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# SPECIAL PURPOSE ACQUISITION COMPANIES: WALL STREET'S LATEST SHELL GAME

Daniel J. Morrissey*

## I. INTRODUCTION

Special Purpose Acquisition Companies ("SPACs") have been called "Wall Street's biggest gold rush of recent years."[1] In

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* Professor of Law and former Dean, Gonzaga University School of Law. The author would like to thank Marc Steinberg, Wendy Couture, M. Thomas Arnold, Catherine McCauliff, Jay Silver, Agnieszka McPeak, Ann Murphy, Wayne Unger, Hon. Robert Miller, Daniel O'Conner, Brian Cochran, Thomas Geoghegan, and Lance Gotthoffer for their helpful comments. The author would also like to thank faculty research assistant Sharalyn Williams, law student Miles Martin, and faculty assistant Nance Moss for their help in the preparation of this Article. The Article is dedicated to the author's dear niece, Maeve Morrissey, and her parents, Matt and Andrea. Maeve has a strong connection to the University of Arkansas Law School. Her grandfather, Len Bradley, graduated from there with honors in 1981 and served with distinction as an Arkansas District Judge from 1983 to 2020. He also holds an undergraduate degree from the University of Arkansas and was a member of the University's chapter of Phi Beta Kappa. In addition, Maeve's mother Andrea received degrees in English and marketing from the University of Arkansas.

1. Anirban Sen et al., *SEC Eyes Guidance on SPAC Projections, Clarity on Liability Shield*, INS. J. (Apr. 28, 2021), [https://perma.cc/DX32-CRYK]. For earlier articles about SPACs, see also Usha Rodrigues & Mike Stegemoller, *Exit, Voice, and Reputation: The Evolution of SPACs*, 37 DEL. J. CORP. L. 849, 850-51 (2013), and Tim Castelli, Note, *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, 237-38 (2009). Of late, SPACs have generated considerable interest in the legal academy.

A symposium was held recently at the University of Arkansas at Little Rock William H. Bowen School of Law to discuss the issues that arise there. Symposium, *SPACs: The New Frontier?*, 45 UNIV. ARK. LITTLE ROCK L. REV. (forthcoming 2022). Videos of the presentations include: Beau Duty, *Intro to SPACs*, VIMEO (Feb. 5, 2022, 12:50 PM), [https://perma.cc/R2D2-PV8P]; Beau Duty, *Panel 1: How Recent Litigation Shaped the SPAC Transaction*, VIMEO (Feb. 8, 2022, 10:44 PM), [https://perma.cc/WEP6-F5CA]; Beau Duty, *Panel 2: How the SEC Responded to the SPAC Bubble*, VIMEO (Feb. 9, 2022, 9:10 AM), [https://perma.cc/YU6G-JSES]; Beau Duty, *Banquet Keynote: Ramey Layne of Vinson & Elkins*, VIMEO (Feb. 9, 2022, 11:07 AM), [https://perma.cc/Q8P4-S9JS].

See also Wendy Gerwick Couture, *Ten Top Issues in De-SPAC Securities Litigation,* 45 UNIV. ARK. LITTLE ROCK L. REV. (forthcoming 2022), one of the many strong papers delivered at the Symposium. See Usha Rodrigues & Michael Stegemoller, *Redeeming SPACs* 3-4 (Univ. Ga. Sch. of L., Working Paper No. 2021-09), [https://perma.cc/VN9F-QFGG], for a fine working paper discussing several harms present in SPACs. There, the

reality, they are just another version of an old strategy to exploit a loophole in the federal securities laws that issuers of stock have used to avoid full registration with the SEC, the federal agency set up to administer and enforce the securities laws.[2] The SPAC process circumvents that important protection for investors by taking private firms public through the back door—merging them into shell corporations.[3] Those are companies whose shares are widely held but have no operations or assets.[4]

In recent years, SPACs have been touted as a hot alternative to conventional SEC registration of stock sold in IPOs.[5] That long-accepted approach set up by the Securities Act of 1933 ("Securities Act") mandates that full disclosure of all aspects of those offerings be made in a registration statement filed with the SEC and available to the public.[6] Before sales of those securities can be made, the Commission's staff has the opportunity to review that document to guard investors from deception.[7] To further assure that a registration statement is totally accurate, the Securities Act provides stringent liability for any material falsehoods it might contain.[8]

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authors allow that, while SPACs are nominally public, they are in fact illiquid investments. *Id.* at 32-33. In addition, their shareholders have no meaningful voice. *See id.* at 28-29. The authors conclude, as does this Article, that SPACs only benefit a small group of insiders, not the general investing public. *Id.* at 45-46.

2. See Rodrigues & Stegemoller, *supra* note 1, at 23-24; see also *What We Do*, SEC (Nov. 22, 2021), [https://perma.cc/WHG3-RG27], for the SEC's description of its work and mission.

3. *See* Steven Kurutz, *Ok, What's a SPAC?*, N.Y. TIMES (July 13, 2021), [https://perma.cc/FYY5-ZCM6].

4. *See* Anna-Louise Jackson & Benjamin Curry, *Special Purpose Acquisition Company: What is a SPAC?*, FORBES ADVISOR (Mar. 4, 2022, 8:50 AM), [https://perma.cc/8ZCE-R4R4].

5. *See* Tom Huddleston, Jr., *What is a SPAC? Explaining One of Wall Street's Hottest Trends*, CNBC (Feb. 23, 2021, 11:13 PM), [https://perma.cc/7NSJ-REAN]; see also Daniel J. Morrissey, *The Troubling Tale of How Wall Street Tried to Exploit a Crack in the Structure of Securities Law*, THE HILL (June 25, 2021, 12:00 AM), [https://perma.cc/M5MJ-J95A], for an earlier discussion introducing this SPAC phenomenon.

6. Securities Act of 1933, ch. 38, 48 Stat. 78, §§ 6-7, scheds. A-B (codified as amended at 15 U.S.C. §§ 77f-g, 77aa).

7. Securities Act of 1933 § 8(b), (d), (e) (codified as amended at 15 U.S.C. § 77h(b), (d), (e)).

8. *See* Securities Act of 1933 §§ 5, 11 (codified as amended at 15 U.S.C. §§ 77e, 77k); see also THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 69 (7th ed. 2017), for a summary of this elaborate process for doing a public offering.

This SPAC end run around traditional SEC registration is akin to similar problematic practices that cunning promoters have engineered for decades. The Commission has looked on these practices with a jaundiced eye, identifying each as just another form of stock manipulation.[9] The SEC's skepticism arises because those methods of selling stock avoid traditional, full-blown registration, which is the principal safeguard that the Securities Act has established to deter fraud. These back-door sales are thus accomplished by exploiting an oversight in that otherwise carefully drafted statute.[10]

SPACs are therefore just the latest example of this evasive approach, and this Article will show how they have diminished the protection that the securities laws afford ordinary investors. Specifically, SPACs have been promoted "as the 'poor man's private equity funds.'"[11] They are said to allow "mom-and-pop investors,"[12] who usually don't get access to the most desired IPOs, to have that opportunity by buying into a SPAC shell before it acquires a target.[13] In reality, however, SPACs typically don't offer retail investors that ability. They only allow them to buy such stock after the SPAC insiders have taken their profits and only then at a price that dilutes what they pay for their shares.[14]

This Article will therefore begin by discussing the importance of traditional SEC stock registration.[15] It will then describe the SPAC phenomenon—what a SPAC entails, how it is

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9. Leib Orlanski, *Going Public Through the Backdoor and the Shell Game*, 58 VA. L. REV. 1451, 1451-52 (1972).

10. See Daniel J. Morrissey, *The Road Not Taken: Rethinking Securities Regulation and the Case for Federal Merit Review*, 44 RICH. L. REV. 647, 647-50 (2010), for the author's discussion of why registration is crucial to protect investors. He wrote that piece after the financial meltdown of 2008 that occurred because of the collapse of collateralized debt obligations secured only by shaky mortgages. *Id.* at 660-61, 670-71. There, he also questioned whether the disclosure philosophy underpinning the federal securities laws was sufficient to protect investors and looked to the merit-based approach that had historically been employed by state securities regulators. *See id.* at 684-85; *see also infra* notes 31-60, 60-63 and accompanying text.

11. *Special-Purpose Acquisition Company*, WIKIPEDIA (Sept. 16, 2022, 1:39 PM), [https://perma.cc/GU2Y-AZLR].

12. Dave Michaels & Eliot Brown, *SEC Seeks to Curb Lofty SPAC Projections*, WALL ST. J. (Apr. 8, 2021, 7:31 PM), [https://perma.cc/HM3R-YQ3C].

13. Jackson & Curry, *supra* note 4.

14. *See infra* notes 201-08 and accompanying text.

15. *See infra* Part II.

carried out, and the exaggerated claims that have been made for it by its sponsors.[16] With that background, this Article will point out why SPACs' avoidance of traditional SEC registration has been harmful to investors.[17] In light of that, it will explain how recent action by the SEC and the results of a significant academic study have exposed the shortcomings of SPACs and led to an overdue reassessment of their value.[18]

After that, this Article will place SPACs in the context of various shell manipulations that have occurred in recent decades.[19] It will also discuss the substantial liability that many SPAC promoters may now face for fraudulent activity and other violations of the securities laws, such as the sale of unregistered securities and the failure to register under the Investment Company Act.[20] These theories of recovery should reinforce the value of traditional SEC registration, deter any further abuses of that process, and put an end to this harmful practice of "going public through the back door," which has been used most recently by SPACs.

After this Article was written and accepted for publication, the SEC took specific action to formally regulate SPACs by proposing a host of regulations that would cover them.[21] In line with comments made earlier by SEC officials, these proposed rules recognize SPACs as true IPOs and treat them as much as possible like traditional registered offerings of securities. As this piece will discuss in the Epilogue, they will require additional disclosure about many aspects of SPACs, particularly focusing on whether they are giving retail investors who bought into the companies adequate value.[22]

The proposal would also restrict SPACs from using projections about the prospects of those companies, as is done in traditional IPOs, to protect investors from being misled about how

16. *See infra* Part III.
17. *See infra* Part IV.
18. *See infra* Section IV.A, IV.B, IV.C.
19. *See infra* Part V.
20. *See infra* Section IV.E.
21. *See infra* notes 407-08 and accompanying text.
22. *See infra* Part VIII.

those firms will perform in the future.[23] They will also expand the scope of SPAC participants who can be held liable for material falsehoods in the offerings.[24] That is related to an argument made in this Article about many SPAC promoters who are, in effect, functioning as underwriters of the sales of shares in those companies to the public by buying shares from the issuer with the intent to resell them directly or indirectly to ordinary investors.[25]

The Epilogue will also provide updated information about the prevalence of SPACs.[26] The SEC's regulatory initiatives, critical comments from academic studies, and events in the stock market have adversely affected SPACs. For the moment, their frenzy has fizzled. Yet, there are significant lessons to be learned from them that may prove instructive in the future if and when crafty promoters devise similar types of stock manipulation.

## II. THE IMPORTANCE OF REGISTRATION

### A. The Origins of the Securities Act

As has been cleverly said, the federal securities laws "did not spring full grown from the brow of any New Deal Zeus."[27] English legislation and state securities laws preceded them.[28] Great Britain's Companies Act, enacted in the nineteenth century, had already gone beyond the requirement that firms seeking capital must not just avoid fraud but had mandated that they make certain disclosures.[29] And in the United States, after the Panic of 1907, President Theodore Roosevelt unsuccessfully asked Congress for legislation "to prevent at least the grosser forms of

23. Special Purpose Acquisition Companies, Shell Companies, and Projections, Securities Act Release No. 11048, Exchange Act Release No. 94546, Investment Company Release No. 34594, 87 Fed. Reg. 29,458 (proposed Mar. 30, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 230, 232, 239, 240, 249, 270).

24. *Id.*

25. *See infra* Part VI.

26. *See infra* notes 410-12, 440-41 and accompanying text.

27. LOUIS LOSS ET AL., SECURITIES REGULATION 4 (6th ed. 2019).

28. *Id.*; *see also* Joel Seligman, *The Historical Need for a Mandatory Corporate Disclosure System*, 9 J. CORP. L. 1, 20 (1983).

29. LOSS ET AL., *supra* note 27, at 7.

gambling in securities and commodities, such as making large sales of what men do not possess and 'cornering' the market."[30]

But in the early part of the twentieth century, the first legislation regulating the issuance of securities came from the states.[31] These regulations were designed to protect citizens of those jurisdictions from securities offerings that did not give appropriate value to investors."[32] They came to be called "blue sky laws" because they targeted promoters who were raising money with such aggressive fraud that it was said "they would sell building lots in the blue sky in fee simple."[33] To counter that, the first state securities law enacted in Kansas required that anyone selling securities had to receive a permit from the State's bank commissioner.[34] That official had authority to deny the permit if he believed the offering lacked merit.[35]

Even though most states swiftly enacted such laws, they proved inadequate to police what had become a national market for the sale of securities.[36] But after the financial speculation and

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30. Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385, 395-96 (1990).

31. LOUIS LOSS & EDWARD M. COWETT, BLUE SKY LAW 3-5 (1958).

32. *See id.* at 7-10.

33. The term apparently first appeared in Thomas Mulvey, *Blue Sky Law*, 36 CAN. L. TIMES 37, 37 (1916).

34. Investment Companies—Providing for Regulation and Supervision, 1911 Kan. Sess. Laws 210, 212.

35. *Id.* The Kansas Bank Commissioner could deny a permit when, among other reasons, the offering contained provisions that were "unfair, unjust, inequitable or oppressive to any class of contributors," or the company did "not intend to do a fair and honest business, and in his judgment [did] not promise a fair return on the stocks, bonds or other securities." *Id.* Many of the state blue-sky laws followed the Kansas model and typically gave state officials the power to determine whether offerings to their citizens were "fair, just and equitable." Mark A. Sargent, *Blue Sky Law: The Challenge to Merit Regulation—Part I*, 12 SEC. REGUL. L.J. 276, 276 (1984); *see also* Stefania A. Di Trolio, *Public Choice Theory, Federalism, and the Sunny Side to Blue-Sky Laws*, 30 WM. MITCHELL L. REV. 1279, 1284-86 (2004). In practice this gave almost unlimited discretion to state officials to deny issuers the right to sell securities to the citizens of their states—often on the grounds that they were too speculative. *See generally* Mark A. Sargent, *supra*, at 279-80; James S. Mofsky, *Blue Sky Restrictions on New Business Promotions*, 1969 DUKE L.J. 273, 273-74, 285.

36. Di Trolio, *supra* note 35, at 1289-90. When federal legislation governing the sale of securities was enacted in the 1930s, those laws specifically did not preempt the blue-sky provisions. *Id.* at 1292-93. As a result, a dual system arose involving both state and federal securities laws. *Id.* Over the years, however, there was substantial criticism that this was duplicative and unduly burdensome on the process of capital formation. *Id.* at 1294. In 1996, with the passage of the National Securities Market Improvement Act, Congress dramatically restricted the power of states to regulate securities. *See* National Securities

subsequent market crash of the 1920s led to a devastating economic downturn, momentum built for federal legislation. The Senate Finance Committee held highly publicized hearings on the wrongdoing involving investments that were spearheaded by Ferdinand Pecora,[37] and another congressional committee made this finding in 1933: "Whatever may be the full catalogue of the forces that brought to pass the present depression, not least among these has been this wanton misdirection of the capital resources of the Nation."[38]

As a renowned observer described the resulting situation, the whole system of "[i]nvestment bankers, brokers and dealers, [and] corporate directors . . . all found themselves the object of criticism so severe that the American public lost much of its faith in professions that had theretofore been regarded with a respect that had approached awe."[39] When President Franklin Roosevelt ("FDR") took office in March 1933, the Great Depression had hit hard. As he put it forcefully in his inaugural address,

> [T]here must be an end to a conduct in banking and in business which too often has given to a sacred trust the likeness of callous and selfish wrongdoing. . . . [T]here must be a strict supervision of all banking and credits and

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Markets Improvement Act of 1996, Pub. L. No. 104-290, sec. 102, § 18, 110 Stat. 3416, 3417-18 (codified as amended at 15 U.S.C. 77r) (amending Securities Act of 1933, ch. 38, 48 Stat. 78, § 18, 48 Stat. 85 (codified at 15 U.S.C. § 77r)).

