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SPECIAL PURPOSE ACQUISITION COMPANIES: SPAC AND SPAN, OR BLANK CHECK REDUX?

I. INTRODUCTION

In September 2005, three former Apple Computer executives launched a new high-tech venture called Acquicor Technology (Acquicor). Acquicor raised $172.5 million in its March 2006 IPO on the American Stock Exchange. Although the amount Acquicor raised in its initial offering was unremarkable for a high-tech company with a prominent management team, Acquicor was anything but a typical high-tech venture. At the time of its IPO, Acquicor had minimal earnings and assets, no employees, and no business operations. Acquicor did not even have a business plan other than to “acquir[e] . . . one or more operating businesses.” While these traits would mean certain failure for a traditional startup company, Acquicor’s successful offering is an archetype of an increasingly popular investment vehicle: the Special Purpose Acquisition Company (SPAC).
SPACs are direct descendants of the corrupt blank check companies that plagued the securities markets in the 1980s. The SEC defines a blank check company as “a development stage company that has no specific business plan or purpose or has indicated its business plan is to engage in a merger or acquisition with an unidentified company or companies, other entity, or person.” Blank check companies were common instruments of fraud in the 1980s, particularly in the penny stock market. In an effort to protect investors and restore investor confidence, Congress in 1990 directed the SEC to enact regulations imposing strict disclosure and management requirements on blank check companies. Blank check companies” (TACs). Sarah Hewitt, Specified Purpose Acquisition Companies, 1 BLOOMBERG CORP. L.J. 97 (2006), available at http://www.thelen.com/resources/documents/06_BCLJ.pdf.


7. SEC, Blank Check Company, http://www.sec.gov/answers/blankcheck.htm (last visited Nov. 10, 2007). A development stage company is one that is “devoting substantially all of its efforts to establishing a new business and either of the following conditions exists: (1) Planned principal operations have not commenced. (2) Planned principal operations have commenced, but there has been no significant revenue therefrom.” Definitions of Terms Used in Regulation S-X, 17 C.F.R. § 210.1-02(h) (2007). The statutory definition of a blank check company for the purposes of this Note also requires that the company “[i]s issuing ‘penny stock’ as defined in Rule 3a51-1.” Offerings by Blank Check Companies, 17 C.F.R. § 230.419(a)(2)(ii) (2006); see infra notes 65, 68 (discussing the impact of the statutory definition of penny stock on the applicability of existing SEC regulations to SPACs).

8. H.R. REP. NO. 101-617, at 11 (1990), as reprinted in 1990 U.S.C.C.A.N. 1408, 1413. Penny stocks are “low-priced, highly speculative stocks generally sold in the over-the-counter (OTC) market and generally not listed on an exchange.” Id. at 8, as reprinted in 1990 U.S.C.C.A.N. 1408, 1410. In a general sense, the schemes in question involved the artificial inflation of the price of a penny stock. So inflating the price allowed multiple parties to benefit: brokers were able to charge excessive mark-ups; insiders were able to sell their stock at inflated prices (commonly known as a pump-and-dump scam); and penny stock promoters were able to direct IPO proceeds to themselves. Telemarketing Fraud: Hearing Before the Subcomm. on the Consumer of the S. Comm. on Commerce, Science, and Transportation, 101st Cong. 25 (1989) [hereinafter Telemarketing Fraud Hearing] (statement of Joseph I. Goldstein, Associate Director, Division of Enforcement, SEC). The victims of penny stock fraud were the individual investors who purchased stock at inflated prices. Once the price deflated, these investors were left with worthless shares. Id. at 27.

companies all but disappeared following the enactment of these
regulations,\textsuperscript{10} but have recently rematerialized in the form of SPACs.

Like the blank check companies of the 1980s, SPACs have no
operating history, assets, revenue, or operations, and are designed to raise
capital in the public equity markets.\textsuperscript{11} Unlike the fraudulent offerings of
the 1980s, however, SPACs are exempt from the controls Congress
imposed on blank check offerings and are therefore no more regulated
than traditional public offerings.\textsuperscript{12} The reemergence of an investment
vehicle branded by regulators as “per se . . . fraudulent”\textsuperscript{13} calls for a
reexamination of blank check companies and relevant securities
regulation, and an inquiry into whether there is a need for further
regulation. Such an examination is timely because of the recent dramatic
growth in the SPAC market.\textsuperscript{14}

This Note analyzes SPACs in a historical and regulatory framework.
First, Part II examines the blank check offerings that were common in the
penny stock market in the 1980s, discussing the pervasive fraud relating to
penny stock securities, the abuse of blank check offerings, and the
regulatory response to such fraud and abuse. Next, Part III compares these
blank check offerings with SPACs, and evaluates the potential benefits
and dangers presented by an investment in a SPAC. Part IV argues that,

\textsuperscript{10} DAVID N. FELDMAN, REVERSE Mergers: TAKING A COMPANY PUBLIC WITHOUT AN IPO 45
(2006); see also Gerald V. Niesar & David M. Niebauer, The Small Public Company After the Penny
been adopted, it is difficult to comprehend why anyone, even the most aggressive promoter, would
attempt a blind pool penny stock offering.”). For a discussion of managers’ responses to these new
regulations, see infra Part II.B.1.

amorphous offerings present “an equity structure that George Costanza would love: the IPO about
nothing.” Id.

\textsuperscript{12} See infra notes 86–90 and accompanying text.

\textsuperscript{13} N. Am. Sec. Adm’rs Ass’n, Resolution of the North American Securities
Administrators Association Declaring Blank Check Blind Pool Offerings to Be
Fraudulent Practices, NASAA Reports (CCH) ¶ 7032 (Apr. 29, 1989). In 1989, the membership
of the North American Securities Administrators Association resolved that
“blank check” blind pool offerings are inherently defective because of a failure to disclose
material facts concerning the offering and issuer, and such offerings have been the subject of
pervasive, recurrent abusive and fraudulent practices in the sale of securities, including but
not limited to manipulation of the price of such securities, sale of securities at prices not
reasonably related to the fair market value of such securities, and fraudulent representations
concerning the business plans and purposes of the issuers.

\textsuperscript{14} See infra Part II.B.3.
despite the apparent similarities between SPACs and the blank check offerings regulated against by the SEC, the SEC was correct in instituting a narrow regulatory scheme by limiting the statutory definition of a blank check company.

II. BACKGROUND

A. History of Blank Check Offerings

1. Fraudulent Offerings in the Penny Stock Market

The 1980s were a decade of massive growth in the securities markets. According to a 1990 Senate report, “[b]etween 1980 and 1989, the number of securities firms increased approximately 90 percent, the number of investment companies grew more than 145 percent, the number of investment advisers more than tripled, the number of registration statements filed annually with the SEC doubled, and the number of tender offer filings increased over 670 percent.” The 1980s also saw a substantial increase in the magnitude and frequency of fraud and corruption in the securities markets. By 1989, claims of securities fraud increased by more than 260 percent from the beginning of the decade. Individual investors suffered billions of dollars in losses due to illegal and unscrupulous securities trading practices, particularly in the penny stock market. While securities fraud grew, the SEC’s power of enforcement


16. Id.

17. Id. Among significant instances of deception and crime in the 1980s were the biggest insider trading scandals in history, widespread incidences of fraudulent financial reporting by financial institutions and other corporations, illegal activity in connection with tender offers, billions of dollars of losses to small investors as a result of illegal activity in the “penny stock” market, market manipulation and other illegal trading activity, and fraudulent and misleading disclosures in the sale of securities.

18. Id. Claims of fraud in the penny stock markets accounted for a disproportionately large percentage of all fraud claims during this period. While penny stock brokers accounted for less than five percent of all registered broker-dealers in the country, claims of fraud in the penny stock market constituted twenty-two percent of all complaints received by the SEC in 1989. H.R. Rep. No. 101-617, at 10 (1990), as reprinted in 1990 U.S.C.C.A.N. 1408, 1412. 

19. S. Rep. No. 101-337, at 2. The increased manipulation of the penny stock market in the 1980s has been linked to two developments: (1) brokerage firms shifted from dealing solely with the initial offerings of penny stocks to also trading the penny stocks on the secondary market, and (2) marketing securities to potential customers became less onerous as communication technology, such as long distance telephone calling, the computer, and the telefax, became less expensive and more accessible to brokerage firms. H.R. Rep. No. 101-617, at 9–10, as reprinted in 1990 U.S.C.C.A.N.
and review did not, resulting in an impotent agency that was “horribly
overmatched by the bad guys in the marketplace.”

By the end of the 1980s, fraud and abuse in the penny stock market had
reached “epidemic proportions.” In 1989, the North American Securities
Administrators Association (NASAA) concluded that “[p]enny stock
swindles [were] . . . the No. 1 threat of fraud and abuse facing small
investors in the United States.” Abuse in the penny stock market was
facilitated by a shortage of reliable information regarding penny stocks,
without which investors could not make informed investment decisions.
Additionally, an extraordinary number of participants in the penny stock
market had a history of criminal securities offenses. These factors,

1408, 1411.

20. Bruce Ingersoll, Inundated Agency: Busy SEC Must Let Many Cases, Filings Go

21. Telemarketing Fraud Hearing, supra note 8, at 2 (statement of Sen. Richard Bryan, Member,
S. Comm. on Commerce, Science, and Transportation). The prevalence of fraud in the penny stock
market is demonstrated by the proportion of complaints received by the SEC regarding penny stock
firms. In the first half of 1988, thirty-four percent of all complaints received by the SEC regarded
penny stock firms, while these firms constituted less than five percent of all registered broker-dealers.
Id. at 27–28 (statement of Joseph I. Goldstein, Associate Director, Division of Enforcement, SEC).

22. H.R. REP. NO. 101-617, at 8, as reprinted in 1990 U.S.C.C.A.N. 1408, 1410; see also
NASAA REPORT, supra note 6, at 1, reprinted in Penny Stock Hearings, supra note 6, at 150. Despite
the large amount of fraud that was committed in the penny stock market, securities regulators
recognized that penny stock offerings were not per se fraudulent. As Frank Birgfeld of the NASD
remarked, “I cannot tell you that a penny stock by itself is per se wrong. You can take a pie and you
cut it in fourths, eighths or sixteenths, you still got a pie. But you have to be deaf, dumb, blind and
terminally naive to think that there are not big problems in this area.” Penny Stock Hearings, supra
note 6, at 82–83 (statement of Frank Birgfeld, Director, District III of the National Association of
Securities Dealers).

of information” included even the most fundamental and essential particulars, such as the market price
of the stock in question. Id. at 20, as reprinted in U.S.C.C.A.N. 1408, 1422. Penny stocks were often
listed on the “pink sheets,” which were “in effect a telephone directory circulated among brokers,
specifying who makes a market in a particular security, and, if the market maker wishes, recent price
quotations for the individual security.” Id. The only requirement for an issuer to list a security on the
pink sheets was that it pay the $120 monthly listing fee. Id. This lack of basic, reliable information
made investing in penny stocks analogous to “stumbling down a dark alley in a crime-ridden inner-
city.” NASAA REPORT, supra note 6, at 6, reprinted in Penny Stock Hearings, supra note 6, at 155.

