June 13. 2022

Chair Gary Gensler
Honorable Commissioners
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549–1090
Via email: rule-comments@sec.gov

Re: RIN 3235–AM90, Special Purpose Acquisition Companies, Shell Companies, and Projections

Dear Commissioners,

On behalf of more than 500,000 members and supporters of Public Citizen from across the country, we provide the following comment regarding Special Purpose Acquisition Companies, Shell Companies, and Projections. Specifically, the Securities and Exchange Commission (SEC, Commission) proposes rules intended to improve investor protections during initial public offerings by special purpose acquisition companies (SPACs), and thereafter, during business transactions between SPACs and private operating companies. The additional disclosures apply to compensation paid to SPAC sponsors, conflicts of interest, and fairness. In addition, the SEC proposes to reduce legal protections for SPAC sponsors in the case of projections about earnings potential. Many of our members are investors and depend on fair markets.

Background

The SEC oversees the robust market for securities, consisting basically of stocks and bonds. Bonds represent debt obligations of existing, operating corporations; stocks represent ownership. The day a company issues stock to the public through what's known as an initial public offering can be a time of economic celebration. This firm may have begun as an innovative idea by a group of entrepreneurs who first invested their own savings, then perhaps borrowed from friends and family. If successful, they may have obtained a bank loan to expand. Once proven as a solid enterprise, they might sell stock. Investors for in these initial public offerings, and subsequently in the stock traded on an exchange, know these companies by their regular disclosures. The Securities Act of 1933 ("Securities Act") requires the disclosure of all material facts about securities that are publicly offered for sale so that investors can make

fully informed investment and voting decisions.[1] These disclosures discuss revenue, expenses, a description of products and much more. In essence, they show that the company is doing real business.

By contrast, a SPAC inverts this process. Instead of describing a company and then soliciting investment, the SPAC raises money and then tells investors about the company. The SPAC raises money through an initial public offering, and then goes hunting for an operating company to purchase. The investor knows nothing. The SPAC raises capital by selling units, which consist of redeemable shares, and derivative securities such as warrants or rights that allow the holder to buy additional shares at a future date. The SPAC sponsor identifies a target firm within a specified period and is compensated with an allocation of equity. Investors have the option to redeem their shares at the initial issue price if they do not approve of the proposed target and are allowed to keep their rights and warrants even after redemption.

Until 2020, SPACs were relatively uncommon. In 2014, for example, there were only 12 SPAC offerings raising a total of $1.3 billion. By 2020, that grew to 248 deals raising $83 billion. In 2021, there were 613 deals raising $162 billion.[2] Behind this abrupt rise in popularity may be overstated promises of returns. While most companies overseen by the SEC must limit their forecasts lest they be sanctioned by the agency or face private litigation for misleading statements, SPACs enjoy a safe harbor under a SEC rule promulgated after passage of the Private Securities Litigation Reform Act of 1995.[3] SPAC sponsors claim that provided their statements are "made in good faith," they cannot be held to account.[4]

Moreover, sponsors can receive handsome returns, encouraging enthusiastic, even overblown public statements. Sponsors often are given a 20% stake in the company following a merger with a previously private firm, known as a "promote."[5] This gives them an almost guaranteed profit, even if the enterprise does not prove especially successful.[6]

Sports figures, television and film personalities, along with Donald Trump, have promoted SPACs, potentially attracting investors compelled more by stardust than sound financial principles.[7]

Finally, sponsors have little incentive to find good merger candidates. The merger process is known as the de-SPAC. The initial investors in a SPAC are often hedge funds, dubbed the "SPAC mafia."[8] The SPAC mafia buys initial investor purchase units, nearly always priced at $10 each, which consist of shares,

---

[1] Memorandum, House Financial Services Subcommittee on Investor Protection, (May 19, 2021) https://financialservices.house.gov/uploadedfiles/hhrg-117-ba16-20210524-sd001.pdf

[2] *SPAC Research*, SPAC RESEARCH (website visited June 1, 2022) https://www.spacresearch.com/

[3] Securities and Exchange Commission, *SPACs, Shell Companies, and Projections: Proposed Rules*, SECURITIES AND EXCHANGE COMMISSION, (March 30, 2022), https://www.sec.gov/files/33-11048-fact-sheet.pdf

[4] Roger E. Barton, *SPACs and Speculation: The Changing Legal Liability Of Forward-Looking Statements*, REUTERS (July 7, 2021) https://www.reuters.com/legal/legalindustry/spacs-speculation-changing-legal-liability-forward-looking-statements-2021-07-07/.

[5] *Beware The SPAC: How They Work And Why They Are Bad,* SEEKING ALPHA (January 5, 2021,) https://seekingalpha.com/article/4397498-beware-spac-how-work-and-why-are-bad.

