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THE ABSURD PANDEMONIUM SURROUNDING SPACS: AN ARGUMENT IN FAVOR OF LEGISLATIVE AND JUDICIAL RESTRAINT

I. Introduction

The early 2020s saw the sudden and explosive return of a popular and fascinating business combination vehicle–the Special Purpose Acquisition Company (SPAC). However, whenever new forms of corporate innovation arise, abuses of that innovation also follow–as do inevitable calls for increased regulation.

Part II of this Comment provides critical background necessary to understand the complexities surrounding SPACs. This section touches first on their organizational structures, followed by their history, origins, and a breakdown of different types of investors. It concludes by dissecting the relevant securities laws and regulations governing them.

Part III analyzes whether the potential benefits of SPACs can outweigh the scrutiny levied upon them and whether any further intervention is required. To answer these questions, Part III focuses primarily on the necessity of increasing congressional oversight, the current regulatory authority provided to executive agencies, and the need, if any, for judicial involvement in order to alleviate regulators' concerns.

Finally, Part IV examines the effects of increasing regulation of SPACs and regulators' failure to acknowledge the systemic causes in the traditional initial public offering (IPO) process that ultimately led to SPAC popularity. This Part concludes by considering the consequences of ignoring the economic benefits inherent in allowing alternative avenues of public financing to private businesses.

This Comment is not an argument advocating on behalf of SPACs. Rather, it is an analysis of the potential advantages offered by alternatives to traditional avenues of public financing. Further, this Comment considers whether such advantages, if any, can outweigh the regulatory scrutiny and implicit threats of increased regulation employed against SPACs.

II. Background

Current securities law and regulation in the United States places exclusionary limits on average retail investors by preventing access to

the unique investment opportunities offered by hedge funds and private equity.[1] As a result, innovative finance professionals have established creative ways to side-step these prohibitory regulations and offer substitute financial products that mimic the restricted investments.[2] Many of the public investors who are precluded from such opportunities turn to alternative avenues to try obtaining similar returns as those with such access.[3] These include, most notably, shell corporations known as SPACs.[4] To understand SPACs and their current impact, this Part will discuss their historical origins, as well as the legislation, regulation, and common law precedent currently governing these corporate vehicles.

A. What are SPACs?

SPACs are shell corporations that are used to raise capital and then take a private entity public.[5] SPACs accomplish this by raising investment funds through an IPO, during which they sell securities[6] to the public, with the sole business objective of using the capital acquired to merge with an already operating company.[7] SPACs have sometimes been referred to as a "poor man's private equity fund," as they "give a wide range of investors an opportunity previously only afforded to accredited (i.e., wealthy) investors: the opportunity to invest in a fund that acquires a private company."[8]

This initial process[9] involves a SPAC issuing an IPO, then holding the proceeds of the initial offering in escrow.[10] The SPAC managers,

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1. Steven M. Davidoff, *Black Market Capital*, 2008 COLUM. BUS. L. REV. 172, 176–78 (2008).
2. Steven M. Davidoff, *Paradigm Shift: Federal Securities Regulation in the New Millennium*, 2 BROOK. J. CORP. FIN. & COM. L. 339, 356–57 (2008).
3. Davidoff, *supra* note 1, at 178–79.
4. *Id*. at 179.
5. Fin. Indus. Regul. Auth., Inc., *Regulatory Notice 08-54: Guidance on Special Purpose Acquisition Companies*, FINRA, https://www.finra.org/rules-guidance/notices/08-54 (last visited Feb. 28, 2022).
6. Usha Rodrigues & Mike Stegemoller, *Exit, Voice, and Reputation: The Evolution of SPACs*, 37 DEL. J. CORP. L. 849, 871 (2013). A typical SPAC unit offering is a combination of securities, including common shares of the SPAC itself, as well as warrants, which offer future redeemable rights. *Id.*; *see also* Max H. Bazerman & Paresh Patel, *SPACs: What You Need to Know*, HARV. BUS. REV. (2021). https://hbr.org/2021/07/spacs-what-you-need-to-know.
7. Fin. Indus. Regul. Auth., Inc., *supra* note 5.
8. Rodrigues & Stegemoller, *supra* note 6, at 851.
9. The SPAC process is the period during which a SPAC conducts its IPO, sells securities to the public, and identifies a target; this precedes the de-SPAC process, which occurs after acquisition and merger proceedings begin; both proceedings must generally be completed within eighteen to twenty-four months. *Id.* at 871–72; Bazerman & Patel, *supra* note 6; *How special purpose acquisition companies (SPACs) work*, PwC, https://www.pwc.com/us/en/services/consulting/deals/library/spac-merger.html.
10. Fin. Indus. Regul. Auth., Inc., *supra* note 5.

known as sponsors, must then identify a private target suitable for acquisition within a specific timeframe.[11] Once such a target is identified, the potential merger must be approved by a vote of the SPAC's shareholders.[12] If such approval is confirmed, the original shareholders have the opportunity "to redeem their shares rather than participate in the merger."[13] The sponsors then begin the process of taking the target company public through a reverse merger.[14] The target merges into the SPAC[15] through a process known as a de-SPAC.[16] The resulting corporation is a publicly traded company operating the target's original business.[17]

Among their many uses, SPACs are commonly perceived as a cheaper, more streamlined alternative to the standard, time-consuming IPO process.[18] For example, in a traditional IPO, the underwriters conduct substantial due diligence on a target company and assume considerable liability for information disclosed pursuant to the company's S-1 registration statement.[19] In SPACs, however, underwriters do not conduct the same thorough "gatekeeping" due diligence on targets.[20] Nevertheless, SPACs are not without limits. For example, any pursuit of a suitable target company must be completed within two years.[21] If the pursuit fails, the SPAC will ultimately dissolve–and the funds raised for the transaction must be returned to the original SPAC shareholders, plus interest owed.[22]

B. Origins, History, and Recent Boom

1. Heirs to Blank-Check Infamy

The predecessors to SPACs are the infamous "blank-check corporations" that arose in the 1980s.[23] Like SPACs, these blank-check corpo-

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11. *Id*.
12. *What You Need to Know About SPACs—Updated Investor Bulletin*, U.S. Sec. Exch. Comm'n (May 25, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin.
13. Michael Klausner et al., *A Sober Look at SPACs*, 39 Yale J. Regul. 228, 230 (2022).
14. U.S. Sec. Exch. Comm'n, *supra* note 12.
15. Or alternatively, into one of the SPAC's subsidiaries. *Id.*
16. *Id.*; PwC, *supra* note 9.
17. U.S. Sec. Exch. Comm'n, *supra* note 12.
18. Klausner et al., *supra* note 13, at 234.
19. Fin. Indus. Regul. Auth., Inc., *supra* note 5; 15 U.S.C. § 77k(a)(5) (1998).
20. Fin. Indus. Regul. Auth., Inc., *supra* note 5.
21. *Id.*; Klausner et al., *supra* note 13, at 230.
22. Klausner et al., *supra* note 13, at 230.
23. Camila Domonoske, *The Spectacular Rise of SPACs: The Backwards IPO That's Taking Over Wall Street*, NPR Bus. (Dec. 29, 2020), https://www.npr.org/2020/12/29/949257672/the-spectacular-rise-of-spacs-the-backwards-ipo-thats-taking-over-wall-street.