The new law not only excluded securities listed on a national securities exchange from state registration, but it also exempted the states from having power to review offerings that are exempt as federal private placements under the SEC's Regulation D. Securities Act of 1933 § 18(a), (b)(1), (4). The state's authority to approve sales of securities is therefore limited to only the smallest and most limited offerings. *See* Securities Act of 1933 § 18(a), (b) (limiting states' abilities to regulate significant categories of securities). State securities agencies do, however, maintain the power to investigate and enforce their anti-fraud laws. Securities Act of 1933 § 18(c).

37. See S. REP. NO. 73-1455, at 1-3 (1934), for the report of these hearings; *see also Subcommittee on Senate Resolutions 84 and 234*, SENATE HIST. OFF., [https://perma.cc/K58H-CGR3] (last visited Oct. 5, 2022). As one commentator summed up his findings: "It [the committee] indicted a system as a whole that had failed miserably in imposing those essential fiduciary standards that should govern persons whose function it was to handle other people's money." James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 30 (1959).

38. H.R. REP. NO. 73-85, at 2-3 (1933).

39. Landis, *supra* note 37, at 30.

> investments; there must be an end to speculation with other people's money.[40]

And so, to restore investor confidence and get needed capital flowing to businesses, FDR made it a top priority to enact a law that would regulate the sale of securities.[41] At first there was "wide demand" for radical reform—the creation of a government agency that would have control over "not only the manner in which securities could be issued but the very right of any enterprise to tap the capital market."[42]

President Roosevelt, however, adopted a more measured approach. In an early message to Congress, he said the federal government should not take any action approving or guaranteeing the soundness of any issuance of securities.[43] Instead, he proposed a system where every offering of securities "shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public."[44]

FDR's approach was in line with the position long advocated by then Supreme Court Justice Louis Brandeis that businesses ought to be regulated by a mechanism that would require all their important operations to be laid bare to public scrutiny.[45] After an earlier version of financial reform legislation proved inadequate, Roosevelt's team turned to Harvard Law Professor Felix Frankfurter, a protégé of Brandeis, for another

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40. Franklin D. Roosevelt, U.S. President, First Inaugural Address (Mar. 4, 1933).

41. *See* Landis, *supra* note 37, at 30.

42. *Id.* Those views for a blue-sky-like federal review of the merits of securities offerings also found their way into the original version of the legislation, which provided for the revocation of the issuer's registration upon a finding "[t]hat the enterprise or business of the issue, or person, or the security is not based upon sound principles, and that the revocation is in the interest of the public welfare," or that the issuer "[i]s in any other way dishonest" or "in unsound condition or insolvent." Federal Securities Act, H.R. 4314, 73d Cong. § 6(c), (e), (f) (1933). That outlook would be echoed strongly in an article written by then law professor William O. Douglas, which he wrote after the passage of the Securities Act of 1933. William O. Douglas, *Protecting the Investor*, 23 YALE REV. 521, 522-24 (1934); *see also infra* notes 61-63 and accompanying text.

43. H.R. REP. NO. 85-73, at 2 (1933).

44. *Id.*

45. *See* LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 92 (1914). As Justice Brandeis had written in his influential book, "Sunlight is said to be the best of disinfectants; electric light the most efficient policeman." *Id.*

draft.[46] Frankfurter accomplished that with the aid of his top students during a weekend of intense work.[47]

### B. Registration—The Heart of the Securities Act

The centerpiece of Frankfurter's proposed statute was the requirement that those who sell securities must first file a registration statement with a public authority[48] and only be able to market them after a waiting period.[49] Unlike the state blue-sky laws, the federal legislation was premised on disclosure.

The government would, thus, not have the power to pass on the quality of particular offerings, but an overseeing commission could keep them from being sold if the information in the registration was false or inadequate.[50] The proposed statute also contained criminal penalties and civil liability for such materially misleading information.[51]

Even though a group of New York lawyers, led by John Foster Dulles, told Congressman Sam Rayburn, who was sponsoring the legislation, that the proposed statute "undermine[s] our financial system,"[52] the Securities Act quickly worked its way through the legislative process.[53] It was passed by both Houses of Congress and was signed into law by President Roosevelt as one of the hallmarks of his first 100 days in office.[54] The law was then hailed as the "Truth in Securities Act."[55]

As a well-respected treatise summed up the central thrust of that legislation: "This Act is concerned by and large with the initial distribution of securities . . . . Securities that are offered to

46. *See* Landis, *supra* note 37, at 30-33; LOSS ET AL., *supra* note 27, at 309. See generally BRUCE ALLEN MURPHY, THE BRANDEIS/FRANKFURTER CONNECTION (1982), for an interesting study of the relationship between Brandeis and Frankfurter and their attempts to influence public policy.

47. Landis, *supra* note 37, at 33-34.

48. Securities Act of 1933, ch. 38, 48 Stat. 78, § 5(c) (codified as amended at 15 U.S.C. § 77e(c)).

49. Securities Act of 1933 § 8(a).

50. Landis, *supra* note 37, at 34-35.

51. Securities Act of 1933 §§ 11, 15, 24.

52. Landis, *supra* note 37, at 40.

53. *See id.* at 41-49.

54. *Id.* at 49.

55. HAZEN, *supra* note 8, at 18; Milton H. Cohen, "*Truth in Securities" Revisited*, 79 HARV. L. REV. 1340, 1340 (1966).

the public through the mails or the channels of interstate commerce must be registered with the SEC by the issuer."[56]
It then went on to describe how that operates:

> The Commission's sole function is to ensure that the registration statement is accurate and complete. A prospectus containing the basic information in the registration statement must be made available to the buyer. Civil and criminal liabilities are imposed for material misstatements or omissions in the registration statement or prospectus.[57]

To justify these provisions, another well-regarded commentator described the following as the two goals of the Securities Act: "(1) to provide investors with adequate and accurate material information concerning securities offered for sale and (2) to prohibit fraudulent practices in the offer or sale of securities."[58] He then elaborated on that, saying, "The

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56. LOSS ET AL., *supra* note 27, at 379. The Act, however, contains exemptions from registration. The most significant of these are for small or limited offerings, for non-public offerings (private placements), and for offerings directed just to residents of the same state where the issuer exists by incorporation or otherwise (intrastate offerings). Securities Act of 1933, 15 U.S.C. §§ 77c(a)(11), 77c(b), 77d(a)(2). Section 28 of the Act also gives the Commission the power to exempt other offerings from registration. Securities Act of 1933 § 77z-3.

The SEC has issued safe-harbor regulations delineating the scope of these exemptions and continually expanded them over the years. Regulation D is the safe harbor for small, limited offerings and for non-public offerings. 17 C.F.R. §§ 230.504, .506 (2021). Today, its Rule 504 exempts offerings up to $10 million under Section 3(b). 17 C.F.R. § 230.504. Its Rule 506 exempts 4(a)(2) offerings, the so-called private placements. 17 C.F.R. § 230.506. And the Commission's Rules 147 and 147A exempt the so-called intrastate offerings. 17 C.F.R. §§ 230.147, .147A (2021). See *Private Placements—Rule 506(b)*, SEC (Apr. 28, 2022), [https://perma.cc/7Q6E-7NTX], for the latest version of the SEC regulations for the private placement exemption, *Exemption for Limited Offerings Not Exceeding $10 million—Rule 504 of Regulation D*, SEC (Apr. 28, 2022), [https://perma.cc/YXQ4-3C9T], for the latest version of the SEC regulations governing the exemption for small or limited offerings, and *Intrastate Offerings*, SEC (Sept. 6, 2022), [https://perma.cc/GTN3-24H6], for the current SEC safe-harbor regulations governing the intrastate exemptions. See Press Release, SEC, SEC Harmonizes and Improves "Patchwork" Exempt Offering Framework (Nov. 2, 2020) [hereinafter Press Release], [https://perma.cc/788B-SV6L], for the SEC's general discussion about how it has recently harmonized these exemptions.

A modified form of registration exists under the SEC's Regulation A, which is, strictly speaking, an exempt offering. 17 C.F.R. § 230.251 (2021). It can now be used by companies under certain conditions to raise up to $75 million. 17 C.F.R. § 230.251(a)(2). See Press Release, *supra*, for the SEC's discussion of the amendments to Regulation A.

57. LOSS ET AL., *supra* note 27, at 379.

58. MARC I. STEINBERG, UNDERSTANDING SECURITIES LAW § 4.1, at 125 (7th ed. 2018).

registration framework of the Securities Act seeks to meet these goals by imposing certain obligations and limitations upon persons engaged in the offer or sale of securities."[59]

### C. Early Criticism of Registration and Its Ultimate Acceptance

Despite this elaborate new regime that the Act established to prevent fraud in the sale of securities, critics on the left quickly argued that the new law did not go far enough. Two commentators derided the Act's disclosure philosophy, saying "a promoter may ask the public to invest in a hole in the ground so long as he does not describe it as a uranium strike without supporting geological data."[60]

Along those lines, then law professor William O. Douglas criticized the law's seemingly minimal approach, saying that investors would not understand disclosures made in a registration statement or, even worse, would ignore them out of speculative enthusiasm.[61] What was needed in the regulation of corporate finance, he wrote, was "a more thoroughgoing and comprehensive control."[62] Beyond that, Douglas even advocated for government direction of the capital markets, which would place control "in the hands not only of the new self-disciplined business groups but also in the hands of governmental agencies whose function would be to articulate the public interest with the profit motive."[63]

The financial community also continued to object to many of the Act's provisions, claiming they would impede capital formation.[64] A year after the Act took effect, no large company

59. *Id.*
60. LOSS & COWETT, *supra* note 31, at 36-37.
61. Douglas, *supra* note 42, at 523-24.
62. *Id.* at 529.
63. *Id.* at 531. Douglas, however, would go on to become the third Chairman of the SEC and have an illustrious career after that as a Supreme Court Justice. His autobiography, *Go East Young Man*, has an interesting chapter about his years at the SEC. WILLIAM O. DOUGLAS, GO EAST, YOUNG MAN 257-96 (1974); see also Daniel J. Morrissey, Book Review, 7 PEPP. L. REV. 491 (1979-1980) for the author of this Article's review, which he first published as a law student.
64. Seligman, *supra* note 28, at 2.

had yet filed a registration statement.[65] The first Chairman of the SEC, Joseph P. Kennedy, and his General Counsel, John J. Burns, therefore had to sell the Act's registration process by going to Bethlehem Steel Co. to persuade its executives to file such a statement rather than doing a private placement.[66]

Corporate America's hostility to registration continued in the post-war era. In 1953, when Dwight Eisenhower became the first Republican President since the Securities Act's inception, he appointed Ralph Demmler, a leading corporate lawyer from Pittsburg, as the first GOP Chairman of the SEC.[67] Under Demmler, the Commission undertook no new initiatives but continued in operation, contrary to the long-time desire of many on Wall Street.[68]

Nevertheless, in the decades after World War II, there was tremendous growth in the securities business.[69] As one commentator described the ramifications of that, "The revival of a strong new issues market in the post-World War II period . . . undercut arguments that the mandatory corporate disclosure system or its enforcement by the SEC in any significant sense obstructed new securities flotations, at least by large corporations."[70] By the late 1950s, there was such a rush of registration statements that it resulted in a delay in their filing so the SEC could have time to clear them.[71]

### D. The Supreme Court Affirms the Securities Act and Its Registration Requirement

Along those lines, the Supreme Court was supportive of the Securities Act and its registration requirements. In an opinion in the early 1950s, it upheld the Securities Act, stating that it was

65. Milton V. Freeman, *A Private Practitioner's View of the Development of the Securities and Exchange Commission*, 28 GEO. WASH. L. REV. 18, 18 (1959).

66. *Id.*

67. ANNE M. KHADEMIAN, THE SEC AND CAPITAL MARKET REGULATION 58-59 (1992).

68. *Id.*; *see also* RALPH H. DEMMLER, THE FIRST CENTURY OF AN INSTITUTION 180-88 (1977) (offering an account of this time from the perspective of practicing attorneys in a firm).

69. Seligman, *supra* note 28, at 2.

70. *Id.*

71. Freeman, *supra* note 65, at 19.

designed "to protect investors by promoting full disclosure of information thought necessary to informed investment decisions."[72] It reemphasized that again in a later opinion, stating, "the purpose[] of the Securities Act [is] to promote full and fair disclosure of information to the public in the sales of securities."[73] In that same decision, it called the registration requirements "the heart of the [Securities] Act."[74] More recently, it has described registration as the "linchpin of the Act," ensuring that companies issuing securities make "'full and fair disclosure' of material information" relevant to a public offering.[75]

### E. What Registration Entails

The preparation of a registration statement is therefore a substantial undertaking, requiring not only the active participation of the company's officials but also the skills of sophisticated counsel, accountants, and investment bankers.[76] Since liability for material falsehoods in a registration statement is stringent and actionable against a host of individuals connected with the offering, great care must be taken in its preparation.[77] This usually includes an elaborate "due diligence" investigation to

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72. SEC v. Ralston Purina Co., 346 U.S. 119, 124, 126-27 (1953). In that case, the Supreme Court was called on to interpret the private placement exemption from registration for sales of securities that did not involve a public offering. *Id.* at 120. The company was claiming it for sales of shares to a large number of "key employees." *Id.* at 121-22. Many of them, however, were not upper echelon officials or working at the firm's headquarters. *Id.* at 120-21. The Court therefore ruled that the exemption would not apply to those sales but only to offerees who could "fend for themselves," those who did not need the disclosure compelled by a registration statement so they could have access to the full truth about the investments offered to them. *Id.* at 124-26.

73. Pinter v. Dahl, 486 U.S. 622, 646 (1988).

74. *Id.* at 638.

75. Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund, 575 U.S. 175, 178, 193 (2015). The *Omnicare* decision is significant because it holds that statements of opinion can be actionable under Securities Act § 11 when the company does not actually believe what it sets forth or if it omits facts in conflict with that which a reasonable investor would want to know. *Id.* at 185-86, 189. This section does, however, generally provide protection from liability for optimistic statements. *See id.* at 195. A noted author, however, offered well-taken critical comments of that position, stating, "Corporate directors and officers should not be accorded the same protection as pre-owned automobile salespersons." MARC I. STEINBERG, RETHINKING SECURITIES LAW 33-34 (2021).

76. See generally HAZEN, *supra* note 8, at 116-23, for a good description of all that this entails.

77. *See* Securities Act of 1933, 15 U.S.C. § 77k(a).

make sure all its representations are accurate and that it omits no material facts.[78]

As one treatise described these procedures:

> A first time registrant for an initial public offering (IPO) can expect a long and rigorous preparation process. The amount of time involved will necessarily depend upon the size and complexity of the offering but it is wise to assume that an IPO will involve a six to twelve month process.[79]

The Securities Act set up a three-stage procedure governing the registration and sale of securities that, with some modification, is in effect today.[80] First, to ensure there is no pre-selling of the issuance, no offers or sales of securities can be made until a registration statement is filed with the SEC.[81] Then a

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78. *See* Securities Act of 1933 § 77k(b)(3) (providing, in essence, that no persons among the potential defendants shall be liable unless they were negligent in its preparation). *Escott v. BarChris Constr. Corp.* is the seminal case on this. 283 F. Supp. 643, 682-83 (S.D.N.Y. 1968). *Escott* provided that a "due diligence" investigation is designed to establish that the defendants were not so negligent and clarified that the statute sets out different standards for performance obligations with respect to portions of the registration statement that were prepared on the authority of an expert and segments that were not. *Id.*

79. HAZEN, *supra* note 8, at 116.

80. See MARC I. STEINBERG, SECURITIES REGULATION § 4.02, at 223-243 (7th ed. 2017), for a good discussion of the framework of this process; see also STEINBERG, *supra* note 75, at 93-97, for a recently published, award-winning book by the same author that, among other things, contains his thoughtful comments about the registration process. He notes that the SEC has continued to support the transaction-based approach to securities registration which, absent an exemption, requires that every offer or sale of securities must follow that procedure. *See id.* at 93. He goes on to compliment the SEC saying, "To a large extent, the Commission has met its objective of designing a flexible and progressive transaction-based Securities Act registration system, thereby avoiding the adoption of a company-based registration regimen that inevitably would have raised uncertainties and novel applications." *Id.* In other words, according to the distinguished commentator, the SEC has rightly stuck with the tried-and-true registration process. *See id.* at 93-94.Professor Steinberg elaborates on his general approval of the Commission's approach saying, "In its determination to maintain a transaction-based Securities Act registration framework while making necessary adjustments, the SEC has made the correct decision. With the improvements made, the registration framework functions in a relatively efficient manner and generally provides investors with adequate safeguards." *Id.* at 94.

