NOTE

THE SPAC PHENOMENON: A TRANSACTION OF REINVENTION AND THE SEC'S RELUCTANT HAND

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SPACs (Special Purpose Acquisition Companies) hit an all-time high in recent years as a popular vehicle for taking companies public. These transactions promised investors early access to high-growth companies and private firms seeking capital the speed and flexibility to bypass the rigors of traditional IPOs. Yet, years later, de-SPAC companies are widely underperforming, with poor returns and mounting bankruptcies. Beneath this innovation lies a fundamental regulatory challenge: the SPAC structure exploits gaps in securities law to create a transaction rife with misaligned incentives.

This Note argues that the SEC's disclosure-based regulatory regime is nonresponsive to the structural flaws embedded in the SPAC lifecycle. By analyzing the legal origins of SPACs and examining the incentive dynamics of Sponsors, directors, PIPEs, and investors, this Note shows that SPACs operate more as tool for capital extraction than for genuine value creation. SPACs are emblematic of a broader trend in financial innovation, where legal engineering and disclosure regimes mask transactions that

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primarily benefit insiders at the expense of public investors and market integrity. This Note calls for more thoughtful deal-making and policymaking from regulators, legal, and financial professionals alike.

I. INTRODUCTION

Amongst other titles, 2020 was crowned "The Year of the SPAC.[1] Special Acquisition Purpose Companies (SPACs), also known as "blank-check" companies, saw an extraordinary

[1] Christopher M. Barlow et al., *The Year of the SPAC*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP AND AFFILIATES (Jan. 26, 2021), https://www.skadden.com/insights/publications/2021/01/2021-insights/corporate/the-year-of-the-spac [https://perma.cc/RVH3-QCHW].

boom in investor interest and capital inflow. While global M&A decreased from 2019 to 2020 by 9.7%,[2] the "SPAC frenzy" saw its namesake transactions increase by 320%.[3] SPAC transactions amounted to a total of $82 billion in 2020, an amount greater than all money previously raised through such transactions.[4] Low interest rates, high money supply, and sudden excess time at home, married with promises of high return, perceived lower risk of tapping into specialized expertise, and celebrity endorsements made SPACs an exceedingly attractive and sought-after investment opportunity in 2020.[5] SPACs made up most of the growth in the U.S. IPO market from 2020 to 2021,[6] with big names like DraftKings, BuzzFeed, WeWork, 23andMe all going public via SPACs.[7]

In the wake of this SPAC frenzy, the initial craze seems to now closer resemble the dot-com bubble rather than the

[2] *Global Mergers and Acquisitions Decrease in 2020 but 2021 is Looking Favorable for M&A*, EY TAX NEWS (July 9, 2021), https://taxnews.ey.com/news/2021-1421-global-mergers-and-acquisitions-decrease-in-2020-but-2021-is-looking-favorable-for-m-and-ampa#:~:text=Global%20M%26A%20decreased%209.7%25%20to,)%2C%20when%20compared%20to%202019 [https://perma.cc/AWK7-TKJY].

[3] Barlow et al., *supra* note 1, at 1.

[4] Amrith Ramkumar, *2020 SPAC Boom Lifted Wall Steet's Biggest Banks*, WALL ST. J. (Jan. 5, 2021), https://www.wsj.com/articles/2020-spac-boom-lifted-wall-streets-biggest-banks-11609842601.

[5] *The US Printed More than $3 Trillion in 2020 Alone. Here's Why it Matters Today*, DEPLEDGE STRATEGIC WEALTH MGMT. (June 17, 2022), https://www.depledgeswm.com/depledge/the-us-printed-more-than-3-trillion-in-2020-alone-heres-why-it-matters-today/ [https://perma.cc/8D4X-B89L]; Rachel Curry, *What to Know About Celebrity SPACs*, PUBLIC, https://public.com/learn/what-to-know-about-celebrity-spacs#:~:text=Other%20noteworthy%20celebrities%20who%20have,invested%20in%20The%20Parent%20Co [https://perma.cc/KBA3-7JM2] (last visited Feb. 24, 2024).

[6] Sanghamitra Saha, *2020 Has Been the Year of SPAC IPOs: Here Are the Prominent 4*, NASDAQ (Dec. 28, 2020), https://www.nasdaq.com/articles/2020-has-been-the-year-of-spac-ipos:-here-are-the-prominent-4-2020-12-28 [https://perma.cc/GG9W-KG6S].

[7] Tom Huddleston Jr., *What is a SPAC? Explaining One of Wall Steet's Hottest Trends*, CNBC (Jan. 30, 2021), https://www.cnbc.com/2021/01/30/what-is-a-spac.html [https://perma.cc/3KFM-W6CC].

revolutionary financial innovation it promised. De-SPAC companies on average are significantly underperforming. The average one-year return on a company that went public via de-SPAC merger in 2021 was -64.2%.[8] Chamath Palihapitiya, the once-crowned "King of SPACs," saw a 70% drop in value from his projects.[9] Other big names that went public via de-SPAC—WeWork, Core Scientific, Inc., and Virgin Orbit Holdings—are filing for bankruptcy in rapid succession.[10]

This Note argues that the newly proposed SEC rules for SPACs, which seek to align the SPAC disclosure regime with traditional IPO disclosures by requiring robust Sponsor background disclosure, a transaction-accompanying fairness opinion, and explicit nullification of the forward-looking safe harbor provided by the Private Securities Litigation Act (PSLRA), fall short of effectively addressing the misaligned incentives that contribute to market inefficiencies. This Note evaluates the exact mechanisms of the transaction, considers the responsiveness of the SEC's new rules to those incentives, and suggests that due to the complex dynamics of SPAC transactions, these financial instruments normatively ought to be more appropriately restricted from retail investor participation. It critically evaluates whether SPACs represent merely the latest in a series of non-value-adding financial innovations that require a move towards more thoughtful, equitable regulatory reforms prioritizing investor protection and market integrity over speculative gains.

Part II of this Note outlines the inception and regulatory evolution of SPACs, detailing their emergence as a response to SEC regulations and their development through legal strategies to navigate these rules. Part III delves into the

[8] Mark Dent, *The Spectacular Failure of SPACs*, THE HUSTLE (Nov. 18, 2023), https://thehustle.co/the-spectacular-failure-of-spacs [https://perma.cc/L6X9-UPRH].

[9] *Id*.

[10] Bailey Lipschultz, *WeWork Joins a Long List of High-Profile SPACs That Have Failed*, BLOOMBERG L. (Nov. 7, 2023), https://www.bloomberglaw.com/bloomberglawnews/capital-markets/X3JG28VC000000?bna_news_filter=capital-markets#jcite [https://perma.cc/4DVU-7NJE].

structure and dynamics of contemporary SPAC transactions, highlighting the roles and incentives of key stakeholders, including Sponsors, directors, PIPEs, and investors, and the implications for target acquisition and merger processes. Part IV critiques the SEC's regulatory proposals for SPACs, arguing that they fall short of addressing the fundamental issues of incentive misalignment and proposing alternative approaches to better align the interests of all parties involved and enhance market integrity.

II. THE RISE OF THE SPAC: THE PSRA, RULE 419, AND LEGAL ENGINEERING

A. The Birth and Early Regulatory Landscape of the SPAC

SPACs have long existed as a tool of reinvention and circumvention. SPACs initially arose in the 1990s as a workaround of the SEC's Penny Stock Reform Act of 1990 (PSRA) and subsequent enforcement mechanism Rule 419. The PSRA and Rule 419 responded to the 1980s' trend of "blank check" companies[11] engaged in "pump-and-dump schemes" whereby these companies would acquire money through issuing penny stocks in an IPO with the purported business plan of merging with an already existing company.[12] They would superficially and temporarily inflate market price of said stock through fraudulent representations and ultimately sell at the inflated price, effectively offloading harm to retail investors. The key to this scheme was the penny stock, which at the time exempted them from registration and thus also from SEC scrutiny and disclosure requirements.