rations had no official business plan–or, alternatively, planned to merge with an unidentified company while issuing penny stocks.[24] These shell corporations quickly became popular vehicles for manipulation and fraudulent abuses.[25] At their height, the perpetrators controlling such companies cost investors approximately $2 billion in losses each year as a result of penny stock fraud.[26] This resulted in substantial regulatory backlash from both Congress and the Securities and Exchange Commission (SEC), who responded with a wave of new laws and promulgated regulations centered around increasing disclosure requirements.[27] These regulations ultimately led to the decline of this first version of shell companies.[28]

However, at the end of the 20th century, blank-check companies were reborn and reimagined as the SPAC.[29] SPACs were initially conceived by investment banker David Nussbaum and attorney David Miller at EarlyBirdCapital Inc. in 1993.[30] Originally, Nussbaum and Miller devised SPACs to give private firms an alternative avenue to go public and to access everyday investors.[31] While SPACs were underutilized and rather obscure for several years,[32] their popularity began to rise exponentially in the early 2000s–until utilization fell during the recession in 2007.[33]

In recent years, SPACs have become a major phenomenon.[34] In 2020 alone, their popularity surged, with more than 240 SPACs going public and raising over $80 billion–"compared to $100 billion raised

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24. Fin. Indus. Regul. Auth., Inc., *supra* note 5.

25. Tim Castelli, *Not Guilty by Association: Why the Taint of their "Blank Check" Predecessors Should Not Stunt the Growth of Modern Special Purpose Acquisition Companies*, 50 B.C. L. Rev. 237, 238–39 (2009).

26. *Id.* Penny stocks are shares of companies that trade for less than five dollars per share. Ramsay Lewis & Jasmine Suarez, *What are Penny Stocks? Definition, Risks, How to Invest*, Bus. Insider (July 14, 2022), https://www.businessinsider.com/personal-finance/what-are-penny-stocks. In the 1980s, Penny stockbrokers devised pump and dump schemes, in which they would shift their large quantities of thinly traded securities between nominee accounts, only to promote such securities' limitless potential to investors. Castelli, *supra* note 25 at 239 n.8. The brokers would then sell their substantial blocks "at an artificially inflated price," resulting in major windfalls for the brokers, to the detriment of the investors they had misrepresented. *Id.*

27. *Id*. at 239. These include the Penny Stock Reform Act of 1990 and SEC Rule 419, both of which will be discussed later on. *Infra* Part II.C.1.

28. Castelli, *supra* note 25, at 239.

29. *Id.*

30. Amrith Ramkumar, *SPAC Pioneers Reap the Rewards After Waiting Nearly 30 Years*, Wall St. J. (Mar. 9, 2021), https://www.wsj.com/articles/they-created-the-spac-in-1993-now-theyre-reaping-the-rewards-11615285801.

31. *Id*.

32. *Id.*

33. Matt Collins, *Special Purpose Acquisition Companies*, 2 Fordham Bus. Student Rsch. J. 5, 7 (2012).

34. Ramkumar, *supra* note 30.

by traditional U.S. firm IPOs."[35] SPACs dominated early 2021 even more, overtaking traditional firms by capturing more than 70 percent of the IPO market and raising over $95 billion.[36] Nevertheless, this early boom was largely smothered by a series of statements from the SEC throughout 2021.[37] Further comments from the SEC, new rule proposals, and a slowing IPO market in early 2022 proved disastrous for SPACs, and their popularity substantially declined throughout the year.[38]

Despite their initial popularity with investors, SPACs continue to remain "tainted in the minds of regulators" and subject to the "SEC's ongoing distaste" due to their shared history with blank-check corporations.[39]

2. The Investors

When considering the nature of SPACs and the impact they have, it is also important to understand the types of investors engaging in these transactions, which include institutional investors and two potential groups of retail investors who may be inclined to participate in the SPAC market.

First, there are the institutional investors, who are the preferred candidates for IPO underwriters.[40] This is because institutional investors have an easier ability "to buy large blocks of IPO shares, assume the financial risk, and hold the investment for the long term."[41] Often, these are highly specialized hedge funds.[42]

Now consider the retail investors looking to profit from a SPAC. These amateur investors receive access to SPACs through two avenues:[43] (1) retail investors can either purchase IPO shares of the SPAC

35. Jennifer Schulp, *SPAC Attack: SEC Slowdown Hits Investment Vehicle*, REASON FIN. (Apr. 5, 2021), https://reason.com/2021/04/05/spac-attack-sec-slowdown-hits-investment-vehicle/.

36. *Id.*

37. *Id.*; *Accounting and SEC Reporting Considerations for SPAC Transactions*, DELOITTE (Apr. 11, 2022), https://dart.deloitte.com/USDART/home/publications/deloitte/financial-reporting-alerts/2020/spac-transactions.

38. Bailey McCann, *Gone but Not Forgotten*, MIDDLE MKT. GROWTH (Sept. 15, 2022), https://middlemarketgrowth.org/spac-gone-but-not-forgotten/.

39. Castelli, *supra* note 25, at 238, 241.

40. Investor.gov, *Initial Public Offerings, Why Individuals Have Difficulty Getting* Shares, U.S. SEC. EXCH. COMM'N, https://www.investor.gov/introduction-investing/investing-basics/glossary/initial-public-offerings-why-individuals-have (last visited Feb. 28, 2022).

41. *Id.*

42. Bazerman & Patel, *supra* note 6.

43. *Nothing But The Facts: Retail Investors and Special Purpose Acquisition Companies*, COMM. CAP. MKT. REGUL., https://www.capmktsreg.org/wp-content/uploads/2021/10/CCMR-NBTF-SPACs-Retail-Investors.pdf (last visited Feb. 28, 2022).

from an underwriter[44] or, alternatively and more commonly, (2) retail investors can purchase shares of the SPAC on the secondary market after the SPAC IPO.[45]

Each investor group retains two primary safeguards on their investment: (1) they can approve or reject the sponsors' proposed target for acquisition, or (2) they can opt to redeem their original investment, plus interest, as opposed to moving forward with shares in the acquired entity.[46]

C. Historical and Contemporary Regulation

1. Securities Act of 1933, Securities Exchange Act of 1934

The Securities Act of 1933 (Securities Act)[47] was devised to effectively achieve two primary goals: (1) require investors to receive significant and financial information concerning publicly sold securities; and (2) prevent misrepresentation, fraud, and deception in the selling of securities.[48] Rule 419 of the Securities Act governs offerings by blank-check companies and has several requirements.[49] First, the Rule mandates investors' funds be held in escrow, not invested elsewhere.[50] Next, it requires the company to file a post-effective amendment once an acquisition agreement has been executed.[51] Finally, it stipulates that any escrowed funds must be returned, should an acquisition fail to transpire within 18–24 months of the company's original registration statement.[52]

Although blank-check companies are required to comply with Rule 419, SPACs are not.[53] Indeed, SPACs were specifically designed to avoid classification as blank-check companies within the meaning of the securities laws.[54]

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44. This rarely occurs, despite the fact that "smaller or individual investors are finding it easier to buy IPO shares through online brokerage firms." U.S. SEC. EXCH. COMM'N, *supra* note 40.

45. COMM. CAP. MKT. REGUL., *supra* note 43.

46. *Id.*; Bazerman & Patel, *supra* note 6.

47. *See* 15 U.S.C. § 77 (2021).

