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Comments on Proposed Rules for Special Purpose Acquisition Companies, Shell companies, and Projections

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COMMENTS ON PROPOSED RULES FOR SPECIAL PURPOSE ACQUISITION COMPANIES, SHELL COMPANIES, AND PROJECTIONS (MARCH 2022)

RE: FILE NO. S7-13-22

June 13, 2022

Vanessa A. Countryman
Secretary, Securities and Exchange Commission
100 F Street NE
Washington DC 20549-1090

Via Electronic Mail (rule-comments@sec.gov)

Dear Ms. Countryman

I submit this comment letter in response to the Securities and Exchange Commission's Release Nos. 33-11048; 34-94546; IC-34549; File Number S7-13-22 (the "Release"), which proposes rules (the "Proposed Rules") regarding Special Purpose Acquisition Companies (SPACs), Shell Companies, and Projections.[1] In light of the limited timeframe for providing comments, I focus on aspects of Parts II and III of the Release.

By way of background, I am a law professor who has researched and written in the areas of securities regulation and corporate law. In recent years, my writing has focused on SPACs, de-SPACs, going-private transactions, and the liability exposure of financial advisors, including underwriters and M&A advisors.[2] The views expressed in this letter are solely my own, and the institutional affiliation provided below is given for identification purposes only.

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[1] See SEC, Release Nos. 13-11048; 34-94546; IC-34549; File No. S7-13-22 (March 2022) ("Release").

[2] See, e.g., Andrew F. Tuch & Joel Seligman, *The Further Erosion of Investor Protection: Expanded Exemptions, SPAC Mergers and Direct Listings*, IOWA L. REV. (current draft attached and soon available on ssrn); Andrew F. Tuch, *M&A Advisor Liability: A Wrong Without a Remedy?*, 45 DEL. J. CORP. L. 177 (2021); Andrew F. Tuch, *Managing Management Buyouts: A US-UK Comparative Analysis*, in RESEARCH HANDBOOK ON COMPARATIVE CORPORATE GOVERNANCE 477 (A. Afsharipour & M. Gelter eds., 2021); Andrew F. Tuch, *Fiduciary Principles in Banking Law*, in THE OXFORD HANDBOOK OF FIDUCIARY LAW (E. J. Criddle, P. B. Miller & R. H. Sitkoff eds., 2019); Andrew F. Tuch, *The Remaking of Wall Street*, 7 HARV. BUS. L. REV. 315 (2017); Andrew F. Tuch, *Banker Loyalty in Mergers and Acquisitions*, 94 TEXAS L. REV. 1079 (2016).

I. PROPOSED NEW SUBPART 1600 OF REGULATION S-K

A. Proposed Rules Modeled on Rules Applicable to Going-Private Transactions

Many key reforms in the proposed new Subpart 1600 are modeled on provisions in 17 CFR 240.13e-3 ("Rule 13e-3") that apply to certain going-private transactions.

Proposed Item 1605 would require disclosure of the background, material terms, and effects of a de-SPAC transaction. Proposed Item 1605 is modeled, in part, on Item 1004(a)(2) and Item 1013(b) of Regulation M-A, which apply to going-private transactions under Rule 13e-3.[3]

Proposed Item 1606 would require SPACs to state whether they reasonably believe the de-SPAC and any related financing transaction are fair to the SPAC's unaffiliated security holders and to discuss the material factors upon which such belief is based. Proposed Item 1606 is modeled on Item 1013 of Regulation M-A, which applies to going-private transactions under Rule 13e-3.

Proposed Item 1607 would require SPACs to state whether the SPAC or SPAC sponsor has received any report, opinion or appraisal from an outside party relating to the transaction and summarize that third party opinion, among other matters. Proposed Item 1607 is modeled on Item 1014 of Regulation M-A, which applies to going-private transactions under Rule 13e-3.

The Proposed Rules would also amend Exchange Act Rules 14a-6 and 14c-2, as well as the instructions to Forms S-4 and F-4, to require a minimum 20-day dissemination period for disclosure documents filed in connection with de-SPAC transactions. These amendments are also modeled on provisions in Rule 13e-3.[4]

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[3] Release, at 47 n. 88.

[4] *See* 17 CFR § 140.13e-3(f).

In footnotes to the Release, the Commission briefly justifies its recourse to Rule 13e-3, stating:

> In our view, these rules [applicable to going-privates subject to Rule 13e-3] are appropriate models for the proposed specialized disclosure requirements for de-SPAC transactions, in that … the same potential for self-interested transactions exists in de-SPAC transactions as in going-private transactions.[5]

Elsewhere in the Release, the commission explains

> In our view, the disclosure requirements in Rule 13e-3 provide an appropriate model for the proposed requirements with respect to de-SPAC transactions, in that the conflicts of interests and misaligned incentives inherent in going-private transactions are similar to those often present in de-SPAC transactions.[6]

B. An Analogy with Going-Private Transactions

To begin, I agree that de-SPACs are analogous to going-private transactions subject to Rule 13e-3 in the conflicts of interests they may create. As Professor Joel Seligman and I argued in *The Further Erosion of Investor Protection: Expanded Exemptions, SPAC Mergers and Direct Listings*,[7] key participants in both types of transactions have opportunities and incentives to engage in self-dealing, to the detriment of unaffiliated security holders. For de-SPACs, these securities holders are public SPAC shareholders unaffiliated with the sponsor; for going-private transactions subject to Rule 13e-3, these security holders are public shareholders in the target unaffiliated with the acquirer.[8] In both transaction types,

[5] Release, at 47 n. 88.

[6] Release, at 52 n. 96.

[7] Tuch & Seligman, *supra* note 2.

[8] *Id*. at 53 (footnotes omitted) ("We can also analogize the regulation of SPAC mergers with that of going-private transactions under federal securities law. The quintessential going-private transaction is the management buyout (MBO), a transaction that, like SPAC mergers, creates conflicts of interest for transaction participants, including corporate fiduciaries. In MBOs, managers of a firm participate in buying the firm, a position that pits managers' self-interest against their fiduciary duties of loyalty. Federal securities law responds to these transactions by requiring enhanced disclosure. Rule 13e-3 compels an issuer and affiliates engaged in a going-private transaction to

countervailing forces also limit the effects of conflicts of interests: in going-private transactions, the requirement for target shareholders' approval disciplines conflicted target managers; in de-SPACs, the right of SPAC shareholders to redeem their shares may deter sponsors and directors from proposing value-decreasing deals, since widespread redemptions may leave a SPAC with insufficient cash to proceed with a de-SPAC. An analogy exists, inviting recourse to Rule 13e-3 because of its evident concern with mitigating the risk of conflict in going-privates.

