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REDEEMING SPACS

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ABSTRACT

Special purpose acquisition companies (SPACs) exploded in popularity in the recent past, luring both adventurous retail investors and sophisticated institutional investors. In a SPAC, a publicly traded shell corporation acquires a private target, thereby taking it public in a manner that circumvents the rigors of a traditional initial public offering (IPO). Proponents vaunt SPACs' ability to simplify the process of accessing the public markets and democratize capitalism, but in their current form, they pose risks to retail investors and to the market as a whole. Using a hand-collected dataset spanning 2010-2021, this Article fills a gap in the literature by providing new empirical data regarding a critical feature of SPACs—the redemption right. SPACs allow their shareholders to vote for an acquisition target while simultaneously pulling their money out—a species of empty voting, where a vote is decoupled from any economic substance. We document a disturbing level of empty voting in SPACs and demonstrate an inverse correlation with stock performance: SPACs with more empty voting perform worse. Backed by this empirical support, we propose a tailored reform that we believe could make SPACs a viable and valuable alternative to traditional IPOs.

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INTRODUCTION

Special purpose acquisition companies (SPACs) exploded in popularity in the past few years to such a degree that they made up 60% of initial public offerings (IPOs) in 2020 and 66% in 2021.[1] Celebrities from Serena Williams to Jay-Z have launched SPACs,[2] and in October of 2021, former president Donald Trump announced plans to launch his new media platform by way of a SPAC.[3] DraftKings and Virgin Galactic went public by way of a SPAC,[4] and retail participation also surged.[5]

SPACs challenge the underpinnings of the traditional IPO model.[6] Proponents tout their ability to allow early-stage companies to access

1. *See infra* note 7 and accompanying text.

2. *See infra* Section I.A.

3. *See infra* note 44.

4. Nicholas Jasinski, *Nikola and DraftKings Stock Started as 'SPACs.' What Investors Need to Know*, BARRON'S (June 22, 2020), https://www.barrons.com/articles/the-hottest-new-stocks-are-spacs-what-investors-need-to-know-51592603415 [https://perma.cc/F492-4E96].

5. *See* Allison Herren Lee, Comm'r, SEC, Statement on the Proposal to Enhance Investor Protections in SPACs (Mar. 30, 2022), https://www.sec.gov/news/speech/lee-statement-spac-proposal-033022 [https://perma.cc/95YN-9PA4].

6. Johannes Kolb & Tereza Tykvová, *Going Public via Special Purpose Acquisition Companies: Frogs Do Not Turn into Princes*, 40 J. CORP. FIN. 80 (2016) (studying the "wave of 'new-generation' SPACs"); *see also* EVA SU, CONG. RSCH. SERV., SPAC IPO: BACKGROUND AND POLICY ISSUES 1 (2021), https://crsreports.congress.gov/product/pdf/IF/IF11655 [https://perma.cc/5BHH-XAJK] ("SPAC IPOs have outpaced traditional IPOs during the first three months in 2021.").

the public capital markets while simultaneously democratizing capitalism.[7] The reality is more complicated, but SPACs do present a rarity: true innovation in how a company offers its shares to the public.

Regulators and legislators alike are paying attention. The SEC has proposed major reforms,[8] and the House of Representatives introduced legislation to protect investors.[9] Yet legal scholars have engaged in limited empirical research on SPACs.[10] The authors of this Article aim to add an important empirical dimension to prior analysis of SPACs.

An understanding of SPAC mechanics is critical, and Part I provides an in-depth description. Conceptually, however, SPACs are simple. They go public as a pile of cash then commence a time-limited hunt for an acquisition target—a private company looking to access the public markets.[11] In this subsequent acquisition, termed the "de-SPAC," the once-private firm instantly becomes public.[12] The de-SPAC is thus the functional equivalent of an IPO, effected via merger rather than public offering.

In this manner, the SPAC form theoretically grants retail investors what is effectively pre-IPO access to investment in private companies. By owning the publicly traded shares of the SPAC pre-acquisition, they supposedly get in on the ground floor of the de-SPAC when the once-private acquisition target merges with the SPAC and reaches the public markets.[13]

Even better, shareholders unhappy with the proposed deal have an escape hatch that sets a floor on investment risk.[14] The money raised in the IPO is placed in a trust account, and shareholders have a redemption right—a right to get their money back from that account upon the completion of a deal or expiration of the SPAC. Specifically, SPACs, by convention, price their IPOs at $10, and each SPAC share carries a redemption right guaranteeing the holder the right to receive

7. Usha Rodrigues & Michael Stegemoller, *Exit, Voice, and Reputation: The Evolution of SPACs*, 37 DEL. J. CORP. L. 849, 851 (2012); Michael Klausner, Michael Ohlrogge & Emily Ruan, *A Sober Look at SPACs*, 39 YALE J. ON REG. 228, 230 (2022); Lora Dimitrova, *Perverse Incentives of Special Purpose Acquisition Companies, the "Poor Man's Private Equity Funds,"* 63 J. ACCT. & ECON. 99 (2017).

8. *SEC Proposes Rules to Enhance Disclosure and Investor Protection Relating to Special Purpose Acquisition Companies, Shell Companies, and Projections*, U.S. SEC. & EXCH. COMM'N (Mar. 20, 2022), https://www.sec.gov/news/press-release/2022-56 [https://perma.cc/QL5N-327N].

9. Protecting Investors from Excessive SPACs Fees Act of 2021, H.R. 5913, 117th Cong. (2021); Holding SPACs Accountable Act of 2021, H.R. 5910, 117th Cong. (2021).

10. With the notable exception of Klausner et al., *supra* note 7, at 230.

11. SU, *supra* note 6, at 1.

12. *How Special Purpose Acquisition Companies (SPACs) Work*, PWC, https://www.pwc.com/us/en/services/consulting/deals/library/spac-merger.html [https://perma.cc/KGZ2-EE8B] (last visited Sept. 23, 2023).

13. *See* Klausner et al., *supra* note 7, at 230-31.

14. *Id.*

$10 back when a deal closes or when the SPAC term expires. In essence, SPACs offer investors something of a "free look" to its shareholders at a business combination to be named later.

But there is a fly in the ointment. SPAC shareholders can vote *for* a business combination *even while they are redeeming their shares.* In effect, they can vote for an acquisition while walking out the door, paradoxically declining to take part in the very transaction they have approved.[15] This ability is a species of empty voting, and the law frowns on it because it permits corporate transactions that do not accurately reflect the true economic preferences of shareholders.[16] With empty voting comes threats not only to SPAC shareholders themselves, but also to the markets as a whole—as our original research demonstrates.

The first problem with the empty vote is that it risks stranding unwary investors. SPACs trade in a relatively illiquid market dominated by hedge funds.[17] Many of these sophisticated investors hold SPAC shares with an eye to the redemption right, which provides a species of guaranteed return unusual in the public markets. But retail investors can invest in SPACs *alongside* the dominant hedge fund investors, and empty voting renders these average investors uniquely vulnerable. In ordinary markets, investors must put their money where their mouth is, and thus the interests of sophisticated investors and small investors align. Retail investors can trust in the knowledge that larger players will vote in accordance with their own fat wallets and indirectly protect those with thinner billfolds.[18] This protection fails if the shareholder vote is decoupled from economic interest. In SPACs, the hedge funds can—and often do—vote for deals and *simultaneously redeem* at remarkably high rates. Those inattentive shareholders left behind face significant dilution and liquidity challenges.

Our research, reported in Part IV, makes clear the prevalence of empty voting. In our sample, 54.2% of SPAC shares are redeemed, on average. Redemptions are highest, with a mean of 75.6%, for the SPACs that initiated the IPO process in 2017. Reports suggest recent

15. Voting for a deal they will not participate in is economically rational for hedge funds because the warrants they hold are only worth something if a deal—any deal—goes through, as Section I.C describes.

16. *See* Henry T.C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811, 815 (2006) ("Sometimes, [hedge funds] hold more votes than shares—a pattern we call 'empty voting' because the votes have been emptied of an accompanying economic stake.").

17. *See* Klausner et al., *supra* note 7, at 241 ("Investors in SPAC IPOs are almost entirely large institutional investment managers affiliated with hedge funds.").

18. *See* Holger Spamann, *Indirect Investor Protection: The Investment Ecosystem and Its Legal Underpinnings*, 14 J. LEGAL ANALYSIS 16 (2022).

SPAC redemptions sometimes reach the 80+% range.[19] These numbers are staggering. What is more, our data suggest that redemptions—an economic vote, if you will—represent a reasonable approximation of a market test of the value of the target company. We find an inverse relationship between rate of redemptions and market performance. In other words, the *more* shareholders redeem their shares, the *worse* the post-merger SPAC performs—even measured a mere ten days after the de-SPAC.[20] Those shareholders who remain with the SPAC often find themselves losing much of the value of their investment.