81. *See* Securities Act of 1933 § 77e(c). In 2005, the Commission, using its rule-making power, liberalized the activities that certain companies may undertake while in registration. Securities Offering Reform, Securities Act Release No. 8591, Exchange Act Release No. 52056, Investment Company Act Release No. 26993, 70 Fed. Reg. 44,722 (Aug. 3, 2005) (amending 17 C.F.R. §§ 220, 228, 229, 230, 239, 240, 243, 249, 274); *see, e.g.*, 17 C.F.R. § 230.163-.163(a) (2020) (allowing certain companies to make statements throughout the registration process and certain communications conducted within a specified time period before a registration statement is filed that do not constitute "offers to sell"). *But see* Joseph

waiting period ensues, during which the issuer can make offers using written materials, such as a preliminary prospectus.[82]

During that time, the SEC may review the registration statement, particularly if it is a company's first time or a novel offering, and send the issuer a letter of comment requesting changes to make its disclosure more meaningful.[83] After the Commission's staff is satisfied with the amendments that the issuer makes in response to its criticism, the SEC may accelerate the effective date of the registration statement, which allows sales of the securities to be made.[84]

### F. The Enduring Relevance of the Securities Act and Registration

From the 1960s on, the SEC has been an active agency dedicated to its important role of protecting the integrity of our capital markets.[85] As one observer put it on the SEC's 60th Anniversary in 1994:

> No agency is perfect, and the SEC has had its ups and downs over the years. . . . [But] [t]he SEC is one important reason why the securities industry is in so much better shape than

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F. Morrissey, *Rhetoric and Reality: Investor Protection and the Securities Regulation Reform of 2005*, 56 CATH. U. L. REV. 561, 605-07 (2007) (arguing that the SEC went too far with those reforms and neglected its mission of protecting investors).

82. *See* Securities Act of 1933 §§ 77b(a)(10), 77e(a)-(b); *see also* STEINBERG, *supra* note 80, at 234-35.

83. See HAZEN, *supra* note 8, at 136-38, for a discussion of how that process works in practice.

84. *See* Securities Act of 1933 §§ 77e(a), 77h(a).

85. *See* SEC, ". . . GOOD PEOPLE, IMPORTANT PROBLEMS AND WORKABLE LAWS": 50 YEARS OF THE U.S. SECURITIES AND EXCHANGE COMMISSION 44-47 (1984) (an autobiography published on the Commission's 50th anniversary). However, not everyone has been enamored with the SEC. One former Commissioner, Roberta Karmel, wrote a critical book about it. *See* ROBERTA S. KARMEL, REGULAITON BY PROSECUTION: THE SECURITIES AND EXCHANGE COMMISSION VS. CORPORATE AMERICA 15 (1982). Homer Kripke, a law professor, has also been a frequent critic of the Commission. *See, e.g.*, Homer Kripke, THE SEC AND CORPORATE DISCLOSURE: REGULATION IN SEARCH OF A PURPOSE 8-9 (1979). In the late 1970s, however, the author of this Article heard Professor Kripke state that the securities markets had much more integrity than before the securities acts were passed and the SEC was created in the 1930s.

other financial service industries, and why U.S. securities markets are the best securities markets in the world.[86]

And during this period the SEC has continued to emphasize the important role that registration plays in achieving its mandate to protect investors. As it says on its website, "A primary means of accomplishing these goals [investor protection] is the disclosure of important financial information through the registration of securities."[87]

## III. THE SPAC PHENOMENON

### A. Going Public Through the Back Door

Yet, despite the Securities Act's avowed purpose to protect ordinary investors from fraudulent public offerings through registration requirements, for some time, various issuers have been circumventing that process. SPACs are just the most recent

86. David L. Ratner, *The SEC at Sixty: A Reply to Professor Macey*, 16 CARDOZO L. REV. 1765, 1779 (1995). However, after the financial crisis of 2008, it became apparent that the SEC's enforcement efforts had been woefully inadequate to police the capital markets. See Daniel J. Morrissey, *After the Meltdown*, 45 TULSA L. REV. 393, 409, 413-17 (2010), for the author's description of that and the Commission's attempts to reinvigorate its important responsibility. One of the most egregious failings by the Commission was that it did not catch a decade long, multi-billion dollar Ponzi scheme run by Bernard Madoff. See Daniel J. Morrissey, Book Review, 44 SEC. REGUL. L.J. 193 (2016) (reviewing HELEN DAVIS CHAITMAN & LANCE GOTTHOFFER, JPMADOFF: THE UNHOLY ALLIANCE BETWEEN AMERICA'S BIGGEST BANK AND AMERICA'S BIGGEST CROOK (2016)), for the author's review of a fine book about that and Madoff's connection with the world's largest bank, J.P. Morgan.

87. *The Laws that Govern the Securities Industry*, SEC, [https://perma.cc/Y3D5-ZS65] (last visited Oct. 5, 2022). The SEC has responded to criticism that the registration process may be unduly burdensome for issuers that are already public and small companies. *See* Seligman, *supra* note 28, at 58-61. It has therefore streamlined this process to make it less costly and easier for them. *Id.* (discussing such initiatives geared towards companies with large assets and significant numbers of shareholders). The SEC has also reduced the disclosure requirements in registration statements for companies with assets of less than $25 million that are going public. Small Business Initiatives, Securities Act Release No. 6949, Exchange Act Release No. 30968, 57 Fed. Reg. 36,442 (Aug. 13, 1992). In addition, as has been discussed, the Securities Act contains exemptions from registration where its costs may be exceeded by its benefits and where state officials may effectively police these offerings for fraud. *See supra* note 56 and accompanying text. Since the 1980s, the Commission has been expanding these by amending its safe-harbor rules such as Regulation D, Rule 147 and Rule 147A. *See supra* note 56 and accompanying text; Susan E. Satkowski, Note, *Rule 242 and Section 4(6) Securities Registration Exemptions: Recent Attempts to Aid Small Businesses*, 23 WM. & MARY L. REV. 73, 74-75 (1981).

version of that questionable way to take a company public. This evasion of the registration requirement has often worked as follows.

A promoter acquires a defunct shell, but one that still has public shareholders.[88] Lawyers and accountants are then hired to settle outstanding creditors' claims and bring the company current with the periodic filings that the Securities Exchange Act of 1934 requires to be made with the SEC.[89] The promoter then uses small brokerage firms to create an over-the-counter trading market in the company's shares.[90]

The activated shell is then sold to a private company, which becomes public by being merged into the shell.[91] That can be accomplished a number of ways, such as by a reverse merger, a share exchange, or by the sale of the private firm's assets to the shell.[92] Typically, the arrangement results in the owners of the private company owning the lion share of the shell's stock, which is then a liquid asset for them just as if their firm had done a registered IPO.[93]

Unlike registration, this procedure of going public through the back door is done with minimum SEC oversight. The Commission's attitude about the process, however, is problematic since the Securities Act does not specifically prohibit it and it is usually done in technical compliance with legal requirements. Yet, one commentator has said that the Commission "frowns

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88. *See* Marvin Dumont, *Reverse Mergers: Advantages and Disadvantages*, INVESTOPEDIA (May 18, 2022), [https://perma.cc/85XL-LA8J].

89. See HAZEN, *supra* note 8, at 328-33, for an overview of the annual and quarterly reports that public companies are required to file with the SEC under the Securities Exchange Act of 1934. To avoid duplicative filings, the SEC, under its integrated disclosure regime, now allows these to be used to satisfy much of the registration requirements for the offer and sale of securities. *Id.* at 125-26.

90. See SEC v. N. Am. Rsch. & Dev. Corp., 424 F.2d 63, 66-67 (2d Cir. 1970), for an example of how this can be used to manipulate the price of a stock.

91. *Id.* at 67.

92. *See* Orlanski, *supra* note 9, at 1451 nn.1-2; *Going Public Through the Backdoor*, NASDAQ, [https://perma.cc/K9LU-MZYW] (last visited Oct. 5, 2022) (providing a definition of this phrase).

93. See Orlanski, *supra* note 9, at 1451-52, 1458-60, for the classic article on this process. In February 2003, Douglas Siddoway gave a fine presentation on this topic at the Northwest Securities Institute. Douglas Siddoway, Nw. Sec. Inst., Uses and Abuses of "Reverse Merger" Transactions in the U.S. (Feb. 21, 2003).

upon" this practice and, in certain situations, has sought injunctive and regulatory action to stop, or at least curb, it.[94]

Along those lines, certain jurisprudence that the SEC has promulgated about compliance with the securities laws is relevant. The Commission often prefaces its safe-harbor administrative rules with statements that they are "not available to any person with respect to any transaction or series of transactions that, although in technical compliance with [a particular rule], is part of a plan or scheme to evade the registration requirements of the Act."[95]

Because of the SPAC frenzy, it is time to take another look at that questionable practice and ask a crucial question: Does such a loophole in the Securities Act really exist that makes this procedure legal? In other words, is a SPAC a legitimate alternative to a conventionally registered IPO that does not violate either the letter or the spirit of the Securities Act?

### B. How SPACs Operate

The SPAC process works like this: promoters set up a shell corporation without any assets or business and raise cash by selling its shares in an SEC-registered IPO.[96] The SPAC's avowed purpose is to search for a private company, a target to merge with in a process called "de-SPACing." SPACs typically have two years to do that.[97]

When such a combination is proposed, SPAC shareholders can opt to redeem their shares, typically for a good profit, rather than continue as shareholders in the surviving company.[98] A reverse merger then takes place between the SPAC, or one of its subsidiaries, and the target.[99] The SPAC, or its sub, survives, but it usually takes the name of its target and allows the target

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94. Orlanski, *supra* note 9, at 1451-52.

95. 17 C.F.R. § 230.144 (2022) (this section is titled, "Persons deemed not to be engaged in a distribution and therefore not underwriters.").

96. *What is a SPAC?*, CB INSIGHTS (Apr. 5, 2022), [https://perma.cc/KS9Z-X4H7].

97. *Id.*; Jackson & Curry, *supra* note 4.

98. Michael Klausner et al., *A Sober Look at SPACs* 3, (Stanford L. & Econ., Working Paper No. 559, 2020), [https://perma.cc/G8VZ-9MKS].

99. *See* Dumont, *supra* note 88; *What is a SPAC?*, *supra* note 96.

company's management to continue to run the business.[100] As a result, the target company's shareholders get stock in the SPAC, whose shares are already trading in the open market.[101] That turns the formerly private company into a public one and makes the equity held by its owners a liquid asset.[102]

SPACs have proliferated because they were thought to be cheaper and faster than having private companies go public in the conventional manner by an SEC-registered offering.[103] In addition, they were claimed to offer more opportunity for disclosure about those companies' prospects than allowed in traditional registration statements because the proxy documents used in the merger could contain projections.[104] They were also said to have less potential for liability under the securities laws since shareholders of the target who were offered stock in the SPAC could not be deceived because they would likely have knowledge of any falsehoods about the SPAC's operations contained in the proxy documents.[105]

Additionally, SPAC advocates claimed that SPACs afforded access to the public market for firms that otherwise might have difficulties with critical comments from the SEC's staff.[106] Those comments were more likely to arise when companies filed a full-blown registration statement rather than the abbreviated one allowed for issuance of stock in a merger.[107] SPACs were encouraged by the Trump administration and others as a way for

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100. *What is a SPAC?*, *supra* note 96; *How Special Purpose Acquisition Companies (SPACs) Work*, PWC, [https://perma.cc/884T-4VAR] (last visited Oct. 5, 2022).

101. Dumont, *supra* note 88.

102. *See Special-Purpose Acquisition Company*, *supra* note 11.

103. Julie Young, *Special Purpose Acquisition Company (SPAC)*, INVESTOPEDIA (June 30, 2022), [https://perma.cc/PL6B-LS8K]; Ramey Layne & Brenda Lenahan, *Special Purpose Acquisition Companies: An Introduction*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 6, 2018), [https://perma.cc/38C8-68BA].

104. *See* Michaels & Brown, *supra* note 12; Klausner et al., *supra* note 98, at 42-45.

105. *See* Klausner et al., *supra* note 98, at 42-45.

106. *See* Ralph V. De Martino, *Federal Regulation of Securities Committee of the Business Law Section of the American Bar Association Takes Aim at SEC Proposed SPAC Rules*, NAT'L. L. REV. (June 21, 2022), [https://perma.cc/AGL3-X2MF].

107. *See* E. Peter Strand, *Minimizing SEC Comments and Managing the Review Process for Form S-4 Registration Statements*, NELSON MULLINS (Sept. 24, 2014), [https://perma.cc/B8A5-PCS4]. Registration of securities issued in a merger is done on an S-4 registration statement. Will Kenton, *SEC Form S-4 Defined*, INVESTOPEDIA (May 7, 2021), [https://perma.cc/HW2U-YHRE].

companies "to go public before they became so-called unicorns," private firms valued at more than $1 billion.[108] There were therefore more publicly traded start-up companies offering opportunities for retail investors.[109]

### C. SPACs Become Big Time

Companies in different sectors have used SPACs. Some were highly visible firms like Richard Branson's Virgin Galactic.[110] Others were early-stage tech companies focusing on finance, health care, or electric vehicles.[111] Joby Aviation, which is developing an all-electric aircraft for commercial passengers, is a good example.[112] When it was profiled on PBS's NOVA series on May 26, 2021, Joby's founder noted that it was preparing to go public by a SPAC.[113] SPAC promoters therefore have claimed that SPACS have revived the market for IPOs of small and emerging growth companies, which has been languishing for the last twenty years.[114]

The SPAC spectacle has been growing steadily over the last decade, with some calling it a "bubble" or a "hype."[115] By 2020, it had become a "frenzy,"[116] with SPACs raising as much money in that one year as they did the entire decade before.[117] By

108. Michaels & Brown, *supra* note 12.

109. Steven Davidoff Solomon, *In Defense of SPACs*, N.Y. TIMES: DEALBOOK (June 12, 2021), [https://perma.cc/LA4Z-LVZK].

110. Young, *supra* note 103.

111. *See* Michaels & Brown, *supra* note 12; *What is a SPAC?*, *supra* note 96; Amrith Ramkumar, *SPAC Insiders Can Make Millions Even When the Company They Take Public Struggles*, WALL ST. J. (Apr. 25, 2021, 4:51 PM), [https://perma.cc/L3DK-FNQJ].

112. *Joby Aviation to be Featured in NOVA Documentary, "Great Electric Airplane Race" Airing May 26 on PBS*, BUS. WIRE (May 25, 2021, 8:03 AM), [https://perma.cc/22GQ-LUJE].

113. *Id.* Press Release, Joby Aviation, Inc., *Joby Aviation Announces Closing of Business Combination with Reinvent Technology Partners to Become Publicly Traded Company* (Aug. 10, 2021, 4:05 PM), [https://perma.cc/XZ65-87BZ].

114. *See* Solomon, *supra* note 109.

115. Klausner et al., *supra* note 98, at 2. As one commentator put it in the Wall Street Journal about other factors contributing to this surge, "With interest rates on the floor and investors chasing young companies, this is a dream scenario for SPACs." Peter Santilli & Amrith Ramkumar, *SPACs Are the Stock Market's Hottest Trend. Here's How They Work.*, WALL ST. J. (Mar. 29, 2021, 5:30 AM), [https://perma.cc/L2E7-V6EY].

