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SPECIAL PURPOSE ACQUISITION COMPANIES (SPACS) AND THE SEC

Neal F. Newman*

Lawrence J. Trautman**

ABSTRACT

Special Purpose Acquisition Companies (SPACs) are simply enterprises that raise money from the public with the intention of purchasing an existing business and becoming publicly traded in the securities markets. If the SPAC is successful in raising money and the acquisition takes place, the target company takes the SPAC's place on a stock exchange in a transaction that resembles a public offering. Also known as "blank-check" or "reverse merger" companies, this process avoids many of the pitfalls of a traditional initial public offering.

During late 2020 and 2021 an unprecedented surge in the popularity and issuance of Special Purpose Acquisition Companies (SPACs) took place. John Coates, the SEC's Acting Director of the Division of Corporation Finance, observed, "Concerns include risks from fees, conflicts, and sponsor compensation, from celebrity sponsorship and the potential for retail participation drawn by baseless hype, and the sheer amount of capital pouring into the SPACs, each of which is designed to hunt for a private target to take public."

We discuss this popular approach to capital formation within the context of the securities issuance process and examine the robust market for SPAC issuance during 2020 and 2021. Financial reporting and auditing considerations are examined, along with regulatory concerns. Several examples of these offerings are provided. We believe this paper adds to the discussion and understanding of this widely employed financing mechanism.

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Keywords: acquisitions, blank check, capitalization, corporate finance, entrepreneurship, ETFs, governance, initial public offering, issuance, M&A, mergers, private equity, regulation, reverse merger, risk, SEC, securities law, special purpose acquisition companies, SPACs, start-up, venture, withdrawal

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OVERVIEW

During late 2020 and 2021 an unprecedented surge in the popularity and issuance of Special Purpose Acquisition Companies (SPACs) took place. Regulator John Coates, the SEC’s Acting Director of the Division of Corporation Finance, observed that his, “Concerns include risks from fees, conflicts, and sponsor compensation, from celebrity sponsorship and the potential for retail participation drawn by baseless hype, and the sheer amount of capital pouring into the SPACS, each of which is designed to hunt for a private target to take public.”¹

Our article proceeds in seven parts. First, we explain Special Purpose Acquisition Companies (SPACs) and their benefits, and we introduce the issuance process basics. Second, we examine the recent robust market for SPAC issuance during 2020 and 2021. Third, we offer a detailed discussion of the securities issuance process as applicable to SPACs. Fourth, we look at financial reporting and auditing considerations. Fifth, we provide an example of Topps Co.’s failed attempt at public listings of their securities via the SPAC process. Sixth, we take a look at a recent SPAC enforcement action by the SEC. Lastly, we conclude. SPACs have provided a source of needed capital during 2020 and 2021. We believe this paper adds to the discussion and understanding of this widely employed financing mechanism.

1. John Coates, *SPACs, IPOs and Liability Risk Under the Securities Laws*, SEC (Apr. 8, 2021), <https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws> [<https://perma.cc/75UA-AH6G>].

I. WHAT IS A SPAC?

Special Purpose Acquisition Companies (SPACs) are simply enterprises that raise money from the public with the intention of purchasing an existing business, thereby achieving liquidity and becoming publicly-traded in the securities markets. According to the SEC, the popularity of SPACs is due, at least in part, to the belief that “a private company can become a publicly traded company with more certainty as to pricing and control over deal terms as compared to traditional initial public offerings.”²

In sum:

These types of transactions, most commonly where a SPAC acquires or merges with a private company, occur after, often many months or more than a year after, the SPAC has completed its own IPO. Unlike an operating company that becomes public through a traditional IPO, however, a SPAC is a *shell company* when it becomes public. This means that it does not have an underlying operating business and does not have assets other than cash and limited investments, including the proceeds from the IPO.³

A. Benefits

If the SPAC is successful in raising money and the acquisition takes place, “the target company takes the SPAC’s place on a stock exchange, in a transaction that resembles a public offering.”⁴ Also known as “blank-check” or “reverse merger” companies, this process avoids many of “the pitfalls of a traditional initial public offering.”⁵ Although receiving a robust investor response during 2020 and early 2021, this financial device is not new. One of your authors, Professor Trautman, a former New York City investment banker at Donaldson, Lufkin & Jenrette and past-president of the New York City and Washington / Baltimore chapters of the National Association of Corporate Directors (NACD), successfully employed this strategy many years ago to capitalize a start-up oil and gas company during

2. *What You Need to Know About SPACs — Updated Investor Bulletin*, SEC. & EXCH. COMM’N (May 25, 2021), <https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin> [<https://perma.cc/P8K3-FZKA>].

3. *Id.* See also Yochanan Shachmurove & Milos Vulanovic, *SPAC IPOs*, OXFORD HANDBOOK OF IPOs, (Douglas Cumming & Sofia Johan, eds., forthcoming 2017), <https://ssrn.com/abstract=2898102> [<https://perma.cc/6DE4-J29G>] (discussing SPACs’ performances since their IPOs).

4. Dave Michaels, *SPAC Warrants Draw SEC Scrutiny*, WALL ST. J., Apr. 13, 2021, at B1.

5. Peter Santilli & Amrith Ramkumar, *Financial Conditions Fuel Creation of Blank-Check Firms*, WALL ST. J., Mar. 30, 2021, at B9.

a global recession and historical downturn in petroleum prices.⁶ This took place during a time when West Texas Intermediate Crude was trading at about nine dollars a barrel and traditional bank financing for petroleum assets in Texas was essentially non-existent because most regional banks were in the process of failing and being acquired by institutions outside the region. The Trautman-led group of investors was able to take a moribund shell of a company that had been in the SEC reporting system for years and employ its publicly-traded securities and traditional bank financing from outside the Texas region to acquire oil assets at historically depressed prices. Fast forward and this entity is now successfully listed on the New York Stock Exchange.⁷ Connor Moore, National Leader of KPMG Private Enterprise, cautions those considering a SPAC:

Speed is often touted as a key benefit for merging with a SPAC. But the reality is that SPACs are not simple transactions. They are closely regulated by the SEC, which means sellers must still complete the normal SEC filing requirements, audit requirements, and due diligence processes. And they must do it all in a compressed timeline. Many private companies simply don't have the appropriate processes or structures in place to do it all properly in an aggressive timeframe.⁸

B. The Process

In short, the registrant files a registration statement with the Commission that simply documents the SPAC investment, disclosing an abbreviated fact pattern since the traditional history, description of business, risk factors, and financials are not yet available for an unknown target acquisition. After successfully raising money, "SPACs typically have two years to complete a deal or they must return the remaining IPO proceeds to the investors. 'Lately [in 2021], many have only needed a few months to

6. See generally Comstock Res., Inc., Annual Report (Form 10-K) (Feb. 17, 2021), <https://www.sec.gov/ix?doc=/Archives/edgar/data/23194/000002319421000015/crk-20201231.htm> [<https://perma.cc/8KT6-G8LD>] (describing Comstock's business, operations, and strategies).

7. Lawrence J. Trautman, *Present at the Creation: Reflections on the Early Years of the National Association of Corporate Directors*, 17 DUQ. BUS. L.J. 1, 21 (2015), <http://ssrn.com/abstract=2296427> [<https://perma.cc/A96T-VHAR>].

8. *The Reality of SPAC Mergers*, KPMG (Mar. 5, 2021), https://www.kpmg.us/insights/2021/ps82-reality-spac-mergers.html?utm_source=google&utm_medium=cpc&mid=m-00004742&utm_campaign=c-00101688&cid=c-00101688&gclid=CjwKCAjwjdOIBhA_EiwAHz8xmysrM_oqCEzvIo2vsrz0Df6dcJPRWbX6Q-j3YsDFvxI0zqlh_-pcEB0CQuCQAvD_BwE [<https://perma.cc/3EFN-Y3TU>].

announce mergers.”⁹ One of the major benefits of employing the SPAC vehicle for private firms is that “their valuation is finalized with a small group of . . . [negotiators] behind closed doors before a deal is announced. [While] in a traditional IPO [initial public offering], pricing can change [dramatically] until the night before shares start trading.”¹⁰ The Wall Street Journal reports:

In the stock market, the SPAC has three lives. The first comes after the IPO, when the company’s only asset typically is \$10 in cash per share. The stock trades around \$10, and savvy investors can make money anytime the price falls too low by getting cash at a discount.

The second occurs after the merger is announced, when the shares often swing based on how investors perceive the deal.

The third happens after the merger is completed, when the shares rise and fall based on the new company’s outlook, just like any other stock. Because the private firm gets the SPAC’s place on a stock exchange, the name of the stock and ticker symbol typically change to reflect the name of the newly public company.¹¹

Professors Gahng, Ritter and Zhang demonstrate that:

From a private operating company’s point of view . . . merging with a SPAC is much more expensive than a traditional IPO. The cost to the median company of going public, as a percentage of post-merger or post-issue market cap, is 14.6% when merging with a SPAC, vs. 3.2% when using a traditional IPO.¹²

Gahng, Ritter and Zhang question, “Then why do some companies still choose a SPAC merger over a traditional IPO?”¹³ Accordingly, they “identify the economic roles of SPAC sponsors and SPAC IPO investors and how these roles can create relative advantages of merging with a SPAC.”¹⁴ Consider:

Specifically, for some operating companies, it is believed that merging with a SPAC is a quicker way to raise capital and go public than a traditional IPO. Although our numbers do not support the idea that merging with a SPAC is necessarily faster than conducting a traditional IPO, we posit that the conventional

9. Santilli & Ramkumar, *supra* note 5.

10. *Id.*

11. *Id.*

12. Minmo Gahng, Jay R. Ritter & Donghang Zhang, SPACs 41 (Feb. 22, 2021) (unpublished manuscript), <https://ssrn.com/abstract=3775847> [<https://perma.cc/V3Z2-FP3T>]

13. *Id.*

14. *Id.*

wisdom that ‘merging with a SPAC is faster’ influences the decision making. . . . Importantly, until recently, the conventional wisdom was that the merger permits the sponsor to make forward-looking statements that fall under the safe harbor provisions of U.S. merger law, whereas a traditional IPO does not offer these safe harbor provisions, although recent statements from the SEC may reduce this regulatory arbitrage. Furthermore, the redemption option that SPAC public shareholders have incentivizes the SPAC sponsor to negotiate a deal that is favorable to both the operating company and the SPAC shareholders, in order to induce the shareholders to approve the merger and not redeem their shares. . . . Alternatively stated, the redemption option helps align sponsor and public shareholder interests.

We document that the sponsors frequently take haircuts in order to ensure that the SPAC has enough cash to consummate the merger. Sponsors often give up some of their shares (17% on average) and/or warrants (19% on average). Frequently, these forfeitures are transferred to some existing shareholders to induce them not to redeem, or to PIPE investors to induce them to inject cash. Furthermore, the IPO underwriters sometimes agree to forego some of their deferred compensation to ensure the completion of a merger. Importantly, these haircuts are state-contingent: sponsors take larger haircuts and provide more inducements, and underwriters surrender commissions more, for weaker deals. Increasingly, some sponsor shares are subject to vesting provisions, resulting in additional forfeitures if stock price targets are not achieved. Thus, we show that average sponsor profits are not as lucrative as sometimes assumed, especially for underperforming deals.¹⁵

Professors Rodrigues and Stegemoller observe that SPAC:

contract design borrows heavily from private equity’s playbook. Private equity managers famously (and sometimes controversially) receive 20% of their fund’s profits, and funds typically last only ten years. From the traditional 20% incentive compensation to a short investment shelf life, SPAC entrepreneurs tried to transfer many hallmarks of the private equity contract to the public market.¹⁶

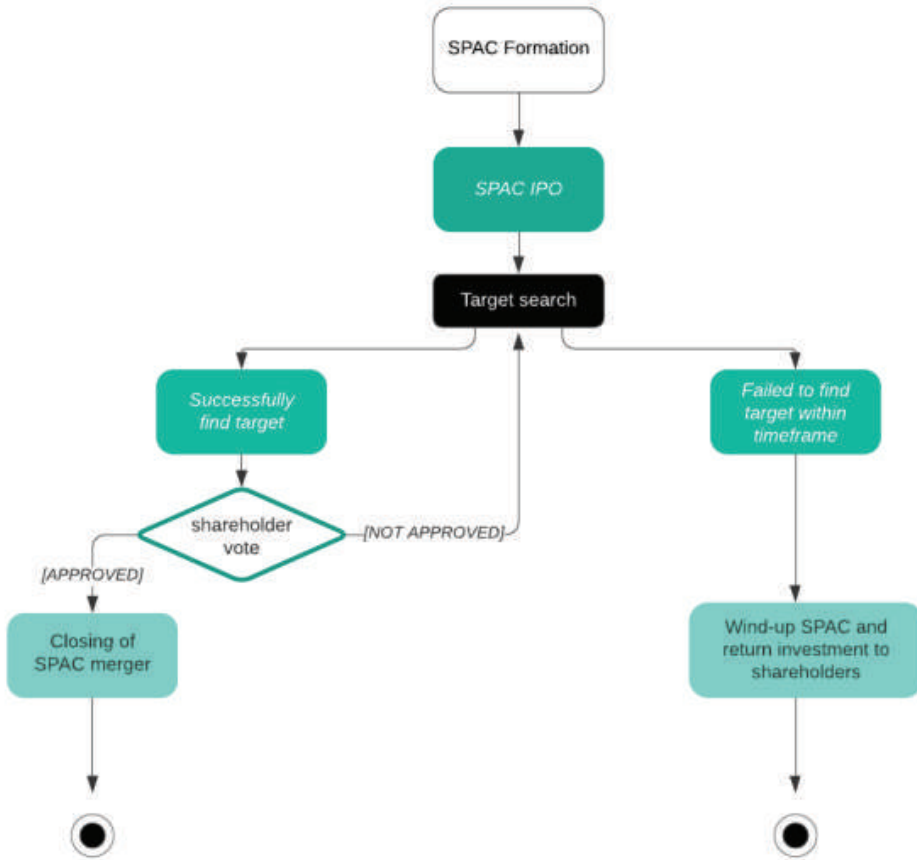
Courtesy of professors Chong, Zhong, Li, Li, Agrawal, and Zhang,

15. *Id.* at 41–42.

16. Usha Rodrigues & Mike Stegemoller, *Exit, Voice, and Reputation: The Evolution of SPACS 1* (U. Ga. Legal Stud. Rsch. Paper Series, Paper No. 11-12, 2015), <https://ssrn.com/abstract=1948642> [<https://perma.cc/3N2W-JKYP>].

Exhibit 1 depicts the different phases of a SPAC investment.¹⁷

Exhibit 1



Different Phases of a SPAC Investment¹⁸

17. Eason Chong et al., *Comprehensive Study of Special-Purpose Acquisition Company (SPAC): An Investment Perspective* 3 (June 11, 2021) (unpublished manuscript), <https://ssrn.com/abstract=3862186> [<https://perma.cc/XF63-SZRB>].

18. *Id.*

II. ROBUST MARKET FOR SPAC ISSUANCE

Rampant capital formation has become available to many early-stage enterprises upon attractive pricing terms not historically achievable during most traditional initial public offering environments. By January 2021, *The Wall Street Journal* observed, “The hottest thing in finance is four letters long . . . It’s called a SPAC, and increasingly it is the favored source of financing for private companies looking to go public . . . Nearly 300 SPACs are now seeking deals, armed with about \$90 billion in cash.”¹⁹ During the first month of 2021 alone, “more are rolling out at a furious clip — so far this year, an average of five new SPACs launched each business day.”²⁰ Consider that during just the first three weeks of January 2021, “SPACs are pulling in more than 70% of all money raised through initial public offerings . . . up from nearly half last year and about 20% the year before.”²¹ And during the first three weeks of January 2021 alone, “the 67 SPACs created . . . have already raked in nearly \$20 billion from investors. That is well above the total from all of 2019, which was a record before last year’s historic haul of \$82 billion.”²² These developments come at a time following Administration change, new leadership at the U.S. Securities and Exchange Commission,²³ volatile securities markets,²⁴ emerging technologies such as

19. Amrith Ramkumar & Maureen Farrell, *Attack of the SPACs*, WALL ST. J., Jan. 23, 2021, at B1.

20. *Id.*

21. *Id.*

22. *Id.*

23. See Press Release 2021—65, Sec. & Exch. Comm’n, Gary Gensler Sworn in as Member of the SEC (Apr. 17, 2021), <https://www.sec.gov/news/press-release/2021-65> [<https://perma.cc/CH2G-QZHX>] (evidencing a change in SEC leadership).

