these transactions by affirming that they are subject to Section 11 liability for that information."[70] The proposed rule likely will change the landscape for underwriters who assist a SPAC to go public and then check out for the rest of the process by reinforcing "that the liability protections in de-SPAC transactions involving registered offerings have the same effect as those in underwritten initial public offerings."[71]

Notable proponents of the proposed rules include the United States Senator of Massachusetts Elizabeth Warren. In her comment letter to the SEC, Warren expressed strong support for the proposed rules, arguing that they "will level the playing field for retail investors and prevent Wall Street insiders from perpetuating scams and fraud to line their own pockets."[72] She further states that deeming underwriters as underwriters in both the initial and the de-SPAC stages will increase accountability in the SPAC transaction.[73] Finally, Warren points

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[66] *See id.*
[67] *See id.*
[68] Proposal, *supra* note 9, at 20.
[69] *See id.*
[70] *Id.*
[71] *Id.* at 96.
[72] Letter from Senator Elizabeth Warren to Gary Gensler, Chair of Sec. & Exch. Comm'n, Sec. & Exch. Comm'n 2 (July 8, 2022), https://www.sec.gov/comments/s7-13-22/s71322-20133948-303857.pdf.
[73] *Id.* at 3.

out that "[c]larifying the role of financial institutions and SPAC sponsors as underwriters in the de-SPAC transaction will give these parties an increased stake in the future of the merged company and open them up to liability from shareholders if the de-SPAC transaction includes undisclosed dilution or fraudulent statements."[74]

Likewise, the Americans for Financial Reform Education Fund ("AFR") signaled its strong support for the proposed rules in the comment letter stating that the proposals would "address the regulatory loopholes for SPACs and better protect investors."[75] Notably, AFR supports the Commission's proposal that "would subject advisors on de-SPAC transactions to the same Section 11 liability and due diligence requirements as apply to other securities offerings," adding much "needed accountability."[76] ARF points out potential "misaligned incentives between advisors and retail SPAC investors" where financial advisors, such as major Wall Street banks, are incentivized by hefty fees to close as many deals as possible that do not always benefit retail investors.[77]

C. Industry Backlash to Underwriter Liability

Unsurprisingly, fierce opposition to the proposed rules, particularly Rule 140a, comes from big law firms often associated with news-worthy mergers. For example, while big law firms like Skadden, Arps, Slate, Meagher & Flom LLP and Kirkland & Ellis LLP generally agree with the proposed rules' goal of enhancing investor protection in SPAC transactions (including both the initial SPAC IPO and the de-SPAC), the firms oppose underwriter liability in the de-SPAC stage.[78] Skadden provides a few reasons for its stance. First, Skadden states that Rule 140a "represents a significant departure from the application of underwriter liability as currently understood by practitioners and transaction participants and as applied by the courts."[79] Second, the firm believes that the

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74 *Id.*

75 Letter from Americans for Fin. Reform Educ. Fund to Vanessa Countryman, Sec'y of Sec. & Exch. Comm'n, Sec. & Exch. Comm'n 1 (June 13, 2022), https://www.sec.gov/comments/s7-13-22/s71322-20131109-301231.pdf.

76 *Id.*

77 *Id.*

78 Letter from Skadden, *supra* note 65, at 2; *see also* Letter from Kirkland & Ellis LLP to Vanessa Countryman, Sec'y of Sec. & Exch. Comm'n, Sec. & Exch. Comm'n 10, (June 15, 2022), https://www.sec.gov/comments/s7-13-22/s71322-20131385-301434.pdf.