While I therefore applaud the Commission's use of Rule 13e-3 as a model for reforms, the Proposed Rules modeled on Rule 13e-3 run into problems. First, I question whether de-SPACs, *as defined in proposed Item 1601*, give rise to "the same" or "similar" potential for self-dealing as going-private transactions subject to Rule 13e-3 sufficient to justify the application of provisions modeled so closely on Rule 13e-3. Second, I question whether de-SPACs ought to be subject to such extensive rules when, under the Proposed Rules, de-SPACS would also be subject to enhanced Section 11 liability. This concern goes to the cumulative deterrent effect of Section 11 liability and provisions modeled on Rule 13e-3. Third, I draw attention to conflicts and uncertainties in empirical evidence on de-SPACs, an understanding of which should limit regulation designed to steer private companies toward traditional IPOs and away from de-SPACs. Finally, I have particular concerns about proposed Item 1606, which will encourage if not practically require the use of fairness opinions in de-SPACs.

C. Definitional Issues

Consider first how de-SPACs, as defined in proposed Item 1601, and going-private transactions subject to Rule 13e-3 compare in exposing unaffiliated security holders to the risk of conflict. By definition, going-private transactions subject to Rule 13e-3 create severe conflicts of interest for corporate fiduciaries. The provision applies to a "Rule 13e-3 transaction," defined, in part, as any transaction or series of transactions involving one or

file with the SEC and to publicly disseminate a Schedule 13E-3, which requires disclosure of the transaction's purposes and a written justification of its structure. The target company and its affiliates must attest that they reasonably believe the transaction is fair to shareholders and must explain why this is so.").

more of certain enumerated transactions. The enumerated transactions are transactions between a target and an "affiliate." They include a tender offer of any equity security made by the issuer of such class of securities by an affiliate of such issuer.[9] So defined, going-private transactions subject to Rule 13e-3 suffer from a structural conflict since the same individuals owing fiduciary duties, often a target company's managers, are on both sides of the transaction. In the quintessential going-private transaction subject to Rule 13e-3,

> [M]anagers of a firm—who are corporate officers and often also directors—participate in buying the firm. Managers participate in the sense of having ongoing roles in the surviving firm, usually as owners and managers. [Such a transaction] therefore puts participating managers on both the buy- and sell-sides of a transaction, a position that pits managers' self-interest against their fiduciary duties of loyalty, creating conflicts of interest. Potentially exacerbating these conflicts, the private equity firms that sponsor these deals (by partnering with managers) usually enlist support from managers early in the deal process, a practice that may undermine arm's-length bargaining over the terms of sale and deter competing bids.[10]

In de-SPACs, corporate fiduciaries (SPAC sponsors and SPAC directors) typically face conflicts of interest. These conflicts result from compensation arrangements under which SPAC sponsors and SPAC directors receive SPAC shares that have value only if the SPAC undertakes a de-SPAC. Since sponsors and directors receive these shares for nominal consideration, they may profit from a value-decreasing de-SPAC, giving them incentives to undertake a de-SPAC even if it harms unaffiliated security holders.[11] As is now well known,

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[9] 17 CFR 140.13e-3 (a)(3)(i)(B).

[10] Deborah A. DeMott, *Directors' Duties in Management Buyouts and Leveraged Recapitalizations*, 49 OHIO ST. L. J. 517 (1988); Matthew D. Cain & Steven M. Davidoff, *Form Over Substance: The Value of Corporate Process and Management Buy-Outs*, 36 DEL. J. CORP. L. 849 (2011); Iman Anabtawi, *Predatory Management Buyouts*, 49 U.C. DAVIS L. REV. 1285 (2016); Andrew F. Tuch, *Managing Management Buyouts: A US-UK Comparative Analysis*, in RESEARCH HANDBOOK ON COMPARATIVE CORPORATE GOVERNANCE 477, 478 (A. Afsharipour & M. Gelter eds., 2021).

[11] *See* Release, at 32-33. As to the conflicts these compensation arrangements produce for SPAC sponsors and SPAC directors, see In re MultiPlan Corp. Stockholders Litigation, C.A. No. 2021-0300-LWW (Del. Ch. Jan. 3, 2022) at 43-47 (regarding sponsor incentives) and 48-50 (regarding board incentives).

the compensation arrangements for SPAC IPO underwriters may exacerbate their incentives to ensure that a SPAC undertakes a de-SPAC within the required investment window.

Whether de-SPACs give rise to the same or a similar risk of conflicts as going-privates subject to Rule 13e-3 is important since the Release provides this empirical claim to justify its decision to subject de-SPACs to onerous provisions modeled on those applicable to certain going-private transactions.[12] But even accepting this claim, a key problem arises with the Proposed Rules. Going-private transactions subject to Rule 13e-3 are defined in terms that assure a severe conflict of interest exists (that the same party is on both sides of the transaction) while proposed Item 1601 fails to define de-SPACs to assure that any conflict arises. Under proposed Item 1601(b), a *special purpose acquisition company* means, generally speaking, a company with a business plan to undertake a SPAC IPO and either complete a de-SPAC within a specified time frame or return the remaining funds from the SPAC IPO to shareholders. The definition does not assure the existence of a conflict of interest; for instance, no mention is made of sponsors' or directors' compensation. As defined, a company with such a business plan is not comparable to a going-private transaction subject to Rule 13e-3 since corporate fiduciaries do not necessarily have conflicts of interest. Similarly, a *de-SPAC transaction* is not defined in proposed Item 1601(a) in terms that assure the existence of a conflict of interest; generally speaking, it is the business combination of a special purpose acquisition company and one or more target companies. Nor do the Proposed Rules define SPAC *sponsor* or *target company* (in proposed items 1601(c) and 1601(d) respectively) in terms that suggest a close analogy with going-private transactions subject to Rule 13e-3.

Provisions modeled on Rule 13e-3 are therefore insensitive to the possibility that the terms of de-SPACs will change to minimize SPAC sponsors' and directors' opportunities and incentives for self-dealing. Under the Proposed Rules, SPACs will be subject to rules modeled on Rule 13e-3 regardless of the conflicts of interest they pose. It is not far-fetched to think that material changes will occur in SPAC sponsors' or SPAC directors' compensation or that the terms of SPACs will otherwise evolve to diminish conflicts between the interests

[12] *See supra* notes 5 and 6 and accompanying text.

of corporate fiduciaries and those of unaffiliated security holders. Indeed, litigation alleging fiduciary breach by SPAC sponsors and SPAC directors in de-SPACs is already creating incentives for reform of market practices. (Consider, for instance, a SPAC board comprised of a majority of directors who are independent of the SPAC sponsor and are not compensated with "founder" shares). It follows that rules in Subpart 1600 modeled on Rule 13e-3 may be, or become, over-broad; they are justified by reference to going-private transactions that necessarily raise severe conflicts of interest but may themselves apply to transactions that raise no such concerns. Even if de-SPAC transactions currently create the same or similar potential for self-dealing as going-private transactions subject to Rule 13e-3, as the Release claims,[13] I recommend that it more narrowly tailor the class of de-SPACs to which the most onerous rules modeled on Rule 13e-3 apply. Since the definitions in proposed Item 1601 have various purposes, it would be more sensible to narrow the range of de-SPACs to which the most onerous rules apply than to redefine terms in proposed Item 1601.

A respone to this definitional problem would be to ensure that the most onerous rules modeled on Rule 13e-3 apply not to de-SPACs generally but only to those de-SPACs that raise risks of severe conflicts of interest. The most onerous such provisions are proposed Item 1606 (concerning the fairness of de-SPACs and related financing transactions) and proposed Item 1607 (concerning reports, opinions, appraisals and negotiations).