24. See generally Lawrence J. Trautman, Personal Ethics & the U.S. Financial Collapse of 2007–08 (Aug. 12, 2017) (unpublished manuscript), <http://ssrn.com/abstract=2502124> [<https://perma.cc/5VNU-KSS6>] (discussing numerous problems intertwined with the markets).

virtual currencies²⁵ and initial coin offerings²⁶ that require new regulatory structures to keep pace.²⁷

Harvard professor Max Bazerman and co-author Paresh Patel provide this overview: “In 2019, 59 [SPACs] were created, with \$13 billion invested; in 2020, 247 were created, with \$80 billion invested; and in the first quarter alone of 2021, 295 were created, with \$96 billion invested . . . In 2020, SPACs accounted for more than 50% of new publicly listed U.S. companies.”²⁸ While announced or completed SPAC mergers are too numerous to list, a few sample transactions include: NYSE parent’s crypto unit Bakkt (expected valuation approaching \$2.1 billion);²⁹ maker of small rockets Astra Space (announced

25. See generally Lawrence J. Trautman & George P. Michaely, *The SEC & The Internet: Regulating the Web of Deceit*, 68 CONSUMER FIN. L.Q. REP. 262 (2014), <http://www.ssrn.com/abstract=1951148> [<https://perma.cc/VB5P-8RDQ>] (describing cyber-securities challenges that are the result of the evolution of Internet technology and capital formation); Lawrence J. Trautman, *Virtual Currencies: Bitcoin & What Now After Liberty Reserve, Silk Road, and Mt. Gox?*, 20 RICH. J.L. & TECH. 13 (2014), <http://www.ssrn.com/abstract=2393537> [<https://perma.cc/FSR4-CYY6>] (describing virtual currency regulation, payment systems, and cybercrimes); Lawrence J. Trautman et al., *Governance of The Internet of Things (IoT)*, 60 JURIMETRICS 315 (2020), <http://ssrn.com/abstract=3443973> [<https://perma.cc/YKD2-QJLH>] (highlighting challenges facing humans in corralling and regulating the vastness of the Internet); Lawrence J. Trautman & Alvin C. Harrell, *Bitcoin Versus Regulated Payment Systems: What Gives?*, 38 CARDOZO L. REV. 1041 (2017), <http://ssrn.com/abstract=2730983> [<https://perma.cc/7NMV-XCRL>] (addressing Bitcoin and other virtual currencies as they interact with legal and financial systems); Lawrence J. Trautman, *Is Disruptive Blockchain Technology the Future of Financial Services?*, 69 CONSUMER FIN. L.Q. REP. 232 (2016), <http://ssrn.com/abstract=2786186> [<https://perma.cc/CB6R-A8VF>] (underscoring the promises and challenges financial service providers must endure as blockchain technology revolutionizes financial services).

26. See generally Neal Newman & Lawrence J. Trautman, *Securities Law: Overview and Contemporary Issues*, 16 OHIO ST. BUS. L.J. 149 (2021), <http://ssrn.com/abstract=3790804> [<https://perma.cc/QC2W-C42P>] (analyzing Bitcoin and other virtual currencies).

27. See generally Lawrence J. Trautman, *Bitcoin, Virtual Currencies and the Struggle of Law and Regulation to Keep Pace*, 102 MARQ. L. REV. 447 (2018), <https://ssrn.com/abstract=3182867> [<https://perma.cc/7KKD-UVCU>] (describing technological changes such as blockchain that disperse quicker than laws and regulations); Lawrence J. Trautman, *Rapid Technological Change and U.S. Entrepreneurial Risk in International Markets: Focus on Data Security, Information Privacy, Bribery and Corruption*, 49 CAP. U.L. REV. 67 (2021), <https://ssrn.com/abstract=2912072> [<https://perma.cc/L624-4GRL>] (emphasizing the risks associated with rapid technological change and Internet growth).

28. Max H. Bazerman & Paresh Patel, *SPACs: What You Need to Know*, HARV. BUS. REV., July–Aug. 2021, <https://hbr.org/2021/07/spacs-what-you-need-to-know> [<https://perma.cc/K8Z4-7DN5>].

29. Alexander Osipovich, *NYSE Parent’s Crypto Unit to Go Public*, WALL ST. J., Jan. 12, 2021, at B1.

\$2.1 billion valuation;³⁰ electric air-taxi developer Archer;³¹ quantum-computing start-up IonQ (\$2 billion valuation);³² shared-office provider WeWork (\$9 billion announced valuation);³³ and ride-hailing company Grab Holdings Inc. (near-\$40 billion valuation),³⁴ just to name a few.

A. History of “Blind Pools”

As shown by Professor Trautman’s experience several decades ago, “SPACs have actually been around for decades. Their predecessors—known as ‘blind pools’—had a shady reputation on Wall Street in the 1980s because they were tied to penny-stock fraud.”³⁵ Some younger readers of this article may not be aware that the market reception to new issuances is very cyclical and not available to many at all during long stretches of months or years. During recent years, “SPACs turned hot for brief periods in the ‘90s, then again in the 2000s, only to fade with market crashes or a surge in traditional IPOs. New laws and regulations helped booster their reputation, as did changes [helping] investors to get their money back before a deal went through.”³⁶

B. Why SPACs? Why Now?

What are the motivating factors responsible for the popularity of the SPAC financing vehicle? The Wall Street Journal reports, “These deals are generating a lot of interest because they produce big paydays for their creators, make it easier for startups in hot industries such as electric vehicles to capitalize on a frothy run-up in the stock market and offer everyday investors a new path to a hot stock.”³⁷ In retrospect, it appears the gold rush “began last March [2020] when the coronavirus pandemic hit, prompting concerns the IPO market would be hampered for months. Some tech companies and venture capitalists saw SPACs as a way to raise money

30. Andy Pasztor & Eliot Brown, *Rocket Startup Set to Go Public at \$2.1 Billion Value*, WALL ST. J., Jan. 3, 2021, at B7.

31. Jon Sindreu, *Blank-Check Firms Take to Air*, WALL ST. J., Feb. 12, 2021, at B10.

32. Sara Gastellanos, *Startup IonQ Plans its Public Debut in \$2 Billion SPAC*, WALL ST. J., Mar 9, 2021, at B5.

33. Maureen Farrell & Elliot Brown, *WeWork Set to Go Public in SPAC Merger*, WALL ST. J., Mar. 27–28, 2021, at A1.

34. Jing Yang & Maureen Farrell, *Grab to Go Public in Record SPAC*, WALL ST. J., Apr. 14, 2021, at A1.

35. Ramkumar & Farrell, *supra* note 19.

36. *Id.*

37. *Id.*

without being subjected to the whims of the suddenly volatile stock market.”³⁸

During 2020 alone, “SPACs raised \$82 billion in the U.S. . . . even as the global pandemic sent shockwaves through businesses and households. Underwriting those deals and other stock offerings created a surprisingly good year for the biggest investment banks.”³⁹ While these impressive underwriting results were not all the result of SPACs, “Goldman’s equity underwriting brought in a record \$1.12 billion in fees in the fourth quarter, nearly triple what it had the year before. For the year [results were] more than double. . . .”⁴⁰ Elsewhere, “because it was second in helping launch new SPACs, [Citigroup, Inc.’s] equity underwriting revenue increased 83% in the fourth quarter and 64% for the year. . . . And smaller Jefferies Financial Group, Inc., a big SPAC supporter, . . . more than tripled its equity underwriting fees.”⁴¹

Harvard professor Maria Lucia Passador writes, “Were we to distill 2020 into a single word, from the capital markets’ perspective at least, it would certainly be SPACs, which — although to a different extent — are now having their momentum on both shores of the pond.”⁴² Her study of SPACs brought to market between January 2010 and December 2019 (pre-Covid) is intended to uncover structural changes and reasons for their recent resurgence. Professor Passador contends that SPACs are likely to “evolve for good” during the near future, “as they have showed themselves capable of doing in the past, thus overcoming the problems and perplexities raised about them.”⁴³

In addition to investment banks and traditional institutional investor-backed venture capital firms, during the pandemic economy of 2020-21, a number of celebrities and those with name recognition have become promoters of SPACs. Among the rich and famous sponsors include: entertainers Ciara, Sammy Hagar, and Jay-Z; sports figures Alex Rodriguez, Steph Curry, Colin Kaepernick, Shaquille O’Neal, and Serena Williams; former Oakland A’s manager Billy Beane—even “[f]ormer House Speaker Paul Ryan joined one.”⁴⁴ Sponsors from the world of business and finance

38. *Id.*

39. David Benoit, *The Other SPAC Winners: Big Banks*, WALL ST. J., Jan. 23, 2021, at B6.

40. *Id.*

41. *Id.*

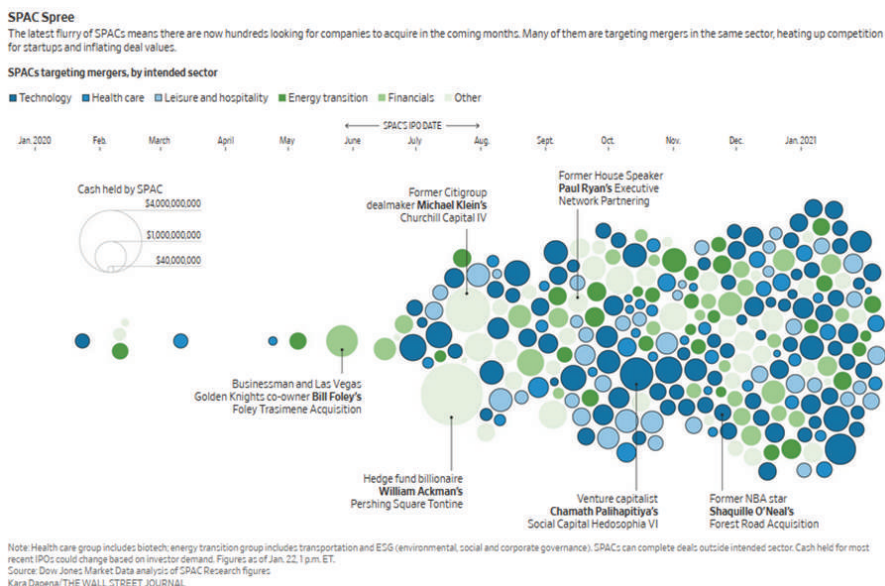
42. Maria Lucia Passador, *In Vogue Again: The Re-Rise of SPACs in the IPO market 1* (Bocconi Legal Stud., Research Paper No. 3820957; Univ. Lux., Law Working Paper No. 2021-005, 2021), <https://ssrn.com/abstract=3820957> [perma.cc/D3MM-9DRQ].

43. *Id.*

44. See Steven Kurutz, *Big Names Like a Once-Obscure Investment: The SPAC*, N.Y.

include Peter Thiel, Richard Branson, Bill Ackman, Michael Ovitz, and Sam Zell, just to name a few.⁴⁵ Exhibit 2 illustrates the rampant SPAC activity during early 2021.

Exhibit 2



Robust SPAC Activity During Early 2021⁴⁶

While many examples exist, and we will look at several, a good place to start our examination of recent developments is to look at the description provided by journalist Andrew Ross Sorkin as he describes how, “In the summer of 2019, Chamath Palihapitiya, a billionaire venture capital investor, announced that his public shell company would merge with Richard Branson’s spaceflight business, Virgin Galactic.”⁴⁷ Journalist Sorkin describes:

TIMES, Feb. 28, 2021, at ST3 (discussing prominent individuals involved with SPACs); see also Amrith Ramkumar, *SEC Probes Trump SPAC Deal*, WALL ST. J., Dec. 7, 2021, at B1 (SPAC sponsored by former President Donald Trump).

45. See Amrith Ramkumar, *Celebrities Fuel Blank-Check Boom*, WALL ST. J., Mar. 18, 2021, at B1 (listing several individuals from the business and finance sector who are involved with SPACs).

46. Ramkumar & Farrell, *supra* note 19.

47. See Andrew Ross Sorkin, *Blank Check for Everyone But Investors*, N.Y. TIMES, Apr. 1, 2021, at B1 (discussing a recent development regarding SPACs).

With his usual bravado, Mr. Palihapitiya compared Virgin Galactic to Tesla on the day of the deal's announcement and forecast that it would reach "profitability in mid-2021 and should achieve real scale by '22." The company published an illustrated presentation for investors with financial projections out to 2023.

Mr. Palihapitiya sold the deal to public investors — many of whom were mesmerized by his words and the future of space travel — in part by investing \$100 million of his own money into the business, a demonstration of his commitment to the future of the company.

Yet this past month, without warning to all those investors who had followed him into the stock, he sold those shares. "I hated to do it but my balance sheet shrank by almost \$2 billion this week," he wrote on Twitter. He maintains a significant stake in Virgin Galactic through his holding company's "sponsor" stake, which is the equity that a SPAC's founders receive in exchange for putting the deal together and making a small investment.

The sale illustrated an uncomfortable truth about the SPACs that are transforming the financial world: Investors and celebrities who put their names behind the next big headline-grabbing merger can exit long before any of those projections are ever realized or, in many cases, missed. (Virgin Galactic's flight timetable has slipped, forcing it to revise its forecasts).⁴⁸

Fast-forward to early May 2021 and *The Wall Street Journal* writes, "Virgin Galactic reported first-quarter earnings six days after it originally intended, following the Securities and Exchange Commission's statement that some special-purpose acquisition companies . . . have improperly accounted for warrants. Redoing the numbers resulted in an extra \$49 million expense, which made Virgin's losses look steeper."⁴⁹

C. Warnings Emerge

As early as January 2021, cracks in the foundation of this enthusiastic parade-to-market became noticed. *The Wall Street Journal* observed, "even some of the people getting rich off the blank-check boom caution that the euphoria could be part of a bubble that overvalues nascent companies. If it bursts, it could leave a few insiders as winners while saddling individual investors who got in late with big losses."⁵⁰ As we will discuss more fully later in this article, in many ways sponsors of these investments enjoy

48. *Id.*

49. Jon Sindreu, *Space SPACs Face Threat --- Investors Should Be Worried About Regulators' Eagerness to Cool the Market*, WALL ST. J., May 12, 2021, at B12.

50. Ramkumar & Farrell, *supra* note 19.

advantages from a relatively high benefit, low risk structure.⁵¹ This results because of the transaction structure when the sponsors, as The Wall Street Journal explains, “initially put up a small amount to cover expenses before the SPAC goes public and then are typically allowed to buy 20% of the company at a deep discount after the SPAC combines with another firm. This allows them to generate returns several times their original investment.”⁵²

Following analysis of SPAC IPOs in the United States, professors Blomkvist and Vulcanovic conducted a study, “using a hand-collected data set of the entire SPAC population since their emergence in 2003. [They] find that both the SPAC volume and SPAC share of total IPOs are negatively related to market-wide uncertainty (VIX) and time-varying risk aversion (variance risk premium).”⁵³ Basing their results on data collected before the late 2020 and early 2021 explosion in investor SPAC interest, Blomkvist and Vulcanovic, “attribute [their] findings to risk-averse investors’ reluctance to invest in opaque securities. In response, the SPAC sponsor can credibly signal the issue’s quality by increasing their ‘skin in the game’ through the purchase of additional warrants.”⁵⁴

Well-connected executives, private equity (PE) firms, or hedge fund sponsors of SPACS are often criticized because they, “receive a ‘promote’ - a material equity stake in the SPAC for a nominal purchase price - and options to purchase warrants in the SPAC, and these benefits often materialize significant profits for the sponsor, even on companies that struggle post-SPAC, because of the promotes exceptionally low acquisition cost.”⁵⁵ Bill Ackman, a prominent hedge fund billionaire, “has specifically criticized the ‘misaligned incentives’ in the compensation structure of SPACs between sponsor interests and ordinary investors (including long-term shareholders) since the discounted shares, and other standard fees, create a ‘drag’ on the latter’s returns.”⁵⁶ Professor Ryan Clements refers to the Klausner, Ohlrogge, and Ruan study⁵⁷ to:

51. See *infra* Part IV (discussing financial reporting and auditing considerations).

52. Ramkumar & Farrell, *supra* note 19.

53. See Magnus Blomkvist & Milos Vulcanovic, *SPAC IPO Waves*, 197 *ECON. LETTERS* (2020), <https://ssrn.com/abstract=3686498> [perma.cc/K3H7-P668] (discussing the results of their study on SPACs).

54. *Id.*

55. See Ryan Clements, *Misaligned Incentives in Markets: Envisioning Finance That Benefits All of Society*, *DEPAUL BUS. & COMM. L.J.* 1, 28 (2021), <https://ssrn.com/abstract=3802178> [perma.cc/WUA9-V7PE] (describing a feature given to several individuals and entities in a SPAC deal).