116. Michaels & Brown, *supra* note 12.

117. Klausner et al., *supra* note 98, at 2.

October 21, 2020, there were 290 SPACs with $86.5 billion in cash in some form of development—either doing an IPO, searching for a target to merge with, or in the process of consummating such a combination.[118]

### D. Big Claims for SPACs

Along those lines, a good description of the benefits said to come from SPACs appeared in a recent profile of Chamath Palihapitiya, one of their major promoters.[119] There he touted them as disruptive mechanisms of the new economy that can bring riches to investors and entrepreneurs from non-privileged backgrounds.[120] He also critiqued our current system of capital formation, saying, "We don't have capital markets that can support young, high-growing, fast companies in a way that really builds for the future of America . . . ."[121]

Accordingly, the piece described how Palihapitiya convinced a group of mutual fund managers to invest in the Virgin Galactica SPAC by telling them the space tourism company would be "helping mankind reach for the heavens."[122] In his pitch, however, he did not say that the company had burned through almost a billion dollars and never made a deadline it set for itself in its fifteen-year history.[123]

When Virgin Galactic did go public by its SPAC, its stock price soared, making Palihapitiya very wealthy.[124] Yet, its revenue forecasts have never been hit, and even though the company's founder, Sir Richard Branson, has gone into space, it is uncertain if Virgin Galactic will ever be able to put its tourist-customers there.[125]

118. *Id.*
119. Charles Duhigg, *The Pied Piper of SPACs*, NEW YORKER (May 31, 2021), [https://perma.cc/R7J3-FN87].
120. *See id.*
121. *Id.*
122. *Id.*
123. *Id.*
124. Duhigg, *supra* note 119.
125. *Id.*

Another high-profile SPAC backer and promoter, Alec Gores, has created thirteen of them.[126] Gores made billions in private equity during the last decade and since then has turned his attention to SPACs, with some of his recent deals involving diverse companies such as Luminar Technologies, a self-driving car firm, and Hostess Brands, Inc., the Twinkie maker.[127] Gores has become so totally involved with SPACs that he has even given up hosting his weekly poker game, where "the buy-in was sometimes $1 million."[128]

## IV. THE PUSH BACK

### A. SPACs Get Stopped

But in spring 2021, the bloom came off the SPAC rose, and SPACs pretty much ground to a halt.[129] Two factors accounted for that. First, a series of releases from the SEC's staff announced that it would give SPACs increased scrutiny.[130] Additionally, an impressive academic study appeared that revealed serious flaws with SPACs.[131] It showed that many of their claimed advantages over traditional SEC registration just didn't pan out.[132] And perhaps more significantly, the study showed SPAC sponsors and other insiders often benefited at the expense of the retail investors in the new public companies that emerged.[133]

The first SEC caveat came from the Commission's Office of Investor Education and Advocacy ("OIEA"), cautioning the public to beware of making decisions based on celebrity

126. Maureen Farrell, *The Man with More SPACs Than Anyone*, WALL ST. J. (May 4, 2021, 4:34 PM), [https://perma.cc/5ZEZ-4EUJ].

127. *Id.*

128. *Id.*

129. Yun Li, *SPAC Transactions Come to a Halt Amid SEC Crackdown, Cooling Retail Investor Interest*, CNBC (Apr. 22, 2021, 9:35 AM), [https://perma.cc/52JA-DSWG]; Solomon, *supra* note 109; see Haimavathi V. Marlier et al., *Five Key Takeaways from the SEC's Evolving Response to the SPAC Boom*, MORRISON FOERSTER (Apr. 22, 2021), [https://perma.cc/Y5XT-9LHP], for a good discussion of how the SEC's positions on SPACs evolved from merely educating investors to alerting them about serious problems.

130. Marlier et al., *supra* note 129; Li, *supra* note 129.

131. *See* Klausner et al., *supra* note 98, at 3.

132. *Id.*

133. *Id.* at 31.

involvement in SPACs.[134] Among the prominent individuals taking part in them were some famed professional athletes like Shaquille O'Neal, Stephen Curry, and Serena Williams.[135]

In its statement, the OIEA warned that "[c]elebrities, like anyone else, can be lured into participating in a risky investment," but they may be better able to bear the resulting losses than less-wealthy people.[136] Most tellingly, the OIEA also alerted the public that SPAC sponsors typically get their equity on more favorable terms than general investors who come later in the open market.[137] Those promoters therefore have motives to complete the resulting business combination on conditions that enrich themselves rather than later participants in the venture.[138]

Shortly thereafter came statements from the SEC's Acting Chief Accountant ("ACA"), Paul Munter, and its Division of Corporate Finance ("Corp. Fin.") that detailed a host of securities law considerations that should concern SPAC organizers.[139] The ACA highlighted numerous accounting matters that specifically pertained to SPACs as well as special provisions about its internal controls and corporate governance.[140] He also called attention to auditing issues there, including the independence of the public accountants of those firms.[141]

On the same day that Munter published his admonitions about SPACs, the Commission's Division of Corporation Finance issued its own initial statement warning about particular

134. *Celebrity Involvement with SPACs—Investor Alert*, SEC (Mar. 10, 2021), [https://perma.cc/66EC-KYSZ].

135. Sophia Kunthara, *Athletes and Celebrities Join the SPAC Boom, SEC Takes Notice*, CRUNCHBASE NEWS (Mar. 11, 2021), [https://perma.cc/QX7D-CK82].

136. *Celebrity Involvement with SPACs—Investor Alert*, *supra* note 134.

137. *Id.*

138. *Id.*

139. Paul Munter, *Financial Reporting and Auditing Considerations of Companies Merging with SPACs*, SEC (Mar. 31, 2021), [https://perma.cc/X7MM-X6BM]; *Staff Statement on Select Issues Pertaining to Special Purpose Acquisition Companies*, SEC (Mar. 31, 2021), [https://perma.cc/WS3Y-FX35].

140. Munter, *supra* note 139. Among them, Munter cited Section 404(a) of the Sarbanes-Oxley Act, which requires public companies to conduct annual evaluations of their internal controls. *Id.*

141. *Id.* Munter warned that when a private audit client prepares to go public through a SPAC, the company should determine whether the continuance of that relationship would be appropriate given the importance of auditor independence. *Id.*

provisions of the securities laws that are applicable to SPACs.[142] Those include restrictions on shell companies, like SPACs, and other relevant rules pertaining to their books, records, and internal controls.[143] It also noted problems that SPACs might encounter in being listed on national securities exchanges because of these exchanges' rules on corporate governance and other standards designed to ensure such companies have sufficient public floats and investor bases to promote a fair and orderly market.[144]

### B. Coates's Public Statement and His Joint Statement with Munter on SPAC Warrants

But the most telling statements by SEC officials came soon after those—one by the Acting Director of Corp. Fin., John Coates,[145] and another jointly published by him and the ACA.[146] Coates began his statement ominously by noting the "baseless hype" surrounding SPACs and the "sheer amount of capital pouring into" them.[147] He then described the SPAC phenomenon and pledged that the SEC's staff would continue "to look carefully at" activity by SPACs.[148]

Coates next focused on the disclosures typically made in the de-SPACing phase, where the private company is merged into the SPAC.[149] He noted claims being made by SPAC promoters that there is more latitude for companies to include projections in these disclosures and that liability concerns are less than in a typical registered offering.[150] As to the former, he acknowledged

142. *See Staff Statement on Select Issues Pertaining to Special Purpose Acquisition Companies*, *supra* note 139.

143. *Id.* Shell companies have either "[n]o or nominal assets" or "[a]ssets consisting solely of cash and cash equivalents." 17 C.F.R. §§ 230.405, 240.12b-2 (2020).

144. *See Staff Statement on Select Issues Pertaining to Special Purpose Acquisition Companies*, *supra* note 139 (citing N.Y. STOCK EXCH., NYSE LISTED COMPANY MANUAL §§ 102.00, 301.00-315.00, 802.01; NASDAQ, U.S. RULEBOOK ser. 5300, 5400, 5500, 5600).

145. John Coates, *SPACs, IPOs and Liability Risks Under the Securities Laws*, SEC (Apr. 8, 2021), [https://perma.cc/EYM7-6MCH].

146. John Coates & Paul Munter, *Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies ("SPACs")*, SEC (Apr. 12, 2021), [https://perma.cc/26VG-E74G].

147. Coates, *supra* note 145.

148. *Id.*

149. *See id.*

150. *Id.*

that the Private Securities Litigation Reform Act ("PSLRA") permits forward-looking statements in certain situations.[151] This gave reason for some to assert that, while they are not allowed in a conventionally registered IPO, they are permissible in a de-SPAC merger.[152]

Yet, said Coates, that attitude may be giving SPAC sponsors less of an incentive to protect investors by doing adequate due diligence on the target and making appropriate disclosures.[153] He also noted that these risks might be even higher than in conventional IPOs because of "potential conflicts of interest in the SPAC structure."[154]

Coates also pointed out that the PSLRA safe harbor for projections is inapplicable where contrary facts cutting against them may be known.[155] In such a case, protection from liability would not be available because those statements would be made with actual knowledge of the falsehoods or without a reasonable belief in their accuracy.[156] And most significantly, that safe harbor is specifically not available to "blank check" companies—which of course is what a SPAC is, a firm with no assets.[157]

Coates's other comments came in regard to claims that SPACs offer less potential for liability than traditional IPOs. A registration is required in the typical de-SPAC merger process because the SPAC exchanges its shares for those owned by the stockholders of the target.[158] Yet, said Coates, the stringent liability for falsehoods in a registration statement under the

151. *See* Coates, *supra* note 145; *see also* Securities Act of 1933, 15 U.S.C. § 77z-2; Securities Exchange Act of 1934, 15 U.S.C. § 78u-5.

152. Coates, *supra* note 145.

153. *Id.*

154. *Id.*

155. *See id.*

156. *Id.* In *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, the Supreme Court similarly found that situations where issuers gave opinions under those circumstances would constitute violations of the anti-fraud provisions of the federal securities laws. 575 U.S. 175, 176 (2015).

157. Securities Act of 1933, 15 U.S.C. § 77z-2(b)(1)(B); Securities Exchange Act of 1934, 15 U.S.C § 78u-5(b)(1)(B); *see also* Securities Act of 1933 § 77g(b)(3) (defining a "blank check company" as "any development stage company that . . . (A) has no specific business plan or purpose; or (B) has indicated that its business plan is to merge with an unidentified company or companies").

158. *See* ANNA T. PINEDO, DISCUSSION OF SEC'S PROPOSED RULES ON SPACS, SHELL COMPANIES, AND PROJECTIONS 12 (2022), [https://perma.cc/2BSU-27U5].

Securities Act is said to be less in a SPAC than in a traditional IPO.[159]

Two reasons have been given for this that affect the standing of shareholders in the target to sue. First, the owners of the target who are offered shares in the SPAC merger may be aware of the material misstatements or omissions pertaining to their company in the registration statement.[160] Second, after the SPAC shares are sold in the market, the subsequent purchasers may not be able to trace their shares to ones that came from the false registration statement as required by the Securities Act.[161]

While those technical issues might lessen the potential for liability in a SPAC registration statement, Coates cautioned that it would still be present.[162] And in a merger, which uses proxy materials, there is also such potential liability for falsehoods, which courts have predicated on a negligence standard.[163] Coates noted that legal accountability may be present there as well for breaches of fiduciary duty under state corporate law.[164]

What Coates called "the upshot of this" is that the whole SPAC transaction, which includes the merger with the target, is really an IPO—filtering SPAC's public shares not only to the target's shareholders but ultimately into the secondary market.[165]

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159. *See* Coates, *supra* note 145.

160. *See* Securities Act of 1933 § 77k(a).

161. *See* Hertzberg v. Dignity Partners, Inc., 191 F.3d 1076, 1080 n.4 (9th Cir. 1999). As one court put it, Section 11(a) requires, "[i]f there is a mixture of pre-registration stock and stock sold under the misleading registration statement, a plaintiff [to] either show that he purchased his stock in the initial offering or trace his later-purchased stock back to the initial offering." *Id. But see* Pirani v. Slack Techs., Inc., 13 F.4th 940, 944, 948-49 (9th Cir. 2021) (holding that "[i]n a direct listing," where there are existing shares in the market under Rule 144, a plaintiff may not be barred from suit because some securities of the same nature as those issued in the registration statement are already in the market).

162. *See* Coates, *supra* note 145.

163. *Id.* (citing Beck v. Dobrowski, 559 F.3d 680, 682 (7th Cir. 2009)).

164. *Id.* (citing Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993); *In re* Transkaryotic Therapies, Inc., 954 A.2d. 346, 357-63 (Del. Ch. 2008)).

165. Coates, *supra* note 145.

And he drove home the need to consider a SPAC to be a full-blown public offering with these emphatic remarks signaling Corp. Fin.'s resolve to review registration statements in those mergers as diligently as those made in traditional IPOs:

> An IPO is where the protections of the federal securities laws are typically most needed to overcome the information asymmetries between a new investment opportunity and investors in the newly public company. . . . [I]t remains true that IPOs are understood as a distinct and challenging moment for disclosure. . . . [T]he public knows nothing about this private company. Appropriate liability should attach to whatever claims it [the company going public] is making.[166]

While stating he was neither "pro- [n]or anti-SPAC," Coates concluded that, since many of the original SPAC investors redeem or sell their shares before the merger, they are not the ultimate public owners of the company.[167] Rather the ultimate public owners are the stockholders who come into the company by such business combinations. They would include shareholders remaining in the SPAC or those who buy stock in the aftermarket. A de-SPAC therefore is every bit as much an IPO as a conventional one. It is the "real IPO," as Coates called it.[168] His clear implication was that questionable projections and lessened liability are just as inappropriate in a SPAC as in a traditional registered offering.

Just a few days after Coates's comments were released, Munter and Coates came out with another even more relevant statement that threw a hard wrench into SPAC transactions.[169] It dealt with how they account for warrants typically sold to insiders during the SPAC's IPO.[170] Those contracts give their holders the right to buy shares in the entity at a price that is fixed when that

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166. *Id.*
167. *Id.*
168. *Id.*
169. *See* Coates & Munter, *supra* note 146.
170. *See id.*; *see also* Michael C. Labriola et al., *SEC Addresses Accounting Treatment for SPAC Warrants*, WILSON SONSINI (Apr. 20, 2021), [https://perma.cc/X8UF-MQ77].

stock is issued.[171] As such, warrants can be quite valuable if the price of the SPAC's shares increases.

SPACs have accounted for them as equity, but Coates and Munter maintain that if the warrants are transferable, as they typically are, they should be considered liabilities of the company.[172] This is because if the warrant holders were to exercise their rights, companies would have to repay them in cash.[173] They should therefore be expenses of the SPAC and would have to be revalued in every earning period.[174]

The financial statements of almost all previous such offerings could then arguably be false and misleading—resulting in the need for them to be restated.[175] And accounting for warrants as costs could change positive earnings into negative ones, which would be extremely disturbing to the way SPACs have been marketed. Those modifications could severely hurt investor confidence in SPACs. As one commentator said about such accounting changes, doing restatements of company financials "shows poorly to the outside and" goes counter to "the level of public trust you really want."[176]

### C. The Academic Study

But a study done by distinguished professors at Stanford University and New York University struck an even more telling blow to SPACs.[177] Those scholars did a detailed analysis of their structure and costs. Their results were alarming to the SPAC industry because the professors found that SPACs would be unsustainable if their post-merger shareholders truly understood them.[178] As they are now structured, those stockholders typically

171. *What You Need to Know About SPACs—Updated Investor Bulletin*, SEC (May 25, 2021), [https://perma.cc/J89G-EW4U].

172. Coates & Munter, *supra* note 146.

173. Robert Freedman, *As SEC Ramps Up SPAC Rules, Lawsuits Could Follow*, CFO DIVE (May 10, 2021), [https://perma.cc/4UFC-EVYZ].

174. *See* Coates & Munter, *supra* note 146.

175. Davina K. Kaile, *SPAC FAQs: SEC Staff Statement on Accounting Issues for SPAC Warrants*, PILLSBURY WINTHROP SHAW PITTMAN LLP (Apr. 26, 2021), [https://perma.cc/SL8X-8EL8].