79 Letter from Skadden, *supra* note 65, at 1 (stating serious concerns about the Proposal imposing "significant costs, burdens and uncertainties on SPACs and de-SPAC transaction participants that will outweigh any benefit to investors and, in certain cases, may result in unintended consequences that could chill capital formation, more generally").

proposed rule fails to define who would be deemed as "participating" in the de-SPAC.[80] Additionally, Skadden points out that underwriters might be unwilling to participate in the de-SPAC transaction and may elect to withdraw.[81] Skadden further states that "the leverage afforded [to] an underwriter in a traditional IPO underwriting agreement would be difficult to duplicate in a de-SPAC transaction, as the SPAC IPO underwriter may have had nothing to do with the de-SPAC transaction."[82] Lastly, the firm argues that the current liability framework, like Rule 10b-5 of the Securities Exchange Act of 1934, sufficiently incentivizes participants in the de-SPAC stage to provide accurate disclosures.[83]

The debate over the extent of underwriter liability in SPAC and de-SPAC phases is a robust and important one. In Section IV, we argue that holding underwriters accountable for the merger and eventual de-SPAC process will strengthen the due diligence done by underwriters and reduce the risk to SPAC investors.

III. *WVA v. EPA* AND ITS APPLICABILITY TO THE SEC'S AUTHORITY TO REGULATE SPACS

While it is important to review and acknowledge contrasting views on the efficacy of the proposed rule on underwriter liability, it is arguably more important to establish whether SEC has the authority to impose such liability on underwriters *ab initio*. Chief Justice Roberts' majority opinion in *West Virginia v. EPA* provides guidance concerning the Congressional mandate and authority given to agencies.

In *West Virginia v. EPA*, the Court considered whether the Environmental Protection Agency ("EPA") had authority under the Clean Air Act to broadly regulate greenhouse gas emissions.[84] The Court held that "Congress did not grant EPA in Section 111(d) of the Clean Air Act the authority to devise emissions caps based on the generation shifting approach the Agency took in the

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[80] *See id.* at 4 ("The proposed text of the rule is devoid entirely of any helpful parameters (indeed, as a gating issue, the Release is not even clear on who would qualify as a SPAC IPO underwriter) and the discussion in the Release does nothing to resolve this uncertainty for transaction participants.").

[81] *See id.* at 5.

[82] *Id.*

[83] *See id.* Section 10b of the Securities Exchange Act and SEC Rule 10b-5 impose liability for any intentional and deceptive false statements that would deceive investors. *See id.* at 6.

[84] 142 S.Ct. 2587, 2596 (2022) ("[T]he only question before the Court is more narrow: whether the 'best system of emission reduction' identified by EPA in the Clean Power Plan was within the authority granted to the Agency in Section 111(d) of the Clean Air Act.").

Clean Power Plan."[85] Further, the Court held that under the standard set in *Utility Air*,[86] the EPA failed to point to "clear congressional authorization" granting it broad authority to regulate carbon dioxide emission in relation to climate change.[87] Importantly, while the majority decision in *West Virginia v. EPA* narrows EPA's authority to regulate greenhouse gas emissions, "the agency can still pursue emission reductions at individual power plants and other regulations that may result in indirect shifting of energy generation to lower-emitting sources."[88]

The opinion clarifies EPA's Congressional authority to regulate carbon dioxide emission by providing a guide for agency authority where agencies can regulate their respective sectors via clear Congressional authorization.[89] Yet, *West Virginia v. EPA* is not just about carbon emissions.[90] It is a case about the administrative state. The holding in *West Virginia v. EPA* has direct application to other agencies and can be used to determine the SEC's authority to promulgate the proposed rules regarding SPACs, specifically Securities Act Rule 140a.

As Chief Justice Roberts' majority opinion dictates, an agency must show clear Congressional authorization in order to exercise its regulatory powers.[91] The analysis for demonstrating this authority starts by examining statutes and the language used by Congress.[92] In the case of the SEC, strong evidence of the Commission's clear Congressional authorization comes from both the Securities Act of 1933 ("Securities Act")[93] and the Securities Exchange Act of 1934 ("Exchange Act").[94] First, the Exchange Act created the SEC, and Congress charged it with a three-part mandate: protect investors, facilitate capital

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85 *Id.*

86 Util. Air Regul. Grp. v. EPA, 573 U. S. 302, 324 (2014).

87 *Id*.

