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Saving SPACs from the SEC's Potentially Ruinous Overreach

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SAVING SPACS FROM THE SEC'S POTENTIALLY RUINOUS OVERREACH

ABSTRACT

The resurgence of Special Purpose Acquisition Companies ("SPACs") in the U.S. securities market has demonstrated potential as an alternative to the traditional initial public offering ("IPO"). However, the evolution of SPACs from their fraudulent "blank check" ancestors has left the Securities and Exchange Commission ("SEC") weary of SPACs' continued presence in the market. Currently, SPACs exist as an exception to Rule 419 and the Penny Stock Reform Act of 1990, thereby allowing them to escape the rigorous disclosure requirements that not only eradicated their ancestors, but also significantly burdened the timeline of the traditional IPO process. While many consider SPACs a unique opportunity for non-institutional investors to reap benefits similar to those seen in private equity, a closer look into their evolution in the market suggests an entirely different conclusion.

This Comment offers a critical assessment of the SPAC structure and advances unique regulatory solutions. It begins with a focus on the landscape surrounding the SPAC structure, looking to the evolution of securities market regulations and the rise and evolution of the SPAC as an alternative to the traditional IPO. Following discussions on the various tensions present in the current form, this Comment sheds light on persistent issues lingering within the current form, illustrating the necessity for SPAC reform. Finally, this Comment proposes four solutions—bringing back investor voice, mitigating dilution to the investors, tidying disclosure requirements, and revisiting due diligence—and argues the need for SPAC creators to accept guidance from the SEC and look inward to SPAC performance to undergo self-reform in order to avoid the possibility of SPACs being regulated out of existence.

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INTRODUCTION

The United States securities market has articulated one thing with utter clarity: investing in private companies—venture capital, leveraged buyout, and hedge funds—is reserved for the wealthy.[1] The average American's participation in the market used to be limited to buying and selling shares after a company made an initial public offering ("IPO"), a process managed by investment banks.[2] The emergence of "blank check companies"[3] in the 1980s demonstrated the first attempt at providing the average American with a newfound opportunity to invest in a private company; however, due to the loose regulatory structure, early blank check offerings frequently took advantage of these non-institutional investors.[4] Following an alarming presence of fraudulent investment schemes, the Securities and Exchange Commission ("SEC") promulgated Rule 419[5] in efforts to enforce the Penny Stock Reform Act of 1990 ("PSRA")[6] and halt the prominent defrauding of inexperienced investors.[7]

In their wake, innovative lawyers developed a new vehicle, Special Purpose Acquisition Companies ("SPACs"),[8] to reinvent the concept of the blank check company—one that was uniquely situated outside the purview of the newly formed SEC regulations.[9] To highlight their legitimate purpose, SPAC creators voluntarily implemented various investor protection mechanisms outlined by Rule 419 into the SPAC's structure.[10]

As the burdensome disclosure requirements from the SEC's enhanced regulations drove the costs for IPOs out of reach for many smaller companies, SPACs have exploded in popularity as a means to democratize capitalism by

[1] *See* Vijay Sekhon, *Can the Rich Fend for Themselves: Inconsistent Treatment of Wealthy Investors Under the Private Fund Investment Advisers Registration Act of 2010*, 7 HASTINGS BUS. L.J. 1, 2–4 (2011).

[2] *See* Christine Hurt, *Moral Hazard and the Initial Public Offering*, 26 CARDOZO L. REV. 711, 712–13 (2005).

[3] For a further discussion on blank check companies, see *infra* Section I.B.

[4] *See* Daniel S. Riemer, *Special Purpose Acquisition Companies: SPAC and Span, or Blank Check Redux?*, 85 WASH. U. L. REV. 931, 936 (2007).

[5] 17 C.F.R. § 230.419 (2021). For a further discussion on Rule 419, see *infra* Section I.C.

[6] Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931. For a further discussion on the PSRA, see *infra* Section I.C.

[7] *See* Riemer, *supra* note 4, at 932 n.9.

[8] *See infra* Part II (discussing the rise and development of the SPAC structure).

[9] *See* Riemer, *supra* note 4, at 933 ("Like the blank check companies of the 1980s, SPACs have no operating history, assets, revenue, or operations and are designed to rase capital in the public equity markets. Unlike the fraudulent offerings of the 1980s, however, SPACs are exempt from the controls Congress imposed on blank check offerings . . . ." (footnote omitted)).

[10] *See id.* at 944 ("The managers of [SPACs] voluntarily complied with most of the Rule 419 provisions in hopes of renewing investor confidence in blank check offerings . . . .").

dethroning the investment banks' executive hold on the traditional IPO.[11] To effectuate this purpose, a SPAC will undergo a SPAC IPO, raising the capital necessary to embark on a two-year hunt for the ideal target company to bring to the public market.[12] Once a target company is identified, the SPAC will utilize a form of reverse merger to provide these small companies with a cash infusion and introduce them into the securities market.[13]

Since SPACs are still a relatively new vehicle in the market, legal scholarship surrounding SPACs has only recently begun to analyze their form.[14] Nevertheless, the SEC has been paying particularly close attention to the new structure's activity with the purpose of determining what regulations—if any—are necessary to ensure SPACs do not abuse their position as an exclusion to the current rules.[15] The recent surge in SPAC activity since 2020 raised concern for upcoming litigation arising from alleged deficiencies in disclosure, issues surrounding various financial statements, redemption rights, the exercise of warrants, and poor returns to investors.[16] Accordingly, the SEC and its staff have

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[11] *See* Usha Rodrigues & Michael Stegemoller, *Redeeming SPACs* 2 (Univ. Ga. Sch. of L. Working Paper, Paper No. 2021-09, 2021) [hereinafter *Redeeming SPACs*], https://ssrn.com/abstract=3906196; Riemer, *supra* note 4, at 947 ("While SPACs accounted for only 5.2 percent of all successful IPOs in 2004, 26.6 percent of all successful IPOs on 2007 were SPACs."); Aswath Damodaran, *The Rise of SPACs: IPO Disruptors or Blank Check Distortions?*, SEEKING ALPHA (Jan 2, 2022, 3:48 PM), https://seekingalpha.com/article/4434059-rise-of-spacs-ipo-disruptors-blank-check-distortions ("In 2020, SPACs accounted for more than half of all deals made, in terms of dollar value, and SPACs are running well ahead of that pace in 2021. . . . [T]he real boom in SPACs has been in the last three years, with the pace picking up in the second half of 2020 and in 2021[.]").

[12] *See What You Need to Know About SPACs*, U.S. SEC. & EXCH. COMM'N INV. ALERTS & BULL. (May 25, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin ("[A] SPAC acquires or merges with a private company . . . often many months or more than a year after[] the SPAC has completed its own IPO.").

[13] *See id.* ("Once the SPAC has identified an *initial business combination* opportunity, its management negotiates with the operating company and, if approved by SPAC shareholders (if a shareholder vote is required), executes the business combination. This transaction is often structured as a reverse merger in which the operating company merges with and into the SPAC or a subsidiary of the SPAC.").

[14] *See Redeeming SPACs*, *supra* note 11, at 2.

[15] *See* John Coates, *SPACs, IPOs and Liability Risk Under the Securities Laws*, U.S. SEC. & EXCH. COMM'N (Apr. 8, 2021), https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws#.

[16] *See* R. Alec Dawson, Russell Franklin, Michael Hacker, Ivan Harris, Brian Herman, Howard Kenny, Grant MacQueen, Marlee Myers, J. Warren Rissier & Charlene Shimada, *The Future of SPACs: Increasing Litigation and Regulation*, JDSUPRA (Dec. 2, 2021), https://www.jdsupra.com/legalnews/the-future-of-spacs-increasing-8958513/#_ftn2 ("Private SPAC litigation is not new, but it is on the rise. Stakeholders have asserted various claims, including breach of duty based upon conflicts of interest, securities law violations arising from alleged deficient disclosures, violations of corporate governance documents, and breach of contract."); MIKE HACKETT, TIMOTHY W. MUNGOVAN, TODD OHLMS, JONATHAN M. WEISS & DAVID HECK, SPAC PROCEDURAL ISSUES & RISKS, BLOOMBERG L. PRO. PERSPECTIVES 1–2 (2021), https://prfirmpwwwcdn0001.azureedge.net/prfirmstgacctpwwwcdncont0001/uploads/54fc0bb8bc03aafc05398 8ef6b46ce97.pdf (explaining issues around financial projections, consummating transactions, conflicts of interest, material non-public information, accounting treatment of warrants, SPAC IPO registration statements,

provided numerous statements cautioning SPACs further away from actions that could mimic their fraudulent past.[17] With these new statements clearly affecting the market presence of SPACs in the latter half of 2021,[18] speculation has arisen as to whether additional regulation is needed to ensure SPACs do not echo the failed patterns of their ancestors.[19]

Looking to the evolution of the regulatory structure in the securities market and the uprising and evolution of the SPAC structure as an alternative offering to the traditional IPO, this Comment identifies weaknesses in the current SPAC form and sheds light on the falsity of the commonly echoed notion that SPACs are a more efficient, functional equivalent to the traditional IPO.[20] This Comment reveals, instead, that the current SPAC structure shortchanges its investors in a desperate attempt to persist as a legitimate vehicle to bring a private company into the public market.[21] This Comment advocates for self-reform as the means to address the current SPAC structure's key weaknesses without compromising SPACs' unique positioning as modern blank check offerings.

An understanding of the history surrounding SPAC mechanics is crucial to grasp the issues embedded deep within its current form. Accordingly, Part I explores the history of the market regulatory framework, walks through the rise and subsequent fall of SPAC's early fraudulent ancestors—blank check

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proxy statements, de-SPAC registration statements, redemption rights and post-SPAC operations as exposed to increased risk to investors); Gerald Hodgkins, *First SPAC-Related SEC Enforcement Action Targets SPAC's Alleged Due Diligence Failures*, COVINGTON (July 14, 2021), https://www.cov.com/en/news-and-insights/insights/2021/07/first-spac-related-sec-enforcement-action-targets-spacs-alleged-due-diligence-failures (discussing SPAC exposure to punitive SEC sanctions for failure to provide due-diligence to investors).

[17] *See Staff Statement on Select Issues Pertaining to Special Purpose Acquisition Companies*, U.S. SEC. & EXCH. COMM'N DIV. CORP FIN. (Mar. 31, 2021), https://www.sec.gov/news/public-statement/division-cf-spac-2021-03-31; *What You Need to Know About SPACs*, *supra* note 12; Coates, *supra* note 15; John Coates & Paul Munter, *Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies ("SPACs")*, U.S. SEC. & EXCH. COMM'N (Apr. 12, 2021), https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs.

[18] *See 2021 SPAC Activity on the Decline*, APPRAISAL ECON.: INDEP. VALUATION EXPERTS (Dec. 14, 2021), https://www.appraisaleconomics.com/2021-spac-activity-on-the-decline/ (describing significant decline of SPAC activity resulting from new regulatory oversight).

[19] *See* Dawson et al., *supra* note 16 ("Recent SEC Guidance concerning SPACs demonstrates, at a minimum, the SEC's increased focus on this area, and may portend increased regulatory enforcement activity."); *see also* Nicholas Jasinski, *The SPAC World Is Eager to Keep Growing, but Regulatory Threats Aren't Going Away*, BARRON'S (June 23, 2021, 1:41 PM), https://www.barrons.com/articles/spacs-ipos-sec-regulation-gensler-51624469993 ("The mere issuance of guidance from SEC has caused sponsors and their lawyers to be more cautious, said [Doug] Ellenoff [partner at Ellenoff, Grossman & Schole], and that means the industry doesn't need more regulation.").

[20] *See Redeeming SPACs*, *supra* note 11, at 4.

[21] *See infra* Section II.B.

companies—and describes the SEC's attempt at mitigating fraud in the market. Part II pivots toward the SPAC structure, discussing its general form, key features distinguishing it from its fraudulent counterparts, and its life cycle, and illuminates its development as an alternative to the traditional IPO. Part III assesses existing tensions between the sponsor, investor, and target company IPO and provides empirical data to illuminate the ongoing issues within the SPAC structure: disappearance of investor voice,[22] poor investor returns as a result of dilution, deficiencies in disclosure, and issues surrounding due diligence. Finally, Part IV proposes potential solutions for each of the above issues and argues these issues should be addressed by SPAC creators rather than by additional regulation from the SEC in efforts to prevent potential overregulation from driving the SPAC structure to extinction.

I. SETTING THE STAGE: UNDERSTANDING THE MARKET REGULATORY FRAMEWORK

Part I explores the development of the securities market regulations most relevant to the unique positioning of the SPAC structure to shed light on how the SPAC structure plays upon the gaps in the existing regulations. Section A outlines a brief history of market regulations surrounding the 1929 stock market crash, focusing on the regulations' attempt to eliminate fraud throughout the market. Section B illustrates the rise of the blank check company, the fraudulent ancestor of the SPAC, despite the presence of newly formed anti-fraud acts. Section C discusses the SEC's second wave of regulations aimed to re-address the lingering fraud in the market.

A. Brief History of Market Regulation

In October 1929, speculation of a potential market crash triggered fluctuation in market prices; as a result, anxiety was entrenched in the minds of non-institutional investors, and national confidence in the stock market plummeted, resulting in the notorious market crash of 1929.[23] With the economy at an all-time low and the Federal Reserve refusing to lower interest rates on loans necessary to prevent institutions and individuals from reaching bankruptcy, it

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[22] *See infra* note 118 and accompanying text (defining voice as a mechanism where investors would vote on proposed acquisitions).