48. Investor.gov, *The Laws That Govern the Securities Industry*, U.S. SEC. EXCH. COMM'N, https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry (last visited Oct. 21, 2022).

49. Fin. Indus. Regul. Auth., Inc., *supra* note 5; *see* 17 C.F.R. § 230.419 (2021).

50. 17 C.F.R. § 230.419(b) (2021).

51. *Id.* at (e)(1).

52. *Id.* at (e)(2)(iv).

53. *What's the Deal? Special Purpose Acquisition Companies,* MAYER BROWN, https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2020/08/whats-the-deal--spacs.pdf (last visited Feb. 28, 2022).

54. *Id.*

The Exchange Act defines the statutory requirements for an organization to constitute a blank-check company.[55] The Penny Stock Reform Act (PSRA) amended the Exchange Act in 1990 by altering Section 3(a) of the statute to include penny stocks, in order to combat the abuse of newly formed shell companies.[56] Shortly thereafter, the usage of traditional blank-check companies substantially diminished, with approximately 2,700 offerings between 1987–1990 falling to fewer than fifteen in the early 1990s.[57]

Although SPACs are often referred to synonymously with their predecessors, they do not issue penny stocks as required by the statutory definition[58] under Rule 3a51-1[59] of the Exchange Act.[60] As such, SPACs are not required to comply with Rule 419 of the Securities Act.[61] Indeed, most SPACs take advantage of the Rule 3a51-1(g) exclusion to avoid the requirements of Rule 419.[62]

2. *PSLRA Amendment*

The Private Securities Litigation Reform Act of 1995 (PSLRA), an amendment to the Securities Act, established protections under safe harbor provisions for forward-looking statements.[63] Forward-looking statements are projections based on the future potential performance of a corporation, "such as revenues and income, plans for future operations, etc."[64] These liability provisions under the PSLRA allow

55. 17 C.F.R. § 230.419(a)(1)–(2); 17 C.F.R. § 240.3a51-1 (2021).

56. Castelli, *supra* note 25, at 249; Penny Stock Reform Act § 503 (1990); *see* 17 C.F.R. § 240.3a51-1 (2021).

57. Derek K. Heyman, *From Blank Check to SPAC: The Regulator's Response to the Market, and the Market's Response to the Regulation*, 2 ENTREPRENEURIAL BUS. L.J. 531, 532 (2007).

58. "Penny stocks" are defined as:

> [A]ny equity security other than a security that is–(i) registered or approved for registration and traded on a national securities exchange that meets such criteria as the [SEC] shall prescribe by rule or regulation for purposes of this paragraph; (ii) authorized for quotation on an automated quotation system sponsored by a registered securities association . . . [after passage of the PSRA]; (iii) issued by an investment company registered under the Investment Company Act of 1940; (iv) excluded, on the basis of exceeding a minimum price, net tangible assets of the issuer, or other relevant criteria, from the definition of such term by rule or regulation which the [SEC] shall prescribe . . . ; or (v) exempted, in whole or in part, conditionally or unconditionally, from the definition of such term by rule, regulation, or order prescribed by the [SEC].

15 U.S.C. § 78c(a)(51)(A) (2012).

59. 17 C.F.R. § 240.3a51-1 (2021).

60. MAYER BROWN, *supra* note 53; *see* 17 C.F.R. § 240.3a51-1 (2021).

61. MAYER BROWN, *supra* note 53.

62. *Id.*; 17 C.F.R. § 240.3a51-1(g) (2021).

63. *See* 15 U.S.C. § 77z-2 (2010).

64. Daniele D'Alvia & Milos Vulanovic, *A Rethinking of Forward-Thinking Statements in U.S. SPACs*, FORDHAM J. CORP. FIN. L. (July 13, 2021), https://news.law.fordham.edu/jcfl/2021/07/13/a-rethinking-of-u-s-forward-looking-statements-in-spacs/.

SPACs to voluntarily disclose valuable investor information about the target corporations' potential future in forward-looking projections during the de-SPAC process; however, these provisions specifically excluded forward looking statements in connection with an offering of securities from a blank check company.[65]

Since SPACs are generally able to evade classification as blank-check companies, these protections offer them "the ability to include forward-looking financial projections in a proxy or registration statement rather than historical financial results"–a sharp contrast to traditional IPOs.[66] In effect, the PSLRA established safe harbor protections for selected issuers, including the public company resulting from a SPAC.[67] This serves as a key distinction between SPACs and a traditional IPO. The PSLRA has modified the qualifications for SPAC targets' forward-looking statements, granting them the ability to utilize forward-looking projections while remaining exempt from liability[68] under the Securities Act[69] and Exchange Act.[70]

3. *Investment Company Act of 1940*

Because SPACs are not usually bound by Rule 419 of the Securities Act, they are not strictly required to hold their investors' funds in escrow.[71] SPACs, however, tend to hold the vast majority of their investors' funds in a trust account, investing them in very safe assets, such as United States Treasury securities and money market funds.[72] Traditionally, such accounts have not been treated as investments. Just as SPACs carefully craft their activities to avoid classification as blank-check companies, so also do they craft the structure of their trust accounts to avoid classification as investment companies within the meaning of the Investment Company Act of 1940 (Investment Act).[73]

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65. *Id.*; John Coates, *SPACs, IPOs, and Liability Risks under the Securities Laws*, U.S. Sec. Exch. Comm'n (Apr. 8, 2021), https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws.

66. D'Alvia & Vulanovic, *supra* note 64.

67. *Id.*

68. *Id*.

69. *See* 15 U.S.C. § 77k (1998).

70. 15 U.S.C. § 78j(b) (2010).

71. Mayer Brown, *supra* note 53. It should also be noted that holding investors' funds in escrow often remains market practice for SPACs, despite this latitude. *Id*.

72. Matt Levine, *SPAC Suit Leads to SPARCs: SPACs as Investment Companies, SPARCs vs SPACs, and Insider Trading on Comparable Companies*, Bloomberg (Aug. 23, 2021), https://www.bloomberg.com/opinion/articles/2021-08-23/spac-suit-leads-to-sparcs.

73. Mayer Brown, *supra* note 53; 15 U.S.C. §§ 80a-3 (2018).

As a result, many critics often point out SPACs are not governed like other investment companies under the Investment Act.[74] Moreover, SPACs are criticized for their substantial sponsor fees, which can often be 20 percent of the post-merger proceeds.[75] These critics assert that if SPACs were considered investment companies within the statute for "hold[ing] [themselves] out as being primarily engaged in . . . the business of investing, reinvesting, or trading in securities . . . or [are] engaged or propose[ ] to engage in the business of investing, reinvesting, or trading in securities," then such fees cannot be permitted.[76] In response, SPACs primarily rely on Rule 3a-1 of the Investment Act, which excludes companies who have no more than 45 percent of their total assets in securities, and no more than 45 percent of the issuer's after-tax net income invested in securities.[77]

D. Legislative, Regulatory, and Judicial Treatment

1. Congress

Congress remains concerned with the popularity of SPACs, as well as the potential issues presented by them.[78] On November 16, 2021, the House Financial Services Committee approved two bills centered around SPAC reforms.[79] These include the "Holding SPACs Accountable Act" and the "Protecting Investors from Excessive SPAC Fees Act."[80]