24. H.R. REP. NO. 101-617, at 10, as reprinted in 1990 U.S.C.C.A.N. 1408, 1412. These individuals included “repeat offenders of state or federal securities laws, other convicted felons, and
persons having strong ties to organized crime.” Id.; see also Penny Stock Hearings, supra note 6, at 2
(statement of Ron Wyden, Member, H. Subcomm. on Energy and Commerce) (acknowledging a
Congressional Research Service Report stating that convicted securities offenders who have been
barred by the SEC from employment in the securities industry frequently work as so-called
independent “consultants” to penny stock firms). As might be expected due to the market participation
of individuals with ties to organized crime, many penny stock schemes provided financing to
organized crime. Id. at 101–122 (statement of Lorenzo Formato, convicted former broker and
participant in the Federal Witness Protection Program); see also Richard L. Stern & Claire Poole,
"Like a Slaughterhouse for Hogs," FORBES, Dec. 25, 1989, at 42 (discussing Formato’s testimony and
coupled with the loose regulatory scheme governing the penny stock market, allowed for a market that fostered, if not encouraged, the emergence of unorthodox and unscrupulous investment vehicles such as blank check offerings.

Blank check offerings became increasingly prevalent as the decade progressed. By 1990, twenty percent of all new registration statements were filed by blank check companies. The typical fraudulent blank check offering of penny stock involved the manipulation of the market price of a small-cap company’s securities primarily for the benefit of the stock’s promoters. In 1988 the SEC formally recognized blank check offerings as a tool for conducting fraud and deception in the penny stock market and formed a task force to oversee more aggressive enforcement activity.
historic cooperation between Congress, the SEC, the NASAA, the National Association of Securities Dealers (NASD), and various state securities regulators animated efforts to introduce corrective legislation. Congress finally took concrete action to prevent further manipulation of blank check offerings by passing the landmark Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (Penny Stock Reform Act).

2. A Paradigmatic Example of Fraud: Onnix Financial

A notable example of the fraudulent use of blank check offerings is the creation of Onnix Financial Group, Inc. (Onnix) and the trading of its securities. Onnix exemplifies the blatant disregard of securities laws and audacious schemes that were prevalent in the penny stock market during the 1980s. Onnix is a particularly poignant example because of both the large number of investors who were affected and the international reach of the fraud.

Between 1984 and 1987, entrepreneurs Arnold “Charlie” Kimmes and Michael Wright formed over seventy blank check companies whose securities traded on the penny stock market. One such venture was Onnix Financial. The initial public offering of Onnix stock was for 1,250,000 units priced at twenty cents apiece, with each unit consisting of ten shares.


32. Niesar & Niebauer, supra note 10, at 244–45. For testimony of representatives from each of these groups, see Penny Stock Hearings (Part 2), supra note 13; Penny Stock Hearings, supra note 6, and Telemarketing Fraud Hearing, supra note 8.


35. Goldstein, Ramshaw & Ackerson, supra note 34, at 791. Kimmes oversaw millions of shares of securities and the proceeds from the sale of those securities. He was responsible for moving the securities between numerous trading accounts and eventually laundering the sales proceeds through Swiss banks. Wright oversaw the daily affairs of the blank check companies. This responsibility included the creation of the companies and the requisite filing of disclosures and regulatory forms, which were prepared by a team of lawyers and accountants whom Wright supervised. Id.

36. Id.
of common stock and forty warrants. All of Onnix’s IPO units were promptly sold to investors throughout the United States and in six foreign countries. By all accounts, the Onnix IPO appeared to have been a complete success.

However, a spate of suspicious activity involving Onnix soon caught the attention of federal regulators. In the summer of 1986, Onnix declared a two-for-one stock split resulting in twenty-five million shares outstanding and 100 million warrants. In January 1987, with no apparent explanation, the holders of Onnix IPO units exercised all of their warrants and sold their shares to a single institutional investor: Blinder, Robinson & Company, a broker-dealer headquartered in Denver. Blinder, Robinson in turn sold the shares to its retail customers.

In the course of the SEC’s two-and-a-half year investigation of this unusual behavior, it discovered that the officers, directors, and shareholders of Onnix were all nominees of Kimmes and Wright. Additionally, most, if not all, of the IPO purchasers were agents of Kimmes and Wright who purchased units with Kimmes-Wright funds.

37. Id. A warrant gives the holder the right to purchase one or more shares of common stock from the issuer at a set price. Id. at 783.

38. Id. at 791–92.

39. At this point, Onnix was still a blank check company with no business operations. Onnix had not made any announcements indicating that it was planning on engaging in a merger or making an acquisition in the near future. Any significant amount of activity in a blank check company at this stage would be viewed as suspicious. Joseph I. Goldstein, Paul D. Ramshaw & Laura A. Novack, An Overview of Market Manipulation: Legal and Practical Aspects, C522 A.L.I.-A.B.A. 41, 86 (1990).

40. Goldstein, Ramshaw & Ackerson, supra note 34, at 792.


42. Goldstein, Ramshaw & Ackerson, supra note 34, at 793.

43. Id. at 792.

44. Id. Kimmes and Wright recruited nominee investors and, like their nominee officers, paid them for the use of their identities. While Kimmes and Wright provided the funding behind these “investors’” purchases of Onnix units, they also created a fraudulent paper trail so that the transactions would appear legitimate to regulators. Sometimes the nominee investors would purchase the units with personal checks or cashiers’ checks and later be reimbursed. Other times Kimmes and Wright would purchase cashiers’ checks in the nominee investors’ names without their knowledge or consent. After the units were purchased, Kimmes and Wright had the nominee investors execute blank stock powers, or they forged the investors’ signatures. The executed stock powers rendered the stock certificates contained in the nominee accounts negotiable as bearer instruments. The certificates were then delivered not to the nominee investors, but to Kimmes and Wright. Id. at 792 & n.78. All currency transactions relating to the purchase of the Onnix stock were structured in amounts of less than
These purchasers subsequently deposited the units into accounts controlled by Kimmes and Wright.\footnote{Goldstein, Ramshaw & Ackerson, supra note 34, at 792. The accounts into which the funds were deposited were known by those familiar with the Kimmes-Wright scheme as “Charlie accounts” in recognition of the fact that they were controlled by Kimmes. Id.} For all practical purposes, Kimmes and Wright owned Onnix before the IPO, and they continued to own it after the IPO.\footnote{Id.}

Kimmes and Wright had entered into an agreement with Blinder, Robinson under which they agreed to provide Blinder with the outstanding securities of companies with no operations.\footnote{Id. at 793. Onnix was only one of sixteen blank check companies that Kimmes and Wright manufactured and sold to Blinder, Robinson. Stern, Schifrin & Poole, supra note 41, at 49.} In return, Blinder paid Kimmes and Wright for their expenses, plus a fifty percent profit.\footnote{Goldstein, Ramshaw & Ackerson, supra note 34, at 793.} In the case of Onnix, Blinder’s retail brokers sold the Onnix shares at a 30 to 112.5 percent markup using “high-pressure, boiler room type tactics.”\footnote{H.R. REP. NO. 101-617, at 16 (1990), as reprinted in 1990 U.S.C.C.A.N. 1408, 1418. Boiler room tactics involve the high-pressure solicitation of securities by inexperienced salespeople. Id. at 13, 22, as reprinted in 1990 U.S.C.C.A.N. 1408, 1414, 1423. The salespeople possess little or no information regarding the companies whose stock they sell. Id. at 12, as reprinted in 1990 U.S.C.C.A.N. 1408, 1414. The boiler room operation is frequently housed in a hotel or other temporary location in order to evade scrutiny. Id. at 13, as reprinted in 1990 U.S.C.C.A.N. 1408, 1414–15.} In two days, Blinder had sold all outstanding Onnix shares, as well as 42,000 nonexistent shares,\footnote{H.R. REP. NO. 101-617, at 16, as reprinted in 1990 U.S.C.C.A.N. 1408, 1418.} to individual investors. Blinder reaped a gross profit of $3.1 million—a 120 percent return on its investment in the course of just a few days.\footnote{H.R. REP. NO. 101-617, at 16, as reprinted in 1990 U.S.C.C.A.N. 1408, 1418.}

The SEC filed charges against various individuals involved in the Onnix scheme for the “sale of unregistered securities, failure to maintain proper books and records, engaging in a scheme to defraud, unreasonable markups, churning, unauthorized trading, and failure to supervise employees.”\footnote{Goldstein, Ramshaw & Ackerson, supra note 34, at 793. Blinder, Robinson purchased Onnix shares at prices ranging from $.02 to $.025 per share, resulting in an outlay of $2.6 million for all Onnix stock. Blinder, Robinson in turn sold the Onnix shares at prices ranging from $.0325 to $.0475 per share. Id.} Meyer Blinder, CEO of Blinder, Robinson, served forty months of a forty-six month sentence, was fined $100,000, and was suspended for life from the securities industry.\footnote{John Accola, Penny Stock King Dethroned, ROCKY MOUNTAIN NEWS, Sept. 14, 2002, at 1C; see also H.R. REP. NO. 101-617, at 13–14, as reprinted in 1990 U.S.C.C.A.N. 1408, 1415. Blinder at first denied the charges against him, claiming, “[t]he only money I washed is I forgot a $10 bill in one of my suits when it went to the dry cleaner, and it got laundered.” Stern Schifrin & Poole, supra note 43.} Kimmes and Wright both


\[\text{\footnotesize 45. Goldstein, Ramshaw & Ackerson, supra note 34, at 792. The accounts into which the funds were deposited were known by those familiar with the Kimmes-Wright scheme as “Charlie accounts” in recognition of the fact that they were controlled by Kimmes. Id.}\]

\[\text{\footnotesize 46. Id.}\]

\[\text{\footnotesize 47. Id. at 793. Onnix was only one of sixteen blank check companies that Kimmes and Wright manufactured and sold to Blinder, Robinson. Stern, Schifrin & Poole, supra note 41, at 49.}\]

\[\text{\footnotesize 48. Goldstein, Ramshaw & Ackerson, supra note 34, at 793.}\]


\[\text{\footnotesize 51. Goldstein, Ramshaw & Ackerson, supra note 34, at 793. Blinder, Robinson purchased Onnix shares at prices ranging from $.02 to $.025 per share, resulting in an outlay of $2.6 million for all Onnix stock. Blinder, Robinson in turn sold the Onnix shares at prices ranging from $.0325 to $.0475 per share. Id.}\]


\[\text{\footnotesize 53. John Accola, Penny Stock King Dethroned, ROCKY MOUNTAIN NEWS, Sept. 14, 2002, at 1C; see also H.R. REP. NO. 101-617, at 13–14, as reprinted in 1990 U.S.C.C.A.N. 1408, 1415. Blinder at first denied the charges against him, claiming, “[t]he only money I washed is I forgot a $10 bill in one of my suits when it went to the dry cleaner, and it got laundered.” Stern Schifrin & Poole, supra note}\]
pled guilty to charges of racketeering and securities fraud violations and testified against Blinder in exchange for government leniency. Both Kimmes and Wright were sentenced to two years in prison.