[23] *See* Gary Richardson, Alejandro Komai, Michael Gou & Daniel Park, *Stock Market Crash of 1929: October 1929*, ECON. RSCH. FED. RSRV. BANK OF ST. LOUIS, https://www.federalreservehistory.org/essays/stock-market-crash-of-1929 (Nov. 22, 2013); *see also* Eugene N. White, *The Stock Market Boom & Crash of 1929 Revisited*, 4 J. ECON. PERSPS. 67, 78 (1990) ("The speculative urge that had propelled the market upwards began to falter in the autumn of 1929.").

became evident the federal government would need to enter the regulatory arena to address the most pressing issues arising from the market crash.[24] Consequently, the crash was viewed as "the straw that broke the camel's back," piloting a number of significant federal securities regulations seeking to reset and rebuild the economy, restore faith in the securities market, and hinder any fraudulent and deceitful activity responsible for its downfall.[25]

In 1933, Congress passed the Securities Act of 1933[26] ("Securities Act") as an attempt to establish a fortified version of the blue sky laws enforceable at the federal level.[27] The Securities Act's stated purpose was "to eliminate serious abuses in a largely unregulated securities market."[28] The scope of the Securities Act focused primarily on addressing issues concerning the distribution of securities within the market.[29] To effectuate this purpose, it required all securities to register any offerings and distributions that would ultimately fall into the public hand, whether through the primary or secondary market.[30] Additionally, it embodied a philosophy of "full disclosure," compelling widespread dissemination of information for all securities to "ensure the full and truthful disclosure of all pertinent facts to undisclosed and unidentified prospective purchasers" such that they could make intelligent investment decisions.[31] Although the Securities Act established a number of new disclosure requirements, its scope was limited: it failed to address secondary market trading and did not extend investor protections to sellers of securities.[32] In turn, this limited the enforceability of the Securities Act.

One year later, Congress enacted the Securities Exchange Act of 1934[33] ("Exchange Act") as a means to address enforceability issues left open by the

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[24] *See* THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 1:16 (7th ed. 2016); *see also* White, *supra* note 23, at 81 ("New York city banks stepped into the breach and quickly increased their loans. They were encouraged by the Federal Reserve . . . [to] let its members know that they could borrow freely at the discount window.").

[25] *See* HAZEN, *supra* note 24, § 1:15. Among these regulations enacted included the 1933 Securities Act and the 1934 Exchange Act. *Id.* § 1:16.

[26] Securities Act of 1933, 15 U.S.C. § 77a. The Securities Act of 1933 is also known as the Truth in Securities Act. HAZEN, *supra* note 24.

[27] *See* Andrew Beattie, *The SEC: A Brief History of Regulation*, INVESTOPEDIA https://www.investopedia.com/articles/07/secbeginning.asp (Sept. 23, 2021).

[28] United Hous. Found., Inc. v. Forman, 421 U.S. 837, 849 (1975).

[29] *See* HAZEN, *supra* note 24, § 1:17.

[30] *See id.*

[31] Woodward v. Wright, 266 F.2d 108, 115 (10th Cir. 1959).

[32] *See* HAZEN, *supra* note 24, § 1:17.

[33] Securities Exchange Act of 1934, 15 U.S.C. § 78a. The Securities Exchange Act of 1934 is also referred to as the Exchange Act or the 1934 Act. *See* HAZEN, *supra* note 24, § 1:18.

Securities Act.[34] The Exchange Act's scope was substantially broader than the Securities Act; in an effort to initiate comprehensive changes in the market, the Exchange Act tenaciously introduced extensive regulation directed at monitoring all aspects of public trading of securities.[35] In fact, the volume of regulatory procedures instituted by the Act compelled Congress to create the SEC to take over administrative responsibilities associated with the securities market.[36]

First, the Exchange Act extended investor protection to include sellers of securities by "bar[ring] fraud and material misstatements or omissions of material facts in connection with any purchase *or sale* of security," so long as there is a "use of an instrumentality of interstate commerce."[37] Second, the Exchange Act expanded upon the various registration requirements: the Act required all securities traded on a "national exchange" to be registered with the SEC, thereby subjecting nearly all securities to the revamped reporting and disclosure requirements, which included "full disclosure of the company's business, financial position, and management as well as numerous periodic reporting requirements."[38] Third, the Exchange Act included numerous

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[34] *See* Beattie, *supra* note 27.

[35] *See* HAZEN, *supra* note 24, § 1:18 ("The Securities Exchange Act of 1934 is directed at regulating all aspects of public trading of securities[,] . . . focus[ing not] only on securities, their issuers, purchasers, and sellers[,] [but] also regulat[ing] the marketplace, including the exchanges, the over-the-counter markets, and broker-dealers generally." (footnotes omitted)).

[36] *See id.* ("The extent of the regulation introduced by the Exchange Act was so vast that Congress felt it was not possible to continue overburdening the Federal Trade Commission with this new administrative responsibility and thus established the Securities and Exchange Commission . . . ."). The Exchange Act granted the SEC considerable power to regulate the market, giving it "every power that can be given to an administrative agency, [except] . . . the authority to resolve disputes between private parties." *Id.* § 1:18 n.2. While the SEC is modest in size compared to other federal regulatory agencies, it is regarded as "one of the most efficient and effective federal agencies." *Id.* § 1:25. *But see, e.g.*, John C. Coffee, Jr., *SEC Enforcement: What has Gone Wrong?*, COLUM. L. SCH.: THE CLS BLUE SKY BLOG (Jan. 2, 2013), https://clsbluesky.law.columbia.edu/2013/01/02/sec-enforcement-what-has-gone-wrong/ (noting that the SEC is overworked, underfunded, risk adverse, understaffed, and not able to investigate issues as thoroughly as necessary).

[37] HAZEN, *supra* note 24, § 1:18 (emphasis added). Courts have construed the interstate commerce requirement in an extremely broad manner; it is highly unlikely a court would ever dismiss a case for lacking a sufficient jurisdictional basis in interstate commerce. *See id.* § 17:13 ("[F]ederal courts have taken a broad view of the securities laws' jurisdictional reach. The broad language regarding the necessary jurisdictional nexus when combined with the courts' expansive interpretation means that most securities transactions will be covered. . . . [F]or example, an intrastate telephone call will support jurisdiction. Similarly, it has been held that the particular communication containing the actionable statement need not be made through an instrumentality of interstate commerce so long as the transaction in question was effectuated through the use of such an instrumentality." (footnotes omitted)).

[38] *Id.* § 1.18; *see also id.* § 9:3 (discussing which securities are traded on a national exchange and therefore required to register with the SEC); *id.* § 9:18 (explaining annual, periodic, and continuous reporting requirements for public companies).

specialized provisions to address "stock manipulation, improper trading while in possession of non-public material information, insider short swing profits, and misstatements in documents filed with the [SEC]."[39] Finally, the Exchange Act provided for regulation of proxy machinery of any publicly traded corporations subject to the Act's reporting requirements.[40]

In the following years, Congress implemented a series of additional regulations formulated to more fully empower the federal regulatory scheme to fight against the persisting fraud.[41] Among these regulations was the Investment Company Act of 1940[42] ("Investment Act"). While the Securities Act and the Exchange Act focused primarily on regulating the sale of securities, the Investment Act targeted the regulation of the structure, management, and activities of investment companies.[43] The Investment Act imposed regulation upon the vast majority of securities by broadly defining "investment company" as "all issuers engaged in the business of investing, reinvesting, or trading in securities and also those which own or hold investment securities having a value exceeding forty per cent of their total assets."[44] The purpose of the Investment Act focused on resolving issues concerning improper disclosure, portfolio management, accounting practices, and changes to the character of the business

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[39] HAZEN, *supra* note 24, § 1:18 (footnotes omitted).

[40] *See id.* (providing additional discussion on proxy regulation); *see also* 15 U.S.C. § 78n(a)–(c) (providing rules and regulations regarding proxies).

[41] *See* HAZEN, *supra* note 24, § 1:20. In 1935, Congress enacted the Public Utility Holding Act to address issues concerning public issue utilities; as the Act affected few companies, the Act was repealed in 2005. *See id.*; *see also* Repeal of the Public Utility Holding Company Act of 1935 and Enactment of the Public Utility Holding Company Act of 2005, 70 Fed. Reg. 75592-01 (Dec. 20, 2005) (to be codified at 18 C.F.R. pts. 365, 366). The Trust Indenture Act of 1939 was enacted to address issues concerning debt financing by issuing bonds to the public, effectively building upon the Securities Act. *See* HAZEN, *supra* note 24, § 1:20. The Securities Investor Protection Act of 1970 addressed concerns arising from increasing numbers of insolvent broker firms. *Id.* In response to various scandals, the SEC effectuated the Sarbanes-Oxley Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act to prevent repeated harm within the market. *See* Beattie, *supra* note 27. In 2012, the Jumpstart Our Business Startups Act ("JOBS Act") was passed with the goal of reducing costs associated with the process of emerging companies going public. *See* Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (codified as amended in scattered sections of 15 U.S.C.).

[42] Investment Company Act of 1940, 15 U.S.C. § 80a-1 to -52.

[43] *See* Warren Motley, Charles Jackson, Jr. & John Bernard, Jr., *Federal Regulation of Investment Companies Since 1940*, 63 HARV. L. REV. 1134, 1142 (1950).

[44] *Id.* at 1137. The term "issuer" includes:

> corporations, trusts, partnerships and even natural persons if they have securities outstanding . . . [but excludes] banks, insurance companies, persons who are essentially underwriters, dealers, or brokers, educational and charitable organizations, pension trusts, voting trusts, and any issuer beneficially owned not by more than 100 persons and not making or proposing to make any public offerings.

Id. at 1137–38 (footnotes omitted).

without shareholders' consent.[45] The Investment Act effectuated this purpose by requiring all investment companies to register with the SEC, acquire a status, and comply with certain reporting requirements to the SEC, investors, and the general public.[46]

Collectively, the passage of these securities acts, coupled with the SEC's added oversight of the securities market, afforded investors enhanced access to information and armed them with an arsenal of remedies for situations where fraudulent activity was not sufficiently deterred by the new regulations.[47] With these new safeguards in place, investors slowly regained their confidence in the market, and the practice of investing regained its popularity; twenty years passed before the market prices surpassed the pre-crash heights.[48] Yet, even with the SEC monitoring the market and periodically adapting the market's regulatory mechanisms in response to occasional scandals and crises, fraud continued to persist,[49] leading to the rise of the blank check company, the fraudulent ancestor of the SPAC.[50]

B. *The Rise of Early Blank Check Companies—Fraud Continues in the Market*

During the 1980s, the number of securities firms and investment companies increased by approximately 90% and 145%, respectively; similarly, "the number of investment advisors more than tripled, the number of registration statements filed annually with the SEC doubled, and the number of tender offer filings increased" nearly sevenfold.[51] Once again, enormous profits enticed additional fraudulent activity, with the SEC seeing investor complaints increase over 260% as a result of illegal activity, including market manipulation, illegal trading activities, and fraudulent or misleading disclosures—especially in areas of the

[45] *See id.* at 1140 n.27.

[46] *See id.* at 1140 ("After registration, the company must comply with various reporting requirements designed to provide the SEC, stockholders, and the general public with current information concerning its operations . . . includ[ing] quarterly and annual reports to the SEC, semi-annual reports to the stockholders, reports to stockholders on the source of dividends, and specialized episodic reports in connection with substantive prohibitions of the Act."). The Act also provides "specific prohibitions and limitations concerning the transactions, affiliations, and functions of investment companies . . . intend[ing] to prevent investment company operation in the interest of management or affiliates, rather than in the interest of the shareholders." *Id.* at 1141.

[47] *See* Beattie, *supra* note 27.

[48] *See* Richardson et al., *supra* note 23.

[49] *Cf. id.*

[50] *See* Riemer, *supra* note 4, at 932.

[51] S. REP NO. 101-337, at 2 (1990).

market where the risk of detection was minimal.[52] Indeed, the market had "witnessed the biggest insider trading scandals in history"[53] during this time, yet the SEC's authority to enforce and review the increasing levels of fraud was nearly stationary, and its staff had not increased proportionally to adequately handle the fraudulent activity plaguing the market.[54] During this period, the "penny stock" market[55] undertook the most significant abuses—its loose regulatory scheme coupled with a general shortage of reliable information primed the market for numerous deceitful investment vehicles.[56]

Among the principal offenders in this area were blank check companies.[57] Early blank check companies would acquire money through an IPO by means of issuing penny stocks to investors with the purported business plan of merging with an already-existing company.[58] After sufficient money was acquired, early blank check offerings would engage in "pump-and-dump schemes"[59] to profit off of a merger by means of temporarily inflating the market price via dissemination of fraudulent and deceitful information.[60] By issuing penny

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52 *Id.*

53 *Id.*; *see* Riemer, *supra* note 4, at 934–35.

54 Riemer, *supra* note 4, at 934–35; *see* S. REP NO. 101-337, at 2.

55 The penny stock market is a specific area of the securities market where penny stocks—"stock[s] offered for sale for less than $5 per share"—are traded. Derek K. Heyman, *From Blank Check to SPAC: The Regulator's Response to the Market, and the Market's Response to the Regulation*, 2 ENTREPRENEURIAL BUS. L.J. 531, 533 n.8 (2007). Despite the significant prevalence of fraud in the penny stock market, securities regulators recognized the penny stock market itself and its offerings were not per se fraudulent. *See id.* at 536; *Penny Stock Market Fraud: Hearings Before the Subcomm. on Telecomms. & Fin. of the H. Comm. on Energy and Com.*, 101st Cong. 82–83 (1989) (statement of Frank Birgfeld, Director, District III of the National Association of Securities Dealers) ("I cannot tell you that a penny stock by itself is per se wrong. You take a pie and you cut it in fourths, eighths or sixteenths, you still got a pie. But you have to be deaf, dumb, blind and terminally naive to think that there are not big problems in this area.").

56 *See* Riemer, *supra* note 4, at 935–36 ("[P]enny stock swindles [were] . . . the No. 1 threat of fraud and abuse facing small investors in the United States." (second alteration in original) (quoting H.R. REP. NO. 101-617, at 10, *reprinted in* 1990 U.S.C.C.A.N. 1408, 1410 (1990))).

57 The Securities Act defined a "blank check company" as "any development stage company that is issuing penny stock . . . that—(A) has no specific business plan or purpose; or (B) has indicated that its business plan is to merge with an unidentified company or companies." Heyman, *supra* note 55, at 533. Preliminary blank check companies were problematic in a number of ways: they often served as vehicles to defraud inexperienced investors, they were used as a means to disguise business ownership from the public or other authorities, and they were utilized as tax avoidance vehicles for legitimate businesses. *See id.* at 534–35.

