SPACs: Changing How the SEC Regulates Initial Public Offerings

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Abstract

Special Purpose Acquisition Companies (SPACs) are publicly listed holding companies formed for the purpose of merging with a private company to bring the private company public. Basically, SPACs exist to give private companies an alternative to going public besides a traditional IPO. While SPACs provide many advantages, they have come under scrutiny of the SEC due to the misaligned incentives inherent in their structure. The SEC released a public statement in 2021 stating that it was considering classifying the time when a SPAC merges with its target corporations ("De SPAC merger") as an IPO within itself. The SEC wants to exclude statements SPAC directors and sponsors make about the target company from the safe harbor protections provided by the Private Securities Litigation Reform Act. This note examines whether the SEC has the power to interpret the definition of an IPO to include a De SPAC merger, and if so, whether the practical effect of this change will be helpful. It is doubtful the SEC could promulgate an interpretation of what constitutes an IPO, as there is no evidence in the legislative history or the text of the PSLRA that Congress intended for IPO's definition to be changed from its plain meaning. Furthermore, there may be negative implications on many other regulations promulgated by the SEC if it was to enforce this expanded definition of IPO.

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INTRODUCTION

The following discussion pertains to the increased attention that SPACs are facing now that they have become an increasingly common vehicle to bring private companies public, and proposes a solution that will allow SPACs to maintain their market utility while discouraging current SPAC promoter abuses. There has been an increase in litigation at the federal level for SPACs concerning potential violations of the Private Securities Litigation Reform Act (PSLRA), primarily relating to forward looking statements.[1] There has also been an increase in litigation at the State level for breaches of fiduciary duties by SPAC sponsors and Board of Directors. The Securities and Exchange Commission (SEC), and Congress's position that SPACs should be stripped of safe harbor protections are inadequate remedies to the problem. A more nuanced, conditional approach that incentivizes SPAC promoters and Board of Directors to operate in the best interests of their shareholders would be more effective in allowing SPACs to keep their utility, while discouraging potentially fraudulent behavior.

I. BACKGROUND AND SPAC STRUCTURE

Special Purpose Acquisition Companies, commonly referred to as SPACs, were created in 1993 for the purpose of giving private companies increased access to everyday investors.[2] A SPAC is essentially a "blank check company" that IPOs on a stock exchange with the sole purpose of merging with a private corporation.[3] An IPO, or initial public offering, is the point in time where a company sells its stock on a public stock exchange for the first time. Generally, the shares of the SPAC are sold for a flat price of

[1] *See Investor Alerts and Bulletins: What You Need to Know About SPACs*, SEC. & EXCH. COMM'N (May 25, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin.
[2] Amrith Ramkumar, *SPAC Pioneers Reap the Rewards After Waiting Nearly 30 Years*, WALL ST. J. (Mar. 9, 2021), https://www.wsj.com/articles/they-created-the-spac-in-1993-now-theyre-reaping-the-rewards-11615285801.
[3] Daniel S. Riemer, *Special Purpose Acquisition Companies: SPAC and SPAN, or Blank Check Redux?*, 85 WASH. UNIV. L. REV. 931, 932 (2007); *see also* 15 U.S.C. § 77g(b)(1).

ten dollars.[4] A SPAC puts shareholders' money in trust for the purpose of acquiring and merging with a private company.[5] When a SPAC identifies a private company that it wants to acquire, it begins what is commonly known as the "de SPAC merger."[6] The company will announce that it has found its target, conduct due diligence, present information about the company to the shareholders, and if the required percentage of shareholder votes is cast in favor of the merger, the SPAC will acquire the target company.[7] If the SPAC cannot find a company to merge with within two years after the IPO, shareholder money is returned with interest.[8]

At the basic level, most SPACs share a similar structure consisting of a Sponsor (sometimes also called a Promoter), Directors, and Shareholders. The SPAC sponsor is the individual or entity that provides the initial funding for the SPAC.[9] The sponsor generally will pay millions of dollars to finance the search for a target corporation, and in return for its investment the sponsor will typically receive 20% to 25% of all outstanding shares at the time of the merger.[10] The directors of the SPAC are generally appointed by the sponsor after formation of the SPAC.[11] The directors will find a target company to merge with and will vote on the merger.[12] Finally, the shareholders will have to vote on the merger before it is authorized.[13]

A. Shareholder Incentives

Shareholders who invest in a SPAC are hoping that the sponsor and board of directors will find an undervalued company to purchase. When a SPAC merger is completed and the stock ticker changes to the target corporation's name, the hope is that the value of the new company will increase and the early investors in the SPAC will profit substantially from their initial investment of 10 dollars per share.

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[4] The money in trust is generally kept in treasury notes to provide shareholders with assurances their money will be safe while the SPAC searches for a target corporation. Riemer, *supra* note 3, at 932.
[5] *Id.*
[6] *Id.*
[7] SEC. & EXCH. COMM'N, *supra* note 1.
[8] *Id.*
[9] *Id.*; Ramey Layne & Brenda Lenahan, *Special Purpose Acquisition Companies: An Introduction*, HARV. L. SCH. F. CORP. GOVERNANCE (July 6, 2018), https://corpgov.law.harvard.edu/2018/07/06/special-purpose-acquisition-companies-an-introduction/.
[10] *See In re* MultiPlan Corp. S'holders Litig., 268 A.3d 784, 791 (Del. Ch. 2022) (stating that the sponsor would receive a 20% promote cut when the SPAC merged with the target corporation); Michael Klausner et al., *A Sober Look at SPACs*, 39 YALE J. ON REG. 228, 246 (2022).
[11] *See In re* MultiPlan Corp. S'holders Litig., 268 A.3d at 794 (stating that the sponsor appointed all the directors of the SPAC); Layne & Lenahan, *supra* note 9.
[12] Michael Gofman & Yuchi Yao, *SPACs' Directors Network: Conflicts of Interest, Compensation, and Competition*, FINREG BLOG (July 18, 2022), https://sites.duke.edu/thefinregblog/2022/07/18/spacs-directors-network-conflicts-of-interest-compensation-and-competition/#:~:text=SPAC%20directors%20play%20a%20critical,directors'%20shares%20are%20worth%20nothing.
[13] *See In re* MultiPlan Corp. S'holders Litig., 268 A.3d at 792.