The PSRA and Rule 419 combated this by requiring disclosure. The PSRA updated the definition of "penny stock"

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

[12] U.S. Sec. & Exch. Comm'n, *Pump and Dump Schemes*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/glossary/pump-and-dump-schemes [https://perma.cc/LFP6-TPA7].

and established mandatory risk disclosure guidelines and specific rules for blank-check companies.[13] Rule 419 specifically addresses blank check companies, requiring: (1) IPO proceeds to be kept in escrow until purchase approval, (2) a post-effective amendment when identifying a probable acquisition target, (3) an amendment upon execution of an acquisition agreement to which an investor has between twenty and forty-five business days to decide whether to remain as an investor, (4) a right of rescission, (5) restrictions on using IPO funds until purchase conditions are met, and (6) an eighteenth-month limit for said company to acquire target or refund investors.[14]

However, because Congress and the SEC still recognized the potential value of blank check offerings in "legitimate business transactions *outside* the penny stock area,"[15] they cabined blank check companies in their amended definition. A blank check company was defined as one "that has no specific business plan or purpose or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies, or other entity or person" *and* "is issuing penny stock."[16] Although simply not issuing penny stock appeared to be the easy way out of the intense regulation of Rule 419, the SEC plugged that hole in its docket release specifically noting that "for blank check offerings, the five dollar price threshold presents an easy mechanism for avoiding the regulatory scheme" and excepted it from applying to offerings from blank check companies so all offerings would be subject to Rule 419.[17]

The modern SPAC is the result of legal engineering developed by David Nussbaum and David Miller in response

[13] Penny Stock Reform Act of 1990, H.R. 4497, 101st Cong. (1990), https://www.congress.gov/bill/101st-congress/house-bill/4497.

[14] 17 C.F.R. § 230.419.

[15] H.R. REP. NO. 101-617 (1990), *reprinted in* 1990 U.S.C.C.A.N. 1408, 1424 (emphasis added).

[16] 17 C.F.R. § 230.419(a)(2) (internal quotation marks omitted).

[17] Penny Stock Definition for Purposes of Blank Check Rule, Securities Act Release No. 33,7024, 55 SEC Docket 722 (Oct. 25, 1993).

to the PSRA and Rule 419.[18] These vehicles circumvented the new legislation by utilizing the exception that excludes from the definition of penny stock a company with net tangible asset over $5 million dollars if the company has been in continuous operation for less than three years.[19] They also voluntarily adopted enough Rule 419 requirements to give the appearance of compliance, though these measures did not necessarily achieve the rule's intended regulatory effect. In some cases, SPACs adopted even more stringent standards, such as providing for an extended timeline[20] or a more accurate minimum target purchase price,[21] which potentially signaled positively to investor confidence. Operating outside of these regulations also allowed the SPAC to be designed with greater trading flexibility. This design, allowing separate trading of stocks or warrants and reserving warrant exercisability, grew interest from hedge fund interest and early investors.[22]

This re-designed vehicle initially sparked optimism in an effective, investor-protected, forward structure that would equalize access to capital markets for revolutionary emerging companies, while also democratizing investor participation.[23] Early responses to SPACs cited shareholder participation,[24]

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[18] Amrith Ramkumar, *SPAC Pioneers Reap the Rewards After Waiting Nearly 30 Years*, WALL ST. J. (Mar. 7, 2021), https://www.wsj.com/articles/they-created-the-spac-in-1993-now-theyre-reaping-the-rewards-11615285801.

[19] 17 C.F.R. § 240.3A51-1(g)(1) (2023).

[20] Up to 24-months, as opposed to the 18-month period typical of Rule 419. 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, 542 (2007).

[21] Calculated by 80% of net assets at time of acquisition, as opposed to 80% of maximum offering proceeds as dictated by Rule 419. *Id.*

[22] *Id.*

[23] Tim Castelli, *Not Guilty by Association: Why the Taint of Their "Blank Check" Predecessors Should Not Stunt the Growth of Modern Special Purpose Acquisition Companies*, 50 B.C. L. REV. 237, 242–43 (2009).

[24] *Id.* at 271.

self-imposed disclosure requirements,[25] and even managerial compensation structure[26] as reasons why the structure created a safe, transparent, and self-incentivizing value-maximizing vehicle that should not be further regulated.[27] This may have held true in those initial years, but as SPACs have evolved and gained prominence as a more common alternative to going public, these claims must be reevaluated. In hindsight, the legislative and regulatory origins of SPACs might have served as early indicators of the challenges and criticisms these vehicles would face. The contemporary SPAC landscape suggests a return to some of the speculative and risky characteristics of their blank check predecessors.

B. How SPACs Circumvent Key Legislation

While SPACs appear to have been designed in a way that protects investors, or at least signal positively to investor reliance, they also actively arbitrage legislation. The main statutory schemes the SPAC is designed to circumvent are the PSRA (and Rule 419), the Investment Company Act of 1940 (ICA), and the Private Securities Litigation Reform Act of 1995 (PSLRA). The niche SPACs have found between these laws have enabled their evolution of complicated, elusive, and incentive-conflicted structure.

First, in order to avoid the unfavorable restrictions imposed by the PSRA and Rule 419, SPACs take advantage of the asset exception to penny stock classification.[28] Rule 419 restrictions are so stringent that they effectively killed the use

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[25] *Id.* at 254; *see also* Daniel S. Riemer, *Special Purpose Acquisition Companies: SPAC and SPAN, or Blank Check Redux?*, 85 WASH. U. L. REV. 931, 963 (2007).

[26] Riemer, *supra* note 25, at 964.

[27] Castelli, *supra* note 23, at 275.

[28] 17 C.F.R. § 240.3a51-1(g). Under 17 C.F.R. § 240.3a51-1(g), an issuer is excluded from the definition of a penny stock if it has net tangible assets exceeding $5 million and has been in continuous operation for less than three years. SPACs structure themselves to meet these criteria, thereby circumventing the more restrictive provisions of Rule 419 that apply to penny stocks.

of blank check offerings.[29] For example, the escrow requirement[30] limits the use of capital and prolong the investment period. Tight restrictions on transferability[31] reduce liquidity and thus attractiveness to investors. The high volume of mandatory disclosures[32] also increase administrative burdens. So, for the SPAC to escape this, it is crucial for the initial IPO and rounds of fundraising to hit the baseline number of $5 million. This baseline cash flow offers a positive signal about investor trust and confidence in the prospective performance of the vehicle.[33] More importantly, this allows the SPAC to escape Rule 419 because they are not issuing penny stock.[34]

The majority of these funds are then deposited in a trust that invests in government securities such as treasury bills, or money market funds that invest only in government securities.[35] A small percentage of proceeds are used to pay fees and operating costs, with the majority resting in the trust.[36] The stability of this investment, as well as the conservative usage of funds, again bolsters belief that the SPAC is a financially savvy, investor-protective vehicle.[37]

Yet, depositing the funds in government securities is also designed to exploit a loophole in the Investment Company Act

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[29] Heyman, *supra* note 20, at 540.

[30] 17 C.F.R. § 230.419(b).

[31] *Id.* § 230.419(b)(3)(ii).

[32] *Id.* § 230.419(c)-(f).

[33] Henry Sheykin, *Why Cash Flow is the Key to Investor Confidence*, FINMODELSLAB (Jan. 24, 2023), https://finmodelslab.com/blogs/blog/leverage-cash-flow-strategic-decisions [https://perma.cc/QXX6-DMGT].