58 *Id.* at 533.

59 According to the SEC, a pump-and-dump scheme is when "fraudsters . . . spread false or misleading information to create a buying frenzy that will 'pump' up the price of a stock and then 'dump' shares of the stock by selling their own shares at the inflated price." U.S. SEC. & EXCH. COMM'N, *Pump and Dump Schemes*, https://www.investor.gov/introduction-investing/investing-basics/glossary/pump-and-dump-schemes (last visited Oct. 5, 2021).

60 *See* Riemer, *supra* note 4, at 955; *see also, e.g.*, Jacob Harper, *The Most Famous Pump and Dump Stocks of Wall Street History*, EQUITIES: NEWS (Nov. 13, 2013), https://www.equities.com/news/the-most-famous-pump-and-dump-stocks-in-wall-street-history (outlining pump-an-dump schemes from RCA, ZZZZ Best, Inc.,

stocks, blank check companies evaded the SEC's current regulations and registration requirements because the stocks were not approved for registration and were not traded on a national securities market.[61]

C. The SEC's Response—Diminishing Early Blank Check Companies

By 1988, the SEC observed the need for regulation in this area of the market: it formally declared blank check offerings as a vehicle for fraud and fashioned a task force dedicated specifically for diminishing the abusive practices within the penny stock market.[62] By 1990, thirty-six states had either substantially restricted or completely banned blank check offerings.[63] Despite the clear disapproval, the SEC recognized "blank check offerings could be and were used in legitimate business transactions outside the penny stock area" and elected to mitigate the fraudulent activity by subjecting them to extensive closing requirements rather than banning them outright.[64] Within the next few years, the SEC promulgated Rule 419 under the PSRA to outline exactly how this area of the market would be regulated.

In 1990, the PSRA[65] was enacted "[t]o amend the Federal securities laws in order to provide additional enforcement remedies for violations of those laws and to eliminate abuses in transactions in penny stocks."[66] Among numerous amendments to the Securities Act, the Exchange Act, and the Investment Act, the PSRA regulated penny stocks generally by defining penny stocks within the Exchange Act and by requiring an automated listing system to supplement the previously unregulated method of sharing information with investors.[67] Additionally, the PSRA regulated blank check companies specifically by (1) defining them within the Securities Act; (2) providing a framework for the regulation of the blank check vehicle, including timely disclosure of information necessary to prevent misleading statements; and (3) providing shareholders with a right of rescission.[68]

Centennial Technologies, and Satyam Computer Services stocks); Riemer, *supra* note 4, at 937–40 (describing Meyer Blinder's $3.1 million profit, forty-six month jail sentence, and life-suspension from the securities market via a pump-and-dump scheme through blank check company Onnix Financial).

[61] Heyman, *supra* note 55, at 535.

[62] Riemer, *supra* note 4, at 936; *see* Heyman, *supra* note 55, at 535.

[63] *See* H.R. REP. NO. 101-617, *reprinted in* 1990 U.S.C.C.A.N. 1408, 1420 (1990).

[64] *Id.* at 1424; Heyman, *supra* note 55, at 535 (quoting H.R. REP. NO. 101-617, *supra* note 63, at 1420).

[65] Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931.

[66] *Id.* (emphasis omitted).

[67] *See* Heyman, *supra* note 55, at 536–37.

[68] *Id.*

Six months after the PSRA, the SEC published its proposal for Rule 419 in an effort to "implement provisions of the Securities Enforcement Remedies and Penny Stock Reform Act."[69] Once enacted in 1992, Rule 419 exerted strict control over the blank check vehicles and provided investors with the opportunity to retract their investment decision after becoming informed of all of the material facts of the company along with its merger target.[70] Rule 419 contains six principal provisions:[71] (1) IPO proceeds must be kept in an escrow account;[72] (2) a post-effective amendment is required upon determining a probable target, providing its financial statements and other relevant information;[73] (3) another post-effective amendment is required upon execution of its merger agreement, providing a prospectus and a waiting period, so that investors may determine whether they intend to remain an investor;[74] (4) rescission rights to the investor;[75] (5) restrictions on and conditions for the release of the IPO proceeds;[76] and (6) an eighteen-month time limit for the blank check company to merge with a target or dissolve and return money to the investors.[77] These provisions built upon the initial investor protections created through the prior securities acts. In practice, these regulations were so restrictive that they effectively hindered the use of blank check companies altogether, ultimately reducing fraudulent activity in the area.[78] The accumulation of these regulations has lent a hand to the development of the SPAC as a vehicle existing between them.[79]

II. THE RISE OF THE SPAC STRUCTURE

The abundance of powerful regulations in the market made it generally difficult for new investment vehicles to evolve. Specifically, the heavy burdens of time and cost surrounding the heightened demand for disclosure and investor protections coupled with the disorganized structure resulting from the SEC's

[69] Blank Check Offerings, Securities Act Release No. 6,891, Exchange Act Release No. 29,096, 48 SEC Docket 962 (Apr. 17, 1991); *see also* Riemer, *supra* note 4, at 941 (quoting Blank Check Offerings, *supra*).

[70] *See* 17 C.F.R. § 230.419 (2021); Heyman, *supra* note 55, at 538.

[71] *See* Heyman, *supra* note 55, at 538–39.

[72] 17 C.F.R. § 230.419(b) (2021).

[73] *Id.* § 230.419(d).

[74] *Id.* § 230.419(e)(2)(iv).

[75] *Id.* § 230.419(e).

[76] *Id.* § 230.419(e)(1).

[77] *Id.* § 230.419(e)(2)(iv).

[78] Heyman, *supra* note 55, at 539–40. "There were approximately 2,700 blank check offerings during the Security and Exchange Commission's . . . 1987–1990 combined fiscal years; in the early 1990s, there were fewer than fifteen." *Id.* at 532 (footnote omitted).

[79] See *infra* Section II.A.2, for a discussion on Rule 419's influence on the SPAC model.

reactive nature of market regulations left little room for alternate offerings.[80] Despite clear challenges in creating a structure which could comport with all of the nuanced SEC requirements, creators of the SPAC model defied the odds, succeeding in development in the wake of the implementation of the PSRA and Rule 419.[81]

The SPAC structure clearly embodies characteristics from the environment in which it was crafted. Section A below outlines the SPAC form, discusses its development in light of the current market regulations, and explains the SPAC life cycle. Section B then compares SPACs to the traditional IPO as a means of bringing a company public to illuminate its unique features.

A. *The Creation of SPACs*

Paying careful attention to the intricacies of the current market regulations, a small group of lawyers and underwriters developed the earliest SPAC model with the purpose of retaining the "blank check"[82] concept from former blank check companies while simultaneously eliminating their fraudulent potential by providing investors with the very same protections portrayed throughout the newly formed regulatory framework.[83] This early SPAC model sought to resolve the problematic patterns that had persisted in the former private equity vehicles by expanding the opportunity to invest in vehicles that acquire private companies beyond the reach of accredited investors, thereby providing a greater range of investors with access to a whole new mechanism to engage in the market.[84]

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[80] *See* Riemer, *supra* note 4, at 943–44 (describing the "onerous requirements of Rule 419" as "more cumbersome and tedious," and explaining how they extended beyond mitigating fraud to "affect[] issuers who were using blank check offerings for legitimate purposes").

[81] *See id.* at 945.

[82] *See* Anh L. Tran, Blank Check Acquisitions 1 (Nov. 16, 2010) (unpublished manuscript), https://ssrn.com/abstract=2070274 ("SPACs are regarded as a 'blind pool' of capital, as investors do not know the operating company that the SPAC managers will ultimately invest their money in. SPACs are also referred to as blank-check companies since investors essentially give the SPAC managers a blank check with which to make an acquisition within a limited time frame.").

[83] *See* Heyman, *supra* note 55, at 532. For additional discussion on how Rule 419 and the PSRA affected the SPAC structure, see *infra* Section II.A.2.

[84] *See* Usha Rodrigues & Mike Stegemoller, *Exit, Voice, and Reputation: The Evolution of SPACs*, 37 DEL. J. CORP. L. 849, 851 (2013) ("SPACs give a wide range of investors an opportunity previously only afforded to accredited (*i.e.* wealthy) investors . . . ."). Accordingly, SPACs are occasionally referred to as the "poor man's private equity fund." *Id.* (quoting Jim Fink, *Special Purpose Acquisition Companies (SPACs): Will Investors Live Long and Prosper?*, INVESTING DAILY (Apr. 10, 2012), http://www.investingdaily.com/10914/special-purpose-acquisition-companies-spacs-will-investors-live-long-and-prosper).

While the SPAC form and function demonstrates a clear resemblance to its blank check ancestors—and is even commonly attributed the same nickname of a "blank check company"—its development ensured it was not merely a resurrection of its fraudulent ancestor.[85] As the result of innovative lawyering, SPACs obtained SEC approval for use in the modern market,[86] operating as legitimate investment vehicles for raising capital.[87] Discussed below is the SPAC form, drawing from concepts explored in Part I of this Comment.

1. *Introducing the Basic Form and Function*

The SEC defines a SPAC as "a company with no operations that offers securities for cash and places substantially all the offering proceeds into a trust or escrow account for future use in the acquisition of one or more private operating companies."[88] In other words, SPACs are single-purpose entities with the sole goal of completing a merger within a self-imposed two-year deadline.[89] This goal is driven by a contractual relationship between SPAC sponsors and its investors: sponsors are only compensated if the SPAC completes a merger within the provided time limit.[90] Thus, sponsors are incentivized to complete the SPAC's goal.[91] As the sponsors are the only existing asset at the time of the SPAC's IPO, investors have a particular interest in understanding the

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[85] *See* Heyman, *supra* note 55, at 540.

[86] SPACs differ from the early fraudulent blank check companies in that the SPAC model emulates all of the investor protections outlined in Rule 419 without becoming subject to the rigors of its provisions; SPACs ultimately exist as an exception to the protections altogether. *See* James Murray, *Innovation, Imitation and Regulation in Finance: The Evolution of Special Purpose Acquisition Companies*, 6 REV. INTEGRATIVE BUS. & ECONS. RSCH. 1, 8 (2017).

[87] *See* Heyman, *supra* note 55, at 532; *see also* William K. Sjostrom, Jr., *The Truth About Reverse Mergers*, 2 ENTREPRENEURIAL BUS. L.J. 743, 756 (2008).

[88] *Special Purpose Acquisition Companies*, U.S. SEC. & EXCH. COMM'N CORPORATION FINANCE (Dec. 22, 2020), https://www.sec.gov/corpfin/disclosure-special-purpose-acquisition-companies#; *see also* U.S. SEC. & EXCH. COMM'N, BLANK CHECK COMPANY, https://www.investor.gov/introduction-investing/investing-basics/glossary/blank-check-company (last visited Oct. 5, 2021) ("A blank check company is a development stage company that has no specific business plan or purpose or has indicated its business plan is to engage in a merger or acquisition with an unidentified company or companies, other entity, or person.").

[89] *See* Douglas Cumming, Lars Helge Hab & Denis Schweizer, *The Fast Track IPO—Success Factors for Taking Firms Public with SPACs*, 47 J. BANKING & FIN. 198, 198–99 (2014).

[90] Though sponsors are not given a salary or fees until after a successful acquisition, sponsors are typically reimbursed for out-of-pocket expenses "incurred in connection with identifying businesses." Rodrigues & Stegemoller, *supra* note 84, at 872.

[91] *See* Cumming et al., *supra* note 89, at 200. While this relationship should theoretically incentivize the sponsors to seek out the best target company to maximize profits for both themselves and the investors, the all-or-nothing style of allocating risk could lead to a conflict of interest, as sponsors would rather complete a less desirable merger than complete none at all. *See id.*

background, expertise, and business goals of the sponsors running the SPAC.[92] If a merger is proposed and approved by the shareholders, the SPAC will merge with the target company, and the target company will begin trading on the public market.[93] Conversely, if the SPAC fails to propose a target company within the specified period or the shareholders elect not to approve the merger, then the SPAC will dissolve and the shareholders will receive a pro rata share of the aggregate amount previously collected by the SPAC.[94] In the modern market, SPACs are utilized as alternative vehicles to the traditional IPO process and are perceived by many as a tidy solution to the problem of the high costs of accessing the public market.[95]

Currently, SPACs are not subject to any special legislation or administrative rules.[96] Accordingly, their relative freedom from regulation offers them flexibility to remain dynamic and adaptive, with the capability of changing their structure in a matter of months.[97] With this in mind, SPACs are often attentive of changes which might contradict the spirit of the current regulatory scheme because a clear divergence from their current form might provoke the SEC to impose reactionary regulation that would abolish SPACs entirely.[98]

2. *Development of the SPAC Structure*

The implementation of Rule 419 posed significant challenges for SPACs. While designed primarily to hinder the fraudulent exploitation of the stockholders' funds commonly observed from the early blank check offerings, the strict limitations it imposed upon certain vehicles were so harsh that it had the unintended effect of deterring the use of these vehicles for legitimate

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92 *See id.*; Rodrigues & Stegemoller, *supra* note 84, at 871 n.176 (describing how SPACs have no running operations or tangible assets, aside from sponsor's ability to make valuable business decisions).

93 Rodrigues & Stegemoller, *supra* note 84, at 872–73.

94 *See id.* at 872; *see also What You Need to Know About SPACs*, *supra* note 12.

95 *See infra* Section II.B.

96 *See* Riemer, *supra* note 4, at 933 (noting that SPACs "are no more regulated than traditional public offerings").