3. Congressional and Regulatory Response

Manufactured blank check companies, such as Onnix, had “no operating history, few employees, few assets, and no legitimate prospects for business success.” Rather, they were created solely and exclusively for the purpose of defrauding investors. It was in response to the “epidemic” of fraud in the penny stock market that Congress enacted the 1990 Securities Enforcement Remedies and Penny Stock Reform Act, amending, in relevant part, Section 7 of the Securities Act of 1933. Recognizing that “[t]he present regulatory environment has permitted the ascendancy of the use of . . . ‘blank check’ offerings, which are used to facilitate manipulation schemes and harm investors,” Section 508 of the Penny Stock Reform Act proposed “special rules with respect to registration statements filed by any issuer that is a blank check company.”

41, at 48. Upon his conviction, Blinder lunged at the prosecutor, Assistant United States Attorney Howard Zlotnick, exclaiming, “Zlotnick! I’ll kill him!” The judge ordered Blinder immediately incarcerated, a month before final sentencing was to be held. John Accola, Caught in the Act; Bricks Conceal Huge Losses, ROCKY MOUNTAIN NEWS, Sept. 4, 2002, at 1C [hereinafter Accola, Caught in the Act].

54. See United States v. Kimmes, Litigation Release No. 12,211, 44 SEC Docket 468 (Aug. 9, 1989); see also United States v. Michael Wright, Litigation Release No. 12,398, 45 SEC Docket 858 (Mar. 5, 1990), available at 1990 WL 1102612. This was not Kimmes’s first brush with the law. He was convicted of federal securities fraud in 1956 and of selling unregistered securities in 1962. Kimmes was also convicted of state securities offenses in California in 1974, and was implicated in suspected gambling operations in California and Nevada in a 1978 report of the California Organized Crime Commission. NASAA REPORT, supra note 6, at 55, reprinted in Penny Stock Hearings, supra note 6, at 208.

55. Accola, Caught in the Act, supra note 53.

56. N.M. Firm’s Stock Takes Dive as Trading Inquiry Intensifies: Grand Jury Checking Possible Link of Solv Ex to Blinder Case Figures, ROCKY MOUNTAIN NEWS, Mar. 26, 1996, at 34A. Kimmes was also sentenced in absentia in a French court to a five-year prison term for securities fraud in Europe. Lorana Sullivan, Quinn Jailed for Fraud, THE OBSERVER (U.K.), July 14, 1991, at 23.


58. See supra text accompanying note 20.


62. Id. § 508, 104 Stat. at 956. Prior to its passing the Penny Stock Reform Act, Congress held hearings to consider the passage of H.R. 4497, proposing a blanket ban on the registration of all blank
Under the Act, the SEC was authorized to promulgate the following categories of rules in regulating blank check companies as it deemed “necessary or appropriate in the public interest or for the protection of investors”: (1) disclosure requirements; (2) limitations on the use of proceeds and issuance of securities; and (3) a right of rescission to shareholders. The Act also narrowly defined the operative term “blank check company” as a company (1) in the development stage, (2) issuing penny stock, and (3) without a business plan (other than to merge with an existing company).

Six months later the SEC published for comment its proposed Rule 419 “to implement provisions of the Securities Enforcement Remedies and Penny Stock Reform Act of 1990.” The proposed rule elaborated somewhat on Congress’s definition of a blank check company, defining it as

a company that (i) is devoting substantially all of its efforts to establishing a new business in which planned principal operations have not commenced, or have commenced but there has been no significant revenue therefrom; (ii) is issuing “penny stock”; and (iii) either has no specific business plan or purpose, or has indicated that

check offerings. This bill received strong support from some industry groups—most notably from the NASAA. The NASAA argued that these offerings, by their very nature, could not meet the full disclosure requirements of federal securities laws. See Penny Stock Hearings (Part 2), supra note 13, at 94–95. The NASD, on the other hand, advocated a limited ban on blank check offerings of penny stock. Id. at 165. The NASD asserted that a blanket ban would curb “legitimate blank check offerings,” including “a number of very large, legitimate acquisition funds with hundreds of millions of dollars sold to sophisticated investors.” Id.

64. Id. § 508(2), 104 Stat. at 956–57.
65. For purposes of this statute, “penny stock” is defined consistent with Rule 3a51-1 of the Securities Exchange Act of 1934. Id. § 503, 104 Stat. at 952 (codified at 15 U.S.C. § 78c(a)(51) (2000)); see Definition of “Penny Stock,” 17 C.F.R. § 240.3a51-1 (1992) (defining “penny stock” as an equity security not traded on a major exchange that is issued by a filer that does not meet certain revenue and asset criteria—namely, the filer has less than five million dollars in assets, has less than two million dollars in assets if it has been operating for more than three years, or the company is seeking to raise less than five million dollars in a firm commitment underwriting).
66. Securities Enforcement Remedies and Penny Stock Reform Act § 508(2), 104 Stat. at 957. This definition excluded nontraditional public shells that are not in the “development stage,” such as blind pools that indicate some degree of investment intent and the shells of bankrupt companies. See Aden R. Pavkov, Ghouls and Godsends? A Critique of “Reverse Merger” Policy, 3 BERKELEY BUS. L.J. 475, 498 (2006). For a discussion of the technical differences between blank checks and blind pools, see infra note 100.
its business plan is to engage in a merger or acquisition with an unidentified company or companies.\(^{68}\)

The proposed Rule suggested that investors in penny stock offerings by blank check companies be accorded numerous forms of protection. These safeguards included (1) deposit of funds raised in the initial offering in an escrow account,\(^{69}\) (2) deposit of securities issued by the blank check company in an escrow account,\(^{70}\) (3) an eighteen-month limit on the company’s right to retain investor funds without completing an acquisition, after which funds would be returned to investors,\(^{71}\) (4) a prohibition on trading securities held in escrow,\(^{72}\) (5) a requirement that the issuer disclose in the prospectus all its obligations regarding the escrow account, including the date on which invested funds would be returned absent an acquisition,\(^{73}\) (6) the filing of a post-effective amendment to the company’s registration statement upon the consummation of an acquisition by the company, including the financial details of said acquisition,\(^{74}\) (7) an opportunity for investors to have their investment refunded if they disapprove of a proposed acquisition,\(^{75}\) and (8) a requirement that the acquisition must account for at least eighty percent of the funds held in escrow.\(^{76}\) In addition to proposed Exchange Act Rule 15g-8,\(^{77}\) the SEC also proposed for comment, and subsequently adopted,\(^{78}\)

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68. Id. Under the proposed rule, “penny stock” is as defined in Exchange Act Rule 3a51-1. The proposed Rule also excluded from consideration as a penny stock: “reported securities” under Exchange Act Rule 11Aa3-1(a) (such as securities listed on the New York Stock Exchange, NASDAQ, or the American Stock Exchange); securities issued by an investment company registered under the Investment Company Act of 1940; put or call options issued by the Options Clearing Corporation; securities priced at five dollars or more; and securities listed on a national exchange that authorizes delisting a security of a company with less than two million dollars in net assets or stockholder equity (which, at the time, included the New York Stock Exchange, the American Stock Exchange, and the Chicago Board Options Exchange, Inc.). Id. at 964 & nn.14 & 17.

69. Id. at 964–65. This escrow account is referred to in the Rule as a “Rule 419 Account.” Id.

70. Id. at 967.

71. Id. at 967–68.

72. Id. at 968. This proposed prohibition was codified in Exchange Act Rule 15g-8. 17 C.F.R. § 240.15g-8 (2007). This Rule prohibits any person from selling or offering to sell a security, or any interest in or related to such security, held in a Rule 419 Account pursuant to the proposed Rule. Id.

73. Proposed Rule 419, supra note 67, at 968.

74. Id. at 969–70.

75. Id. at 970–71.

76. Id. at 969.

77. 17 C.F.R. § 240.15g-8; see supra note 72.

78. See Offerings by Blank Check Companies, 17 C.F.R. § 230.419 (2007); see also Blank Check Offerings, Securities Act Release No. 6,932, Exchange Act Release No. 30,577, 51 SEC Docket 284 (Apr. 13, 1992) available at 1992 WL 81725. Five minor changes were made to the proposed rules: (1) funds slated to be used to pay for certain expenses unaffiliated with the registrant did not need to be deposited in escrow; (2) the registrant was allowed to use up to ten percent of the offering
an amendment to Rule 174, which delays termination of the prospectus delivery period for ninety days following the release of raised funds from escrow.79

B. The Emergence of SPACs

1. The Effect of Rule 419 on the IPO Market

Rule 419 had “an immediate and dramatic positive effect on abuses” in the penny stock market, as its promulgation all but eliminated blank check companies from the United States securities industry.80 The onerous requirements of Rule 419 made it nearly impossible for a blank check company to complete an acquisition. Because shareholders were given the right to rescind their investment once a combination was announced, management could not know exactly how much capital was available to the company until the refund period passed. Because it was impossible to know the amount of proceeds at the company’s disposal while searching for a combination, it became extremely difficult for blank check companies to effectively negotiate the acquisition of a business.81

The escrow and rescission provisions of Rule 419 ensured that funds raised by blank check companies in a public offering could not be misused by the company’s management. Because Rule 419 required at least ninety percent of the funds raised by a blank check company to be held in a Rule 419 escrow account, the funds were inaccessible to the issuing company’s management for personal use. By requiring the approval of a eighty percent of the shareholders and simultaneously giving shareholders a right of rescission, Rule 419 ensured that the process of making an acquisition could not be done hastily. As regulations made the acquisition process more cumbersome and tedious, it became unlikely, if not impossible, for

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81. COHN, supra note 29.
management to hijack the company for its own gain or to surreptitiously profit by engaging in a pump-and-dump scheme.82

The enactment of Rule 419 also affected issuers who were using blank check offerings for legitimate investment purposes.83 Some of these issuers anticipated the SEC’s pending regulation and, in an attempt to “grandfather in” blank check offerings, created as many blank check companies as possible before the new rule took effect.84 Others conducted reverse mergers by combining preexisting private companies with the public shells of recently bankrupt or dormant companies, effectively taking the private companies public.85

A third group chose to substantially comply with Rule 419.86 Although the offerings issued by this group were, in essence, blank checks,87 the securities they issued were not penny stocks.88 Therefore, they did not fall within the regulatory framework of Rule 419 and were no more regulated than a traditional stock offering. The managers of these offerings voluntarily complied with most of the Rule 419 provisions in hopes of renewing investor confidence in blank check offerings—confidence that was severely harmed by the well-publicized frauds in the penny stock market and Congress’s response.89 These blank check companies were the first generation of SPACs.