[34] 17 C.F.R. § 230.419(a)(2).

[35] Anna T. Pinedo et al., *What's the Deal? – Special Purpose Acquisition Companies*, MAYER BROWN (Aug. 10, 2020), https://www.mayerbrown.com/en/perspectives-events/publications/2020/08/whats-the-deal-special-purpose-acquisition-companies [https://perma.cc/V8TH-WHLU].

[36] U.S. Sec. and Exch. Comm'n, *What You Need to Know About SPACs – Updated Investor Bulletin*, INVESTOR.GOV (May 25, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin.

[37] Castelli, *supra* note 23, at 269.

of 1940 (ICA).[38] This investment decision allows SPACs to utilize Rule 3a-1 under the ICA, which excepts vehicles from the definition of "investment company" and "issuer" where no more than 45% of the value of total assets and 45% of post-tax net income are invested in securities (*except for* government securities).[39] SPACs assert that their primary business is not in the investing of securities to avoid capture by the ICA.[40]

This particular circumvention is strategic as the ICA imposes stringent regulatory and compliance requirements, such as restrictions of diversification mandates, and detailed disclosure obligations that can limit the SPAC's operational flexibility.[41] Crucially, if governed by the ICA, SPACs would be subject to the Investment Advisers Act (IAA) that bars the complex, securities-based structure SPACs use as attractive compensation to their investment advisers.[42]

Avoiding definition as a "blank check company" has also enabled another key feature of the SPAC/De-SPAC transaction: the usage of forward-looking statements. The PSLRA established a limited safe harbor for forward-looking statements, or future projections. This encompasses future economic performance like revenue, income, and future operations.[43] However, this safe harbor excludes forward-looking statements made by a blank check company.[44] It also

[38] Pinedo et al., *supra* note 35.

[39] 17 C.F.R. § 270.3a-1.

[40] Matt Levine, *Money Stuff: SPAC Suit Leads to SPARCs*, BLOOMBERG (Aug. 23, 2021), https://www.bloomberg.com/news/newsletters/2021-08-23/money-stuff-spac-suit-leads-to-sparcs?embedded-checkout=true [https://perma.cc/4HEN-WLMH].

[41] Gregory Merz, *Investment Company Act of 1940 Exceptions: Guide for Transactional Lawyers*, WESTLAW: PRACTICAL (2025) (on file with the Columbia Business Law Review).

[42] Cydney Posner, *Are SPACs Really "Investment Companies"?*, COOLEY PUBCO (Aug. 30, 2021), https://cooleypubco.com/2021/08/30/spacs-investment-companies/ [https://perma.cc/4WP8-RXCE].

[43] Daniele D'Alvia & Milos Vulanovic, *A Rethinking of U.S. Forward-Looking Statements in SPACs*, FORDHAM J. CORP. & FIN. L. (July 13, 2021), https://news.law.fordham.edu/jcfl/2021/07/13/a-rethinking-of-u-s-forward-looking-statements-in-spacs/ [https://perma.cc/KGQ3-7Q2M].

[44] 15 U.S.C. § 78u-5(b)(1)(B).

excludes forward-looking statements made in connection with an IPO.[45] Prior to new SEC regulation explicitly nullifying the safe harbor, SPACs were able to take advantage of this safe harbor because they are structured so that the initial SPAC is not a blank check company, and the later merger, although a quasi-IPO event, is still not a traditional IPO. Since SPACs often take early-stage companies public, the ability to utilize forward-looking statements gives them a wider range of targets to choose from that can still be represented in an attractive light to investors. This allows the proponents of this transaction form to argue that SPACs are valuably widening access to capital from the company end and opportunity to invest in cutting-edge business ideas and technologies from the investor end.

However, the safe harbor never explicitly allowed SPACs to take advantage of the provision. Instead, based on the two features described, SPACs had simply been operating on the assumption that the safe harbor applies to them.[46] SEC Commissioner John Coates noted that the applicability of the safe harbor is "uncertain at best,"[47] and his concerns were resolved by its later nullification.

III. THE CONTEMPORARY SPAC: STRUCTURE AND INCENTIVES

This regulatory backdrop informs the understanding of the mechanics of the contemporary SPAC and de-SPAC transaction. This section first addresses the formation and initial public offering of the SPAC, with attention to the critical roles of Sponsors, and directors. This is followed by analysis of the target acquisition and de-SPAC process, with

[45] *Id.* § 78u-5(b)(2)(D).

[46] Cydney Posner, *The House Hears About SPACs*, COOLEY PUBCO (June 1, 2021), https://cooleypubco.com/2021/06/01/house-hears-spacs/ [https://perma.cc/7K5C-YEK9].

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

attention to the instrumental role of PIPE financing. The final part of this section critically examines the various incentive structures, from Sponsors to retail investors, exposing potential misalignments and challenges within the strategic and regulatory landscape of modern SPACs.

A. Sponsors and Directors: Formation and Target Acquisition

The life cycle of a SPAC begins with a Sponsor; this could be individuals with a business idea, private equity firms,[48] celebrities,[49] operators,[50] or any other entity with the necessary financial and managerial capabilities. The key requirement to be a SPAC Sponsor is the ability to meet the financial contribution requirement. The SPAC Sponsor makes an initial investment by buying a stake in the SPAC, called a "promote."[51] This amounts to generally a nominal investment of around $25,000[52] and forms the basis for the primary

[48] Kristi Marvin, *2022 Awards and SPAC Deal of the Year*, SPACINSIDER (Dec. 29, 2022), https://www.spacinsider.com/news/spacinsider/spacinsider-2022-awards [https://perma.cc/E755-X6RS].

[49] Sophia Kunthara, *Athletes and Celebrities Join the SPAC Boom, SEC Takes Notice*, CRUNCHBASE NEWS (Mar. 11, 2021), https://news.crunchbase.com/public/athletes-and-celebrities-join-the-spac-boom-sec-takes-notice/ [https://perma.cc/D9XX-PC3T].

[50] Operators have former C-suite operating experience. *See Leader vs. Manager vs. Operator*, INDEED (Dec. 9, 2022), https://www.indeed.com/career-advice/finding-a-job/leader-vs-manager-vs-operator; Kurt Chauviere, Tao Tan & Alastair Green, *Earning the Premium: A Recipe for Long-Term SPAC Success*, MCKINSEY & CO. (Sept. 23, 2020), https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/earning-the-premium-a-recipe-for-long-term-spac-success [https://perma.cc/ND55-C6UK].

[51] Michael D. Klausner & Michael Ohlrogge, *Is SPAC Sponsor Compensation Evolving? A Sober Look at Earnouts* 4 (Stan. L. & Econ. Olin Working Paper No. 567, N.Y.U. L. & Econ. Research Paper No. 22-10, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4022611 [https://perma.cc/G5Z3-8RD7].

[52] Ortenca Aliaj, Sujeet Indap & Miles Kruppa, *The SPAC Sponsor Bonanza*, FIN. TIMES (Nov. 13, 2020), https://www.ft.com/content/9b481c63-f9b4-4226-a639-238f9fae4dfc [https://perma.cc/S97K-WUVT].