56. *Id.*

57. Michael Klausner, Michael Ohlrogge & Emily Ruan, *A Sober Look at SPACs*, 39

identify an additional “incentive misalignment” between sponsors and ordinary investors in the common practice of the sponsors infusing the SPAC initial public offering with several hundred million dollars because the investment will be lost if a merger doesn’t take place; therefore the sponsor may pressure the SPAC to merge on terms unattractive to long-term shareholders.⁵⁸

Professor Mira Ganor observes that, “shareholder action is exercised mainly through a binary system: for example, the shareholders vote either to approve a proposal or to reject it.”⁵⁹ Because almost half of U.S. IPO transactions have been in the form of SPACs, Professor Ganor offers this, “is one example that illustrates the weakness of the binary system and the consequent vulnerability of small and unsophisticated shareholders. Remarkably, investors in SPACs can vote ‘yes’ on management proposed acquisition transactions and nonetheless, simultaneously choose to redeem their shares.”⁶⁰ Therefore, “Unsophisticated retail investors may not realize that they, as well, will be better off if they redeem their shares even though the transaction received the approval of the majority of the shareholder vote.”⁶¹ Professor Ganor advances:

a proposal to amend the law and allow shareholders to act in a way that is contingent on a simultaneous non-contingent action by other shareholders. For example, a shareholder of a SPAC should be able to choose to redeem her shares if and only if at least a specified percentage of redemption rights are exercised unconditionally. Similarly, a shareholder who has preemptive rights should have the right to exercise her rights with a limit that caps her participation and maintains her percentage holdings in the company.

Generally, shareholders should have the option to act contingently when they are exercising a shareholder right, such as preemptive rights or appraisal rights, and when they are given a choice to participate in transactions such as tender offers and stock-buybacks. Unlike mandatory disclosure rules imposed on insiders, the proposed non-binary, contingent, shareholder action treats all shareholders equally and increases the power of the shareholder’s action without incurring high costs of collaboration and

YALE J. REG. (forthcoming 2022) (hereinafter Klausner, et. al.), <https://ssrn.com/abstract=3720919> [perma.cc/S9BW-XJT9].

58. See Clements, *supra* note 55, at 28; see also *infra* §IV (discussing regarding corporate governance).

59. Mira Ganor, *The Case for Non-Binary, Contingent, Shareholder Action*, 23 U. PA. J. BUS. L. 390, 390 (2021), <https://ssrn.com/abstract=3530596> [perma.cc/8U8M-J952].

60. *Id.* at 391.

61. *Id.* at 408.

communication among the shareholders.⁶²

D. After-Market Price Performance

In a study and analysis of 47 SPACs that merged between January 2019 and June 2020, Professors Klausner, Ohlrogge, and Ruan find “that costs embedded in the SPAC structure are subtle, opaque, higher than has been previously recognized, and higher than the cost of an IPO.”⁶³ Consider:

Although SPACs raise \$10.00 per share from investors in their IPOs, by the time a SPAC merges with a private company to take it public, the SPAC holds far less in net cash per share to contribute to the combined company. For SPACs that merged during our primary sample period of January 2019 through June 2020, mean and median net cash per share were \$4.10 and \$5.70, respectively. Between June 2020 and November 2021, net cash per share was somewhat higher but far below \$10. We find that SPAC costs are not born by the companies they take public, but instead by the SPAC shareholders who hold shares at the time SPACs merge. These investors experience steep post-merger losses, while SPAC sponsors profit handsomely.⁶⁴

Klausner et al. conclude, “by suggesting that the SEC promulgate disclosure requirements specific to SPAC mergers that make clear SPACs’ costs and sponsors’ incentives, and that equalize regulatory preferences that SPACs enjoy compared to IPOs.”⁶⁵ During July 2021, Professors Gahng, Ritter, and Zhang write:

From an investor’s point of view, between the SPAC IPO and the business combination or liquidation, we find lucrative risk-adjusted returns considering the downside protected nature of the investment. Specifically, for 210 SPAC IPOs purchased at the offer price from January 2010 – December 2019, the average annualized return during this SPAC period has been 15.9%, with all 210 returns being positive. Investing in SPAC IPOs can be viewed as investing in underpriced *default-free* convertible bonds with extra warrants. Our back of the envelope calculation shows that the SPAC IPO investors are being given free warrants.

On the other hand, investor returns in the deSPAC period on the merged companies are mixed. For the 114 SPACs that completed a merger with an

62. *Id.* at 391.

63. Klausner, et al., *supra* note 57, at 1.

64. *Id.*

65. *Id.*

operating company from January 2012 – September 2020, weighting each deal equally, common share investors have lost money on average, while warrant investors have earned positive returns. The equally weighted average one-year return on the merged company shares has been -8.1%, underperforming the market by 24.7%. However, investor returns on a dollar-weighted basis are not as bad as the EW numbers would suggest, with a dollar-weighted average return of 4.5%. This improvement is due to the tendency for investors to redeem many of the shares for the mergers that generate disappointing subsequent returns. For the 105 out of 114 merged companies that had outstanding warrants, the EW average one-year return has been 68.0%. Consequently, focusing exclusively on the EW common share returns paints a worse picture of the deSPAC period investment returns than the average public investor experience.⁶⁶

During April 2021, *The Wall Street Journal* reported that three new exchange-traded funds were playing the SPAC market, with a mixed verdict thus far.⁶⁷ Also during April 2021, headlines start to appear warning, “SPACs’ Red-Hot Streak Begins To Cool: Increased regulatory scrutiny of alternative path to going public puts damper on trend.”⁶⁸ During May 2021, a Thompson Reuters study found that over 100 SPACs “that announced mergers this year on average have gained under 2% from the price they traded at when they first listed on the stock exchange. Most . . . began trading last year, and the group’s median performance has trailed the S&P 500 by 15 percentage points.”⁶⁹ Professors Gahng, Ritter, and Zhang observe:

The SPAC market has experienced rapid changes recently. In the first quarter of 2021, 298 SPACs went public with an average first-day return of 3.7%. This is a significant jump from the 1.6% average in 2020, which was already higher compared to prior years. Until the end of 2020, the SPAC period return was mostly realized when the merger is announced. However, the average first-day return of 3.7% in the first quarter of 2021 shows that the

66. See Gahng, Ritter & Zhang, *supra* note 12, at 40–41; see also Tim Jenkinson & Miguel Sousa, *Why SPAC Investors Should Listen to the Market*, 21 J. APPLIED FIN. (2015), <https://ssrn.com/abstract=2691586> [<https://perma.cc/XB84-3X2T>] (asserting that investors should pay close attention when investing in SPACs).

67. Tim Mullaney, *The SPAC Attack Spreads to ETFs*, WALL ST. J., Apr. 5, 2021, at R5 (describing how SPACs have spread to the ETF market).

68. Dave Michaels, Amrith Rankumar & Alexander Osipovich, *SPACs’ Red-Hot Streak Begins to Cool*, WALL ST. J., Apr. 17, 2021, at A1.

69. Noel Randewich, *Analysis: SPAC Returns Trail S&P 500 as Retail Investors Temper Interest*, REUTERS (May 4, 2021), <https://www.reuters.com/business/spac-returns-trail-sp-500-retail-investors-temper-interest-2021-05-04/> [perma.cc/8D9F-2DEC].

market started to reprice the SPAC units immediately, reducing the abnormal returns for investors who purchase SPACs in the market, similar to what we find for operating company IPOs.⁷⁰

According to BoardRoomAlpha.com, “October through December [2021] alone saw over 160 SPACs price IPOs (49 in December) for over \$9B in fresh SPAC capital. Though, in order to get these deals done, the terms have gotten significantly sweeter for investors which, in turn, eats away at the sponsor’s economic returns.”⁷¹ In addition:

[R]ampant issuance is still upon us and given that a large portion of new issues in the last three months were from first time sponsor groups, we’d expect to see a continuation of some of this behavior in the new year, with increasingly advantageous investor terms fueling it. . . . There are currently over 570 SPACs actively looking for a merger target. 2022 will surely start to get some SPACs nervous as their deal deadlines will start approaching in far greater numbers than we have seen in 2020 and 2021. While liquidations are certain to rise relative to historical numbers, we’d expect most sponsors to do everything that they can to get *something* over the finish line. That will translate to a much larger increase in ‘bad’ SPAC deals than liquidations. . . . Overall. . . deal enthusiasm is muted with the majority of announced-deal SPACs still trading close to NAV [net asset value] with about ¾ trading below their \$10 offer prices.⁷²

III. THE SECURITIES ISSUANCE PROCESS

A. General

From a regulatory and compliance standpoint, a SPAC initial public offering (IPO) works the same as a traditional IPO. The SPAC is required to prepare a Registration Statement that needs to be filed with the Securities and Exchange Commission. Same as in the traditional IPO context, the SPAC’s Registration Statement must be prepared in accordance with Regulation S-K and Regulation S-X.⁷³ Appropriate Risk Factors, Description of the Business, Management Bios, and audited financial

70. See Gahng, Ritter & Zhang, *supra* note 12, at 42.

71. David Drapkin, *SPAC Market Review – December 2021*, BOARDROOMALPHA (Dec 29, 2021), <https://www.boardroomalpha.com/spac-market-review-december-2021/> [perma.cc/H32P-LXJ8].

72. *Id.*

73. Regulation S-K, 17 C.F.R. § 229.10-229.1406 (2021); Regulation S-X, 17 C.F.R. § 210.1-01–210.13-02 (2021).

statements need to be included in accordance with those Regulations.⁷⁴ As alluded to earlier, SPACs differ, however, from the traditional IPO issuance process in that when the SPAC IPO is formed there is no company with salable products or services. The SPAC is merely a shell company; an entity formed for the sole purpose of researching, selecting, and acquiring a Target Company.⁷⁵ Accordingly, the disclosures in a SPAC IPO will revolve around an explanation of how the SPAC structure works and the process involved with researching, selecting, and acquiring a company that produces actual goods or provides actual services (the Target Company or Target).⁷⁶

B. SPAC IPO Proceeds

The share proceeds from SPAC IPOs are held in a trust.⁷⁷ Those funds are set aside for the sole purpose of funding the Target acquisition once the Target has been researched and selected.⁷⁸ As a benchmark figure, SPACs will place at least 80% of the offering proceeds in the Trust account.⁷⁹ Some SPACs will place more in the Trust. That amount depends on anticipated expenses involved in researching, selecting, and acquiring a Target. Appreciate that, until the SPAC finds and acquires a Target, the SPAC will have ongoing expenses related to operating as a publicly held company, not the least of which are the ongoing periodic financial reports that must be filed both quarterly and annually.

C. Structure of the Securities Being Offered

The shares offered in a SPAC IPO generally will consist of both a common share and at least one or more warrants.⁸⁰ A warrant gives the warrant holder the right to buy shares in the SPAC at a specified price. The combined share and warrants will comprise a unit.⁸¹ Thus, an investment in

74. See Form S-1 (directing that the S-1 portions be completed in accordance with Regulation S-K provisions).

75. See Acquicor Technology Inc., Registration Statement (Form S-1) (Sept. 2, 2005), at 3, <https://www.sec.gov/Archives/edgar/data/0001337675/000095014905000576/f11842sv1.htm#110> [perma.cc/8R58-YJYN] (hereinafter Acquicor) (providing the registration details for Acquicor's blank check filing).

76. *Id.*

77. *Id.* at 3.

78. *Id.*

79. *Id.*

80. *Id.* at 2.

81. *Id.*

a SPAC IPO will garner the investor a common share coupled with one or more warrants.⁸² The warrant terms typically allow the investor to purchase additional shares after the SPAC's acquisition of the Target Company has been consummated.⁸³ The warrant kickers are designed to create a value added incentive to keep the initial investors as part of the deal once the SPAC selects and acquires the Target. The purchase price in exercising the warrants is often for a fraction of the unit price and the warrants will typically convert to common shares at a one-to-one ratio; i.e., one warrant converts to one common share.⁸⁴

D. Redemption Rights for the SPAC Shareholders

A feature that is unique to SPACs is that they give the public shareholder the right to redeem the shares they hold in the SPAC⁸⁵ and receive the investor's pro-rata share of the funds held in the Trust in the form of cash. This redemption right that the SPAC affords can create some challenges for the SPAC. If a significant number of shareholders decide to exercise their redemption rights, then the amount of capital held in the Trust gets depleted, which can then compromise the SPAC's ability to acquire a suitable Target. Consequently, that SPAC may be in a position where it must raise additional funds in order to consummate a business combination.

E. The SPAC Shares Issued to the Promoters

The SPAC "Promoters," comprised of the founding SPAC directors, officers, and initial shareholders (collectively the "SPAC Promoters" or "Promoters"), will take an equity stake in the SPAC as well; typically, a 20% stake.⁸⁶ The SPAC Promoters, however, will pay a fraction of what the public shareholders will pay for their shares. For example, in one of the

82. *Id.*

83. *Id.* at 3.

84. *Id.* at 2.

85. *Id.* at 38.

86. See Acquiror, *supra* note 75, at 16 (detailing that 20 percent of Acquiror's shares will be owned by directors, officers, and special advisors); see also Valence Merger Corp. I, Registration Statement (Form S-1)(Jan. 19, 2022), at 65, <https://www.sec.gov/Archives/edgar/data/0001892747/000149315222001613/forms-1.htm> [<https://perma.cc/Q9JN-3VX6>] (listing another SPAC where initial shareholders will own 20% of the total shares); 10X Capital Venture Acquisition Corp. II, Registration Statement (Form S-1) (Mar. 4, 2021), at 29, https://www.sec.gov/Archives/edgar/data/0001848898/000119312521068620/d123170ds1.htm#tx123170_9 [<https://perma.cc/F6DW-MQ82>] (stating that initial shareholders will own 25% of outstanding shares).

SPAC IPOs used as a research reference for this article, the Promoters paid \$.004 per share for their shares. They paid a total of \$25,000 and acquired 6,250,000 shares. By comparison, the public shareholders paid \$6 for their shares, paying a total of \$150,000,000 and acquiring 25,000,000 shares, comprising an 80% stake in the SPAC.⁸⁷ Here in Exhibit 3 is a summary of Acquiror's projected capital structure just prior to its offering.

Exhibit 3

	Shares Purchased		Total Consideration		Average Price per Share
	Number	Percentage	Amount	Percentage	
Acquiror Management LLC	6,250,000	20.00%	\$ 25,000	0.02%	\$ 0.004
New investors	25,000,000	80.00%	150,000,000	99.98%	\$ 6.000
Total	31,250,000	100.00%	\$ 150,025,000	100.00%	

Summary of Acquiror's projected capital structure just prior to its offering⁸⁸

The dynamic of dilution, where the promoters pay significantly less for their equity stake in the SPAC, has been a subject of much criticism.⁸⁹

F. The Target Acquisition Process

Once the SPAC's infrastructure has been established, the SPAC can move forward with its intended purpose, which is to find and acquire a suitable Target Company. This section discusses how that process works.

Finding a suitable Target Company for the SPAC to acquire is the lynchpin of the whole endeavor. In ideal circumstances, the SPAC will find and acquire a Target Company early on in its eighteen to twenty-four month window.⁹⁰ And that Company will be one that grows, is profitable, and appreciates in value over the ensuing years. Recent history indicates that these endeavors rarely work out smoothly.⁹¹ Often, the process is a bumpy

87. Acquiror, *supra* note 75, at 28.

88. *Id.*

89. *Id.*

90. See Acquiror, *supra* note 75, at 7 (detailing the timeline to find a target company).

91. See Ben Foldy, *Lordstown Motors Discloses Justice Department Investigation as Truck Launch Looms*, WALL ST. J. (Jul. 16, 2021), <https://www.wsj.com/articles/electric-truck-startup-lordstown-motors-discloses-justice-department-investigation-11626443066> [perma.cc/UB5D-TMR4] (explaining the state and federal probes into the truck start-up's reverse merger).

one fraught with myriad challenges and issues to address along the way. If the SPAC fails to find a suitable Target Company, and no acquisition takes place, then the whole endeavor is for naught and the SPAC venture will be considered a failure. Therefore, a well-conceived SPAC is one that has been intentional about the selection process long before the SPAC has even been established.

A SPAC positioned for success is one where the Promoters have industry knowledge, expertise, experience, and contacts in a specific field or business sector and the promoter leverages these assets to find the ideal Target.⁹² The final piece then is post-merger. Ultimate success for the venture involves the SPAC positioning the Target for post-merger success.