2. The Advent of SPACs

The mid-1990s saw the U.S. economy emerging from the deep recession of the late 1980s.90 As the economy began to improve and small companies were experiencing increased growth, the potential benefits of

82. See supra note 8 for an explanation of the pump-and-dump scheme.
83. See infra note 176 for examples of legitimate uses of blank check companies at that time.
84. FELDMAN, supra note 10, at 46.
85. Id. A reverse merger allows a private company to go public through the use of a shell corporation: a company that is generally bereft of value other than its access to a public market for its securities. Pavkov, supra note 66, at 478. The equity owners of the private company purchase a majority stake in the public shell company from its owners. Id. The private company then merges with the public shell, giving the equity owners of the formerly private company ownership of the newly public company. Id. The SPAC structure carries advantages over traditional reverse mergers in that SPACs provide their targets with an influx of cash from the IPO and are “pristine shells,” not sullied by bankruptcy or other liabilities. Hewitt, supra note 5.
86. FELDMAN, supra note 10, at 46.
87. These were blank check companies in that they were development-stage companies with no specific business plan other than to merge with or acquire an existing company. See SEC, Blank Check Company, supra note 7.
88. FELDMAN, supra note 10, at 44, 46.
89. Id.
90. Id. at 180.
public offerings increased in kind. David Nussbaum, Chairman of GKN Securities, sought to capitalize on the convergence of the changing economic tide and the new regulatory environment created by Rule 419. The key to Nussbaum’s idea was to create a hybrid blank check offering: on the one hand, the offerings were exempt from Rule 419 because the filer had more than five million dollars in assets, and therefore its issued stock did not fall within the statutory definition of penny stock, on the other hand, Nussbaum's offerings voluntarily adopted substantially all of the Rule 419 restrictions, enforced by means of contractual agreements and charter provisions. Nussbaum adopted the Rule 419 restrictions both to attract investors who were wary of investing in blank check companies and to keep securities regulators at bay. Between 1993 and 1994, Nussbaum and his team launched thirteen blank check companies, twelve of which successfully completed acquisitions. Thus the SPAC was born.

This first generation of SPACs afforded investors familiar protections. Most of the money raised was held in an escrow account, except for a small portion that the SPACs used to cover operating expenses. The SPACs also gave investors a right of rescission once an acquisition was

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92. See supra note 65. To take advantage of the net-asset exception under Rule 3a51-1, an issuer must file a Current Report (Form 8-K) once the IPO is consummated, declaring that the company has net assets worth more than five million dollars. Rule 3a51-1 previously contained an additional exception, exempting securities trading for more than five dollars from the definition of “penny stock.” Issuers with net assets less than the statutory threshold could previously circumvent Rule 419 by simply pricing the IPO units higher than five dollars. However, the SEC modified Rule 3a51-1 in 1993 by eliminating this exception for purposes of Rule 419, in recognition of the fact that “the five dollar price threshold present[e]d an easy mechanism for avoiding the regulatory scheme contemplated by Congress.” Penny Stock Definition for Purposes of Blank Check Rule, Securities Act Release No. 7,024, Exchange Act Release No. 33,095, 55 SEC Docket 722, 723–24 (Oct. 25, 1993), available at 1993 WL 432358.

93. Feldman, supra note 10, at 180–81; see M. Ridgway Barker & Patricia Lee, Kelley, Drye & Warren LLP, Hot Topics in Securities Offerings: SPACs, slides 4–7 (June 20, 2007) (slides from presentation, on file with author). See Table I, infra Part II.C, for a comparison of the standard SPAC structure with Rule 419.

94. ICR Conference Call, supra note 91, at 3. Nussbaum conferred with federal securities regulators regarding the proposed SPAC offerings with the goal of making these new entities as “un-abusible” as possible. Id.

95. Id. at 4.

96. Feldman, supra note 10, at 181. Typically between eighty-five and ninety-five percent of funds raised were held in an escrow account and invested in government-backed treasury bills. See infra text accompanying notes 148, 153; see also Feldman, supra note 10, at 187 (“More and more current deals are distinguishing themselves in the investor marketplace by offering to retain even higher percentages of invested funds in the escrow account.”).
announced. However, in contrast to the Rule 419 requirements, SPAC managers had two years, as opposed to the Rule 419 limit of eighteen months, to complete an acquisition. Additionally, Nussbaum and GKN permitted the trading of the blank check companies’ securities before an acquisition was completed. Each first-generation SPAC targeted an acquisition in a specific industry or geographic region, making it more akin to a blind pool than a blank check. To further enhance their legitimacy, Nussbaum aimed to attract prominent and well-respected managers to head these early SPACs.

As the IPO market began to heat up during the tech boom of the mid-1990s, smaller companies were increasingly successful in raising funds using traditional IPOs. As a result, the need for SPACs, which provided smaller companies access to the capital markets through alternative means, was obviated. However, Nussbaum’s successful SPACs proved that

97. **FELDMAN, supra note 10, at 181.** SPAC investors essentially have three options once an acquisition is proposed: (1) they can reaffirm their investment position, in which case they will own stock in the newly public target company; (2) they can exercise their right of rescission, in which case they will be refunded their initial investment; or (3) they can elect to sell their SPAC shares on the open market. **ICR Conference Call, supra note 91, at 5.**

98. **FELDMAN, supra note 10, at 181.** While a two-year limit was (and remains) typical, because SPACs are not bound by a statutory time limit, management may institute a longer or shorter limit at its discretion. Second-generation SPACs generally require that a letter of intent to conduct a business combination be filed within eighteen months of the IPO and that the combination be completed within twenty-four months. **Id. at 190.**

99. **Id. at 181.** As SPAC IPO units typically included both common stock and warrants, investors could recoup their initial investment by selling either the stock or warrants when the market price reached the IPO price. Investors could continue to benefit from their investment by holding on to the other security in hopes that its value would continue to increase. **Id.**

100. **Id. at 181.** Although the term “blind pool” is often used synonymously with “blank check,” blind pools historically are a subcategory of blank check offerings. While a traditional blank check offering provides investors with no indication as to what type of investment the fund’s management seeks to enter into, a blind pool provides investors with a slightly more focused prospectus. Although SPACs list a target sector in their Form S-1 registration statements, and therefore seem more akin to blind pools, the SEC refers to them under the broader banner of “blank check offerings.” It should also be noted that blank check offerings are distinct from “blank check stock.” The latter refers to stock, as authorized by shareholders, as to which board of directors has authority to determine “preferences, limitations, and relative rights of any class or series before the shares are offered and issued.” **COHN, supra note 29.**

101. **ICR Conference Call, supra note 91, at 4.** This was part of Nussbaum’s “effort to legitimize the vehicle by taking the top tier people there and showing the world that this was not . . . a little scummy [sic] kind of vehicle but something that was attracting the best and the brightest people in the deal world.” **Id.**

102. **Id.**

103. **Id.** Smaller companies are deterred from going public due to the immense costs and efforts that must be expended in doing so. Because SPACs offer smaller companies a sort of “back door” to the public market, the popularity of SPACs is inversely correlated to the strength of the IPO market for small and mid-cap companies. When the IPO market is hot and smaller companies can confidently
blank check offerings could still provide investors with an innovative, potentially profitable, and reasonably safe investment. Investor funds were protected from fraud by the voluntarily adopted Rule 419 regulations, and investors could opt out either before or after an acquisition was announced.104 Nussbaum and GKN profited from the commissions generated from issuing the SPAC stock and from trading the stock while investors awaited a merger.105

3. The Current Resurgence in the SPAC Market

A second generation of SPACs has recently emerged and has quickly gained in popularity. In 2004, twelve SPACs conducted IPOs.106 There was a dramatic increase in the number of SPAC filings in subsequent years, as twenty-eight SPACs conducted IPOs in 2005, thirty-seven SPACs conducted IPOs in 2006, and sixty-five SPACs conducted IPOs in 2007.107 SPACs comprise a growing percentage of the total IPO market. While SPACs accounted for only 5.2 percent of all successful IPOs in 2004, 26.6 percent of all successful IPOs in 2007 were SPACs.108 The amount of capital raised in SPAC offerings has continued to increase: in 2007, SPACs raised an average well in excess of $100 million in their IPOs.109 While early SPACs were underwritten by small, specialty enter the market using “front door” traditional public offerings, there is no need for the “back door” access to the market that SPACs offer. See id.; see also FELDMAN, supra note 10, at 182.

104. FELDMAN, supra note 10, at 181. Investors who opted out would not necessarily be refunded their entire investment. Investors who opted out before an acquisition was proposed by selling their shares would receive the market value of their shares and warrants (assuming they could find a willing purchaser). Investors who opted out after an acquisition was announced were refunded the portion of their original investment that was held in escrow. Alternatively, investors wishing to opt out of an announced acquisition could generally recoup their entire investment by selling their shares (the price of which typically moved up once an acquisition announcement) on the open market once an acquisition was announced. They could then still remain invested in the SPAC by dint of their warrants, which could rise in value dramatically. Id.

105. See id.


107. Id.

108. Id.

109. Id. See also infra note 122 and accompanying text for a discussion of the increasing average amount of capital raised by SPACs. The largest SPAC IPO to date was conducted by Liberty Acquisition Holdings Corp., which raised $1.035 billion in its December 2007 IPO. Liberty Acquisition Holdings Corp., Current Report (Form 8-K), at 2 (Dec. 17, 2007). The largest acquisition completed by a SPAC to date was conducted by Freedom Acquisition Holdings, Inc., which raised $528 million in its December 2006–January 2007 IPO. Freedom Acquisition Holdings, Inc. Annual Report (Form 10-K), at 38 (Mar. 27, 2007). Freedom acquired GLG Partners, a European hedge fund with over $20 billion in assets, in a June 2007 cash and stock transaction valued at $3.4 billion. Ken MacFadyen, SPAC Invaders, INVESTMENT DEALERS’ DIG., July 16, 2007, at 8, 18.
investment banks, recent offerings have been managed by prominent Wall Street firms such as Merrill Lynch, Deutsche Bank, and Citigroup. These large investment banks are especially well suited to handle SPAC offerings because of their close connections with hedge funds and other institutional investors, who are the primary investors in second-generation SPACs. Investment banks are increasingly eager to become involved in the SPAC market because of the potential profits they can reap at several stages of the SPAC’s lifespan, including underwriting the initial offering, advising the management on the acquisition of an existing private company, and helping the management secure any necessary postcombination financing.

Early second-generation SPACs were traded primarily on the over-the-counter bulletin board (OTC-BB), which is regulated by the NASD. Most later SPACs list their shares on the American Stock Exchange.
While SPACs listed on the OTC-BB are subject to state registration requirements, securities traded on a national exchange such as the AMEX are considered “covered securities” and are therefore exempt from state securities regulation.116

The diverse qualities of second-generation SPACs demonstrate the adaptable nature of this investment vehicle. Recent SPACs have sought acquisitions in such assorted sectors as technology,117 shipping,118 natural resources,119 advertising,120 and healthcare.121 Second-generation SPACs have successfully raised capital in amounts ranging from as little as $7.88 million to as much as $1.035 billion.122 Recent SPACs have been founded

115. Lynn Cowan, The Magic of Blank-Check Firms, WALL ST. J., Feb. 19, 2008, at C3. The AMEX has imposed additional informal guidelines on blank check companies they list: “(1) there will be a review of the underwriter with regard in particular to its internal policies and suitability, and (2) the minimum gross offering must be approximately $60 million, with at least $50 million in cash in the escrow account.” Id. For a thorough discussion of the AMEX listing requirements as they apply to SPACs, see Barker & Hedin, supra note 114, at 12.