B. SPAC and Private Company Incentives

SPAC Promoters and board members get extremely favorable benefits for completing a merger with a target corporation.[14] Pursuing an irresponsible deal for short term gains can create conflicts of interest. SPAC promoters can achieve a better deal for acquiring a private corporation, because by merging with a SPAC, a private corporation can sidestep certain cumbersome requirements that it would have to comply with if it went through the traditional IPO process.[15] SPAC Sponsors, who advertise, fund the initial investment, and elect the board of directors generally get a "founders cut" which entitles them to acquire a large amount of equity in the company at a reduced price.[16] The incentives for the board of directors of a SPAC to merge with another company have at times been misaligned with SPAC shareholders because the Sponsors of a SPAC will generally profit regardless of whether the acquisition is successful in the long term for the shareholders.[17]

SPAC directors and sponsors are also given warrants that they can exercise after the price of the SPAC reaches a certain level, generally with a value of $11.50.[18] A promoter or sponsor will want the price of the SPAC to go above the price where they can exercise their warrants so that they can sell them for a large profit.[19] Public warrants are also issued by SPACS, but they generally have less favorable terms than the private warrants to which SPAC sponsors have access.[20] The warrants can also be sold to other institutional investors.[21] The profitability of these warrants correlate to the price of the SPAC after it announces the merger target, and can be exercised after a predetermined amount of months once the merger is completed.[22] This

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[14] *See* Joel Rubinstein & Daniel Nussen, *Private Equity Funds Drive Transformation of SPACs*, WINSTON & STRAWN (Apr. 9, 2018), https://www.winston.com/images/content/1/3/v2/135485/Winston-SPACs-March-26-CARE.pdf.

[15] *Id.*

[16] *See id.*; Noam Hirschberger & Eric Gelb, *SPAC Warrant Valuation: Insights and Considerations*, PKF O'CONNOR DAVIES (Jan. 20, 2022), https://www.pkfod.com/wp-content/uploads/2021/07/SPAC-Warrant-Valuation-Insights-and-Considerations.pdf ("'Private Warrants' are typically offered to SPAC Sponsors … Private warrants can have a purchase price or even a strike price significantly below the original issue price of the SPAC shares").

[17] *See In re* Multiplan Corp. S'holders Litig., 268 A.3d 784, at 792 (alleging that the Directors of the SPAC were receiving part of the sponsors Promote cut upon finding and merging with a corporation).

[18] *See* SIMON M. LORNE & JOY MARLENE BRYAN, 11 ACQUISITIONS & MERGERS: NEGOTIATED AND CONTESTED TRANSACTIONS § 3:11.20 (2023); *See* Soumya Sharma et al., *SPAC Lifecycle and Considerations for Private Companies*, BLOOMBERG L. (2020), https://www.bloomberglaw.com/product/btic/document/XBCO8JUC000000?criteria_id=5859adc008e264cbc6456720e66893e3; Matt Smith & Peter Tomov, *What's Behind the SEC's SPAC Warrant Concerns?*, CFODIVE (June 14, 2021), https://www.cfodive.com/news/whats-behind-the-secs-spac-warrant-concerns/601658/; Noam Hirschberger & Eric Gelb, *SPAC Warrant Valuation: Insights and Considerations*, PKF O'CONNOR DAVIES (July 12, 2021), https://www.pkfod.com/wp-content/uploads/2021/07/SPAC-Warrant-Valuation-Insights-and-Considerations.pdf.

[19] *See* Hirschberger & Gelb, *supra* note 16.

[20] *See id.*

[21] *See* SEC. & EXCH. COMM'N, *supra* note 1.

[22] *Id.*

can lead SPAC promoters to deliver news that will continue to drive up the price of a SPAC until they can exercise their warrants, and prioritize an optimistic forecast for the target company regardless of the merits of their claims.[23]

Most notably, SPAC Promoters receive what is commonly referred to as a "promote cut" which, upon successful completion of a De SPAC merger, gives the Promoters roughly twenty to twenty-five percent of all outstanding shares as compensation.[24] Receiving twenty percent of all outstanding shares of the SPAC for free can be a massive incentive to find a company to merge with in twenty four months, but it does not necessarily incentivize Sponsors and Directors to close a deal that is beneficial for all shareholders.[25] The personal incentives for Promoters to close a merger deal in the allotted lifespan of a SPAC has led to derivative and class action lawsuits against SPACs at the state and federal level.[26]

C. Contemporary View of SPACs

In the past five years, SPACs have become increasingly popular as a vehicle to bring private companies to the market.[27] Between 2003 and 2006 there was a total of 87 SPACs listed on the market for an estimated $5.5 billion dollars.[28] In 2021 alone there were 613 SPAC IPOs for an estimated $162 billion dollars.[29] SPACs have been the dominant form of IPO in the US for 2021, constituting 62% of all IPOs in the United States.[30] The massive surge in the popularity of SPACs has led to many derivative and class action lawsuits filed against SPACs and increased scrutiny of federal regulatory agencies, primarily the SEC.[31] Examples of successful SPACS are Virgin Galactic and Draftkings.[32] Furthermore, in the Fall of 2021 notable

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[23] *See* Rubinton & Nussen, *supra* note 14.
[24] *Id.*
[25] *See* Hirschberger & Gelb, *supra* note 16.
[26] *See* Murdeshwar v. SearchMedia Holdings, Ltd., No. 11-Civ-20549-Ungaro, 2011 BL 400086, at *15 (S.D. Fla. Aug. 8, 2011) (alleging SPAC Promoters lied to Shareholders about the fact they were funding the target company primarily with companies that they had an ownership stake in, and accounting statements were fraudulent for the purpose of soliciting a shareholder majority for the merger agreement); *See* Press Release, Sec. & Exch. Comm'n, SEC Charges SPAC, Sponsor, Merger, Target, and CEOs for Misleading Disclosures Ahead of Proposed Business Combination (Jul. 13, 2021) (available at https://www.sec.gov/news/press-release/2021-124) (describing charges against Stable Road Acquisition with Securities Fraud for not disclosing the CEO of the target company is deemed a national security risk and lying about the viability of their technology to shareholders in their proxy statement).
[27] *See* SPAC ANALYTICS, https://www.spacanalytics.com/ (last visited Apr. 6, 2023).
[28] *See* Carol Boyer et al., *SPACs as Alternative Investments: an Examination of Performance and Factors that Drive Prices*, 11 J. PRIV. EQUITY 1, 7 (2008) (displaying an exhibit which shows the number of SPACs which IPO'd between 2003 and 2006).
[29] *SPAC and US IPO Activity,* SPAC ANALYTICS (Nov. 22, 2021, 11:26 AM), https://www.spacanalytics.com/ (showing in 2016 that there were 13 SPAC IPOS, and in 2021 there were 613 SPAC IPOs).
[30] *Id.*
[31] LORNE & BRYAN, *supra* at note 18, at § 3:11.30.
[32] Sarah McBride, *Branson's Flight Validates the Space SPACs that Virgin Started*, BLOOMBERG L. (Jul. 12, 2021, 12:08 PM), https://news.bloomberglaw.com/mergers-and-acquisitions/richard-bransons-flight-validates-the-space-spac; Renaissance Capital,

companies such as Forbes and Monster Energy announced they are contemplating merging with SPACs to become publicly traded.[33]