The first act would effectively exclude SPACs from the safe harbor provisions protecting liability for forward-looking statements under the PSLRA.[81] The second would authorize the SEC to prevent those SPACs who do not provide the necessary disclosures, or those that provide certain types of compensation to sponsors from trading their securities to retail investors.[82]

2. The Securities and Exchange Commission

The SEC has released several statements over the past two years foreshadowing increased scrutiny and tighter disclosure regulations

74. Levine, *supra* note 72; *see* 15 U.S.C. §§ 80a-1–80a-64.
75. Klausner, et al., *supra* note 13 at 232–34, 236.
76. Levine, *supra* note 72; 15 U.S.C. § 80a-3(a).
77. MAYER BROWN, *supra* note 53; 17 C.F.R. § 270.3a-1(a) (2021).
78. *Committee Passes Legislation to Protect Retail Investors from Predatory Practices and Promote Fair Hiring Opportunities*, U.S. HOUSE COMM. FIN. SERVS. (Nov. 16, 2021), https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=408688.
79. *Id.*
80. *Id.*; H.R. 5910, 117th Cong. (2021); H.R. 5913, 117th Cong. (2021).
81. U.S. HOUSE COMM. FIN. SERVS., *supra* note 78, at 2; H.R. 5910, 117th Cong. (2021).
82. U.S. HOUSE COMM. FIN. SERVS., *supra* note 78, at 3; H.R. 5913, 117th Cong. (2021).

for SPACs. The first of these statements was released in December 2020 when the Division of Corporation Finance issued guidance on several disclosures, including sponsor/management conflicts of interest in competing organizations, the compensation structure of the SPAC, and financial incentives for completing a merger within a certain timeframe.[83] They also released guidance on a number of additional disclosures for de-SPAC transactions themselves, ranging from additional financing disclosures, to convertible securities' terms, target company selection details, and requirements to obtain a fairness opinion, among others.[84]

In March 2021, the agency also announced that SPACs must provide better recordkeeping with regard to their internal accounting, throughout both the pre-IPO process and de-SPAC transaction.[85] The Division of Corporation Finance stated that, once a SPAC merged with a target company, the new entity must be in compliance with SEC public reporting requirements.[86] The Division of Corporation Finance also noted the various governance and financial reporting issues that should be carefully considered by any private company considering a business combination with a SPAC.[87]

Then on April 8, 2021, the agency issued a statement on the PSLRA's safe harbor liability protections for forward-looking statements, clarifying that such provisions only apply to private litigation action–not SEC enforcement–and only if particular conditions are satisfied.[88] The SEC's scrutiny surrounding SPACs went even further when they declared that "the Commission could use the rulemaking process to reconsider and recalibrate the applicable definitions, or the staff could provide guidance explaining its views on how or if at all the PSLRA safe harbor should apply to de-SPACs"–a move that could exclude SPACs from the financial projection safe harbor protections of the PSLRA.[89]

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83. Div. Corp. Fin., *CF Disclosure Guidance: Topic No. 11*, U.S. SEC. EXCH. COMM'N (Dec. 11, 2020), https://www.sec.gov/corpfin/disclosure-special-purpose-acquisition-companies.

84. *Id.*

85. Div. Corp. Fin., *Staff Statement on Select Issues Pertaining to Special Purpose Acquisition Companies*, U.S. SEC. EXCH. COMM'N (Mar. 31, 2021), https://www.sec.gov/news/public-statement/division-cf-spac-2021-03-31.

86. *Id*.

87. These include restrictions limiting shell companies and those operating companies that they acquire, particularly with regard to financial statements and any reporting obligations under the Exchange Act. *Id.*

88. Coates, supra note 65.

89. *Id.*; Whitney Shephard & Ketan Bhirud, *The SPAC Age: SEC Moves to Increase Oversight Amid Meteoric Rise in Use of "Blank-Check" Companies*, TROUTMAN PEPPER (Oct. 18, 2021),

Four days later, the SEC issued another statement, announcing that warrants issued by SPACs may be required to be accounted for as liabilities under generally accepted accounting principles (G.A.A.P.).[90] This requirement is conditioned on whether or not there is a provision to change the settlement amount of the warrant or if there is a qualifying tender offer that entitles all warrant holders to cash and only certain common stockholders to cash.[91] Not only did these changes in accounting requirements worry investors,[92] but they also had the potential to delay a significant number of SPAC mergers and IPOs.[93] Following the issuance of these April 2021 statements, there was a notable decline in SPAC IPOs.[94]

Then in March 2022, newly proposed rule changes were announced that would force SPACs to operate more like traditional IPOs, with increased liabilities for underwriters and more accounting, disclosure, and marketing requirements.[95] The proposal "led to a pullback from issuers and financiers as they evaluate exposure and compliance risk, and consider adjustments to existing due diligence practices in order to align with any eventual rule revisions."[96] The new proposal would also allow SPACs to fall under the Investment Act and qualify as investment companies under the statute, should they fail to "announce a deal within 18 months from the date of its IPO and close within 24 months."[97] SEC Chairman Gary Gensler, however, stated that the new proposal, if adopted, would "help[ ] ensure that investors in these vehicles get protections similar to those when investing in traditional initial public offerings."[98]

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https://www.regulatoryoversight.com/2021/10/the-spac-age-sec-moves-to-increase-oversight-amid-meteoric-rise-in-use-of-blank-check-companies/.

90. John Coates & Paul Munter, *Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies ("SPACs")*, U.S. SEC. EXCH. COMM'N (Apr. 12, 2021), https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs.

91. *Id*.

92. Steven Bertoni & Antoine Gara, *Hot SPAC Market Could Freeze After Potential SEC Rule Change*, FORBES (Apr. 12, 2021), https://www.forbes.com/sites/stevenbertoni/2021/04/12/hot-spac-market-could-freeze-after-potential-sec-rule-change/?sh=7e885239444c.

93. Steven Davidoff Solomon, *In Defense of SPACs*, N.Y. TIMES (June 12, 2021), https://www.nytimes.com/2021/06/12/business/dealbook/SPACs-defense.html.

94. *Id*.

95. McCann, *supra* note 38; Gary Gensler, *Statement on Proposal on Special Purpose Acquisition Companies (SPACs), Shell Companies, and Projections*, U.S. SEC. EXCH. COMM'N (Mar. 30, 2022), https://www.sec.gov/news/statement/gensler-spac-20220330.

96. McCann, *supra* note 38.

97. Michelle Celarier, *Nearly Half of SPACs are Likely to Liquidate if SEC Rules are Adopted*, INSTITUTIONAL INV. (Aug. 9, 2022), https://www.institutionalinvestor.com/article/b1z8phz164g3kq/Nearly-Half-of-SPACs-Are-Likely-to-Liquidate-If-SEC-Rules-Are-Adopted.

98. Gensler, *supra* note 95.

3. The Judiciary

In addition to SEC statements and scrutiny, various lawsuits have also led to uncertainty against SPACs. Many of these suits assert SPACs should be classified as investment companies within the meaning of the Investment Act.[99] This position is based on SPAC sponsors' responsibilities managing investors' funds, which are generally placed in safe securities until a target is identified.[100] As a result, these lawsuits desire judicial intervention to redefine the way courts have interpreted law governing SPACs over the past two decades.

