UNITED STATES OF AMERICA

BEFORE THE

SECURITIES AND EXCHANGE COMMISSION

In the Matter of: Special Purpose Acquisition Companies, Shell Companies, and Projections	)	File No. S7-13-22

COMMENTS OF JULIANNA MARANDOLA, STUDENT

BOSTON COLLEGE LAW SCHOOL

I am grateful for the opportunity to submit comments on the Securities and Exchange Commission's ("SEC") proposed rules ("the proposed rules") regarding special purpose acquisition companies ("SPACs"), shell companies, and projections. As a retail investor and a first-year law student interested in securities regulation and litigation, I am eager to participate in, and offer thoughts on, this important rulemaking process. I write both to express my support for the regulatory goals reflected by the proposed rules and to raise my concerns about the scope and application of certain items therein.

INTRODUCTION

On March 30, 2022, the SEC released a Notice of Proposed Rulemaking broadly addressing disclosure requirements, underwriter liability, and safe harbor provisions applicable to SPACs. As noted in the SEC's corresponding press release, the proposed rules seek to better align the investor protections and regulatory tools available for SPACs with those available for "traditional" initial public offerings ("IPOs").[1] Of the variety of rules and amendments proposed by the SEC in this Notice of Proposed Rulemaking, my comments relate to Item 1609 of Regulation S-K and Rule 140a.

Proposed Item 1609 of Regulation S-K relates to the use of financial projections in de-SPAC filings and will require additional disclosures about such projections, including the identity of preparing parties and the material bases and assumptions on which the projections rely.[2] Rule 140a seeks to clarify the underwriter status and associated liability for involved parties in subsequent de-SPAC transactions.[3]

I applaud the SEC for taking steps toward a more robust regulatory framework for SPACs and offer the following comments on the proposed rules:

I. Item 1609 is a necessary and appropriate measure that will meaningfully benefit retail investors.

II. The SEC must clarify the parties to whom Section 11 liability will attach under Rule 140a, as it is unworkably vague and untenable in the context of the other rules with which it is proposed.

COMMENTS

I. Item 1609 is a necessary and appropriate measure that will meaningfully benefit retail investors.

The ability for a private company to provide such forward-looking statements is a centrally defining feature of the SPAC process in comparison to the IPO process.[4] In this context, it is no surprise that empirical data suggests that the vast majority of SPAC merger

---

[1] *SEC Proposes Rule to Enhance Disclosure and Investor Protection Relating to Special Purpose Acquisition Companies, Shell Companies, and Projections*, U.S. SEC. AND EXCH. COMM'N (Mar. 30, 2022), https://www.sec.gov/news/press-release/2022-56#.
[2] Special Purpose Acquisition Companies, Shell Companies, and Projections, U.S. SEC. AND EXCH. COMM'N 133-34 (proposed Mar. 30, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 230, 232, 239, 240, 249, & 270), https://www.sec.gov/rules/proposed/2022/33-11048.pdf.
[3] Id. at 249-250.
[4] See Knowledge at Wharton Staff, *Why SPACs are Booming,* UNIV. OF PA. (May 4, 2021), https://knowledge.wharton.upenn.edu/article/why-spacs-are-booming/.

transactions ("de-SPACs") — up to 80% to 90% — provide at least one financial projection.[5] Among de-SPACs who provide projections, revenue and EBITDA are the most commonly provided projected metrics.[6] Under Item 1609, registrants involved in de-SPAC transactions who provide projections will be required to disclose the purpose for which and by whom the projections were prepared, all material projection bases and assumptions, any factors that may materially impact such projections, and whether the projections still reflect the relevant board or management's view of forward performance.[7] Given the ubiquity of projections in de-SPAC transactions and the attendant risks, these contextual disclosures will empower retail investors to make more informed choices, especially when choosing between retaining and redeeming their shares prior to the de-SPAC closing.[8]