1. Federal Scrutiny

While SPACs have become a convenient and efficient vehicle for bringing private companies public, its increasing popularity has been met with more attention from the SEC.[34] Over the past years, the SEC has started to monitor and issue guidance for SPACs.[35] The SEC is concerned with securities fraud under section 10(b) of the Securities Exchange Act regarding "misleading statements or omissions" made by SPAC Promoters or Directors.[36] The SEC claims that SPAC Promoters may not be protected by the PSLRA's safe harbor provisions for "forward looking statements" made by directors or executives of publicly traded companies.[37] The SEC's focus when issuing these violations is on the SPAC's board of directors and Promoters materially misleading SPAC shareholders to vote for a merger that is not in their best interest.[38] This stems from two concerns: First, that SPAC Promoters, who receive a large amount of equity in a target corporation at a discount, will profit even if the prospects of the corporation do not meet retail investors' expectations.[39] Second, that the misaligned incentives for Directors and Promoters will end up having a negative impact on the shareholders, who may be left with a bad investment based on misleading information.

Congress passed the Private Securities Litigation Reform Act (PSLRA) to prevent burdensome litigation, commonly referred to as "strike suits," against directors or other high ranking corporate executives who made statements about their company's future performance.[40] Before the PSLRA,

DraftKings Lists on NASDAQ Following the SPAC Merger; Up More than 5% in Early Trading, NASDAQ (Apr. 24, 2020, 1:17 PM), https://www.nasdaq.com/articles/draftkings-lists-on-the-nasdaq-following-spac-merger-up-more-than-5-in-early-trading-2020.

[33] *See* Jessica Bursztynsky, *Forbes Announces Plan to Go Public Via SPAC*, MSNBC (Aug 26, 2021, 8:59 AM), https://www.cnbc.com/2021/08/26/forbes-announces-plan-to-go-public-via-spac.html; Greg Roumeliotis, *Monster Beverage Exploring Merger with Constellation Brands*, REUTERS (Nov. 21, 2021, 11:40 PM), https://www.reuters.com/markets/deals/monster-beverage-exploring-deal-with-constellation-brands-bloomberg-news-2021-11-22/.

[34] Statement from John Coates, Acting Dir., Div. Corp. Fin., Sec. & Exch. Comm'n, on SPACs, IPOs and Liability Risk Under the Securities Laws (Apr. 8, 2021) (available at: https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws).

[35] LORNE & BRYAN, *supra* at note 18, at § 3:11.30.

[36] 15 U.S.C.A § 78u-4 (West). *See* Coates, *supra* note 34.

[37] *See* 15 U.S.C.A. § 78u-5 (West).

[38] *See* Coates, *supra* note 34. Statement from John Coates & Paul Munter, Sec. & Exch. Comm'n, on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies ("SPACs") (Apr. 12, 2021) (available at https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs) (describing the incentives for SPAC Directors and Sponsors to push through a merger regardless of its success due to the stock warrants they will receive and be able to exercise).

[39] *See* Coates, *supra* note 34.

[40] *See* 15 U.S.C.A. § 78u-5(a)(2) (West); Matthew Brinker, *Adding Meaning to "Meaningful Cautionary Statements": Protecting Investors with a Narrow Reading of the PSLRA's Safe Harbor for Forward-Looking Statements*, 84 TEMP. L. REV. 481, 494–95 (2012) ("The goal was to weed out meritless claims, preserve meritorious ones, and strike a balance between the costs of unnecessary class actions and the benefits of private enforcement of securities fraud").

private parties had a valid claim against a corporation if the forward-looking statements did not meet expectations.[41] The "safe harbor" provisions in the PSLRA provide publicly traded companies the ability to make forward looking statements and to be exempt from litigation that stems from them, as long as they are accompanied by a cautionary statement. Additionally, the company must not be purposefully misleading shareholders, or purposefully omitting contradictory information that they have knowledge of.[42] Forward looking statements are generally not granted the same safe harbor protections when a company uses the traditional IPO process and shareholder access to GAAP compliant accounting and financial statements are required.[43] This means that the financial statements SPACs disclose about a target company for a merger may not meet the normally accepted standards the SEC requires of a company issuing shares through the traditional IPO process.[44]

With a SPAC, the blank check company has already IPO'd, and, therefore, its forward-looking statements receive safe harbor protection.[45] If a private company merges with a SPAC, the SPAC Promoters are allowed to use the protection of the safe harbor provisions and make forward-looking statements to convince their shareholders to merge with the target company. The SEC argues that because Directors feel they are protected by the safe harbor provisions of the PSLRA, they have a large temptation to make forward-looking statements about a private company going public that normally would not be granted such protections. The combination of safe harbor protections and SPAC Directors' financial incentives to merge can create a situation where the Directors will advocate for a merger with potentially inaccurate or misleading information.[46]

There are also cases filed by shareholders against SPACs for violations of the Securities Exchange Act of 1934.[47] Generally, these cases allege a violation of SEC regulation 14a-9 which applies to Proxy Statements.[48] A Proxy Statement is a document filed by a publicly traded company when a "significant event" occurs that the shareholders will have to vote on at the

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[41] Brinker, *supra* note 40, at 494–95.
[42] *See* 15 U.S.C.A. § 78u-5(a)(2) (West); Brinker *supra* note 40, at 494–95.
[43] *See* 15 U.S.C.A. § 78u-5(c)(1)(B) (West) (stating as an exclusion from the safe harbor rule that companies in the process of initial public offering are excluded from safe harbor protection for forward looking statements). *But cf.* John L. Orcutt, *A Signal for Honest Management Forecasts: Expanding the PSLRA Safe Harbor to IPO Issuers with Extended Lockup*, 6 BUS. & FIN. L. REV. 1 (2022) (arguing that the PSLRA safe harbor should be extended to IPO issuers in certain situations and under a constraint of lock-up).
[44] *See* 15 U.S.C.A. § 78u-5(c)(1)(B) (West).
[45] *See* Souyama Sharma et al., *SPAC Lifecycle and Considerations for Private Companies*, BLOOMBERG L. (Jan. 20, 2022), https://www.bloomberglaw.com/product/blpg/document/XBCO8JUC000000 ("Once capitalized, the SPAC files an initial registration statement on Form S-1 with the SEC to register the shares that will be sold to the public in the IPO").
[46] *See* Murdeshwar v. SearchMedia Holdings, Ltd., Case No: 11-Civ-20549-Ungaro, 2011 BL 400086, at *15 (S.D. Fla. Aug. 8, 2011).
[47] *See* 15 U.S.C.A. § 78n(a) (West).
[48] 17 C.F.R. § 240.14a-9.