In a particularly noteworthy series of suits filed by former SEC Commissioner Robert Jackson and law professor John Morley, the two argued the primary purpose of SPACs is the same as that of other investment companies–to invest in securities.[101] Each complaint made the same allegations: (1) SPACs operate as investment companies within the meaning of the Investment Act by investing in securities; (2) investing in securities is all these companies have ever done; (3) the manner in which the defendant SPACs have structured the shell companies poses the exact danger the Investment Act sought to address; and (4) defendant sponsors have used their dominance and control over the companies to pay illegal compensation at shareholder expense.[102]

Under section 3(a)(1)(A) of the Investment Act, an investment company is one that holds itself to be "engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting or trading in securities."[103] Therefore, Jackson and Morley alleged SPACs engage primarily in the business of investing and contend they should be subject to the more stringent standards required by the Investment Act.[104]

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99. Alison Frankel, *49 Firms in 72 Hours: How the SPAC Bar United Against Law Profs' Splashy Lawsuits*, REUTERS (Aug. 30, 2021), https://www.reuters.com/legal/litigation/49-firms-72-hours-how-spac-bar-united-against-law-profs-splashy-lawsuits-2021-08-30/.

100. *Id.*

101. *Id.*

102. Assad v. Pershing Square Tontine Holdings, Ltd. et al., No. 1:21-cv-06907-AT (S.D.N.Y. Aug. 17, 2021); Assad v. Go Acquisition Corp., No. 1:21-cv-07076-JPC (S.D.N.Y. Aug. 20, 2021); Assad v. E.Merge Tech. Acquisition Corp., No. 1:21-cv-07072-JPO (S.D.N.Y. Aug. 20, 2021). *See also Lawsuits Targeting SPACs as Unregistered Investment Companies*, GOODWIN PROCTOR (Sept. 1, 2021), https://www.goodwinlaw.com/publications/2021/09/09_01-lawsuits-targeting-spacs-as-unregistered.

103. 15 U.S.C. § 80-3(a)(1)(A) (2018); *Over 60 of the Nation's Leading Law Firms Respond to Investment Company Act Lawsuits Targeting the SPAC Industry*, KIRKLAND & ELLIS (Sept. 2, 2021), https://www.kirkland.com/-/media/publications/alert/2021/08/49-of-the-nations-leading-law-firms-respond-to-inv.pdf.

104. Frankel, *supra* note 99.

Over sixty major law firms leaped to defend SPACs, with proponents contending the investment trust accounts established serve only to protect the investors of the SPAC, as the accounts are limited to short-term treasuries and qualifying money market accounts.[105] While many of these firms are involved with SPAC sponsors, many Investment Act specialists whose firms do not represent SPAC sponsors also circulated drafts of the joint statement to attorneys at other firms.[106] Indeed, it is the belief of many SPAC attorneys that, if courts agree with the claimants' theory, "it would wreak havoc in the industry, forcing sponsors to restructure their compensation and find new ways to safeguard investors' capital."[107] Further, many defenders also asserted that SPACs are not "in the business of investing, reinvesting, or trading in securities"–rather, they "are engaged primarily in identifying and consummating a business combination with one or more operating companies within a specified period of time."[108]

III. Analysis

The following section of this Comment will analyze the potential threats attributed to SPACs, the increasing regulatory scrutiny levied by the legislature, the SEC, and litigious actors, and the underlying justification for such intervention. It will also examine the potential benefits SPACs offer to retail investors and the market altogether. However, this analysis is not an argument advocating for SPACs. Rather, it is an examination of whether the SPAC alternative to the traditional IPO can outweigh the threats concerning so many regulatory forces, as well as the necessity and efficacy for such SPAC interventions or future action–particularly those of legislative and judicial origin.

A. Congressional Intervention is Unnecessary

The particularly callous treatment SPACs have received from government actors disregard and downplay the possible benefits they can offer. Indeed, these same actors over-emphasize the potential dangers posed by these IPO alternatives. Such notoriety may sometimes be warranted due to SPACs unfortunate connection to the infamous blank-check companies of the 1980s.[109] To determine whether regulators have outshined the benefits SPACs can offer retail investors

105. Kirkland & Ellis, *supra* note 103; Goodwin Proctor, *supra* note 102.
106. Frankel, *supra* note 99.
107. *Id.*
108. Kirkland & Ellis, *supra* note 103.
109. Domonoske, *supra* note 23.

through their rapacious attempts to quash their rise, it is necessary to first consider prior legislative scrutiny and recent attempts to further intervene.[110]

Throughout the history of the American financial market system, Congress has enacted a variety of legislation governing financial markets on several occasions.[111] Those most relevant to SPACs remain the Securities Act,[112] the Exchange Act,[113] and the Investment Act,[114] along with a variety of amendments to each respective act. As explained in Part II, many of these statutes serve to protect investors from any number of frauds and misrepresentations surrounding shell company abuses.[115] Nevertheless, some individuals contend that even more congressional action is still necessary to achieve these goals.[116]

Already, there are fewer private companies going public than seen in prior decades.[117] Of those that ultimately go public, they are waiting substantially longer to do so.[118] SPACs offer a much-needed alternative avenue for private entities to enter the public market. Their careful design in evading classification as blank-check companies and their ability to avoid inclusion in the Securities Act Rule 419 requirements make them an attractive option for private companies by allowing less liability exposure than conventional IPOs.[119] Further, SPACs' ability to take advantage of the Rule 3a51-1(g) exclusion and avoid the otherwise required Rule 419 prohibitions on securities trading during a business combination is critical to the SPAC process success.[120] Indeed, one of the major differences between SPACs and traditional IPOs is the SPACs' ability to take advantage of the

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110. Investor.gov, *The Laws that Govern the Securities Industry*, U.S. SEC. EXCH. COMM'N, https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry (last visited Jan. 28, 2022); *Waters Opening Statement at Hearing on SPACs, Direct Listing, and Public Offerings*, U.S. HOUSE COMM. FIN. SERVS. (May 24, 2021), https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=407916.

111. Investor.gov, *The Laws that Govern the Securities Industry*, U.S. SEC. EXCH. COMM'N, https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry (last visited Jan. 28, 2022).

112. 15 U.S.C. §§ 77a.

113. 15 U.S.C. §§ 78a.

114. *See* 15 U.S.C. §§ 80a-1–80a-64; *supra* Part II.C.

115. *See supra* Part II.

116. U.S. HOUSE COMM. FIN. SERVS., *supra* note 110.

117. *See infra* Part IV.

118. *Id.*

119. Frantz Jacques, *The Evolving Landscape of SPACs*, ABA. (Feb. 7, 2022), https://www.americanbar.org/products/inv/book/415163622/.

120. MAYER BROWN, *supra* note 53.

PSLRA's safe harbor protections.[121] Opting for a SPAC merger rather than a traditional IPO is very much dependent on such distinctions.

Nevertheless, some legislators have already taken steps to close this loophole to SPACs. In May 2021 hearing regarding SPACs, the Chairwoman of the House Committee on Financial Services stated: "I have deep concerns about the lack of transparency and accountability that is a hallmark of the SPAC process," and that "[SPACs] are structured to ensure Wall Street insiders receive huge profits and retail investors pay the cost."[122] Then in November 2021, the Committee approved two bills, aptly named the "Holding SPACs Accountable Act" and the "Protecting Investors from Excessive SPAC Fees Act."[123]

If passed into law, these acts would result in a major overhaul in the application of the forward-looking PSLRA's safe harbor protections to SPACs,[124] and they would authorize the SEC to require more specific disclosures.[125] These actions would not only be devastating to the SPAC process, but they are unnecessary and superfluous for a variety of reasons, including the fact that there is not enough ongoing retail investing to warrant further congressional intervention, and the SEC already has sufficient authority to effectively regulate SPACs.