Yet SPACs' empty voting threatens more than just the retail shareholders that stray into SPAC investments. Empty voting also renders SPACs a threat to the public markets. Understanding why requires understanding the incentives driving SPACs in the first place. The SPAC derives much of its attraction from its elimination of many of the checks an IPO traditionally puts in place to filter out companies unfit or unready for the public stage. The chief gatekeeper in the IPO is the investment bank.[21] Because they face strict liability under Section 11 of the 1933 Act, banks scrutinize a company's initial disclosure documents for accuracy.[22] But because the de-SPAC is technically not an IPO, the banks have been, up until now, understood not to face the same liability.[23]

The banks' lack of strict liability removes an important check on the momentum for the SPAC to complete an acquisition and take the firm public. Every major player in the SPAC is incentivized to find a target and take it public, *even if it is a value-destroying transaction*. The SPAC's founders, termed sponsors, receive a significant payoff if—and

19. Roger E. Barton, *High Redemption Rates See SPACs Relying on Alternative Financing*, REUTERS (Jan. 14, 2022, 11:44 AM), https://www.reuters.com/legal/transactional/high-redemption-rates-see-spacs-relying-alternative-financing-2022-01-14/ [https://perma.cc/3KQ8-7G63].

20. This relationship is not merely a function of money coming out of the SPAC, because each redemption takes not only $10 out of the SPAC's assets, but also reduces the number of shares outstanding by one share. Thus, the share price of the remaining shares outstanding should remain the same due to the mechanical impact of the redemption. Increased redemptions do increase the dilution on the remaining shareholders in one respect; because the underwriters' deferred fees, typically around 3.5%, are calculated based on the initial offering amount, high redemptions do impose additional costs on those who remain. *See* Klausner et al., *supra* note 7, at 250.

21. *See* Elisa Martinuzzi, *SPACs Are a Pretty Wild Party for Wall Street's Finest*, BLOOMBERG (Mar. 26, 2021, 5:00 AM), https://www.bloomberg.com/opinion/articles/2021-03-26/sec-spac-probe-how-investment-banks-are-exploiting-the-frenzy [https://perma.cc/2UUP-HV4T]. Section 11 of the Securities Act of 1933 assigns the banks strict liability in the IPO for any material misstatements or omissions. *See* 15 U.S.C. § 77k.

22. *See* William K. Sjostrom, Jr., *The Due Diligence Defense Under Section 11 of the Securities Act of 1933*, 44 BRANDEIS L.J. 549, 555-65 (2006).

23. *See* Public Statement, John Coates, Dir., Div. of Corp. Fin., SEC, SPACs, IPOs and Liability Risk Under the Securities Laws (Apr. 8, 2021), https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws [https://perma.cc/L2SU-UUJY].

only if—they complete an acquisition.[24] The investment banks pocket deferred underwriting fees if—and only if—an acquisition occurs.[25] The SPAC IPO investors, largely hedge funds, hold warrants that have value if—and only if—they complete an acquisition.[26] The target firm itself—and private investors that often invest during the merger[27]—has decided that the transaction is beneficial (in terms attractive to *it*... not necessarily to the retail SPAC investors). Thus, *all the major players* in the SPAC are deeply incentivized to see the deal pushed forward. In other words, SPACs lack a gatekeeper. And that means SPAC targets can be let loose on the market inadequately prepared or imperfectly priced.

Historically, there was one check on SPACs' desire to close a deal, any deal: a robust redemption threshold. Throughout the early 2000s, SPACs provided for a maximum number of redemptions: if too many shareholders redeemed their shares, the deal could not go forward.[28] Thus, even though a formal shareholder vote occurred, in some sense the true vote was the redemptions: if too many shareholders wanted their money back, the deal was off.[29] The elimination of the redemption threshold in the wake of the financial crisis created the empty voting perversity we have now, where the economics of the transaction are misaligned with the formal vote.

Recent literature and regulatory reform proposals for SPACs have focused on increased disclosure and on leveling the regulatory playing field between SPACs and IPOs.[30] While these proposals have merit, this Article intervenes in the debate with a contribution grounded in

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24. The proxy statement for the DraftKings' de-SPAC contains typical language:

> Directors and officers of DEAC have potential conflicts of interest in recommending that stockholders vote in favor of approval of the Business Combination and approval of the other proposals described in this proxy statement/prospectus . . . . Our Sponsor, officers and directors will lose their entire investment in us if we do not complete a business combination by May 14, 2021.

Diamond Eagle Acquisition Corp., Proxy Statement of Diamond Eagle Acquisition Corp. (Schedule 14A) (Apr. 15, 2020) [hereinafter Diamond Eagle Acquisition Corp. Proxy Statement].

25. *See* Klausner et al., *supra* note 7, at 245-46.

26. *Id.* Warrants are essentially promises to sell the company stock in the future at a set price. They function in a manner similar to employee stock options but are typically issued to outsiders rather than service providers. *Id.*

27. These private investments in public equity (PIPEs) have become more common. *See infra* Section I.C.

28. Rodrigues & Stegemoller, *supra* note 7, at 856.

29. Part II will describe how and why that threshold was eliminated.

30. The two main differences are the availability of the PSLRA safe harbor for de-SPAC disclosures and the elimination of Section 11 liability. Public Statement, Coates, *supra* note 23 ("This . . . is the reason that sponsors, targets, and others involved in a de-SPAC feel comfortable presenting projections and other valuation material of a kind that is not commonly found in conventional IPO prospectuses.").

our data. Our Article advocates for reuniting voting power with economic interest, so that if more than 50% of SPAC shareholders redeem, the merger fails. This reform creates a true referendum on the merger to ensure that at least a majority of stakeholders with skin in the game believe in it.

This suggested reform, which the SEC could enforce directly or via reforms to listing standards, avoids the empty voting practices that currently predominate in SPACs and, according to our results, destroy value. Such a reform addresses both the threats to stranded SPAC shareholders and the broader market vetting concerns we have laid out: an economic vote on the de-SPAC protects both SPAC shareholders and the market as a whole from predictably bad deals.

I. BACKGROUND

A. Popularity

The IPO market in recent years has surged, and SPACs made up a significant and unusually high share of those IPOs: 25% in 2018, 34.5% in 2019, 60% in 2020, and 66% in 2021.[31] This staggering increase meant that SPACs drove a considerable portion of the total IPO market in this period. SPACs raised a record-setting $87.9 billion in the first quarter of 2021, eclipsing in just three months the $83.4 billion raised in 2020.[32] Despite a slowing in the pace of new SPAC issuances under increased regulatory scrutiny from the SEC, 2021 closed with $160 billion raised.[33]

Celebrities have launched SPACs in noteworthy numbers, prompting warnings from the SEC in an investor alert specifically tailored to the phenomenon.[34] Sports stars, including Shaquille O'Neal, Serena

31. In 2018, there were 46 SPACS as compared to 134 traditional operating company IPOs; in 2019, 59 as compared to 112; in 2020, 248 as compared to 165; and in 2021, 613 as compared to 309. JAY R. RITTER, INITIAL PUBLIC OFFERINGS: UPDATED STATISTICS 46-48 (2021) (excluding SPACs; closed-end funds; REITS; unit offers; IPOS with an offer price of less than $5.00; commercial banks and savings and loan companies not promptly listed on the Amex, NYSE, or Nasdaq; natural resource master limited partnerships; small best-efforts offers; and foreign companies issuing American Depository Receipts).

32. Yun Li, *SPACs Break 2020 Record in Just 3 Months, but the Red-Hot Industry Faces Challenges Ahead*, CNBC (Mar. 19, 2021, 10:34 AM), https://www.cnbc.com/2021/03/19/spacs-break-2020-record-in-just-3-months.html [https://perma.cc/JV2D-WNXQ].

33. Roy Strom, *Law Firms Won Big on SPACs in 2021 With $160 Billion Raised (1)*, BLOOMBERG L. (Jan. 10, 2022, 11:17 AM), https://news.bloomberglaw.com/business-and-practice/law-firms-won-big-in-2021-with-record-160-billion-spac-boom [https://perma.cc/ZLB8-N3EX].

34. *Celebrity Involvement with SPACs—Investor Alert*, U.S. SEC. & EXCH. COMM'N (Mar. 10, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/celebrity-involvement-spacs-investor-alert#:~:text=Never%20invest%20in%20a%20SPAC,magazines%2C%20television%2C%20or%20radio [https://perma.cc/T9QX-M3HN] (warning in bold that "*[i]t is never a good idea to invest in a SPAC just because someone famous sponsors or invests in it or says it is a good investment.*").