next annual or special meeting, such as finding a target to merge with.[49] There are cases recently filed in Federal District Court that allege violations of section 14(a) due to materially misleading statements and omissions made in the Proxy Statements by SPAC Directors.[50]

2. The SEC Has Hinted At Potential Action It May Take To Solve Identifiable Problems With SPACs

The SEC has informally proposed that broadening the scope and definition of an IPO would solve the misaligned incentive problem.[51] While this proposal has not yet been argued in court or addressed in any current regulations, the SEC has stated in recent memorandum that the characterization of what constitutes an IPO was never properly defined in the PSLRA or any other legislation by Congress. Therefore, an IPO can be broadly defined as bringing a company public, even after an initial IPO has already occurred.[52] Since SPACs are essentially a holding company that exists to bring a company public, the De-SPAC phase of a SPAC's lifecycle should be considered an independent IPO for the target company. This would mean that a SPAC's safe harbor protection would only apply to forward looking statements related to the holding company and would not extend to the target corporation until the De SPAC merger is complete. If this argument is accepted, private litigation could be brought against any forward-looking statements provided to shareholders about a merger target.[53]

Congress held a financial services committee meeting in which members questioned notable SPAC Sponsors about how SPACs work.[54] Members of Congress expressed concern about the misaligned incentives SPAC Sponsors may have, which could cause them to not act in the best interests of their shareholders. While Congress would have the power to address the problems with SPACs through legislation, it is less clear whether Congress has granted the SEC the power to fundamentally change the definition of an IPO.

II. ANALYSIS

SPACs, while being an extremely useful and innovative investment vehicle, currently lack incentives for the Sponsors and Directors to act in the best interest of their shareholders. The utility of SPACs providing funding

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[49] *Proxy Statement*, SEC. & EXCH. COMM'N, https://www.sec.gov/answers/proxy.htm (last modified Sept. 8, 2011); *See* Alicia Tuovila, *What is a Proxy Statement? Definition, What's in It, and Voting*, INVESTOPEDIA, https://www.investopedia.com/terms/p/proxystatement.asp (last updated Aug. 8, 2021).

[50] *See generally* Shorab v. Anderson et al., No. 6:22-cv-06023 (W.D.N.Y. filed Jan. 14, 2022) (alleging SPAC directors made multiple misleading statements in their proxy materials including lying about business with certain clients and fabricating profits in the attempt to get stockholders to vote to merge with the target company).

[51] Coates, *supra* note 34.

[52] 15 U.S.C.A. § 78u-5 (West); Coates, *supra* note 34.

[53] 15 U.S.C.A. § 78u-5 (West); Coates, *supra* note 34.

[54] *Going Public: SPACs Direct Listings, Public Offerings, and the Need for Investor Protections: Hearing before the Subcomm. on Inv. Prot., Entrepreneurship & Cap. Mkts. of the H. Comm. on Fin. Serv.* 117th Cong. 1 (2021) (statement of Rep. Brad Sherman, Chairman, Subcomm. on Inv. Prot., Entrepreneurship & Cap. Mkts. of the H. Comm. on Fin. Serv).

and bringing new companies into the world of public investment should be weighed against protecting the shareholders that invest their money with a group of individuals who stand to profit from the completion of a merger, regardless of its future success. However, a solution must be found to correct the inherent misaligned incentives present in SPACs that does not make SPACs an unattractive alternative to a traditional IPO. Therefore, Congress should amend the PSLRA in a way that (1) does not outright strip SPACs of their safe harbor protections, but rather (2) conditions their PSLRA protections on SPAC promoters disclosing their conflicts of interest and discussing incentives that they have for completing a deal before an acquisition target has been identified.

SPACs should not be stripped of their safe harbor protections from forward-looking statements under the PSLRA, because the policy rationale of protecting companies from strike suits should not be upended for the convenience of SPAC liability. Removing all safe harbor protections from SPACs would make Sponsors and Directors potentially liable for anything they say about the future performance of the target corporation and may completely eliminate the utility of a SPAC.[55] The PSLRA was created to protect Public Corporations from extensive litigation, which would include statements that a corporation made about a company it is merging with.[56] There is no indication in the PSLRA that a SPAC should fall under one of its safe harbor exemptions, or that Congress intended that a holding company or shell company would have no protection for forward looking statements.[57] Since SPACs provide a benefit by allowing private companies to become publicly traded in a more efficient manner, it is more beneficial to find a solution that would not discourage their use by making them vulnerable to frivolous litigation.[58]

A. Analysis of the Validity of Potential SEC Regulatory Action

The SEC has signaled that it may be interested in depriving SPACs of safe harbor protections granted in the PSLRA for forward-looking statements through increased regulatory measures involving the definition of an IPO. In April 2021, former acting SEC Director John Coates released a public statement examining the various legal issues of SPACs and foreshadowed potential SEC regulation.[59] Coates argued that "the PSLRA's exclusion . . . does not refer to any definition of 'initial public offering.' No definition can be found in the PSLRA, nor . . . in any SEC rule."[60] A statement like this could foreshadow future action by the SEC in which it may either (1) create a rule that expands the initial public offering safe harbor exclusion of the PSLRA to De SPAC transactions, or (2) not attempt to change the rule, but imply a private lawsuit can be brought under the PSLRA arguing a De SPAC transaction is equivalent to an IPO.[61]

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[55] *See* Brinker *supra* note 40, at 494–95.
[56] *Id*.
[57] *See* 15 U.S.C.A. § 78u-5(b)(1)(B) (West).
[58] *See* Brinker, *supra* note 40, at 512–13.
[59] *See* Coates, *supra* note 34.
[60] *Id.*
[61] *See* 15 U.S.C.A. § 78u-5(b)(2)(D) (West); Coates, *supra* note 34.

1. Examination Of The PSLRA Text And Statutory Construction

First, in order to determine whether the SEC has the power to define what an IPO is, an examination of the relevant text of the statute is necessary to ascertain whether the SEC has the authority to change the definition of "initial public offering." The PSLRA dictates that forward-looking statements "made in connection with an initial public offering" are excluded from the safe harbor protections provided by the act.[62] Coates notes in his public statement that Congress has never defined what constitutes an IPO and contends that silence may leave interpretation up to the SEC to decide what should be considered an IPO.[63] Congress defines many other terms in the safe-harbor section, such as "blank check company," "going private transaction," "investment company," and refers to where to find the definition for nine other additional terms.[64] The fact that Congress decided to expressly point to where "going private transaction" was defined, but not even mention a definition for "initial public offering" indicates Congress believed there was no disagreement or confusion about what IPO means.[65]