116. Lola Miranda Hale, SPAC: A Financing Tool with Something for Everyone, J. CORP. ACCT. & FIN., Jan./Feb. 2007, at 67, 73; see Securities Act of 1933 § 18(b)(1)(A)-(B), 15 U.S.C. § 77r(b)(1)(A)-(B) (2000) (exempting securities listed on the NYSE, AMEX, NASDAQ, and other national securities exchanges from state securities regulations). NASDAQ and NYSE rules currently prohibit the listing of blank check companies, but SPACs may list on these exchanges following the completion of an acquisition. Colleen Marie O’Connor, Increased Competition Tightens Spac Structures, INVESTMENT DEALERS’ DIG., Feb. 6, 2006, at 7, 8. Though still a minority, an increasing number of SPACs are listing on the London Stock Exchange’s Alternative Investment Market (AIM). Avery, supra note 110, at 86. SPACs listing on the AIM need not comply with cumbersome U.S. regulations (such as the Sarbanes-Oxley Act), may identify potential acquisition targets before completing the initial offering, and do not need to spend eighty percent of the escrowed funds on their first acquisition. Id.; Vyvyan Tenorio, Blind, Blank, Private, THEDEAL.COM, July 20, 2007, http://www.thedeal.com (subscription required; article on file with author); see also Barker & Hedin, supra note 114 (describing the process of listing a SPAC on the AIM). Alternatively, SPACs can largely avoid government regulation by privately placing their shares only to Qualified Institutional Buyers under Rule 144A. Tenorio, supra; see Private Resales of Securities to Institutions, 17 C.F.R. § 230.144A (2007).

117. See, e.g., Acquicor Tech. Registration Statement, supra note 3, at 1.

118. See, e.g., Star Maritime Acquisition Corp., Registration Statement (Form S-1), at 1 (June 9, 2005).

119. See, e.g., Platinum Energy Res., Inc., Registration Statement (Form S-1), at 1 (June 10, 2005).

120. See, e.g., Shine Media Acquisition Corp., Registration Statement (Form S-1), at 1 (Aug. 2, 2005).

121. See, e.g., Healthcare Acquisition Corp., Registration Statement (Form S-1), at 1 (May 6, 2005).

122. Hewitt, supra note 5, at 2; see supra note 109. The average size of SPACs has increased considerably. In 2005, “approximately one-third of new SPAC filings sought to raise under $50 million, slightly more than one-third sought to raise between $50 million and $100 million, and just under one-third sought to raise $100 million or more.” M. Ridgway Barker & Randi-Jean G. Hedin, Special Purpose Acquisition Corporations: Specs to Consider When Structuring Your SPAC – Part I, METROPOLITAN CORP. COUNS., Aug. 2006, at 6. In the first half of 2006, “25% . . . sought to raise under $50 million, 25% . . . sought to raise between $50 million and $100 million and 50% have sought to raise $100 million or more.” Id. By December 2007, the average SPAC had a capitalization
and managed by such diverse persons as professional athletes, politicians, and Wall Street moguls.\(^{123}\)

C. Anatomy of a SPAC

SPACs are, in essence, publicly traded buyout firms.\(^{124}\) They are incorporated with the sole objective of raising funds for an acquisition through a public offering of their securities.\(^{125}\) Only when a SPAC has merged with or acquired an existing private company does it focus on conducting business for profit. Upon its incorporation, a small group of investors (known as the “Initial Stockholders” or “Founding Stockholders”) own the SPAC’s securities.\(^{126}\) These initial investors generally comprise the management team that will market the SPAC to other investors and search for an appropriate business combination.\(^{127}\)

In order to offer securities in the public markets, a SPAC is required to file a registration statement (Form S-1) with the SEC disclosing the details of the offering.\(^{128}\) Typically, the first line of the Prospectus section of a SPAC’s S-1 will indicate that the filer is a blank check company.\(^{129}\) If applicable, the registration statement sets forth a description of the sector in which the SPAC intends to conduct a merger or acquisition and the criteria to be used in determining the suitability of a target company for combination.\(^{130}\) The registration statement identifies the SPAC’s management team, details the securities to be offered, and lists any foreseeable risks relevant to blank check offerings in general and to the

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123. See infra note 182 for a list of recent prominent SPAC managers.


126. See, e.g., Barker & Hedin, supra note 114 (“Typically, the Founding Stockholders and other directors and officers of the SPAC do not receive salaries or management or finders’ fees . . . .”); see also, e.g., Primer on SPACs, supra note 125, at 2 (“[I]t usually begins as a corporation formed by a small group of sophisticated investors (the ‘Initial Stockholders’) who will initially hold 100% of the common equity of the SPAC . . . .”).

127. Rader & de Búrca, supra note 115, at 3; see also Primer on SPACs, supra note 125, at 2.

128. Primer on SPACs, supra note 125, at 2. See supra note 28, which describes the role of the registration statement.

129. See, e.g., Acquiror Tech. Registration Statement, supra note 3, at 1.

130. Barker & Hedin, supra note 114; see, e.g., Acquiror Tech. Registration Statement, supra note 3, at 32–41.
specific SPAC in question. To make the risks inherent in the investment more comprehensible to investors, the registration statement also includes a table comparing the terms of the instant SPAC offering with the terms of an offering under Rule 419.

The SEC examines SPAC filings with increased scrutiny. In one instance, the SEC temporarily halted review of all SPAC registration statements in early 2005 when a SPAC announced a merger a mere two months following its IPO. This led the SEC to suspect that the SPAC management had entered into negotiations with the target company prior to its IPO. Had this been so, the management team’s actions would have been in violation of securities laws, as a SPAC is required to disclose a potential target’s identity and the risk factors specific to that target in its registration statement. The SEC also recently investigated practices relating to SPAC warrants, but ultimately did not take action to change current practice.

131. Barker & Hedin, supra note 114.
132. See Rader & de Búrca, supra note 115, at 4–5; see, e.g., Acquiror Tech. Registration Statement, supra note 3, at 42–44. See Table I, infra Part II.C, for a comparison of the standard SPAC structure with Rule 419.
133. Feldman, supra note 10, at 184 (“The examiners of SPAC registration filings have tried different tactics to put roadblocks in the way of this technique.”). Because the SEC has not “mandated a set of rules governing the SPAC structure,” SPAC managers must “work out the kinks through an iterative process of comments and regulatory responses on specific transactions.” Tenorio, supra note 116. Despite opposition from SEC regulators, “[t]he recent involvement of larger banks, and the simple fact that the SPACs are legal and permitted under SEC rules, means that, in the end, the SEC must allow them to continue.” Feldman, supra note 10, at 184. SPACs are reviewed by the SEC’s Office of Emerging Growth Companies. Encouraging Small Business Growth and Access to Capital: Hearing Before the Subcomm. on Oversight and Investigations of the H. Comm. on Financial Services, 108th Cong. 35 (2004) available at http://financialservices.house.gov/media/pdf/108-113.pdf (prepared remarks of Alan L. Beller, Director, Division of Corporate Finance, SEC).
134. See Feldman, supra note 10, at 184. International Shipping Enterprises, the SPAC in question, was among the industry’s largest SPACs when it was formed in September 2004. The SPAC was formed with support from industry leader Angeliki Frangou and raised $196 million in its December IPO. International Shipping signed a letter of intent to acquire Navios Maritime Holdings in February 2005. Stephen Lacey, Money for Nothing, INT’L FIN. REV., Sept. 2005, at 10, 10, available at http://www.sablaw.com/files/ibl_s47Details%5CFileUpload265%5C4967%5C231249_final.pdf.
136. Id.
137. Loeb & Loeb LLP, SEC Accepts Loeb’s Position on the Applicability of EITF 00-19 to SPAC Warrants, Dec. 2006, http://www.loeb.com/corporateandsecurities/alerts/ec acceptse december2006/ (detailing a decision not requiring SPACs “to maintain on [their] balance sheet a contingent liability equal to the difference between the exercise price and the current market price of the warrants issued in [their] IPO(s]); see Feldman, supra note 10, at 184; see also Ronald Fink, New Specs for SPACs, CFO, Oct. 2006, at 90, 90 (describing one example of the SEC’s disdain for SPACs, where the SEC required a target company to treat warrants issued by its SPAC acquiror as debt rather than equity to prevent inflation of shareholder equity).
The units sold in a SPAC IPO are typically priced at either six, eight, or ten dollars, and are comprised of one or more shares of common stock and one or more warrants exercisable for the purchase of common stock at a set price. IPO units trade as a single entity for ninety days following the Prospectus date, after which the common stock and the warrant (or warrants) trade separately. Even though the warrant may be bought and sold at that point, it may not be converted into common shares until the later of (1) the completion of a business combination, or (2) one year from the Prospectus date.

The primary task of a SPAC’s management team is to find a target company with which to combine and to engineer a successful combination. In searching for an appropriate target, management generally looks for entities “large enough to sustain a public company but small enough not to either interest private equity investors or be a viable IPO candidate.” Once management has identified an appropriate target, management presents the potential combination to stockholders for approval. Investors who opt out of the combination are refunded their investment to the extent required pursuant to provisions in the SPAC’s organizational documents. If the requisite percentage of investors approve management’s proposal, the SPAC management executes the combination. The combination may be conducted by any method, including a merger, stock acquisition, or asset acquisition.

A SPAC’s structure is established through contractual agreements and charter provisions. Although Rule 419 does not govern SPAC offerings,
the SPAC structure provides many of the protections that Rule 419 affords investors in a blank check offering. However, subtle differences between the Rule 419 protections and the protections provided in SPAC offerings have emerged, and continue to evolve. These distinctions are described in Table I below.

**Table I: Comparison of the Terms of Blank Check Offerings Under Rule 419 with Offerings by a Special Purpose Acquisition Company**