This concern about the breadth of the definition of de-SPACs is all the more serious since Rule 13e-3 does not apply to all going-private transactions. In applying Rule 13e-3, issues arise as to who is an "affiliate" and who is "engaged in" a relevant transaction, creating room for deal planners to structure going-privates to minimize the risk of conflict and avoid the application of Rule 13e-3. According to commentators:

> [T]here are instances in which Rule 13e-3 may be avoided even where management is involved in the [going-private] deal. This may be true, for example, where there are no, or only preliminary or non-binding arrangements

[13] *See supra* notes 5 and 6 and accompanying text.

> with management at the time of signing such that the parties can argue that no seller affiliate was engaged in the transaction at the relevant time.[14]

Notably, because it applies to going-private transactions that raise risks of severe conflict, Rule 13e-3 provides incentives for deal planners to structure transactions to avoid these risks and thereby avoid the application of Rule 13e-3, such as by not compromising the incentives of corporate fiduciaries at the relevant time. If de-SPACs are to be subject to rules largely modeled on Rule 13e-3, on the basis that de-SPACs give rise to the same (or similar) risk of conflict, the Proposed Rules should ensure that only de-SPACs creating similarly severe risks will fall within their ambit. That requires, at a minimum, restricting the de-SPACs to which the most onerous rules modeled on Rule 13e-3 are subject, in particular, Items 1606 and 1607.

D. Cumulative Deterrent Effect of Proposed Rules

The second question is whether the Proposed Rules would subject de-SPACs to heavier regulatory burdens than those applicable to either going-private transactions subject to Rule 13e-3 or traditional IPOs. I suggest they do since, in addition to subjecting de-SPACs to rules modeled on Rule 13e-3, the Proposed Rules would subject the SPAC transaction participants to enhanced Section 11 liability under the Securities Act of 1933. This matters because Section 11, the most potent liability provision in the federal securities regulatory arsenal, strongly deters misconduct by corporate directors, performing a similar function to rules targeting conflicts of interest, including provisions under Rule 13e-3.[15]

The threat of Section 11 liability distinguishes de-SPACs from going-private transactions subject to Rule 13e-3. Transaction participants in going-private transactions subject to Rule 13e-3 rarely face the prospect of Section 11 liability, a fact that underscores the importance of Rule 13e-3 for these transactions. De-SPACs may also face tougher regulation under state corporate law than going-private transactions subject to Rule 13e-3, although courts have had

[14] FRANCI J. BLASSBERG, THE BEST OF THE DEBEVOISE & PLIMPTON PRIVATE EQUITY REPORT 72 (2006).

[15] As to Section 11, see 9 LOUIS LOSS, JOEL SELIGMAN & TROY PAREDES, SECURITIES REGULATION 322-60 (5th ed., 2018).

few opportunities to articulate any differences. In *In Re Multiplan Corp. Stockholders Litigation,*[16] the Delaware Court of Chancery suggests that the conduct of corporate fiduciaries will be assessed under the rigorous entire-fairness standard, whereas corporate fiduciaries' conduct in going-private transactions typically enjoys BJR protection due to the use of cleansing mechanisms, including the use of fully informed and uncoerced votes of disinterested stockholders.[17] It is unclear from *MultiPlan* whether the use of cleansing mechanisms by corporate fiduciaries in de-SPACs will provide BJR protection to corporate fiduciaries. If they do not, Delaware fiduciary law will have greater deterrent effect on transaction participants in de-SPACs than it does on corporate fiduciaries in going-private transactions subject to Rule 13e-3. Even leaving aside state fiduciary law, federal securities law would more strongly deter misconduct, including self-dealing, occurring in de-SPACs than in going-private transactions subject to Rule 13e-3, a result of the application of Section 11 under the Proposed Rules. This heavier regulatory burden on de-SPACs is not justified by analysis in the Release or by other evidence of which I am aware.

In addition to subjecting de-SPACs to stricter regulation than going-private transactions subject to Rule 13e-3, the Proposed Rules would subject them to stricter regulation than traditional IPOs, this despite the SEC's expressed objective to "align more closely the treatment of private operating companies entering the public markets through de-SPAC transactions with that of companies conduct traditional [IPOs]" and "to provide investors with disclosures and liability protections comparable to those that would be present if the private operating company were to conduct a traditional firm commitment [IPO]."[18] Traditional firm commitment IPOs are not subject to the requirements of Rule 13e-3, even though founders and promoters in IPOs have interests in conflict with those of IPO investors.

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[16] No. 2021-0300-LWW, Del. Ch. Ct, Jan. 3, 2022.

[17] Corwin v KKR Holdings LLC, 125 A.3d 304 (Del.2015). *For a more detailed explanation, see* Andrew F. Tuch, *Managing Management Buyouts: A US-UK Comparative Analysis*, in RESEARCH HANDBOOK ON COMPARATIVE CORPORATE GOVERNANCE 477, 483-85, 490 (A. Afsharipour & M. Gelter eds., 2021); Iman Anabtawi, *Predatory Management Buyouts*, 49 U.C. DAVIS L. REV. 1285, 1308 (2016); Matthew D. Cain & Steven M. Davidoff, *Form Over Substance: The Value of Corporate Process and Management Buy-Outs*, 36 DEL. J. CORP. L. 849, 895-97 (2011).

[18] Release, at 66.

For example, in determining the IPO offer price, founders' interests are in tension with those of public IPO investors. It is this conflict of interest that scholars and others point to in justifying gatekeeper liability, including Section 11 liability.[19] Although I regard Section 11 liability as justified in the context of de-SPACs,[20] the imposition of such liability must be accounted for in determining the extent to which de-SPACs are subject to rules modeled on Rule 13e-3.

In short, the Proposed Rules would subject de-SPACs to more onerous regulation than either going-private transactions subject to Rule 13e-3 or traditional IPOs. A way to address this is to apply Items 1606 and 1607 more selectively, to those de-SPACs raising heightened risks of self-dealing by SPAC fiduciaries, or perhaps not to apply these proposed items at all. Reforms should provide transaction participants with incentives to structure de-SPACs to minimize the risk of conflict. Reforms should also account for the threat of liability that transaction participants face under Section 11. For example, proposed Items 1606 and 1607 might be applied only to SPACs that lack cleansing mechanisms such independent boards or board committees to review and approve transactions.

E. Empirical Evidence on the net costs of De-SPACs

The available empirical evidence about de-SPACs has important points of agreement and disagreement. The available evidence does not suggest that de-SPACs have created net collective harm; in fact, even the most critical evidence of de-SPACs reveals the opposite. The evidence is uncertain on whether de-SPACs are more or less expensive *from target companies' perspective* than traditional IPOs. The evidence is also uncertain as to the extent of any benefits that de-SPACs offer target companies over traditional IPOs. If de-SPACs are more expensive for target companies than traditional IPOs, as some scholars claim, we can infer that target companies have nevertheless undertaken these transactions because they offer significant benefits not provided by traditional IPOs. An assessment of the evidence suggests that the Commission should not impose reforms that reveal a regulatory preference

[19] Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 614-21 (1984); Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239, 288–89 (1984); Andrew F. Tuch, *Multiple Gatekeepers*, 96 VA. L. REV. 1583, 1594 (2010).
[20] For reasons developed in detail in Tuch & Seligman, *supra* note 2, 46-54.

for traditional IPOs over de-SPACs, or vice versa, or for rules that would channel private companies intending to "go public" away from one type of transaction to the other. Reforms having this effect lack a clear basis in either the SEC's analysis or scholarly research.