It is important to analyze this claim through various canons of statutory interpretation because courts will use these canons to determine the SECs regulatory authority. A fundamental tool of statutory interpretation is the plain meaning rule.[66] Words defined by Congress are to be given that definition in respect to the statute, but if Congress does *not* define a word, it will generally be given its ordinary meaning.[67] An initial public offering ("IPO") is a point in time when a private corporation, following relevant SEC guidelines, issues shares on a public marketplace where institutional and retail investors can purchase equity in the company.[68] Therefore an IPO, as examined under the plain meaning rule, is a singular point in time. The word of utmost importance in the phrase is "initial." According to Merriam-Webster Dictionary, initial means "of or related to the beginning," or "placed at the beginning."[69] Furthermore, synonyms for initial include "earliest [and] original", which, in the case of SPACs, would relate to the first-time shares of the corporation are offered to the public.[70]

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[62] *See* 15 U.S.C.A. § 78u-5(b)(2)(D) (West).
[63] *See* Coates, *supra* note 34.
[64] *See* 15 U.S.C.A. § 78u-5(i) (West).
[65] *See id.* (Showing Congress chose not to define what an initial public offering was in the "definitions" section of the statute).
[66] *See* VALERIE C. BRANNON, CONG. RSCH. SERV., R45153, STATUTORY INTERPRETATION: THEORIES, TOOLS, AND TRENDS 18 (2023) (describing how the "ordinary meaning" of a term is often the first approach courts will take in statutory interpretation).
[67] *See* Morissette v. United States, 342 U.S. 246, 263 (1952) (stating that when interpreting a common or technical word in a statute that "absence of contrary direction [of the meaning of the word] may be taken as satisfaction with widely accepted definitions, not as a departure from them"); BRANNON, *supra* note 66, at 18.
[68] *See* SEC. EXCH. COMM'N, INVESTOR BULLETIN: INVESTING IN AN IPO 1 (Oct. 14, 2022), https://www.sec.gov/files/ipo-investorbulletin.pdf [hereinafter: SEC. EXCH. COMM'N, *Investing in an IPO*] (SEC stating that an IPO "has referred to the first time a company offers its shares of capital stock to the general public).
[69] *Initial Public Offering*, MERRIAM-WEBSTER, https://www.merriam-webster.com/dictionary/initial%20public%20offering (last visited Apr. 9, 2023).
[70] *Id.*

In the case of SPACs, the initial public offering of shares for retail investors on a stock exchange are shares of the SPAC before it has merged or identified its target corporation.[71] The prospectus of the SPAC, located in the Registration Statement required by Form S-1, details the Sector of the market in which the SPAC will try and merge with a company, but says nothing of the company itself.[72] Therefore, under the plain meaning rule, the pre-merger SPAC shares are the *initial* shares that are *publicly offered* to potential investors. Post-merger shares would not fall under the plain meaning of "initial public offering," and arguments for the SECs interpretation based purely on the text of the statute likely would fall short in a judicial proceeding.

The SEC could argue that under the plain meaning rule courts should allow De SPAC mergers to be considered an IPO because at the time when the legislation was passed in 1995, members of Congress did not know about SPACs, and if they did, they would have included them.[73] This argument has some merit, as SPACs were a relatively new alternative IPO vehicle at the time and had only been used in the market for about two years.[74] This argument may be persuasive enough to allow for judicial expansion of the original statute if, ignoring the initial public offering requirement of the PSLRA, SPACs would fit into the other notable exemptions from the safe harbor rule.[75]

2. The Legislative History Of The PSLRA And The SEC's Current Stance On IPOs Indicates The SEC Has Limited Power To Expand The Definition Of An IPO

Examination of the limits on the rulemaking authority of the SEC under the PSLRA requires examining the legislative history of the PSLRA in tandem with the statutory text. The PSLRA's primary objective was to protect investors and companies from frivolous shareholder class action suits.[76] The safe harbor provisions of the PSLRA were meant to allow companies to make forward looking statements and not be concerned that every time their statements are not correct, they would be sued.[77] The SEC is given broad rulemaking authority in the PSLRA, as Congress granted it the ability to expand regulations or exempt certain companies from certain statutory requirements.[78] However, as noted in the House Committee Report on the subject of who qualifies for safe harbor protection, the PSLRA only mentions that the SEC can "expand" the types of information and

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[71] *See Latest IPOs*, SPAC RESEARCH (Feb. 20, 2023), https://www.spacresearch.com/ (showing that there are over 350 pre deal SPACs currently listed on the market, which have only identified the sector they are planning on acquiring a target).

[72] *Registration Statement*, SEC. EXCH. COMM'N (Jan. 20, 2022), https://www.investor.gov/introduction-investing/investing-basics/glossary/registration-statement#:~:text (stating that prospectus is almost always included in the registration statements provided by companies when they IPO).

[73] *See* H.R. REP. NO. 104-369 (1995) (Conf. Rep.) (SPACs not mentioned anywhere in the house report); Ramkumar, *supra* note 2.

[74] *See* H.R. REP. NO. 104-369 at 32–33.

[75] *See* 15 U.S.C.A. § 78u-5(b) (West).

[76] *See generally* H.R. REP. NO. 104-369

[77] *See id.*

[78] 15 U.S.C.A. § 78u–5(b) (West).

corporations that receive safe harbor protection.[79] In the report, the Committee said that the guidelines set forth in the PSLRA for safe harbor provisions are a "starting point" and that the SEC should, as appropriate, promulgate rules or regulations to *expand* the statutory safe harbor by providing additional exemptions from liability or *extend* its coverage to additional types of information.[80] Therefore, regarding safe harbor provisions, Congress likely intended to give the SEC rulemaking authority to expand the types of companies and information that would be granted safe harbor protection.

3. The SEC's Current Definition Of An IPO

Lastly, it is important to examine how the SEC currently defines an IPO, and if any type of merger would fall under this definition because it will reveal if the SEC has used its authority in the past to reclassify a merger as an IPO. The SEC, through its Office of Investor Education and Advocacy, defines an IPO as "the first time a company offers its shares of capital stock to the general public."[81] The SEC goes on to state that to file for an IPO, an individual must file an S-1 form.[82] It is noted that an "important part of this registration statement is the prospectus" and that the SEC pays close attention to what corporations put in their prospectus.[83] There are no statements made in the SEC's description of an IPO that would provide any support for its assertion that a De SPAC merger is equivalent to an IPO.[84] Form S-1 is completed *only* when a corporation wants to publicly register its securities to be able to trade on a stock exchange.[85] The SEC states that Form S-1 is essentially an "IPO investment Prospectus," and there are no indications that a merger of any kind would require a public company to fill out another S-1 form.[86] This demonstrates that the SEC itself has not defined any type of merger as being equivalent to an IPO and has no procedural or administrative regime to support such a contention.