Williams, Alex Rodriguez, Colin Kaepernick, Steph Curry, Patrick Mahomes, Naomi Osaka, Peyton Manning, Andre Agassi, Steffi Graff, and Kevin Durant, have launched their own SPACs or been associated with their founding.[35] So have celebrities, including Ciara, Jay-Z, and Sammy Hagar, and politicians, including Paul Ryan and Wilbur Ross.[36]

Just as notable, there have been several high-profile SPAC failures. One was Nikola Motor Company, which announced its intentions in March 2020 to merge with VectoIQ Acquisition Corporation,[37] a SPAC run by a former executive of General Motors.[38] Nikola began trading on June 4, 2020.[39] By June 9, its shares had doubled.[40] By August 2020, Nikola was valued at $13 billion. But on September 21, its founder and chair, Trevor Milton, resigned after a short-seller firm released a report alleging fraudulent activities by the company and the SEC began investigations.[41] The resignation caused a 30% drop in share prices.[42] Milton was indicted in July of 2021 and faced criminal and civil securities fraud charges.[43]

Lordstown Motors, another electric vehicle startup, made headlines when President Trump highlighted its efforts to reopen a shuttered General Motors factory in Ohio. Lordstown merged with a SPAC in October of 2020, touting "tens of thousands of 'pre-orders' for its pickup

35. Amrith Ramkumar, *The Celebrities from Serena Williams to A-Rod Fueling the SPAC Boom*, WALL ST. J. (Mar. 17, 2021, 5:32 AM), https://www.wsj.com/articles/the-celebrities-from-serena-williams-to-a-rod-fueling-the-spac-boom-11615973578 [https://perma.cc/22MB-9HDU].

36. *Id.*

37. Kristi Marvin, *VectoIQ Acquisition Corp. (VTIQ) to Combine with Nikola Corporation*, SPACINSIDER (Mar. 3, 2020, 9:47 AM), https://spacinsider.com/2020/03/03/vectoiq-to-combine-with-nikola-corporation/ [https://perma.cc/7MMH-RFVC].

38. *See generally* VECTOIQ, https://www.vectoiq.com [https://perma.cc/2YT4-HMGQ] (last visited Sept. 23, 2023).

39. John Rosevear, *Done Deal: VectoIQ's Merger with Nikola Motor Has Closed*, MOTLEY FOOL (June 3, 2020, 2:14 PM), https://www.fool.com/investing/2020/06/03/done-deal-vectoiqs-merger-with-nikola-motor-has-cl.aspx [https://perma.cc/P43D-R3SM].

40. Ben Foldy, *Electric-Truck Startup Nikola Bolts Past Ford in Market Value*, WALL ST. J. (Oct. 22, 2020, 10:50 PM), https://www.wsj.com/articles/electric-truck-startup-nikola-bolts-past-ford-in-market-value-11591730357 [https://perma.cc/3SWV-ZAAC].

41. *See Nikola: How to Parlay an Ocean of Lies into a Partnership with the Largest Auto OEM in America*, HINDENBURG RSCH. (Sept. 10, 2020), https://hindenburgresearch.com/nikola/ [https://perma.cc/LSJ5-GCHN]; Claudia Assis, *Nikola Corp. Details New SEC Probe*, MARKETWATCH (May 7, 2021, 11:48 AM), https://www.marketwatch.com/story/nikola-corp-details-new-sec-probe-2021-05-07 [https://perma.cc/R4Q5-VSKC].

42. Christine Wang & Marty Steinberg, *Nikola Founder Trevor Milton to Voluntarily Step Down as Executive Chairman; Stock Plunges*, CNBC (Sept. 21, 2020, 11:14 AM), https://www.cnbc.com/2020/09/21/nikola-founder-trevor-milton-to-voluntarily-step-down-as-executive-chairman.html [https://perma.cc/7QWD-8P5U].

43. Matthew Goldstein & Niraj Chokshi, *Nikola Founder Is Charged with Fraud in Rebuke to Wall Street*, N.Y. TIMES (July 29, 2021), https://www.nytimes.com/2021/07/29/business/nikola-trevor-milton-fraud.html?searchResultPosition=1 [https://perma.cc/YP3F-7V3V].

truck."[44] Once public, news came that these "pre-orders" were nonbinding.[45] Its CEO and CFO resigned, the SEC launched an investigation,[46] and the company eventually filed for bankruptcy.

SPACs have also brought fresh attention to high-profile names. In October 2021, WeWork completed a de-SPAC to emerge as a public company, twenty-five months after its IPO flameout.[47] That same week, Digital World Acquisition Corporation, a SPAC, announced an acquisition of Trump Media and Technology Group, a social media startup led by former President Donald Trump.[48]

This surge in SPAC activity brought corresponding interest from regulators. The SEC proposed rules for reform,[49] and even in advance of that rulemaking, the Division of Corporation Finance issued public statements aimed directly at SPACs.[50] A U.S. House of Representatives Subcommittee on House Finance Committee held a hearing on Going Public: SPACs, Direct Listings, Public Offerings, and the Need for Investor Protections.[51]

In short, there is intense popular and regulatory interest in this financial form. This Article offers both empirical data on how SPACs function and recommendations for their reform. But before presenting that data, we must contextualize it. The SPAC form is complex, and understanding it requires grasping the mechanics of how it works; to this end, Section I.B undertakes a description. The raison d'être of the

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44. Matthew Goldstein et al., *Lordstown, Truck Maker That Can't Afford to Make Trucks, Is on the Brink*, N.Y. TIMES (Sept. 30, 2021), https://www.nytimes.com/2021/06/14/business/lordstown-motors-steve-burns-julio-rodriguez.html [https://perma.cc/6CVE-EW8P].

45. Andrew Ross Sorkin et al., *What Lordstown's Meltdown Means for SPACs*, N.Y. TIMES (June 15, 2021), https://www.nytimes.com/2021/06/15/business/dealbook/lordstown-spacs-sec.html [https://perma.cc/XPD4-HZPS].

46. *Id.*

47. Samantha Subin, *WeWork Shares Jump More Than 13% in Public Markets Debut After SPAC Merger*, CNBC (Oct. 21, 2021, 4:17 PM), https://www.cnbc.com/2021/10/21/wework-goes-public-through-spac-.html [https://perma.cc/WJ64-ZC4Z] (explaining the turmoil and comeback seen by WeWork during its IPO and SPAC processes).

48. Sabrina Escobar, *This SPAC Is Merging with Trump Media. The Stock Ends the Session 380% Higher*, BARRON'S (Oct. 21, 2021, 4:08 PM), https://www.barrons.com/articles/trump-media-spac-merger-51634818779 [https://perma.cc/UBW6-5NAR].

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

50. Public Statement, Coates, *supra* note 23; Public Statement, John Coates, Dir., Div. of Corp. Fin., SEC & Paul Munter, Chief Accountant, SEC, Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies ("SPACs") (Apr. 12, 2021), https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs [https://perma.cc/8EX6-KF4E].

51. *Going Public: SPACs, Direct Listings, Public Offerings, and the Need for Investor Protections: Hearing Before the Subcomm. on Inv. Prot., Entrepreneurship, & Cap. Markets of the H. Comm. on Fin. Services*, 117th Cong. (2021); *see also* H.R. 5913, 117th Cong. (2021); H.R. 5910, 117th Cong. (2021).

form is the alternative it offers to a traditional IPO; Section I.B.1 highlights the precise ways in which the SPAC marks a departure from traditional public offerings. Armed with this context, Section I.C addresses the all-important question of incentives, emphasizing that—unlike in the traditional IPO—every major player in the SPAC has the incentive to greenlight the offering.

B. Mechanics

Understanding the economics of SPACs is crucial. They begin with a sponsor—who devotes time, money, and reputational capital in exchange for 20% of the SPAC—*if, and only if*, it completes an acquisition. While these upfront expenses are sunk costs, if a deal is completed, then the sponsor receives 20%.[52] This fact is the economic driver for the SPAC and the explanation for its allure. But the payout remains contingent on a merger actually materializing. Thus, for the sponsor, merging with a private firm even with relatively poor prospects, and receiving 20% of it, is vastly preferable to the alternative of receiving no payoff at all.