It is not apparent that they weigh the cumulative effect of Section 11 liability and provisions modeled on Rule 13e-3, with the result that they subject de-SPACs to more onerous regulation than either going-private transactions subject to Rule 13e-3 or traditional IPOs. To be sure, unaffiliated security holders need greater protection, but regulators must be careful not to tilt the regulatory balance so firmly against de-SPACs.

A solution is to limit the extent to which provisions modeled on Rule 13e-3 apply to de-SPACs.

For convenience, I refer to a synthesis of the empirical evidence that Professor Joel Seligman and I offer in *The Further Erosion of Investor Protection: Expanded Exemptions, SPAC Mergers and Direct Listings* (omitting references):[21]

> [S]cholarly views diverge on which of the remaining transaction participants [SPACs or target operating companies] bear the high costs of raising funds via a SPAC merger: target shareholders or non-redeeming SPAC, a group that includes retail investors. The answer will depend on the terms of the agreement the merger parties strike and, in particular, whether targets negotiating mergers account for the heavily dilutive effect of founder shares, warrants, and rights, a consequence of which is that SPACs hold less cash per share than their $10 nominal share value suggests. Klausner et al. suggest that, in negotiating with SPACs, targets protect their interest by accounting for SPAC's dilutive structure. Pointing to the substantial price declines SPACs experience after a merger and to their finding of a strong correlation between those declines and the extent of dilution, Klausner et al. infer that "SPAC shareholders bear the costs … embedded in the SPAC structure," although "they extract some [modest] surplus from the deal, so their net losses are partially mitigated." Non-redeeming SPAC shareholders

[21] Tuch & Seligman, *supra* note 2, at 48-54.

"unwittingly subsidize" target companies, with the result that, from a target's perspective, going public via a SPAC "has been cheap—cheaper than an IPO."

The evidence presented by Klausner et al. that SPAC shareholders—rather than target companies—bear the brunt of the expense is equivocal. Considering *immediate* post-merger prices, rather than the longer-term post-merger prices on which Klausner et al. base their inferences, and taking an alternative perspective to valuing IPO costs, Klausner et al. report the opposite result, that "SPACs would seem to be very expensive for target companies." But Klausner et al. are skeptical of this alternative approach, suggesting instead that SPAC post-merger prices may be slow to adjust. Rather than rely on a SPAC's immediate post-merger price, Klausner et al. point to evidence that SPAC prices decline in the weeks and months post-merger, which they interpret as consistent with the view that SPAC investors are bearing the cost of SPAC mergers. Again, however, this interpretation hinges on the view that SPAC prices are not highly informationally efficient but rather adjust slowly, a plausible but contestable claim.

Gahng and coauthors prefer the alternative approach, regarding the costs at the time of merger as falling on target shareholders rather than SPAC shareholders. Gahng and coauthors therefore pose the difficult question of why target companies would engage in SPAC mergers rather than less costly conventional IPOs. Klausner et al. need not answer that question, as they suggest that, *from a target's perspective*, SPAC mergers are cheaper than traditional IPOs, making the appeal of SPACs more obvious, especially considering the higher regulatory burdens traditional IPOs carry. But Klausner et al. must explain why SPAC shareholders would have agreed to bear these costs, a question they cannot answer definitively. Under both interpretations, however, the bottom line is that SPAC mergers have been significantly more costly than traditional IPOs, largely due to their highly dilutive structure. Nonredeeming SPAC shareholders have also fared poorly, with SPAC shares generally declining in price post-merger.

In addition to disputing the relative cost of SPAC mergers and traditional IPOs, scholars contest the extent to which SPAC mergers provide unique benefits. Scholars speculate that SPAC mergers offer advantages for firms with information that is difficult to convey to investors or firms that investors have difficulty valuing. SPAC deals are thought to be speedier to execute, have more certain deal terms, and benefit from sponsors giving advice and certification to private companies. If these benefits exist, they might well explain why so many companies have preferred SPAC mergers when, on Gahng et al.'s view, SPAC mergers are more expensive than traditional IPOs for target companies. However, Klausner et al. doubt whether SPAC mergers are executed more quickly or result in more certain deal terms. They accept that sponsors may provide value in selecting and advising targets and that PIPE investors may certify the transaction and thus aid in price discovery. But Klausner et al. suggest that these benefits are available at less cost by integrating certain features of SPACs into traditional IPOs.

The point, however, is that dispute exists as to the relative costs of SPAC mergers and traditional IPOs and to the existence and size of any benefits SPAC mergers provide. Moreover, even critics of de-SPACs find that during their study period de-SPACs created social value, meaning that these transactions provide, on average, a net collective gain among all parties involved. This suggests that with changed terms, de-SPACs might also be value-increasing for non-redeeming SPAC shareholders, although that would mean lower returns for SPAC sponsors, IPO investors, and underwriters. The evidence therefore fails to establish that traditional IPOs strictly dominate SPAC mergers by providing greater welfare, or vice versa, suggesting that reforms should avoid seeking to channel private companies away from one type of transaction to the other.

Rather than targeting areas requiring reform, the Proposed Rules, in cumulative effect, display a preference for traditional IPOs, an approach unsupported by the available empirical evidence.

F. **Concerns about proposed Item 1606**[22]

Proposed Item 1606 would require SPACs to state whether they reasonably believe the de-SPAC and any related financing transaction are fair or unfair to the SPAC's unaffiliated security holders and to discuss the material factors upon which such belief is based. Although framed as a disclosure provision, the proposed rule requires a SPAC's board to make a reasonable determination as to fairness, a requirement that, if adopted, would likely lead boards to engage financial advisors to provide fairness opinions, to aid in their decision-making. Indeed, numerous commentators have pointed to fairness opinions as a way for a SPAC's board to substantiate the reasonableness of its belief as to a transaction's fairness to unaffiliated security holders.[23]

However, fairness opinions that would be responsive to proposed Item 1606 confront major obstacles. Financial advisors giving these opinions would need to opine on the fairness of a de-SPAC *to unaffiliated security holders*. Such an opinion would be far from routine. As the Commission highlights in the Release, the structure of SPACs dilutes the financial interests of unaffiliated security holders primarily due to the grant of founder shares to sponsors for nominal consideration. By convention, parties to a de-SPAC refer to an "implied" enterprise value based on an assumed $10 price per SPAC share. However, due to dilution, the value that each SPAC share represents at the time of the de-SPAC on a net cash basis is significantly lower than $10.[24] Confirming the importance of net cash per share, econometric research has established that the value of SPAC shares has tended to fall over

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[22] Research underlying these comments in Section F is based on joint work with Harald Halbhuber for a project tentatively titled "Fairness Opinions in SPAC Mergers." Comments are my own.