The need for more vigorous de-SPAC projection disclosure requirements is underscored by the dramatic rise in SPAC claims and litigation. In 2021, SPAC-related cases represented 16% of total securities class action lawsuits filed, up drastically from the 1% to 2% share held by SPAC-related cases in both 2019 and 2020.[9] On an aggregate basis, federal SPAC filings more than sextupled between 2020 and 2021 and surpassed the number of 2021 COVID-19 and

---

[5] Michael Dambra et al., *Should SPAC Forecasts be Sacked?* 13 (Jan. 24, 2022) (unpublished manuscript) (on file with SSRN); Elizabeth Blankespoor et al., *A Hard Look at SPAC Projections*, MANAGEMENT SCIENCE (forthcoming 2022) (manuscript at 2) (on file with SSRN).
[6] See Blankespoor et al,, *supra* (manuscript at 2) (finding that revenue and EBITDA projections appeared in 98% and 85% of de-SPACs that include future projections, respectively).
[7] Special Purpose Acquisition Companies, Shell Companies, and Projections, *supra* note 2, at 249-250.
[8] See Ramey Layne and Brenda Lenahan, *Special Purpose Acquisition Companies: An Introduction*, HARVARD LAW SCH. F. ON CORP. GOVERNANCE (July 6, 2018), https://corpgov.law.harvard.edu/2018/07/06/special-purpose-acquisition-companies-an-introduction/.
[9] Leo Cho, *SPAC-Related Filings —2022 Update*, SEC. CLASS ACTION CLEARINGHOUSE AT STANFORD LAW SCH. (Apr. 25, 2022), https://securities.stanford.edu/news-reports/20220425-SPAC-Related-Filings-2022-Update.pdf.

cryptocurrency-related federal securities filings combined.[10] The rate of core litigation[11] for SPACs in 2021 sat at 13%, compared to 6.3% and 11.5% in the one year and two year post-IPO periods, respectively, for companies who went public in roughly the last decade.[12] Of particular note, the number of filings alleging Rule 10b-5[13] violations decreased by 17% across all federal filings between 2020 and 2021 but increased by more than 500% (albeit off of a low base given the timing of the so-called "SPAC boom") for SPACs in the same time period.[14]

Outside of the growing body of litigation stemming from the current state of de-SPAC projections, the apparent disconnect between these projections and actual performance affirm the need for Item 1609's projection disclosure requirements. Given that so many private companies targeted in de-SPACs are at an early stage, it is understandable and, to an extent, necessary that financial projections, despite their inherently speculative nature, are frequently provided to interested investors.[15] Between 2H2020 and Q1 2021, for example, 64% of target companies were either pre-revenue or pre-EBITDA.[16] That this is the existing reality of the SPAC market, however, should not provide SPACs and their private targets with the opportunity to untether their forward-looking statements from financial realities.

---

[10] *Securities Class Action Filings: 2021 Year in Review*, CORNERSTONE RESEARCH 5 (Feb. 2022), https://www.cornerstone.com/wp-content/uploads/2022/02/Securities-Class-Action-Filings-2021-Year-in-Review.pdf.

[11] Defined as all federal securities class actions excluding M&A filings, which are defined as securities class actions filed in federal courts that have Section 14 claims, but no Rule 10b-5, Section 11, or Section 12(a) claims and involve merger and acquisition transactions.

[12] *Securities Class Action Filings: 2021 Year in Review*, *supra* note 10, at 8, 40.

[13] 17 C.F.R. § 240.10b-5 provides in relevant part: "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange…(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading…"

[14] *Securities Class Action Filings: 2021 Year in Review*, *supra* note 10, at 2, 8.

[15] See *Why Have SPAC Valuations Skyrocketed?*, FTI CONSULTING (Aug. 3, 2021), https://www.fticonsulting.com/insights/fti-journal/why-have-spac-valuations-skyrocketed.

[16] Id.