Sponsor compensation structure. This initial investment is held in a trust, with payment following only after a successful merger. Payment is in the form of 20% of the SPAC's common stock, designated as "Founder's Shares."[53] Sponsors also make an investment in SPAC warrants and/or shares and proceeds from this investment cover initial expenses like the SPAC's IPO underwriting fees.[54]

SPAC Sponsors in turn elect directors and managers, often leveraging their personal network in the process.[55] Due to the specialized structure of the entity, SPAC directors also play the management role,[56] so there is no significant distinction between directors and managers. This Note will refer to these roles collectively as directors. SPAC boards are small, requiring a minimum of three independent directors at formation. This smaller size and the relatively young regulatory landscape have resulted in a lack of commonly established board norms and less stringent requirements such as select disclosure, inconsistent committee establishment, and exemption from diversity requirements. SPAC directors can come from a wide range of backgrounds, although they are typically recruited for industry-specific or financial expertise.[57] An important factor in director selection is name power: since the SPAC has no existing business, they often rely on the reputation of both the Sponsors and directors to attract investment, effectively "backing the jockey, not the horse."[58] Accordingly, directors are expected to contribute

[53] Pinedo, *supra* note 35, at 2.

[54] Klausner, *supra* note 51, at 4.

[55] George Anderson, Jason Baumgarten & Lauren E. Callaghan, *Board Governance and SPACs: New Competition for Capital and Talent*, SPENCER STUART (May 2021), https://www.spencerstuart.com/research-and-insight/board-governance-and-spacs-new-competition-for-capital-and-talent [https://perma.cc/AK9P-JMMY].

[56] Michael Gofman & Yuchi Yao, *SPACs' Directors Network: Conflicts of Interest, Compensation, and Competition*, S&P GLOB. MKT. INTELL. (Jun. 28, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4148668 [https://perma.cc/E3SE-6UP3].

[57] Anderson et al., *supra* note 55, at 8.

[58] *Id.* at 7; Riemer, *supra* note 25, at 958.

potential targets in the initial search process.[59] With the proliferation of SPACs, competition for target companies has risen.[60] Powerful Sponsor and director reputation seek to ensure a favorable bargaining position. Like Sponsors, director compensation is tied to the success of the transaction. Directors are granted the right to purchase a certain number of founder's shares from the Sponsor also at a nominal price, contingent also upon successful consummation of the merger.[61]

Once a team is formed, SPAC Sponsors and directors work together through the deal process to vet targets. The SPAC first completes its IPO. They may embark on roadshows to attract investors[62] and file the S-1 with a broad prospectus. At the IPO stage, institutional investors[63] dominate, comprising up to eighty-five percent of investor makeup. Underwriter fees accumulate at this stage, amounting to typically 5.5% of IPO proceeds, 3.5% percent of which is deferred until the time of merger.[64] Investors purchase "units" rather than just traditional shares: these units are priced typically at $10.00

[59] Anderson et al., *supra* note 55, at 8.

[60] *Navigating the SPAC Explosion: Target Company Considerations When Contemplating a Sale to a SPAC*, LINCOLN INT'L (Apr. 2021), https://www.lincolninternational.com/wp-content/uploads/Navigating-the-SPAC-ExplosionApril-2021.pdf [https://perma.cc/76PC-KTPK].

[61] Hunter Fortney, SPAC Attack: An Examination of SPAC Director Compensation and Its Legal Implications 5 (Aug. 11, 2021) (unpublished manuscript), http://www.law.harvard.edu/programs/olin_center/Prizes/2022.pdf [https://perma.cc/KK9K-XNEE].

[62] SPACs are classified as "shell companies" under Securities Act Rule 405 and accordingly may not issue a free writing prospectus, which includes any roadshow that is written communication. However, they may still conduct live roadshows and transmit unrecorded presentations. *See* Pinedo, *supra* note 35, at 5.

[63] Institutional investors exercise investment discretion over $100 million or more in Section 13(f) securities. COMM. ON CAP. MKTS. REGUL., NOTHING BUT THE FACTS: RETAIL INVESTORS AND SPECIAL PURPOSE ACQUISITION COMPANIES (Oct. 2021), https://capmktsreg.org/wp-content/uploads/2021/10/CCMR-NBTF-SPACs-Retail-Investors.pdf [https://perma.cc/5L4J-N7HG]; 17 CFR § 240.13f-1 (2011).

[64] Robert Armstrong, *SPAC's Fee Problem*, FIN. TIMES (Sept. 30, 2021), https://www.ft.com/content/6b1d70db-edae-474c-bd6f-bb60dfa99c51 [https://perma.cc/L249-R3X8].

per unit and are comprised of (1) shares of common stock and (2) warrants, or a fraction of a warrant.[65] Warrants are beneficial to the company, representing future capital, but also attract investment as profit-earning potential.[66] At some point after the IPO and before the merger, the shares and warrants begin trading separately.[67] Here, the practical benefit of circumventing Rule 419 arises: the separation of stock and warrants is particularly attractive to institutional investors who can devise trading strategies around both.[68] At this point in the pre-merger stage, price fluctuations of the unit reflect the expected value of a merger as the managerial team works to find viable targets.[69] The clock starts ticking once the IPO has closed, and the managerial team begins the process of finding, evaluating, and negotiating a merger within the 18-to-24 month timeframe.

B. Shareholders and PIPEs: The De-SPAC Merger

Once a Target has been determined, shareholders of the SPAC must approve the merger. Here, a combination of forces is at play. By the nature of the game, SPAC Targets are typically smaller and potentially riskier companies than those

[65] U.S. Sec. and Exch. Comm'n, *What You Need to Know About SPACs – Updated Investor Bulletin*, INVESTOR.GOV (May 25, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin [https://perma.cc/TU28-7ZJ9]; Brian Kmet, Mike McKay & Thomas Olsen, *SPACs: Tapping an Evolving Opportunity*, BAIN & CO. (Mar. 1, 2021), https://www.bain.com/insights/spacs-global-private-equity-report-2021/ [https://perma.cc/A8FF-PCLZ].

[66] Myron Mallia-Dare & Genesa Olivieri, *Sweetening the Deal: Using Warrants to Get the Deal Done*, BUS. L. TODAY (Oct. 8, 2021), https://businesslawtoday.org/2021/10/sweetening-the-deal-using-warrants-to-get-the-deal-done/ [https://perma.cc/S6W4-BMC9].

[67] The exact timeframe varies according to terms of the particular warrant. U.S. Sec. and Exch. Comm'n, *supra* note 65, at 3.

[68] *See* Heyman, *supra* note 20, at 542.

[69] Frank Fagan & Saul Levmore, *SPACs, PIPEs, and Common Investors*, 25 U. PA. J. BUS. L. 103, 109 (2023).

prepared to go public through traditional IPO.[70] Often, the Targets are "pre-revenue" or low-revenue companies that may not have produced the proposed product or accomplished the end business activity.[71] This includes Fisker, a car company that went public via a SPAC with no cars yet manufactured,[72] and Virgin Galactic, a space tourism company that completed their merger before completing a space flight.[73] So, to communicate information to investors and attract investor approval, SPACs rely heavily on the assumed forward-looking statement safe harbor of the PSLRA to provide and dress up key information about valuation and risk.[74] Investors then signal their evaluation of the deal by their vote and redemption action. Shareholders may redeem their shares at the purchase price while keeping all warrants.[75] Even if redeeming, shareholders retain their right to vote.[76] This typically results in a very high mean redemption rate of 54.2%, and in some cases as high as 80%.[77]

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[70] Jessica Bai, Angela Ma & Miles Zheng, Segmented Going-Public Markets and the Demand for SPACs, S&P GLOB. MKT. INTELL. 5 (Jan. 1, 2021) (unpublished manuscript), https://ssrn.com/abstract=3746490 [https://perma.cc/A9TV-EBL8].

[71] Joanna Glasner, *SPAC to the Future: How Blank-Check Acquirers Could Reshape Emerging Companies' Roles in Public Markets*, CRUNCHBASE NEWS (Oct. 19, 2020), https://news.crunchbase.com/startups/spac-to-the-future/ [https://perma.cc/654M-W6K4].