<table>
<thead>
<tr>
<th>Escrow of offering proceeds</th>
<th>Rule 419</th>
<th>SPACs</th>
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<tbody>
<tr>
<td>At least ninety percent of offering proceeds must be deposited in an escrow account or “[a] separate bank account established by a broker or dealer . . . in which the broker or dealer acts as trustee for persons having the beneficial interests in the account.”147</td>
<td>Early SPACs held between eighty-five and ninety-five percent of offering proceeds in escrow. Later SPACs have tended to hold between ninety-seven and ninety-eight percent of offering proceeds in escrow.148</td>
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<tr>
<th>Investment of offering proceeds</th>
<th>Rule 419</th>
<th>SPACs</th>
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<tr>
<td>Proceeds may be invested in 1. an account constituting a “deposit” under the Federal Deposit Insurance Act;149 2. a money market fund registered under the Investment Company Act of 1940;150 and/or</td>
<td>Proceeds are invested in money market funds meeting the requirements of the Investment Company Act of 1940152 or short-term U.S. government securities, such as treasury bills.153</td>
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148. ICR Conference Call, supra note 91, at 5; see also Hale, supra note 116, at 68. The escrowed funds are not available for expenses related to the offering, the search for a target business, or legal and accounting fees. Id. Rather, these costs “are payable only from net proceeds of the offering not held in the trust account or from interest earned on the principal in the trust account up to some preset maximum.” Id.; see also ICR WHITE PAPER, supra note 138, at 2 (noting that the remaining funds not deposited in the escrow account are used to pay “ongoing legal, accounting and SEC fees, as well as working capital requirements”). Some recent SPACs have placed 100 percent of the offering proceeds (net of underwriter’s expenses and compensation) in escrow. Barker & Hedin, supra note 114; see, e.g., Alternative Asset Mgmt. Acquisition Corp., Registration Statement (Form S-1), at 33 (Mar. 27, 2007). A SPAC that places 100 percent of proceeds in escrow can raise additional funds to cover operating expenses by borrowing from managers or conducting a private placement offering to the SPAC’s management. Barker & Hedin, supra note 114.
150. Investment Company Act of 1940, 15 U.S.C. §§ 80a-1–80a-52 (2000). Such a money market fund must also meet the conditions of Money Market Funds, 17 C.F.R. § 270.2a-7(c)(2)–(4),(2007); see infra note 151.
153. SPAC proceeds are invested in funds that ensure that the company is not deemed to be an “investment company” under the Investment Company Act of 1940. See id. Namely, this allows investment in Treasury Bills with maturities of less than 180 days. Hewitt, supra note 5, at 2. A short maturity also guarantees that the securities will be convertible into cash within a short timeframe should the SPAC liquidate or complete a combination.
<table>
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<th><strong>Rule 419</strong></th>
<th><strong>SPACs</strong></th>
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<tr>
<td>3. “[s]ecurities that are direct obligations of, or obligations guaranteed as to principal or interest by, the United States.”</td>
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<td><strong>Limitation on value of target business</strong></td>
<td>Must be equal to or greater than eighty percent of all proceeds. Must be equal to or greater than eighty percent of net assets at the time of a proposed business combination, excluding such funds used for “working capital, investment income and other fluctuations in value.”</td>
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<tr>
<td><strong>Trading of issued securities</strong></td>
<td>No trading of IPO units is permitted until a business combination is completed. IPO units may be traded following the filing of the Prospectus, and common shares and warrants may be traded separately after a period of time specified in the Prospectus.</td>
</tr>
<tr>
<td><strong>Exercise of the warrants</strong></td>
<td>Warrants may be exercised at any time, but all securities must remain in the Rule 419 Account. Warrants may not be exercised until either a business combination is completed (or, if the combination is completed within one year of the filing of the prospectus, one year after the filing of the Prospectus), or when the SPAC is liquidated.</td>
</tr>
<tr>
<td><strong>Right of rescission</strong></td>
<td>Investors must communicate their approval or disapproval of a proposed combination in writing between twenty and forty-five days after the filing of a post-effective amendment. Unless “a sufficient number of purchasers confirm their investment,” the fund is dissolved and investors are entitled to a pro rata share of the Rule. Investors are sent a proxy statement disclosing the details of the proposed combination. Election to rescind investment entitles investors to a pro rata share of the escrow account. Unless a majority of investors affirmatively approve a combination, and less than twenty percent of investors vote against the combination, the fund is dissolved and is liquidated.</td>
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154. 17 C.F.R. § 230.419(c)(i).
155. Rader & de Búrca, supra note 115, at 5. This protection assures investors that managers will not circumvent the other SPAC protections by entering into a small transaction, triggering the release of IPO funds from escrow. Barker & Lee, supra note 93, at slide 15.
157. Rader & de Búrca, supra note 115, at 5. This is frequently ninety days following the effective date of the offering. Hale, supra note 116, at 69.
158. 17 C.F.R. § 230.419(b)(3)(iii).
159. Rader & de Búrca, supra note 115, at 5; supra note 141; see, e.g., Acquicor Tech. Registration Statement, supra note 3, at 43.
160. 17 C.F.R. § 230.419(c)(2)(ii). An investor’s failure to affirm approval of the combination causes that investor’s pro rata share of his Rule 419 Account to be automatically returned. 17 C.F.R. § 230.419(c)(2)(ii).
161. Hale, supra note 116, at 72. An investor’s failure to return the proxy card results in forfeiture of her right of rescission. See Rader & de Búrca, supra note 115, at 5. Management typically agrees to vote its shares consistently with the majority of the SPAC’s investors. Hale, supra note 116, at 72. Despite their holding shares or warrants, managers waive their right to participate in the liquidation of the fund should the SPAC fail to complete an acquisition. Id.
162. Hale, supra note 116, at 72–73. An investor’s pro rata share is equal to the total amount of funds held in escrow, plus any interest earned, less any amount held in escrow representing a portion of the underwriter’s discount, divided by the number of shares issued in the IPO. Id. If the SPAC is dissolved, the calculation of the investor’s pro rata share of the escrowed funds must also account for
Rule 419 | SPACs
--- | ---
419 Account. | investors are entitled to a pro rata share of the escrow account.
Business combination deadline | Eighteen months.
Release of funds | The earlier of a successful combination or fund liquidation upon failure to complete a combination within the allowed time limit.

III. Analysis

A. Blank Check Companies Entailed Overwhelming Risk

Congress authorized the SEC to regulate blank check offerings because of (1) the lack of information made available to potential investors and (2) the individuals to whom these investments were marketed were not sufficiently sophisticated to understand the risks associated with a blank check investment. Managers and brokers selling fraudulent blank check offerings in the penny stock market intentionally withheld information from investors. For example, brokers who engaged in pump-and-dump schemes intentionally kept pricing information from their customers, as they needed to prevent investors from selling their shares lest the market price of the company decline before the brokers were able to reap their illegitimate profits. Because the managers of such penny stock schemes...
were engaged in illegal and unethical activities, it was naturally in their best interests to keep investors in the dark to the greatest extent possible.

Fraudulent penny stocks were specifically marketed to the ‘individuals who could least afford financial loss . . . by high-pressure and minimally educated salespersons who had little knowledge of the financial markets but a lot of knowledge about closing a sale.’\textsuperscript{171} The victims of penny stock fraud included multitudes of “low-income, elderly individuals whose primary sources of income [were] Social Security and other retirement benefits.”\textsuperscript{172} The primary method of marketing penny stocks was through “[h]igh pressure, unsolicited telephone calls to unsophisticated small investors.”\textsuperscript{173} Because of the low share price of penny stock offerings, less-sophisticated investors were led to believe that they were purchasing more affordable investments with a high potential rate of return.\textsuperscript{174}

When Congress resolved to regulate blank check offerings, these vehicles were used “primarily, if not exclusively, as a means of market


\textsuperscript{172} Niesar & Niebauer, supra note 10, at 240. For the testimony of individuals and other examples of the targeting of susceptible populations under penny stock schemes, see Telemarketing Fraud Hearing, supra note 8.

\textsuperscript{173} Goldstein, Ramshaw & Ackerson, supra note 39, at 50. Exchange Act Rule 15c2-6 (the “Penny Stock/Cold Call Rule”), adopted by the SEC on August 28, 1989, addressed this specific sales tactic. 54 Fed. Reg. 35,481 (Aug. 28, 1989) (codified at 17 C.F.R. § 240.15c2-6 (1991). The rule was subsequently reassigned as Sales Practice Requirements for Certain Low-Priced Securities, 17 C.F.R. § 240.15g-9 (2007) (Rule 15g-9). See 58 Fed. Reg. 37,417 (July 12, 1993). The Cold Call Rule requires broker-dealers who sell securities over the phone to learn about a potential investor’s financial situation and investment objectives and to make a written determination that the marketed securities are appropriate for that specific investor. Rule 15g-9 also requires investors to provide written confirmation of the accuracy of the information recorded by the broker-dealer and of their desire to purchase the marketed securities (for the first three trades conducted with the broker-dealer). See 17 C.F.R. § 240.15g-9. For an example of the documents used, see NASD Suggested Customer Suitability Statement and Agreement to Purchase Form, http://finra.complinet.com/file_store/pdf/rulebooks/90-65-form.pdf (last visited Nov. 10, 2007). These safeguards aim to ensure that investors are not sold securities that are unsuitable for their objectives, to ensure that penny stocks are not sold using high-pressure sales tactics, and to provide a paper trail for regulators in the event of an audit. Telemarketing Fraud Hearing, supra note 8, at 42, 55–56. It is notable that Rule 15g-9 contains an exception excluding accredited investors from these requirements. Id. at 56; see infra notes 210–15 and accompanying text. For an in-depth analysis of the practices leading to the enactment of Rule 15c2-6, see A Symptomatic Approach to Securities Fraud: The SEC’s Proposed Rule 15c2-6 and the Boiler Room, 72 YALE L.J. 1411 (1963).

\textsuperscript{174} Niesar & Niebauer, supra note 10, at 240. A typical sales technique was to explain that a stock selling at five cents would need to appreciate by a mere five cents to produce a 100 percent return for the investor. Id.
However, Congress was keenly aware that blank check offerings could be, and were being, used as legitimate investment instruments in other circumstances. It was for this reason that Congress did not impose a blanket ban on blank check offerings (as some states did), and the SEC confined its definition of blank check companies under Rule 419 to companies issuing penny stock. While SPACs do not fall within the framework of Rule 419, it must be determined whether they are the type of legitimate investment envisioned by Congress when it chose to regulate blank check offerings, or whether the current regulatory scheme governing blank check companies should be broadened to include SPACs. To determine whether SPACs require further regulation, it is necessary to evaluate the advantages and risks of investing in a SPAC.

B. Advantages and Risks of a SPAC Investment

1. Management Teams

Investing in any company entails risk. Investing in a blank check company entails extra risks, and SPAC managers make no effort to hide this fact from their investors. Primary among these risks is the lack of


176. SEC Chairman Richard Breeden and NASD Enforcement Director John Pinto agreed that blank check offerings were a source of fraud; however, they “were of the view that blank check offerings could be and were used in legitimate business transactions outside of the penny stock area. Accordingly, they opposed an outright ban of all blank check offerings.” H.R. REP. NO. 101-617, at 22 (1990), as reprinted in 1990 U.S.C.C.A.N. 1408, 1424. Breeden noted in his remarks regarding penny stock market fraud that blind pools were a “proven mechanism for raising capital for productive uses” in the fields of “venture capital, real estate, oil and gas exploration, and equipment leasing programs.” *Penny Stock Hearings (Part 2),* supra note 13, at 31. In 2004 the SEC reaffirmed this view, stating that “[n]either blind pool offerings nor blank check offerings are inherently fraudulent. Many responsible businesspersons sponsor legitimate blind pool and blank check offerings.” Use of Form S-8 and Form 8-K by Shell Companies, 69 Fed. Reg. 21,650, 21,651 n.18 (Apr. 21, 2004).

177. The SEC could theoretically achieve such a broadening of Rule 419 by eliminating the requirement that blank check companies, for the purposes of the rule, issue penny stock. See 17 C.F.R. § 230.419(a)(2)(ii) (2007).

178. A successful SPAC can benefit fund managers, investors, and private companies seeking to raise capital in the public markets. For example, managers are given the opportunity to capitalize on their reputation and experience without having to make a full-time commitment, investors are given access to investment opportunities traditionally restricted to private equity funds, and private companies can be spared the costs and efforts of a public offering and simultaneously receive an influx of cash. Douglas S. Ellenoff & Stuart Neuhauser, *SPACs: Backing the Jockey, Not the Horse,* EQUITIES MAG., Dec. 22, 2006, at 36, 36–37. Because of the limited scope of this Note (focusing on past and prospective regulations aimed at protecting investors), this analysis will primarily focus on SPACs’ potential impact on investors.