[23] *See, e.g.*, Sullivan & Cromwell LLP, SEC Proposes Sweeping Changes Regulating SPAC Formation and De-SPAC Transactions, March 31, 2022, at 1 ("[A]lthough the proposed rules would not require a SPAC to obtain a fairness opinion from a financial advisor, a SPAC may seek a fairness opinion to substantiate its "reasonable belief" as to the fairness of the transaction"); Sidley, Expansive New SEC Rule Proposals Seek to Rewrite the SPAC Playbook, April 1, 2022 ("SPACs should particularly note the proposed fairness disclosure requirement and consider whether to obtain fairness opinions for pending and future de-SPAC transactions."); Wachtell, Lipton, Rosen & Katz, SEC Proposes New Rules for SPACs and De-SPAC Transactions, April 1, 2022 (SEC proposed rules "could influence whether SPACs and their boards seek fairness opinions, which are not provided in a majority of de-SPAC transactions currently").

[24] *See* Michael Klausner, et al., *A Sober Look at SPACs*, 39 YALE J. REG. 228 (2021); Minmo Gahng et al., *SPACs* 25, 43 (Working Paper, Jan. 29, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3775847.

the 12 months following a merger toward that lower level.[25] This dilution makes it possible if not inevitable that the interests of unaffiliated SPAC investors will diverge from those of the SPAC.

A de-SPAC may nevertheless be fair to unaffiliated security holders for either or both of two reasons.[26] First, the target shareholders—rather than public SPAC shareholders—may bear the effects of dilution. This is possible, although well-advised target companies are aware that the $10 value a convention. Second, the SPAC merger may promise to create significant value, such as that arising from public company status or from the expertise that sponsors may bring to the post-combination company. This latter reason seems more likely (but still far from certain or even probable) than assuming ignorance or weak bargaining on the part of target companies.

Whether a proposed merger will create enough value to overcome the dilutive effect of typical in SPACs is highly speculative. The greater the dilution, the greater these gains would need to be to make the merger fair to unaffiliated security holders. To give such an opinion, a financial advisor would need to consider first, the extent of dilution inherent in the transaction, a calculation would need to be performed on a contingent basis, since the actual redemption level would not then be known, and second, whether sources of value exist to overcome that deficit from the perspective of unaffiliated security holders.

A study of market practices reveals that financial advisors giving fairness opinions have generally not disclosed analyses that would allow them to opine on the fairness of a de-SPAC to unaffiliated security holders. In de-SPACs, fairness opinions have tended to be given sparingly when a target company is affiliated with a sponsor.[27] In all but a small handful of de-SPACs, these opinions opined on the fairness of a transaction to the SPAC, rather than the transaction's

[25] *Id.*

[26] Michael Klausner, Michael Ohlrogge & Harald Halbhuber, *Net Cash Per Share: The Key to Disclosing SPAC Dilution*, 40 YALE J. REG. BELLTIN 18, 21 (2022).

[27] Jenny Hochenberg & Justin C. Clarke, *SPAC Litigation: Current State and Beyond, 56 The Review of Securities & Commodities Regulation* 33 (2022), https://www.cravath.com/a/web/s1q7XMGjLjQMubcJsjWCFp/3DuuWK/hochenberg_clarke_rscr_final-b.pdf ("Fairness opinions are less common in SPACs, however, except when the target company has some affiliation with the sponsor.").

fairness to unaffiliated security holders. These opinions therefore avoided the issue that proposed Item 1606 would require SPACs to address.

In the 330 de-SPACs completed from January 1, 2019 to June 8, 2022, SPACs obtained fairness opinions from a financial advisor in 40 (or 12.1 percent) of the transactions.[28] I reviewed each of these fairness opinions. In 37 (or 92.5 percent) of these 40 opinions, the opinion stated, without more, that the consideration paid was fair from a financial point of view *to the SPAC*. In two (or 5 percent) of these fairness opinions the financial advisor opined that the transaction was fair *to unaffiliated security holders*. These fairness opinions were given by Scalar Group and Mediabanca.[29] One (or 2.5 percent) of the 40 fairness opinions—given by ThinkEquity LLC—stated simply that the transaction was fair, without stating to whom.[30]

All 40 opinions were provided by small or "boutique" advisors rather than major investment banks. Moelis & Company, Duff & Phelps, and Houlihan Lokey were the most frequent authors of these letters, giving them in 10, 6, and 5 de-SPACs, respectively. Other financial advisors that gave fairness opinions (and the number of de-SPACs for which they did so) were BTIG (1), Cassel Salpeter (2), Craig-Hellum Capital Group (1), Guggenheim Securities (2), Lake Street Capital Markets (1), Mediabanca (1), Northland Capital (1), Northland Securities (1), Primary Capital (1), Rothschild (2), Scalar Group (1), SVB Leerink (1), ThinkEquity LLC (3), and Vantage Point Advisors (1).

Major investment banks advised on many of the de-SPACs for which fairness opinions were given. These included Goldman Sachs, Morgan Stanley, Credit Suisse Securities, Deutsche Bank Securities, Banc of America Securities, and Citigroup Global Markets. But none of these firms provided a fairness opinion.

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[28] This analysis relies on data from Deal Point Data to identify relevant transactions.

[29] The transactions were for acquisition of Ermenegildo Zegna Holditalia S.p.A. by Investindustrial Acquisition Corp, completed on December 17, 2021, for which Mediobanka provided a fairness opinion, and the acquisition of Revelation Biosciences by Petra Acquisition Inc., completed on January 10, 2022, for which Scalar Group provided a fairness opinion.

[30] The transaction was for FG New American Acquisition Corp.'s acquisition of Opportunity Financial, LLC, completed on July 20, 2021.

The financial advisors giving these opinions were generally careful to avoid any interpretation that they were opining as to fairness to SPAC shareholders. Again, all but three of these letters opined only on fairness to the SPAC, an entirely different question since SPAC interests can be expected to diverge from those of unaffiliated security holders. Many of these opinions also stated that they were giving no opinion as to the value of shares to SPAC shareholders or were assuming, for purposes of their analysis, that each SPAC share was valued at $10, an assumption that sidesteps the issue of dilution.

For example, the fairness opinion provided by Moelis in the 2021 merger between Gores Metropoulos II, Inc., a SPAC, and Sonder Holdings Inc, stated that the opinion "does not address the fairness of the [SPAC merger] or any aspect or implication thereof to, or any other consideration of or relating to, the holders of any class of securities, creditors or other constituencies of the [SPAC] or Target."[31] The opinion provided by Houlihan Lokey in the 2021 merger between Auror Innovation, Inc and Reinvent Technology Partners Y assumed a value per share of $10 and expressly disregarded the dilutive impact of founder shares.[32] Of course, the opinions were also careful to avoid lending weight to the projections they used as inputs in their valuation analyses, noting that these projections were supplied by management and had not been independently verified.