97 Rodrigues & Stegemoller, *supra* note 84, at 873–74.

98 *See id.*; *see also* Riemer, *supra* note 4, at 933 (discussing potential inquiry as to whether SPACs need further regulation). Riemer argues SPACs are:

> creative and advantageous investment vehicles that do not pose sufficient risk to require regulation under Rule 419. Most SPAC investors are sufficiently informed of the terms of their investment to understand the risks . . . . While the SEC could ensure that SPACs continue to adhere to the current structure by adopting regulation similar to Rule 419, doing so risks overregulating. . . . Mirroring the Rule 419 protections is the touchstone of the SPAC structure, and it is highly unlikely that SPACs could successfully raise capital without continuing to adhere to this structure.

Riemer, *supra* note 4, at 963.

purposes.[99] In effect, Rule 419's strict limitations drove the early blank check companies to extinction.[100]

To address this problem, creators sought to position the SPAC structure outside the bounds of Rule 419; effectively, this meant the SPAC vehicle would need to avoid classification as a penny stock.[101] While the obvious method of evading the penny stock definition would be to price the SPAC IPO units above the five-dollar threshold,[102] the SEC recognized "the five dollar price threshold present[ed] an easy mechanism for avoiding the regulatory scheme contemplated by Congress . . . undercut[ting] the investor protection purpose of the blank check rules."[103] Consequently, the SEC elected to remove the five-dollar threshold in a later release.[104] Nevertheless, the SEC intentionally left other exemptions designed to exclude certain companies; the exclusion relevant to SPACs provides that companies that have net tangible assets exceeding $5 million and which are in operation for less than three years are excluded from the penny stock definition.[105] Since the proceeds from a SPAC IPO easily exceed $5 million[106] and a SPAC tailors its acquisition period to be between eighteen to twenty-four months to complete its target merger, the SPAC structure exists by operating in a "loophole" the SEC deliberately left open in the regulatory regime.[107]

By intuitively nestling itself outside the scope of the penny stock definition, the SPAC structure is effectively exempt from all of Rule 419's regulations and requirements, providing it with significant flexibility to operate in the market.[108] For example, SPACs could now allow the common stocks and warrants to be traded separately; the separation of these two offerings attracted hedge funds because it provided them with the opportunity to construct a wide array of

99 *See* Murray, *supra* note 86, at 8–9; *see also* Riemer, *supra* note 4, at 943–44.

100 *See* Heyman, *supra* note 55, at 540.

101 *See id.* For the six major provisions of Rule 419, see *supra* note 71 and accompanying text.

102 Heyman, *supra* note 55, at 540.

103 *Id.* (quoting Penny Stock Definition for Purposes of Blank Check Rule, Securities Act Release No. 33-7024, 55 SEC Docket 722 (Oct. 25, 1993)).

104 *Id.* Even though the threshold has been eliminated as a formal requirement, prices for units sold in a SPAC IPO are still set above $5, typically offered around $10 per unit. *What You Need to Know About SPACs*, *supra* note 12. For more discussion on SPAC units, see *infra* note 126 and accompanying text.

105 Heyman, *supra* note 55, at 540–41; 17 C.F.R. § 240.3a51-1(g)(1) (2007).

106 The size of SPAC IPOs has ranged from $20 million to $900 million. Sjostrom, *supra* note 87, at 757; *see, e.g.*, Rest. Acquisition Partners, Inc., Prospectus 1 (Form 424B4) (Dec. 15, 2006) (depicting $20 million SPAC IPO offer in 3,333,333 units); Liberty Acquisition Holdings Corp., Prospectus 1 (Form 424B4) (Dec. 6, 2007) (depicting $900 million SPAC IPO offering in ninety million units).

107 *See* Heyman, *supra* note 55, at 541.

108 *See id.*

trading strategies not otherwise possible under Rule 419.[109] The resulting interest by hedge funds increased the value of SPACs in the modern market.[110] However, apprehensions of being regulated out of existence led SPACs to adopt and modify substantially all of the investor protections outlined in Rule 419, discussed below.[111]

First, regarding the use of proceeds, both SPACs and Rule-419-compliant blank check offerings place the majority of their funds—typically over 90%—in a trust account, using the remaining 10% of the proceeds to fund the ongoing search for a target company with which to merge.[112] Here, SPACs are safer than Rule-419-compliant blank check offerings because they often place greater than 90% of their proceeds into a trust or escrow, whereas Rule 419 only requires 90%; this means more of the capital is eligible for return in the event of a failed merger.[113] Second, while Rule 419 permits the exercise of warrants prior to completion of the merger, the SPAC model only allows for warrants to be exercised after the merger has been completed; this provides additional protection to investors by preventing warrant holders from exercising their options to gain additional voting shares prior to the merger.[114] Third, unlike the eighteen-month time period outlined in Rule 419, SPACs provide for a twenty-four-month period, affording the vehicle extra time to find an ideal target company and complete the merger.[115] Fourth, whereas Rule-419-compliant blank check companies set the minimum purchase price of the target company at 80% of the maximum offering proceeds, the SPAC model measures this price as 80% of the net assets post-merger, leaving a safety net of working capital available for running the SPAC.[116] Finally, much like Rule 419, the SPAC model provides investors with the right of rescission.[117] Unlike Rule 419, where an investor was required to specifically exercise their right of rescission before merger, the SPAC model allowed investors the right to opt out of the SPAC either before or after a merger was completed.[118]

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[109] *Id.* at 542.

[110] *See id.*

[111] *See* Riemer, *supra* note 4, at 945. These voluntary restrictions were enforced through contractual agreements and charter provisions. *Id.*

[112] Murray, *supra* note 86, at 9. As SPAC IPOs grew in size, less of the proceeds were necessary to fund the search; therefore, SPACs with larger IPO offerings would place about 90% of its proceeds in a trust. *See id.*

[113] Heyman, *supra* note 55, at 542.

[114] Murray, *supra* note 86, at 9.

[115] Heyman, *supra* note 55, at 542. The time restriction is relaxed to be between eighteen to twenty-four months to help reduce risks associated with finding a target acquisition within a limited timeframe. *See* Murray, *supra* note 86, at 10.

[116] Heyman, *supra* note 55, at 542.

[117] *See* Murray, *supra* note 86, at 9.

[118] *See* Rodrigues & Stegemoller, *supra* note 84, at 877; Riemer, *supra* note 4, at 947.

In fact, SPAC creators initially implemented a mechanism where investors would vote on proposed acquisitions ("voice"), as well as a rescission right that could be utilized prior to an acquisition ("exit").[119] While the concept of voice was "important in convincing the SEC to allow SPACs to go public," it brought forth the "unintended consequence" of providing shareholders with a holdout right.[120] As the SPAC model continued to evolve, voice was ultimately removed, as it appeared the exit served as a sufficient mechanism of investor protection on its own.[121] Accordingly, while the implementation of Rule 419 in the securities market created clear hurdles for the establishment of new vehicles, the SPAC structure artfully developed around the harsh restrictions while simultaneously embodying some of the most important principles surrounding investor protection.

3. *The SPAC Life Cycle—Form, Acquire, Merge, and Dissolve*

The life of a SPAC is comprised of four key stages: (1) the SPAC forms and raises funds; (2) the SPAC seeks a private, operating company to acquire (the target company); (3) the SPAC announces the target company to shareholders and seeks approval for the acquisition; and (4) the SPAC utilizes the funds raised in the SPAC IPO to acquire the target company and lists the target company on a public exchange.[122] If the SPAC fails to find a target company or complete the acquisition within the specified period, it dissolves.[123] Each of the stages is discussed in more detail below.

A SPAC is formed when a group of sponsors take a shell company[124] public via an IPO (the SPAC IPO) and file a registration statement declaring the SPAC as a public company.[125] In this first stage, sponsors utilize the SPAC IPO process to raise capital from public investors in order to fund the SPAC's operation, attract a target company, and fund the subsequent merger.[126] In the SPAC IPO,

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[119] *See* Rodrigues & Stegemoller, *supra* note 84, at 854–55. The concept of voice provided investors with "robust control" over SPACs because it required investors to approve the merger before it could be completed. *Id.* at 909.

[120] *Id.* at 910.

[121] *Id.* at 911.

[122] Kimball Chapman, Richard Frankel & Xiumin Martin, SPACs and Forward-Looking Disclosure: Hype or Information? 8–10 (Oct. 21, 2021) (unpublished manuscript), https://ssrn.com/abstract=3920714.

[123] *See What You Need to Know About SPACs*, *supra* note 12.

[124] A shell company is a company with no set business plan or purpose, having "no operating history, assets, revenue, or operations." Riemer, *supra* note 4, at 933. The shell company itself is the SPAC.

[125] Rodrigues & Stegemoller, *supra* note 84, at 871; *see* Chapman et al., *supra* note 122, at 9.

[126] As the capital raised in the SPAC IPO constitutes the SPAC's sole material asset, by purchasing a SPAC unit, an investor is essentially purchasing a management team. Rodrigues & Stegemoller, *supra* note 84, at 871.

sponsors raise capital by offering a unit,[127] which is comprised of a share of common stock[128] and a fraction of a warrant.[129] The vast majority of the proceeds obtained in a SPAC IPO—with the exception of a small portion utilized to pay taxes, fees, and other necessary expenses—is held by a third party, typically in a trust account, until the SPAC completes its merger or dissolves.[130] Generally, SPAC IPOs can be completed in as little as eight weeks because its "IPO registration statement is mostly boilerplate language," with the addition of "director and officer biographies."[131]

In the second stage, the SPAC sponsors will seek a target company to merge with, engaging in private negotiations with potential target companies.[132] Generally, SPACs will provide for a two-year period to identify and merge with a target company; however, some SPACs intentionally opt for a shorter period to complete this process.[133] Depending on the specific governing structure, a SPAC may, under certain circumstances, have the ability to extend this period.[134] In the event an extension is permitted, a SPAC is still obligated to complete a merger or dissolve within three years of the SPAC IPO process to remain within

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[127] SPAC units can be traded after their initial offering in the SPAC IPO; additionally, each of the components comprising a unit can be traded "separately with their own unique trading symbols." *What You Need to Know About SPACs*, *supra* note 12. Since a unit, a share of common stock, and a warrant may vary greatly in their offerings, the SEC urges investors to look carefully at the unique symbols to determine whether they are purchasing units, common stock, warrants, or some combination of the three. *See id.*

[128] A common stock is a share of the public interest of the SPAC and is held by public shareholders. *See* Alan Stephen Jones, Mike Bellin & Eric Watson, *How Special Purpose Acquisition Companies (SPACs) Work*, PWC (Nov. 21, 2021, 5:03 PM), https://www.pwc.com/us/en/services/audit-assurance/accounting-advisory/spac-merger.html. The public interest in a SPAC is generally about 80% of a SPAC's total interest and is calculated by subtracting the interest reserved for the sponsors from the total interest. *Id.* The sponsor's interest is usually modeled after the private equity vehicles; accordingly, the sponsors usually retain 20% of the SPACs total interest. *Id.*

[129] A warrant, also called a call option, is a contract that provides its holder the right to purchase additional shares of common stock at a certain price at some point in the future. *What You Need to Know About SPACs*, *supra* note 12. The terms of warrants vary significantly across different SPACs; thus, the SEC cautions investors to read a SPAC's prospectus to determine the specific terms of the SPAC's warrants. *Id.*

[130] *Id.* Though SPACs generally invest the proceeds in a trust, there is no formal rule restricting them to place the proceeds only in these instruments; thus, the SEC advises investors to carefully review the specific terms in a SPAC's prospectus to determine where the money is going. *Id.*

[131] 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/. A SPAC must prepare and file a Form S-1 to disclose its general investment plans to the SEC. *Id.* The SEC usually provides few comments, none of which are generally cumbersome. *Id.*

[132] *See* Laura Stavisky, *SPACs: An Overview of the Investment Vehicle Dominating Headlines in the COVID-19 Market*, 40 REV. BANKING & FIN. L. 85, 87 (2021).

[133] *What You Need to Know About SPACs*, *supra* note 12.

[134] *Id.* The governing instruments of a SPAC may provide for an extension of the purported time and may require shareholder approval to do so. *Id.*

the Rule 419 exemption.[135] During this stage, a private investment in public equity ("PIPE") will raise additional capital through a private offering to additional investors in order to supplement the SPAC's IPO proceeds.[136]

The third stage begins when the SPAC identifies a prospective target company worth at least 80% of the SPAC's net asset value.[137] During this stage, a SPAC must disclose the proposal for the merger along with material information about the target company.[138] At the same time a SPAC discloses information to investors, SPAC sponsors seek shareholder approval for the merger by filing a proxy statement.[139] Shareholders vote on the merger and may elect to remain as an investor or redeem their shares for a pro rata share of the aggregate amount currently in the trust.[140] As warrants trade independently, shareholders electing to redeem their shares can keep their warrants or sell them separately on the market.[141]

Where voice is still required, at least 50% of the SPAC's shareholders must approve the merger, and the number of shareholders electing to redeem their right must not exceed the threshold (typically between 20–40%) to allow the SPAC to move to the fourth and final stage: completing the merger.[142] As mentioned above, any shareholders voting against the deal at this point may exit and redeem their shares.[143] In this stage, the SPAC will bring in its exchange listing along with the proceeds previously held in trust; the SPAC will utilize the proceeds as fresh equity to complete the business combination with the private

[135] *See id.* For a discussion on the Rule 419 exception, see *supra* note 105 and accompanying text.

[136] Stavisky, *supra* note 132.

[137] Cumming et al., *supra* note 89, at 201.

[138] *See* Chapman et al., *supra* note 122, at 9. The target business information is disclosed in a Form 8-K or 425 filing. *Id.*

[139] *Id.* This is achieved on a Schedule 14A; if additional financing is needed, then a combined proxy statement should be provided on Form S-4. *Id.*

[140] *What You Need to Know About SPACs*, *supra* note 12. If an investor opts to redeem their shares, they must do so and tender the shares no later than two days prior to the shareholder meeting. Chapman et al., *supra* note 122, at 9.

[141] Cumming et al., *supra* note 89, at 201. For a discussion on warrants, see *supra* note 129 and accompanying text.