4. The SEC Will Likely Not Be Granted *Chevron* Deference

If the SEC decided to promulgate a regulation or interpretation where it declares that forward-looking statements made to shareholders in relation to De SPAC mergers by the SPAC directors are not granted safe harbor protection, then it will almost certainly be contested by affected parties that the SEC does have the authority to make this interpretation. The question of whether the SEC was within its rights to make an interpretation will be analyzed by the courts under the standard set forth in *Chevron*.[87] *Chevron* set

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[79] *See* H.R. REP. NO. 104-369, at 46–47 ("Conference committee expects the SEC to consider expanding the safe harbor . . . where appropriate." "The legislation authorizes the SEC to adopt exemptive orders for those whom a safe harbor should be made available").
[80] *Id.* at 46.
[81] SEC. EXCH. COMM'N, *Investing in an IPO*, *supra* note 68., at 1.
[82] *Id.*
[83] *Id.*
[84] *See id.* at 1–2.
[85] *See id.* at 2.
[86] *See* SEC, FORM S-1: REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933 (2021), https://www.sec.gov/files/forms-1.pdf.
[87] *See* Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837, 844 (1984); Kent Barnett et al., *Administrative Law's Political Dynamics*, 71 VAND. L. REV. 1463, 1473

forth a two-prong test used by the court to decide if an executive agency is within its rights to create a certain regulation.[88] The two prongs of the Chevron test are: (1) if Congress intended for the executive agency to regulate the matter in question and (2) if so, if the interpretation by the executive agency is "reasonable."[89]

Looking to the text of the PSLRA, Congress gave the SEC the power to expand categories of companies or statements that can be afforded safe harbor protection.[90] Classifying a De SPAC merger as an IPO has the opposite effect because it expands the types of companies exempt from safe harbor protection, as opposed to being afforded safe harbor protection. A reviewing court could conclude, just from the text of the statute, that Congress did not intend for the SEC to redefine what constitutes an IPO, rather Congress intended for the SEC to expand the definition of who would qualify for safe harbor protection.[91] Furthermore, when considering the legislative history of the PSLRA relating to safe harbor protections, there is even more support for the fact that Congress considered the text of the PSLRA to be a starting point of who is provided safe harbor protection.[92] There is no mention in the House Joint Committee Report that Congress expected the SEC to limit the types of corporations afforded safe harbor protection.[93]

In conclusion, the SEC was not intended to further limit companies afforded safe harbor protection beyond the statutory text. This is evidenced by the PSLRA which authorizes the SEC to expand who has statutory protection, as opposed to the power to tighten who is owed protection.[94] Furthermore, the legislative history bolsters the position that the SEC was intended to increase the amount and types of corporations which would receive safe harbor protection.[95] Lastly, under the plain meaning rule, the definition of IPO would not include De SPAC mergers.[96] Therefore, the SEC would be exceeding its statutorily granted authority by classifying an De SPAC merger as an IPO.

B. SPACs do not neatly fit into the penny stock or blank check company categories excluded from safe harbor protection under the PSLRA.

The other exclusions from the safe harbor protection in the PSLRA are blank check companies and penny stocks, but SPACs do not neatly fit into

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(2018) (referring to the two-step inquiry, stating step one calls for a primarily textual inquiry, and step two calls for reasonableness inquiry in the statutory interpretation by an executive agency).

[88] *See* Chevron, 467 U.S. at 844.

[89] *See id.*

[90] *See* 15 U.S.C.A. § 78u-5(c)(4)(g) (West).

[91] *See* H.R. REP. NO. 104-369, at 46-47 (1995) (Conf. Rep.).

[92] *See id.*

[93] *See id.*

[94] *See* 15 U.S.C.A. § 78u-5(g) (West) (stating specifically the SEC has the power to expand who is exempt from liability related to forward looking statements).

[95] *See* H.R. REP. NO. 104-369, at 46–47.

[96] *See* 15 U.S.C.A. § 78u-5(i) (West); Morissette v. United States, 342 U.S. 246, 263 (1952); BRANNON, *supra* note 66, at 19 (2023); SEC. EXCH. COMM'N, *Investing in an IPO*, *supra* note 68, at 1.

either of these categories.[97] While there is no justification to classify SPACs as penny stocks, the SEC would have better ground to hold SPACs under the Blank Check Company Exclusion from safe harbor protection.[98]

Next, SPACs do not fit into the safe harbor protection in the PSLRA for forward-looking statements made "in connection to an offering of securities made by a blank check company."[99] SPACs are considered "blank check companies," because they exist for the purpose of identifying a company with which to merge and keep the money they receive in escrow until it can be used to execute a merger.[100] However, the PSLRA states that only statements made "in connection" to securities offered by the blank check companies are excluded, meaning only forward looking statements about the actual SPAC securities, not about the company that they are targeting, are exempt.[101] The text of the statute does not expressly forbid blank check companies from making forward-looking statements about a company that a blank check company wants to merge with.

Furthermore, the types of companies which Congress intended to exclude from safe harbor protection in the PSLRA are vastly different than SPACs. Congress's intent for the blank check exclusion is primarily concerned with making forward looking statements about the sale of shares in the holding company before a merger target is even identified, which demonstrates they were concerned about investors being told false statements relating to the security itself, not the target corporation.[102] There is no evidence in the text of the statute that "in connection with" concerns forward-looking statements made in a proxy statement about an upcoming merger.[103] SEC created the current definition of "blank check company" in the 1990s to help regulate brokers that would sell penny stock in holding companies to consumers.[104] The plain meaning of the statutory language

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[97] 15 U.S.C.A. § 78u-5(b)(1)(B)–(C) (West).

[98] SPACs cannot be considered Penny stocks based on the fact that their market cap and share prices are higher than the statutory requirements. *See* 17 C.F.R. § 240.3a51-1 (listing all requirements that must be met to not be considered a Penny Stock: these generally include having a very low market cap, being in operation for a short period of time, having very few investors, and having a price of over 5 dollars); *See* Michael Klausner et al., *supra* note 10, at 254 (SPACs issue shares for roughly 10 dollars and value their shares at 10 dollars when they merge).

[99] 15 U.S.C.A. § 78u-5(b)(1)(B) (West).

[100] *See Blank Check Company,* SEC. EXCH. COMM'N (Jan. 22, 2022), https://www.investor.gov/introduction-investing/investing-basics/glossary/blank-check-company (giving definition of an Blank Check Company and using SPACs as an example of a Blank Check Company).

[101] 15 U.S.C.A. § 78u-5(b)(1)(B) (West).

[102] *See* 15 U.S.C.A. § 78u-5(b)(1)(B) (West) (excludes forward looking statements about the blank check company itself but makes no reference to statements the blank check corporation makes about a target corporation).

[103] *See id.*

[104] 17 C.F.R. § 230.419; *see* Derek K. Heyman, *From Blank Check to SPAC*: The Regulator's Response to the Market, and the Market's Response to the Regulation, 2 ENTREPRENEURIAL BUS. L.J. 531, 535 (2007).

points only to statements made about the holding company itself, and not about the corporation the blank check is targeting.