176. *See* Li, *supra* note 129.

177. *See* Klausner et al., *supra* note 98, at 3-5.

178. *See id.* at 4.

see a substantial dilution in their investments and are really subsidizing the target companies that go public. By contrast, the study showed that the insiders and promoters of SPACs usually do quite well by selling or redeeming their shares prior to the merger.[179]

The professors refuted four advantages touted for SPACs: (1) that they are less expensive to do than traditional IPOs; (2) that they offer more effective pricing and are cheaper; (3) that they afford a way of going public to firms shut out of the traditional process; and (4) that they are a "'poor man's' private equity," allowing retail investors to benefit by putting their funds into start-ups.[180] The study concluded that all those claims were overstated—blowing the whistle on what they called the SPAC "bubble" and the SPAC "hype."[181]

The study did find that SPACs have some advantages over SEC-registered offerings in terms of regulatory leniency and better valuations of companies that may be hard to accurately price in a traditional IPO.[182] Yet the authors suggested that those benefits might be achieved through other mechanisms that would not have the disadvantages that they describe as inherent in the way SPACs are done.[183]

Chief among those is the dilution that SPACs' post-merger investors suffer, which results in large part from the arrangements that its sponsors make when they form them. Those promoters may be private equity firms, prominent business people, or others with no particularly relevant experience.[184] Rarely are they "mom-and-pop" investors as claimed by SPAC advocates.[185] The study thus gave the lie to the SPAC marketing claim that those offerings are a "'poor man's' private equity."[186] It therefore found that even though some retail investors may purchase shares

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179. *See id.* at 3.
180. *Id.*
181. *Id.* at 2-3.
182. Klausner et al., *supra* note 98, at 5.
183. *Id.* at 5, 50-52.
184. *Id.* at 6.
185. *Id.* at 5.
186. *Id.*

of a SPAC later and hold them through the merger, "SPACs [are not] instruments of financial democracy."[187]

Rather, the initial investors in these offerings are a SPAC Mafia who "often have little intention to remain" with the company through its merger.[188] They are richly rewarded, however, for their efforts in starting up the SPAC corporation and selling its shares to make a public shell. To that end, they receive a block of shares, called the "promote," for a nominal price.[189] This inside deal typically amounts to 25% of the SPAC's IPO proceeds and 20% of its post-IPO equity.[190]

This stock is issued as part of units that the SPAC typically sells to its promoters for $10 each.[191] These units also include warrants, giving the holders the right to purchase stock at $11.50 per share.[192] Sometimes the units also have rights that can be exchanged for one-tenth of a share at no cost if the SPAC merges with a target.[193]

When a SPAC proposes such a combination, its shareholders have a right to redeem their stock for its IPO price plus interest.[194] Often, well over two-thirds of the SPAC's original shares are redeemed, but the stockholders get to keep their warrants and rights, which can be quite valuable.[195] SPACs often replenish cash paid out in those redemptions, funding them by selling additional shares in private placements.[196]

When the SPAC merges with the target, the shareholders of that formerly private firm then own most of the equity in the newly restructured public company.[197] The cash that the target receives most often comes from new investors in the SPAC or

187. Klausner et al., *supra* note 98, at 13.
188. *Id.* at 11.
189. *Id.* at 5-7.
190. *Id.* at 6.
191. *Id.* at 7.
192. Klausner et al., *supra* note 98, at 7.
193. *Id.*
194. *Id.*
195. *Id.* at 7, 9.
196. *Id.* at 9. The title of a piece by one commentator summed up how these SPAC investors do so well: *SPAC Insiders Can Make Millions Even When the Company They Take Public Struggles*. Ramkumar, *supra* note 111.
197. Dumont, *supra* note 88; Klausner et. al., *supra* note 98, at 9.

from SPAC sponsors.[198] In the latter case, those early investors often receive side payments to induce them not to redeem their shares.[199]

The upshot of this, the study found, is that financing the SPAC and its merger with the target are often two unrelated transactions.[200] Characterizing SPACs as private equity therefore is incorrect unless they are seen as private equity with a convenient exit option that enriches its sponsors.[201] Likewise, later SPAC investors cannot really be seen as participating in private equity because the role of such shells is to be vehicles for turning private companies into public ones, not to provide start-up financing to new firms.

When the study did the math on this process, it found SPAC sponsors do quite well from their "promotes" and redemptions. Considering the value of the warrants and the rights they receive, redeeming shareholders get a risk-free 11.6% annualized return.[202] Sometimes, this can be even more lucrative. Grab Holdings Inc., a food sharing and delivery service in Southeast Asia, hit $40 billion in a SPAC megadeal, giving its organizers "90% of the promote in return."[203] And information on how such promotes get distributed is murky.[204]

If the SPAC cannot find a target to merge with in two years, of course, all that potential gain evaporates—with the sponsors merely getting their original investment back with modest interest.[205] SPAC promoters therefore have a strong motivation to bring such a combination about.[206]

But what about the shareholders who remain in the SPAC after the merger? There are heavy costs for them, the study found, that water down their investments. As it succinctly amplified,

198. Klausner et al., *supra* note 98, at 10, 15.
199. *Id.* at 15.
200. *Id.* at 17.
201. *See id.* at 16.
202. *See id.* at 24.
203. 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://perma.cc/Q7AP-UA78].
204. *Id.*
205. Jackson & Curry, *supra* note 4.
206. Klausner et al., *supra* note 98, at 20.

"[T]he sponsor's promote, the underwriting fee for redeemed shares, and the warrants and rights included in publicly issued units create an overhang of dilution for the SPAC's eventual merger, and the redemption right amplifies that dilution."[207]

In addition, the warrants and rights take value away from the SPAC's unredeemed remaining stock, and the more shares that are so bought back, the greater the dilution the remaining shares suffer.[208] In a hypothetical analysis of that, where the study postulated a 50% redemption rate, it found the value of post-merger shares fell from $10 to $6.67—a loss of one-third of their worth.[209]

The study did allow, however, that SPACs with high-quality sponsors could ultimately produce good post-merger returns for the remaining shareholders. First, fewer shareholders might redeem their stocks, or more private investment might come in.[210] Second, the involvement of such high-quality organizers might add value because of their continuing relationship with the new firm.[211]

If either of those scenarios happened, as the study put it, the sponsors "could fill the dilution hole created by the inevitable dilution still built into the SPAC structure."[212] The study found, however, that the post-merger performance of the 2019-2020 cohort of companies that it selected was "weak" vis-à-vis returns earned on other stock indices.[213] And it discovered the same was true for SPACs from prior years.[214] From that, it drew this conclusion: "[T]he source of SPACs' poor performance is the dilution embedded in their structure."[215]

The post-merger SPAC stockholders therefore not only subsidize gains for their sponsors but also pick up the tab for the target going public. As the study summed up, "It is hard to believe that SPAC shareholders will continue for long to buy and

207. *Id.* at 26.
208. *Id.*
209. *Id.* at 32.
210. *Id.* at 33.
211. Klausner et al., *supra* note 98, at 33-34.
212. *Id.* at 34.
213. *Id.* at 35.
214. *Id.* at 54.
215. *Id.* at 37.

hold shares through mergers that leave them bearing the costs of the SPAC structure."[216]

Trying to discover the answer to why SPACs persist, the study found that the business press often portrays them "as efficient new vehicles that allow investors to profit from providing companies better and cheaper paths to the public markets than previously available."[217] But not only is such profitability largely illusive for post-merger shareholders, the study also found that SPACs are not really any cheaper or preferable to traditional SEC-registered IPOs.[218]

To that end, it went on to debunk the regulatory advantages SPACs are said to have. The study found they offer no cheaper compliance costs than traditional public offerings, they afford no greater price or deal certainties, and they are not quicker to accomplish than SEC-registered issuances.[219]

One often-cited advantage is that SPACs may include projections because they are provided in joint merger statements made by the SPAC and the target.[220] The PSLRA permits them under certain circumstances for companies that are already public but not in traditional registration statements.[221]

But the study, like the analysis by Corp. Fin. official Coates, saw that as a "loophole for SPACs" that "undermines" protections for investors in companies that make initial offerings to the public.[222] Given Coates's recent statement firmly equating SPACs to IPOs, the SEC will now certainly be taking a hard look at any such forward-looking statements made in SPAC filings.[223]

The study concluded by noting that once the hidden costs and liabilities of SPACs are better known, the "craze" may end.[224] In fact, it was a regulatory "loophole" that was never intended,[225] and SPAC regulation should be brought "up to the level of IPO

216. Klausner et al., *supra* note 98, at 39.
217. *Id.* at 40.
218. *Id.* at 3-4.
219. *Id.* at 48.
220. *See, e.g.*, *id.* at 42-43.
221. *See supra* note 151 and accompanying text.
222. Klausner et al., *supra* note 98, at 43.
223. *See infra* notes 422-26.
224. Klausner et al., *supra* note 98, at 54-57.
225. *Id.* at 55.

regulation,"[226] as Corp. Fin. now seems inclined to do.[227] They may then continue in a more straightforward manner if the high sponsor costs are adjusted and if their proponents can justify them as having some benefits over traditional IPOs.[228]

To that end, one of the academic study's principal authors, Law Professor Michael Klausner of Stanford University, sees some possible promise in SPACs once the public learns their costs and true risks.[229] In that regard, he gave this opinion about their future: "I would be in favor of a SPAC in which the sponsor's compensation is lower and tightly tied to shareholder returns."[230]

Another commentator defended SPACs more broadly, arguing that they make it possible for certain companies to go public that would have a hard time doing so in a traditional IPO.[231] Those would include firms that are quite risky and may not show profits for a number of years—or those that are "too cutting-edge to be easily understood."[232]

### D. SPACs After the Fall

As of summer 2021, however, SPACs seemed if not dead in the water at least barely treading it. The regulatory concerns noted by the SEC's staff certainly prompted that, but market activity has accounted for much of trend's decline as well. Shares in many companies connected to SPACs have fallen precipitously in recent months,[233] perhaps indicating increased investor understanding that these stocks may not be great deals.[234] One commentator ascribed that to "a bitter reality check" arising from

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226. *Id.*

227. *See infra* notes 413-14.

228. Klausner et al., *supra* note 98, at 57.

229. Duhigg, *supra* note 119.

230. *Id.*

231. *Id.*

232. *Id.*

233. Bansari Mayur Kamdar & Medha Singh, *SPAC Boom Fizzles as Investors Cash Out on Big Names*, REUTERS (Dec. 23, 2021, 5:37 AM), [https://perma.cc/T2DW-EAQE]; Ramkumar, *supra* note 111 (stating that while investors in one SPAC "have suffered steep losses[,] [p]romoters of the SPAC still stand to make millions").

234. See Ivana Naumovska, *The SPAC Bubble Is About to Burst*, HARV. BUS. REV. (Feb. 18, 2021), [https://perma.cc/A38K-2SQU], for an earlier prediction that this was bound to happen.

market awareness of "unpredictable revenue and growing pains" from these start-ups.[235]

Because of this sea-change, CEOs of companies have been turning down merger solicitations from SPACs. At the end of May 2021, there were more than 400 SPACs searching for targets who have become progressively more reluctant to entertain their bids.[236] As one CEO said, "It's gone from being a bona fide alternative path to an IPO to 'We don't really want to be a punch line.'"[237]

Another said this about his reluctance to hear overtures from SPACs: "It feels like a shortcut . . . . I got increasingly more uncomfortable."[238] Accordingly, CEOs now say they are inclined to look in the direction of more traditional start-up financing such as venture capital and private equity.[239]

The trend also hit so-called "Green SPACs," those that pledged to merge with environmentally friendly businesses such as companies focused on renewable energy vehicles.[240] They had done well but waned in summer 2021.[241] One commentator noted that many of those businesses were speculative, and many were not transparent about achieving the lofty goals they professed.[242]

SPAC promoters were thus looking at returning money to their investors and forfeiting the funds they put up to get their SPACs up and running. In that case, one commentator described this even more disappointing result for SPAC sponsors: "In that scenario, they also don't get the deeply discounted shares that let

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235. Heather Somerville, *For Startup Leaders, SPACs Have Lost Their Allure*, WALL ST. J. (May 23, 2021, 9:00 AM), [https://perma.cc/5D2P-XDSZ]. One prominent SPAC deal that collapsed involved Topps Co., the famed baseball card company which had agreed to merge in April 2021 with a SPAC called Mudrick Capital Acquisition Corp. II. Matt Grossman, *Topps SPAC Merger Collapses After Loss of MLB Trading-Card Deal*, WALL ST. J. (Aug. 20, 2021, 11:03 AM), [https://perma.cc/8KCE-BT8C]. Topps aborted later in the summer after Major League Baseball and its players' association made an exclusive licensing agreement with another firm, Fanatics Inc. *Id.*

236. Somerville, *supra* note 235.

237. *Id.*

238. *Id.*

239. *Id.*

240. *See* Justin Scheck, *Green SPACs Struggle After Years of Success*, WALL ST. J. (June 17, 2021, 5:30 AM), [https://perma.cc/8HXY-X6YD].

241. *Id.*

242. *Id.*

them make several times their initial investment, on average."[243] Yet another observer noted that trend could be reversed, "particularly if some strong deals draw investors back into the space."[244]

After the critical statements by Corp. Fin. and ACA, the SEC's staff took action that has contributed to SPAC activity grinding to a virtual halt. By mid-May 2021, it had only approved a half-dozen SPAC proxy statements as opposed to the hundreds that were filed in the first few months of 2021.[245] It also published a lengthy investor bulletin to educate ordinary investors about all aspects of SPACs.[246] Pointedly, it described how their promoters purchase equity on more favorable terms than ordinary investors and will benefit more from SPACs in the ultimate business combination.[247]

Congress has also gotten into the act with Senator John Kennedy (R.-La) introducing legislation to require more disclosure in SPAC transactions, specifically targeting the deals that their promoters get.[248] In late May, new SEC Chairman Gary Gensler appeared before a subcommittee of the House Appropriations Committee and testified that the Commission's staff is preparing new rules or guidelines for SPACs.[249]

In his remarks, Gensler questioned if the real story about SPACs is being told, particularly regarding who is benefiting there and whether investors are being appropriately protected.[250] Echoing the concerns of academic research, he asked whether retail shareholders in SPACs truly understand the risks they are taking and the dilution they may suffer.[251] As of late summer and

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243. Amrith Ramkumar, *SPAC Pullback Pressures Creators to Find Quality Mergers*, WALL ST. J. (June 1, 2021, 4:47 PM), [https://perma.cc/4VXF-CAZC].

244. *Id.*

245. Freedman, *supra* note 173.

246. *What You Need to Know About SPACs—Updated Investor Bulletin*, *supra* note 171.

247. *Id.*

248. *See* Chris Prentice, *U.S. Congress to Hold Hearing on SPACs, Ramping Up Scrutiny*, REUTERS (May 21, 2021, 9:52 AM), [https://perma.cc/3JXE-V8EJ].

249. Dave Michaels, *SEC Weighs New Investor Protections for SPACs*, WALL ST. J. (May 26, 2021, 4:01 PM), [https://perma.cc/7GMM-XHKM].