Of the 40 fairness opinions given in de-SPACs since 2019, only two opined that the merger transaction was fair to unaffiliated security holders. These were for the merger of Petra Acquisition Inc, a SPAC, and Revelation Biosciences, Inc. and that of Investindustrial Acquisition Corp, a SPAC, and Ermenegildo Zegna Holditalia S.p.A. In another transaction, the merger of FG New American Acquisition Corp. with Opportunity Financial, the financial advisor failed to state from whose perspective the merger consideration was fair, leaving open the

[31] Rule 424(b)(3) prospectus for merger of Gores Metropoulos II, Inc. and Sonder Holdings Inc., dated Dec. 23, 2021, at J-2.

[32] Rule 424(b)(3) prospectus for merger of Aurora Innovation, Inc. and Reinvent Technology Partners Y, dated Oct. 12, 2021, at K-1 ("We… have assumed that the value of each share of Acquiror capital stock … is equal to $10.00 per share (with such $10.00 value being based on Acquiror's initial public offering and Acquiror's approximate cash per outstanding Acquiror Class A Ordinary Share (excluding, *for the avoidance of doubt, the dilutive impact of outstanding Acquiror Class B Ordinary Shares or any warrants to purchase Acquiror Class A Ordinary Shares or Acquiror Class B Ordinary Shares*)) [emphasis added].

possibility, at least based on its concluding statement of opinion, that it was speaking to the perspective of unaffiliated security holders.

Analysis of these opinions underscores concerns about the limits of SPAC fairness opinions in addressing substantive fairness concerns. Despite their concluding opinions, none can reasonably be taken to provide unaffiliated security holders with reassurance about the relevant merger's fairness. This is not to say that appropriate opinions cannot be given; in principle, they can. Rather, opinions given to date would not be responsive to proposed Item 1606.

Consider first the Revelation Biosciences merger, in which Scalar Group provided an opinion that the merger consideration "is fair to [the SPAC] and [the SPAC's] unaffiliated stockholders from a financial point of view."[33] The letter demonstrates no explicit basis for this opinion. The letter compares the target company with selected comparable public companies in the biotech and pharmaceutical industries, allegedly chosen for the similarity of their operations to those of the target. The opinion applies numerous adjustments to determine "a range of selected implied equity values" for the target of $43 million to $126 million, which "compares to the equity consideration of $106 million to be issued to [the target's] shareholders per the Business Combination Agreement." Next, the financial advisor reviews de-SPACs and IPOs involving certain selected healthcare companies, listing their transaction prices and providing summary statistics. Based on this analysis, the fairness opinion concludes that the merger consideration is fair to the SPAC and its public stockholders from a financial point of view.

What is missing is any analysis of the dilution caused by the founder shares, etc. The disclosed opinion fails to consider whether unaffiliated security holders bore the effects of this dilution, as we would expect if the target bargained hard, aware of the dilution inherent in the conventional de-SPAC structure. And the opinion is devoid of any consideration of the possibility of uplift coming from public company status or the sponsor's ongoing role in advising the target. The opinion thus provides no apparent basis for its conclusion regarding fairness to

[33] Rule 424(b)(3) prospectus for merger of Revelation Biosciences and Petra Acquisition, dated Dec. 16, 2021, at 111.

unaffiliated security holders. Rather, its valuation analyses broadly mirror those of fairness opinions that expressed no opinion regarding fairness to unaffiliated security holders.

Consider next the de-SPAC between Ermenegildo Zegna Holditalia and Investindustrial Acquisition Corp. Financial advisor Mediobanca opines that the merger consideration is "fair, from a financial point of view, to the holders of the ordinary shares of [the SPAC]."[34] This letter also fails to disclose any firm basis for such an opinion. First, the financial advisor "assumed that the value of each Ordinary Share is equal to $10.00 per share," sidestepping the core issue of a lack of a market price for the SPAC stock, stripping the opinion of meaning. Second, as with the Revelation de-SPAC, the valuation analyses fail to speak to the fairness or otherwise of the merger consideration to unaffiliated security holders. Again, what is missing is any analysis of the dilution caused by the founder shares, etc., or where these costs fall.

Neither of these opinions provides real comfort that the relevant transactions were fair from a financial point of view to unaffiliated security holders—despite their concluding statements.

In the merger of SPAC FG New American Acquisition Corp. with Opportunity Financial, ThinkEquity opined that the merger consideration paid by the SPAC "is fair from a financial point of view," without saying to whom.[35] This opinion, and the accompanying proxy statement disclosures, disclose scant valuation analyses. Nothing in them assesses the value of SPAC shares in the merger to unaffiliated security holders, and so this opinion, too, could not reasonably receive much weight in demonstrating fairness to unaffiliated security holders.[36] Moreover, the letter does disclose conflicts; this is a rare deal in which the financial advisor also served as an underwriter in the SPAC IPO and in connection with the IPO, received both common stock and warrants in the SPAC that would be worthless if no merger occurred within

[34] Rule 424(b)(3) prospectus for merger of Investindustrial Acquisition Corp and Ermenegildo Zegna Holditalia S.p.A, dated Nov. 29, 2021, at 145.

[35] Proxy Statement pursuant to Section 14(a) for merger of Opportunity Financial and New America Acquisition Corp, dated June 22, 2021, at K-3.

[36] The opinion employs the comparable companies approach and the DCF approach without considering the implications for unaffiliated security holders.

the defined investment window.[37] This conflict undermines the force of the letter's expressed opinion. Despite the apparent breadth of its conclusion, this opinion fails to address the issue of substantive fairness to unaffiliated security holders.

In short, only three of the fairness opinions given in de-SPACs since January 1, 2019 state an opinion that, on its face, even addresses fairness to unaffiliated security holders. On deeper inspection, none of these opinion letters can reasonably be regarded as addressing substantive fairness concerns for unaffiliated security holders. These fairness opinions lack convincing analysis and include statements undermining the force of their concluding opinions. None were provided by a major investment bank, even though these banks advised SPACs on many of the deals.

In view of this evidence, I make two recommendations. First, and most importantly, any fairness opinions provided in de-SPACs must be required to clearly state that they study fairness from the perspective of unaffiliated security holders. Opinions should grapple with the dilutive effects of the transaction. To buttress the required board opinion, fairness opinions might therefore state the net cash per share at the time of the de-SPAC and precisely why the financial advisor considers the de-SPAC fair to unaffiliated security holders. Opinions should not assume a SPAC value of $10 per share for purposes of their analysis. Without such analysis, a bald statement as to fairness, even such a statement speaking to the position of unaffiliated security holders, lacks credibility and should not be regarded as allowing SPAC boards to satisfy their obligation under proposed Item 1606.

Second, consistent with my arguments above, proposed Item 1606 should be reserved for those de-SPACs in which conflict concerns are the most serious. Opinions addressing fairness to unaffiliated security holders are tough to give. Whether financial advisors will be willing to give them is doubtful; to date, no major investment bank has done so, and the small handful of opinions that appear to address the issue would seem to lack supporting analysis. For de-SPACs that have already adopted effective measures to mitigate severe conflicts, imposing proposed Item 1606 would be unduly burdensome.