1. Congress Intended To Target Blank Check Companies That Differ Greatly From SPACs

The blank check companies referred to in the PSLRA are not of the same character as the blank check companies formed for a SPAC merger.[105] The blank check companies Congress was concerned about were generally trying to merge with very small companies and would issue penny stock.[106] These companies were often so obscure or unknown that investors could not reliably obtain information about them.[107] On the other hand, SPACs are funded with hundreds of millions to billions of dollars, unlike the blank check companies targeted in the PSLRA.[108] The market cap of SPACs that are currently pending mergers is over 28 billion dollars.[109]

2. The SEC's Ability To Expand The Definition Of Blank Check Companies Under The PSLRA

Furthermore, it must be determined whether Congress authorized the SEC to expand the definition of a blank check company under the Securities Act of 1933.[110] The Securities Act of 1933 enables the SEC to promulgate special rules for blank check companies, and the SEC defined blank check companies as "any development stage company that is issuing a penny stock" and "(A) has no specific plan or purpose or (B) has indicated that its business plan is to merge with an unidentified company or companies."[111] SPACs do not fit neatly into Congress' definition because they are not issuing a penny stock and SPACs target a certain sector, such as technology or energy, which can satisfy the "specific plan or purpose" mentioned in subsection A above.[112] While SPACs fall under requirements set forth in subsection B, they do not meet the prerequisite condition of issuing penny stock, and therefore would not fall within the SEC's definition of a blank check company.[113]

On the other hand, it can be argued that the Securities Exchange Act of 1933 was not concerned with SPACs, as they did not exist at the time, but they should be included now. Congress could have created new legislation in the wake of increasing SPAC IPOs, but they still have not. Congress's

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[105] *See* Securities Enforcement Remedies and Penny Stock Reform Act Of 1990, Pub. L. No. 101–429, §§ 502–505, 104 Stat. 931, 951–55 (codified as amended in scattered sections of 15 U.S.C.)..
[106] *See id.*
[107] *See id.*
[108] *What is a SPAC?*, STOCK MARKET MBA, https://stockmarketmba.com/whatisaSPAC.php (last visited Apr. 8, 2023) ("Our database currently contains 764 SPACs that are traded on U.S. stock exchanges, with a total market capitalization of $160,499,469,344. So on average, a SPAC has a market capitalization of $210,077,839").
[109] *See id.*
[110] *See* 15 U.S.C.A. § 77g (West).
[111] 15 U.S.C.A. § 77g (b)(1)-(3) (West).
[112] 17 C.F.R. § 240.3a51-1 (SPACs are not penny stocks because they exceed the share price description of being under five dollars and market cap descriptions of less than 5 million dollars).
[113] *Id.*

inaction in legislating on SPACs does not implicitly grant the SEC the right to redefine the scope of the rulemaking ability granted to them by the Securities Act of 1933. Further evidence that "blank check company" was not intended to encompass SPACs is shown by draft legislation by Congress submitted in 2021. This legislation proposed an amendment to the safe harbor provision of the section of the Securities Exchange Act by striking "blank check company" from the statute and replacing it with "a development stage company that has no specific business plan or purpose or has indicated its business plan is to acquire or merge with an unidentified company, entity, or person."[114] Even in Coates's statement on behalf of the SEC he does not question or remark that SPACs fall under the holding company exclusion for forward-looking statements.[115]

III. Practical Effect of the SEC Having the Authority to Classify a De SPAC Merger as an IPO

If the SEC were to include a De SPAC merger in the definition of an IPO (assuming arguendo that the SEC has the authority), it would be accompanied by conflicts with current statutory law and a revision of administrative rules the SEC itself has promulgated. In doing so, the SEC would likely have to deem that a SPACs proxy statement is equivalent to an S-1 form. By creating an exclusion of SPACs from the safe harbor rule there may be extensions of all forms and information that companies must provide for an IPO.

This approach could create unintentional inconsistencies with how the SEC currently defines Proxy Statements. Proxy statements are generally filed for the purpose of informing shareholders of important events, such as when a company announces it will merge with another company.[116] Representations made by SPAC Sponsors, Promoters, and Directors about the target corporation in the proxy statement are granted safe harbor protection.[117] This leads to many problematic questions such as: Would Proxy statements for SPACs be treated as Form S-1's and have to include all information required in an S-1 form? Would the SEC then revise its definition of a proxy statement and what needs to be included inside of it just for De SPAC mergers? Does the SEC have the authority to change what a proxy statement is for a single type of business organization? Does the target corporation have to file its own S-1 Form or does the SPAC have to file a separate S-1 form/specialized proxy statement?

Redefining what is considered an IPO can have far reaching and more expansive consequences than simply excluding SPACs from the safe harbor protections of the PSLRA. All the above questions may have an answer or a solution that is within the SEC's authority, but redefining multiple terms that

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[114] *See generally* Holding SPACs Accountable Act of 2021, H.R. 5910, 117th Cong. (2021). ("to amend the Securities Act of 1933 and 1934 to exclude certain Special Purpose Acquisition Companies from safe harbor for forward looking statements, and for other purposes").

[115] *See* Coates, *supra* note 34.

[116] 15 U.S.C.A. § 78(n) (West).

[117] Coates, *supra* note 34.

have been a component of the statutory foundation of the PSLRA and the Securities Exchange Act will create more confusion than benefits.

Besides the administrative issues created by categorizing De SPAC Mergers as an IPO, substantive issues will arise. Primarily, SPACs will lose almost all their utility. If the same regulations afforded to traditional IPOs are also applied to De SPAC mergers, then there would be no beneficial purpose for a private company to IPO through a De SPAC merger. It is not possible to know how many private companies IPO'd via SPAC merger would not have been able to IPO without the use of a SPAC, but SPACs have unquestionably sped up the process through which private companies go public.[118]

The most problematic outcome, however, would be that any forward-looking statements provided by SPACs about the target company would be subject to private litigation.[119] Meaning any potential profit projections or reports of future performance by the forward-looking company, even made in good faith and with credible support can be scrutinized in court.[120] Because of the potential administrative nightmare and detrimental consequences of an SEC recategorization of a De SPAC merger as an IPO equivalent, there should be a balanced solution that will maintain SPAC utility and provide adequate investor protection.

A. Recommendations

There are serious problems with the inherent misalignment of incentives for SPAC shareholders and SPAC Directors and Sponsors. Consequently, the SEC is correct in being concerned about shareholders being misled in their SPAC investments. There are solutions to the inherent inequality that exists in SPACs that would have less detrimental substantive and administrative consequences.