Although offering circulars will note that the SPAC has neither identified nor has been provided with the identity of any potential business Targets,⁹³ as an investor, you would hope and expect that the SPAC Promoters have researched and assessed the viability of potential Targets within the SPAC Promoters' area of expertise and that this forethought has occurred prior to the SPAC's formation.

Accordingly, the SPAC Promoters will draw upon their contacts with private equity firms, venture capital funds, public and private companies, business brokers, investment bankers, attorneys and accountants, and whatever other sources and contacts the Promoters can solicit to generate suitable Target possibilities.⁹⁴ In evaluating possible Target companies, the Promoters will consider, among other things, the Target's:

- financial condition and results of operations;
- growth potential;
- managerial experience and the availability of additional personnel;
- capital structure and capital requirements;
- competitive position and barriers to entry into the Target business' industry;
- stage of development;
- degree of current or potential market acceptance;
- proprietary features and degree of intellectual property protection;
- regulatory environment of the Target business' industry; and
- costs associated with effecting the business combination.⁹⁵

92. See Acquicor, *supra* note 75, at 1 (highlighting the management team's experience in relevant industries).

93. Acquicor, *supra* note 75, at 33.

94. *Id.* at 35.

95. *Id.* at 36.

These criteria are not exhaustive but give a good layout of what the SPACs consider in the Target Company selection process. Again—the thoughtfulness in the SPAC’s selection process is paramount to the venture’s likelihood of overall success. Accordingly, many major investment banking and prominent venture capital firms have found SPAC sponsorship to be a highly lucrative activity during 2020 and 2021.⁹⁶ In sum, a strong Target selection sets the whole venture up for success.

G. Variables that weigh on the SPAC’s Selection Process – The 80% Minimum

The initial Target business or businesses that the SPAC acquires must collectively have a fair market value equal to at least 80% of the SPAC’s net assets at the time the Targets are being acquired.⁹⁷ Recall that this 80% minimum was placed in Trust for the sole purpose of acquiring a suitable Target.⁹⁸ The reasons for the 80% minimum are beyond this paper’s scope, but the minimum dates back to an era when shell companies were used to invest in penny stocks, sometimes resulting in fraudulent transactions.⁹⁹ The 80% requirement was one of the protective measures used presumably to protect the investors by ensuring that the bulk of the offering proceeds would be used for acquiring the Target Company versus the money being allocated elsewhere (i.e. back to the Promoters).

Note that the SPAC is not limited to purchasing just one Target company. The criteria merely requires that 80% of the net assets then existing in the trust be used at the time the acquisition occurs. Thus, the SPAC is not limited to merging with just one Target. As a practical matter, however, SPACs rarely end up acquiring more than one Target. The logistics of acquiring two or more Targets at one time are formidable. At the forefront of the challenges are the accounting and financial reporting that would be

96. Amrith Ramkumar, *2020 SPAC Boom Lifted Wall Street’s Biggest Banks*, WALL ST. J. (Jan. 5, 2021), <https://www.wsj.com/articles/2020-spac-boom-lifted-wall-streets-biggest-banks-11609842601> [perma.cc/L6AF-XDLB].

97. See Acquicor, *supra* note 75, at 36 (explaining the fair market value necessary at the time of acquisition).

98. Acquicor, *supra* note 75, at 3.

99. See generally Daniel S. Riemer, *Special Purpose Acquisition Companies: SPAC and SPAN, or Blank Check Redux?*, 85 WASH. U.L. REV. 931 (2007) https://openscholarship.wustl.edu/cgi/viewcontent.cgi?article=1160&context=law_lawreview [perma.cc/9NMN-K7NG] (discussing the history of blank check companies, how those transactions have evolved into the current SPAC model, and how the evolution was due to the fraud occurring under the blank check company model).

required if the SPAC were to acquire more than one Target. If the SPAC was to endeavor to acquire more than one Target, the SPAC would then be required to prepare pro forma financial statements presenting the two Target entities on a consolidated basis. The time, cost, and effort to address the accounting issues alone can be enough to bog down the venture. Accordingly, the SPAC dynamics lend themselves to selecting just one Target company, thus underscoring the importance of choosing wisely, as everything is riding on that single selection.

H. Further Challenges to Target Selection

Baked into the SPAC deal structure are stock preferences that can make it challenging for the SPAC to complete its mission of acquiring an ideal Target. First off, as mentioned earlier, shareholders have the right to convert their shares into a pro rata number of trust shares and then redeem the share value from the trust in cash.¹⁰⁰ If a significant number of SPAC shareholders decide to exercise their conversion rights, then the assets remaining in the trust may be insufficient for acquiring a suitable Target. As shareholder conversions are foreseeable and, in many cases, expected, SPACs have the contingency plan in place of executing one or more private offerings to counter the capital lost from conversions. These deals are called PIPEs (Private Investment in Public Entities). The downside of a PIPE transaction is the dilutive effect that a PIPE transaction may have on those shareholders who choose to remain as shareholders post-merger. The SPAC may be forced to offer the private shares on deal terms favorable to the private investors to the detriment of current shareholders.¹⁰¹

The redemption right provides an appealing option for investors. Indeed, given the uncertainties inherent in a SPAC venture, the redemption option is almost a necessity as investors are investing based on their confidence in the Promoters' ability to research, select, and acquire a suitable Target. At the time the investors make their initial investment, however, they have no idea who the ultimate Target Company may be.¹⁰² It can be argued that the redemption right is the feature that gives investors the comfort to move forward with a SPAC investment in the first place. But the redemption right can also make consummating a business combination a challenge at times, because each dollar redeemed is one less dollar the SPAC

100. See Acquiror, *supra* note 75, at 4 (“Public stockholders voting against a business combination will be entitled to convert their stock into a pro rata share of the trust account.”).

101. See Klausner et al., *supra* note 75, at 38 (discussing PIPEs).

102. *Id.* at 10.

can use to consummate a business combination.

I. SPACs Typically Require Shareholder Vote

SPACs will set up its governance structure such that approval from the publicly held shares is required before the SPAC will move forward with a proposed business combination.¹⁰³ Generally the vote that is required is majority approval.¹⁰⁴ The majority approval requirement falls in line with most state corporate law codes which generally require shareholder approval for “fundamental corporate changes” – acquiring a company or merging with a company would be considered a “fundament corporate change.” Again, the voting requirement is one that gives the shareholders some say and some control over the process. Likewise, the voting requirement gives shareholders the voting power to scuttle a proposed business combination, even in those instances where the Target may be a perfectly suitable one.

J. SPACs and Their Hidden Costs

SPAC critics have dissected the SPAC structure and have cited several ways in which the SPAC deal structure ends up costing the investors. These shareholder costs are subtle and are not apparent until the investor is no longer in a position to act or react.

The first and perhaps the most significant cost to shareholders is the exorbitant fee that the public shareholders pay to the SPAC Promoters. It’s not apparent why the investors don’t push back on this. Perhaps the investors see the SPAC promote as a cost of doing business. Some have argued that the ultimate compensation or return on investment that the Promoters end up receiving far outweighs the effort the promoter’s put into researching, selecting, and ultimately acquiring a Target.¹⁰⁵

As discussed earlier, the Promoter’s essentially make their money on a SPAC transaction based on the extremely low price that the promoter’s pay for their shares. For example, with Acquicor Technology, Inc., the Acquicor Promoters paid \$.004 per share, paying a total of \$25,000 for which the Acquicor Promoters acquired 6,250,000 Acquicor Technology, Inc. shares. In contrast, the public shareholders paid \$6 per share for each of the 25

103. See, e.g., Acquicor, *supra* note 75, at 4 (requiring shareholder approval for an initial business combination).

104. See, e.g., Acquicor, *supra* note 75, at 4.

105. Matt Levine, *SPACs Aren’t Cheaper Than IPOs Yet*, BLOOMBERG (July 27, 2020, 10:59 AM), <https://www.bloomberg.com/opinion/articles/2020-07-27/spacs-aren-t-cheaper-than-ipos-yet> [https://perma.cc/JQG4-MDEP].

million shares issued to them. Exhibit 3¹⁰⁶ illustrates dilution in the shares issued, percentage ownership, consideration paid, and the price paid per share:

Exhibit 3

	Shares Purchased		Total Consideration		Average Price per Share
	Number	Percentage	Amount	Percentage	
Acquicor Management LLC	6,250,000	20.00%	\$ 25,000	0.02%	\$ 0.004
New investors	25,000,000	80.00%	150,000,000	99.98%	\$ 6.000
Total	31,250,000	100.00%	\$ 150,025,000	100.00%	

Summary of Acquicor's Dilution to New Investors¹⁰⁷

As Exhibit 3 illustrates, the Promoters are contributing .02% of actual cash consideration but receiving 20% of the SPAC's equity.¹⁰⁸ The disparity is evident. The apparent argument from the promoter's standpoint is that they are earning their 20% equity stake through "sweat equity" in lieu of cash consideration. Establishing the SPAC, time and effort spent finding a suitable Target, the "due diligence" time involved, vetting a suitable Target and consummating the business combination. Their argument is that these value-added efforts is what warrants their share allotment for virtually no cash consideration. The question becomes whether the Promoter's involvement in the deal equates to \$37,475,000?¹⁰⁹ (i.e., the additional consideration the Promoters *would* pay if their purchase price were equal to the price the public shareholders paid).

Accordingly, the large price disparity between the cash consideration that the promoter's paid and the cash consideration that the public shareholders paid creates a dilutive effect for the public shareholders at the outset and lowers the public shareholder's book value per share immediately.

K. The SPAC Redemption Feature

The deal structure component that ultimately ends up costing a subset of public shareholders is the redemption right that SPACs grant to the public shareholder.¹¹⁰ The redemption right grants any public shareholder the right

106. Acquicor, *supra* note 75, at 28.

107. *Id.*

108. *Id.*

109. Simply the difference between the \$.004 per share that the promoters actually paid and the \$6 per share that the public shareholders paid.

110. See Acquicor, *supra* note 75, at 4 (SPACs may refer to this as a conversion right. Either way, the mechanics are the same).

to redeem his SPAC shares up until a point just prior to a pending business combination.¹¹¹ The public shareholder's right to redeem the shares is triggered in the event the shareholder votes against a business combination. Presumably, the SPAC affords the redemption right to induce shareholder investment in a speculative venture where the investor has no idea whether the SPAC will select a Target Company that will add shareholder value or will ultimately be a bust. At the time the SPAC conducts the IPO, there is no Target Company in play and therefore no way to value the shareholder's investment.

At that point, the investment is in the shareholders' faith in the Promoters' ability to find, select, and merge with a suitable Target company. But for the redemption right that gives the public shareholder a risk-free exit from the venture at the shareholders' calling, SPAC investing may be deemed too risky to be viable. Thus, the redemption right gives the shareholder the necessary contingency plan that allows him to move forward with making the initial investment in the SPAC in the absence of having any real sense of the investment's ultimate value proposition.

Professors Klausner, Ohlrogge, and Ruan show that SPAC shareholders on average redeem their shares at an average rate of 73%.¹¹² The way most SPAC redemptions work is that the SPAC shareholder is entitled to the shareholders' pro-rata share of the net proceeds then remaining in the trust net of any taxes that might be payable. As mentioned earlier, the IPO proceeds are held in a trust account pending the SPAC finding and merging with a suitable Target company. The trust account in which the proceeds are held is often an interest-bearing account that yields a modest yet solid return. Thus, many of the initial shareholders opt to redeem their shares prior to any business combination and therefore have no stake or involvement if and when the SPAC ultimately merges with a selected Target.

Consequently, the redemption right afforded to the public shareholders often creates significant challenges for the SPAC Promoters while at the same time diminishes the value proposition for those shareholders who choose not to redeem their shares. When SPAC shareholders exercise their redemption rights, each redemption depletes the capital held in the trust. The more shares redeemed, the less capital available to be used in a potential business combination. The SPAC promoter, in turn, will take several measures to counteract the capital being depleted in the Trust.

First and most significant, the SPAC Promoters may seek to raise additional capital to offset the capital being depleted through redemptions.¹¹³

111. See Acquicor, *supra* note 75, at 4.

112. Klausner et al., *supra* note 57, at 14.

113. See Acquicor, *supra* note 75, at 8.

The SPAC Promoters will accomplish this through one or more private offerings. Private offerings in this context are referred to as “PIPES” – Private Investment in Public Entities. The SPAC will issue unregistered shares to private investors through these PIPE transactions. Appreciate the context in which these PIPE transactions are occurring. The SPAC’s Trust Account has been depleted due to significant redemptions. If the SPAC is well into the 24-month window, then the SPAC is in a time pressured situation where the SPAC may have to liquidate the Trust and return ALL the proceeds to the shareholders if the SPAC fails to acquire a Target within the allotted eighteen to twenty-four month window. In this event the SPAC Promoters stand to lose out on the returns they would have realized from acquiring a stake in an actual entity for which they paid a nominal amount in actual cash consideration.

These “pressure points” on the venture gives the private placement investors leverage in the transaction which enables them to purchase the additional shares on favorable terms; likely at a price per share significantly less than what the public shareholders paid in the initial IPO. The lowered price is necessary to make the investment palatable to the private investors. The value proposition for the private shareholders is much more speculative as they likely will not have the same redemption rights that were afforded to the public shareholders. At the juncture where private investors come into the picture, a Target Company may presently be in play and under consideration. Thus, the private investor is not investing blindly as was the case with the public investors. But the venture is still a speculative one depending on the ultimate Target and that Target’s prospects for success going forward as the entity that has merged with the SPAC. Thus, all these unknowns will be baked into the share price the private investors pay and will likely be at a share price that is less than what the public shareholders paid.

Likewise, as was the case with the nominal share price for which the SPAC issued shares to the Promoters, selling the shares at a cheaper price to the private investors also has a dilutive effect on the shares, as the initial shareholders will now own a smaller percentage of the company with each share issued in the private placement.¹¹⁴ Each share sold to private investors at the lower price, dilutes the share value for those that acquired shares in the IPO.

114. *Id.* at 10 (discussing the dilutive effects of additional issuances of common stock).

L. The Underwriting Fee – Another Hidden Cost

The underwriting fee is also a hidden cost to SPAC shareholders that isn't readily apparent. Advocates for the SPAC structure in comparison to the IPO cite, among other things, that the underwriting fees charged in SPAC transactions are less expensive than the underwriting fees charged in IPOs. At initial glance this is true. The underwriting fee for traditional IPOs is around 5-7% of net proceeds, whereas in the SPAC deals, the underwriting fee is typically 5.5%.¹¹⁵ In real costs, however, the underwriting fee for SPACs typically end up being a greater percentage of net proceeds. Again, this is due to the SPAC's redemption feature. For each SPAC shareholder that redeems its shares, the underwriting fee then is a greater percentage in terms of net proceeds.¹¹⁶ As discussed earlier, on average, 73 percent of net proceeds are redeemed by the SPAC shareholders thereby raising the actual underwriting fee as a percentage of net proceeds.¹¹⁷ The apparent price advantage that SPACs provide generally ends up not being the case once the redemptions are accounted for.

M. Are SPACS a Valued Added Proposition?

Whether SPACs are a value-added proposition for those that invest, of course, depends on several variables. Each will have bearing on whether investing in a SPAC proves to be a value-added proposition. The first factor depends on the capacity in which the shareholder is investing. Promoter, public shareholder, or private placement investor. The investor's capacity and how they manage that investment *vis-à-vis* the SPAC will have a large bearing on the investor's ultimate return.

SPAC Promoters have the greatest potential for return. This is so because their upfront cash consideration is minimal.¹¹⁸ Therefore, it doesn't take much in terms of upside for the promoter to realize a positive return. If the SPAC ultimately finds a suitable Target and the transaction is consummated, a positive return for the SPAC Promoters is virtually assured even if the economics of the business combination are modest. Recall in the Acquiror Technology SPAC, the Promoters paid \$.004 per share.¹¹⁹ Thus, \$.004 per share is the benchmark for the Promoters. Any returns that exceed

115. See Klausner et al., *supra* note 57, at 6.

116. *Id.* at 27–28.

117. *Id.* at 14.

118. See Acquiror, *supra* note 75, at 28 (indicating an average price per share of \$.004 for SPAC promoters).

119. See Acquiror, *supra* note 75, at 28.

this nominal upfront payment amount to a positive return on investment for the SPAC Promoters.¹²⁰

N. Value Proposition for Public Shareholders

For the SPACs' public shareholders, the value proposition is less certain, and the ultimate return depends how public shareholders decide to navigate their investment. As discussed earlier, when the public shareholder votes against a proposed business combination, the redemption right is triggered for the SPAC public shareholder.¹²¹ If the public shareholder decides on that option then it will be entitled to its pro rata share of the proceeds remaining in the Trust Account at the time it exercises its option to redeem.¹²² But recall, the SPAC will already have taken a portion out for operating expenses to cover costs incurred for that eighteen to twenty-four month window in which the SPAC is seeking a suitable Target.¹²³

Additionally, as discussed earlier, the SPAC public shares also come with warrants. Generally, the warrant holder will be able to exercise the warrant following the SPAC's successful completion of a business combination. Per the SPAC terms, the public shareholder does not redeem the warrants but merely the common shares. Thus, if a business combination is consummated, the public shareholder can still exercise the warrants even if the shareholder has already redeemed its common shares.