250. *Id.*

251. *Id.* Shortly after Gensler's testimony, the author of this Article had a conversation with Congressman Brad Sherman (D-CA), who is on the House Subcommittee on Financial

fall 2021, there were still some SPAC deals being done.[252] The most prominent was one involving former President Donald Trump that was under investigation by the SEC.[253]

### E. Fraud and Other Issues in SPACs

In addition to those concerns about the dilution that ordinary investors are likely to face in SPACs, those vehicles can pose even greater dangers such as outright fraud. They may also involve breaches of fiduciary duties by their sponsors, who might conceal material information that impairs shareholder redemption rights. The way they are structured may also violate the Investment Company Act[254] and the Investment Advisers Act.[255]

Such frauds are well exemplified by a case involving a SPAC currently in litigation.[256] A private equity firm set up a SPAC as a shell corporation that raised over $1 billion through an IPO.[257] It then identified two oil-and-gas companies, AMH and Kingfisher, to acquire.[258] Although the two were technically

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Services. Sherman told the author he was amazed at the profits SPAC insiders make on these deals. The congressman, however, indicated that he believed the SEC would be on top of these issuers to protect investors.In more recent remarks, Chairman Gensler expressed those concerns even more strongly. *See* Benjamin Bain, *Gensler Warns Executives Against Using SPACs to Shirk U.S. Rules*, BLOOMBERG (Dec. 7, 2021, 12:03 PM), [https://perma.cc/Z49G-75U3]. About SPACs he said, "Private companies are thinking this is an alternative way to go public." *Id.* He went on to state, "These three core tenants about disclosure, marketing and gatekeepers to ensure that the protections in the traditional IPO market are comparable here and that we don't have some imbalance or what people might call an arbitrage between the two approaches." *Id.*

252. *See* Kate Kelly, *SPACs Went Up, Then Down, But They're Not Out*, N.Y. TIMES: DEALBOOK (Aug. 21, 2021), [https://perma.cc/8XN2-R3GU]. One involved the notorious WeWork that previously had failed to complete an IPO because of, among other things, self-dealings by its founder, Adam Neumann. Andrew Ross Sorkin et al., *WeWork Hits the Stock Market*, N.Y. TIMES: DEALBOOK (Oct. 21, 2021), [https://perma.cc/TUE2-H7JM].

253. *See infra* notes 293-95 and accompanying text.

254. *See* Investment Company Act of 1940, 15 U.S.C. §§ 80a-3, -7; see Daniel J. Morrissey, *Are Mutual Funds Robbing Retirement Savings?*, 14 N.Y.U. J.L. & BUS. 143 (2018), and Daniel J. Morrissey, *Mutual Funds Keep Winning at the Expense of Their Investors*, 47 SEC. REGUL. L.J. 1 (2019), for articles by the author on that topic.

255. *See generally* Investment Advisers Act of 1940, 15 U.S.C. § 80b-3.

256. *See* Camelot Event Driven Fund v. Alta Mesa Res., Inc., No. 4:19-CV-957, 2021 WL 1416025, at *11-12 (S.D. Tex. Apr. 14, 2021).

257. *Id.* at *1-2.

258. *Id.* at *2.

separate entities, they were deeply connected by overlapping ownership and operations.[259]

The SPAC's management saw great things coming from their recent acquisition and were planning to take Kingfisher public.[260] The two companies were to be merged into the SPAC through a transaction that was valued at $3.8 billion.[261] It solicited proxies for shareholder approval, stating, among other claims for future success, "that AMH and Kingfisher were poised for accelerating growth immediately following the [merger]."[262]

To that end, the proxy materials had all kinds of estimates and projections that were said to be based upon the "observable trends and capabilities, as well as economically justified assumptions regarding the expected cash flows of" the two companies.[263] It also asserted that the target had appropriate policies and practices regarding its estimates of oil and gas reserves.[264] The SPAC's shareholders approved the merger, and the surviving company became known as Alta Mesa, with AMH and Kingfisher as its subsidiaries.[265]

But less than two months after that, bad news came out and kept on coming.[266] Alta Mesa first announced that the production estimates in its "[p]roxy had been dramatically reduced."[267] More disappointing information followed, including another downward adjustment in AMH's production estimate.[268] Then, just ten months after the merger, Kingfisher announced that its EBITDA, the earnings from its core operations, were almost 80% less than projected in the proxy.[269]

The company next revealed that it had "ineffective internal control over [its] financial reporting due to an identified material weakness."[270] Alta Mesa ended up writing down its assets by

259. *Id.*
260. *Id.* at *2.
261. *Camelot*, 2021 WL 1416025, at *2-3.
262. *Id.* at *3 (alteration in original).
263. *Id.*
264. *Id.*
265. *Id.* at *4.
266. *Camelot*, 2021 WL 1416025, at *4.
267. *Id.*
268. *Id.*
269. *Id.* at *5.
270. *Id.*

$3.1 billion even though it had valued them at $3.8 billion in the merger.[271] Correspondingly, the company's stock plunged.[272] In the bankruptcy proceeding that followed, the firm's assets were sold for just $320 million, less than 10% of what their worth was stated to be in the merger documents.[273]

Investigation supported by information from confidential witnesses revealed that management of AHM and Kingfisher had engaged in wide-spread fraudulent practices to create an appearance that the companies had more oil reserves than they actually did.[274] They also showed that those executives had "temporarily inflate[d] production in a manner Defendants knew would undermine the long-term viability of [AMH's] wells."[275]

Suits by shareholders of the SPAC followed against a number of Alta Mesa's executives and board members as well as two individuals who were executives of the SPAC that became Alta Mesa.[276] The actions alleged fraud both in the sale of securities under Section 10(b) and in proxy solicitation under Section 14(a) of the Securities Exchange Act of 1934.[277] The court sustained those claims, refusing to dismiss the case under Federal Rule of Civil Procedure 12(b)(6).[278] It also upheld causes of action against three business entities alleged to be control persons of those defendants.[279]

The Delaware Chancery, in addition, has weighed in for the first time on SPACs, applying what it called its "well-worn fiduciary principles."[280] The class action there involved a fairly typical SPAC whose sponsor got shares for a nominal price and then went public for $10 per share.[281] The SPAC then merged

271. *Camelot*, 2021 WL 1416025, at *5.
272. *See id.*
273. *Id.* at *7.
274. *See id.* at *7-8.
275. *Id.* at *7 (second alteration in original).
276. *Camelot*, 2021 WL 1416025, at *10-11.
277. *Id.* at *9-10.
278. *Id.* at *8-9, *12.
279. *Id.* at *12.
280. *In re* Multiplan Corp. S'holders Litig., 268 A.3d 784, 792 (Del. Ch. 2022); see also Daniel J. Morrissey, *M&A Fiduciary Duties: Delaware's Murky Jurisprudence*, 58 VILL. L. REV. 121, 126-28 (2013), for the author of this Article's views on those principles.
281. *See In re Multiplan*, 268 A.3d at 791.

with a target, and few of its shareholders redeemed their stock before the merger.[282]

The complaint alleged that the SPACs promoters were fiduciaries for those shareholders and that they had violated their duties by withholding information from the shareholders about how the target's largest customer was building an in-house platform to compete with it.[283] That allegedly impaired the public shareholders' rights to redeem their stock.[284] After the merger, the shares declined several dollars below the $10 price that shareholders originally paid per share.[285] "By contrast, the founder shares, which converted into shares of the post-merger entity, were pure upside to the SPAC's insiders."[286] The Chancellor allowed those claims to go forward against the SPAC's sponsor, directors, and controlling shareholder.[287]

Other pending challenges to SPACs involve claims that they are investment companies, and their sponsors are investment advisors, but that they have not registered under federal acts which govern those entities and individuals.[288] Those Acts regulate companies whose primary business is investing in securities.

In the theory of liability advanced there, SPACs are set up, as their name states, to acquire other companies.[289] They hold securities like assets of the U.S. government and shares in money market funds while they search for target companies.[290] The SPAC insiders take their compensation by way of their ownership interest in those companies, many times getting interests in those firms of at least 20% of their equity.[291] Since those SPAC promoters are therefore running investment companies, these

282. *Id.* at 791-92.
283. *Id.* at 792.
284. *Id.*
285. *Id.* at 792, 798.
286. *In re Multiplan*, 268 A.3d at 792.
287. *See id.* at 792, 799-800.
288. *See, e.g.*, Verified Direct & Derivative Complaint for Breach of the Investment. Co. Act of 1940 and the Investment Advisers Act of 1940 at 2, 20-21, Assad v. E.Merge Tech. Acquisition Corp., No. 1:21-CV-07072 (S.D.N.Y. Aug. 20, 2021).
289. *See id.* at 4.
290. *See id.*
291. *See id.* at 4-5.

suits seek to rescind their compensation because it is taken in violation of those Acts.[292]

In addition, one prominent SPAC involves a company that has planned to merge with a social media firm owned by former President Donald Trump.[293] Senator Elizabeth Warren (D-Mass.) asked the SEC to investigate whether Trump and his companies "may have committed securities violations by holding private and undisclosed discussions about the merger as early as May 2021, while omitting this information in [SEC] filing and other public statements."[294] The Commission is following up on that.[295]

## V. SEC ACTION ON SIMILAR MANEUVERS

### A. Early SEC Response to Going Public Without Registration

But beyond such fraud, breaches of fiduciary duty, and other claims, the biggest challenge to SPACs may be that they aren't really a new phenomenon, just a more recent version of the questionable practice of "going public through the back door." To understand them better, some historical perspective is helpful, particularly from earlier cases regarding entities similar to SPACs and multi-stage transactions that violate the letter and spirit of the registration requirement.

Back in the late 1960s, the SEC became aware that a number of private companies were using shells to create a trading market in their stock.[296] They would sell their shares to the shells in what was purported to be an exempt private placement, and then the shells would pass that stock on to its public shareholders as a stock dividend.[297] That was done in reliance on an earlier Commission opinion which said those transactions were not sales

292. *Id.* at 4-5.

293. Dan Mangan, *Trump SPAC Under Investigation by Federal Regulators, Including SEC*, CNBC (Dec. 7, 2021, 12:47 PM), [https://perma.cc/R6AQ-RNPT].

294. *Id.* (alteration in original).

295. *See id.*

296. *See* Orlanski, *supra* note 9, at 141-52.

297. HAZEN, *supra* note 8, at 263.

because they were not distributions for value, as sales are defined in Section 2(a)(3) of the Securities Act.[298]

In response, the SEC issued a release to address this rash of indirect stock distributions. It questioned "the issuance by a company, with little, if any, business activit[ies], of its shares to a publicly owned company in exchange for what may or may not be nominal consideration," which was followed by a spin-off of those shares by the public company.[299] Looking at the total transaction, it found that the distribution of the spun-off shares "does not cease at the point of receipt by the initial distributees of the shares but continues into the trading market involving sales to the investing public at large."[300]

The SEC therefore recognized that this indirect dispersal of stock would lead to sales of those securities to public investors who would need the information registration provides. In assessing the totality of that process, the SEC took the position that the shell was an underwriter.[301] It was getting the shares of the private company and passing them on to its stockholders, who would then resell them in the market.

The shell was thus a conduit, taking stock "purchased from an issuer with a view to . . . distribution," which is the statutory definition of underwriter under Section 2(a)(11) of the Securities Act.[302] Because an underwriter was involved, the Section 4(1) exemption was not available, and the entire transaction constituted an illegal sale of unregistered securities.[303]

In the same release, the Commission also warned about a more direct pattern of shell manipulation by unscrupulous promoters that was similar to what was occurring when public companies spun off their shares.[304] The SEC then followed up on that by bringing several litigated actions to stop practices that exemplified that wrongdoing.

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298. *Id.* at 260.

299. Spin Offs and Shell Corporations, Securities Act Release No. 4982, Exchange Act Release No. 8638, 34 Fed. Reg. 11,581 (July 2, 1969).

300. *Id.*

301. HAZEN, *supra* note 8, at 263 n.86.

302. *See* SEC v. Chinese Consol. Benevolent Ass'n, 120 F.2d 738, 740 (2d Cir. 1941).

303. *Id.* at 741.

304. Spin Offs and Shell Corporations, 34 Fed. Reg. at 11,581.

One was a classic "pump and dump."[305] There, promoters found an inactive shell, fraudulently "dress[ed] up" its assets as having "enormous potential value," and sold them to public investors without registration.[306] The court realistically analyzed this as "a new offering."[307] It held that the promoters were its underwriters and thus could "find no comfort in the Section 4(1) exemption."[308] That, it held, was "intended to cover everyday trading between members of the investing public," not situations, like in this case, involving a distribution to the public by "an issuer, underwriter or dealer."[309]

In addition to enjoining the defendants from violations of the anti-fraud provisions of the Securities Acts, the court therefore also found they had violated the registration requirements.[310] Citing the primary purpose of the Act as "the protection of 'those who do not know market conditions from the overreachings of those who do,'" the court enjoined many of the participants in the scheme from engaging in the sale of unregistered securities as well as from violating the anti-fraud provisions of the securities laws.[311]

About the same time the Commission brought another case, *SEC v. Harwyn Industries Corp.*, that involved the other situation it discussed in the release—taking companies public by spinning off their shares.[312] There, a public company actively acquired private companies seeking to go public.[313] The public company then held those corporations as subsidiaries and distributed some of their shares to its stockholders so that a trading market for them would ensue.[314]

Because of that, the court ruled that the closely held firms, the subsidiaries of the public company, were making

305. *See* SEC v. N. Am. Rsch. & Dev. Corp., 424 F.2d 63, 66-67, 74 (2d. Cir. 1970).
306. *Id.* at 66-67, 71.
307. *Id.* at 72.
308. *Id.*
309. *Id.* at 71.
310. *See N. Am. Rsch. & Dev. Corp.*, 424 F.2d at 70-80.
311. *Id.* at 66, 82.
312. 326 F. Supp. 943, 945 (S.D.N.Y. 1971); *see also supra* note 304 and accompanying text.
313. *Id.* at 945.
314. *Id.* at 945-46.

unregistered, non-exempt sales of their securities.[315] They received value when they sold their shares to the public company with a view to having them publicly traded.[316] And the unregistered sales of those shares by the stockholders of the public company were done for value too and thus were also in violation of the registration requirement.[317]

Shortly after that, the SEC brought another case, *SEC v. Datronics Engineers, Inc.*, that involved a similar pattern of using an existing public company, Datronics Engineers, Inc. ("Datronics"), to create a trading market in the shares of private firms.[318] There, Datronics entered into agreements with a number of closely held companies that provided they would be merged into either an existing subsidiary of Datronics or a new one.[319] The shareholders of the private company would receive a majority of the stock in those subsidiaries or new corporations.[320]

Datronics would then distribute the shares of those subsidiaries to its public shareholders without filing a registration statement for them.[321] The appellate court held this scheme involved a sale of the stock of the closely held companies because a trading market for them began promptly.[322] Furthermore, Datronics and its officials, who received some of those shares, benefited from that process.[323] Each of the private companies thus became public, and the purchasers of their shares in the resulting trading market were not afforded the protection of registration.[324]

Therefore, not only did the merged corporations violate the Securities Act's registration requirement as issuers of those spun-off securities but Datronics did so as well. The court held it was both a co-issuer and an underwriter in all those transactions, purchasing the private companies' shares with a view to

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315. *Id.* at 953, 955.
316. *Id.* at 954.
317. *Harwyn Indus. Corp*., 326 F. Supp. at 954.
318. *See* 490 F.2d 250, 253-54 (4th Cir. 1973).
319. *Id.* at 253.
320. *Id.*
321. *Id.*
322. *Id.*
323. *Datronics Eng'rs, Inc.*, 490 F.2d at 253-54.
324. *Id.*

distributing them.[325] As such, Datronics, an issuer and underwriter of securities, could not claim the Section 4(1) exemption from registration.[326]

### B. Rule 145

Those attempts to use dividends of the stock of subsidiaries to go public without registration may have led the Commission more broadly to revise its earlier position that exchanges of stock in certain corporate combinations do not constitute a sale. As has been said, the SEC had traditionally found no sale of securities there even though they were "disposed of for value," as Section 2(a)(3) of the statute defined that event.[327] Registration was therefore not needed.

This "no sale theory" was based on the highly formalistic theory that this just involved "corporate acts," that there was no volitional action by the individual shareholders.[328] But in 1972, the SEC changed its view, realizing the shareholders whose approval would be requested for these transactions would thereby be sold securities.

The Commission took care of this problem by promulgating Rule 145.[329] It allowed that the registration of this stock, exchanged for other shares, could be done on Form S-4, which

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325. *Id.* at 254.

326. *Id.* at 253.