179. It is typical for a SPAC to disclose in the introductory section of its Form S-1 registration
operating history upon which investors can base a prediction of future performance. Instead of looking to past performance of the fund, SPAC investors must rely on the competence, reputation, and past performance of the management team as a forecast of how the SPAC might perform.\textsuperscript{180} This blind faith in management has been analogized to “[b]acking the [j]ockey, [n]ot the [h]orse.”\textsuperscript{181} It is for precisely this reason that SPACs are founded and managed by experienced and skillful individuals who are often well-known and well-connected figures in the business community.\textsuperscript{182} The dramatic growth in both the number of SPAC offerings

\begin{itemize}
\item the competitive nature of the SPAC market;
\item the possibility that the SPAC will be unable to consummate an acquisition because of lack of funds;
\item the vulnerability of funds raised by the SPAC to claims by third-parties;
\item the possibility that investment risk could rise if the SPAC acquires a company with inherent risk;
\item the potential dilution of existing shareholders’ position if additional shares are issued to finance an acquisition;
\item the chance that leverage and risk may increase if the SPAC issues debt; and
\item other risks specific to the acquisition being pursued.
\end{itemize}

See id. at 7–23. For example, Acquicor’s Form S-1 contains a section listing “[r]isks associated with technology, multimedia and networking sectors.” Id. at 20. This section calls investors’ attention to the evolving and competitive nature of the sector in which Acquicor pursued an acquisition. Specific risks listed include the danger posed by a potential misappropriation of intellectual property, the cyclical nature of the high-tech sector, and government regulation of the telecommunication and media sectors. Id. at 20–23.


181. Ellenoff & Neuhauser, supra note 178, at 36. This “backing the jockey” approach is much akin to a venture-capital investment—the main difference being that venture capitalists generally are not consulted regarding the use of their funds following their initial investment, while SPAC investors have the ability to opt out of proposed business combinations. Feldman, supra note 10, at 188; see also Mark Cecil, \textit{Where Underwriters Leave Off, PE Pros Pick Up with SPACs}, BUYOUTS, Feb. 6, 2006 at 30, 30 (“All a SPAC has, essentially, is a man with a plan . . . .”); Tenorio, supra note 112 (“[Y]ou’re buying to some degree a pig in a poke. While the risk is capped to some degree, you don’t know ultimately what the entity will look like or if it will in fact mature into an entity . . . .” (quoting James Shorris, Executive Vice President and Head of Enforcement at the NASD)).

182. For example, Steve Wozniak, Gil Amelio, and Ellen Hancock, all former executives at Apple Computer, formed Acquicor Technology. See Acquicor Tech. Registration Statement, supra note 3, at 1. Other notable SPAC managers include Richard A. Clarke, former intelligence and anti-terrorism advisor to Presidents Reagan, George H.W. Bush, Clinton, and George W. Bush; C. Thomas McMillen, former congressman and professional basketball player; George Tenet, former CIA Director; and Nicolas Berggruen, former principal of a billion-dollar hedge fund. Hester, supra note 113; Terence O’Hara, \textit{McMillen Brings Big Names To New Venture}, WASH. POST, Mar. 28, 2005, at E1. According to Rick Bartlett, co-head of equity capital markets at Citigroup, when a bank is
and amount raised in SPAC IPOs is a testament to the tenacity and efforts of SPAC management teams.183

SPAC managers do not receive salaried compensation or a management fee.184 Additionally, managers are generally not required to commit a specific amount of time to the SPAC and its search for a combination, and may therefore choose to allocate their time between multiple business pursuits.185 In order to incentivize management’s search for an advantageous acquisition, SPACs have an unconventional compensation scheme. Managers typically purchase twenty percent of the SPAC’s common equity as “founders’ shares” for a nominal investment of $20,000–$25,000.186 These shares are usually priced between one-and-a-half and three cents, and are held in escrow for two to three years following a successful IPO.187 This management stake with a high amount of potential value puts a SPAC’s management’s “skin in the game,” and aims to ensure that the management team’s interests are aligned with those of the investors.188 While the requisite investment by members of the management team is not very sizeable, it often represents their only chance at profiting from the venture. At the end of the day, a SPAC’s management only profits if its investors profit.189

evaluating a SPAC, “management is almost as important as the type of structure used.” O’Connor, supra note 116, at 7.

184. ICR WHITE PAPER, supra note 138, at 2.
185. Hale, supra note 116, at 71; Kamen & Helfgott, supra note 180 (“These talented managers often are involved in other projects that may distract them from focusing on the best interests of the SPAC.”). Managers are even free to affiliate with other SPACs searching for similar targets. Hale, supra note 116, at 71. To mitigate any potential conflict of interest resulting from their dual loyalty, managers who are affiliated with multiple businesses may be required by contract to present to the SPAC any business opportunities they encounter that the SPAC may reasonably be expected to pursue. Id. at 71–72.

186. Hewitt, supra note 5; see also Barker & Hedin, supra note 114. This is comparable to the twenty percent ownership stake that private-equity managers generally have in the fund they manage. ICR WHITE PAPER, supra note 138, at 3. However, unlike private-equity management, SPAC management is not paid a salary or a management fee in addition to its ownership stake. Rather, a SPAC manager’s investment in the SPAC represents the only potential profits from his work. Id. Because its only method of gaining financial compensation for its efforts is to ensure the performance of the SPAC, management’s economic interest is closely aligned with that of its investors. Id.

187. Hewitt, supra note 5. See also ICR WHITE PAPER, supra note 138, at 5; ICR Conference Call, supra note 91, at 6. This mandatory escrow of the management team’s investment further protects investors from the risk of an unscrupulous management team hoping to make a quick profit by dumping its shares once an acquisition is announced. See id.

188. ICR WHITE PAPER, supra note 138, at 5. If a SPAC liquidates due to a failure to complete an acquisition within the requisite time limit, management does not participate in the liquidation distribution. ICR Conference Call, supra note 91, at 6.

189. ICR Conference Call, supra note 91, at 6. Some criticize this compensation structure, claiming that a SPAC’s management profits when a business combination is completed, whether such
2. Risk of Liquidation and Potential Profits of an Acquisition

If a SPAC fails to complete a combination before the twenty-four-month deadline, or if an investor chooses to opt out of a proposed combination, that investor receives his or her pro rata share of funds held in escrow. Because most SPACs do not hold one hundred percent of the offering proceeds in escrow, this amount may not account for the entire amount of capital invested.190 For SPAC investors who choose to opt out of an acquisition, this failure to receive the full amount of their investment is essentially a “penalty” for withdrawing their investment.191 However, the amount refunded includes the interest that accrued over the period that the funds were in escrow. Therefore, the worst-case scenario for SPAC investors is that they are refunded the portion of their initial investment that had been accruing interest in escrow, instead of the more dramatic potential returns of a merger.192

SPACs that successfully conduct an acquisition offer investors the potential for extraordinary profits. The average return of SPACs that completed a business combination between September 2003 and March 2006 was nearly forty percent.193 SPAC common stock typically trades

combination is advantageous for shareholders or not. This structure may incentivize managers to search out any combination that satisfies the investor protection requirements. See, e.g., Hale, supra 116, at 71. However, it is unlikely that management would enter into a grossly imprudent combination because no combination can be completed without investor approval. See supra text accompanying note 163.

190. See supra notes 162, 163 and accompanying text.
191. Rader & de Búrca, supra note 115, at 5. Funds held in escrow are subject to additional reductions should “management [incur] additional liabilities that cannot be satisfied from funds that remain outside the escrow and management does not make good on its promise to reimburse such excess liabilities.” Id. An additional expense involved in the fund’s liquidation is the lost opportunity for investors to invest their funds elsewhere during the time that management searched for a business combination. FELDMAN, supra note 10, at 190. Considering that most SPAC investors are aggressive institutional investors, such as hedge funds, this opportunity cost is very significant. Id.
192. See supra notes 152–56 and accompanying text. Alternatively, investors can decrease their cost basis by selling their warrants, thereby increasing their profit even if the fund is liquidated due to management’s failure to complete an acquisition. Tenorio, supra note 112, at 37. For example:

Hedge fund X invests $6 per unit, $5.75 of which goes into a trust. X can sell the two warrants, which are generally valued at between 50 cents to 70 cents apiece. If X sold the warrants immediately for 70 cents each, the $6 cost goes down to $4.60. For $4.60, X has bought something that has cash behind it of $5.75.

Id.

193. Avery, supra note 110, at 83. The Morgan Joseph Acquisition Company Index, an index that tracks the share prices of SPACs until they complete a combination, appreciated by more than fifty percent from its inception in 2005 through December 2007. Bloomberg Chart Builder, http://www.bloomberg.com/apps/cticker?ticker=MJACI:IND. However, other analyses maintain that annual returns have been more modest. See, e.g., Elizabeth Hester, Wall Street Peddles Blank-Check IPOs as Returns Trail S&P 500, BLOOMBERG.COM, Jan. 7, 2008, http://www.bloomberg.com/
lower than its initial offering price while awaiting the announcement of a business combination and generally returns to or exceeds the initial price once an acquisition is announced. \textsuperscript{194} Investors often sell their common shares at a profit once a merger is announced and retain their warrants in hopes that the price will continue to climb. \textsuperscript{195} Alternatively, SPAC investors can potentially profit by trading SPAC securities prior to the announcement of a combination. \textsuperscript{196}

3. \textit{Limited Risk Due to Increased Investor Control and Fund Liquidity}

SPACs reduce investors’ downside risk by providing for investor control and liquidity. Because SPACs place almost all IPO proceeds in an interest-earning escrow account, investors’ funds remain safe from manipulation—and even appreciate in value—while the managers seek a merger. \textsuperscript{197} Additionally, SPAC investors can control their risk threshold and exit an unsatisfactory investment by exercising their right of rescission once an acquisition is proposed, or by simply selling their shares. While venture-capital and private-equity investors may not liquidate their investment until the fund has a liquidity event, \textsuperscript{198} SPAC investors can divest at any time, assuming they can find a buyer. \textsuperscript{199} The ability of SPAC investors to rescind their investment should they disagree with a proposed acquisition contrasts starkly with the unlimited downside risk endured by private equity investors, who stand to lose their entire investment should management invest their money unwisely. \textsuperscript{200} On a collective level, because
majority shareholder approval is necessary for the consummation of an acquisition, investors as a group have the power to veto a proposed deal.201

4. Compliance Costs and Speed of Deal Completion

In contrast to privately owned buyout firms, SPACs must comply with all “required filings, corporate governance processes, investor relations obligations and ongoing regulations” of public companies.202 Depending on the method of listing, these regulations may include compliance with the Sarbanes-Oxley Act, proxy solicitation rules and Section 16 reporting requirements.203 Aside from the significant costs associated with fulfilling these obligations,204 a management team that lacks prior experience fulfilling such requirements could easily find itself preoccupied and distracted from its primary goal: engineering a successful business combination.205

Raising capital using a SPAC is faster than doing so through private equity, as the entire SPAC fundraising process can be completed in as few as twelve weeks.206 Additionally, the process of acquiring a target company is faster and less complicated when using a SPAC. While traditional acquisitions are frequently delayed and complicated by the need to secure funding for a proposed combination and compliance with conditions set by the financier, SPAC combinations are pre-funded using the cash raised through the IPO.207 The managers of a SPAC are motivated