Both de-SPAC valuation metrics and the performance metrics of target companies post-SPAC point to a tendency for registrants to provide overly aggressive projections to investors. On an enterprise value to forward revenue basis, de-SPAC target companies' median valuation multiple pronouncedly increased from less than 4.5x between 2016 and 1H2020 to over 9.0x in 2H2020 and Q1 2021.[17] Likewise, the median compound annual revenue growth rate ("revenue CAGR") projected by a SPAC over the first five years post-de-SPAC is 116%, compared to an *actual* revenue CAGR of 41% for recent IPO firms over the same time period.[18] Registrants are also pushing projection horizons to the point of farce, with two-thirds providing revenue projections for periods longer than two years and more than half providing such projections for periods longer than five years.[19] In stark contrast, less than 10% of pre-2016 transactions provided revenue projections for periods longer than two years.[20] When tested by actual performance, the majority of de-SPAC projections fail.[21] Empirical data from firms who have been public long enough to compare actual and projected results suggests that only 35% of forecasts are met or exceeded, with this proportion decreasing further as projection horizons increase.[22] As projections continue to blur the line between optimism and speciousness, there is a clear need for such projections to be cabined within Item 1609's contextual disclosures.

Finally, Item 1609's specific call for disclosures of material projection bases, assumptions, and influencing factors is particularly critical in light of retail investor behavior. While disclosing the purpose, preparer and management view of projections creates more direct accountability by compelling parties to affirmatively address the projections they provide,

[17] Id.
[18] Blankespoor et al,, *supra* note 5 (manuscript at 12).
[19] See id. (manuscript at 9).
[20] See id.
[21] See id. (manuscript at 3).
[22] See id.

disclosing the actual projection drivers seems more likely to influence investor behavior.[23] The comparative levels of abnormal trading around a SPAC's five-day post-merger announcement and attendant projections suggest that de-SPAC revenue forecasts "appear to capture the attention of retail investors more so than institutional investors," pointing to a retail investor's lesser ability to separate the informative value of these forward-looking statements from the structural and incentivized optimistic bias therein.[24] In combination with retail investors' historical tendency to prioritize expectations about a company's future economic outlook in making investment decisions, retail investors' perception of de-SPAC projections play an important role in choosing to redeem or retain capital prior to completion of the de-SPAC.[25] Confronting investors with Item 1609's projection assumptions, bases, and influential factors will better position retail investors to take a more objective view of even the most positive de-SPAC projections and encourages healthy skepticism in investors' assessment of the level of rationality and realism embedded in these projections.

II. The SEC must clarify the parties to whom Section 11 liability will attach under Rule 140a, as it is unworkably vague and untenable in the context of the other rules with which it is proposed.

While incentivizing greater due diligence of companies that are the target of de-SPAC transactions is a laudable goal, Rule 140a, creates a zone of Section 11[26] liability, 15 U.S.C. § 77k(a)(5), for parties involved with SPACs that is far too murky. As currently described, it is unclear what parties will be considered a SPAC IPO underwriter for the purposes of proposed

[23] See Dambra et al., *supra* note 5 (manuscript at 4); H. Kent Baker and John A. Haslem, *Information Needs of Individual Investors*, 136 J. OF ACCT. 64, 66 (1973).
[24] See Dambra et al., *supra* note 5 (manuscript at 21-22).
[25] See Brad M. Barber and Terrance Odean, *The Behavior of Individual Investors*, *in* HANDBOOK OF THE ECONOMICS OF FINANCE 1533, 1565 (George M Constantindes et al. eds., 2013) ("We believe that buying is forward-looking and selling backward-looking."); Baker and Haslem, *supra* note 21, at 66-67.
[26] 15 U.S.C. § 77k provides in relevant part: "(a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security…may…sue…(5) every underwriter with respect to such security."