327. *See, e.g.*, Isquith v. Caremark Int'l, Inc., 136 F.3d 531, 533-34, 537 (7th Cir. 1998) (finding that a spin-off did not require registration). Among other things, there the parent had received a no-action letter from the SEC to that effect, and the court found there was no sale of the securities because it was akin to a stock dividend. *Id.* at 533-34. The Commission's Division of Corporation Finance has given its opinion that a spin-off does not require Securities Act registration if these conditions are met: (1) shareholders of the parent corporation "do not provide consideration for the spun-off shares," (2) the spun-off shares are distributed pro rata to the parent corporation's shareholders, (3) adequate information about the subsidiary and the spin-off is provided by the parent corporation to both the stockholders and the securities trading markets, (4) the parent corporation has a valid business purpose justifying the spin-off, and (5) if the parent corporation elects to spin off restricted securities, it has held them for a requisite period of time. SEC Staff Legal Bulletin No. 4 (Sept. 16, 1997), [https://perma.cc/85EB-FMDK].

328. 17 C.F.R. § 230.133 (1968), *rescinded*, Registration of Certain Transactions Involving Mergers, Consolidations and Acquisitions of Assets, Securities Act Release No. 5316, Exchange Act Release No. 9804, Investment Company Act Release No. 7405, 37 Fed. Reg. 23,631 (Nov. 7, 1972).

329. 17 C.F.R. § 230.145 (2013).

was specifically designed for issuances of shares in corporate combinations.[330] There, the registrants could use the proxy statements required to solicit approval of a merger as registration statements as well.

The SEC's changed position as to the merging corporations brought to light a subtler issue—who is an underwriter in these transactions? Under the statutory definition of that term in Section 2(a)(11), underwriters could include affiliates of the issuer at the time of the merger.[331] If they or those selling for them could be considered engaged in a distribution, they would thus be underwriters precluded from using the Section 4(a)(1) exemption from registration.

That issue was muddied a bit, however, in 2007 when the Commission did away with the presumptive underwriter doctrine, which restricted all affiliates that were parties to such transactions from selling their shares.[332] In its new approach, the SEC said that sales by these affiliates would not be part of a distribution if they were made in compliance with certain requirements of Rule 144.[333] However, that repeal of the presumptive underwriter doctrine did not apply to shell companies created solely for the purpose of effectuating a business combination involving another company.[334]

### C. Use of Shells When Multiple Players Are Involved

More recently, courts have also ruled that defendants using shells to go public cannot insulate themselves from the registration requirements through dealings that involve layers of participants. An important decision there, *SEC v. Cavanagh*,

330. *See id.*

331. *See* HAZEN, *supra* note 8, at 259.

332. *Id.*

333. Revisions to Rules 144 and 145, Securities Act Release No. 8869, 72 Fed. Reg. 71,546 (Dec. 6, 2007). Securities Act Rule 144 allows affiliates of companies to sell their securities in certain conditions without being deemed underwriters. 17 C.F.R. § 230.144 (2022). Under Rule 145(c), affiliates of an issuer engaged in one of these mergers will not be underwriters if they sell in compliance with Rule 144(d)'s volume limitations and make their sales in ordinary brokerage transactions. HAZEN, *supra* note 8, at 259. Other requirements of Rule 144 apply to those sales as well. *See id.*

334. HAZEN, *supra* note 8, at 259.

premised its holding on the integration doctrine.[335] That securities law jurisprudence allows courts to scrutinize purportedly separate dealings and view them as a single transaction.[336]

The central figure in *Cavanagh* was what the court called a "malevolent investment banker," who with a lawyer and a broker-dealer agreed to raise capital for a company in need of funds.[337] Instead of doing that, however, they obtained a large block of the company's stock right before they merged the company into a public shell that they secretly controlled.[338] Some of those shares were then purchased by three Spanish entities in what were alleged to be private sales made by the company's management.[339] The defendants then sold the other shares they owned in the merged company on the public market at inflated prices, gaining over $5 million from "small, on-line investors."[340]

The defendants argued that their sales were exempt under 4(1) because they did not involve an underwriter.[341] To that end, one of them claimed "he was no longer an affiliate of the" issuer "because he had resigned" his position "as an officer and director."[342] The court, however, considered all the various actions by the defendants involved in forming the shell, capitalizing it, and merging it into the public company.[343] In that light, it held that the purposes of the Securities Act were best

335. 1 F. Supp. 2d 337, 364 (S.D.N.Y. 1998), *aff'd*, 155 F.3d 129 (2d. Cir. 1998).

336. See Daniel J. Morrissey, *Integration of Securities Offerings—The ABA's "Indiscrete" Proposal*, 26 ARIZ. L. REV. 41, 54, 56 (1984), for an earlier article by this author on that doctrine as it applies to purportedly separate offerings that are each allegedly exempt from registration. The integration doctrine there combines those multiple offerings if they are done for the same purpose or are part of a single plan of financing. *Id.* at 56. The result is that many times the total integrated offering does not qualify for an exemption from registration. *See id.* at 43-44, 76-77.For the SEC's latest statement about the integration doctrine, simplifying its application, see generally 17 C.F.R. §§ 227.100-.504 (2016); 17 C.F.R. §§ 230.251-.263 (1992); 17 C.F.R. §§ 230.500-.508 (1982); 17 C.F.R. §§ 229.10 -.1305 (1982). There, the Commission created broader safe harbors than had existed before that to prevent exempt offerings from being integrated in a number of situations.

337. *Cavanagh*, 1 F. Supp. 2d at 344.

338. *See id.* at 344, 350.

339. *Id.* at 365, 368-69.

340. *Id.* at 341.

341. *Id.* at 361.

342. *Cavanagh*, 1 F. Supp. 2d at 361.

343. *See id.* at 360-84 (considering claims under Securities Act of 1933, 15 U.S.C. §§ 77f, 77j, 77q).

served by treating them as having been "jointly conceived and jointly consummated."[344]

To do that, the court applied what it called "an 'integrated' analysis" to determine whether exemptions from registration are improperly claimed for separate transactions which are "actually part of a larger offering for which no exemption is available."[345] Applying that outlook, the court scrutinized the merger with the shell company and the alleged private sales of stock to the Spanish entities.[346] Those were then transferred to the defendants for their sale, and therefore, the whole process did not involve separate transactions.[347] They were really one in the minds of the defendants who designed them.

As such, the court found they "were so interconnected that one would not have happened without the other."[348] In the words of an earlier SEC release on the integration doctrine, all the sales were "part of a single plan of financing, and shared the same general purpose."[349] Following that logic, the court concluded that whether a violation of the registration requirement occurred depended on "the implications of these events for investors who ultimately bought or sold the shares that were made available to the public as a result of these transactions."[350]

Since the shares of the individuals who ultimately purchased them were not registered, they received no honest information about the offering. And using the integration analysis, the court found the defendants were control persons of all those dealings, and thus it ruled that their sales involved underwriters precluding their use of the 4(1) exemption.[351] Since a distribution of securities was occurring, their sales were not exempt and therefore violated the registration requirement.[352]

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344. *Id.* at 364 (quoting SEC v. N. Am. Rsch. & Dev. Corp., 424 F.2d 63, 70-71 (2d Cir. 1970)).

345. *Id.* at 363 (quoting LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION 278 (3rd ed. 1995)).

346. *Id.* at 364-65.

347. *Cavanagh*, 1 F. Supp. 2d at 365.

348. *Id.* at 364.

349. *Id.* at 365; *see also* Non-public Offering Exemption, Securities Act Release No. 4552, 27 Fed. Reg. 11,316 (Nov. 16, 1962).

350. *Id.* at 365-66.

351. *Id.* at 361-62, 366-67.

352. *Cavanagh*, 1 F. Supp. 2d at 367.

*SEC v. Lybrand* exemplifies another significant use of a shell corporation to evade registration where the court considered all the transactions involved in the sale of shares to the public.[353] There, defendants Richard and Debra Kerns and Charles Wilkins formed shell corporations, distributing their shares to family members and friends.[354] They then arranged for the stock of one of these shells to be publicly traded and negotiated the sale to another defendant, Peter Lybrand.[355] Lybrand advised them to manipulate the price of the shares by engineering various fraudulent transactions like match orders, which they did.[356] The Kernses and Wilkins then transferred the shares of those shells to Lybrand, who continued to manipulate them.[357]

Among other things, the SEC charged the Kernses and Wilkins with being underwriters of the sale of the shells' stock to the public.[358] Those defendants responded they had only made "private sales" to Lybrand and, furthermore, that they were not engaged in the public distribution of stock because they had made substantial compliance with Rule 144.[359]

The court, however, focused on the broad definition of underwriters as "all persons who might operate as conduits for securities being placed into the hands of the investing public" and who thereby sell for an issuer in a distribution.[360] It also noted that the statutory definition of underwriter equates control persons with their issuers and thus makes their sales ineligible to claim the 4(1) exemption.[361]

With that background, the court found that the Kernses and Wilkins were underwriters because they had engaged in a distribution by transferring the shares of their shell corporation to Lybrand.[362] To support that, it specifically cited *Cavanagh* to the

353. *See* 200 F. Supp. 2d 384, 386 (S.D.N.Y. 2002), *aff'd on other grounds*, *sub nom*. SEC v. Kern, 425 F.3d 143 (2d Cir. 2005).

354. *Id.* at 387.

355. *Id.* at 388.

356. *See id.* at 389-90.

357. *Id.* at 390.

358. *See Lybrand*, 200 F. Supp. 2d at 391-92.

359. *Id.* at 392.

360. *Id.* at 393 (quoting 1 THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 431 (4th ed. 2002)).

361. *Id.* at 393.

362. *Id.* at 393-96.

effect that "the sales and transfer should be viewed as part of a single transaction for each entity."[363]

The court also held that those actions could not be exempt under the criteria of Rule 144 because, among other things, the defendants' argument was "nothing more than an extension of their claim that they did not acquire the shell corporations' securities 'with a view to' participating in a distribution."[364] Like *Cavanagh*, the court thus found that shell organizers who are indirectly involved in the sale of their unregistered shares to the public violate the Securities Act.[365]

## VI. SPAC PROMOTERS AS UNDERWRITERS

### A. Sales by SPAC Insiders

Under the theories developed in cases like *Cavanagh*, *Lybrand*, and their predecessors that also involved manipulation of shells, SPAC promoters may be exposed to liability as underwriters. If that is so, their sales of SPAC stock would not be exempt from registration under the current version of Section 4(1), 4(a)(1). Absent another exemption, such unregistered sales violate Section 5 of the Securities Act, which requires that all offers and sales of securities be registered with the SEC.[366] In these situations, buyers of shares have the right to bring a civil action to rescind their purchases.[367]

The Securities Act is designed so that in the initial distribution of securities by issuers the public is protected by a registration process. As has been said, it must provide them all the information they need to make an investment decision.[368] As two renowned early commentators said about the purpose of that legislation: "All the Act pretends to do is to require the 'truth about securities' at the time of issue, and to impose a penalty for

363. *Lybrand*, 200 F. Supp. 2d at 396.
364. *Id.* at 394.
365. *Id.* at 395, 397-98.
366. Securities Act of 1933, 15 U.S.C. § 77e(c).
367. Securities Act of 1933 § 77*l*(a).
368. *See supra* notes 72-75 and accompanying text.

failure to tell the truth. Once it is told, the matter is left to the investor."[369]

In addition, the Act presupposes that issuers make their sales through underwriters who act as conduits for securities placed in the hands of public buyers.[370] They are intermediaries who facilitate the transfers of securities. The House and Senate hearings thus made clear that the registration requirement covers not only the issuer but those in control of it and their agents.[371] As such, underwriters are an integral part of the selling process, and their inclusion in the registration requirement is necessary so that members of the public are given full information about the investments they are offered.[372]

As has been said, Section 2(a)(11), the statutory definition of an underwriter, sets forth three ways individuals or entities can fall into that category: (1) by buying from the issuer with a view towards distribution; (2) by directly or indirectly participating in an underwriting effort; (3) and by selling securities on behalf of a control person or operating as the controlling entity.[373] The sales by SPAC promoters seem to fit into both the first and third of those provisions.

Using the logic of cases like *Cavanagh* and *Lybrand*,[374] SPAC sponsors can be seen as participants in selling stock of the target companies in the process called de-SPACing. That constitutes a de facto public distribution of their shares. SPAC promoters are the initial stockholders in the SPAC, purportedly providing its start-up capital. They may purchase those shares from the SPAC in an SEC-registered offering, but most likely they have received their block of shares in an exempt private placement at a deep discount or for a nominal price.[375]

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369. William O. Douglas & George E. Bates, *The Federal Securities Act of 1933*, 43 YALE L.J. 171, 171 (1933).

370. *See* HAZEN, *supra* note 8, at 222.

371. Robert J. Ahrenholz & William E. Van Valkenberg, Note, *The Presumptive Underwriter Doctrine: Statutory Underwriter Status for Investors Purchasing a Specified Portion of a Registered Offering*, 1973 UTAH L. REV. 773, 777.

372. *See* HAZEN, *supra* note 8, at 222.

373. Securities Act of 1933, 15 U.S.C. § 77b(a)(11).

374. *See* SEC v. Cavanagh, 1 F. Supp. 2d 337, 337-38, 371-72 (S.D.N.Y. 1998); SEC v. Lybrand, 200 F. Supp. 2d 384, 392, 394-95 (S.D.N.Y. 2002).

375. *See What You Need to Know About SPACs—Updated Investor Bulletin*, *supra* note 171.

As has been discussed, those SPAC sponsors often exercise their rights to have their shares redeemed by the SPAC before its merger with the private target company.[376] Subsequently, that stock, now owned by the SPAC, becomes shares of the merged company that is created in the de-SPACing process.[377] Since the SPAC's stock is already trading in the public market, the shares that the promoters sell back to the SPAC most likely end up there, where they are bought by the investing public.[378]

Not only does the SPAC process evade the registration requirement by taking private companies public through the back door, but the promoters of those SPACs therefore also appear to be underwriters in those offerings. They take their shares from the SPAC in its IPO or in a private placement with a view to reselling them back to the SPAC before its merger with the target. Those sales are made without registration but look to their introduction into a trading market without their ultimate public purchasers having the benefit of registration. As the *Cavanagh* case held, this indirect sale to the public through a multi-staged approach, if done without registration, violates Section 5 of the Act.[379]

Using the integration doctrine, *Cavanagh* found that the purportedly separate sales involved in such a transfer to the public were in effect a single transaction.[380] As has been described, earlier cases like *Harwyn* and *Datronics* involved using spin-offs to bring about unregistered sales to public purchasers.[381] Like the sales by SPAC sponsors, spin-offs were also accomplished through such a multi-stage technique that the courts found violated the Securities Act.[382]

As one authority noted, the Act places great emphasis on who the ultimate purchasers of the securities will be, rather than the nature of the person acting to transmit them.[383] In such

376. *See supra* note 195 and accompanying text.

377. *See supra* notes 96-101 and accompanying text.

378. *See supra* notes 165-68 and accompanying text.

379. *See Cavanagh*, 1 F. Supp. 2d at 364-67.

380. *Id.* at 363-65.

381. *See supra* notes 312-26 and accompanying text.

382. *See* SEC v. Harwyn Indus. Corp., 326 F. Supp. 943, 945-46, 954-55 (S.D.N.Y. 1971); SEC v. Datronics Eng'rs, Inc., 490 F.2d 250, 253 (4th Cir. 1973).

383. HAZEN, *supra* note 8, at 222.

situations, the intent of the SPAC sponsors at the time they resell their shares back to that entity should be irrelevant because they most likely know then that their shares will be resold in the public market. They are therefore underwriters because they have taken their securities with a view to such an ultimate distribution.

That result is further supported because the selling SPAC sponsors have been instrumental in forming that shell with the purpose of merging it into a private target. In the words of *Cavanagh*, all those actions "were so interconnected that one would not have happened without the other."[384] The SPAC shareholders have thus taken their shares from the issuing SPAC with obvious knowledge that, when they resell the shares, they will end up in the public market.