Having organized the SPAC, the sponsor then works with an investment bank to sell it to the public through an IPO. The IPO process for a conventional operating company is quite grueling because it entails disclosing a great deal of information to the public for the first time, and the bank and the company face considerable liability if they mislead the public.[53] In contrast, a SPAC has little to disclose at its IPO because, at that stage, it is but an empty shell buoyed by cash. Pricing a SPAC also requires no expertise in valuation as compared to the arduous book-building process for a traditional IPO because, by convention, the offering price is merely the amount set to be raised divided by the shares issued, calculated mechanically to arrive at $10 per unit.[54]

Importantly, the SPAC initially issues "units" in its IPO, a security composed of both a share of common stock and a warrant—a right to buy shares in the future at a certain price. The unit, a hybrid security consisting of these two components, usually prices at $10.[55] After a certain amount of time, determined contractually in the IPO prospectus

52. Rodrigues & Stegemoller, *supra* note 7, at 855; *see, e.g.*, Jeff Reeves, *The SPAC List: 10 Dealmakers to Watch*, KIPLINGER (Apr. 13, 2021), https://www.kiplinger.com/investing/stocks/ipos/602601/spacs-list-dealmakers-to-watch [https://perma.cc/PM8P-XXRZ]; *see also* Elana Dure, *Top Performing SPACs of 2020*, INVESTOPEDIA (Dec. 30, 2020), https://www.investopedia.com/top-performing-spacs-of-2020-5093918 [https://perma.cc/G2WT-WJSX]; Vince Martin, *The Top 10 SPAC IPOs of the Last Year*, INVESTORPLACE (June 12, 2020, 11:28 AM), https://investorplace.com/2020/06/top-10-spac-ipos-last-year/ [https://perma.cc/28PW-DGUS].

53. *A Guide to Every Step in the IPO Process*, PITCHBOOK (Sept. 20, 2022), https://pitchbook.com/blog/ipo-process-explained [https://perma.cc/M3LN-RDHA].

54. *See infra* Section I.B.1.

55. Klausner et al., *supra* note 7, at 236.

and which is usually ninety days or less, the warrants and common stock can detach and trade separately.[56] The value of the common stock has a floor equal to the redemption price, which is the price paid for the unit (again, usually $10). The accompanying warrants are a form of option exercisable, typically at $11.50, if *and only if* the SPAC acquires a target.[57] The warrants were initially seen as a "sweetener"[58] to entice IPO buyers that could not expect the "pop" that accompanies a typical IPO.[59] As we will see, they thus create a kind of perverse incentive for the common holders.

The sponsor places the money raised in the IPO into a trust account, where it is invested in government-backed securities and earns a small amount of interest.[60] The sponsors then hunt for a likely target.[61] The SPAC shareholders are investing in the unknown, trusting in the skill of the SPAC managers to find a good target. This may feel risky—and, indeed, is—but the SPAC form crucially seeks to reassure its shareholders with the fail-safe protection of a redemption right.[62] SPAC shareholders have the right to redeem their shares, taking back their share of the trust account—usually around $10 per share because of the money that the sponsors have contributed.[63] Contractually, they can exercise this redemption right under two circumstances: right before the merger is accomplished or if the SPAC fails to find a target and its shelf life expires.[64]

This is another key feature of SPACs: they are time-bound. SPAC managers do not have an unlimited amount of time to search for a likely target. Initially, SPACs lasted two years. In our sample, the median SPAC allows for twenty-four months for completion, although the mean, twenty-two months, is somewhat lower because a number of SPACs allow for only eighteen months to close a deal.[65]

At first blush, SPACs' time limits seem a formidable shareholder protection mechanism. Shareholders do give SPAC managers a "blank

56. FIN. INDUS. REGUL. AUTH., REGULATORY NOTICE 08-54: GUIDANCE ON SPECIAL PURPOSE ACQUISITION COMPANIES 1, 3 (Oct. 2008) ("Typically, a SPAC will trade as a single unit following the IPO. After a certain period, often 90 days following the IPO, the common stock and warrants trade separately.").

57. *See, e.g.*, Klausner et al., *supra* note 7, at 248.

58. Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1577 (1989).

59. Klausner et al., *supra* note 7, at 255; Klausner et al., *A Sober Look at SPACs* 7 (Stan. L. & Econ. Olin, Working Paper, Paper No. 559, 2022) ("The warrants and rights are used to attract IPO investors by compensating them for parking their cash in the SPAC for two years.").

60. Rodrigues & Stegemoller, *supra* note 7, at 854.

61. *See* Klausner et al., *supra* note 7, at 236-37.

62. *See id.* at 243.

63. *See infra* Section IV.B (showing price converging at $10 per share).

64. Holger Spamann & Hao Guo, *The SPAC Trap: How SPACs Disable Indirect Investor Protection*, 40 YALE J. ON REG. BULL. 75, 78-81 (2022); Klausner et al., *supra* note 7, at 239-41.

65. *See infra* Section IV.C.

check" in their quest for a likely target—but with that blank check comes a short leash. In theory, then the discipline of a short time horizon should yield improved results.[66]

SPAC expiration dates are not as draconian as they may at first seem, however. It is true that SPACs' time limits are enshrined in their articles of incorporation—the corporation's constitutive document.[67] But articles can be amended. Because amending the articles of incorporation requires board recommendation and shareholder approval, any request for extension requires a shareholder vote.[68] Typically, SPAC shareholders are allowed to redeem their shares at the extension if they choose to jump ship rather than wait to see whether giving the SPAC managers additional time will yield a deal.[69] That is, with the decision to vote to extend comes a concomitant right to exit. In our sample, extensions occur in 28.8% of SPACs that complete an IPO.

In short, the SPAC organizers basically offer this promise to their shareholders: give us your money for a limited time, and we will search for a target. Once we find one, you can stay with us or get your money back. If we need more time, you can get your money back. And if we do not find a target, you get your money back then, too.

Now, a reader would be forgiven for assuming that the money being held in the trust account would go to fund the eventual acquisition if it takes place. That used to be the case. But as Section II.C will explain, in SPACs today, shareholders can vote yes for a merger *but still* redeem their shares—a point that Part II will discuss at length. Keep in mind for now that the redemption right provides a species of guarantee, a floor below which the value of a SPAC share should not fall. But SPAC shareholders can only redeem their shares at the de-SPAC, extension, or failure of the SPAC.

With these ground rules in place, the SPAC managers begin their time-limited hunt for an acquisition. Once they identify one, negotiations begin. If these bear fruit, then the SPAC announces the proposed acquisition. It makes public disclosures explaining the business combination and the process whereby shareholders will vote to

66. In practice, two problems present themselves. The first, which Section I.C describes, is a last-period problem. As SPACs near the end of their shelf life, their managers have the incentive to close a deal, any deal—even a bad deal. These time limits are the subject of some attention. Two law professors, one a former SEC commissioner, have joined forces with a plaintiff's firm to sue several SPACs, alleging that the Investment Company Act of 1940 should govern them once their duration exceeds twelve months. Anecdotal evidence suggests that time limits may be trending shorter, perhaps in response to these suits.

67. *What You Need to Know About SPACs—Updated Investor Bulletin*, U.S. SEC. & EXCH. COMM'N (May 25, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin [https://perma.cc/D7Z5-TS7R].

68. MODEL BUS. CORP. ACT § 10.03 (2021).

69. Usually, the sponsors also put additional funds in the trust account to provide a larger payout for those investors who stick with the SPAC past its initial term.

approve or reject the transaction.[70] If the SPAC obtains the necessary shareholder vote (as it does in every case in our sample), the private company merges with the public SPAC shell and begins trading, usually under a new trading symbol.[71] If the SPAC fails to identify a target or conclude a deal within the time specified in the IPO, then the shareholders receive their escrowed money back, and the sponsors receive nothing.[72]

These, then, constitute the basics of a SPAC. To understand what an innovation the SPAC represents, we need to pause here and examine the larger context of traditional IPOs. As we will see, IPOs use an elegant mechanism for vetting companies—they task a deep-pocketed repeat player, who holds major reputational concerns, with ensuring the accuracy of disclosures and the liquidity of the offering. Current SPACs dispense with these functions entirely.

1. SPACs vs IPOs

The traditional IPO process is long and expensive—typically costing $2 million or more and lasting four to six months.[73] Investment banks act as gatekeepers to the process, given that the traditional IPO imposes both legal and financial risk upon them, as further described below.

The IPO process involves filing a registration statement and other materials with the SEC, which describe the company's business and operations, on a Form S-1. Issuers generally first file a confidential draft registration statement, which the SEC then scrutinizes and issues comments asking for clarification and further information.[74] Issuers will revise their S-1s multiple times in response to SEC comments, and when they and the bank feel reasonably comfortable, they will file a public (but not yet operative) version.[75]

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70. Sean Donahue et al., *Going Public Through a SPAC: Current Issues for SPAC Sponsors and Private Companies*, MORGAN LEWIS (Dec. 2, 2020), https://www.morganlewis.com/-/media/files/publication/presentation/webinar/2020/morganlewisgpcaspacpresentation12022020.pdf [https://perma.cc/7QZX-PHCX]; *see also* Mira Ganor, *The Case for Non-Binary, Contingent, Shareholder Action*, 23 U. PENN. J. BUS. L. 390, 409-16 (2021).