Rule 140a, particularly given the rule's failure to define what it means to "otherwise participate (directly or indirectly) in the de-SPAC transaction."[27] Given that parties considered underwriters would be subject to liability for material omissions or misstatements made by target companies during a de-SPAC, such a sweeping liability dragnet is likely to dissuade a variety of parties whose contributions and guidance in the de-SPAC process would otherwise benefit SPAC investors from participating.[28]

Other rules and amendments in the Notice of Proposed Rulemaking regarding SPACs clearly demonstrates the SEC's recognition of the role third parties play in making SPAC investments fair and accessible. Take, for example, Item 1606, which requires a SPAC to state whether it reasonably believes a de-SPAC is fair to investors and the bases of this belief.[29] Likewise, Item 1607 requires the SPAC to disclose whether it or its sponsor has received a report, opinion, or appraisal from an outside party regarding the fairness of the de-SPAC.[30] Taken seriously, these proposals are designed to incentivize SPACs and their sponsors to bring on third-party valuation firms, consultants, and advisors to act as a counterweight to the SPAC's self-interest in completing a de-SPAC and to provide a more unbiased and technically-based opinion on the proposed de-SPAC on which investors can more comfortably rely.[31] However, if these third-parties are unsure where they stand with respect to underwriter liability given the vagueness of Rule 140a, it is only logical to conclude that their participation in the de-SPAC process will be chilled. In this way, Rule 140a undermines both other proposed rules and the broader goal of compelling SPACs to involve more neutral parties in their due diligence.

---

[27] Special Purpose Acquisition Companies, Shell Companies, and Projections, *supra* note 2, at 96.
[28] See Jacob Adelman, *The SEC Has Signaled More Oversight of SPACs. Big Banks Are Getting the Message.*, BARRON'S (Apr. 2022), https://www.barrons.com/articles/the-sec-has-signaled-more-oversight-of-spacs-big-banks-are-getting-the-message-51650477914.
[29] Special Purpose Acquisition Companies, Shell Companies, and Projections, *supra* note 2, at 24.
[30] Id.
[31] See id.

In addition to the vagueness of the term "underwriter" in Rule 140a, the proposed rule is also ambiguous as to the liability of investment banks who take a SPAC public but do not necessarily take an active role in the subsequent de-SPAC transaction.[32] By the SEC's own admission, SPAC IPO underwriters "typically are not retained to act as firm commitment underwriters in the de-SPAC transaction," although they may act in an advisory capacity.[33] Without an explicit statement as to what advisory activities constitute participation as an underwriter, SPAC IPO underwriters will be left in an indefinite legal limbo — as a particularly salient example, Citi, the most active SPAC IPO underwriter in 2021, has paused its SPAC IPO underwriting activities this month in response to the ambiguity of Rule 140a and other proposals.[34] Rule 140a, then, does little to quell the regulatory confusion that has plagued SPACs despite previous signaling and SPAC accounting rule changes from the SEC.[35]

Even for SPAC IPO underwriters who do not take on an advisory role in the de-SPAC transaction cannot be sure whether or not they fall under Rule 140a's ambit. The most common underwriter fee structure in a SPAC IPO is bifurcated, with the underwriter typically receiving 2% of gross proceeds at the close of the IPO and 3.5% as deferred compensation when the subsequent de-SPAC transaction is completed.[36] As written, Rule 140a fails to definitively state

---

[32] Gillian Tan, *Citi to Pause New SPAC Issuance as SEC Signals Crackdown*, BLOOMBERG (Apr. 2022), https://www.bloomberg.com/news/articles/2022-04-04/citi-said-to-pause-new-spac-issuance-as-sec-signals-crackdown.
[33] Special Purpose Acquisition Companies, Shell Companies, and Projections, *supra* note 2, at 97.
[34] See Tan, *supra* note 29.
[35] See Alison Frankel, *Law Profs Defend Theory That SPAC is Illegal Under Investment Company Act*, REUTERS (Nov. 2021), https://www.reuters.com/legal/transactional/law-profs-defend-theory-that-spac-is-illegal-under-investment-company-act-2021-11-01/; Steve Bertoni and Antoine Gara, *Hot SPAC Market Could Freeze After Potential SEC Rule Change*, FORBES (Apr. 2021), https://www.forbes.com/sites/stevenbertoni/2021/04/12/hot-spac-market-could-freeze-after-potential-sec-rule-change/?sh=33042cea444c.
[36] Layne and Lenahan, *supra* note 8.