[37] *Id*. at at K-2.

II. Aligning de-SPAC Transactions with Initial Public Offerings

A. A Need for Increased Deterrence Force

Absent the Proposed Rules, Section 11 provides a significantly weaker deterrent force in de-SPACs than traditional IPOs.[38] Proposed Rules designed to buttress the deterrent force of Section 11 in de-SPACs are generally well-tailored. First, the Proposed Reforms would help prevent disparities in regulation for transactions that vary in legal structure but not in economic substance. Second, Proposed Rules regarding underwriter liability are justified and, more specifically, the justification for underwriter liability for de-SPACs is as strong as it is for traditional IPOs. I touch on the reasons here, which are spelled out in more detail in the attached article.

B. Accounting for Differences in de-SPAC Transaction Structure

First, as Joel Seligman and I argue in *The Further Erosion of Investor Protection*, the liability risk of transaction participants depends on a de-SPAC's legal structure. Various structures exist for de-SPACs, including a conventional or "SPAC-on-top" structure, a "target-on-top" structure, and a double-dummy structure.[39] Relevantly, these structures differ according to whether the transaction involves a registered offering and for those that do involve a registered offering, whether the party that registers the securities offered is the SPAC, the target, or another entity. Variations exist along other dimensions too. For reasons we explain, the upshot is that reforms need to account for variations in legal structure to assure that structures equivalent in economic substance are treated equivalently.

i. Private Operating Company as Co-Registrant to Form S-4 and Form F-4

Proposed reforms to Forms S-4 and F-4, making target operating companies co-registrants with SPACs, goes some way toward ensuring equivalence in treatment. These reforms have implications for the conventional SPAC-on-top structure, in which the SPAC or a subsidiary of the SPAC issues securities in a proposed offering and itself becomes the

[38] *See* Tuch & Seligman, *supra* note 2, at 26-46; Klausner et al., *supra* note 24, at 285-87.

[39] *See* Tuch & Seligman, *supra* note 2, at 29-31.

registrant. By making target companies co-registrants, the Proposed Rules ensure that target operating companies and their directors and officers have strong incentives under Section 11 to deter disclosure errors and other misconduct, even in conventionally-structured de-SPACs. To be sure, these proposed reforms making target operating companies co-registrants would subject both SPACs and target operating companies to strict liability, increasing the range of potential defendants under Section 11 relative to traditional IPOs (in which there is a single registrant). While this risks over-deterring misconduct in de-SPACs, the proposed reforms limit liability to those parties that have the capacity to actively deter disclosure wrongs, making the proposed regime closely analogous to that for traditional IPOs. SPACs and target operating companies, and their respective directors and officers, are aware of the accuracy and completeness of the disclosures required in a de-SPAC or at least have such control over disclosure in a registration statement that they can help ensure the statement's accuracy and completeness.

ii. Deeming business combination of shell company to involve a "sale"

Proposed Rule 145a would deem any business combination of a reporting shell company involving another entity that is not a shell company to involve a "sale" of securities to the reporting shell company's shareholders. This reform would also help prevent certain disparities in regulation for transactions that vary in legal structure but not in economic substance, ensuring that unaffiliated security holders enjoy the protections that come from investing in a registered offering.[40]

Any reform that goes further by also making sponsors an enumerated defendant under Section 11, such as by requiring the sponsor to sign a Form S-4 or Form F-4 filed in connection with a de-SPAC, as Request for Comment #68 suggests, would be going too far, tilting the regulatory balance against de-SPACs and in favor of alternative transactions including traditional IPOs. As it is, sponsors may find themselves liable under Section 11 as control persons (or liable under Section 12(a)). Under the Proposed Rules, for de-SPACs the strict liability net under Section 11 is cast wider than it is for traditional IPOs since it would

[40] For further discussion, see Harald Halbhuber, *An Economic Substance Approach to SPAC Regulation*, 40 YALE J. ON REG. BULLETIN 44 (2022).

encompass targets. Making SPAC sponsors signatories of registration statements may counteract incentives created by proposed Subpart 1600, which may lead sponsors to relinquish some control over de-SPACs, such as by making SPAC boards are more willing to promote the interests of unaffiliated SPAC investors.

C. Underwriter Status and Liability under Section 11

I broadly agree with the Proposed Rules intended to enhance Section 11 liability for underwriters. While the Proposed Rules go further than simply clarifying the law, I suggest that they are justified to the extent they would regard SPAC IPO underwriters as underwriters of de-SPACs. The case justifying Section 11 underwriter liability needs to be carefully made. Rather than simply establishing in an absolute sense that an increased risk of Section 11 liability for transaction participants in de-SPACs is justified, the SEC can better make the case by reference to traditional IPOs. In *The Further Erosion of Investor Protection: Expanded Exemptions, SPAC Mergers and Direct Listings*, Professor Joel Seligman and I give the following reasons for enhancing Section 11 liability in de-SPACs, focusing on underwriter liability in particular (omitting references):

> First, we contend that the benefits of underwriter liability are at least as great for SPAC mergers as they are for traditional IPOs. Both SPAC mergers and traditional IPOs introduce largely unknown and untested companies to public markets, and in such settings, information asymmetries between investors and companies seeking capital are likely to be substantial. In both transactions, information comes from the companies themselves, parties with incentives "to act opportunistically by misrepresenting the accuracy … of the information." After all, traditional IPOs and SPACs represent companies' best shot at capitalizing on their innovations, so firms face pressure to attract funds on the most favorable terms. These environments of high information asymmetries are precisely the ones in which the investor protections of federal securities law "are typically most needed." If anything, the benefits of underwriter liability may be greater in the SPAC setting because SPAC sponsors and SPAC IPO underwriters have incentives misaligned with those of SPAC

> investors, which magnifies the risk of disclosure error.
>
> Second, the costs of underwriter liability are no greater for SPAC mergers than they are for traditional IPOs. In both settings, investment banks have roles that allow them to perform due diligence. These firms have developed time-tested methods for assuring the accuracy of registration statements and other disclosures, methods that would seem equally applicable in both settings. Indeed, some legal advisors have advised participants to consider performing IPO-style due diligence in SPAC mergers without regarding cost as a barrier to banks.
>
> Assuming the accuracy of these claims regarding costs and benefits, the case for underwriter liability is as strong for SPAC mergers as it is for traditional IPOs. On this reasoning, underwriter liability would generate benefits for SPAC mergers at least as great as those accrued to traditional IPOs, without imposing additional costs. If Section 11 underwriter liability is justified for traditional IPOs, the same is true for SPAC mergers.

Professor Seligman and I also argue that Section 11 underwriter liability is indeed justified for traditional IPOs.[41]

The Proposed Rules are right to enhance the prospect of Section 11 underwriter liability in de-SPACs, although the discussion in the Release creates unnecessary ambiguity. The Release suggests that a range of actors *other than SPAC IPO underwriters* may be liable as statutory underwriters without specifying when this would occur. In doing so, the Release may cast doubt on the longstanding understanding that financial advisors in mergers and acquisitions (M&A advisors) are not statutory underwriters,[42] without explaining when these advisors would be statutory underwriters or what implications exist for the role of M&A advisors in M&A transactions other than de-SPACs.