71. Scott Eichhorn, *What Makes SPACs So Special?*, 29 PIABA BAR J. 319, 323 (2022).

72. Viany Datar, Ekaterina Emm & Ufuk Ince, *Going Public Through the Back Door: A Comparative Analysis of SPACs and IPOs*, 4 BANKING & FIN. REV. 17, 19 (2012).

73. Sophia Kunthara, *Want to Take Your Startup Public? What It Actually Costs to IPO*, CRUNCHBASE NEWS (Nov. 4, 2020), https://news.crunchbase.com/public/want-to-take-your-startup-public-heres-what-it-actually-costs-to-ipo/ [https://perma.cc/FM8P-JLRY]; Annie Nova, *Here's What You Should Know About the IPO Process*, CNBC (Mar. 24, 2019, 10:10 AM), https://www.cnbc.com/2019/03/23/heres-what-you-should-know-about-the-ipo-process.html [https://perma.cc/HL2G-HD2T].

74. U.S. SEC. & EXCH. COMM'N, OFF. OF INV. EDUC. AND ADVOC., SEC PUB. NO. 133 (2/13), INVESTOR BULLETIN, INVESTING IN AN IPO 1 [hereinafter SEC, INVESTOR BULLETIN], https://www.sec.gov/files/ipo-investorbulletin.pdf [https://perma.cc/J5MT-KG6M].

75. *Id.*

The underwriter and issuer then embark on a roadshow to tell the company's "story" to the market.[76] In terms of mechanics, an investment bank underwrites the offering—meaning it buys the shares from the issuer at a discount and then sells them to the public markets at full price.[77] The bank thus faces a financial risk in a firm commitment offering.[78] Therefore, it does not allow the IPO to price unless and until it is confident that the offering will sell out.[79] Once the SEC has signed off on the registration statement, and the bank is confident as to the pricing of the IPO, the offering will price and commence trading.[80] Thus, the traditional IPO is a slow and arduous process, driven by the banks' financial and legal risks further detailed below.

Enter the SPAC. A SPAC goes through the traditional IPO process,[81] but sidesteps many of its burdens. To be sure, the SPAC goes public in a typical fashion, complete with an S-1, roadshow, and pricing. But the drafting of the registration statement is a relatively easy affair. No details regarding the SPAC's operating history or current operations are necessary—the firm has no operations at all.[82] It is merely a shell.[83] It essentially asks investors to give it money for a future, as-yet-unidentified acquisition. SPACs seek to differentiate themselves by managerial expertise, industries they will target, operational expertise, and the like. But that is about it. Pricing is laughably easy—by convention, SPACs price at $10 per unit.[84]

Once public, the SPAC identifies a likely target firm and negotiates a transaction. Upon closing, that target effectively goes public, i.e., becomes a publicly traded firm.[85] But the target debuts on the public markets without the constraints of the traditional IPO[86]: the first key difference is that the banks are not subject to the liability that

76. Nova, *supra* note 73.

77. SEC, INVESTOR BULLETIN, *supra* note 74, at 2.

78. Where it agrees to buy the shares rather than use its "best efforts" to sell the shares without actually purchasing them. *See id.* at 4.

79. *See* Thomas S. Conner, *Underpricing in the Initial Public Offering: A Solution for Severely Affected Issuers*, 40 SEC. REG. L.J. 423 (2012).

80. Rebecca Lake, *What Is the IPO Process?*, SOFI LEARN (July 22, 2021), https://www.sofi.com/learn/content/what-is-the-ipo-process/ [https://perma.cc/PP6B-Z67Z].

81. SU, *supra* note 6, at 1.

82. Daniel S. Riemer, Note, *Special Purpose Acquisition Companies: SPAC and Span, or Blank Check Redux?*, 85 WASH. U. L. REV. 931, 933 & n.11 (2007) (describing the emptiness of a SPAC).

83. Rodrigues & Stegemoller, *supra* note 7, at 871.

84. There are some distinctions in terms of how the warrants are priced, about which we say more in Section I.B. And there are important different requirements in terms of the vote or redemption threshold. *See* Douglas Cumming et al., *The Fast Track IPO—Success Factors for Taking Firms Public with SPACs*, 47 J. BANKING & FIN. 198, 201-02 (2014).

85. *Id.*

86. *Id.* (explaining that SPAC IPOs face less regulatory security because they do not have business operations yet).

accompanies an IPO.[87] Indeed, the two other main differences between a traditional IPO and a SPAC flow from this lack of liability: with a SPAC, targets are more likely to make forecasts[88] and have reasonable certainty that the deal will close and the price at which it will sell. These attractions are enormously appealing to a private company as it contemplates its public debut. The next parts examine these differences between a SPAC and a traditional IPO in more detail.

(a) Investment Bank Liability

Investment banks face considerable economic and legal risk in a traditional IPO. As to the economic risk, remember, in a firm commitment offering, the bank buys the shares from the company at a discount and then sells them to the public. The bank mitigates this risk by ensuring the market's appetite for the offering and by failing to go forward if there are doubts about its ability to sell.

As to the legal risk, Section 11 of the 1933 Act puts the underwriter "on the hook"—that is, subjects it to strict liability—for fraud in the sale of the securities and in the registration statement that describes the firm's business and the offering.[89] Section 11 provides an affirmative defense, if the banks have performed due diligence and found support for the assertions in the prospectus.[90] Thus, Section 11 motivates the banks to flyspeck all the company filings. Investment banks share liability with the issuer for statements made in the offering documents and for violations that occur in the process of a traditional public offering.[91] By putting the "deep pockets" of a repeat player (the bank) on the hook, U.S. securities laws in essence deputize the investment bank to police the offering documents and ensure their accuracy.[92] Issuers do promise to indemnify banks for losses,[93] but risks nonetheless remain: financial risk, if the issuer were to go bankrupt and be unable to pay the indemnification, and reputational risk, if the bank is found to have failed to uncover material information.

87. *Id.* at 200 (describing how SPAC sponsors offering a fixed price for a target company's equity shares results in SPAC targets possibly enjoying more funding and price certainty).

88. While IPO rules do not prohibit making forward-looking statements, in practice, they rarely feature in IPO registration statements. John C. Coates, *SPAC Law and Myths*, 78 BUS. LAW. 371, 390-91 (2022). The SEC recently suggested that the PSLRA's forward-looking statements' safe harbor might not apply to SPAC acquisitions. *See also* Public Statement, Coates, *supra* note 23.

89. *See* 15 U.S.C. § 77k.

90. *Id.* § 77k(b)(3).

91. Andrew F. Tuch, *Multiple Gatekeepers*, 96 VA. L. REV. 1583, 1637 (2010).

92. Celia R. Taylor, *Breaking the Bank: Reconsidering* Central Bank of Denver *After Enron and Sarbanes-Oxley*, 71 MO. L. REV. 367, 368-70 (2006); Brett Adcock, *Initial Public Offerings*, STREETOFWALLS, http://www.streetofwalls.com/finance-training-courses/investment-banking-technical-training/initial-public-offerings/ [https://perma.cc/WJ4Y-74X9] (last visited Sept. 23, 2023) (explaining the responsibilities of investment banks in the IPO process).

93. *See* 15 U.S.C. § 77k(e).

While this risk-shifting mechanism is elegant in its simplicity, the ramifications of making the investment banks responsible for both the selling of the offering and the accuracy of the offering documents are that the process is expensive and slow.[94] Thus, in a traditional IPO, investment banks (alongside the issuer) shoulder liability for the issuer's statements and therefore bear responsibility for mitigating the risks associated with asymmetric information.[95] In the SPAC form, the banks are merely transferring these risks to investors and are therefore no longer providing the gatekeeping function they play in the traditional IPO process.

The next Section will argue that this change of incentives is central: underwriters, rather than risking liability for greenlighting an IPO, instead in a SPAC only earn their full fees if and when a merger occurs. In a de-SPAC, the banks do not bear the same risk if the target's claims are overstated. The question of incentives is the focus of the next Part, and the diminished incentives—on the part of anyone involved in the SPAC—to vet the offering is troubling. Section II.C will examine the redemption decision as a potential place of reform. The central point, though, is that *someone* needs to be determining whether a private firm looking to go public is in fact a viable player in the public market.[96]

(b) Forward Projections

The market is intensely interested in information about private firms making their debut on the public markets. The SEC limits the kind of information—particularly forward-looking information—that issuers can provide in the quiet period.[97] In the waiting period, after the filing of the S-1, banks have exhibited great reluctance to allow issuing companies to make projections—doubtless because of the Section 11 liability that attaches to the IPO.[98]

During the de-SPAC, the banks are merely facilitating the transaction, and the ordinary rules apply. These ordinary rules include a specific safe harbor for forward-looking statements, created by Congress in the Private Securities Litigation Reform Act of 1995 (PSLRA).[99] With the PSLRA, Congress acknowledged that these kinds

94. Taylor, *supra* note 92 (listing out all the parties involved in providing "significant input" to investment banks during the IPO process).