88 Shay Dvoretzky et al., *West Virginia v. EPA: Implications for Climate Change and Beyond*, SKADDEN (Sept. 21, 2022), https://www.skadden.com/insights/publications/2022/09/quarterly-insights/west-virginia-v-epa; West Virginia v. EPA, 142 S. Ct. at 2595 ("This is a major questions case. EPA claimed to discover an unheralded power representing a transformative expansion of its regulatory authority in the vague language of a long-extant, but rarely used, statute designed as a gap filler. That discovery allowed it to adopt a regulatory program that Congress had conspicuously declined to enact itself. Given these circumstances, there is every reason to 'hesitate before concluding that Congress' meant to confer on EPA the authority it claims under Section 111(d)." (quoting FDA v. Williamson Tobacco Corp., 529 U.S. 120, 159–60 (2000)).

89 *See West Virginia*, 142 S.Ct. at 2629.

90 *Id.* at 2626.

91 *See id.* at 2630.

92 *See id.* at 2622.

93 *See* Securities Act of 1933, 15 U.S.C. § 77a–mm.

94 *See* Securities Exchange Act of 1934, 15 U.S.C. § 78a–kk.

formation, and maintain fair, orderly and efficient markets.[95] Moreover, SEC's regulatory responsibilities include, but are not limited to, "establishing rules regulating the conduct of market participants, stock exchanges, and self-regulatory organizations ("SROs")."[96] In other words, the SEC has direct authority from Congress to regulate and discipline market participants,[97] including those partaking in a SPAC transaction. The Exchange Act provides the SEC with clear authorization by Congress to promulgate laws regulating SPACs and SPAC participants, including the underwriters.[98]

Further, the Securities Act, enforced by the SEC, grants the SEC the ability to regulate underwriters.[99] Congress promulgated the Securities Act shortly after the stock market crash of 1929, with the goals of creating more transparency in the financial statements of corporations through public disclosure of material information and helping investors make more informed investment decisions.[100] Those goals were achieved in part by establishing laws and regulations against misrepresentation and fraud in the financial market.[101] To comply with the Securities Act, companies must "disclose important financial information through the registration of securities" with the SEC under Section 5 of the Securities Act.[102] Importantly, under Section 11, an underwriter faces civil liability for "any part of the registration statement that contains an untrue statement of material fact or omits a material fact required to be stated therein to make the statement not misleading."[103] The plain text of the Securities Act demonstrates that the SEC has authority to regulate the public markets through registration with the Commission and mandatory disclosures, as well as imposing liability on underwriters to provide investors with reliable financial information and punish those who mislead or defraud the market and the

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[95] *Id.* at § 77d; *see also* Karen E. Woody, *Securities Law as Foreign Policy*, 15 NEV. L.J. 297, 299 (2014).

[96] *Securities Exchange Act of 1934 Overview*, CORNELL L. SCH.:. LEGAL INFO. INST. (June 10, 2019), https://www.law.cornell.edu/wex/securities_exchange_act_of_1934.

[97] *See id.* In addition, securities exchanges like NASDAQ and NYSE must register with the SEC. *See* 15 U.S.C. § 78e–f.

[98] *See* 15 U.S.C. § 78c.

[99] *See id.*

[100] *See, e.g.*, Paul S. Atkins, Comm'r, U.S. Sec. & Exch. Comm'n, Remarks before the Sec. Traders Ass'n (Oct. 7, 2004).

[101] *See id.*

[102] *Registration Under the Securities Act of 1933*, INVESTOR.GOV (last updated Dec. 15, 2022), https://www.investor.gov/introduction-investing/investing-basics/glossary/registration-under-securities-act-1933.