1. Retail Investing is Insufficient to Warrant Intervention

Detractors of SPACs generally point to investor harm to justify their impassioned pursuit of further regulation and oversight.[126] As noted earlier, a few reservations have been raised on policy issues concerning SPACs, such as the current "disclosure requirements and securities law liability standards" which govern them.[127] However, most of the apprehension surrounding SPACs throughout 2020 and 2021 was primarily focused on the alleged negative impact SPAC investing has on retail investors, as well as the role these amateurs play when investing.[128]

And yet, from the data that is currently available on participating SPAC investors, it seems that retail investors only make up a trivial

121. *See supra* Part II.C.2 (discussing the safe harbor protections of the PSLRA or the Private Securities Litigation Reform Act of 1995); Davidoff Solomon, *supra* note 93.

122. U.S. House Comm. Fin. Servs., *supra* note 110.

123. U.S. House Comm. Fin. Servs., *supra* note 78.

124. *See supra* Part II.C.2 (discussing the safe harbor protections).

125. U.S. House Comm. Fin. Servs., *supra* note 78.

126. Heister M. Peirce, *Inside Chicken: Remarks before Fordham Journal of Corporate and Financial Law Conference: "Here to Stay: Wrestling with the Future of the Quickly Maturing SPAC Market,"* U.S. Sec. Exch. Comm'n (Oct. 22, 2021), https://www.sec.gov/news/speech/peirce-remarks-fordham-journal-102221.

127. Comm. Cap. Mkt. Regul., *supra* note 43.

128. *Id.*

percentage of those currently attempting to invest.[129] In fact, the median ownership of SPACs by large institutional investors was found to be 85 percent immediately following a SPAC IPO, and 87 percent immediately before a SPAC merger.[130] Retail trading on the secondary market between the SPAC IPO and merger was minimal as well, making up approximately 0.08 percent of all outstanding shares for "the 30-day average trading volume for all SPACs."[131]

SEC Commissioner Hester Peirce stated that many critics contend that SPACs "are not appropriate for retail investors" and "the complexity, opacity, and mechanics of the [SPAC] process and the slimmed down protections work to the detriment of retail investors and the benefit of the sophisticated parties involved in these transactions."[132] However, such criticism is inordinate, considering retail participation is negligible.[133] Even though retail investors have access to SPACs in the secondary market and potential access prior to their initial offerings, findings demonstrate that, at present, retail investments are relatively minimal.[134] Rather, the vast majority of investments in SPACs are from institutional investors.[135] So if there is currently minimal participation from retail investors in SPAC IPOs, and extremely limited retail trading in the secondary market,[136] it seems relatively ineffectual to contend that SPACs are working to the detriment of retail investors when such investors are not participating on a substantial scale.

Admittedly, Peirce even stated "[i]f retail investors are being fleeced, as some critics assert, then I agree we need to evaluate how to level the playing field and ensure appropriate protections. However, the limited evidence thus far suggests retail investors may play a limited role in SPACs."[137] Afterward, she continued to confirm the current reality: institutional investors contribute most of the capital at the SPAC IPO stage, with extremely limited participation from retail investors in the secondary market.[138] Therefore, the theory that the SPAC process works only to benefit a small group of malevolent and

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129. *Id.*

130. *Id.*

131. *Id.*

132. Peirce, *supra* note 126. *See also Investor Advisory Committee Meeting*, U.S. SEC. EXCH. COMM'N (Mar. 11, 2021) (available at https://www.sec.gov/video/webcast-archive-player.shtml?document_id=iac031121) (discussing Special Purpose Acquisition Companies).

133. COMM. CAP. MKT. REGUL., *supra* note 43.

134. *Id.*

135. *Id.*

136. *Id.*

137. Peirce, *supra* note 126.

138. *Id.*

sophisticated Wall Street executives at the expense and detriment of amateur retail investors is simply not substantially supported by available data, as retail investor participation in SPACs is minimal.[139] As a result, congressional action against SPACs to protect retail investors is not only unnecessary, but excessive.

2. The SEC Has Adequate Authority to Regulate SPACs

In addition to current data showing little retail investing in SPAC transactions, congressional action is also unnecessary because the SEC already has sufficient authority to regulate SPACs. Over the past two years, the SEC has issued numerous statements against SPACs expressing several potential increases in regulatory action.[140] SEC chairman Gary Gensler is a proponent of stricter financial regulations,[141] he openly described the SEC's intention to align SPACs' structures and registration obligations with those of standard IPOs,[142] and supported such action when the SEC issued its proposal in March 2022.[143] Furthermore, the additional guidance and regulations implemented by the SEC between 2020 and 2022 have already substantially impacted the SPAC markets.[144]

The SEC's 2021 statements threatening higher regulation reduced SPAC activity from a boom to a trickle.[145] Such a considerable move demonstrates the impressive weight of authority the agency retains over SPACs.[146] The agency's statements asserting that the PSLRA's safe harbor protections protect only against private litigation–not SEC enforcement–ignited a firestorm of investor uncertainty.[147] The SEC further panicked investors when they declared that the SEC could redefine IPOs to include de-SPAC transactions as an IPO–which would effectively exclude SPACs from the safe harbor provisions altogether.[148] Mere days later, the agency issued additional guidance man-

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139. COMM. CAP. MKT. REGUL., *supra* note 43; Peirce, *supra* note 126.

140. *See supra* Part II.D.2 (discussing the various SEC statements on SPAC requirements and regulation).

141. Robert J. Anello & Anthony Sampson, *Gensler Gets Philosophical: Calls for New SPAC Rules and Hints at PSLRA Change*, FORBES (Jan. 6, 2022), https://www.forbes.com/sites/insider/2022/01/06/gensler-gets-philosophical-calls-for-new-spac-rules-and-hints-at-pslra-change/?sh=7985e10f7eac.

142. *Id.*

143. Gensler, *supra* note 95.

144. *See supra* Part II.D.2.

145. *Id.*

146. *Id.*

147. *See Id.* (discussing the SEC regulations implemented in April 2021); Coates, *supra* note 65.

148. Coates, *supra* note 65.

dating SPACs to account for warrants issued as liabilities rather than equity, which caused a major accounting debacle among the shell companies.[149]

Then in 2022, the SEC's new rule proposal all but crushed any remaining popularity surrounding the SPAC alternative to the traditional IPO process.[150] In her dissent, SEC Commissioner Heister Peirce stated "[t]he proposal–rather than simply mandating sensible disclosures around SPACs and de-SPACs, something I would have supported–seems designed to stop SPACs in their tracks . . . [a]ccordingly, I dissent."[151]

The SEC's power display with these statements and proposals adequately demonstrates their ability to control the SPAC market, and it seems like the agency has no intention of allowing SPACs to continue without a substantial increase in regulatory scrutiny.[152] Gensler has openly exhibited his express intention to implement stricter regulations in 2022 if necessary.[153]

This approach to SPAC regulation appears to be more than adequate, and the commissioners are not proceeding like regulators with their hands bound by a lack of congressionally authorized authority. They are prepared and empowered to crackdown on SPACs whenever, constantly analyzing the need for further regulations. Commissioner Peirce, while averse to the SEC's proposed rule changes, confirmed "[i]f we adopt the rule that we are voting on today, we will not need additional resources to deal with Special Purpose Acquisition Companies." Nevertheless, proponents of increasing regulations remain equally concerned with supposedly competing interests inherent in SPAC leadership, which include excessive SPAC fees and sponsor compensation.[154]

SPAC critics concerned with such competing interests remain wary of the SEC's approach to regulating incentive conflicts, contending that the motivations driving different investors are inherently borne by the SPAC structure and are seen within different stages of the

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149. *See supra* Part II.D.2.