Accordingly, depending on the depletion in the trust account, and the economics of the business combination, those variables will have a bearing on the public shareholder's ultimate return on its investment. With the warrants in play, the public shareholder gets two bites at the apple. The first would be through a redemption. And the second would be through the exercise of the warrants that the shareholder was able to keep even after redeeming its shares.

Public shareholders also have the option of selling the SPAC shares on the open market, as these are publicly traded shares. Again, given the unique deal structure for SPACs, and that there may be no Target Company in play when the public shareholder seeks to sell its shares, it is doubtful whether the

120. It is acknowledged that there are opportunity costs associated with the time the Promoters spend on searching, selecting, and ultimately acquiring a Target Company. Quantifying that time, though considerable, would be speculative. Though it does raise the question of whether that time spent is equivalent to the cash consideration that the public shareholders pay for their shares.

121. See Acquiror, *supra* note 75, at 4 ("Public stockholders voting against a business combination will be entitled to convert their stock into a pro rate share of the trust account.").

122. *Id.*

123. *Id.* at 24.

SPAC shareholder will be able to command a price much higher than the initial IPO price.

Finally, the public shareholder could hang on to its shares until the consummation of the SPAC completing a business combination. The public shareholder's value would then be a function of the acquired Target's value. Again – recognizing that by the time the SPAC gets around to consummating a business combination, the initial public shareholder's stake in the venture has been diluted through 1) the twenty percent promoter's equity stake in the business that was acquired for nominal cash consideration; 2) any public shareholders exercising their redemption options; and 3) the ultimate offset in the depleted Trust through the SPAC raising additional capital by issuing additional shares in a private placement and doing so at terms more favorable than the price the initial public shareholders paid in the public offering.

Where SPACs have been touted as more appealing investments than traditional IPOs due to some certainties such as the redemption right and the right to vote on whether to move forward with a proposed business combination, the SPAC, upon further examination, has several variables, which makes its value proposition less clear. There is a return to be realized on SPAC investments, but much has to do with timing and buy-sell decisions where such decisions are made prior to acquiring an actual Target; the whole reason for the SPAC in the first place.

O. The Decision to Withdraw the IPO

In their study covering the period 2003-2019 of 370 SPACs intending to IPO, professors Dimic, Lawrence, and Vulcanovic find that, “both prospectuses’ characteristics and market characteristics determine choices of withdrawal.”¹²⁴ They note that “[t]he likelihood of withdrawals is in direct relation with the level of volatility on the day of IPO/withdrawal and if the acquisition target is in the private equity domain.”¹²⁵ In addition:

SPACs are less likely to withdraw their IPO if they have a clear focus of acquisition, have a larger number of underwriters in the syndicate, and if their legal counsel is specialized in the SPAC market. We also document that the speed of IPO for SPACs is directly related to the level of the market, size of IPO, and if the CEO was previously manager of other public companies. On the other side, IPO takes longer if

124. Nebojsa Dimic, Edward R. Lawrence & Milos Vulcanovic, *THE DETERMINANTS OF IPO WITHDRAWALS: EVIDENCE FROM SPACs* (2020), <https://ssrn.com/abstract=3538671> [<https://perma.cc/T9YZ-FA9H>].

125. *Id.*

two lead underwriters underwrite the SPAC.¹²⁶

IV. FINANCIAL REPORTING AND AUDITING CONSIDERATIONS

A. SPAC Financial Reporting

The rules that apply for disclosures generally in the Initial Public Offering context likewise apply for SPACS.¹²⁷ Issuers must disclose all “material” financial and business information pertaining to the company. Granted, the shell company that formed the SPAC will not have any material operations per se as the company at that point is merely a shell, with no operations to report.¹²⁸ Thus, the financial statements in the SPAC’s initial offering document will be modest at best. The balance sheet will reflect the shares issued to the Promoters and the nominal consideration paid.¹²⁹ Additionally, the SPAC may borrow a sum of money to use as working capital to get things in place.¹³⁰ In the Acquicor Technology offering document, Acquicor Management LLC, the company’s sole shareholder prior to the offering, loaned the SPAC \$275,000 which was reflected as a “[n]ote payable to a stockholder” on the SPAC’s balance sheet.¹³¹ Likewise, the Statement of Operations and the Statement of Cash Flows will reflect these nominal activities to date. The Statement of Operations will reflect any nominal expenses that have been incurred up until that point. Likewise, the Statement of Cash Flows will show the cash infusion from the note payable, as well as the nominal consideration that the Promoters paid in cash for the twenty percent equity stake they acquired in the SPAC.¹³² Thus, at the

126. *Id.*

127. SPAC Offerings and IPOs are both Initial Public Offerings. SPAC Offerings are different in the fact that with the SPAC there is no actual company that is offering shares – merely a Shell company that is formed to acquire a target company. But both are subject to the exact same disclosure regime commensurate with an S-1 Registration Statement and the corresponding Regulation S-K and S-X.

128. *See* Acquicor, *supra* note 75, at 1 (“To date, our activities have been limited to organizational activities.”).

129. *See* Acquicor, *supra* note 75, at F-3.

130. *Id.*

131. *See* Acquicor, *supra* note 75.

132. *Id.* at F-6 (providing Acquicor’s statement of cash flows).

outset, financial reporting for the SPAC is minimal and won't be of much assistance to the reader of the SPAC's initial offering document.

But when the SPAC eventually locates and selects its Target, then of course, all the Target's material financial and business operations must be disclosed going forward.

Regarding the SPAC itself and the SPAC's operation before acquiring the Target - given the SPAC's nature, the relationship between the promoters and the public shareholders, the allowance for redeeming shares, and the possibility of additional funding that may be required - there are key pieces of information regarding the dynamics between these parties that should be disclosed in the SPAC's initial offering document.

B. The SPAC Promoters and Their Potential Conflicts

Regarding the SPAC Promoters, what should be made very clear in the offering document is all the ways in which the interests between the Promoters and the shareholders may not align and in many instances may be in direct conflict. These conflicts of interest and misaligned incentives are attributed to the SPACs unique deal structure, its timelines, and the way the Promoters profit from SPAC ventures. Shareholders should be made aware of these conflicts.¹³³

C. The Two-Year Window for Selecting and Acquiring a Target

Unique to the SPAC deal structure, the SPAC essentially has twenty-four months to select and acquire a Target Company.¹³⁴ If the SPAC fails to do so, the SPAC is required to return all unused proceeds from its offering back to shareholders.¹³⁵ Depending on how the SPAC transaction is structured, if the Promoters fail to identify and acquire a suitable Target within the allotted time, then the Promoters stand to lose out on millions. The offering document should explain the deal terms and should explain the financial consequences to the Promoters in the event the Promoters fail to find a suitable Target within the allotted time. Depending on how those compensation and investment terms are structured, the Promoters could be

133. *Special Purpose Acquisition Companies*, SEC. & EXCH. COMM'N (Dec. 22, 2020), <https://www.sec.gov/corpfin/disclosure-special-purpose-acquisition-companies> [<https://perma.cc/3SGR-7C45>].

134. See Acquicor, *supra* note 75, at 5. Usually, the SPAC deal documents allow up to eighteen months to enter into a Letter of Intent with a Target and then up to twenty-four months to complete the business combination.

135. *Id.*

incentivized to make decisions that are in the Promoter's best interest but may be to the detriment of the SPACs public shareholders. Consider the scenario where the twenty-four-month window is winding down and the Promoters have failed to acquire or even identify a suitable Target. In that event, the SPAC would be forced to liquidate the remaining proceeds held in the Trust and return those proceeds back to the Shareholders. Under that scenario, faced with the prospect of losing out on investment and compensation returns incorporated into the deal structure, the Promoter's otherwise sound decision making may become compromised. In lieu of no Target being acquired, the Promoters may select a less than suitable Target or may select a Target under inferior deal terms i.e., paying an inflated value for a Target as the Target uses the SPAC's closing twenty-four-month window as leverage to negotiate a deal that is advantageous to the Target but less so to the SPAC.

D. Proper Disclosure of Target Selection

Many SPAC Promoters are specialists in a certain industry or business sector.¹³⁶ Their particular SPAC may have been formed to target a business or businesses within that sector. Accordingly, it is foreseeable that the Promoters may select a Target where one or more of the Promoters may be affiliated with that selected Target. In this event, the offering document should disclose both the nature of those affiliations, how that affiliation poses actual or perceived conflicts of interest, and, most importantly, how the SPAC intends to manage those conflicts so that Shareholders are aware of how those conflicts may adversely affect their investment in the SPAC.¹³⁷

E. Altering the SPAC Terms

When a SPAC seeks to acquire or merge with a target, these can be fluid situations which may require adjustments to the deal terms or deal structure to make the transaction work. The need for fluidity becomes even more acute in the context of a SPAC transaction where timelines for consummating a deal are finite and where the capital available to complete the deal is the sum offering amount raised in the IPO which will dwindle over time due to the costs incurred to find, select, and consummate a business combination with a selected Target. Accordingly, the need for flexibility can often be structured into the SPAC schematic and will be outlined in the

136. *Id.* at 45 (describing the backgrounds of Acquiror's directors and executive officers).

137. Special Purpose Acquisition Companies, *supra* note 133.

SPACs governing documents. From a disclosure standpoint, the Promoter's ability to alter the SPACs deal structure should be disclosed in the offering document. For instance, if the SPAC Promoters have the authority to extend the twenty-four-month window under certain circumstances in order to consummate a merger, the triggering event for the extension should be disclosed.

Another key element in the SPAC structure is the SPAC's ability to raise additional capital when necessary. Recall, that most SPACs have the redemption feature where shareholders who received shares in the IPO have the option to redeem their shares at times prior to the SPAC's merger with a selected Target. This redemption option can leave the SPAC in a position where it may need to acquire more capital to consummate the merger. The SPAC Promoters may address this in several ways. The Promoters may infuse the additional capital themselves; they may enter into some type of "side" agreement with the current shareholders and incentivize them NOT to redeem their shares. The SPAC Promoters may also seek additional capital from private investors through a PIPE. These different contingencies will affect the public shareholders in different ways. For example, consider the dilutive effect on the SPAC's public shareholders of offering shares in the private placement. Often, to induce the private investors, the SPAC Promoter may have to "sweeten" the deal. The valuation on which the private investors purchase their shares may be lower than the typical \$10 price per share that the public shareholders paid.¹³⁸ If the SPAC governing documents make allowances for any of these contingencies, then the SPAC should disclose these contingencies, and to the extent possible, the SPAC should make attempts to quantify how each of the contingencies may affect the value of the public SPAC shareholder's shares.

F. The SPAC Promoters and their Previous Experience

SPAC Promoter expertise, knowledge and experience can vary greatly. These attributes may likely prove highly correlated to the ultimate success of any given SPAC. Accordingly, pointed, factual disclosure regarding the management team comprising the SPAC Promoters should be included in the offering document in sufficient detail. Numerous examples of experienced SPAC promoters and examples of their success are noted versus more novice sponsors. For example, some of the largest transactions to be brought include: that by Brad Gerstner, founder of Altimeter Capital

138. Often the price per share for SPAC IPOs are set at between \$6 and \$10 per share (more recently, most are at \$10).

Management, who “reached a \$40 billion SPAC deal for app operator Grab Holdings Inc. in April” 2021;¹³⁹ ten companies in the space industry have successfully announced or raised funds via SPACS;¹⁴⁰ Idealab incubator entrepreneur Bill Gross’s sponsorship of solar-power firm Heliogen.¹⁴¹ However, some high visibility announced transactions simply don’t close—such as the \$40 dollar valuation of Universal Music by Bill Ackman.¹⁴²

G. *The SPACs Target Selection Process*

The overall success of a SPAC transaction will be determined by the Target Company the SPAC acquires and the price paid for it. Accordingly, material disclosures will involve explaining the process the SPAC intends to engage to select a suitable Target. Once a Target is selected, the SPAC should disclose the thought process involved with concluding that the selected Target Company was the best and most suitable choice. Additionally, the SPAC should reveal all the material merger terms including any conflicts of interest between the selected Target and the SPAC Promoters, officers, and directors.

Ideally, prior to the SPAC’s formation and commencing the IPO, it is hoped and expected that the SPAC Promoters have an approach in mind as to their planned process for selecting a Target. Indeed, the Target Company selection process is a disclosure mine field for the SPAC. It is reasonable to deduce that in some SPAC formations, the Promoters may already have a Target Company in mind prior to forming the SPAC. There is no prohibition against this per se. But, if it becomes evident that the SPAC did have a Target Company already in mind prior to forming the SPAC, then the disclosure rules mandate that the SPAC disclose in its IPO offering document that the SPAC has one or more Target companies already under consideration.

139. Juliet Chung & Amrith Ramkumar, *As SPAC Creators Get Rich, How Incentives Are Shared Remains Murky*, WALL ST. J. (Aug. 3, 2021, 3:50 PM), <https://www.wsj.com/articles/as-spac-creators-get-rich-how-incentives-are-shared-remains-murky-11627995686> [https://perma.cc/8XUA-32K9].

140. Erin Woo, *Start-Ups on the Launching Pad*, N.Y. TIMES (July 7, 2021), <https://www.nytimes.com/2021/07/07/technology/space-start-ups.html> [https://perma.cc/7FN7-K6V6].

141. Amrith Ramkumar, *Solar-Power Firm Heliogen Plans to Merge With SPAC*, WALL ST. J. (July 6, 2021, 3:50 PM), <https://www.wsj.com/articles/concentrated-solar-power-firm-heliogen-to-go-public-in-2-billion-spac-merger-11625607000> [https://perma.cc/P9ZU-82S5].

142. Michael J. de la Merced, *Bill Ackman Drops SPAC Deal with Universal Music*, N.Y. TIMES (July 19, 2021), <https://www.nytimes.com/2021/07/19/business/bill-ackman-universal-music.html> [https://perma.cc/59CT-VC49].

Once the SPAC does select a Target Company, then disclosing how the SPAC arrived at its decision would be appropriate through material disclosure. Appreciate that the SPAC Promoters may be leveraging their relationships and connections in that business sector or industry to broker a deal. Additionally, as alluded to earlier, the SPAC Promoters, directors, or officers may have some type of affiliation with the selected Target. That affiliation could be as a major shareholder, an officer, or director. In any event, the SPAC should likewise be disclosing all relationships that fall into this category. Finally, if the relationship is such that it is or could conflict with the Shareholder's interests, the SPAC should be disclosing with clarity what those conflicts are and the potential adverse effects those conflicts could have on the public shares.

In sum, regarding financial disclosures, the SPAC structure creates a unique relationship between the SPAC's public shareholders and the SPAC's Promoters, directors, and officers. At times, the SPAC's incentive structure can create situations where SPAC Promoter's incentives may not align or may even conflict with the SPAC's public shareholders. The offering document needs to make these incentives and any potential conflicts clear and apparent. The offering document also needs to make clear the situations or the potential contingencies in which these conflicts might occur. Hiding the ball in this regard exposes the SPAC to Section 11 violations.

H. Internal Control Considerations

The Federal Securities laws have specific requirements that relate to publicly traded companies regarding their internal controls over financial reporting (ICFR).¹⁴³ In short, public companies are generally required to maintain internal control over financial reporting and disclosure controls and procedures (DCP).¹⁴⁴ These requirements hold for all publicly traded companies and are not unique to SPAC acquired Target companies. But what is unique and what can be a challenge for SPAC acquired Targets are the abbreviated timelines.¹⁴⁵ The Target has to appreciate that financial accounting and internal control protocols may have to be revamped on a

143. See § 404 Sarbanes-Oxley Act, Management Assessment of Internal Controls, Pub. L. 107-204, 116 Stat. 745 (2002) (discussing required internal controls over financial reporting in the Sarbanes-Oxley Act).

144. *Financial Reporting and Auditing Considerations of Companies Merging with SPACS*, SEC. EXCH. COMM'N (Mar. 31, 2021), www.sec.gov/news/public-statement/munter-spac-20200331 [<https://perma.cc/CJY9-58KC>] [hereinafter *Financial Reporting and Auditing Considerations*] (discussing internal controls, specifically for companies that merge with SPACs).