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[41] Tuch & Seligman, *supra* note 2, at 12-16, 26-38, 46-48.

[42] As to the regulation of M&A advisors, see Andrew F. Tuch, *M&A Advisor Misconduct: A Wrong Without a Remedy?* 45 DEL. J. CORP. L. 177 (2021).

A risk with the Commission's approach is that SPAC IPO underwriters would now have powerful incentives to cease advising SPACs they have taken public that have yet to undertake de-SPACs. Some investment banks are already considering taking this approach, according to reports.[43]

A preferable regulatory approach may be to treat a SPAC IPO and de-SPAC transaction as integrated by deeming SPAC IPO underwriters to be statutory underwriters for purposes of any associated de-SPAC. This would ensure that de-SPACs have the benefit of underwriter-level due diligence.

In *The Further Erosion of Investor Protection: Expanded Exemptions, SPAC Mergers and Direct Listings*, Professor Joel Seligman and I suggest an alternative:

> We recommend that a SPAC's IPO underwriters bear liability under Section 11 for any misstatements or omissions in registration statements used in connection with a SPAC merger. This could be achieved by viewing a SPAC IPO and its associated SPAC merger as one integrated transaction. The purpose would be to treat underwriters of the SPAC IPO as underwriters of the SPAC merger under Section 11. These investment banks may be formally retained by the SPAC as M&A advisors and in any event, often advise on or otherwise facilitate the SPAC merger—having incentives to do so because of their deferred compensation. If these investment banks were to face suit, they would benefit from the due diligence defense under Section 11. In practice, such liability would likely result in an underwriter undertaking due diligence to avoid liability, including seeking negative assurance and comfort letters from the SPAC's counsel and auditors, respectively, attesting to the accuracy of the relevant registration statement. These heightened standards would apply to SPAC mergers only, a distinguishable class of merger in which special investor risks arise, rather than to mergers generally.

[43] Goldman Is Pulling Out of Most SPACs Over Threat of Liability, Bloomberg, May 9, 2022, https://news.bloomberglaw.com/capital-markets/goldman-is-pulling-out-of-most-spacs-over-threat-of-liability ("Goldman Sachs Group Inc. is pulling out of working with most SPACs it took public, spooked by new liability guidelines from regulators").

These proposed standards would also align due diligence standards with those of traditional IPOs, buttressing investor protections.

However, if SPAC IPO underwriters are to be statutory underwriters for de-SPACs, the Commission might consider giving these parties control over whether a de-SPAC proceeds. In traditional IPOs, underwriters are true gatekeepers in the sense that they can prevent a transaction from proceeding if they are, for example, dissatisfied with the content of the registration statement; underwriters can then simply refuse to underwrite the offering, giving them powerful sway over an issuer impatient to execute a transaction. The same is true of auditors, which must give an opinion before an IPO can proceed. In de-SPACs, it is not apparent that SPAC IPO underwriters have a similar "gate" to "keep" during a de-SPAC, even if they are serving as M&A advisors in the transaction. It may be that transaction participants can proceed with a de-SPAC over the objections of the SPAC IPO underwriters and M&A advisors. If the Commission intends to make SPAC IPO underwriters liable as statutory underwriters, it might consider allowing these actors to dissociate themselves from a transaction, such as by making a statement to that effect. This mechanism would give SPAC IPO underwriters and other potential statutory underwriters influence consistent with that of conventional underwriters in a traditional IPO, giving SPACs and targets strong incentives not to proceed with a de-SPAC if the statutory underwriter has concerns about the registration statement's accuracy or completeness.

In Request for Comment #85, the Release raises the issue of "tracing." In *The Further Erosion of Investor Protection*, Professor Seligman and I do not regard tracing with as much concern as other commentators do.[44]

Finally, the Commission's approach toward underwriter liability in the setting of direct listings is worth considering. In permitting direct floor listings, the Commission rejected concerns about the inadequacy of underwriter liability, stating that "the financial advisors to issuers in Primary Direct Floor Listings have incentives to engage in robust due diligence, given their reputational interests and potential liability, including as statutory underwriters

[44] Tuch & Seligman, *supra* note 2, at 29-31.

under the broad definition of that term."[45] Although the Commission might consider engaging in more rulemaking for direct listings, its emphasis in the Release is consistent with its approach toward primary direct floor listings of insisting on the importance of statutory underwriter liability in deterring wrongs in IPO-equivalent transactions.

D. PSLRA Safe Harbor

I support the Proposed Rules intended to limit the application of the PSLRA safe harbor to de-SPACs. Just as the legal structure of de-SPACs determines the threat of liability to transaction participants, it also determines the application of the PSLRA safe harbor. Recall that there are at least three main transactional forms for de-SPACs.[46] In the target-on-top and double-dummy structures, a private target and a newly formed holding company make *initial* offerings of securities to the public during a de-SPAC. These structures contrast with the conventional structure whereby an issuer of securities in the de-SPAC (the SPAC) has already undertaken an initial offering of securities. The argument that de-SPACs are not "initial public offerings" within the PSLRA exclusions is more plausible for transactions that do not adopt the conventional structure. In interviews undertaken in writing the *Further Erosion of Investor Protection: Expanded Exemptions, SPAC Mergers, and Direct Listings*, practitioners were candid that many de-SPACs do not rely on PSLRA safe harbors for forward-looking statements.[47] Nevertheless, SPACs have routinely made use of forward-looking statements in de-SPACs, without apparent regard for how they are structured. This practice suggests that the availability of the PSLRA safe harbor may *not* be a significant factor in determining the use of forward-looking statements in de-SPACs; at a minimum, it suggests that the PSLRA safe harbor is not necessarily regarded by transaction participants as essential protection in de-SPACs. If that is right, it overstates the case to argue that the Proposed Rules would put SPACs between a rock and a hard place, depriving SPACs of protections for statements that state law requires them to disclose. At a minimum, the

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[45] Securities Exchange Act Release No. 90,768, at 33.

[46] *See supra* note 39 and accompanying text.

[47] *See* Tuch & Seligman, *supra* note 2, at 46-47.

Commission needs to understand why transaction participants have willingly disclosed projections in circumstances when the safe harbor is generally understood not to be available.

Relatedly, I agree that de-SPACs should not be regarded as "initial public offerings" for purposes of the PSLRA (see Request for Comment #77). That is a strained interpretation of the term "initial public offering." For example, a de-SPAC might involve an offer and sale of the SPAC's securities to holders of the target company's securities in consideration of their interests in the target company. In this case, the offer and sale to target shareholders may not be regarded accurately as the SPAC's *initial* public offering. While there may be other reasons why de-SPACs should not be regarded as initial public offerings for purposes of the PSLRA, this reason should be enough because it shows that regarding de-SPACs as IPOs for purposes of the PSLRA may well produce disparities in the treatment of de-SPACs based on the legal structure participants use—a result inconsistent with a motivating principle of the Proposed Rules.

* * *

Thank you for the opportunity to comment on the Release. I would be pleased to discuss these comments further.

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[submission version with emendation]