150. McCann, *supra* note 38.

151. Heister M. Peirce, *Damning and Deeming: Dissenting Statement on Shell Companies, Projections, and SPACs Proposals*, U.S. Sec. Exch. Comm'n (Mar. 30, 2022), https://www.sec.gov/news/statement/peirce-statement-spac-proposal-033022.

152. David Gura, *SEC Chair Gary Gensler says tougher rules for hot, buzzy SPACs are coming*, NPR Bus. (Dec. 7, 2021), https://www.npr.org/2021/12/07/1062004006/sec-chair-gary-gensler-says-tougher-rules-for-hot-buzzy-spacs-are-coming-soon; *see* Peirce, *supra* note 126.

153. Gura, *supra* note 152; Gensler, *supra* note 95.

154. Coates, *supra* note 65. *See also* Peirce, *supra* note 126.

SPAC process no matter what.[155] They claim that "the economic incentives for an IPO investor may differ from those of an investor who purchased later in the secondary markets, and PIPE investors[156] who receive discounted shares may have different incentives than the SPAC shareholders."[157]

Of these competing interests, SPAC sponsors often find themselves in conflict with the best interests of the SPACs' shareholders.[158] After the de-SPAC transaction, various fees are generally covered at the expense of the shareholders' profits.[159] While sponsor compensation plans are generally very high, often worth as much as 20 percent of the equity raised from the original investors,[160] some advocate sponsors deserve such percentages for taking on the risks associated with the venture.[161]

Concerns over this issue are also unnecessary, however, as the SEC is more than prepared to deal with this as well. Commissioner Peirce noted the possibility of SEC intervention in 2021, acknowledging the rise in celebrity-sponsored SPACs:[162] "[i]n spite of the complexity inherent in the [SPAC] structure, SPACS are so popular that celebrities have gotten into the game. Or maybe they are so popular *because* celebrities have gotten into the game."[163] The rule proposal issued in March 2022 also contained new sponsor conflict of interest requirements to deal specifically with these concerns,[164] solidifying the contention that the SEC is more than capable of dealing with this issue as well with its current regulatory authority.

As a result, the SEC leadership continues to convey confidence in the SEC's abilities to properly regulate SPACs,[165] and the question

155. Peirce, *supra* note 126.

156. PIPE refers to a Private Investment in Public Equity, i.e., wealthy and institutional investors who inject substantial amounts of capital in exchange for discounted shares. *Id.*

157. *Id.*

158. *Id.*

159. Commissioner Peirce noted "[SPAC critics] identified substantial dilution of the post-merger shares that stems from the sponsor's promote fee, underwriting fees, and warrants and rights and observed that these costs are primarily borne by the SPAC shareholders." *Id.*

160. Bazerman & Patel, *supra* note 6.

161. *Id.*

162. Celebrity-Sponsored SPACs in particular have caused the most concern, as many celebrities are far from prudent financial managers. *Celebrity Involvement with SPACs – Investor Alert*, U.S. SEC. EXCH. COMM'N (Mar. 10, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/celebrity-involvement-spacs-investor-alert.

163. *Id.*

164. *SEC Proposes Sweeping Changes to SPAC Regulatory and Disclosure Regime*, SIMPSON & THATCHER (Apr. 27, 2022), https://www.stblaw.com/docs/default-source/memos/firmmemo_04_27_22.

165. U.S. SEC. EXCH. COMM'N, *supra* note 162; Peirce, *supra* note 151; Gensler, *supra* note 95. The repeated statements of Commissioner Peirce and Chairman Gensler imply that the agency is

shifts to *how* the SEC should regulate SPACs. It could have followed Commissioner Peirce's more cautious course of action, which she described in October 2021. Peirce described her plan to revise SPAC regulation.[166] First, the SEC should identify and understand investor behaviors and incentives at each stage of the SPAC process.[167] Second, the SEC should ensure that SPAC disclosures are sufficient to actively inform investors of necessary information and to avoid conveying any misinforming.[168] Third, "the SEC should maintain a sensible substantive regulatory framework for SPACs."[169] Specifically, the SEC should provide a framework that can effectively guide private companies seeking to go public through a SPAC transaction by ensuring they are aware and prepared for the serious obligations that come with becoming a public company.[170]

Instead of this approach, the SEC went with a proposed rule change that effectively killed the SPAC market.[171] In dissenting, Peirce stated the SEC's proposal "imposes a set of substantive burdens that seems designed to damn, diminish, and discourage SPACs because [the SEC] do[es] not like them, rather than elucidate them so that investors can decide whether they like them."[172]

While the SEC has previously granted SPACs relatively broad latitude when it comes to fees and sponsorship compensation, the agency has demonstrated that it can constrict that leeway, should it so desire. Considering the effects the SEC's official statements and proposals had on SPAC IPOs, the comments from SEC leadership, and the potential for further regulatory action, it remains abundantly apparent that the agency is in no need of additional congressional authority to adequately regulate SPACs.

B. Judicially Re-Classifying SPACs Would Be Erroneous

Judicial classification of SPACs as investment companies would be nothing but folly. Traditionally, SPACs have dealt with any number of lawsuits concerning fraud, conflicts of interest, disclosure failures, and

more than capable of handling SPAC regulation with its current arsenal of regulatory authority. *Id.*

166. Peirce, *supra* note 126.

167. The SPAC IPO stage, the pre-acquisition secondary trading stage, the potential PIPE stage, and the post-merger stage. *Id.*

168. *Id.*. *See also* Anello & Sampson, *supra* note 141.

169. Peirce, *supra* note 126.

170. *Id.*

171. Peirce, *supra* note 151; Gensler, *supra* note 95; McCann, *supra* note 38.

172. Peirce, *supra* note 151.

other forms of traditional securities violations.[173] Surprisingly, the three Jackson-Morley lawsuits,[174] aiming to reclassify SPACs as investment companies under the Investment Act, remain arguably the most obtrusive.

These derivative lawsuits have received substantial criticism from attorneys and legal experts worldwide.[175] These include Investment Act specialists whose firms are not working for SPAC sponsors.[176] The controversial suits ask for courts to diverge from over two decades of standard practice and procedure of treating SPACs as separate from investment companies.[177] By September 2021, over sixty of the United States' most prestigious and leading white-shoe law firms issued a joint statement condemning the SPAC litigation.[178] The firms contend that although SPACs generally hold the proceeds of their initial IPO in qualifying money market funds and treasuries, they certainly are not in the business of investing in securities within the meaning of the statute.[179]

As noted in Part I, under the Investment Act, an investment company is one that presents itself "as being engage[d] primarily, or proposes to engage primarily, in the business of investing, reinvesting or trading in securities."[180] The lawyers condemning the action rightly note that SPACs do not meet this definition. The attorneys are correct, because SPACs' primary purpose–proposed and in practice–is to identify and complete a combination with another company within a specific time period.[181] The coalition of firms further demonstrate the absurdity of the plaintiffs' claim, asserting:

> [c]onsistent with long-standing interpretations of the 1940 Act, and its plain statutory text, any company that temporarily holds short-term treasuries and qualifying money market funds while engaging in its primary business of seeking a business combination with one or more operating companies is not an investment company under the 1940 Act.[182]

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173. JOSEPH W. BARTLETT, EQUITY FINANCE: VENTURE CAPITAL, BUYOUTS, RESTRUCTURINGS AND REORGANIZATIONS (Aspen Publishers, 2nd ed. 2022).