145. *Id.*

short timeline to comply with federal securities laws. Specific internal control compliance requirements are triggered once the Target Company becomes publicly traded. The Target company's internal control protocols, if it hasn't happened already, will have to be revamped to comply with provisions of the Sarbanes-Oxley Act.¹⁴⁶

I. Auditor Considerations

Auditor considerations are not unique to SPAC transactions. These requirements pertain to all publicly traded companies. But again, the need to get things in place quickly with the SPAC structure's abbreviated timelines are what's at issue here. All publicly traded companies must adhere to periodic reporting requirements which, among other things, requires audited annual financial statements. Additionally, the audits must be performed in compliance with the requirements established by the Public Company Accounting Oversight Board (PCAOB).¹⁴⁷ Additionally, the audit must be performed by an accounting firm that meets both PCAOB and Securities and Exchange Commission (SEC) independence requirements.¹⁴⁸ Key components to these requirements are 1) the firm performing the financial audits for the Target Company cannot be serving in the dual capacity as consultant or advisor to that Target company. Whether actual or perceived, the Commission felt that serving in the dual capacities compromises the auditor's independence; and 2) that the firm be independent from the stand point that the accounting firm is not auditing its own work.¹⁴⁹ In other words, to the extent that that accounting firm is auditing financial statements that it previously may have had a hand in preparing, such a relationship would run contrary to the PCAOB's and the SEC's auditor independence guidelines. Again, these independence requirements are not unique to SPAC acquired companies. However, issues like having a Target companies' financial statements audited by a properly qualified accounting firm and making sure financial reporting and disclosure deadlines are adhered to and are completed timely are unique. Both the SPACs corporate governance teams as well as the Target Companies' management teams must coordinate well and must stay on top of these issues. If not handled properly, these snafus could cause a de-SPAC transaction to be delayed, or the deal could get scuttled altogether. Thus, staying on top of these infrastructure

146. § 404 Sarbanes-Oxley Act, Management Assessment of Internal Controls, *supra* note 143.

147. *Financial Reporting and Auditing Considerations*, *supra* note 144.

148. *Id.*

149. *Id.*

issues are of primary importance to smoothly completing the SPACs merger with the Target and then seamless operation post-merger.

J. Corporate Governance

Knowledgeable officers and directors are paramount to a successful SPAC acquisition and post-merger operation.¹⁵⁰ From the SPACs standpoint – the ideal situation is one where the SPAC management team has prior knowledge and expertise on both executing a SPAC’s acquisition of a Target, and being knowledgeable about all the corporate governance requirements commensurate with a SPAC acquisition that will result in a near overnight transition from being privately held to being publicly traded. Such a transformation can be a shock to the Target company’s system. The Target Company officers and directors may lack public company governance experience and may have a steep learning curve to climb and a short span of time in which to get up to speed.¹⁵¹ Seasoned corporate directors are absolutely required and will need to be recruited if not already onboard.¹⁵² Thus, we underscore the importance of the SPAC management team being

150. See Lawrence J. Trautman, *The Matrix: The Board’s Responsibility for Director Selection and Recruitment*, 11 FLA. ST. U. BUS. REV. 75 (2012), <http://www.ssrn.com/abstract=1998489> [<https://perma.cc/Q34A-6US9>] (discussing the paramount importance of selecting knowledgeable directors and officers); Lawrence J. Trautman, Seletha Butler, Frederick Chang, Michele Hooper, Ron McCray & Ruth Simmons, *Corporate Directors: Who They Are, What They Do, Cyber and Other Contemporary Challenges*, 70 BUFF. L. REV. (forthcoming 2022), <http://ssrn.com/abstract=3792382> [<https://perma.cc/ZLP6-J7YL>] (discussing the roles of corporate directors and their challenges).

151. See Lucian A. Bebchuk & Roberto Tallarita, *Will Corporations Deliver Value to All Stakeholders?*, 75 VAND. L. REV. (forthcoming May 2022), <https://ssrn.com/abstract=3899421> [<https://perma.cc/LD3H-6NGB>] (discussing balancing stakeholders concerns and creating value for all stakeholders); Lawrence J. Trautman, *Who Qualifies as an Audit Committee Financial Expert Under SEC Regulations and NYSE Rules?*, 11 DEPAUL BUS. & COMM. L.J. 205 (2013), <http://www.ssrn.com/abstract=2137747> [<https://perma.cc/G54P-RTFC>] (discussing who qualifies as an audit committee financial expert).

152. See Lawrence J. Trautman, *Present at the Creation: Reflections on the Early Years of the National Association of Corporate Directors*, 17 DUQ. BUS. L.J. 1 (2015), <http://ssrn.com/abstract=2296427> [<https://perma.cc/6JTB-5XC3>] (discussing earlier issues and goals of corporate directors to be used as a source of continuing director education); Lawrence J. Trautman, *Who Sits on Texas Corporate Boards? Texas Corporate Directors: Who They Are and What They Do*, 16 HOUS. BUS. & TAX L.J. 44 (2016), <http://ssrn.com/abstract=2493569> [<https://perma.cc/7FY3-UP6P>] (discussing who Texan board directors are); Lawrence J. Trautman, *The Board’s Responsibility for Crisis Governance*, 13 HASTINGS BUS. L.J. 275 (2017), <http://ssrn.com/abstract=2623219> [<https://perma.cc/AP9H-8FCL>] (discussing a board’s responsibilities for crisis governance).

knowledgeable about what governance issues need to be addressed and when.¹⁵³ Target company management may lack prior experience with issues important to the SEC, institutional investors, and the disclosure process such as ESG,¹⁵⁴ diversity,¹⁵⁵ and cybersecurity protection.¹⁵⁶

153. See John Armour, Henry Hansmann & Reinier H. Kraakman, *The Essential Elements of Corporate Law* (Eur. Corp. Governance Inst., Working Paper No. 134, 2009), <https://ssrn.com/abstract=1436551> [<https://perma.cc/U4FD-AVP3>] (discussing agency issues that arise in corporate governance); Stephen Mark Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 119, (2006), <https://ssrn.com/abstract=808584> [<https://perma.cc/DK77-QRUX>] (discussing the conflicts between director powers over the shareholder); Lucian A. Bebchuk, Alma Cohen & Allen Ferrell, *What Matters in Corporate Governance?*, 22 REV. FIN. STUD. 783 (2009), <https://ssrn.com/abstract=593423> [<https://perma.cc/S8VB-EBEA>] (discussing what matters in corporate governance); Lucian A. Bebchuk & Jesse M. Fried, *Pay Without Performance: Overview of the Issues*, 30 J. CORP. L. 647 (2005), <https://ssrn.com/abstract=761970v> [<https://perma.cc/RHG6-8PX2>] (discussing director compensation); see also Lawrence D. Brown & Marcus L. Caylor, *Corporate Governance and Firm Valuation*, 25 J. ACCT. & PUB. POL'Y 409, (2006), <https://ssrn.com/abstract=754484> [<https://perma.cc/PRX4-6F77>] (discussing corporate governance's role on corporate valuation); Brian R. Cheffins, *The History of Corporate Governance*, in OXFORD HANDBOOK ON CORP. GOVERNANCE, Mike Wright, Donald Siegel, Kevin Keasey and Igor Filatotchev, eds., (Oxford U. Press, 2013), <https://ssrn.com/abstract=1975404> [<https://perma.cc/4BN9-GHGQ>] (reviewing the history of corporate governance); John C. Coffee, *A Theory of Corporate Scandals: Why the U.S. And Europe Differ* (Ctr. for L. & Econ. Stud., Working Paper No. 274, 2005), <https://ssrn.com/abstract=694581> [<https://perma.cc/X8JC-3CSD>] (discussing how the differences between U.S. corporations and European corporations create differences in scandals); Jeffrey N. Gordon, *Systematic Stewardship*, (Eur. Corp. Governance Inst., Working Paper No. 566, 2021), <https://ssrn.com/abstract=3782814> [<https://perma.cc/B3LW-KERB>] (framing stewardship engagement by large institutional investors); Michael Jensen, *Agency Costs of Overvalued Equity* (Eur. Corp. Governance Inst., Working Paper No. 39, 2004), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=480421 [<https://perma.cc/Q7BW-NU6T>] (discussing agency costs' effect on firms); Donald C. Langevoort & Hillary A. Sale, CORPORATE ADOLESCENCE: WHY DID 'WE' NOT WORK? (2021), <https://ssrn.com/abstract=3762718> [<https://perma.cc/Y3QX-BAU6>] (discussing fiduciary deficits in U.S. firms); Veronica Root Martinez & Gina-Gail S. Fletcher, *Equality Metrics*, 130 YALE L.J. FORUM 169 (2021), <https://ssrn.com/abstract=3772895> [<https://perma.cc/HY6S-36AT>] (discussing corporate involvement in the Black Lives Matter Movement and tackling issues of race in corporations).

154. Lawrence J. Trautman & Neal Newman, *The ESG Debate Emerges from the Soil of Climate Denial* (Oct. 10, 2021) (unpublished manuscript), <http://ssrn.com/abstract=3939898> [<https://perma.cc/KVW9-N9ZD>].

155. See Lawrence J. Trautman, *Corporate Boardroom Diversity: Why Are We Still Talking About This?*, 17 THE SCHOLAR 219 (2015), <http://www.ssrn.com/abstract=2047750> [<https://perma.cc/V6VR-A9ZX>] (discussing diversity).

156. Lawrence J. Trautman & Peter C. Ormerod, *Corporate Directors' and Officers' Cybersecurity Standard of Care: The Yahoo Data Breach*, 66 AM. U. L. REV. 1231 (2017), <http://ssrn.com/abstract=2883607> [<https://perma.cc/9APY-J3P>]; H. Justin Pace & Lawrence J. Trautman, *Mission Critical: Caremark, Blue Bell, and Director Responsibility for Cybersecurity Governance*, 2022 WIS. L. REV. (forthcoming)

Recently, Professors Klausner and Ohlrogge write, “SPACs must address an inherent conflict between the interests of a SPAC sponsor and its public shareholders in entering into a merger.”¹⁵⁷ Consider:

The economic structure of a SPAC creates an inherent conflict between a sponsor and the SPAC’s public shareholders. The conflict arises in two related ways. First, if the SPAC does not merge, it must liquidate, in which case the sponsor gets nothing, and the cash the SPAC holds in trust is paid out to the public shareholders. If the best merger a sponsor can find will be worth less than the \$10 liquidation price to public shareholders, the shareholders will prefer a liquidation, but the sponsor will favor the value-decreasing merger. Second, when a SPAC board proposes a merger, the public shareholders have the first claim to the cash in the trust. They retrieve that cash by exercising their redemption right. The SPAC has a claim only to the cash remaining in the trust after shareholder redemptions, which is then used to fund the merger. If the amount of post-redemption cash in the trust is below the minimum required by the SPAC’s merger agreement, the target may terminate the agreement, in which case the SPAC will liquidate unless it finds another merger opportunity before its time runs out. Furthermore, the more cash that remains available to fund the merger, the more valuable the post-merger company will be for the sponsor. A sponsor, therefore, not only has an incentive to merge when doing so is not in the public shareholders’ interest, it also has an incentive to dissuade the public shareholders from redeeming their shares.¹⁵⁸

Professors Klausner and Ohlrogge recognize that “The central governance challenge of a SPAC is to manage the inherent conflict between the sponsor and the public shareholders.”¹⁵⁹ Post-IPO funding:

[T]he SPAC’s sponsor and management search for a merger candidate. The shareholders are hopeful for a merger that will result in the appreciation of their shares above their redemption or liquidation price of about \$10, but if no such opportunity is available, the shareholders will want their money back, either through the exercise of their redemption right when the board proposes a merger, or through a liquidation set in motion by the

<http://ssrn.com/abstract=3938128> [<https://perma.cc/XS4K-LKT3>].

157. Michael Klausner & Michael Ohlrogge, *SPAC Governance: In Need of Judicial Review* 3 (N.Y. Univ. Sch. L. L. & Econ. Rsch. Paper Series, Working Paper No. 22-07, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3967693 [<https://perma.cc/NSS7-X5TM>].

158. *Id.* at 5–6.

159. *Id.* at 6.

board. The sponsor also would like a value-increasing merger, if it can find one.¹⁶⁰

And now we come to the heart of the inherent conflict between the public shareholders and the SPAC sponsor. As Klausner and Ohlrogge explain, if the sponsor is unsuccessful in locating “a target with which it can negotiate a good deal, the sponsor’s incentive is to take a bad deal rather than liquidate. The sponsor gets nothing in a liquidation; its shares do not participate in the distribution of cash.”¹⁶¹ In sum:

This is the key governance challenge for SPACS. In a liquidation, the sponsor gets nothing and loses its initial investment. Even in a merger that is a worse deal for public shareholders than a liquidation, the 20% equity interest that the sponsor received essentially for free will typically be worth many millions of dollars.¹⁶²

V. TOPPS CO. ATTEMPTS GOING PUBLIC VIA SPAC

During early April 2021, Mudrick Capital Acquisition Corp. II, announces its intention to merge with baseball-card manufacturer Topps Co. in a SPAC transaction valuing Topps at about \$1.16 billion.¹⁶³ Purchased during 2007 by the private-equity firm Madison Dearborn Partners for \$385 million, this transition received unusual notice due, in part, to involvement by the former Walt Disney chairman and CEO Michael Eisner, who remains chairman of Topps post-merger.¹⁶⁴

Professors Rodrigues and Stegemoller highlight SPAC harms that may present corporate governance issues; “First, they are singularly illiquid investments—even when nominally public, SPACs are generally owned and traded by the very few. Second, SPACs evolved to eliminate meaningful shareholder voice on the acquisition of a private target, using instead a species of ‘empty voting,’ [where] . . . such vote had no economic impact.”¹⁶⁵ Rodrigues and Stegemoller contend, “By rendering the

160. *Id.*

161. *Id.*

162. *Id.*

163. Dave Sebastian, *SPAC Sees Digital Trophy in Topps*, WALL ST. J., Apr. 7, 2021, at B1.

164. *Id.*

165. Usha Rodrigues & Michael Stegemoller, *SPACs: Insider IPOs 1* (Univ. Ga. Sch. L. Roch. Paper Series, Working Paper No. 2021-09, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3906196 [<https://perma.cc/4G7C->

shareholder vote a nullity, SPACs can now virtually guarantee that a target will go public. This laxity of process creates the risk that subpar firms will trade side by side with quality public companies, tarnishing the market as a whole.”¹⁶⁶

A. Description of Topps

Topps provides the following general description in its merger agreement with Mudrick Capital Acquisition Corporation II:

Topps is a global consumer products company that entertains and delights consumers through a diverse, engaging, multi-platform product portfolio that includes physical and digital collectibles, trading cards, trading card games, sticker and album collections, memorabilia, curated experiential events, gift cards and novelty confections. Founded in 1938, we have evolved from a Brooklyn, NY based family-owned chewing gum company to a global sports and entertainment, digital/media and confections company. Our diverse, yet complementary businesses and longstanding relationships with many brands, celebrities, distributors, brick & mortar and direct to consumer retailers and consumers have created a strong foundation for growth. Our brand and retail partnerships have been built on a long history of trust. Many of our products have had a prominent position on retailers’ shelves and check-out stands for decades. We have also forged strong consumer connections through our worldwide e-commerce business, led by *topps.com* along with a portfolio of mobile digital applications (“apps”) that were downloaded in over 100 countries last year. Finally, we operate a gift cards business (“Gift Cards”) with a global platform that processed over \$1 billion in gift card sales for several leading digital companies last year. We believe our years of experience, brand recognition and customer engagement and loyalty lead to robust product innovation and performance.

We have an attractive financial profile with recurring, organic net sales growth, increasing margins, and a low level of capital expenditures. These attributes allow us to generate significant free cash flow. In fiscal year 2020, we generated \$566.6 million in net sales, \$83.7 million in net income and \$101.0 million in Adjusted EBITDA. From fiscal year 2018 to fiscal year 2020, our net income margin increased by 14.3 percentage points to 14.8% in

R9HX].

166. *Id.*

2020 from 0.5% in 2018, and our Adjusted EBITDA margin grew by 9.1 percentage points to 17.8% in 2020 from 8.7% in 2018. Our focus on product and platform innovation has fueled expansion of our digital businesses which has driven significant margin expansion alongside strong revenue growth. Our net sales, net income and Adjusted EBITDA in fiscal year 2020 reflect compound annual growth rates of 11.9%, 491.9% and 60.3%, respectively, since 2018. . . .

We produce and sell a diverse portfolio of multi-platform products across two operating segments: Sports & Entertainment and Confections.