[142] Cumming et al., *supra* note 89, at 201. In early SPAC models, the concept of voice effectively imposed a supermajority approval requirement, requiring an initial investor vote on approval—voice—as well as setting a limitation on a threshold of investors who could exercise their redemption right—exit—to allow the merger to go forward. *See* Rodrigues & Stegemoller, *supra* note 84, at 909; *see also, e.g.*, Joe Barbeau, Jeff Petit, Anne Pogue & Marcie Areias, *Deal-Breakers*, GIBSON DUNN (May 18, 2009), https://www.gibsondunn.com/deal-breakers/ (identifying supermajority approval as usually 80% and difficult to acquire). As discussed above, the power of voice was ultimately eliminated as the SPAC model continued to evolve. *See supra* notes 119–21 and accompanying text.

[143] *See* Cumming et al., *supra* note 89, at 201.

company via a form of a reverse merger.[144] In addition, within four business days of completion of the merger, the SPAC must file a special form disclosing all information which would have otherwise been disclosed at the initial registration.[145] "Depending on the financing structure of the deal and the size of the stake," sponsors can remain majority shareholders, become minority shareholders, or may retire altogether.[146]

If a SPAC has not completed a merger within the specified period, the SPAC must file a special form announcing its liquidation and termination of corporate existence.[147] In this case, the full trust account, including interest, will be redistributed to shareholders as a pro rata value of their stock.[148]

B. *SPACs as an Alternative to the Traditional IPO*

The architecture of U.S. capital markets has undergone rapid transformation in the twenty-first century due to globalization and a series of important technological and regulatory developments.[149] Given the current market structure, the SPAC structure is touted to be an appealing alternative to the traditional IPO process of bringing a company public.[150] Currently, both SPACs and the traditional IPO seek approval from the SEC and acquire funds by means of an IPO in the public market.[151] SPACs differ from the traditional IPO in that the SPAC vehicle itself completes the IPO process and then subsequently targets and merges with a private company to bring it public through a form of a reverse merger.[152] This allows the SPAC to sidestep a number of the burdens typically

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144 *Id.* In the event of a business combination, the SPAC will continue to exist as combined with the newly public company. *Id.*

145 Chapman et al., *supra* note 122, at 10.

146 Cumming et al., *supra* note 89, at 201.

147 *What You Need to Know About SPACs*, *supra* note 12.

148 Cumming et al., *supra* note 89, at 201–02.

149 *See, e.g.*, George S. Georgiev, *The Breakdown of the Public-Private Divide in Securities Law: Causes, Consequences, and Reforms*, 18 N.Y.U. J.L. & BUS. 221, 264–77 (2021) (discussing the deregulatory cascade that caused significant changes in the U.S. capital markets over the past twenty years and illustrating the resulting increase in complexity of the current capital raising regulatory regime).

150 Tim Castelli, *Not Guilty by Association: Why the Taint of Their "Blank Check" Predecessors Should Not Stunt the Growth of Modern Special Purpose Acquisition Companies*, 50 B.C. L. REV. 237, 253 (2009).

151 *See Redeeming SPACs*, *supra* note 11, at 12.

152 *See* Sjostrom, *supra* note 87, at 743 ("A reverse merger . . . is a non-traditional method of going public. Instead of hiring an underwriter to market and sell the company's shares in an [IPO], a private operating company works with a 'shell promoter' to locate a suitable non-operating or shell public company."). Unlike a typical reverse merger, a SPAC discloses material information regarding the target prior to its acquisition, allowing for review by the SEC. Rodrigues & Stegemoller, *supra* note 84, at 877–78.

associated with the traditional IPO, providing the SPAC with a number of perceived benefits.[153]

First, the SPAC model is argued to take about half the time it would take a company to go public via an IPO.[154] Second, it is contended SPACs are a cheaper alternative to the traditional IPO because, unlike the traditional IPO, they (1) have lower direct expenses and indirect costs; (2) are not subject to the perceived underpricing issues; and (3) have very little to disclose.[155] Third, SPACs are claimed to provide the target company with increased price certainty because unlike traditional IPOs—where pricing information is disclosed one day before market entry—SPACs specify the share exchange rate prior to consummation of the deal.[156] In addition, SPACs—unlike traditional IPOs—are shielded from liability for forward-looking statements, allowing them to make speculative

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[153] *See Redeeming SPACs*, *supra* note 11, at 12.

[154] Vaishali Kanamalla, Exploring an Alternative to IPOs: Special Purpose Acquisition Companies (SPACs) 10 (2021) (Honors Scholar Thesis, University of Connecticut), https://opencommons.uconn.edu/srhonors_theses/801 ("Usually, SPAC business combinations take about 3–4 months from the letter of intent (LOI) to the closing, while traditional IPOs may take 6–9 months from the drafting of the initial prospectus to the transaction close."). The primary reason SPACs take less time is because they have no operations, and therefore have very little information to disclose. *Understanding SPAC IPOs Versus Traditional IPOs*, WOODRUFF SAWYER (2022), https://woodruffsawyer.com/industries/spacs/spac-ipos-traditional-ipos-difference/. Also, SPACs transfer the risks associated with asymmetric information to the investors. *Redeeming SPACs*, *supra* note 11, at 13. In contrast, traditional IPOs take longer because investment banks are held liable for fraud in both the sale of the securities and in the accuracy of the registration statements, thereby making the process expensive and slow. *Id.* A study by Douglas Cumming and others revealed SPAC management has an incentive to reduce the duration of the entire SPAC life cycle as to maximize their chances at obtaining a successful merger. Cumming et al., *supra* note 89, at 210.

[155] *See* Michael Klausner, Michael Ohlrogge & Emily Ruan, *A Sober Look at SPACs* 3–4 (ECGI Working Paper Series in Fin., Working Paper No. 746, 2021), https://ecgi.global/sites/default/files/working_papers/documents/klausnerohlroggeruanfinal.pdf. A study from January 2019 to June 2020 suggests that while commentators say SPACs are a cheap way to go public, they are right, but only because SPAC investors are bearing the cost, which is an unsustainable situation. *See id.* at 3, 38. Many argue a key benefit of SPACs is its cost-effective means of bringing a company public. *See id.* at 3 ("[Commentors] claim that SPACs are a cheaper way of going public than an IPO because they avoid the IPO 'pop'—the perceived underpricing that some believe shortchanges issuers."); Kanamalla, *supra* note 154, at 11 ("Traditional IPOs also tend to be more expensive than SPACs which have lower direct expenses and indirect costs."); Rodrigues & Stegemoller, *supra* note 84, at 871 ("[U]nlike the typical initial public offering, there is very little for the SPAC to disclose."). However, the stake reserved for a SPAC's sponsors could be just as large as the costs associated with the underwriting process. *See* Sjostrom, *supra* note 87, at 750–51 (illustrating how 20% stake in a $50 million SPAC merger would cost more than 18% offering proceeds necessary to fund a traditional IPO). It appears a number of SPACs have claimed status as an "emerging growth company" in accordance with the JOBS Act, thereby reducing the reporting and compliance requirements. Murray, *supra* note 86, at 14. As such, SPACs can use this exception within the JOBS Act to present themselves as a reduced cost alternative to access the public market. *Id.*

[156] Kanamalla, *supra* note 154, at 11; *see* Klausner et al., *supra* note 155, at 3. From a valuation perspective, traditional IPOs are disadvantageous because they deal with issues surrounding underpricing; on the other hand, SPACs have direct control to negotiate its pricing structure. Kanamalla, *supra* note 154, at 11.

statements so long as they are accompanied with specific cautionary language.[157] Moreover, commentators have discussed how early SPAC models provided companies, which were otherwise unable to utilize the traditional IPO, with an outlet to go public.[158] Finally, SPACs are considered advantageous because the vehicle is available to almost anyone, allowing for reliance on sponsors' expertise and assisting the target company in producing value by providing it with a network of physical investors.[159]

While each of these purported benefits may lend support to the notion that SPACs are a superior mechanism for private companies to go public, the reality is that investors bear the brunt of the pitfalls associated with making SPACs more efficient.[160] This actuality is the predicate of the weaknesses of SPACs as they currently exist and exhorts the need to reform the current structure.

III. ANALYZING SPACS: TENSIONS TO REVEAL KEY ISSUES IN THE CURRENT STRUCTURE

To understand the specific reforms that should take place, Part III engages in a deeper analysis of the current tensions between each of the SPAC's key participants—investors, sponsors, and target company—to illuminate the key issues contributing to the shortchanging of its investors. Section A explores various tensions existing between the three SPAC participants, aiming to uncover persistent issues due to the misaligned goals of each party. Section B then utilizes empirical data to define and more critically unpack the issues lingering in the current SPAC vehicle.

A. Tensions Between the Investor, Sponsor, and Target Company

Given the intricate nature of the SPAC form and the inherent differences in goals between the investor, the sponsor, and the target company, tensions are likely to arise between these persons which may impede the efficiency of the SPAC. It may be difficult to align the interests of each of these key players in such a way that is optimal for everyone involved. However, by identifying the value sought by each of the SPAC players, it becomes possible to identify how

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[157] *Redeeming SPACs*, *supra* note 11, at 14; *see also* Klausner et al., *supra* note 155, at 42 ("SPACs do enjoy certain regulatory advantages that stem from the fact they bring companies public in merger transactions, and as a result they are regulated under merger rules, not public offering rules. . . . SPAC mergers are covered by a safe harbor for inclusion of forward-looking statements in their proxy statements.").

[158] Klausner et al., *supra* note 155, at 3.

[159] *See id.*

[160] *See infra* note 202 and accompanying text (explaining dilution as a source for harm to investors).

future regulations surrounding SPACs may work to better align these goals and therefore resolve—or at least reduce—these tensions.

The SPAC form provides different value for each of the participants.[161] For the investor, the SPAC model provides investors with an opportunity to (1) fund the sponsors' mission to seek and merge with a potentially undervalued target company; and (2) reap the potential benefits of the subsequent acquisition.[162] For the sponsors, the SPAC model offers a means to (1) acquire funds from the general public needed to finance a private merger; (2) provide the independence to freely choose any target company it desires—subject to shareholder approval (in some cases); and (3) protect from forward-looking statements.[163] For the target company, the SPAC model provides (1) an alternative pathway to enter the public market; (2) a means to bypass the significant costs and time involved in the traditional IPO; (3) greater price and deal certainty; (4) access to a network of physical investors; and (5) a company with the ability to maintain its autonomy in ways not possible through other acquisition mechanisms.[164]

Between the investor and sponsor, a common goal exists in maximizing the profits of the SPAC merger.[165] As sponsors are only compensated if a merger

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[161] *See* Riemer, *supra* note 4, at 966 ("SPACs present investors with the unique opportunity to invest in a management team with a proven track record and to participate in a private-equity-style venture in a safer and more liquid manner.").

[162] *See* Rodrigues & Stegemoller, *supra* note 84, at 871–72; *see also, e.g.*, Riemer, *supra* note 4, at 966 (discussing advantages of SPACs not offered by private equity vehicles).

[163] *See* Rodrigues & Stegemoller, *supra* note 84, at 874 ("[SPACs] allow a management team to raise funds from the public to finance the quest for a target."); Klausner et al., *supra* note 155, at 5 ("SPACs and their merger targets can avail themselves of a safe harbor against liability under the securities laws for projections and other forward-looking statements.").

[164] *See* Rodrigues & Stegemoller, *supra* note 84, at 874 (discussing SPACs as an alternate pathway, a means to avoid costly traditional IPO process, and as a vehicle for maintaining autonomy); Andrew R. Brownstein, Andrew J. Nussbaum, Igor Kirman, Matthew M. Guest, David K. Lam, DongJu Song, Raaj S. Narayan & Alon B. Harish, *The Resurgence of SPACs: Observations and Considerations*, WATCHELL, LIPTON, ROSEN & KATZ (Aug. 20, 2020), https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.27066.20.pdf (stating the benefit of SPAC compared to IPOs is greater price certainty). *But see* Klausner et al., *supra* note 155, at 4 ("We find that the commentators' claims that SPACs deliver great price and deal certainty compared to IPOs, are understated. One reason, among others, is that they do not fully appreciate the sources of SPAC dilution and as a result do not recognize that the extent of SPAC's dilution [sic] is not known until the time of the merger . . . .").

[165] Investors profit from obtaining SPAC units: these units become separable into a share of the common stock and a warrant (an option to purchase additional shares of stock "either 30 days after the De-SPAC transaction or twelve months after the SPAC IPO"). CFI Team, *Special Purpose Acquisition Company (SPAC): A Corporation Formed for the Sole Purpose of Raising Investment Capital Through an IPO*, CFI, https://corporatefinanceinstitute.com/resources/knowledge/strategy/special-purpose-acquisition-company-spac/ (Jan. 5, 2022). Sponsors profit by purchasing founder shares, resulting in a 20% ownership stake in the outstanding shares after completion of the IPO, meant to compensate the sponsors for the completion of an

occurs, tension may arise when the SPAC timeline is nearing its end and a meaningful acquisition has not manifested itself because the sponsors would rather complete a less-than-ideal merger—and recuperate some of their costs from the past two years—than have to dissolve and return the money raised back to the investors.[166] Conversely, tension may arise in a SPAC utilizing voice, where a large percentage of investors challenge the sponsors' proposed acquisition because the investors are not relying on the sponsors to make sound business decisions.[167]

With regard to the sponsor and target company, their values are most closely aligned when a SPAC merger would be a more beneficial route than a traditional IPO, thus allowing the sponsors to profit in a manner most beneficial to the target company.[168] Generally, utilizing a SPAC is more beneficial when the target company is smaller, the management of the target company does not want to give up a portion of their control to private equity companies, or some of the management are interested in cashing out by selling their shares on the public market after a merger has been completed.[169] Tensions may arise when the sponsor is not considerate of the target company's needs throughout the business combination. Specifically, if the sponsors are solely focused on making a profit rather than creating a deal that is valuable for the target company, the sponsors' actions may put the SPAC merger at risk of being lost to an alternative opportunity.[170] On the other hand, tensions may arise if the target company is

acquisition. *Id.* Where a merger is successful, investors will have value in both their stocks and warrants, and sponsors will receive more money from the 20% ownership. *See id.*

[166] By completing a less-than-ideal merger, the investors' value is damaged because the value of the common stock will be lower, and if the business does not do well long term, the warrants will be worth little, if anything. *See* Heyman, *supra* note 55, at 549–50 ("In terms of the executives involved, they've got every incentive to do a deal, whether it makes sense or not, because if they don't do one, they give the money back . . . [.] If they do a deal, that entitles them to a gravy train of salary for the foreseeable future." (quoting Scott Malone, *Crunch Time Coming for Blank-Check Companies*, REUTERS NEWS (Mar. 26, 2006))).