[72] Ben Klayman, *Electric Car Maker Fisker to Go Public Through SPAC Deal at $2.9 Billion Valuation*, REUTERS (July 13, 2020), https://www.reuters.com/article/idUSKCN24E1M4/.

[73] Jeff Foust, *Virgin Galactic to Merge with Investment Company, Go Public*, SPACENEWS (July 9, 2019), https://spacenews.com/virgin-galactic-to-merge-with-investment-company-go-public/ [https://perma.cc/75AG-E5LN].

[74] Elizabeth A. Nelson, *Special Purpose Acquisition Companies and the PSLRA's Safe Harbor for Forward Looking Statements*, 26 N.C. BANKING INST. 229, 239–40 (2022).

[75] Snehal Banerjee & Martin Szydlowski, Harnessing the Overconfidence of the Crowd: A Theory of SPACs 7 (Sept. 24, 2021) (unpublished manuscript), https://ssrn.com/abstract=3930346.

[76] Usha Rodrigues & Michael Stegemoller, *Disclosure's Limits*, 39 YALE J. ON REGUL. 37, 41 (2022).

[77] *Id.* at 40.

These high redemption rates, while preserving voting rights, result in a form of "empty voting," where the shareholder vote is devoid of economic significance.[78] Whereas the shareholder vote is typically a protective mechanism that reflects deal impact on interests, the shareholder vote in the de-SPAC transaction fails to serve this purpose because regardless of how shareholders vote, they can redeem and exit. Indeed, for investors, it is in their interest to vote in favor of the merger while redeeming and exiting. This is because of the separate trading of shares and warrants, so that redeeming shares has no impact on warrants. However, warrants are typically only exercisable if the stock trades at or above $11.50,[79] so investors have every incentive to exit and make back their initial investment while still voting for the deal and making clean profit if the deal ends up successful.

SPACs are upfront about the maintenance of voting rights in case of redemption.[80] Accordingly, SPACs anticipate redemption and bring in PIPE (Private Investment in Public Equity) financing after redemptions have been made to replenish the cash supply. PIPE investors are investment firms, mutual funds, and other large, accredited investors who buy below-market-value shares[81] to provide a much-needed cash infusion to the SPAC. Since Sponsors urge merger consummation to ensure their payout, high redemption rates (and thus low cash funds) hands increasing bargaining power to PIPEs in negotiating deal terms. There is less PIPE financing availability than demanded, likely explainable by the additional diligence required since PIPE interests will attach directly to the Target. Sponsors incentivize PIPEs by offering favorable terms: stakes at below-market prices not offered to other investors, convertible debt and equity, and additional warrants. The worse or more speculative that the

[78] *Id.* at 41.

[79] Klausner et al., *supra* note 51, at 236.

[80] Rodrigues & Stegemoller, *supra* note 76, at 41.

[81] Troy Segal, *What is a Private Investment in Public Equity (PIPE)?*, INVESTOPEDIA (June 30, 2024), https://www.investopedia.com/terms/p/pipe.asp [https://perma.cc/W6K3-QDXR].

target's profit prospects are, the higher redemption rates are likely to be. The more redemptions there are, the less cash there is in the SPAC trust—and thus the greater the need is for a cash infusion. The more desperate the Sponsor for such cash infusion, the better the terms PIPEs receive.

In sum, the SPAC transaction presents a variety of competing incentives. Sponsors are focused solely on finalizing mergers with little concern for the Target's long-term quality, investors who redeem their shares benefit from warrants if the target succeeds with no downside if it fails, and PIPE investors who capitalize on a comparatively lower-risk investment through below-market prices. As a result, though, Sponsors and PIPE investors hold varied but detached interests in the long-term success of the target. This leads to dilution to the investors most committed to the long-term success of the target—typically unsophisticated retail investors who do not redeem and hold their shares.[82]

C. Parties That Benefit Most From The Transaction

Sponsors and directors stand only to benefit from the SPAC/de-SPAC transaction. Bill Ackman dubs the transaction "one of the greatest gigs ever for the sponsor" because "you get 20 per cent of the company tax free until you sell the stock."[83] Directors are in a similarly beneficial position. It is common practice that directors sit on multiple competing SPAC boards.[84] Additionally, because of corporate opportunity waivers, directors are not obligated to bring all

[82] Banerjee & Szydlowski, *supra* note 75, at 34.

[83] Ortena Aliaj, Sujeet Indap & Miles Kruppa, *The SPAC Sponsor Bonanza*, FIN. TIMES (Nov. 13, 2020), https://www.ft.com/content/9b481c63-f9b4-4226-a639-238f9fae4dfc?accessToken=zwAGDftF8KCwkdObSBxj-bRCJtOmOSOPn65N_A.MEYCIQDIzzN2IBE5yHEW7AqP5sQ2UDf_1KqULkD9JwdbmyBxwAIhANvezfoxCg5rYSUnid176aiSwJ135nUb77YQwaYS5_8X&sharetype=gift&token=a8b33517-dd9b-48c3-afb7-3c1f5ed8a0a2 [**https://perma.cc/TEN2-H8Z2].**

[84] Michael Gofman & Yuchi Yao, SPACs' Directors Network: Conflicts of Interest, Compensation, and Competition 9 (June 28, 2022) (unpublished manuscript), https://ssrn.com/abstract=4148668.

opportunities they come across to the SPAC. This raises considerable conflict of interest concerns between directors and shareholders of older, incumbent SPACs who may offer less competitive compensation. Directors commonly review multiple potential targets while maintaining responsibility for multiple SPACs at likely varying life cycle stages. They should generally prioritize providing high-quality targets to SPACs with the highest liquidation risk. However, newer SPACs have been empirically shown to actively compete against older SPACs by attracting incumbent SPAC directors with more favorable compensation terms. These terms act to functionally "buy out" directors. The ultimate incentive of directors is to ensure the consummation of a merger as, like Sponsors, their payday is tied to the merger. So, directors are incentivized to ensure SPACs offering more favorable terms undergo a merger and exit the market as soon as possible. This gives rise to inefficient allocation of high-quality targets to newer SPACs over older incumbent SPACs as transaction decisions are based on director compensation incentives rather than best strategic alignment.[85] However, compensation structure does not change for older incumbent SPACs, which still must undergo a merger before the director receives compensation. As incumbent SPACs run out of time, the likelihood of a value-decreasing merger with a low-quality company increases. Ultimately, directors are incentivized to act in their own economic interests, to the detriment of shareholders.[86] When directors prioritize younger SPACs and accordingly force the incumbent SPAC to enter a value-decreasing merger, shareholders experience negative returns, a significant difference from the average 18% return that shareholders who hold and do not redeem receive on their

[85] *Id*. at 34–35.

[86] Prior to the merger, directors hold founder shares, distinct from public shares held by retail and institutional investors. Founder shares are typically acquired at a nominal price and often convert into a significant equity stake post-merger, incentivizing directors to complete a deal regardless of its long-term viability. In contrast, public shareholders purchase shares at market value and bear the full downside risk if the target underperforms. *Id*. at 9–10.

investment.[87] Taken along with the 20% promote and standard fees that goes to compensate Sponsors and directors, public SPAC investors start 25% in the hole.[88]

Non-redeeming shareholders face further dilution on multiple fronts: (1) underwriter and other service fees dilute net asset values (2) redeeming shareholders who maintain and vest their warrants and (3) certain packages offered to PIPEs consisting of warrants, preferred shares, and below-market shares further dilute.[89] Empirically, the mean net cash per share post-dilution ranges from a low of $4.10 to a high of $6.60,[90] still significantly lower than the starting $10 share price. Given the systemic issues within the transaction, from the inherent conflicts of interest to the dilutive effects on shareholder value, it is clear the current SPAC structure disproportionately favors Sponsors and directors.