[6] Office of Sen. Elizabeth Warren, The SPAC Hack, Office of Sen. Warren (May 2022) https://www.warren.senate.gov/imo/media/doc/SPACS.pdf

[7] Bailey Lipschultz, *Celebrity SPACs Produced Lackluster Returns For Star-Struck Investors This Year,* FORTUNE (Dec. 16, 2021) https://fortune.com/2021/12/16/celebrity-spac-jay-z-martha-stewart-donald-trump-investors-2021/

[8] Stephen Deane, *Testimony, Going Public: SPACs, Direct Listings, Public Offerings, and the Need for Investor Protections,* HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON INVESTOR PROTECTION, (May 24, 2021) https://financialservices.house.gov/uploadedfiles/hhrg-117-ba16-wstate-deanes-20210524.pdf

warrants,[9] and, in some cases, rights. In practice, this initial group of investors chooses to sell their shares (but not warrants) at the time of the de-SPAC announcement. If the current share price exceeds their initial purchase price), they may sell their shares on the open market. If the market price is less than the initial purchase price, they will instead redeem their shares to the SPAC. As former SEC Office of Investor Advocate staffer Stephen Deane explained, "When initial IPO investors redeem or sell their shares, they get to keep their warrants. This is about as close to a free lunch as one can get in the investing world." Deane further explained that while the "SPAC mafia may vote against the merger, it is in their interest to vote in favor, because they retain their warrants, "even if they believe it is a bad deal." [10] In addition, since they face time pressure to find a merger, they may finalize an inferior deal.[11]

For investors, this SPAC boom has been a bust. According to a *Wall Street Journal* analysis, "Nearly half of all startups with less than $10 million of annual revenue that went public last year through a . . . SPAC . . . have failed or are expected to fail to meet the 2021 revenue or earnings targets they provided to investors."[12] 21 of 33 SPACs connected to a celebrity posted negative returns in 2021.[13] One index that tracks SPACs is down 40% as of the end of December, 2021.[14] A Harvard study found that "SPAC investors that hold shares at the time of a SPAC's merger see post-merger share prices drop on average by a third or more."[15]

The SEC Proposal

With this context, Public Citizen welcomes the SEC's proposal to reform SPACs. Raising money from uninformed investors with overblown promises embellished by celebrities where sponsors and privileged insiders make nearly guaranteed profits is a market that demands reform.

The SEC proposes to increase disclosures. First, it will require greater information about potential conflicts of interest between the sponsors and initial investors on the one hand, and subsequent average investors. We support these disclosures. It will require the SPAC to state whether it "reasonably believes" that the de-SPAC transactions are "fair" to investors, and whether it has received any outside report or

---

[9] Warrants give the holder the right, but not the obligation, to buy shares (or a fraction of a share) at a certain price (for SPACs, $11.50 per share) from the post-merger company. After about two months (usually 52 days after the IPO), the warrants and rights detach from the shares and can be traded separately.10 After this time, an investor buying shares on the public market will receive no warrants or rights.

[10] Stephen Deane, *Testimony, Going Public: SPACs, Direct Listings, Public Offerings, and the Need for Investor Protections,* HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON INVESTOR PROTECTION, (May 24, 2021) https://financialservices.house.gov/uploadedfiles/hhrg-117-ba16-wstate-deanes-20210524.pdf

[11] Office of Sen. Elizabeth Warren, The SPAC Hack, Office of Sen. Warren (May 2022) https://www.warren.senate.gov/imo/media/doc/SPACS.pdf

[12] Heather Somerville, *SPAC Startups Made Lofty Promises. They Aren't Working Out*, WALL STREET JOURNAL, (February 25, 2022) https://www.wsj.com/articles/spac-startups-made-lofty-promises-they-arent-working-out-11645785031

[13] Bailey Lipschultz, *Celebrity SPACs Produced Lackluster Returns For Star-Struck Investors This Year,* FORTUNE (Dec. 16, 2021) https://fortune.com/2021/12/16/celebrity-spac-jay-z-martha-stewart-donald-trump-investors-2021/

[14] Id

[15] Michael Klausner, *A Sober Look at SPACs*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE, (Nov. 19, 2020) https://corpgov.law.harvard.edu/2020/11/19/a-sober-look-at-spacs/

appraisal regarding the fairness.[16] This can help police initial investors voting in favor of a merger they believe to be bad

To address overblown statements, the SEC proposes to deem a SPAC IPO underwriter that "takes steps to facilitate" or "otherwise participates (directly or indirectly)" in a subsequent de-SPAC transaction to be a statutory underwriter for purposes of the de-SPAC transaction. This expands the potential for the underwriting financial institution to be held liable. In addition, the SEC proposes to require that the registration statement filed in connection with the de-SPAC transaction register not just the offering of shares to the target company's shareholders but also register an offering to the existing SPAC shareholders, who are deemed to be electing to receive shares at such time. This way, the SPAC IPO underwriters would be subject to liability to a broad set of plaintiffs for any material misstatement or omission of fact in the registration statement filed in connection with the de-SPAC transaction.

We enthusiastically support all of these disclosure and liability reforms. Average investors should not be prey to misleading statements and conflicted promoters and should be able to hold wrongdoers accountable in a court of law.

While we support these reforms from the Commission, we also believe Congress should ban SPACS and blank check companies entirely. This model subverts the conventional trajectory of initial public offerings by proven, growing companies that constitute the bulwark of American enterprise. Sophisticated investors with sizeable assets may invest in untested companies through the private equity market. But untested companies should not be funded by consumers who lack the ability to weather a significant or total loss of their investment.

Again, we thank the SEC for promoting this immediate reform.

For questions, please contact Bartlett Naylor at

Sincerely,

Public Citizen

[16] Securities and Exchange Commission, *Special Purpose Acquisition Companies, Shell Companies, and Projections*, FEDERAL REGISTER, (May 13, 2022) https://www.govinfo.gov/content/pkg/FR-2022-05-13/pdf/2022-07189.pdf