[167] While the investors are likely attempting to maximize their value from the SPAC investment in this case, their actions demonstrate a lack of trust for the sponsors decisions, creating a "holdout right" which complicates the merger process. *See* Rodrigues & Stegemoller, *supra* note 84, at 910–11. As a result, many of the modern SPAC models have eliminated voice, finding instead an exit right for investors provides them sufficient protection. *Id.*

[168] *See* Heyman, *supra* note 55, at 547.

[169] *See id.*; *see also* Castelli, *supra* note 150, at 257 ("A reverse merger with a SPAC provides the private company with a large infusion of cash from the proceeds of the SPAC's IPO.").

[170] *See* Riemer, *supra* note 4, at 962 ("[A] management team that lacks prior experience . . . could easily find itself preoccupied and distracted from its primary goal: engineering a successful business combination."). Sponsors must negotiate "an effective combination that creates more value for the target relative to its other options—and is also attractive to the investors." Max H. Bazerman & Paresh Patel, *SPACs: What You Need to Know*, HARV. BUS. REV. (Aug. 2021), https://hbr.org/2021/07/spacs-what-you-need-to-know. Additionally, SPACs must compete with other SPACs to garner interest of the target company. Castelli, *supra* note 150, at 268–69.

unable to demonstrate to SPAC sponsors that their financial records are in compliance with relevant regulations; sponsors may become uneasy about moving forward with the merger, resulting in use of precious time to discover whether the deal is beneficial for all involved.[171]

Looking to the relationship between the target company and the investor, their values are aligned when the merger is financially and opportunistically optimized for both parties.[172] Tensions can arise when investors are more interested in investing in the early stages of the SPAC, electing to exit upon an acquisition; exiting close to the merger can harm target companies by preventing them from having security through long-term investor support and can even put the deal at risk.[173] These tensions have the potential to build upon the tensions between the investor and sponsor mentioned earlier: with many investors opting to exit the SPAC, sponsors are left to raise additional funds through outside sources to maintain an appeal to potential target companies, or cut price deals to ensure some form of a merger is completed within the allotted time.[174] On the other hand, while it may initially appear as if the target company has significant leverage on SPACs due to the short timeline for proposed mergers to be competed, tensions arise when target companies negotiate using unreasonable terms.[175] As many SPAC models still allow for investors to reject deals, a target company negotiating with unreasonable terms would cause high investor exit, putting the deal at significant risk.[176]

Accordingly, the value for each of the parties will be the highest—and therefore the tensions between them will be lowest—when each party acts with mindfulness of the values of the other parties. In so doing, SPACs can continue to serve as a powerful vehicle in the market.

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[171] *See* Bazerman & Patel, *supra* note 170.

[172] Target companies must balance the various kinds of value that can be gained from SPACs: dilution, execution of the deal, cash inflow, publicity, shareholder liquidity, and post-merger (exercise of warrants). *See id.* Likewise, investors must balance the potential value that can be obtained from the SPAC: "[n]ot all SPAC investors seek high-flying returns, nor are they necessarily interested in the business combination itself"; the structure allows for a variety of returns and risk profiles and timelines. *Id.*

[173] Where an investor is primarily interested in investing before or at the SPAC IPO and exiting just before or after acquisition, it is unlikely the investor will incur much loss. *See* David Stein, *What Are SPACs and Should You Invest in Them?*, MONEY FOR THE REST OF US, https://moneyfortherestofus.com/318-what-is-a-spac/ (Aug. 26, 2022) ("SPACs are unlikely to fall much below the IPO price until after a merger is closed."). However, where a target company is seeking long-term investments, the utilization of a SPAC as a means to go public could contradict their overall goals. *See id.*

[174] *See* Kate Kelly, *SPACs Went Up, Then Down, but They're Not Out*, N.Y. TIMES: DEALBROOK NEWSL. (Aug. 21, 2021), https://www.nytimes.com/2021/08/21/business/dealbook/spac-market-future.html.

[175] *See* Bazerman & Patel, *supra* note 170.

[176] *Id.*

B. Key Issues Within the Current SPAC Structure

The current SPAC model—while often considered a more appealing alternative to the traditional IPO—has demonstrated through its evolution in the current market that even a significant divergence from its blank check ancestors is not enough to make it an ideal investment vehicle.[177] In practice, SPACs can fail at any stage of the life cycle. Specifically, some SPACs succeed in going public and completing a merger,[178] other SPACs never make it to the market,[179] and still others fail to locate a target or succeed in finding a target but fail in gaining shareholder approval.[180] Through an analysis of the benefits and risks of the current form,[181] as well as a discussion surrounding various internal tensions,[182] this Comment has revealed the current SPAC form is far from perfect. Accordingly, this section will summarize the most notable issues present in the current SPAC form, including harm to the investor and harm to the public, each of which needs immediate attention.

1. Harm to the Investor—Removal of Voice and Dilution of Ownership

From the perspective of the investor, the current SPAC model places crucial shortcomings on the shoulders of its investors. Namely, the SPAC's evolution to remove voice and place the burden of dilution solely on investors presents two critical issues, each of which is discussed in greater depth below.

As previously discussed in this Comment, early SPAC forms placed significant emphasis on the investors' ability to have a voice in voting on proposed acquisitions.[183] Initially, the function of voice provided investors with

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[177] See *supra* Section II.A.2, for a discussion on how SPACs have distinguished themselves from their fraudulent ancestors.

[178] *See, e.g.*, Rodrigues & Stegemoller, *supra* note 84, at 884–85 (describing how Services Acquisition Corp., International registered S-1 form in February of 2005, went public in July of 2005, announced a merger with Jamba Juice for $265 million in March of 2006, and completed the merger on November of 2006, listing the company on the NASDAQ).

[179] *See, e.g.*, *id.* at 879–80 (explaining how HCM Acquisition Company filed its initial registration statement on October of 2007, released a prospectus proposing to be listed on AMEX, filed several amendments in November of 2007 disclosing stock certificates, bylaws, charter, etc., and then ceased to make filings without issuing shares to the pubic).

[180] *See, e.g.*, *id.* at 880–84 (recalling how Alpha Security Group Corp filed an S-1 in August of 2005, released a prospectus announcing intent to focus on homeland security, went public on March of 2007 and generated $63 million, issued letter of intent to merge by March of 2009, entered into and subsequently backed out of a merger agreement with Soya China Pte., Ltd. in March of 2009, and then dissolved).

[181] *See supra* Section III.B.1 (discussing risks of dilution associated with current SPAC form).

[182] *See supra* notes 119–21 and accompanying text (discussing the removal of voice in SPACs).

[183] *See supra* Section II.A.2 (describing functions of voice and exit and explaining voice's subsequent removal through current SPAC structures).

the opportunity to vote on the proposed merger, as well as veto its completion if a sufficient number elected to exit after approval was obtained.[184] The early emphasis on voice was mostly a means to convince the SEC that SPACs were a vehicle worthy of going public.[185]

As the SPAC model has continued to evolve, many recent forms have opted to remove voice, suggesting investors retain sufficient protection through exit alone.[186] While the elimination of voice appears to provide sponsors with additional freedom by eliminating the strict supermajority requirement needed for merger,[187] the result from the view of the investor is different: removal of voice effectively thwarted the investors' ability to provide real checks on the managerial pressure to close a deal.[188] Where voting lingers in modern SPAC structures, votes are "empty"—in other words, the investor's vote and the economic vote are separate—meaning an investor can exit after voting affirmatively for a merger.[189] This structure poses a significant harm to the investor because it has divested them of their influence on the outcome of the SPAC merger, effectively tipping the balance too far in favor of the sponsors.[190] While their power to exit remains, investors have effectively been silenced, further alienating them from moderating the merger process.[191]

Along with being harmed through the removal of voice, investors who elect to remain invested in SPACs post-merger are also harmed by the substantial amount of dilution.[192] A comparison of the post-merger returns of sponsors with the post-merger returns of investors illustrates this issue of dilution.

Presently, the contemporary SPAC structure heavily favors the sponsors.[193] Specifically, looking to the performance of SPACs in the 2019–2020 Merger Cohort, at three and six months following a merger, mean sponsor returns are

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[184] *See* Rodrigues & Stegemoller, *supra* note 84, at 909–12 (explaining emergence of voice and how it provided investors with robust control over SPACs).

[185] *Id.* at 910 (describing that the initial purpose of voice was to garnish SEC approval for SPACs).

[186] *See id.* (clarifying that voice was removed due to sufficient protective measures from exit).

[187] *See* Cumming et al., *supra* note 89 (indicating supermajority requirement of voice as combination of affirmative investor vote as well as not meeting threshold of investor exit).

[188] *Redeeming SPACs*, *supra* note 11, at 23–24.

[189] *See id.* at 24.

[190] Damodaran, *supra* note 11.

[191] *See Redeeming SPACs*, *supra* note 11, at 24.

[192] *See infra* notes 194–200 (contrasting success of sponsor returns with poor performance investor returns and further analyzing investor performance by quality of sponsor).

[193] *See* Damodaran, *supra* note 11 (describing how the current SPAC model allows sponsors to receive shares of ownership up to five times the invested capital stake).

close to 400%; by twelve months, sponsor returns decrease to 187%.[194] The SPAC structure provides such high returns to sponsors because they also carry the risk of receiving nothing—and losing out on their skin in the game—if they fail to complete an acquisition.[195]

In contrast, average returns for investors from all SPACs at three, six, and twelve months following a merger are -2.9%, -12.3%, and -34.9%, respectively.[196] It is only by investigating the difference in the performance of SPACs when separated by the quality of the sponsor—high quality versus non-high quality[197]—that investor returns are positive; even then, investor returns for high-quality SPACs after three, six, and twelve months are only 31.5%, 15.8%, and -6.0%, respectively.[198] To further analyze these numbers, it is important to note some SPAC deals—such as DraftKings and Virgin Galactic—have demonstrated significant success for investors, with the merged company's stock prices soaring well over 400%.[199] Unfortunately, these "outsized winners" are the exception and not the norm: it appears "no matter which measure of returns you look at, and over almost every time period, investors in SPAC-merged companies lose money."[200] While it is true that repeat sponsors do better than new sponsors, this advantage fades within three months post-merger, indicating investors rarely profit from SPACs in the long term.[201]

The losses observed by non-redeeming investors in both high-quality and non-high-quality SPACs suggest investors bear the brunt of the costs of

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[194] Klausner et al., *supra* note 155, at 38–39. In other words, the sponsor's 20% stake in the outcome will see a significant return in the event a merger is completed.

[195] *See* Rodrigues & Stegemoller, *supra* note 84, at 853.

[196] Klausner et al., *supra* note 155, at 34 & tab.6. Looking at the median values, returns are much worse than the average, suggesting that a few highly successful SPACs have skewed the data and returns are generally worse than depicted. *See id.*; *see also* Damodaran, *supra* note 11.

[197] A sponsor is considered high quality when it is either (1) "affiliated with a fund listed in PitchBook with assets under management of $1 billion or more"; and/or (2) "a former CEO or other senior officer . . . of a Fortune 500 company." Klausner et al., *supra* note 155, at 33. A sponsor not meeting either of the above criteria is classified as non-high quality. *Id.*

[198] *See id.* at 33–34 & tab.6. High-quality SPACs observe greater returns because they may not be as dilutive, and they can add value to the target company post-merger through ongoing engagement. *Id.* at 33.

[199] *See* Damodaran, *supra* note 11.

[200] *Id.*

[201] *See id.*

dilution.[202] For example, a study of SPACs from January 2019 to June 2020[203] indicates that while SPACs issue units for $10 and value their shares for $10 when they merge, by the time the merger has been completed, the median SPAC holds cash equivalent of only $6.67 per share.[204] To make matters worse, redemptions by investors further magnify dilution by reducing the number of shares that are backed by cash.[205] With mean and median redemptions for SPACs being 58% and 73%, respectively, many SPACs have turned to selling new shares through private placements contemporaneously with their mergers in efforts to replace at least part of the money lost.[206]

Since dilution is inherent in the current SPAC structure, how do investors justify investing in SPACs? The answer lies in speculation: investors must believe that when a SPAC merges, they will receive at least $10 per unit to justify giving up their redemption right.[207] Effectively, the merger must create a sufficient surplus—consisting of the value of the target company becoming public plus the value created by sponsors from continuing engagement in the post-merger target company—for investors to break even or come out ahead.[208] Given the one-shot nature of the SPAC, one primary concern is the lack of history of the management team for the particular SPAC at issue: investors are essentially placing their "blind faith" in the sponsors to look out for their best interests.[209] In determining whether a SPAC will succeed in bridging the gap of dilution, "investors must rely on the competence, reputation, and past

[202] *See* Klausner et al., *supra* note 155, at 37 ("We find that SPAC dilution is highly correlated with SPAC shareholder losses . . . . SPACs with high dilution, and thus little cash per share at the time of their mergers, do much worse following a merger than do those with less dilution. This strongly implies that the source of SPACs' poor performance is the dilution embedded in their structure." (footnote omitted)). Dilution in SPACs arises from three sources: (1) the sponsors "promote" of 20% post-IPO equity; (2) sponsor's promise of an attractive return to allow them to hold investors' cash for two years; and (3) an underwriting fee based on IPO proceeds. Michael Klausner, Michael Ohlrogge & Emily Ruan, *A Sober Look at SPACs*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 19, 2020), https://corpgov.law.harvard.edu/2020/11/19/a-sober-look-at-spacs/.