Sports & Entertainment - Our Sports & Entertainment segment produces products in the form of physical and digital collectibles including trading cards, trading card games and sticker and album collections and curated experiential events featuring sports and entertainment personalities, as well as manages the gift card programs for widely recognized global digital companies. We are one of the oldest and most familiar brand names in the sports and entertainment collectibles industry, and we strategically leverage the Topps name throughout the segment's portfolio. We have longstanding relationships with key sports and entertainment licensors and maintain distribution and marketing capabilities that have enabled us to become the licensing partner of choice for many of the most iconic global brands. We have enduring multi-year license agreements with widely recognized properties and an increasing focus on international sports and entertainment licenses, including a 70-year relationship with Major League Baseball ("MLB"), a 43-year relationship with Lucasfilm for Star Wars (The Walt Disney Company), a 15-year relationship with World Wrestling Entertainment, a 12-year relationship with the German Bundesliga ("Bundesliga"), a 7-year relationship with Major League Soccer, a 6-year relationship with UEFA Champions League and a 4-year relationship with the National Hockey League. Most recently, we added Formula 1 and other UEFA tournaments. We also have a collection of wholly-owned proprietary intellectual property including Garbage Pail Kids, Wacky Packages and Mars Attacks, and we license from third parties other entertainment properties including Minions.

Our Physical Sports & Entertainment products are distributed globally through over 580,000 retail outlets, as well as partner websites. Digital Sports & Entertainment focuses on free-to-play apps. Our apps foster communities of users who collect and purchase digital trading cards and other virtual goods and play interactive contests. Our portfolio of apps is based on many widely recognized sports and entertainment properties including

the following apps (license partners): Topps BUNT (Major League Baseball), Topps KICK (Major League Soccer, UEFA Champions League and Bundesliga), Topps NHL Skate (National Hockey League), Disney Collect! by Topps (The Walt Disney Company), Marvel Collect! by Topps (Marvel/The Walt Disney Company), Star Wars: Card Trader by Topps (Lucasfilm/The Walt Disney Company) and Topps WWE Slam (World Wrestling Entertainment). The average user rating of our apps is over four out of five stars on both the Apple App and Google Play platforms. In addition to mobile digital applications, we are focused on developing digital collectibles that utilize blockchain technology and successfully released several products in 2020 with more planned in the near-term.

Our Gift Cards business is a leading processor, distributor and program manager of prepaid gift cards and provider of cloud-based financial services and white label e-gift solutions for widely recognized digital businesses that include Airbnb, Deliveroo, DoorDash, Hulu, Instacart, Netflix, Nike, Twitch and Uber. We manage our clients' gift card programs through a network of over four million worldwide locations, as well as partner websites. We have generated over \$1 billion of gift card sales for our partners in fiscal year 2020.

Our Sports & Entertainment segment generated \$368.2 million in net sales and \$88.4 million in Adjusted EBITDA (an Adjusted EBITDA margin of 24.0%) for fiscal year 2020. Fiscal year 2020 net sales and Adjusted EBITDA reflect compound annual growth rates of 28.0% and 122.7%, respectively, since Fiscal year 2018.

Confections - Using the Bazooka Candy Brands tradename, our Confections segment produces, markets and distributes novelty confections under iconic brands including Ring Pop, Push Pop, Baby Bottle Pop, Juicy Drop, Finders Keepers, Mega Mouth, Bazooka bubble gum and certain licensed products worldwide. Our product lines include lollipops, gummies, and chewy candy; however, we also have offerings in gum and chocolate. . . . Our Confections products reach over 125,000 U.S. retail outlets including leading mass merchants, warehouse clubs, grocery stores, convenience stores, drug stores, home improvement stores, discount chains, military outlets, e-commerce retailers, other specialty accounts and also reach retail news and confections outlets around the world. Confections generated \$198.4 million in net sales and \$38.8 million in Adjusted EBITDA (an Adjusted EBITDA margin of 19.5%) for fiscal year 2020.¹⁶⁷

167. Mudrick Cap. Acquisition Corp. II, Proxy Statement Pursuant to Section 14(a) of the

In terms of Topps recent major developments, *The Wall Street Journal* reports that, “Topps . . . recently expanded into nonfungible tokens, digital assets also known as NFTs that use technology behind cryptocurrencies to create unique tokens, each with its own identification that isn’t replicable. These tokens serve as a digital deed for original editions of online art, music and even memes.”¹⁶⁸

B. Topps Merger Proposal

A description of the material terms of the transaction contained in the Proxy Statement filed with the Securities and Exchange Commission on form 14 A, dated July 30, 2021, consists of multiple thousands of words and consumes many pages, far exceeding the space limitations imposed on any one law review article. However, a sample of some of the relevant information is reproduced here to acquaint the reader with a brief summary of the transaction, as follows:

MUDS was organized to effect a merger, capital stock exchange, asset acquisition, stock purchase, reorganization or other similar business combination with one or more businesses.

On December 10, 2020, MUDS consummated its initial public offering of 27,500,000 units. Each unit consists of one share of Class A common stock and one-half of one redeemable warrant, with each whole warrant entitling the holder thereof to purchase one share of Class A common Stock at a purchase price of \$11.50 per share, subject to adjustment, as provided in MUDS’ final prospectus filed with the Securities and Exchange Commission on December 9, 2020 (File No. 333-249402).

On December 14, 2020, the underwriters fully exercised their over-allotment option, resulting in an additional 4,125,000 units issued for an aggregate amount of \$41,250,000. The units from the MUDS IPO (including the exercise of the over-allotment option) were sold at an offering price of \$10.00 per unit, generating gross proceeds to MUDS of \$316,250,000. Since the

Securities Exchange Act of 1934 (Schedule 14A) 181–82 (July 30, 2021), <https://www.sec.gov/Archives/edgar/data/1820727/000119312521231629/d161477ddefm14a.htm> [<https://perma.cc/2L3J-NYEM>] [hereinafter Mudrick Schedule 14A].

168. See Sebastian, *supra* note 163 (describing Topps’ expansion into NFTs); see also Lawrence J. Trautman, *Virtual Art and Non-fungible Tokens*, 50 HOFSTRA L. REV. (forthcoming 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3814087 [<https://perma.cc/U328-M53Z>] (describing how NFTs have expanded into the virtual art space); Brian Elzweig & Lawrence J. Trautman, *When Does A Nonfungible Token (NFT) Become A Security?*, <http://ssrn.com/abstract=4055585> [<https://perma.cc/SXX6-9KA4>].

MUDS IPO, MUDS' activity has been limited to the evaluation of business combination opportunities.

Topps is a global consumer products company that entertains and delights consumers through a diverse, engaging, multi-platform product portfolio that includes physical and digital collectibles, trading cards, trading card games, sticker and album collections, memorabilia, curated experiential events, gift cards and novelty confections.

The MUDS Board, in evaluating the Transactions, consulted with MUDS' management and financial and legal advisors. In reaching its unanimous resolution (i) that the Merger Agreement and the Transactions are advisable and in the best interests of MUDS and its stockholders and (ii) to recommend that the stockholders adopt the Merger Agreement and approve the business combination and the transactions contemplated thereby, the MUDS Board considered and evaluated a number of factors, including the factors discussed in this proxy statement. . . .¹⁶⁹

Presented below are highlights from MUDD's disclosure and discussion of risk factors, where the issuer observes:

The following risk factors apply to the business and operations of Topps and will also apply to the business and operations of the post-combination company following the completion of the business combination. The occurrence of one or more of the events or circumstances described in these risk factors, alone or in combination with other events or circumstances, may adversely affect the ability to complete or realize the anticipated benefits of the business combination, and may have an adverse effect on the business, cash flows, financial condition and results of operations of the post-combination company. . . .

*RISKS RELATED TO TOPPS' BUSINESS
ECONOMIC RISKS AND CURRENT EVENTS*

The COVID-19 pandemic has had and may continue to have, and other public health crises or epidemics could in the future have, a material adverse impact on our business, operations, financial condition, liquidity and results of operations. . . .

Reductions in discretionary consumer spending, including as a result of global and regional economic downturns, could have an adverse effect on our business, financial condition and results of operations. . . .

OPERATIONAL RISKS

169. See Mudrick Schedule 14A, *supra* note 167, at 12–13 (describing the business history of MUDS).

If we do not effectively maintain and further develop our relationships with retail customers and distributors, our business, financial condition, and results of operations could be harmed. If our distributors fail to promote our products and services actively and effectively, or if they implement operational decisions that are inconsistent with our interests, our future growth and results of operations may suffer. . . .

We depend upon third-party manufacturers, and if our relationship with any of them is harmed or if they encounter difficulties in their manufacturing processes, we could experience product defects, production delays, unplanned costs or higher product costs, or the inability to fulfill orders on a timely basis, any of which could adversely affect our business, financial condition, and results of operations. . . .

Damage to our reputation could have a material adverse effect on our business, financial condition, and results of operations. . . .

Our business depends in large part on our vendors and outsourcers, and our ability to effectively operate our business, as well as our reputation, may be harmed by actions taken by these third parties outside of our control. . . .

Our operating results may fluctuate from quarter to quarter and year to year due to the seasonality of our business and the timing of new product releases. . . .

We are subject to risks from unanticipated business disruptions. . . .

Our success is critically dependent on the efforts and dedication of our officers and other employees, and the loss of one or more key employees, or our inability to attract and retain qualified personnel, could adversely affect our business. . . .

Our decision to accept and hold cryptocurrency, such as bitcoin, may subject us to exchange risk and additional tax and regulatory requirements. . . .

Our principal asset is our interest in The Topps Company, Inc., and we are, and expect to continue to be, dependent upon the results of operations and cash flows of The Topps Company, Inc. and its consolidated subsidiaries and distributions we receive from The Topps Company, Inc. . . .

REGULATORY RISKS

A failure to comply with laws and regulations relating to privacy and the protection of data relating to individuals and certain audiences may result in negative publicity, claims, investigations and litigation and adversely affect our financial performance. . . .

We operate in a highly and increasingly regulated environment, and the failure by us or the businesses that participate in our distribution network to comply with applicable laws and regulations could have a material adverse effect on our business, financial condition and results of operations. . . .

We could be subject to future product liability suits or product recalls which could have a significant adverse effect on our business, financial condition and results of operations. . . .

Our Confections business is subject to local, national and multinational regulations related to labeling, health and nutrient claims, packaging, pricing, marketing and advertising and other related areas. . . .

STRATEGIC RISKS

Our success and ability to maintain and grow our business depend on our ability to execute our business strategy, along with a number of factors which are outside of our control. . . .

Our business is largely dependent on content development and creation by third parties. . . .

We have an evolving business model and have been expanding our digital ecosystems. . . .

STRATEGIC RISKS IN OUR SPORTS & ENTERTAINMENT BUSINESS

The growth of our Digital Sports & Entertainment business will depend on our ability to attract and retain users, and the loss of our users, failure to attract new users in a cost-effective manner, or failure to effectively manage our growth could adversely affect our business, financial condition and results of operations. . . .

We cannot assure you that we will be able to design and develop products that will be popular with consumers, or that we will be able to maintain the popularity of successful products. A sustained decline in the popularity of certain types of collectibles and a resulting decrease in demand for our products could adversely impact our business, financial condition and results of operations. . . .

Consumer demand for sports and entertainment products can and does shift rapidly and without warning. . . .

If the mobile applications market fails to grow or is disrupted by new technologies, and we are not able to appropriately adapt our business, our business will suffer. . . .

Changes in the retail industry and hobby industry and markets for consumer products affecting our retail and hobby customers of our Physical Sports & Entertainment business could negatively impact our business, financial condition and results of operations.

. . .

STRATEGIC RISKS IN OUR CONFECTIONS BUSINESS

We must continue to offer new and innovative confections products that meet our consumers' expectations. An inability to develop and introduce confections products in a timely and cost-effective manner may damage our business. . . .

Obesity and other health-related concerns may reduce demand for our Confections products. . . .

INDUSTRY RISKS

Our industry is intensely competitive and subject to rapid changes, including technological changes, which may materially and adversely affect our revenues and profitability. If we are unable to compete effectively with existing or new competitors, our sales, market share and profitability could decline. . . .

Competition for access to the intellectual property we license is intense, and we must vigorously compete to obtain licenses to the intellectual property we need to produce our products. . . .

Our Gift Cards business could suffer if there is a decline in the attractiveness of gift cards to consumers. . . .

INTERNATIONAL BUSINESS RISKS

Our businesses are subject to risks associated with doing business outside of the United States. . . .

INFORMATION TECHNOLOGY RISKS

Despite our security measures, our information technology and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions. Any such breach could compromise our networks and the information stored there could be accessed, publicly disclosed, lost or stolen¹⁷⁰

170. See Lawrence J. Trautman & Peter C. Ormerod, *Industrial Cyber Vulnerabilities: Lessons from Stuxnet and the Internet of Things*, 72 U. MIAMI L. REV. 761 (2018), (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2982629) [<https://perma.cc/HQR4-ALFD>]; Lawrence J. Trautman & Peter C. Ormerod, *WannaCry, Ransomware, and the Emerging Threat to Corporations*, 86 TENN. L. REV. 503 (2019), (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3238293) [<https://perma.cc/UR89-7Y7H>]; Lawrence J. Trautman, *Is Cyberattack The Next Pearl Harbor?*, 18 N.C. J. L. & TECH. 232 (2016), (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2711059) [<https://perma.cc/F9E8-SZUF>]; Lawrence J. Trautman, *Managing Cyberthreat*, 33 SANTA CLARA HIGH TECH. L.J. 230 (2016), (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2534119) [<https://perma.cc/7L92-B96E>]; Lawrence J. Trautman, *E-Commerce, Cyber and Electronic Payment System Risks: Lessons from PayPal*, 17 U.C. DAVIS BUS. L. J. 261 (Spring 2016), (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2314119) [

Systems failures and resulting interruptions in the availability of our Digital Sports & Entertainment applications, Gift Cards or platform could adversely affect our business, financial condition, and results of operations. . . .

INTELLECTUAL PROPERTY AND LICENSE RISKS

We may not realize the full benefit of our licenses if the licensed material has less market appeal than expected, or if revenue from the licensed property does not exceed minimum guaranteed royalties. . . .

Our current licenses require us to pay minimum royalties. . . .

Our business is highly dependent upon our license agreements with third parties, and a limited number of our licensors account for a large portion of our net sales. If we lose a license, we may not be able to ensure our consumers have continued access to the digital assets created under that license. In addition, such licenses may be difficult and expensive to obtain and, in some cases, retain.

. . . .

If we or our licensors are unable to obtain, maintain and protect our intellectual property rights, in particular trademarks and copyrights, our ability to compete could be negatively impacted. . . .

Failure to adequately protect the confidentiality of our trade secrets, know-how, proprietary applications, business processes and other proprietary information could adversely affect the value of our technology and products. . . .

LIQUIDITY AND FINANCING RISKS

Our indebtedness could adversely affect our financial health and competitive position. . . .

RISKS RELATED TO MUDS AND THE BUSINESS COMBINATION

MUDS' initial stockholders have agreed to vote in favor of the business combination, regardless of how MUDS' public stockholders vote. . . .

The Sponsor, certain members of the MUDS Board and certain MUDS officers have interests in the business combination that are different from or are in addition to other stockholders in recommending that stockholders vote in favor of approval of the business combination proposal and approval of the other

A89G]; Lawrence J. Trautman, *How Google Perceives Customer Privacy, Cyber, E-Commerce, Political and Regulatory Compliance Risks*, 10 WM. & MARY BUS. L. REV. 1 (2018), (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3067298) [<https://perma.cc/4YT2-F6MU>].

proposals described in this proxy statement. . . .

The NASDAQ may not continue to list our securities, which could limit investors' ability to make transactions in our securities and subject us to additional trading restrictions. . . .

The MUDS Board did not obtain a third-party valuation or fairness opinion in determining whether or not to proceed with the business combination. . . .

Because the post-combination company will become a publicly-traded company by virtue of a merger as opposed to an underwritten initial public offering, the process does not use the services of one or more underwriters, which could result in less diligence being conducted. . . .

Future resales of our outstanding shares may cause the market price of our securities to drop significantly, even if our business is doing well. . . .

If third parties bring claims against MUDS, the proceeds held in the trust account could be reduced and the per-share redemption amount received by stockholders may be less than \$10.15 per share. In such event, MUDS directors may decide not to enforce the indemnification obligation of the Sponsor, resulting in a reduction in the amount of funds in the trust account available for distribution to public stockholders. . . .