95. *See* 15 U.S.C. § 77k.

96. The SEC reviews the registration statement for compliance with securities laws but does not conduct a merits review of the company's pricing or readiness for the market.

97. LATHAM & WATKINS LLP, US IPO GUIDE 14-16 (2023), https://www.lw.com/en/insights-landing/admin/upload/SiteAttachments/lw-us-ipo-guide.pdf [https://perma.cc/B7P7-DBWY] (detailing restrictions on communications during the quiet period).

98. *See* James C. Spindler, *IPO Liability and Entrepreneurial Response*, 155 U. PA. L. REV. 1187 (2007) (explaining liability under Section 11 and incentives of under disclosure).

99. *See* 15 U.S.C. § 78u-5; *see also* Ann Morales Olazabal, *False Forward-Looking Statements and the PSLRA's Safe Harbor*, 86 IND. L.J. 595 (2011).

of forward-looking statements, while speculative, contain just the kind of information that is of great interest to investors: management's views of the firm's future business prospects.[100] It therefore created a safe harbor, allowing companies to make projections as long as they are clearly identified as forward-looking statements.[101] But Congress created an exception to the safe harbor: statements during "initial public offerings" do not enjoy the PSLRA's protection.[102]

Forward-looking projections are regularly touted as a key feature of SPACs,[103] and they have sometimes proved problematic. For example, the SEC has instituted proceedings against Stable Road Acquisition Corporation and its acquisition target, Momentus, a maker of propulsion technology for use in space rockets.[104] In its 2020 de-SPAC disclosures, Stable Road forecasts that Momentus would grow from $0 in revenue in 2019 to over $4 billion in 2027.[105] Section I.A described another such claim by Lordstown regarding thousands of pre-orders. Lordstown's CEO later remarked on CNBC, "I don't think anyone thought that we had actual orders, right?"[106] De-SPACs enable such cavalier assertions in a way that IPOs simply do not because in IPOs, forward-looking statements are not allowed.

Yet there is another side to this forward projections differential, with a decidedly more egalitarian cast: proponents point out that forward projections actually *do* form a key part of the traditional IPO process. It is just that those projections are shared only with analysts and institutional investors in the course of the IPO road show.[107] One of the oddities of quiet period/roadshow regulation is that statements are permissible in real-time unrecorded settings that are not permissible if written or recorded.[108] The effect of these rules is that the

100. *See* Olazabal, *supra* note 99, at 600 n.14.

101. *See* 15 U.S.C. § 78u-5.

102. *See* Public Statement, Coates, *supra* note 23.

103. *See* Klausner et al., *supra* note 7, at 299 ("SPAC mergers enjoy more lenient regulatory treatment than IPOs in certain respects. Although SEC staff have raised doubts about this proposition, SPAC mergers are widely understood to be covered by the PSLRA's safe harbor for projections and other forward-looking statements."); Chris Bryant, *Why Chamath Palihapitiya Loves SPACs So Much*, BLOOMBERG OP. (Jan. 28, 2021, 1:30 AM), https://www.bloomberg.com/opinion/articles/2021-01-28/why-chamath-palihapitiya-loves-spacs-so-much [https://perma.cc/H86J-VFNZ].

104. Momentus, Inc., Securities Act Release No. 10955, Exchange Act Release No. 92391, 2021 WL 2953701 (July 13, 2021) [hereinafter In the Matter of Momentus].

105. *Id.*

106. Neal E. Boudette & Matthew Goldstein, *Bottom Drops Out of the Red-Hot Market for Electric Vehicle Start-Ups*, N.Y. TIMES (July 26, 2021), https://www.nytimes.com/2021/05/12/business/lordstown-stock-price.html?searchResultPosition=9 [https://perma.cc/EG8S-2YRY].

107. LATHAM & WATKINS LLP, *supra* note 97, at 59 (describing when analysts and institutional investors generally seek forward-looking projections).

108. ALEXANDER F. COHEN ET. AL., LATHAM & WATKINS LLP, THE GOOD, THE BAD AND THE OFFER: LAW, LORE AND FAQS (2014), https://www.lw.com/thoughtLeadership/how-to-

market participants in the room where the road show happens are privy to the kind of soft projections the rest of the market is not.[109] Thus, the argument goes, allowing the forward-looking information to be disseminated broadly in a SPAC actually in some sense levels the playing field.[110]

(c) Deal Certainty and Price Certainty

The last attraction of acquisition by a SPAC, from the target's perspective, is that it purports to offer a guarantee of going public and does so on definite terms. The issuer's fate in a traditional IPO is much more dependent on contingencies outside of its control. The underwriting bank controls the process. If doubts arise during the due diligence process as to the accuracy or completeness of the statements, the bank may not let the IPO go forward. If doubts arise during the book-building and roadshow as to the market's appetite for the offering, the bank may not let the IPO go forward. Even if, through no fault of the company, the IPO "window" closes (that is, if market conditions are judged not to be receptive), the bank may not let the IPO go forward, largely because the bank's own money and reputation is also on the line.

In contrast, targets have more control—although not complete control—of their destiny when they de-SPAC. Sometimes SPACs announce mergers only to have them fail to close.[111] Klausner and Ohlrogge detail five cases in their sample where just this happened; we have at least fourteen cases in our own.[112] Our impression is that these occurrences—of an announced deal cratering and resulting in a failure to go public—are less frequent than in the IPO process, particularly because the IPO window closes upon a consensus of investment banks and can remain closed for years. Indeed, one reason we have heard to explain SPACs' explosion in popularity is that the pandemic temporarily closed the IPO window. Ultimately, the relative deal certainty between IPOs and SPACs is an empirical question—although given the existence of confidential initial S-1s, it may unfortunately be an unanswerable one.

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navigate-publicity-and-offers-of-securities [https://perma.cc/8Z4X-S6AQ] (explaining the dynamics of roadshow written and oral statements).

109. *Id.* at 9-10.

110. For an in-depth look at the origins and policy behind the PSLRA safe harbor, and the state law complications associated with imposing it on de-SPACs, see Amanda Rose, *SPAC Mergers, IPOs, and the PSLRA's Safe Harbor: Unpacking Claims of Regulatory Arbitrage*, 64 WM. & MARY L. REV. 1757 (2023).

111. *See* Klausner et al., *supra* note 7, at 276 ("Furthermore, SPAC deals can and do fail.").

112. There are likely many more than twenty cases because we do not track transactions that failed prior to a successful de-SPAC with a different target. These appear in our sample as merely a successful de-SPAC.

Aside from deal certainty, price certainty is another vaunted advantage of SPACs. Even if an IPO *does* go forward, pricing decisions occur only at the end of the process and are completely out of the hands of the company itself. The banks set the price, while the company plays the role of concerned spectator.[113]

Moreover, that price is often a low one. Airbnb and DoorDash's IPOs are relatively recent examples of this pop. In their opening debuts, Airbnb and DoorDash's stock prices closed trading 115% and 85% above IPO price respectively.[114] Underpricing is a persistent and international phenomenon and it imposes real costs to the issuer.[115] The difference between the offering price and the price at which the shares trade on the first day represents capital raising foregone, a cost that can far eclipse the nominal costs of fees and the underwriting spread.[116] In short, every investor who profits from the IPO "pop" does so at the expense of the company. The cost of this underpricing is money "left on the table" that could have gone to the company.

There are accounts of this behavior that attribute the pop to the banks' desire to please favored customers with deliberately underpriced stock to curry favor and generate future business.[117] Other theories argue that the pop is merely a function of supply and demand: first, the issuer needs to price the offering at a clearing price sufficient to raise the money it needs, which may well need to be lower than the price the most eager buyer will pay. And second, only a fraction of IPO buyers will sell on the first day of trading.[118]

With a de-SPAC, the target—not the bank—drives the transaction. Once the merger agreement is signed, the target is promised comparatively more price certainty: it knows it will go public and

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113. *See* Royce de Rohan Barondes, *Correcting the Empirical Foundations of IPO-Pricing Regulation*, 33 FLA. ST. U. L. REV. 437, 441-44 (2005).