[203] Klausner et al., *supra* note 155, at 3.

[204] *See* Klausner et al., *supra* note 202.

[205] *See id.* ("Consider a hypothetical SPAC that sells 80 shares to the public and gives 20 shares to the sponsor for a nominal fee. That is, 80% of the shares are backed by cash, and 20% are not. If 50% of the SPAC's 80 public shares are redeemed, the sponsor's 20-share promote, initially equal to 25% of publicly owned shares, will equal 50% of the 40 remaining publicly owned shares. Equivalently, of the 60 shares remaining after redemptions, 67% have cash behind them, and 33% do not.").

[206] *Id.* Over the same time period, over one third of those SPACs had redemption rates exceeding 90%. *Id.*

[207] *See id.*

[208] *See id.*

[209] Riemer, *supra* note 4, at 957–58 (describing how SPACs lack operating history, leading investors to rely on competence, reputation, and past performance of management team as "forecast of how the SPAC might perform").

performance" of sponsors in previous SPAC transactions.[210] As such, former executives with track records of creating value in prior SPAC acquisitions "are the best asset a SPAC can have."[211] Nevertheless, some SPACs have seen significant surges in public interest simply as the result of celebrity endorsement.[212] "SPACs have become so fashionable, in fact, that they've been popularized beyond Wall Street by celebrities like the pop star Jennifer Lopez and the basketball legend Shaquille O'Neal."[213] To mitigate this risk, investors often turn to the required filings and forward-looking statements to better understand the proposed deal.[214] Alternatively, investors hold the safe haven of exit: they can opt out at any time by exercising their redemption right and receiving a pro rata share of funds held in escrow.[215]

The drastic losses taken on by investors as observed throughout the vast majority of SPACs indicate investors alone absorb the costs of dilution arising from (1) the sponsors' 20% compensation; (2) the sponsors' promise of an attractive return for investors who will eventually exit; and (3) the underwriting fee of a successful SPAC merger.[216] To make matters worse, dilution is further magnified when more investors elect to exit because exiting reduces the number of remaining shares backed by cash.[217] With mean and median redemption rates both exceeding 50%, investor returns are suffering additional dilution through investor exit.[218] These findings raise questions as to whether the current regulatory treatment of SPACs is justifiable;[219] the unsettling balance against the investor calls for correction in efforts to maximize the efficiency of the SPAC.[220]

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[210] *Id.*

[211] Heyman, *supra* note 55, at 544; *see also* Brad Meikle, *Where Underwriters Leave Off PE Pros Pick Up with SPACs*, BUYOUT INSIDER (Feb. 6, 2006), https://www.buyoutsinsider.com/where-underwriters-leave-off-pe-pros-pick-up-with-spacs/ ("All a SPAC has, essentially, is a man with a plan . . . .").

[212] *See* Kelly, *supra* note 174.

[213] *Id.*

[214] *See* Riemer, *supra* note 4, at 962; *see also* Coates, *supra* note 15 ("Investors . . . commonly view forward-looking information as decision-useful and relevant. . . . But forward-looking information can also be untested, speculative, misleading or even fraudulent, as reflected in the limitations on the [Private Securities Litigation Reform Act]'s liability protections . . . ."). As for sponsors, their risk in only receiving payment on completion of a merger lies with the "unconventional compensation scheme" of receiving 20% of the SPAC's common equity for a nominal investment. Riemer, *supra* note 4, at 959.

[215] Riemer, *supra* note 4, at 954, 961.

[216] *See supra* note 202 and accompanying text (explaining dilution and its effect on reducing investor returns).

[217] *See supra* note 205 (illustrating how increasing number of investors electing to exit reduces shares backed by cash, thereby increasing costs of dilution).

[218] *See supra* note 206 (highlighting mean and median redemption rates at 58% and 73%, respectively).

[219] Klausner et al., *supra* note 155, at 55.

[220] See *supra* Section III.A, for further discussion on various tensions arising within the SPAC structure.

2. *Harm to the Public Market—Deficient Disclosure and Lack of Due Diligence*

Turning more broadly to the perspective of the market, the current SPAC model—in its capacity as an alternative to the traditional IPO while circumventing many of the regulatory gatekeeping requirements—demonstrates the potential to harm the public market because of its relative exclusion to the rules.[221] Notably, an increase in litigation surrounding allegations of deficient disclosure and lack of due diligence suggest each are critical issues arising from SPACs in need of course correction.[222] Accordingly, each will be discussed below.

The freedom SPACs enjoy from SEC regulations provides them with a safe harbor from liability "for projections and other forward-looking statements."[223] While earlier forms of the SPAC model attempted to employ use of such statements, engagements have proved futile, with the majority of SPACs facing litigation as a result of failing to disclose, misstating important information, or even asserting fraudulent claims.[224] While private securities litigation is not a new occurrence, the recent surge in the utilization of SPACs within the market has brought with it an increase in litigation surrounding their shortfalls.[225] For example, investors have brought forth claims surrounding securities law violations based upon deficient disclosures.[226] Companies like Lordstown Motors, Nikola, and Momentus—each of which merged with, or planned to merge with, a SPAC—have found themselves in hot water with the SEC for

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[221] *See* Heyman, *supra* note 55, at 541 (describing SPACs flexibility due to its formation as an exception to Rule 419); *see also Redeeming SPACs*, *supra* note 11, at 65 ("SPACs allow unvetted firms to enter the public markets unprepared for the rigorous requirements of actually being public."). *But see* Riemer, *supra* note 4, at 945 (explaining how concerns of future litigation have ushered SPACs to voluntarily adopt nearly all Rule 419 considerations).

[222] *See supra* note 16 and accompanying text (finding litigation surrounding SPACs increased as result of SPAC surge).

[223] Klausner et al., *supra* note 155, at 5 ("SPACs and their merger targets can avail themselves of a safe harbor against liability under the securities laws for projections and other forward-looking statements.").

[224] *See, e.g.*, *Litigation Risk in the SPAC World*, QUINN EMANUEL TRIAL LAWYERS (Sept. 30, 2020), https://www.quinnemanuel.com/the-firm/publications/litigation-risk-in-the-spac-world/ ("When [SPAC] deals do not work out, litigation will follow."); Kevin LaCroix, *The Other Kind of Merger-Related Litigation*, THE D&O DIARY (May 3, 2012), https://www.dandodiary.com/2012/05/articles/securities-litigation/the-other-kind-of-merger-related-litigation/ ("[SPAC] lawsuits, typically launched by the target company shareholders, are filed shortly after a merger announcement and usually object to some aspect of the proposed merger or of the merger-related disclosure."); *see also, e.g.*, Momentus, Inc., Securities Act Release No. 10955, Exchange Act Release No. 92391, 2021 WL 2953701 (July 13, 2021) (illustrating Stable Road Acquisition Corp.'s claim to use water-propulsion-thruster technology to power rockets in space on acquisition of Momentus).

[225] *See* Dawson et al., *supra* note 16.

[226] *Id.*

providing misleading information to investors by inflating sales prospects.[227] In response, in March of 2021, the SEC released a staff statement reminding SPACs of the need to comply with existing disclosure requirements.[228] In April of 2021, the SEC further advanced its intention on tightening SPAC requirements by issuing another statement that warned SPACs against believing the SPAC IPO allows for forward-looking statements not able to be made in the traditional IPO process.[229] On March 30, 2022, the SEC approved proposed rules regarding SPACs, which are aimed at strengthening SPAC disclosure requirements by imposing onto SPACs many of the disclosure rules surrounding traditional IPOs.[230] Together, the abundance of litigation coupled with the SEC's active participation in releasing statements surrounding disclosure suggest reform is long overdue.

To the extent disclosure is overlooked, the process of due diligence—especially in a manner similar to that which is performed by investment banks in a traditional IPO—would undoubtedly identify and correct any mistakes in disclosure, whether a result of naivete or outright fraud.[231] In an IPO, the process of due diligence affords investment banks multiple opportunities to review and correct filings, from initial drafting to filing publicly, through SEC scrutiny, and through questions and comments subsequently released on filings prior to an IPO.[232] However, the current SPAC model appears to sluff the costs associated with information asymmetry and sloppy disclosure procedures to the investors.[233] Not only does this further shortchange investors by additionally reducing their potential returns, but it also has the potential to harm the public by reducing the quality of public firms in the public market.[234] As such, the most logical solution is to reform the SPAC model, to ensure it does not perpetuate damage to investors or the public eye.

[227] Kelly, *supra* note 174.

[228] Noah Ganz & Alonzo Llorens, *To SPAC or Not to SPAC: How Is the SEC Answering That Question?*, PARKER POE (Sept. 30, 2021), https://www.parkerpoe.com/news/2021/09/to-spac-or-not-to-spac-how-is.

[229] *Id.*

[230] Ralph V. De Martino, *Federal Regulation of Securities Committee of the Business Law Section of the American Bar Association Takes Aim at SEC Proposed SPAC Rules*, ARENTFOX SCHIFF (June 21, 2022), https://www.afslaw.com/perspectives/alerts/federal-regulation-securities-committee-the-business-law-section-the-american.

[231] *See Redeeming SPACs*, *supra* note 11, at 46.

[232] *See id.*

[233] *See id.*

[234] *See id.*

IV. REFORM WITHOUT REGULATION: PROPOSED REFORM FOR SPACS TO PERSIST AS ASSETS

Utilization of SPACs by target companies as an alternative route to enter the public market has undoubtedly surged, especially within the past three years.[235] Given the checkered history of early forms of blank check offerings[236] and the constantly evolving nature of securities regulations seeking to eliminate fraud in the securities market,[237] SPACs carry the burden of distinguishing themselves from their fraudulent ancestors to communicate to the public—and to the SEC—that they are in fact legitimate vehicles deserving of permanent placement within the market.[238] With the recent surge in SPAC activity, "costly and notorious mistakes" by some are inevitable.[239] As a result, SPACs are facing significant scrutiny.[240] In fact, the increasing utilization of SPACs in recent years has landed the SPAC model as a topic on the SEC's rulemaking agenda for 2022.[241] This

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[235] In 2019, 59 out of 213 U.S. IPOs were SPAC IPOs, comprising 28% of the market; by 2021, 613 out of 968 U.S. IPOs were SPAC IPOs, comprising 63% of the market. SPAC ANALYTICS: SPAC & US IPO ACTIVITY, https://www.spacanalytics.com (last visited Jan. 8, 2022). Over half of 2021's SPAC IPOs were completed in the first quarter. *See* Appraisal Econ., *supra* note 18 ("First quarter 2021 boasted 317 SPAC IPO completions."). Beyond the first quarter, SPAC activity experienced a sharp decline, due to increased regulatory oversight by the SEC. *See id.* Despite the dwindling activity, investors still show great interest in the opportunities to invest at the SPAC IPO stage. *Id.*

[236] *See supra* Part I (discussing the persistence of fraud in the market via blank check offerings).

[237] *See supra* Section I.C (explaining the emergence of Rule 419 and the PSRA in light of fraud caused by early blank check companies).

[238] *See supra* Section III.A.

[239] Woodruff Sawyer, *supra* note 154; *see, e.g.*, *SPAC-tacular Failures—A How-Not-To Guide*, ACURIS CAP. INTEL. (Sept. 21, 2021), https://capitalintelligence.acuris.com/spac-tacular-failures-a-how-not-to-guide#! (describing securities fraud allegations as a result of ATI Holdings missed turnover targets and rolled-back revenue guidance).

[240] *See* Martin Bell, Stephen Blake & Brooke Cucinella, *Continued Scrutiny of SPACs and Media Statements*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 22, 2021), https://corpgov.law.harvard.edu/2021/08/22/continued-scrutiny-of-spacs-and-media-statements/(describing how the SEC charged a SPAC with securities fraud for misleading social media statements); Dave Michaels, *Regulators Step Up Scrutiny of SPACs With New View on Warrants*, WALL ST. J., Apr. 13, 2021, at B1 (describing the SEC's increased scrutiny on SPACs for improper accounting of warrants); William N. Haddad, *Law360 Quotes Bill Haddad on Increased Regulatory Scrutiny of SPACs*, VENABLE LLP (Dec. 28, 2021), https://www.venable.com/about/news/2021/12/law360-quotes-bill-haddad-on-increased ("The torrid pace finally cooled in the spring as the U.S. Securities and Exchange Commission (SEC) stepped up scrutiny, concerned that companies going public through SPACs may be evading investor protections associated with traditional IPOs.").

[241] *See SEC Announces Annual Regulatory Agenda*, SEC (June 11, 2021), https://www.sec/gov/news/press-release/2021-99 (showing SEC considering proposing rule amendments related to SPACs). The proposed rule identification number is 3235-AM90. AGENCY RULE LIST—SPRING 2022, U.S. SEC. & EXCH. COMM'N, https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf_token=7CE97CC2D49C9B6B708 68F7B2752E582C86F1945A4A46F34426C18AF1ABE101E611318F64B67159C3A36E7556BD0FB872C8F (last visited Oct. 29, 2022).

signifies a clear message: the current SPAC structure is in dire need of reform if it wants to remain a viable investment tool in the future. This Comment proposes four mechanisms of self-reform critical to ensure SPACs can become a more efficient functional equivalent to the traditional IPO.

Section A discusses proposed reforms meant to mitigate each issue without damaging the unique positioning of the SPAC as a blank check offering. Section B illustrates the need for self-regulation, discussing why enforcement by the SEC runs the risk of overregulating the SPAC, potentially causing the model to be regulated out of existence.

A. Reforms to Advance SPACs as a Legitimate Vehicle

With four key issues in the current SPAC structure—removal of investor voice, dilution, deficiencies in disclosure, and lack of due diligence—now identified, this section proposes reforms meant to assist the SPAC in stepping into its purported position as a more efficient, functional equivalent to the traditional IPO. This section addresses potential reform for bringing back voice, dispersing dilution, enhancing precision in disclosure, and revisiting due diligence.