IV. THE SEC'S RESPONSE IS NONRESPONSIVE: THE FAILURES OF A DISCLOSURE-BASED REGIME

A. The SEC's Proposal

In 2022, the SEC proposed rules to specifically address the opaqueness of SPAC transactions.[91] Predictably, the SEC sought to address transaction issues through robust disclosure.[92] The new rules target parties and pieces of the

[87] Calculated average return on investment for non-redeeming shareholders from SPACs went through IPO between January 2010 to December 2021. *Id.* at 4, 40.

[88] Aliaj, Indap & Kruppa, *supra* note 83.

[89] Fagan & Levmore, *supra* note 69, at 111.

[90] Michael D. Klauser, Michael Ohlrogge & Emily Ruan, *A Sober Look at SPACs*, 39 YALE J. ON REG. 228, 295 (Stan. Law And Econ. Olin Working Paper No. 559, NYU Law And Econ. Research Paper No. 20-48, Eur. Corp. Governance Inst. – Fin. Working Paper No. 746/2021, 2022), https://ssrn.com/abstract=3720919.

[91] Special Purpose Acquisition Companies, Shell Companies, and Projections, 87 Fed. Reg. 29458 (May 13, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 230, 232, 239, 240, 249, 270).

[92] *Id.*

transaction from various angles. For Sponsors, they propose disclosure of experience, material roles and responsibilities, lock-up agreements, and nature and amount of compensation. Importantly, conflicts of interests now must be reported with clear assessment of fiduciary duties owed.[93] The de-SPAC transaction must also be accompanied with a fairness opinion on whether the overall transaction is unfair to unaffiliated shareholders and bases of opinion.[94] There is an overarching goal of aligning the de-SPAC disclosure regime with a traditional IPO in regard to enacting a mandatory notice period, treating the private company as a co-registrant, and explicitly incorporating underwriters into applicable liability regimes.[95]

The greatest hit to the SPAC scheme is the explicit nullification of the PSLRA safe harbor for forward-looking statements. By amending the definition of "blank check company" to now encompass SPACs, they will no longer be able to claim the previously afforded protection.[96] This is particularly relevant for the statements of private companies, whose pre- or low-revenue status required great reliance on the implicit safe harbor to attract investor attention and confidence.[97] Now, these companies must exercise a greater level of care in volunteering projections on future revenues, prospects, and profitability, and face liability for misstatements.

Potentially, the proposal also reflects the SEC's ambivalence toward how to most effectively regulate the transaction: it acknowledges the potential applicability of the ICA but charts the middle ground of creating a statutory safe

[93] *Id.* at 29467.

[94] *Id.* at 24970.

[95] *Id.* at 24976.

[96] *Id.* at 29481–82.

[97] Brian V. Beheny et al., *Securities and Exchange Commission Proposes Significant Changes to Rules Affecting SPACs*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP AND AFFILIATES (Mar. 2022), https://www.skadden.com/insights/publications/2022/03/sec-proposes-significant-changes-to-rules-affecting-spacs [https://perma.cc/TB3Y-RMVJ].

harbor. If the SPAC (1) has assets solely consisting of Government monies, (2) is primarily engaged in the business of the target company, and (3) abides by the eighteen month duration limitation, the SPAC will not be regulated under the ICA.[98] This approach suggests a reluctance to confront the core regulatory challenges of misaligned interests between the managing parties' desire to quickly complete a merger in order to receive payment and exit, and the non-redeeming shareholders' interests in the long term success of the target, highlighting a missed opportunity for more substantive reforms.

B. The Proposed Rules Do Not Re-Align Incentives

While the proposed rules seem comprehensive, their impact may be limited. The emphasis on disclosure and increased legal complexity does not address the core misaligned incentives. Many now mandated disclosures, such as sources of dilution and the empty voting scheme, are already voluntarily provided by SPACs. Further, SPACs often operate within the bounds of what is now formalized by the ICA safe harbor. While these clarifications aid legal compliance, they fail to realign fundamental incentives and to thoughtfully consider the larger policy questions surrounding the transaction.

The reliance on disclosure also faces the critique of the actual efficacy of the SEC's mightiest tool. SPACs are inherently complicated transactions.[99] The existing literature, although growing, is piecemeal and focuses on various crucial aspects of each transaction. As the legal and academic worlds work to fully understand the intricacies of SPAC transactions,[100] it is fair to ask how productive disclosure will be to retail investors. Disclosure adds to informational

[98] Special Purpose Acquisition Companies, Shell Companies, and Projections, 87 Fed. Reg. 29458–98 (May 13, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 230, 232, 239, 240, 249, 270).

[99] Rodrigues & Stegemoller, *supra* note 76, at 37–39.

[100] *Id.* at 38.

overload and quickly faces diminishing returns. It is not news that retail investors do not pay thorough attention to disclosure, especially if celebrity involvement and promotion of these investments continue to provide an easy source of reliance. Contrarily, institutional investors are positioned to benefit most from disclosure, to extract valuable insight and enhance hedging strategy.

Ultimately, as the SEC proposal acknowledges, the challenges with SPAC transactions are structural.[101] Yet, they urge that their enhanced disclosure and liability scheme will sufficiently address these concerns.[102] While disclosure-based regulation does create incentives by welcoming public scrutiny of transaction details, this consistent perspective is premised on allowing investors to make their own informed decisions. There is a crucial nuance here between the purported goal of well-informed investors, and actual tangible regulation that addresses the structural inequities at play.

C. Framing Impact on Investors

With the goal to "improve the usefulness and clarity of the information provided to investors so that they can make better informed decisions,"[103] it is crucial to keep in mind *who* the investors are. SPAC investors are largely institutional: retail investors make up about 15% of the investor population with very little pre-merger trading volume.[104] Yet, because Sponsors, directors, and redeeming shareholders generally exit immediately post-merger, these retail investors ultimately bear the majority of the losses when the post-merger company fails to meet performance expectations and stock price subsequently declines. Although a minority, it is not an insignificant number *per se*—there still exists a

[101] Special Purpose Acquisition Companies, Shell Companies, and Projections, 87 Fed. Reg. 29458, 29505–42 (May 13, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 230, 232, 239, 240, 249, 270).

[102] *Id.*

[103] *Id*. at 29463.

[104] COMM. ON CAP. MKTS. REGUL., supra note 63, at 2–3.

substantial number of non-professional investors dealing with a complex transaction against a body of sophisticated institutional investors. Thus, the analysis of whether the SEC's proposed rules offer sufficient protection turns on the perspective of how to treat these groups of investors.

If the focus is on the significance of percentage of retailed investors—so that regulation should effectively protect them—then a disclosure-based regime is insufficient. Transparency alone fails because the nuances of the transaction can obscure the real risks and valuations from retail investors. Such a scheme necessitates an approach that actively works toward incentive realignment. Such realignment, in turn, could be achieved through several mechanisms. For example, Sponsor compensation could be modified to be performance-based or tied to post-merger performance. Pegging compensation to a longer temporal framework would address the immediate 20% dilution and eliminate guaranteed payment simply upon merger consummation. For example, compensation contingent on performance, such as the ability to meet financial milestones or stock performance, would encourage more prudent decision-making and target allocation. Alternatively, compensation could be tied specifically to post-merger performance, where Sponsors would only benefit if the merged entity achieved long-term success, such as sustained revenue growth or improved stock performance. The adjustment thus realigns the interests of Sponsors and directors with those of shareholders in merging with a high-quality Target.

Further, the conflict within the shareholder pool could be a space for regulation. The crux of this tension—the empty voting scheme—has historically evaded public visibility and regulation.[105] While the SEC attempts to address this through dilution disclosure, direct prohibition of empty voting would both realign incentives[106] and simplify the transaction. If

[105] Henry T.C. Hu & Bernard Black, *Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms*, 61 BUS. LAW. 1011, 1016–1017 (2006).