174. *Id.*; *see* Assad v. Pershing Square Tontine Holdings, Ltd. et al., No. 1:21-cv-06907-AT (S.D.N.Y. Aug. 17, 2021). *See* Assad v. Go Acquisition Corp., No. 1:21-cv-07076-JPC (S.D.N.Y. Aug. 20, 2021). *See also* Assad v. E.Merge Tech. Acquisition Corp., No. 1:21-cv-07072-JPO (S.D.N.Y. Aug. 20, 2021).

175. KIRKLAND & ELLIS, *supra* note 103.

176. *See supra* Part II.D.3.

177. Peirce, *supra* note 126.

178. KIRKLAND & ELLIS, *supra* note 103.

179. *Id.*

180. *Id.* 15 U.S.C. § 80a-1(a)(2).

181. KIRKLAND & ELLIS, *supra* note 103.

182. *Id.*

The SEC's rule change proposals in March 2022 introduced a safe harbor that would bring SPACs under the Investment Act, in a drastic shift from prior interpretation.[183] Kristi Marvin, founder of SPAC Insider, stated that "[a]s investment companies, [SPACs'] activities would be severely restricted and subject to very burdensome compliance requirements . . . [and that] . . . [t]hose requirements can get quite expensive, and most SPACs do not have the funds available to pay for it . . . liquidating would be the most palatable and likely solution."[184]

In the wake of the SEC proposals, former SEC Commissioner Robert Jackson, one of the main proponents of the lawsuits noted earlier, contends "[w]hat we did by suing is showing that the Investment Company Act is important and you need to pay attention to it."[185] The SPAC Jackson sued has since liquidated following the proposed rule changes.[186] While Jackson's class action was not the killing blow, Bill Ackerman stated that uncertainty surrounding the SEC's proposal was a contributing factor to the liquidation.[187]

The SEC's move to bring SPACs under the Investment Act, however, only reinforces the proposition that the courts should refrain from unnecessarily intervening with longstanding regulatory interpretation.

IV. Impact

To judicially redefine and reclassify SPACs as investment companies within the meaning of the Investment Act would constitute a grievous error. Further, the decision to increase regulation of SPACs through either congressional or additional judicial action is grossly excessive and unnecessary. Despite the current appeal of alternative avenues of accessing public financing to many private companies and other advocates, there remains little reason to revise current securities jurisprudence surrounding SPACs. Retail investors are not substantially at risk, as they are not notably engaging in such transactions; and redefining investment companies to include SPACs would break with over two decades of judicial precedent and accepted regulatory enforcement policy, when the SEC has already demonstrated its abilities regarding SPAC regulation. Therefore, the control mechanisms in place are more than satisfactory without excessive congressional or judicial

183. Peirce, *supra* note 151; Simpson & Thatcher, *supra* note 164.
184. Celarier, *supra* note 97.
185. *Id.*
186. *Id.*
187. *Id.*

interference, as the SEC has a sufficient arsenal of regulatory powers available to subdue misadventures resulting from any such abuse of investors, unreasonable fees, or excessive compensation packages.

Indeed, apart from their alleged abuses, SPACs offer a variety of benefits to retail investors and the market altogether. The most important of these–attracting private companies to the public market–is nothing less than essential to the future of American economics. There are currently over thirty million small businesses in the United States, with about 4,000 public companies.[188] However, this number has declined since its peak in the 1990s,[189] and the companies that do eventually choose to go public wait much longer to do so.[190] Therefore, the SEC and regulators face a grander problem than SPACs can impose: a shrinking public market, lessening investment opportunities, and an increasingly expanding private market.[191] When giving her remarks to the Fordham Journal of Corporate and Financial Law conference, Commissioner Peirce made note of this issue, stating "[m]any companies doing the cost-benefit analysis are concluding that the benefits of going public do not justify the costs. Consequently, a lot of growth is happening outside of the public markets and thus outside of the nest eggs of most retail investors."[192]

To increase SPAC regulations through either congressional or judicial intervention will only further exacerbate this growing economic issue. Already, the SEC has rightfully taken measures to reduce the impact SPACs have on the IPO market while considering increasing disclosure requirements and other regulations to ensure investors are protected, but have also acknowledged the need to attract companies to the public market. With these measures, it is clear the SEC has accepted the current reality–alternatives to the traditional IPO process, including SPACs, have something greater to offer investors than the traditional IPO. If SPACs have done nothing else, they attracted a notable faction of private entities to the public market, granting everyday retail investors access to more diverse investment opportunities.

In her concluding remarks at the Fordham conference, Commissioner Peirce acknowledged that the existence and unexpected opulence of SPACs is, at the very least, a condemnation of many unappealing restrictions inherent in a traditional IPO.[193] Indisputably,

188. Peirce, *supra* note 126.
189. *Id*.
190. *Id.*
191. *Id*.
192. *Id.*
193. *Id.*

SPACs have attracted private businesses to go public, bringing back the IPO market for innovative, smaller companies.[194] In 2021 alone, almost twice as many companies opted to go public through SPAC IPOs instead of the traditional avenue.[195]

Commissioner Peirce even went so far as to contemplate the possibility of revisiting the potential application of the PSLRA to the traditional IPO procedures in the future.[196] She claimed:

> [i]f [forward-liability] projections are so important to companies going public through the SPAC process and if the safe harbor is a motivating factor of using the SPAC vehicle, then perhaps we should re-visit the policy considerations that have led to the prohibition on a new public company conducting a traditional IPO from relying on the safe harbor.[197]

Contrary to SPAC regulation, such an IPO action–ironically inspired by SPAC ingenuity–would ultimately require congressional policy reform since the prohibition on IPO forward-looking projections is written into statute.[198]

This suggests that the escalation of SPACs and their usage under the current securities laws have not only been attractive to investors in the market, but also considered–as noted by securities regulators, including an SEC Commissioner, as innovative and attractive to private entities seeking to go public. Overall, these factors taken together suggest that SPACs contain a variety of benefits that will have a lasting impact on the public market, the SEC's policies, and the future of securities regulation.

V. Conclusion

SPACs provide a much-needed alternative for private entities to gain access to financing and to enter the public market through a cheaper and easier process than a traditional IPO. Despite their critics, SPACs do not share the same abuses as their predecessors, and have served as a pipeline for bringing private companies public. Therefore, further congressional action, as well as judicial intervention, is unwarranted and unnecessary. The SEC has demonstrated time and again that it can sufficiently regulate SPACs.

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194. Peirce, *supra* note 126. *See* Davidoff Solomon, *supra* note 93.
195. Davidoff Solomon, *supra* note 93. *See* Bartlett, *supra* note 173.
196. Peirce, *supra* note 126.
197. *Id.*
198. *Id.*