First, Congress can revise the definition of "blank check company" in the Securities Exchange Act or pass new legislation to include more companies other than ones that issue penny stock.[121] Congress could accomplish this by increasing the minimum price of securities that will fall under the safe harbor exclusion to ten or more dollars. However, this can lead to the unintended consequence of SPACs increasing their initial share price to ensure they will once again fall outside of the blank check company exclusion. Therefore, on its own, this will not be wholly satisfactory but may impose a moderate barrier to certain SPACs that would like to form. The potential market forces acting here could persuade SPACs to provide more accurate and transparent information about the target corporation they want to merge with. It is unlikely that this alone could completely solve the

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[118] John Lambert, *SPACs versus IPOs*, KPMG (Jan. 2021), https://advisory.kpmg.us/articles/2021/why-choosing-spac-over-ipo.html#:~:text=Faster%20execution%20than%20an%20IPO,usually%20takes%2012%E2%80%9318%20months. ("A SPAC merger occurs in 3-6 months while a traditional IPO takes 12-18 months on average).

[119] *See generally* H.R. REP. NO. 104-369 (1995) (Conf. Rep.).

[120] *See id.*

[121] 17 C.F.R. § 230.419.

problem, but Congress expanding the definition of a blank check company can contribute to solving the issue.

Next, Congress can decide to include SPACs as an exclusion from the safe harbor for forward looking statements. This would be the most effective solution, but also the most detrimental for SPACs, potentially deterring SPAC Sponsors from pursuing bringing any company public through the SPAC investment vehicle. While this would solve the problem of misleading investors with SPACs, it would likely eliminate SPACs' ability to efficiently bring private companies public. Obtaining a shareholder vote for a merger while not being able to make any forward-looking statements about the target corporation would be more difficult because SPAC Directors will not be able to make any statements about future projections of the target corporation. Congress has certainly hinted toward regulating SPACs more closely, but there has not been any indication that they want to eliminate SPAC usage.[122] The risk of litigation for all statements made about the target corporation to shareholders would be very high in this circumstance. A more even-handed solution should attempt to strike a balance in legislating on SPACS; they have proven to be extremely effective at bringing private companies public, and it would be wise to not completely hamper their ability to operate.

The SEC has other ways to encourage proper behavior from SPACs, even without amendments to the PSLRA by Congress. The SEC increasingly suing SPACs for securities fraud may change the way that SPACs choose to represent the deals they are going to make.[123] While Securities fraud is difficult to prove, the threat of litigation may influence the way future SPACs structure its transaction incentives.[124]

Another solution that could hamper the inherent conflict of interests between SPAC shareholders and the sponsor and director would be to create a disclosure regime that would grant SPACs safe harbor protection if they met certain disclosure standards. For example, SPACs can avail themselves of statutory safe harbor protection for forward looking statements if (1) sponsors promote cut and relationship to directors is disclosed, (2) difference in stock warrants between insider and common shareholders is disclosed, (3) requirement of 20/30% independent directors, (4) SPACs disclose due diligence procedures for target company identification and release a report to shareholders that demonstrates how procedures were met. An approach

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[122] *Going Public: SPACs Direct Listings, Public Offerings, and the Need for Investor Protections: Hearing before the Subcomm. on Inv. Prot., Entrepreneurship & Cap. Mkts. of the H. Comm. on Fin. Serv.* 117th Cong. 1 (2021) (statement of Rep. Brad Sherman, Chairman, Subcomm. on Inv. Prot., Entrepreneurship & Cap. Mkts. of the H. Comm. on Fin. Serv); Merkel et al., *Memorandum: Litigation Risk in the SPAC World*, QUINN EMANUEL (Sept. 30, 2020), https://www.quinnemanuel.com/the-firm/publications/litigation-risk-in-the-spac-world/.

[123] *See* Coates, *supra* note 34 (States that PSLRA only protects against litigation from private parties, and that the SEC can still bring action against SPACs regardless of the safe harbor rule).

[124] *See* Verified Shareholder Derivative Complaint at 3, Shorab v. Anderson et al., No. 6:22-cv-06023 (W.D.N.Y. 2022) (alleging SPAC directors made multiple misleading statements in their proxy materials including lying about business with certain clients and fabricating profits in the attempt to get stockholders to vote to merge with the target company).

like this would incentivize good behavior by SPACs while also allowing SPACs to keep their utility as an alternative investment vehicle.

A disclosure regime would be effective in mending the misaligned incentives in SPACs because SPAC sponsors and directors will have to publicly disclose the benefits they are receiving in the event of a de-SPAC merger. This would allow potential shareholders to inform themselves about potential misaligned incentives and may influence their decision to purchase a certain SPAC. Furthermore, requiring a requisite number of independent directors on a SPAC board to receive safe harbor protection would be a strong incentive for SPACs to act in the interest of shareholders. Independent directors would not be receiving equity in the target corporation post-merger, and will be more likely to look at a potential merger in a critical fashion. Lastly, requiring the SPAC board to release a report that demonstrates its search for a target corporation and its following of due diligence responsibilities would allow shareholders to make a more informed decision on their merger vote.

IV. CONCLUSION

In conclusion, SPACs are a useful tool for bringing private companies public and are growing in popularity.[125] The problems that arise from SPAC sponsors potentially misaligned incentives for closing a deal should be solved in a way that does not destroy the utility of SPACs. To solve this problem, Congress could amend the PSLRA to allow SPAC or SPAC-like investment vehicles to be afforded safe harbor protection from securities fraud claims if SPAC promoters disclose their conflicts of interests and deal-closing incentives before a target company is identified. This will keep intact the policy purposes of the safe harbor provisions to avoid unwanted litigation and will incentivize SPAC promoters to disclose their conflicts of interests to shareholders so that they are more adequately prepared to analyze and scrutinize a target acquisition company before voting on the merger.

The SEC will likely not be able to classify De SPAC mergers as an IPO due to the statutory text and legislative history of the PSLRA pointing towards granting the SEC the authority to expand the types of companies that are granted safe harbor protection, not to expand the types of companies that are unable to benefit from safe harbor protection. There is no evidence or support for a theory that a De SPAC transaction can rightfully be identified as a "constructive" IPO, or an IPO in its own rights. Furthermore, if this definition was adopted by the SEC there would need to be an immense amount of redefining statutory terms and amending regulations to comply with this new interpretation. A middle ground solution involving certain disclosure criteria that will enable SPACs to be afforded safe harbor protection would be preferable as it would balance the interests of consumer protection and allow for alternate investment vehicles to bring companies to the public market. Therefore, the most effective solution is to have Congress legislate SPACs into the safe harbor exemption, which will avoid many

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[125] *See* Ramkumar, *supra* note 2.

unintended consequences of changing the definition of an IPO, but also may ruin the utilities and upsides to SPACs.