[106] Rodrigues & Stegemoller, *supra* note 76, at 42–43.

investors who redeem must also vote "no," their vote meaningfully reflects their evaluation of investment quality and the efforts of the management team. Investors who do not redeem (typically retail investors) face a smaller risk of being sidelined by the strategic moves of institutional investors or short-term financial engineering.

If the focus is on the majority institutional investors and the 15% as "merely 15%," a disclosure-based regime may bolster access to the information required for these institutional investors to make informed decisions. Specifically, this may inform their decision to hold or redeem. Currently, one in four de-SPAC transactions face redemption rates of 95% or more.[107] If institutional investors continue to redeem at these high rates, or potentially even higher rates, based on the new disclosure regime, will this signal the death of the transaction? Higher redemption rates would require higher PIPE participation to fill in the gap, but conversely, high redemption rates signal lack of investor confidence that would deter PIPE investors. This would require even more favorable terms to attract investment and thus lead to less favorable outcomes to remaining investors. The process becomes cyclical, where the necessity to offer increasingly attractive terms further erodes the transaction's appeal to both existing and potential investors. This cycle may ultimately undermine the transactions viability, signaling a critical juncture for the sustainability of SPACs in the financial landscape. Perhaps this cycle that ends in a potential death of the SPAC is the policy outcome the SEC anticipates. If so, regulating in this roundabout way undermines transparency in policymaking and leaves unclear why the SEC avoids a more direct prohibition.

Further, this leaves open the potential shift toward even greater retail investor involvement, incentivized by the illusion of regulatory oversight. Disclosure requirements that appear robust but fail to address structural risks may reassure retail investors; but in reality, they do little to

[107] COMM. ON CAP. MKTS. REGUL., *supra* note 63.

mitigate the underlying misaligned incentives and dilution, exacerbating risks for this group.

D. Is the SPAC Just a Vehicle for Minting Capital?

This cycle also reveals what the current incentive structure seems to suggest: that SPACs are mechanisms primarily focused on capital generation for insiders and early investors, at the expense of broader investor value and market integrity. As it stands, the primary winners in both the pre- and post-regulation scenarios remain the Sponsors, directors, and institutional investors. While these regulations purport to safeguard the market's integrity and protect individual investors, the practical outcome perpetuates the status quo.

The SEC's current regulatory approach repeats the cycle that started with the promulgation of the PSRA and Rule 419 in the 1990s. Again, they chart the middle path by providing guidelines to operate within, without material regulation of the embedded misalignments and institutionalized conflicts. The embedded misalignments, such as the Sponsor compensation structure prioritizing merger completion over long-term performance, are not solved by disclosure because transparency alone does not create accountability. The institutionalized conflicts at the heart of the transaction, designed to extract value and leaving left-behind investors at risk, are not solved by disclosure because the complexity of the SPAC obscures these conflicts. Here, increased disclosure only adds informational noise that further conceals these flaws. The agency perpetuates a regulatory environment that appears to regulate yet fails to confront the core issues. The stove is on, but nothing is boiling.

A review of the composition of commenters on the proposed regulations reflects a predictable divide in perspectives.[108] Academics who have extensively studied the transaction focus on the structural issues and criticize the disclosure-based

[108] Comments on Special Purpose Acquisition Companies, Shell Companies, and Projections, Exchange Act Release No. 33-11048; 34-94546; File No. S7-13-22, https://www.sec.gov/comments/s7-13-22/s71322.htm (last visited Jan. 16, 2025).

regime as inadequately responsive. These stakeholders emphasize the need for substantive reforms to address systemic flaws.[109] Conversely, institutions that stand to benefit from the existing SPAC framework—such as law

[109] *See, e.g.*, ***Yuchi*** **Yao,** *Learning from the Market: The Choice Between IPOs and SPAC Mergers*, **Submission in Response to Proposed Rule: Special Purpose Acquisition Companies, Shell Companies, and Projections, File No. S7-13-22, to the U.S. Sec. & Exch. Comm'n (Dec. 10, 2023), https://www.sec.gov/comments/s7-13-22/s71322-314859-820425.pdf [https://perma.cc/UT5H-SJLC]; Alexander Groh, et al.,** *Leave No Money on the Table: Venture Capitalists' SPAC Exits*, **Submission in Response to Proposed Rule: Special Purpose Acquisition Companies, Shell Companies, and Projections, File No. S7-13-22, to the U.S. Sec. & Exch. Comm'n (Dec. 5, 2022), https://www.sec.gov/comments/s7-13-22/s71322-20152273-320245.pdf** [https://perma.cc/C57S-J39G]; **Michael Gofman & Yuchi Yao,** *SPACs' Directors Network: Conflicts of Interest, Compensation, and Competition*, **Submission in Response to Proposed Rule: Special Purpose Acquisition Companies, Shell Companies, and Projections, File No. S7-13-22, to the U.S. Sec. & Exch. Comm'n (Dec. 31, 2022), https://www.sec.gov/comments/s7-13-22/s71322-20154239-322479.pdf** [https://perma.cc/3VT8-3GM4]; **Felix Feng et al.,** *The Incentives of SPAC Sponsors*, **Submission in Response to Proposed Rule: Special Purpose Acquisition Companies, Shell Companies, and Projections, File No. S7-13-22, to the U.S. Sec. & Exch. Comm'n (Jan. 2023), https://www.sec.gov/comments/s7-13-22/s71322-20156792-324947.pdf [https://perma.cc/TQ3A-XR6N]; Michael Klausner, Michael Ohlrogge & Emily Ruan,** *A Sober Look at SPACs*, **Submission in Response to Proposed Rule: Special Purpose Acquisition Companies, Shell Companies, and Projections, File No. S7-13-22, to the U.S. Sec. & Exch. Comm'n (Jan. 2022),** https://www.sec.gov/comments/s7-13-22/s71322-20134162-303968.pdf [https://perma.cc/SKQ6-NQK7]; **Snehal Banerjee & Martin Szydlowski,** *Harnessing the Overconfidence of the Crowd: A Theory of SPACs*, **Submission in Response to Proposed Rule: Special Purpose Acquisition Companies, Shell Companies, and Projections, File No. S7-13-22, to the U.S. Sec. & Exch. Comm'n (Apr. 1, 2022),** https://www.sec.gov/comments/s7-13-22/s71322-20122362-278393.pdf [https://perma.cc/55Z2-2SLQ].

firms, [110] financial institutions,[111] and trade associations[112]—generally argue that the current disclosure requirements are sufficient and often overreaching in scope. They caution against overregulation, claiming that stricter rules could stifle capital formation, limit market access, and hinder financial innovation. Lawyers are earning fees from drafting complex SPAC deals and advising on regulatory compliance, while venture capitalists are leveraging the SPAC structure to secure quick exits and significant returns. Despite extensive empirical research and input from diverse public representatives, including academics and elected officials, the SEC still sidestepped and opted for a disclosure-based approach.

The Commission should have a clear view of this cycle: the SPAC was born as a workaround to an incomprehensive

[110] *See, e.g.*, White & Case LLP, Comment Letter on SEC Release No. 33-11099 (Feb. 14, 2023), https://www.sec.gov/comments/s7-13-22/s71322-20132359-302926.pdf [https://perma.cc/XLC5-UTVD]; Kirkland & Ellis LLP, Comment Letter on SEC Release No. 33-11099 (Feb. 14, 2023), https://www.sec.gov/comments/s7-13-22/s71322-20131385-301434.pdf [https://perma.cc/G89T-XWC3]; Goodwin Procter LLP, Comment Letter on SEC Release No. 33-11099 (Feb. 14, 2023), https://www.sec.gov/comments/s7-13-22/s71322-20131322-301503.pdf [https://perma.cc/NDX5-79ZC]; Skadden, Arps, Slate, Meagher & Flom LLP, Comment Letter on SEC Release No. 33-11099 (Feb. 14, 2023), https://www.sec.gov/comments/s7-13-22/s71322-20131124-301316.pdf [https://perma.cc/SF7B-AHTM].