114. *See* Emily McCormick, *Airbnb IPO: Airbnb Opens at $146 per Share, Soaring 114.7% Above IPO Price*, YAHOO! FIN. (Dec. 10, 2020), https://www.yahoo.com/now/airbnb-shares-open-for-trading-initial-public-offering-ipo-coronavirus-pandemic-183858304.html#:~:text=Yahoo%20Finance-,Airbnb%20IPO%3A%20Airbnb%20opens%20at%20%24146%20per%20share,soaring%20114.7%25%20above%20IPO%20price&text=Airbnb's%20(ABNB)%20stock%20opened%20for,of%20the%20newly%20public%20company [https://perma.cc/9YN8-8K4R]; *see also* Jessica Bursztynsky, *DoorDash Skyrockets in Market Debut, Closes up 85%*, CNBC (Dec. 9, 2020, 6:42 PM), https://www.cnbc.com/2020/12/09/doordash-ipo-dash-trading-nyse.html [https://perma.cc/GW7F-F6WD].

115. *See* Sean J. Griffith, *Spinning and Underpricing: Legal and Economic Analysis of the Preferential Allocation of Shares in Initial Public Offerings*, 69 BROOK. L. REV. 583, 599-630 (2004).

116. *See id.*

117. PHILIPPE ESPINASSE, IPO BANKS: PITCH, SELECTION AND MANDATE 11 (5th ed. 2014) (discussing the conflict of interest underwriters have between duty of care for issuers and maintaining relationships with institutional investors and high net worth individuals).

118. Alex Rampell & Scott Kupor, *In Defense of the IPO, and How to Improve It*, ANDREESSEN HOROWTIZ (Aug. 28, 2020), https://a16z.com/2020/08/28/in-defense-of-the-ipo-and-how-to-improve-it/ [https://perma.cc/PE4K-9QJQ].

theoretically the price it will receive. Klausner et al. point out, however, this price certainly can be overstated.[119] SPAC merger agreements can be and often are amended, sometimes with the result of lowering the consideration the target receives.[120] Moreover, redemptions can sap the target of cash it may have been counting on in entering the transaction. The agreement can require a minimum amount of cash to close—in effect providing an "out" for targets if the SPAC cannot fund the minimum between the trust account and PIPE investments. But a target must be willing to walk away, and targets may waive the minimum if the de-SPAC represents their only path to going public.[121]

These, then, are the vaunted attractions of a de-SPAC over a traditional IPO: lack of investment bank liability, the ability to make forward-looking projections, and deal and price certainty. The relative attractions of each feature in the SPAC form are more complicated than proponents argue, but they remain differences in regulatory treatment of SPACs versus IPOs.[122] These differences amount to little more than regulatory arbitrage, and we argue in Section V.C that they should be equalized.[123]

But the focus of this Article is on a simple reform that will help protect both SPAC shareholders and the broader market. To understand the need for this reform, Part II will describe the evolution of SPACs. Importantly, deal certainty is a relatively new innovation in the SPAC market. Originally, a major contingency remained after the merger deal was inked: whether shareholders would vote for the deal or redeem their shares. And as we will also see, in a substantial number of modern SPACs, shareholders vote for the merger but still redeem their shares. Understanding how problematic this redemption practice is requires an understanding of both the incentives of the various players and the history of SPACs. This Part accordingly concludes with a discussion of incentives, setting up Part II's description of SPAC evolution.

C. Incentives

The merger is a time of great peril for shareholder, sponsor, and underwriter alike. In 2014, we documented this powerful last-period

119. Klausner et al., *supra* note 7, at 274-75.

120. *Id.* at 275 ("Consider for instance Nesco.").

121. *Id.* at 276 (explaining that targets "may waive that condition if it becomes clear" that their only other option is to not go public).

122. A major structural difference between SPACs and IPOs is the market SPACs create for information of still-private companies. That topic is the subject of our companion paper, *Inequity in Equities*, BYU L. REV. (forthcoming) (on file with authors).

123. For a thoughtful analysis of claims of regulatory arbitrage, see Rose, *supra* note 110.

pressure.[124] Both our past and current research suggests that SPACs disproportionately complete acquisitions in the last few days before they expire.[125] The incentives of the major SPAC players—sponsors, private investors, investment banks, and the target—all tilt inexorably towards closing a deal.

Sponsors devote their own money and time to a SPAC and will receive compensation if and only if they complete an acquisition.[126] Otherwise, they will lose the millions of dollars they have invested. Press reports have detailed examples where even bad deals can result in paydays for SPAC sponsors.[127] The *Wall Street Journal* described a case where, although a post-acquisition SPAC's shares were down about 30%, its sponsor's initial $20 million investment was valued at about $140 million.[128] The monetary incentive is both consistently present and often impressive enough to compel the sponsors to do whatever they can to push a deal through.

The investment bankers—the gatekeepers in the traditional IPO—are likewise motivated to close a deal. For a typical IPO, the spread (that is, the discount from the public offering price that the bank receives when it purchases the shares from the issuer to resell to the public) is conventionally set at 7%.[129] Banks underwriting SPACs began with the same pricing model but moved to a lower average of 5.5%.[130] Given the relative simplicity of drafting a SPAC S-1 (in comparison to that of an operating company), this price reduction makes good sense—but underwriters further innovated by deferring a portion of their compensation until the acquisition.[131] The underwriter would thus not receive the full spread until—and unless—an acquisition ultimately occurred.[132] This delayed and contingent compensation, therefore, incentivizes the bank to ensure an acquisition occurs. Thus, the investment banker, who plays the role of fly-specker and gatekeeper in a traditional IPO, has every incentive to wave the deal forward in a SPAC acquisition.

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124. *See* Usha Rodrigues & Michael Stegemoller, *What All-Cash Companies Tell Us about IPOs and Acquisitions*, 29 J. CORP. FIN. 111, 119 (2014).

125. *See id.*

126. *Id.*

127. Amrith Ramkumar, *SPAC Insiders Can Make Millions Even When the Company They Take Public Struggles*, WALL ST. J. (Apr. 25, 2021, 4:51 PM), https://www.wsj.com/articles/spac-insiders-can-make-millions-even-when-the-company-they-take-public-struggles-11619343000?mod=article_inline [https://perma.cc/C7Z8-98C7].

128. *Id.*

129. *See generally* Hsuan-Chi Chen & Jay R. Ritter, *The Seven Percent Solution*, 55 J. FIN. 1105 (2000).

130. Matt Levine, *SPACs Aren't Cheaper Than IPOs Yet*, BLOOMBERG OP. (July 27, 2020, 11:59 AM), https://www.bloomberg.com/opinion/articles/2020-07-27/spacs-aren-t-cheaper-than-ipos-yet [https://perma.cc/X75H-JTFL].

131. Rodrigues & Stegemoller, *supra* note 7, at 914.

132. *See* Klausner et al., *supra* note 7, at 236-41.

Ironically, the investment banks do not even play the more limited certifying role that they play in mergers and acquisitions in terms of valuation of the target. In a typical merger, an investment bank will provide a fairness opinion attesting that the merger price is within a certain range and thus "fair."[133] Generally, fairness opinions protect the board of the target company from shareholder suits claiming that the merger consideration was too low.[134] They can also protect a strategic acquiror from shareholder claims of overpayment, especially when the acquiror is issuing enough stock to require a shareholder vote.[135] While the law does not require fairness opinions, they became customary in practice after the seminal case of *Smith v. Van Gorkom* to show that the board had fulfilled its fiduciary duty.[136]

Those familiar with mergers and acquisitions transactions will be surprised to learn that SPACs regularly do not obtain an opinion attesting to the fairness of the merger consideration. In the case of SPACs, the target is closely held, and presumably the major shareholders are at the bargaining table and would not require a fairness opinion. But a fairness opinion *would* shield the SPAC's board against claims of overpayment—a particularly useful protection given that the shareholders who remain throughout the de-SPAC are at risk of dilution.[137] SPAC shareholders are left at the mercy of the board's judgment as to whether the merger price is fair—and the board, dominated as it is by the sponsors, has every incentive to close a deal, even if it means overpaying.

Many SPAC shareholders are likewise incentivized to get a deal done—because, at least at the outset, they are warrant holders as well. Warrants, recall, are issued in the IPO and afford their holder the right to purchase a share or a fraction of a share for a set price.[138] After some variation at the beginning of our sample period, by 2014, the exercise price is set at $11.50 per share.[139] Once the warrants and stock separate, they trade separately, and SPAC shareholders are free to sell or redeem their shares and to retain their warrants.