1. Bringing Back Investor Voice

SPACs' evolution to decouple the voting and economic rights—effectively removing the investor's voice—detached investors' ability to provide checks on the managerial pressure to close a deal.[242] With diminished power, investors cannot assist in ensuring the merger is beneficial by vocalizing against a poor one. Accordingly, the current SPAC model has tipped the benefits too far in favor of the sponsors, leaving the investor with only one option: to jump ship if they dislike the merger.[243] In an effort to ensure the investor, sponsor, and target company each maximize their benefit from a proposed SPAC merger, it is important to recouple the investors' voting rights.[244] To correct this imbalance, SPAC creators should require redemption thresholds of at least 50% for a SPAC to continue a merger.[245] In addition to re-empowering the investor, the effect of this reform reintroduces price certainty by ensuring at least 50% of the investor

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[242] *See supra* note 188.

[243] *See supra* notes 119–21 and accompanying text.

[244] *See* Damodaran, *supra* note 11 (discussing how aligning sponsor and investor interests would ensure incentive to complete quality merger exist).

[245] *Redeeming SPACs*, *supra* note 11, at 47 (proposing the SEC should require NYES and Nasdaq to require 50% redemption right threshold).

shares will remain backed by cash.[246] Setting the threshold at 50% ensures the reintroduced voice will make completing an acquisition easier to accomplish than the previous supermajority,[247] while simultaneously serving as an effective threshold against a mass exit immediately prior to an acquisition.

2. Dispersing Dilution

Currently, the SPAC structure features enormous gains for sponsors, yet investors rarely see a positive return from the merger and in the months beyond.[248] Since one of the most prominent sources of dilution is the sponsors' subsidy of 20%, a reform targeting the means by which sponsors are paid would serve as an effective means to rebalance the interests between the sponsor and the investor. While one possible solution would be to simply reduce the percentage from 20% to 15%,[249] the result would significantly reduce returns for the sponsors, while providing the large group of investors with only a nominal return.

Another potential solution lies in the unique structure of Pershing Square Tontine Holdings ("PSTH"), a newer form of SPAC, which combats dilution by, inter alia, shifting the sponsors' stake from a 20% stock-based interest to a 20% warrant-based interest.[250] By shifting sponsor investment to warrants—and more particularly to warrants that do not become exercisable until multiple years after the initial business combination—sponsors will only benefit if the target company's stock has increased by at least 20% compared to its price during the SPAC IPO at the time the warrants are exercisable.[251] Such a restructure effectively eradicates dilution by shifting sponsors' incentive away from the SPAC's available cash. Moreover, this reform effectively restructures the entire SPAC system, more closely aligning the sponsors', investors', and target company's interests by placing significant focus on the long-term success of the merger.[252] While undoubtedly beneficial to the interests of the investors, such a shift has the effect of removing the sponsor's control over the target company's business operations post-merger. From the view of the target company, it is

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[246] *See supra* note 205.
[247] *See supra* note 187.
[248] *See supra* notes 194, 200.
[249] *See* Damodaran, *supra* note 11 (proposing reduction in sponsor subsidy).
[250] *See* Klausner et al., *supra* note 155, at 52–53. In July 2020, PSTH broke the mold of the current SPAC, going public as the largest SPAC in history, with numerous differences: sponsors take no promote, its warrants are smaller than those of other SPACs, it rewards non-redeeming shares with additional warrants, and is substantially less dilutive. *Id.*
[251] *Id.* at 52.
[252] *See id.* at 53.

possible this is more beneficial, as it provides a serious influx of cash without risking a loss in control over the initial vision of the company. To best realize the benefits of this reform, other characteristics from PSTH's structure—such as awarding additional warrants to non-redeeming shares over time—should also be implemented to further incentivize each party's continued commitment in the business venture.[253]

3. Enhancing Precision in Disclosure

A lack of standardization surrounding disclosure contributes to the inflation of a SPAC's value after its SPAC IPO and the subsequent crash following the announcement of a merger by creating a lack of cohesive information surrounding a SPAC's purported plan. The significant fluctuations in value throughout a SPAC's life suggests it needs reform, yet current legal scholarship has suggested it is difficult to quantify exactly what area of the disclosure process needs reform.[254]

Many scholars have echoed to "level the playing field" with regard to equalizing SPAC and traditional IPO disclosures, arguing the existence of two business structures with functionally similar purposes and very different disclosure requirements cannot persist.[255] While enhancing disclosure can serve as a meaningful reform to provide additional protection to investors,[256] it is not always an increase in quantity of information that is most helpful to potential investors.[257] Meaningful reform surrounding SPAC disclosure must look to balance the need to disclose all information pertinent to an investor becoming educated on a SPAC's purported plan with the potential for such disclosure to unnecessarily burden the SPAC's short timeline. Since the more formal disclosure requirements mandated by the SEC have proven to be

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[253] *Id.* at 52–53.

[254] *See Redeeming SPACs*, *supra* note 11, at 46 ("The fact that two academic researchers, experts in securities, finance, and corporate law and well-versed in SPACs, struggled to document this information indicates a problem.").

[255] *E.g.*, Damodaran, *supra* note 11 ("Level the playing field on disclosures/capital . . . ."); Klausner et al., *supra* note 155, at 55–57 ("[I]f the regulatory playing field between SPACs and IPOs is to be leveled, the leveling should take the form of bringing SPAC regulation up to the level of IPO regulation.").

[256] *See Redeeming SPACs*, *supra* note 11, at 47.

[257] Damodaran, *supra* note 11. On June 17, 2022, the Federal Regulation of Securities Committee of the Business Law Section of the American Bar Association issued a letter responding to the SEC's March 30, 2022 proposed rules, generally agreeing to the concept of providing robust disclosure to investors, but opposing, among other things, the requirements of fairness opinions, and the elimination of the safe harbor from forward looking statements, reasoning that these regulations would burden the SPACs much like traditional IPOs, thereby reducing the diversity of investment opportunities. *See* De Martino, *supra* note 230.

cumbersome,[258] it is important to be mindful toward ensuring the disclosure process remains more efficient than that of the traditional IPO.

As such, reform surrounding disclosure should aim to level the value of a SPAC throughout its life by ensuring each of the items being disclosed have potential to enlighten the investor in determining whether they should invest in the SPAC. In utilizing current disclosure requirements as a framework to build upon, information that adds significant value to investors should be disclosed, while information containing little to no value should be eliminated, but only when its absence does not have the potential to deceive the investor on a larger scale. Creators of subsequent SPACs should be critical of continuously implementing the SEC's informal guidance, thereby ensuring SPAC disclosure does not need subsequent regulation by the SEC.

4. Revisiting Due Diligence

Finally, turning to due diligence, the current SPAC structure is wholly lacking in consistency with due diligence.[259] On its own, many of the issues associated with disclosure could be mitigated with an increase in due diligence surrounding file creation, review, and dissemination.[260] In reforming due diligence through the SPAC model, creators should "leverage" experts to assist in the diligence process from start to finish.[261] By bringing in experts, SPACs can more quickly sort through potential mergers and formulate strategic plans for completing a more meaningful merger within the allotted time period.[262] Such a boost in due diligence further ensures SPACs are precise with all disclosed information, providing investors with confidence that SPACs are a safer—and therefore more viable—vehicle within the market.

B. Reform, Not Regulation—Why SPACs Must Self-Regulate

With clear solutions for SPAC reform in mind, it becomes important to consider how to effectuate these changes in the SPAC model in a way sufficient to afford investors with the protection they deserve, without irreparably disfiguring the unique status of the SPAC as a blank check offering. In other words, it is important to address each of the SPAC's key weaknesses—removal

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[258] *See supra* note 155.

[259] *See Redeeming SPACs*, *supra* note 11, at 46.

[260] *Id.*

[261] Kurt Chauviere, Alastair Green & Tao Tan, *Earning the Premium: A Recipe for Long Term SPAC Success*, MCKINSEY & CO. (Sept. 23, 2020), https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/earning-the-premium-a-recipe-for-long-term-spac-success.

[262] *Id.*

of voice, dilution, deficiencies in disclosure, and a lack of due diligence—without also risking the loss of its purported strengths as an alternative to the IPO—decreased cost and increased efficiency, price certainty, flexibility, and accessibility.

Various scholars have taken different positions as to how SPACs should move forward—for instance, proponents of SPACs will argue the inherent nature of the SPAC is risky and that investors have voluntarily assumed the risk by engaging with a SPAC.[263] As the regulatory regime has permitted SPACs to trade with public companies under the impression they are a more efficient alternative to the traditional IPO, it seems logical the public should be able to demand the same disclosure and investor protections afforded by alternative vehicles.[264] Thus, the vast majority of scholars have agreed that some manner of reform is necessary.[265] Some scholars have taken the position additional regulation by the SEC is the optimal solution, suggesting proposed rules which would effectively regulate SPACs in accordance with IPOs.[266] In contrast, another group of scholars has asserted the SEC's issuance of additional guidance by the SEC has sufficiently cautioned SPACs to reform themselves.[267]

This Comment argues SPAC creators should take it upon themselves to reform the SPAC structure in compliance with SEC statements and with a mindfulness to the weaknesses identified in the current form. It further argues reform is superior to regulation for three key reasons. First, SPACs are creatures of exception to the current regulatory regime.[268] By existing outside the scope of the current regulatory regime, the SPAC structure retains significant flexibility and could evolve to comport with the SEC's new issuance of statements in a matter of months.[269] Since the threat of subsequent litigation is

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[263] *See, e.g.*, *Redeeming SPACs*, *supra* note 11, at 45.

[264] *See id.* at 46.

[265] *See, e.g.*, Damodaran, *supra* note 11 (suggesting reduction in sponsor subsidy, alignment of sponsor and investor interests, loosening IPO disclosure, and reduced underwriting fees); Klausner et al., *supra* note 155, at 55–56 (proposing full disclosure of sponsor payments and cash per share to be delivered under range of merger scenarios).

[266] *See, e.g.*, Harald Halbhuber, *How to Regulate De-SPACs as IPOs*, HARV. L. SCH. F. ON CORP. GOV (May 12, 2021), https://corpgov.law.harvard.edu/2021/05/12/how-to-regulate-de-spacs-as-ipos/ (discussing potential SEC rules which would by backed by precedent).

[267] *See, e.g.*, Jasinski, *supra* note 19 ("The mere issuance of guidance from SEC has caused sponsors and their lawyers to be more cautious, said [Doug] Ellenoff, [partner at Ellenoff, Grossman & Schole,] and that means the industry doesn't need more regulation."); Riemer, *supra* note 4, at 963 ("[I]t is highly unlikely that SPACs could successfully raise capital without continuing to adhere to [Rule 419's] structure.").

[268] For a discussion on SPACs formation outside of Rule 419 and the PSRA's regulatory regime, see *supra* Section II.A.2.

[269] *See* Heyman, *supra* note 55, at 541.

always possible, SPACs will continue to comport with guidance from the SEC—especially since it has the authority to effectively remove SPACs altogether.[270] Second, evolution has demonstrated SPACs' consistency in adhering to the spirit of the regulatory regime.[271] Specifically, SPAC creators have demonstrated a commitment to adopt and modify substantially all of the investor protections outlined in Rule 419.[272] Moreover, as the SEC has issued continued guidance, SPAC activity has exhibited a temporary dip, suggesting SPAC creators have adapted to the suggestions as necessary to continue existing outside regulation.[273] Finally, additional regulation by the SEC runs the risk of overregulating the unique structure.[274] Rather than subjecting SPACs to the same regulations bogging down the traditional IPO, the SEC can effectively guide the SPAC through informal statements, with the looming threat of subsequent litigation down the road. Formal regulation runs the risk of damaging the creative and advantageous potential of the model.[275]

The implications for this argument are fairly straightforward. First, the SEC should continue to propose guidance in the form of informal statements. In issuing these informal statements, the SEC can effectively guide SPACs away from persistent issues. Since the possibility of litigation is always on deck, SPACs are very likely to adhere to new guidance—a single clear act of non-compliance could result in their demise. Second, SPACs should operate with a mindful eye; by constantly analyzing their strengths and weaknesses, SPAC creators can take on a more prominent role in continuing to evolve the SPAC form in a way most beneficial for all parties involved. As SPACs continue to evolve into safer and more profitable vehicles, their use will continue to gain popularity, allowing everyone to reap the benefits from their efficiencies.

CONCLUSION

The evolution of the SPAC structure from its fraudulent "blank check" ancestors has seen significant advancement in the past few years. Yet an analysis on the current form in light of its historic upbringing suggests it still has a long way to go. While SPACs have been touted as a more efficient, functional

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[270] *See* Jasinski, *supra* note 19 ("The mere issuance of guidance from SEC has caused sponsors and their lawyers to be more cautious . . . .").

[271] *See supra* note 98 and accompanying text.

[272] *See* Riemer, *supra* note 4, at 945.

[273] *See* Appraisal Econ., *supra* note 18 (describing temporary slow in SPAC activity resulting from SEC announcements); Jasinski, *supra* note 19.

[274] Riemer, *supra* note 4, at 963.

[275] *See id.* ("[I]t is highly unlikely that SPACs could successfully raise capital without continuing to adhere to [Rule 419's] structure.").

equivalent to the traditional IPO, the reality is that SPACs fall short of this promise, instead placing their shortcomings largely on the shoulders of the investors.

By focusing on the landscape surrounding the SPAC structure, looking to the evolution of securities market regulations, and considering the rise and evolution of the SPAC structure as an alternative to the traditional IPO, this Comment reveals the need for reform. Through self-regulation, SPACs can quickly and effectively mitigate crucial points of weakness in investor voice, dilution, disclosure, and due diligence, providing SPACs with the newfound structure to revamp their status as a creative and advantageous vehicle in the modern securities market without risking becoming regulated out of existence. Even if the SEC imposes additional regulation upon the SPAC structure, it is likely the SPAC market will find a way to work around the rules: if there is one thing the SPAC market has been successful with, it is reinventing itself.[276] Thus, the commitment to self-regulation—while daunting at a glance—provides this powerful vehicle the opportunity to continue to adapt to the market without risking becoming regulated out of existence.

CARSON S. CLEAR[*]

[276] *See supra* Part II.

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