The exercise of MUDS' directors' and officers' discretion in agreeing to changes or waivers in the terms of the Transactions may result in a conflict of interest when determining whether such changes to the terms of the Transactions or waivers of conditions are appropriate and in MUDS stockholders' best interest. . . .

If MUDS is unable to complete the Transactions or another initial business combination by September 10, 2022 MUDS will cease all operations except for the purpose of winding up, redeeming 100% of the outstanding public shares and, subject to the approval of its remaining stockholders and the MUDS Board, dissolving and liquidating. In such event, third parties may bring claims against MUDS and, as a result, the proceeds held in the trust account could be reduced and the per-share liquidation price received by stockholders could be less than \$10.15 per share. . . .

MUDS stockholders may be held liable for claims by third parties against MUDS to the extent of distributions received by them. . . .

Activities taken by existing MUDS stockholders to increase the likelihood of approval of the business combination proposal and the other proposals described in this proxy statement could have a depressive effect on MUDS' stock. . . .

A significant portion of Class A common stock following the business combination will be restricted from immediate resale, but

may be sold into the market in the future. This could cause the market price of Class A common stock to drop significantly, even if our business is doing well. . . .

The Sponsor, Tornante, MDP and the PIPE Investors will beneficially own a significant equity interest in MUDS and may take actions that conflict with your interests. . . .

We will qualify as, and intend to elect to be treated as, a “controlled company” within the meaning of the NASDAQ listing standards and, as a result, our stockholders may not have certain corporate governance protections that are available to stockholders of companies that are not controlled companies. . . .

Our dual class capital structure will have the effect of concentrating voting power with Tornante, which will limit an investor’s ability to influence the outcome of important transactions, including a change in control. . . .

We cannot predict the impact our dual class capital structure may have on the stock price of Class A common stock. . . .

MUDS stockholders who do not redeem their public shares will experience immediate dilution as a consequence of the issuance of shares as consideration in the business combination and may experience dilution from several additional sources in connection with and after the business combination. Having a minority share position may reduce the influence that MUDS’ current stockholders have on the management of MUDS. . . .

We have no operating history and our results of operations and those of the post-combination company may differ significantly from the unaudited pro forma financial data included in this proxy statement. . . .

Our warrants are accounted for as liabilities and the changes in value of our warrants could have a material effect on our financial results. . . .

We have identified a material weakness in our internal control over financial reporting as of December 31, 2020. If we are unable to develop and maintain an effective system of internal control over financial reporting, or if we identify additional material weaknesses in the future or otherwise fail to maintain effective internal control over financial reporting, we may not be able to accurately report our financial results in a timely manner, which may adversely affect investor confidence in us and materially and adversely affect our business and operating results. . . .

We and, following the Transactions, the post-combination company, may face litigation and other risks as a result of the material weakness in our internal control over financial reporting.

. . . .

Topps’ financial forecasts, which were presented to the MUDS

Board and are included in this proxy statement, may not prove accurate. . . .

Termination of the Merger Agreement could negatively impact MUDS. . . .

Even if MUDS consummates the business combination, there is no guarantee that the public warrants will ever be in the money, and they may expire worthless and the terms of the warrants may be amended. . . .

If MUDS is unable to complete an initial business combination, MUDS' warrants may expire worthless. . . .

MUDS may redeem the unexpired public warrants prior to their exercise at a time and at a price that is disadvantageous to public warrant holders, thereby making their public warrants worthless, and exercise of a significant number of the public warrants could adversely affect the market price of Class A common stock. . . .

Our ability to successfully effect the business combination and to be successful thereafter will be dependent upon the efforts of certain key personnel, including the key personnel of Topps. The loss of key personnel could negatively impact the operations and profitability of our post-combination business and its financial condition could suffer as a result. . . .

MUDS and Topps will be subject to business uncertainties and contractual restrictions while the business combination is pending. . . .

We will be required to pay Topps stockholders for a significant portion of the tax benefits relating to pre-business combination tax assets and attributes and such payments may exceed the amount of any tax savings realized. . . .

Unanticipated changes in effective tax rates or adverse outcomes resulting from examination of our income or other tax returns could adversely affect our financial condition and results of operations. . . .

Subsequent to the completion of the business combination, MUDS may be required to take write-downs or write-offs, restructuring and impairment or other charges that could have a significant negative effect on MUDS' financial condition, results of operations and MUDS' stock price, which could cause you to lose some or all of your investment. . . .

Following the consummation of the business combination, our only significant asset will be our ownership interest in the Topps business and such ownership may not be sufficiently profitable or valuable to enable us to pay any dividends on our Class A common stock or satisfy our other financial obligations. . . .

Delaware law, the Charter and the Amended and Restated

Bylaws will contain certain provisions, including anti-takeover provisions, that limit the ability of stockholders to take certain actions and could delay or discourage takeover attempts that stockholders may consider favorable. . . .

The Charter designates a state court within the State of Delaware, to the fullest extent permitted by law, as the sole and exclusive forum for certain types of actions and proceedings that may be initiated by stockholders, which could limit the ability of stockholders to obtain a favorable judicial forum for disputes with or with our directors, officers or employees and may discourage stockholders from bringing such claims. . . .

Subsequent to the completion of the business combination, we may be required to take write-downs or write-offs, restructuring and impairment or other charges that could have a significant negative effect on our financial condition, results of operations and our stock price, which could cause you to lose some or all of your investment. . . .

If the business combination's benefits do not meet the expectations of investors, stockholders or financial analysts, the market price of our securities may decline. . . .

Our quarterly operating results may fluctuate significantly following the business combination. . . .

There is no guarantee that an active and liquid public market for shares of the Class A common stock will develop. . . .

We may be unable to obtain additional financing to fund our operations or growth. . . .

Changes in laws, regulations or rules, or a failure to comply with any laws, regulations or rules, may adversely affect our business, investments and results of operations. . . .

The JOBS Act permits "emerging growth companies" like us to take advantage of certain exemptions from various reporting requirements applicable to other public companies that are not emerging growth companies. . . .

RISKS RELATED TO THE REDEMPTION

You must tender your shares of Class A common stock in order to validly seek redemption at the special meeting. . . .

MUDS does not have a specified maximum redemption threshold. The absence of such a redemption threshold may make it possible for us to complete a business combination with which a substantial majority of MUDS stockholders do not agree. . . .

Public stockholders, together with any affiliates of theirs or any other person with whom they are acting in concert or as a "group," will be restricted from seeking redemption rights with respect to more than 20% of the public shares. . . .

*We cannot be certain as to the number of public shares that will be redeemed and the potential impact to stockholders who do not elect to redeem their public shares. . . .*¹⁷¹

It is often possible to learn as much, if not more, from failures than successes. As an indication of just how fragile some of these transactions can be, during August 2021, “[t]he deal fell through by mutual agreement after MLB [Major League Baseball] and the Major League Baseball Players Association both reached new exclusive licensing deals with Fanatics, Inc., an online sports-merchandise retailer, starting in the coming years.”¹⁷² Then, during January 2022, “Fanatics . . . struck a \$500 million deal to purchase Topps’s trading card business itself. . . . The sale comes less than five months after the deals struck by Fanatics scuttled Topps’s plan to go public in a blank-check merger.”¹⁷³

VI. SEC DEVELOPMENTS

Writing during April 2021, Acting Director of the Division of Corporation Finance John Coates states, “Over the past six months, the U.S. securities markets have seen an unprecedented surge in the use and popularity of Special Purpose Acquisition Companies (or SPACs).”¹⁷⁴ Director Coates continues, “Shareholder advocates – as well as business journalists and legal and banking practitioners, and even SPAC enthusiasts themselves – are sounding alarms about the surge.”¹⁷⁵ Particular concerns and warnings, “include risks from fees, conflicts, and sponsor compensation, from celebrity sponsorship and the potential for retail participation drawn by baseless hype, and the sheer amount of capital pouring into the SPACs, each of which is designed to hunt for a private target to take public.”¹⁷⁶ As a result, Director Coates cautions:

With the unprecedented surge has come unprecedented scrutiny,

171. See Mudrick Schedule 14A, *supra* note 167, at 48–94 (summarizing the different categories of risks taken from MUDS’s disclosure statement).

172. Matt Grossman, *Topps SPAC Merger Collapses After Loss of MLB Trading-Card Deal*, WALL ST. J. (Aug. 20, 2021), <https://www.wsj.com/articles/topps-spac-merger-collapses-after-loss-of-mlb-playing-card-deal-11629463989> [perma.cc/TXA3-MDKX].

173. Jared Diamond & Andrew Beaton, *Fanatics Inc. to Buy Topps Card Business*, WALL ST. J., Jan. 4, 2022, at B1; see also Lauren Hirsch, *In \$500 Million trading Card Deal, Fanatics Buys Topps*, N.Y. TIMES, Jan. 5, 2022, at B5 (discussing the deal in further detail).

174. John Coates, Acting Dir., Div. of Corp. Fin., Statement on *SPACs, IPOs and Liability Risk under the Securities Laws*, SEC (Apr. 8, 2021), <https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws> [https://perma.cc/2TNX-X2J3].

175. *Id.*

176. *Id.*

and new issues with both standard and innovative SPAC structures keep surfacing.

The staff at the Securities and Exchange Commission are continuing to look carefully at filings and disclosures by SPACs and their private targets. As customary, and in keeping with the Division of Corporation Finance's ordinary practices, staff are reviewing these filings, seeking clearer disclosure, and providing guidance to registrants and the public. They will continue to be vigilant about SPAC and private target disclosure so that the public can make informed investment and voting decisions about these transactions.¹⁷⁷

Cornell University Law School student James Rowe states in his thesis, "My qualitative research uncovered an outsized role played by the U.S. Government in the growth and popularity of SPACs."¹⁷⁸ Mr. Rowe contends, "Additionally, precedent research demonstrated that the U.S. Federal Government's proposed solution of additional regulations will not work and will, instead, create a new alternative investment vehicle in the same fashion that overregulation of IPOs led to SPACs."¹⁷⁹ Consider:

To solve the concerns regulators have voiced, officials charged with developing and altering the IPO regulatory framework must loosen the grip of listing-crushing regulations. If smaller businesses were able to access the markets via an IPO, they would do so because there is more certainty in the legal grounding of an IPO, and the process is an established one familiar to the business world. Any actions, on the government's part, to tighten already strangling regulations will lead to more of the same.¹⁸⁰

A. Example of Recent Enforcement Action: Momentum Inc.

Exhibit 4 illustrates just one example of an SEC enforcement action charges brought against an issuer and certain individuals regarding SPAC misleading disclosures.¹⁸¹

177. *Id.*

178. James Rowe, *Special Purpose Acquisition Companies (SPACs): The Private Sector's Solution to Government Overreach* (May 21, 2021) (J.D. thesis, Cornell University Law School), <https://ssrn.com/abstract=3851605> [<https://perma.cc/CZ3N-94AC>].

179. *Id.*

180. *Id.*

181. Press Release 2021-124, U.S. Sec. & Exch. Comm'n, SEC Charges SPAC, Sponsor, Merger Target, and CEOs for Misleading Disclosures Ahead of Proposed Business Combination (Jul. 13, 2021), <https://www.sec.gov/news/press-release/2021-124> [<https://perma.cc/MU38-Y2P4>].

Exhibit 4

Enforcement Action in the Matter of Momentus Inc.

Press Release

SEC Charges SPAC, Sponsor, Merger Target, and CEOs for Misleading Disclosures Ahead of Proposed Business Combination

Charges Relate to Planned Merger of Stable Road Acquisition Company and Space Transportation Company Momentus Inc.

FOR IMMEDIATE RELEASE

2021-124

Washington D.C., July 13, 2021 —

The Securities and Exchange Commission today announced charges against special purpose acquisition corporation Stable Road Acquisition Company, its sponsor SRC-NI, its CEO Brian Kabot, the SPAC's proposed merger target Momentus Inc., and Momentus's founder and former CEO Mikhail Kokorich for misleading claims about Momentus's technology and about national security risks associated with Kokorich. The SEC's litigation is proceeding against Kokorich, against whom the SEC filed a complaint in the U.S. District Court for the District of Columbia. All other parties are settling with the SEC, with terms including total penalties of more than \$8 million, tailored investor protection undertakings, and the SPAC sponsor's forfeiture of founder's shares it stands to receive if the merger, currently scheduled for August 2021, is approved.

According to the SEC's settled order, Kokorich and Momentus, an early-stage space transportation company, repeatedly told investors that it had "successfully tested" its propulsion technology in space when, in fact, the company's only in-space test had failed to achieve its primary mission objectives or demonstrate the technology's commercial viability. The order finds that Momentus and Kokorich also misrepresented the extent to which national security concerns involving Kokorich undermined Momentus's ability to secure required governmental licenses essential to its operations. In addition, the order finds that Stable Road repeated Momentus's misleading statements in public filings associated with the proposed merger and failed its due diligence obligations to investors. According to the order, while Stable Road claimed to have conducted extensive due diligence of Momentus, it never reviewed the results of Momentus's in-space test or received sufficient documents relevant to assessing the national security risks posed by Kokorich. The order finds that Kabot participated in Stable Road's inadequate due diligence and in filing its inaccurate registration statements and proxy solicitations. The SEC's complaint against Kokorich includes factual allegations that are consistent with the findings in the order.

“This case illustrates risks inherent to SPAC transactions, as those who stand to earn significant profits from a SPAC merger may conduct inadequate due diligence and mislead investors,” said SEC Chair Gary Gensler. “Stable Road, a SPAC, and its merger target, Momentus, both misled the investing public. The fact that Momentus lied to Stable Road does not absolve Stable Road of its failure to undertake adequate due diligence to protect shareholders. Today’s actions will prevent the wrongdoers from benefitting at the expense of investors and help to better align the incentives of parties to a SPAC transaction with those of investors relying on truthful information to make investment decisions.”

“Our enforcement team worked with incredible speed, efficiency, and creativity to file today’s actions so that investors will have the benefit of complete and accurate information when voting on the proposed merger,” said Melissa R. Hodgman, Acting Director of the SEC’s Division of Enforcement. “Today’s settlement will deter future misconduct in the SPAC market without inhibiting capital formation, while also allowing for the distribution of monetary relief to harmed investors.”

“Momentus’s former CEO is alleged to have engaged in fraud by misrepresenting the viability of the company’s technology and his status as a national security threat, inducing shareholders to approve a merger in which he stood to obtain shares worth upwards of \$200 million,” said Anita B. Bandy, Associate Director of the SEC’s Division of Enforcement. “Our litigation against Kokorich demonstrates our commitment to holding individuals accountable for their statements to investors, which are of particular concern when they are aimed at improperly capitalizing on public interest in popular investment vehicles such as SPACs.”

The SEC’s order finds that Momentus violated scienter-based antifraud provisions of the federal securities laws and caused certain of Stable Road’s violations. It also finds that Stable Road violated negligence-based antifraud provisions of the federal securities laws as well as certain reporting and proxy solicitation provisions. The order finds that Kabot violated provisions of the federal securities laws related to proxy solicitations and that Kabot and SRC-NI caused Stable Road’s violation of Section 17(a)(3) of the Securities Act of 1933. Without admitting or denying the SEC’s findings, Momentus, Stable Road, Kabot, and SRC-NI consented to an order requiring them to cease and desist from future violations. Momentus, Stable Road, and Kabot will pay civil penalties of \$7 million, \$1 million, and \$40,000, respectively. Momentus and Stable Road have also agreed to provide PIPE (private investment in public equity) investors with the right to terminate their subscription agreements prior to the shareholder vote to approve the merger; SRC-NI has agreed to forfeit 250,000 founders’ shares it would otherwise

have received upon consummation of the business combination; and Momentus has agreed to undertakings requiring enhancements to its disclosure controls, including the creation of an independent board committee and retention of an internal compliance consultant for a period of two years.

The SEC's complaint against Kokorich alleges that Kokorich violated antifraud provisions of the securities laws and aided and abetted Momentus's violations of the same provisions. The complaint seeks permanent injunctions, penalties, disgorgement plus prejudgment interest, and an officer-and-director bar against Kokorich.¹⁸²

VII. CONCLUSION

During late 2020 and 2021 an unprecedented surge in the popularity and issuance of Special Purpose Acquisition Companies (SPACs) takes place. When discussing SPACs, John Coates, Acting Director of the SEC's Division of Corporation Finance, observes, "Concerns include risks from fees, conflicts, and sponsor compensation, from celebrity sponsorship and the potential for retail participation drawn by baseless hype, and the sheer amount of capital pouring into the SPACs, each of which is designed to hunt for a private target to take public."¹⁸³ We believe this paper adds to the discussion and understanding of this widely employed financing mechanism.

182. *Id.*

183. Coates, *supra* note 174.