whether the receipt of the deferred fee is sufficient for establishing underwriter status, noting only that it "could" be enough to do so.[37]

To leave such a crucial question unanswered is problematic in two ways. First, by making it virtually impossible for a bank to know its status for the purposes of Rule 140a, the proposed rule runs counter to the very spirit of the principle of fair notice.[38] Second, if it is a possibility that the bifurcated fee structure establishes underwriter status, investment banks may feel compelled to require upfront payment of their full fee at the time of the SPAC IPO closing. While doing so may eliminate legal liability under the proposed rule, it may also eliminate an important self-imposed incentive for investment banks to perform reasonable due diligence on the SPAC's possible target companies without regulatory prodding.[39] If a SPAC does not complete a de-SPAC transaction, the deferred 3.5% compensation is never paid to the underwriters.[40] Faced with the possibility of receiving only a 2% fee, as opposed to the full 5.5% SPAC fee or the traditional 7% fee for non-SPAC IPOs, SPAC IPO underwriters are motivated to take on as clients only those SPACs and SPAC sponsors whom they believe can successfully achieve shareholder approval for a target company merger in a de-SPAC.[41] Thus, if the natural consequence of its vagueness is a fee structure change as described, it is possible that Rule 140a will inadvertently de-incentivize selectivity in bringing SPACs to the public markets.

Given the foregoing concerns about Rule 140a, the SEC should consider revising the proposed rule in three ways. First, Rule 140a should be limited in application to underwriters of

[37] Special Purpose Acquisition Companies, Shell Companies, and Projections, *supra* note 2, at 97.
[38] Theodore Boutrous, Jr. and Blaine H. Evanson, *The Enduring and Universal Principle of "Fair Notice,"* 86 S. CAL. L. REV. 2, 194 (2013) ("In requiring far notice of a civil penalty imposed by a regulatory agency, [FCC v. Fox Television Stations, Inc., 132 S. Ct. 2307 (2012)] and [Christopher v. SmithKline Beecham Corp., 132 S. Ct. 2156 (2012)] remove any doubt that where a defendant — whether criminal or civil — faces punishment, the standards of conduct giving rise to such punishment must be reasonably discernible *before* the punishment is imposed.")
[39] See Adelman, *supra* note 26.
[40] Layne and Lenahan, *supra* note 8.
[41] See Adelman, *supra* note 26; id.

SPAC IPOs and firm commitment underwriters in de-SPAC transactions; third parties otherwise brought on to enhance a SPAC's regulatory compliance and provide greater objectivity in the information it provides to investors, such as those alluded to in Items 1606 and 1607, should be excluded. Second, Rule 140a should clearly enumerate what advisory activities constitute underwriter status for banks that underwrite SPAC IPOs but do not act as firm commitment underwriters in the subsequent de-SPAC transactions, such as bringing in a certain percentage of the aggregate Private Investment in Public Equity ("PIPE") funds or assisting in the identification of the SPAC's ultimate target company. Finally, Rule 140a should not attach underwriter status to SPAC IPO underwriters whose only participation in a de-SPAC is the receipt of deferred compensation.

CONCLUSION

I support the SEC's goal of providing a more robust regulatory framework for SPAC and de-SPAC transactions, particularly with respect to requiring contextual projection disclosures as outlined in Item 1609. However, where Item 1609 adds much-needed clarity to the information provided to potential and current SPAC investors, Rule 140a obfuscates the chain of liability when such information is materially misleading or incomplete. It is my hope that these comments will be useful as the SEC refines these critically important proposed rules and works toward Chairperson Gensler's Aristotelian goal in regulating SPACs: "to treat like cases alike."[42]

April 30, 2022

Respectfully submitted,

Julianna Marandola
Boston College Law School
885 Centre Street
Newton, MA 02459

---

[42] Gary Gensler, *Statement on Proposal on Special Purpose Acquisition Companies (SPACs), Shell Companies, and Projections*, U.S. SEC. AND EXCH. COMM'N (Mar. 2022), https://www.sec.gov/news/statement/gensler-spac-20220330.