[111] *See, e.g.*, I-Bankers Securities, Inc., Comment Letter on SEC Release No. 33-11099 (Feb. 14, 2023), https://www.sec.gov/comments/s7-13-22/s71322-20132947-303301.pdf [https://perma.cc/F5MQ-TRE8]; Virtu Fin., Inc., Comment Letter on SEC Release No. 33-11099 (Feb. 14, 2023), https://www.sec.gov/comments/s7-13-22/s71322-20131097-301132.pdf [https://perma.cc/65M3-LEDH]; Thomas M. Merritt, Deputy Gen. Couns., & Michael D. Ryan, Chief Exec. Officer, Bullet Point Network, LP, Comment Letter on SEC Release No. 33-11099 (Feb. 14, 2023), https://www.sec.gov/comments/s7-13-22/s71322-20131125-301317.pdf [https://perma.cc/P3AV-PZQT].

[112] *See, e.g.*, Nat'l Venture Cap. Ass'n, Comment Letter on SEC Release No. 33-11099 (Feb. 14, 2023), https://www.sec.gov/comments/s7-13-22/s71322-20131133-301325.pdf [https://perma.cc/SUN3-XX8D]; Comm. on Cap. Mkts. Regul., Comment Letter on SEC Release No. 33-11099 (Feb. 14, 2023), https://www.sec.gov/comments/s7-13-22/s71322-20131114-301236.pdf [https://perma.cc/WB3Q-93US].

regulatory scheme of a financial scam. Now, the realities of the SPAC scheme again reveal it as another maneuver that prioritizes insiders and institutional investors. The disclosure-based regime is another band-aid fix that creates an illusion of control and safety while keeping open regulatory holes for innovative lawyers to continue developing increasingly sophisticated workarounds. Thus, the SEC is actively adding to the equation where they are enabling the economically privileged to continue exploiting these gaps by creating not just permissive, but instructive legal structures to navigate and manipulate the financial system to their advantage.

Those in favor of SPACs cite significant benefits. Arguments focus on how these vehicles offer private companies the opportunity to grow with cash rather than debt, facilitate job growth, and democratize general access to investment opportunities.[113] If the SEC deems the financial opportunities provided to private companies are worthy of protection and maintenance, they must also thoughtfully evaluate if allowing retail investment access to such mechanisms truly serves public interest or merely exposes unsophisticated investors to undue risk. If the SEC concludes that this transaction does not benefit retail investors, it must answer so firmly. The Commission should not fall down its other route of half-enforcement by sorting SPACs into the category of "sophisticated" investment vehicles beyond the reach of retail investors. Such investments are restricted according to the rationale that they protect investors from risks associated with complex and less transparent investments. This would reposition SPACs alongside other complex investment vehicles like over-the-counter derivatives, bank-owned or private funds, venture capital limited partnerships, and notably, investments in pre-IPO shares.[114]

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[113] Castelli, *supra* note 23, at 271–74.

[114] *What's the Difference Between Retail and Institutional Investors?*, YIELDSTREET (May 6, 2024), https://www.yieldstreet.com/resources/article/retail-vs-institutional-investors/ [https://perma.cc/6Y59-FRYQ]; David Stein, *A Complete Guide to*

Barring retail participation in complex investments fairly raises concerns of regulatory paternalism. However, the issue at hand extends beyond a simplistic fear of potential financial loss. At its core, the vehicle is designed in a manner where the asymmetry of information and the distribution of financial outcomes are skewed in favor of a select few. Thus, even the permissive shelving of SPACs into the retail investor-barred category is a band-aid fix. The challenge for regulators, and the legal architects behind these financial instruments, is to critically assess the broader implications of their creations. It is essential to consider not only the legal feasibility, but also their social and economic utility. The fundamental imbalance raises questions not just about investor protection but about the overall utility and fairness of SPACs in the investment ecosystem. Are these vehicles merely exploiting legal and regulatory loopholes for the benefit of a few, or do they offer genuine, equitable opportunities for growth and investment across the board?

From creation to regulation, SPACs exemplify the disconnect in the contemporary market where financial engineering is prioritized over genuine value creation. Consequently, value extraction becomes a cyclical process, primarily enriching founders and insiders through various lucrative paydays, at the expense of genuine market value and investor interests. Increasingly, financial motives, markets, and institutions drive economic outcomes. SPACs embody this phenomenon in its channeling resources and rewards toward those who engineer the transactions, while sidelining the productive investment and sustainable growth that should underpin public markets. The result is a system where financial engineering serves as an end in itself.

As the financial landscape evolves, it is crucial for regulators and lawyers to collaborate in prioritizing design

Investment Vehicles, MONEY FOR THE REST OF US (June 25, 2024), https://moneyfortherestofus.com/investment-vehicles/ [https://perma.cc/HL5E-YU86]; *Pre-IPO Investing 2023 – What It Is, Process, Examples & Risks*, EQUIFUND, https://equifund.com/blog/pre-ipo-investing/ [https://perma.cc/273X-QKLT] (last visited Jan. 25, 2025).

that is fair, transparent, and socially valuable. Historically, financial innovations have often introduced novel investment structures that prey on and marginalize segments of the investor population. SPACs represent the latest chapter in this ongoing story. It is important for all parties to recognize these recurring patterns and critically assess the impact of their creations. They must answer whether their efforts are aimed at building a more equitable financial market or merely perpetuate the cycle.

V. CONCLUSION

SPACs emerged from sophisticated legal structuring to navigate early SEC regulations aimed at preventing blank check company abuses. These entities undergo an initial IPO with broad business purposes, leverage reputation and name power of managerial parties, and work within a timeframe up to two years whereby they find and take a private company public via merger. Close analysis of the various dynamics involved reveal a contradictory incentive structure. This is attributable to the compensation scheme of Sponsors and directors and an empty voting structure. Sponsors and directors are the primary beneficiaries from the transaction, as they make a nominal investment and are guaranteed payment upon consummation of a merger, regardless of long-term Target quality. Institutional investors may still benefit from risk-free speculative investment due to the empty voting mechanism where economic interests are decoupled from voting rights, so that they might redeem their initial investment and opportunity to exit and re-enter if the Target performs well. PIPEs, brought in to fill the capital gap from redemptions, may benefit from receiving favorable terms. Retail investors, however, typically do not redeem shares, facing dilution and relying on the long-term success of the Target. Accordingly, they suffer the greatest harm from various sources of dilution and possible lack of expertise on the empty voting mechanism.

Recent SEC proposed regulation relies heavily on disclosure to remedy market volatility from SPAC transactions. However, the disclosure-based regime is ultimately unresponsive to the conflicting incentives. The SEC must accordingly make a policy decision on who they want to protect and how—their disclosure-based regime primarily benefits institutional and other sophisticated investors who can rely on additional information to make more informed hedges. If the SEC truly wants to protect retail investors, it ought to pass substantive legislation re-aligning incentives or definitively condone the continuance of these vehicles. This calls for a critical reevaluation of whether permitting SPACs to continue operating amounts to an enabling of a capital-mining scheme that continues to benefit select insiders without creating general social value. Regulators and lawyers should reflect on the cycle of enabling the creation of speculative investment vehicles and proceed thoughtfully in financial and legal innovation.