201. See supra note 163 and accompanying text.
202. Kamen & Helfgott, supra note 180. The disclosure obligations “also make it more difficult to keep important information away from competitors.” FELDMAN, supra note 10, at 12.
203. Kamen & Helfgott, supra note 180.
204. These additional expenses can include:
   retaining attorneys to deal with the SEC (which can cost anywhere from $50,000 to $150,000 per year just for basic service);[] instituting internal financial controls that comply with [Sarbanes-Oxley] section 404 . . . ;] hiring auditors to perform the annual audit and review each quarterly financial statement[,] paying SEC filing costs[,] adding additional company staff, in particular finance and shareholder relations staff, to deal with additional requirements[,] engaging a public relations and investor relations firm (can easily be $150,000 per year);[,] [and] paying travel and entertainment costs in connection with Wall Street activities.
FELDMAN, supra note 10, at 14.
205. Kamen & Helfgott, supra note 180 (“[T]hese obligations may divert attention from successful business operations and prove to be intrusive, as [SPAC managers] now must disclose their salaries, corporate perks and retirement packages.”).
206. Cecil, supra note 181, at 31 (“[I]n just three months, a dealmaker can go from no capital to deal hunting.”). Raising capital using a SPAC is also significantly faster than doing so through a traditional IPO. See FELDMAN, supra note 10, at 191 (“[A]s is the case with most every alternative IPO deal structure, SPAC mergers generally are completed much faster than IPOs.”).
207. Andrew Dolbeck, Risky Business: Gambling on SPAC Investments, WEEKLY CORP. GROWTH
to find a merger target as quickly as possible in order to comply with their self-imposed time limit. Because SPACs operate within this strictly defined time limit, investors can commit their funds with confidence that they will know the result of their investment, for better or for worse, within two years.

C. SPACs Do Not Require Further Regulation

Considering the potential benefits and risks presented by SPACs, it is the thesis of this Note that SPACs are creative and advantageous investment vehicles that do not pose sufficient risk to require regulation under Rule 419. Most SPAC investors are sufficiently informed of the terms of their investment to understand the risks involved, are sufficiently wealthy that they can sustain the losses associated with a failed SPAC, and are sufficiently experienced to judge whether or not a given SPAC is a wise investment. While the SEC could ensure that SPACs continue to adhere to the current structure by adopting regulation similar to Rule 419, doing so risks overregulating.

IV. PROPOSAL

Because SPACs voluntarily comply with substantially all of the Rule 419 requirements, investors are provided with a deluge of information and comprehensive protections against fraud. Mirroring the Rule 419 protections is the touchstone of the SPAC structure, and it is highly unlikely that SPACs could successfully raise capital without continuing to adhere to this structure. SPACs must issue all reports and disclosures required of public companies, and they must also comply with the disclosure requirements of the exchanges on which they trade. Unlike the blank check offerings of the 1980s, SPACs are managed by reputable and often well-known managers who are interested in preserving their

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208. See supra text accompanying note 165. An integral part of this motivation is management’s knowledge that, should the SPAC liquidate without having completed a combination, it will not receive any compensation and all securities it purchased in the SPAC will be worthless. See supra note 188.

209. See supra note 114 and accompanying text. Because no regulating body required companies issuing penny stock on the pink sheets to disclose this information, investors did not have access to such disclosures. See Telemarketing Fraud Hearing, supra note 8, at 49. See also supra note 23 for a discussion of the listing of penny stock on the pink sheets.
reputation in the business world—a sharp contrast with the dubious and disreputable offerors of the 1980s. Managers have a tremendous incentive to afford all reasonable protections to investors, as they only stand to profit should a majority of investors elect to participate in a proposed combination.

The majority of SPAC investors are accredited investors. Accredited investors, who are among the most wealthy and experienced investors and institutions, are considered under federal securities law to be capable of “fend[ing] for themselves” in navigating the securities markets. Such investors do not need the concrete protection afforded by a regime of federal securities regulation aimed at protecting unsophisticated investors. Rather, the SEC has deferred to accredited investors to protect themselves through market discipline. Accredited investors can safely invest their funds under the liquid and constantly evolving SPAC contractual regime.

In contrast with the cold-call techniques that penny stock brokers employed to wrest funds away from unwitting and often unsophisticated investors, SPACs are primarily marketed to “hedge funds, equity funds, and other institutional investors with expertise in the securities market”


Such funds have largely been structured as limited partnerships, with the investors as the “limited partners” or “LPs” and the private equity manager as the “general partner.” In the United States, each LP of a private equity fund must generally be an “accredited investor,” which is a person or legal entity that meets certain net worth and income qualifications. Regulation D of the Securities Act of 1933 permits accredited investors to invest in a private equity fund without the protections of a registered public offering under the Securities Act.


211. See, e.g., SEC v. Ralston Purina Co., 346 U.S. 119, 125 (1953) (holding that the pivotal element in determining whether a private offering is exempt from the registration requirements under the Securities Act of 1933 is whether the offerees are “able to fend for themselves”); see also 3 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 1361–98 (3rd ed. rev. 1999).

212. The theory behind providing less protection to accredited investors “holds that certain investors are in a position to bargain for the information they need, and therefore those investors should be allowed to opt out of [certain] registration requirements.” Larry E. Ribstein, Private Ordering and the Securities Laws: The Case of General Partnerships, 42 CASE W. RES. L. REV. 1, 36 (1992). Even if an accredited investor lacks sophistication with regard to a given investment, “the investor’s “financial resources are such that (i) they can seek assistance with their investment decisions and (ii) they can bear more risk.” John L. Orcutt, Improving the Efficiency of the Angel Finance Market: A Proposal to Expand the Intermediary Role of Finders in the Private Capital Raising Setting, 37 ARIZ. ST. L.J. 861, 934 (2005).
using the traditional “road show” format. Very few SPACs currently attempt to sell their securities on a retail basis, even to accredited investors, as most states prohibit the sale of blank check offerings under their securities laws.

Permitting SPACs to continue operating without additional regulation will allow the SPAC structure to remain dynamic and adaptive. To date, there has been no litigation involving SPACs, and no reported fraud or misappropriation of investor funds. While some may argue in favor of anticipatory regulation, it would be difficult for regulators to formulate a regulatory regime that would effectively and efficiently protect investors from a kind of abuse that has not yet happened. In the post-Enron era, the SEC has subscribed to a precautionary view of securities regulation that favors anticipatory regulation over responsive regulation. Anticipatory regulation allows regulators to try to prevent problems before they emerge, rather than merely prevent future injury once investors have already been harmed. However, inherent in a regime of anticipatory regulation is the risk of overregulation. Anticipatory regulation can be overly broad, as regulators “must try to encompass as many activities as possible just to assure that nothing is omitted.” Responsive regulation, on the other hand, allows regulators to act with “the benefit of empirical knowledge of the market” and to formulate precise regulation that is tailored to impede a specific risk.

The SEC must strike a delicate balance between protecting investors and encouraging capital growth through the emergence of new financial products. To achieve the latter, innovation and creativity in the financial community must be encouraged. Imposing further regulation on SPACs presupposes problems that do not exist and may never emerge. Therefore, the SEC should not regulate SPACs under the purview of Rule 419.

213. Hewitt, supra note 5.
214. Id. at 2.
216. Troy A. Paredes, On The Decision to Regulate Hedge Funds: The SEC’s Regulatory Philosophy, Style, and Mission, 2006 U. ILL. L. REV. 975, 1006 (2006). “Simply put, the precautionary principle provides that it is better to be safe than sorry—an aggressive regulatory policy of anticipation and preemption intended to avoid certain harms.” Id. at 1007 (citing Cass R. Sunstein, Beyond the Precautionary Principle, 151 U. PA. L. REV. 1003, 1003–04 (2003)).
217. Paredes, supra note 216, at 1007.
219. Id.
V. CONCLUSION

SPACs present investors with the unique opportunity to invest in a management team with a proven track record and to participate in a private-equity-style venture in a safer and more liquid manner. The protections afforded investors by the SPAC structure allow them to control their destiny, and prevent managers from surreptitiously abusing the funds at their disposal. Although there is a degree of uncertainty inherent in a SPAC investment, wealthy and experienced individuals and institutions can handle this risk.

SPACs provide a concrete economic benefit to the U.S. economy. While the fraudulent blank checks offerings of the 1980s destroyed capital, SPACs make a positive contribution to domestic capital formation. According to the NASAA’s estimates, penny stock fraud in the late 1980s cost the U.S. economy $2 billion annually. This loss directly translated to a reduction in the amount of funding available for new businesses in search of capital. In practical terms, $2 billion would have been sufficient funding to launch approximately 80,000 small businesses and create 150,000 new jobs. SPACs, on the other hand, are estimated to have raised over $15 billion to date and to have provided investors with a ten percent aggregate annualized return.

SPACs fill a void in the U.S. IPO market. Because investment banks generally only underwrite large IPOs, it is difficult for smaller companies to successfully go public. SPACs are uniquely situated to take companies public that otherwise could not. The regulatory environment created by the passage of Sarbanes-Oxley has made it more difficult for smaller firms to raise funds in the public markets. SPACs allow such firms access to public capital by merging them with an already public company. SPACs serve sectors and markets where private equity financing is in short supply and can also offer private equity firms an alternative and unexploited avenue of capital.

220. NASAA REPORT, supra note 6, at 5, reprinted in Penny Stock Hearings, supra note 6, at 154.
221. Id.
223. Cecil, supra note 181, at 31. While SPACs have been particularly successful in taking smaller companies public, the very same format has been successful in taking larger companies public, as well. This further demonstrates the versatility of the SPAC as an effective investment vehicle in a variety of circumstances. See supra note 122 and accompanying text for a discussion of the range of SPAC deal sizes.
224. ICR WHITE PAPER, supra note 138, at 4.
225. In one such instance, private equity firm McCown De Leeuw & Co. (McCown) was
In 1946 the United States Supreme Court recognized that “[w]hat matters more than the form of an investment scheme is the ‘economic reality’ that it represents. The question is whether an investor, as a result of the investment agreement itself or the factual circumstances that surround it, is left unable to exercise meaningful control over his investment.”226 SPACs are unorthodox investments, but for experienced and sophisticated investors, the SPAC structure yields a high degree of control and safety, as well as the opportunity to participate in a growing and potentially profitable investment endeavor.

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informed by fund placement agents that it lacked the performance and personnel to raise additional capital. Dan Primack, McCown Takes Stab at SPAC for New Fund, PRIVATE EQUITY WK., Sept. 5, 2005, at 1. Instead of closing shop, McCown turned to the public markets to raise additional capital with a SPAC. McCown formed MDC Acquisition Partners (MDC), a SPAC that aimed to raise $80 million and acquire “businesses within the consumer and business service industries.” MDC Acquisition Partners Inc., Registration Statement (Form S-1), at 1 (July 1, 2005). Market analysts opined that MDC had a fair chance of success because it offered investors a management team experienced in private equity transactions. Primack, supra. Despite having successfully filed a registration statement with the SEC, MDC did not proceed to conduct a public offering. See Ken MacFadyen, A Different Kind of Tombstone, MERGERS & ACQUISITIONS J., Sept. 1, 2007, available at 2007 WLNR 17239412.


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