[103] Scott Mascianica & Michael W. Stockham, *Writing on the Wall for SPAC Underwriters? New SEC Rule Increases Exposure and Risks*, HOLLAND & KNIGHT LLP (Apr. 15, 2022), https://www.hklaw.com/en/insights/publications/2022/04/writing-on-the-wall-for-spac-underwriters.

public.[104] This is exactly the kind of clear Congressional authority that Chief Roberts discusses in his majority opinion in *West Virginia v. EPA*.[105] Given that the SEC has Congressional authority to regulate SPACs, and extend underwriter liability, we now turn to discussing the implications of the proposed rule.

IV. IMPLICATIONS AND THE FUTURE OF SPACS

The proposed rules, if adopted, will have important practical implications for companies, banks, and law firms, among other participants in the securities industry. These rules, which provide for increased liability for SPAC sponsors and underwriters, also provide for increased investor protection, in addition to an increase in investor confidence when making investments in SPACs, at any stage of the process.[106] Critically, one of the major functions of the SEC is to ensure investor protection.[107] Investor protection is at the heart of the proposed rule on SPACs, and for good reason.

There are, however, certain practical downsides to the proposed rule, none of which outweigh the benefits. The downsides nevertheless should be named. First, it is possible that companies across the U.S. could see increased costs of going public via a SPAC because of stringent, overly burdensome regulations.[108] The regulations require additional due diligence and likely a slower process for listing on a national exchange.[109] For underwriters, especially with the proposal of Rule 140a, there will be increased scrutiny and liability at all stages of a SPAC, much like in a traditional IPO.[110] Some investment banks might cap the number of public offerings or forego participating in SPAC mergers altogether.[111] Likewise, law firms that represent companies in SPAC mergers could reduce the number of clients or shift away from SPAC-related work.[112]

However, as noted above, these practical downsides are minor in relation to the necessary regulation of the volatile and speculative SPAC market. Investors in SPACs saw their protections eroded when they slowly lost the ability to vote

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104 *See id.*

105 *See* West Virginia v. EPA, 142 S.Ct. 2587, 2623.

106 *See* Gensler, *supra* note 56.

107 *See* Securities Exchange Act of 1934, 15 U.S.C. § 78a–kk.

108 *See supra* Section II.C.

109 *See id.*

110 *See* Gensler, *supra* note 56.

111 *See e.g.*, Janet H. Cho, *Goldman Curtails SPACs After SEC Signals Disclosure Crackdown*, BARRON'S (May 9, 2022), https://www.barrons.com/articles/goldman-sachs-is-cutting-its-involvment-in-spacs-amid-proposed-sec-rules-51652127844.

112 *See supra* Section II.C.

on the merger target.[113] As noted above, this resulted in retail investors being "stuck" in the SPAC without a say on the merger target, which exposed them to significant risk.[114] In addition, there was no incentive for underwriters in a SPAC to protect investors because they often left the table once the initial SPAC went public and did not assist in the merger or de-SPAC stage. Rule 140a addresses these problems artfully.

CONCLUSION

The proposed regulations are a concrete step toward reining in the "Wild West" mentality that has consumed the SPAC space of late, and the proposal shows the SEC's seriousness regarding investor protection and safeguarding the public.[115] Specifically, Rule 140a's creation of underwriter liability will help ensure that SPACs can remain a viable alternative to IPOs while hopefully sifting out the bad or ill-conceived investments.[116] While some will critique the regulation as killing the "SPAC shortcut" to the market, it is possible the SPAC craze will be invigorated by these additional protections.[117] At the end of the day, regulators, like the SEC, are tasked with striking a balance between safeguarding retail investors and allowing for innovative start-up companies to enter the public market.[118] The SEC's proposed rule on SPACs strikes that balance.

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113 *See* Cho, *supra* note 111.
114 *See id.*
115 *See* Gensler, *supra* note 56.
116 *See supra* Section II.B.
117 *See supra* notes 72–77.
118 *See supra* note 95 and accompanying text.