In addition to finding SPAC sponsors to be underwriters because of their role in transmitting shares to the public, the alternate application of that term would apply here as well.[385] SPAC promoters are certainly control persons of such entities. As such, individuals such as brokers, who sell for them in connection with a distribution, are underwriters too. Since an underwriter is then part of the transaction, the 4(a)(1) exemption will not apply to anyone involved, such as the selling SPAC sponsors.[386]

The more recent *Lybrand* case is also on point.[387] It adopted a broad definition of underwriters as "all persons who might operate as conduits for securities being placed into the hands of the investing public."[388] In *Lybrand*, certain defendants, after manipulating the shares they owned and arranging for a public market for them, then transferred the shares to another individual who sold them to the public.[389] Like *Cavanagh*, the *Lybrand* court integrated that entire activity, holding that all those sales and transfers should be viewed as a single transaction involving the sale of unregistered securities.[390]

384. *See Cavanagh*, 1 F. Supp. 2d at 364.
385. *See supra* notes 360-61 and accompanying text.
386. *See* SEC v. Chinese Consol. Benevolent Ass'n., 120 F.2d 738, 741 (2d Cir. 1941).
387. *See* SEC v. Lybrand, 200 F. Supp. 2d 384, 397-98 (S.D.N.Y. 2002).
388. *Id.* at 393 (quoting HAZEN, *supra* note 360, at 431).
389. *See Lybrand*, 200 F. Supp. 2d at 390-91, 393.
390. *Id.* at 395-96.

The same pattern is evident in sales by SPAC promoters. They sell their shares back to the SPAC knowing that a large number of them will find their way into the public market. And the logic of *Lybrand* precluding the applicability of Rule 144 applies here too. A holistic view of the actions of the SPAC promoters indicates that they have taken their shares with a view to participating in their ultimate distribution through the merged company to the investing public. Therefore, they cannot be the isolated sales that Rule 144 exempts because they are part of a plan to sell a larger number of securities to the public.

### B. The Presumptive Underwriter Doctrine of Rule 145

As has been discussed, Rule 145 reversed the SEC's previous position that exchanges of stock in mergers did not require registration.[391] In 1972, the Commission did that about-face, stating that in such situations where stockholder approval is required, there would indeed be a disposition of a security for value (i.e., a sale).[392] The SEC allowed, however, that registration there could be done by Form S-4, which uses the proxy statements required to solicit shareholder approval for a merger.[393]

Up until 2007, the Commission also maintained that any affiliates of an issuer who sold securities coming from a Rule 145 transaction would be engaged in a distribution and therefore considered underwriters, necessitating the registration of their securities. But in amendments to Rule 145 promulgated that year, the SEC excluded those making such "downstream" sales from underwriter status so long as the transactions were made under the volume limitations of Rule 144(d) and in ordinary brokerage transactions.[394]

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391. *See supra* Section V.B.

392. *See supra* notes 327-29 and accompanying text.

393. *See* SEC, FORM S-4: REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933, at 2-3 (2022), [https://perma.cc/P6S3-U3RT].

394. *See supra* notes 332-33 and accompanying text.

But in an important proviso, the Commission added in Rules 145(c):

> However, based on our experience with transactions involving shell companies that have resulted in abusive sales of securities, we believe that there continues to be a need to apply the presumptive underwriter provision to reporting and non-reporting shell companies and their affiliates and promoters. We are amending Rule 145 to eliminate the presumptive underwriter provision except when a party to the Rule 145(a) transaction is a shell company.[395]

However, Rule 145(c), which contains that provision, carves out an exemption when the company without assets or operations is created solely for the purpose of a business combination involving a non-shell company.[396] That would seem to apply in a SPAC situation because the shell there is created to merge with a target company that has real operations and assets.[397]

Even without that saving exemption, however, the prohibition on downstream sales would not seem to apply to SPAC sponsors because they usually sell their shares before the merger occurs.[398] Yet the logic of Rule 145 and its original concept of the presumptive underwriter present important background to support the arguments made above that the SPAC sponsors are indeed underwriters.

As pointed out, SPAC promoters obviously control such an issuer.[399] Under the statutory definition of underwriter in Section 2(a)(11), they are therefore deemed tantamount to the issuer so that anyone who sells for them in connection with a distribution is an underwriter.[400] The section 4(a)(1) exemption therefore does not apply to anyone involved in that transaction. Since an underwriter is involved in such sales, which include the control persons themselves, those individuals are liable for the sale of unregistered securities because they are part of the entire transaction.

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395. 7 J. WILLIAM HICKS, EXEMPTED TRANSACTIONS UNDER THE SECURITIES ACT OF 1933 § 5:10 (2022).
396. 17 C.F.R. § 230.145(c) (2013).
397. *See supra* notes 96-100 and accompanying text.
398. *See supra* notes 194-95 and accompanying text.
399. *See supra* note 351 and accompanying text.
400. *See supra* note 373-74 and accompanying text.

In addition, given the approach taken by *Cavanagh* and *Lybrand*, the volume limitation exemption adopted from Rule 144 in 2007 should be not controlling here.[401] Those cases used integration to combine sales by various participants in shell manipulations.[402] That appears to be exactly what is happening when numerous members of the SPAC Mafia together bail out and reap substantial profits before the de-SPACing process, which dilutes the investments of the remaining shareholders.

## VII. CONCLUSION

The SPAC phenomenon should therefore occasion a reaffirmation of the importance that securities sold to the public be first registered and reviewed by a federal agency acting in the public's interest. In addition to all their other problems, SPACs are merely the latest version of "going public through the back door"—a cunning maneuver that stock promoters have used for years to sidestep the important protection that registration provides for investors.

What the academic study calls a "loophole"[403] appears to have been at best an oversight in the Securities Act. The SEC has, over the years, fought to close or at least restrict it. It certainly violates the spirit of that law and likely even its letter because underwriters are precluded from using the 4(a)(1) exemption.[404]

And so, the role that SPAC organizers and promoters play in bringing about this dubious practice makes them both control persons and underwriters.[405] Considering the total impact of these transactions, they are underwriters of their SPACs' shares that are sold to the public and also are control persons of the entire venture. That makes those who sell for them underwriters as well. Under both theories, therefore, the 4(a)(1) exemption is unavailable.

The SPAC promoters thus have no exemption from registering their transactions and are making sales of their

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401. *See supra* notes 334, 363-65 and accompanying text.

402. *See supra* notes 345-49, 363 and accompanying text.

403. *See supra* note 225 and accompanying text.

404. *See* SEC v. Chinese Consol. Benevolent Ass'n, 120 F.2d 738, 741 (2d Cir. 1941).

405. *See supra* notes 351-52, 360-62 and accompanying text.

securities in violation of the securities laws. Their purchasers, using the remedy of Section 12(a)(1), can therefore rescind their sales and obtain recovery from those SPAC sponsors who have violated Section 5 by selling unregistered securities.

## VIII. EPILOGUE

After this Article was written and accepted for publication, two significant events occurred impacting the future of SPACs. First, as Chairman Gensler indicated in his congressional testimony,[406] on March 30, 2022, the Commission published new proposed rules governing SPACs.[407] Its intent is generally in line with the position Corp. Fin. Director Coates took in his earlier remarks equating SPACs with traditional IPOs, and the proposal would bring SPAC regulation up to match the level of IPO regulation.[408] In addition, the SEC buttressed its proposal with recommendations made in fall 2021 from its Investor Advisory Committee and its Small Business Capital Formation Advisory Committee, which highlighted the inadequate disclosures that often occur in SPAC offerings.[409]

Second, by summer 2022, investor appetite for SPACs appeared to be dead in the water. As one commentator noted, the "regulatory crackdown," as well as the market's volatility, hit SPACs hard.[410] Another commentator agreed, stating "General market volatility in 2022 and an uncertain market environment resulting in losses in the public markets have . . . dampened enthusiasm for SPACs."[411] Thus, while there were 613 SPAC IPOs in 2021, by October 2022, there had only been about 80.[412]

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406. *See supra* note 249 and accompanying text.

407. Special Purpose Acquisition Companies, Shell Companies, and Projections, Securities Act Release No. 11048, Exchange Act Release No. 94546, Investment Company Release No. 34594, 87 Fed. Reg. 29,458 (proposed Mar. 30, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 230, 232, 239, 240, 249, 270).

408. *See supra* notes 165-68, 226 and accompanying text.

409. Special Purpose Acquisition Companies, Shell Companies, and Projections, 87 Fed. Reg. at 29,462-63.

410. Yun Li, *SPACs Wipe Out Half of Their Value as Investors Lose Appetite for Risky Growth Stock*s, CNBC (June 27, 2022, 2:01 PM), [https://perma.cc/Y926-AVMS].

411. *Id.*

412. *Summary of SPACs*, SPAC ANALYTICS, [https://perma.cc/5LBH-2VUZ] (last visited Oct. 2, 2022).

In announcing the new SPAC proposal, Chairman Gensler was quite explicit about his intent to treat SPACs as much as possible like regular registered public offerings.[413] To that end, he quoted one of Aristotle's key principles of jurisprudence: "Treat like cases alike."[414] No doubt his attitude was shaped by an astounding fact that the Commission's release pointed out—more than half the public offerings in 2020 and 2021 were done as SPACs, raising more than $83 billion and $160 billion, respectively.[415]

SPACs then appeared on their way to swallowing up the finely calibrated securities regulation system, described above,[416] that the SEC had established under the Securities Act to oversee and control public offerings. As Chairman Gensler stated, the proposal's intent was to reverse the SPAC's trend of undercutting that process because it "would strengthen disclosure, marketing standards and gatekeeper and issuer obligations by market participants in SPACs, helping ensure that investors in these vehicles get protections similar to those when investing in traditional IPOs."[417]

The Commission's proposed regulations have several significant aspects. First, they would require specific disclosures regarding compensation paid to SPAC sponsors, conflicts of interests, dilution, and the fairness of the transactions to unaffiliated investors.[418] SPACs are a process where, as has been pointed out, unaffiliated investors appear to be unfairly subsidizing transactions that enrich the promoters of those entities and the shareholders of the target companies.[419] This may be similar to the dilution public investors experience when buying stock in traditional IPOs. But the Commission and state

413. Joel L. Rubinstein et al., *SEC Proposes Rules to Regulate SPACs*, WHITE & CASE (Apr. 18, 2022), [https://perma.cc/2FRV-6K5C].

414. *Id.*

415. Special Purpose Acquisition Companies, Shell Companies, and Projections, Securities Act Release No. 11048, Exchange Act Release No. 94546, Investment Company Release No. 34594, 87 Fed. Reg. 29,458 (proposed Mar. 30, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 230, 232, 239, 240, 249, 270).

416. *See supra* Sections II.E, II.F.

417. Rubinstein et al., *supra* note 413.

418. Special Purpose Acquisition Companies, Shell Companies, and Projections, 87 Fed. Reg. at 29,464.

419. *See supra* notes 194-99 and accompanying text.

regulators have worked to keep that at reasonable levels. In addition, the SPAC sponsors may have every incentive to find a merger partner who may be unsuitable for the interests of their unaffiliated shareholders.[420]

Along those lines, the new regulations would also require disclosure about whether the SPAC believes that the de-SPAC transaction is fair to investors.[421] In addition, the proposal would not allow the use of forward-looking statements.[422] SPACs would be defined as blank-check companies, so they would not be eligible to use such statements under the PSLRA[423] and could not "make bullish forward-looking statements about the firms they plan to merge with."[424] As has been pointed out, abuses have occurred there involving unjustified forecasts about the prospects of the target companies.[425] SPACs would thus be brought more in line with the practice of traditional IPOs, where the Commission has historically looked on projections with a jaundiced eye as ways to potentially deceive eager investors.[426]

Along the lines this Article has advocated, the proposal would also expand liability. The private target companies would be made co-registrants in these transactions and would thus also be responsible for false or misleading statements in those documents.[427] And the new rules would specifically make underwriters of the SPAC's IPO also underwriters of the de-SPACing process.[428] They would thus have due diligence

420. *See supra* notes 205-06 and accompanying text. As has been described, if the SPAC's promoters fail to identify a merger partner in two years, they miss out on their lucrative "promotes" and redemptions, and merely get back their original investment with modest interest.

421. Special Purpose Acquisition Companies, Shell Companies, and Projections, 87 Fed. Reg. at 29,463.

422. *Id.*

423. *Id.*

424. Yun Li, *Goldman Sachs Is Shrinking Its SPAC Business Amid Regulatory Crackdown and Market Turmoil*, CNBC (May 9, 2022, 4:07 PM), [https://perma.cc/M5ZM-DJVK].

425. *See, e.g.*, *supra* notes 260-86 and accompanying text.

426. *See supra* notes 150-53, 220-23 and accompanying text.

427. Special Purpose Acquisition Companies, Shell Companies, and Projections, 87 Fed. Reg. at 29,479.

428. *Id.* at 29,486.

obligations there to make sure public investors are told the full truth about the offering.[429]

On that point, one Commissioner, Allison Herren Lee, went further in her statement supporting the proposal and made this remark: "[T]here are a number of participants in the de-SPAC transaction that may also be subject to statutory underwriter liability if they participate in the distribution."[430] In a general sense, this echoes the argument of this Article that advocates for SPAC sponsors' potential liability as underwriters.[431]

The proposal also contains a safe-harbor rule that SPACs could avail themselves of to claim they are not investment companies and thus not subject to the Investment Company Act of 1940.[432] To qualify for the safe harbor, they would have to meet certain conditions about their length of time, assets, and business purpose.[433]

The Commission approved the issuance of the proposal in a 3-1 vote.[434] The dissenting Commissioner Hester M. Peirce said she would have supported sensible disclosure requirements for SPACs but claimed the new regulations were "designed to stop SPACs in their tracks" by imposing "a set of substantive burdens."[435] Her concerns were supported by critical comments that the Business Law Section of the American Bar Association ("ABA") made about the proposal. While generally approving of enhanced disclosure requirements, the ABA objected to the mandate for a fairness opinion and the additional underwriter liability provided by the proposal.[436]

It also argued that projections in these mergers were often quite useful for investors who want to place their money with

429. *Id.*

430. Allison Herren Lee, Comm'r, SEC, Statement on the Proposal to Enhance Investor Protections in SPACs (Mar. 30, 2022), [https://perma.cc/J623-7TNT].

431. *See supra* Part VI.

432. Special Purpose Acquisition Companies, Shell Companies, and Projections, 87 Fed. Reg. at 29,497.

433. *Id.* at 29,498-501.

434. De Martino*, supra* note 106.

435. Hester M. Peirce, Comm'r, SEC, Damning and Deeming: Dissenting Statement on Shell Companies, Projections, and SPACs Proposal (Mar. 30, 2022), [https://perma.cc/VU6U-9YM7].

436. De Martino, *supra* note 106.

unseasoned companies.[437] It therefore said the Commission's restriction on such forecasts would "create[] a level of uncertainty regarding potential and actual liability that adversely affects these transactions as viable capital-raising and capital markets alternatives."[438] The law firm White & Case LLP issued its own list of critical comments also arguing that the proposal would "have a chilling effect on the SPAC market and thereby undermine one of the SEC's core missions of facilitating capital formation."[439]

But as of summer 2022, the SPAC frenzy appeared to have ended. As one report noted in May, "After a year of issuance explosion in 2021, there are now more than 600 SPACs searching for an acquisition target,"[440] and Goldman Sachs tellingly stated, "We are reducing our involvement in the SPAC business in response to the changed regulatory environment."[441]

As this Article has argued, this is a good result. SPACs have been vehicles to evade provisions of the Securities Act that have been carefully crafted to give public investors the protection they need from fraud. Using a merger with a corporate shell to "go public through the backdoor," if not strictly illegal, has a long history of being an unsavory practice.[442]

The SEC's proposal should close that rear entry to the capital markets or at least put SPACs on equal footing with the traditional way to do an IPO. As this Article has described, that process is in line with the intent of the great securities law reforms of the 1930s that have served our financial system well by giving investors confidence that they are being treated honestly.

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437. *See* Letter from Fed. Regul. of Sec. Comm. of the Bus. L. Section of the Am. Bar Ass'n to Vanessa A. Countryman, Sec'y, SEC 1, 54-55 (June 17, 2022), [https://perma.cc/R7MC-TZM7] (stating that it authored the letter "in response to the request for public comments by the" SEC regarding the proposed rules).

438. *Id.* at 3.

439. Rubinstein et al., *supra* note 413.

440. Li, *supra* note 424.

441. *Id.*

442. *See* Orlanski, *supra* note 9, at 1451-52.