SPACs have a redemption value of $10 per share, so logically $10 should constitute a floor value. Indeed, in most cases, SPACs do trade at around this base-level price,[140] which represents the holder's view

133. *See* Steven Davidoff Solomon et al., *Fairness Opinions in M&As*, *in* THE ART OF CAPITAL RESTRUCTURING: CREATING SHAREHOLDER VALUE THROUGH MERGERS AND ACQUISITIONS 483 (H. Kent Baker & Halil Kiymaz eds., 2011).

134. *See id.* at 484.

135. *See id.* at 486.

136. *See id.*

137. *See generally* Klausner et al., *supra* note 7.

138. *See id.* at 233.

139. *Id.* at 236. Sometimes the IPO unit also consists of a right to acquire a fraction of a share when the de-SPAC is complete. *Id.*

140. *See id.*

that the SPAC either will not complete a transaction or will purchase a target that is perfectly valued or overvalued. SPACs do sometimes trade above their offering price, especially if there is particular excitement about a manager, structure, or announced acquisition.[141] These higher trades are the exception, rather than the rule, particularly in our sample period.

With warrant exercise prices commonly set at $1.50 above the share redemption price, the most likely path towards warrants being worth something is for there to be a merger. If there is a merger, the warrant holder stands a chance of the operating company doing well enough to render the warrants valuable.[142] Studies suggest that most IPO investors do indeed hold on to their shares, at least unless and until they trade above $10, and retain their warrants as a modicum of "up-side" should the de-SPAC merger prove successful.[143]

Finally, the incentives of independent directors are problematic as well.[144] The exchange rules require independent directors, defined as lacking financial ties to the issuer or familial ties to its directors and officers.[145] This lack of ties to the issuer is supposed to help ensure that independent directors can exercise their independent judgment and protect shareholders.[146] SPACs tend not to pay independent directors fees, but instead award them founder shares—that is, the same stock as the sponsors. The recent *Multiplan* opinion held that these supposedly independent directors are, like the sponsors, financially incentivized to vote for a deal—any deal.[147] It held SPAC directors with such interests may be self-interested and lacking in independence because of precisely these conflicts of interest.[148]

Given the complexity of the above-described relationships, we have waited until now to introduce the final major player in current SPACs: private investments in public equity (PIPEs).[149] In a PIPE, third-party

141. For example, Bill Ackman's Pershing Square Tontine Holdings regularly traded above its offering price. Jen Wieczner, *The Not-So-Happy Story of the World's Biggest SPAC*, INTELLIGENCER (July 23, 2021), https://nymag.com/intelligencer/2021/07/psth-the-not-so-happy-story-of-the-worlds-biggest-spac.html [https://perma.cc/KN2Z-F6L4].

142. Of course, the rights by definition only have value if the de-SPAC is successful.

143. *See* Klausner et al., *supra* note 7, at 236-41.

144. Director independence is a core shareholder protection, but independence carries different connotations in different contexts. The exchanges define independence as a lack of financial ties with the issuer. Delaware, in contrast, defines independence as a lack of financial interest in a particular transaction. Usha Rodrigues, *The Fetishization of Independence*, 33 J. CORP. L. 447 (2008).

145. *Id.*

146. *See generally* Lucian A. Bebchuk & Assaf Hamdani, *Independent Directors and Controlling Shareholders*, 165 U. PA. L. REV. 1271 (2017).

147. *In re* MultiPlan Corp. S'holders Litig., 268 A.3d 784 (Del. Ch. 2022).

148. *Id.* at 813-14.

149. Leslie Picker & Ritika Shah, *How Financing SPAC Takeovers Became Wall Street's New Favorite Trade*, CNBC (Jan. 25, 2021, 1:23 PM), https://www.cnbc.com/2021/01/25/how-

investors, typically institutional investors, agree to invest in the merged company. PIPE investors conduct their own due diligence in a concentrated time period and make an investment that can dwarf the size of the trust account.[150] Some commentators describe the PIPE investment as a validation of the acquisition—it means that a sophisticated institutional investor has gone "over the wall" of the target and has assessed it as a worthy investment.[151] The participation of a sophisticated institutional player thus can serve as a stamp of approval for the SPAC, indicating that the target is a viable public company.[152] Certainly, a PIPE investment is at least a signal of quality. The SPAC investor has some modicum of comfort knowing that the PIPE investors have looked under the hood and desire to go forward with an investment.

But that comfort may be cold—or at least incomplete. Importantly, the PIPE investment does not necessarily occur at the same valuation or on the same terms as the SPAC's acquisition.[153] PIPE investors may negotiate terms that are more favorable than those of SPAC holders, who can suffer considerable dilution.[154] Indeed, we have been assured of the existence of these kinds of "sweetheart deals" by SPAC participants. The PIPE investors cannot provide true comfort to retail investors unless they enjoy equivalent price terms. Otherwise, there is a risk of reproducing the problem with sponsor incentives: misaligned incentives could reward PIPE investors who got in a relatively weak deal on the cheap.

But even if the investments occur on equal terms, the argument that PIPE investors validate the de-SPAC rests on a contestable presumption: that the PIPE investor is a shrewd market participant able to value a firm reliably well. Yet many examples exist of supposedly seasoned investors who misstep. WeWork is one example.[155]

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financing-spac-takeovers-became-wall-streets-new-favorite-trade.html [https://perma.cc/ZRN3-AXNZ] ("PIPEs are increasingly being deployed in conjunction with a surge in SPAC mergers"). Reliance on the trust account was always problematic because of the risk of a surfeit of redemptions driving the value too low to accomplish the deal (thus creating, practically speaking, an economic check to the transaction even without a contractual conversion threshold). 64% of the Klausner study sample feature third-party PIPEs.

150. Klausner et al., *supra* note 7, at 273.

151. *See, e.g.*, David N. Feldman, *Reverse Mergers + PIPES: The New Small-Cap IPO Reprinted and Updated from PIPEs: Revised and Updated Edition—A Guide to Private Investments in Public Equity (Bloomberg Press, 2005)*, 3 BUS. L. BRIEF 34, 35 (2007). *See generally* William K. Sjostrom, Jr., *PIPEs*, 2 ENTREPRENEURIAL BUS. L.J. 381 (2007).

152. *See* Robert Berger, *SPACs: An Alternative Way to Access the Public Markets*, 20 J. APPLIED CORP. FIN. 68, 68-70 (2008).

153. Klausner et al., *supra* note 7, at 273.

154. *Id.*

155. *See* Reuters Staff, *Solyndra Withdraws IPO, Raises $175 mln*, REUTERS (June 18, 2010, 2:28 PM), https://www.reuters.com/article/solyndra-ipo-idAFN1814596320100618 [https://perma.cc/9N35-XZE8] (stating that solar panel maker Solyndra withdrew its IPO

The reader takes the point. Institutional investors often get it wrong. If the investors are private—as those of WeWork and Theranos were—then the damage done is contained to the accredited and institutional investors market. But in the SPAC, retail investors relying on the PIPE for validation take their chances that the PIPE investors were appropriately discerning. Moreover, one cannot assume that the retail investor and the PIPE investor are adding the SPAC to underlying portfolios with similar risk characteristics.

PIPE investors also receive bargained-for registration rights, and there is no guarantee that they will continue to hold shares of the de-SPAC'd, newly public company for long. But once a PIPE investor is secured, then inevitably it too is pushing to get a deal done—on its own terms.

There is one final SPAC player with incentives that diverge from the SPAC shareholder. The target wants to go public. It has weighed the attractions of a traditional IPO versus a de-SPAC and, in a crowded SPAC marketplace, may have been in negotiations with several SPACs.[156] Having announced a deal and satisfied itself with its merits, it is also generally eager to close. Indeed, the less attractive targets are presumably most eager to close a deal that will bring them liquidity.

Thus, generally, the incentives of participants in the SPAC IPO all tilt towards approval of the de-SPAC: everyone is for a transaction to go forward, and there is little incentive for second-guessing the suitability of the private company for the public markets. No wonder there have been some highly publicized flameouts such as Nikola and Lordstown. But this state of affairs is not how the SPAC form began, and the story of how SPACs evolved to their current incarnation is a revealing one.

II. THE EVOLUTION OF SPACS

As we have seen, the SEC is the ultimate arbiter as to if and when a firm goes public. Without the SEC's blessing (and the investment bank's), a traditional IPO simply cannot occur.[157] Thus, SPAC evolution is ultimately a story of deregulation.

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because of "'adverse' public market conditions"); *see also* Joanna Glasner, *Why Webvan Drove Off a Cliff*, WIRED (July 10, 2001, 2:00 AM), https://www.wired.com/2001/07/why-webvan-drove-off-a-cliff/ [https://perma.cc/VH4M-7T76] (reporting that Webvan, an early online grocery shopping service, filed for bankruptcy eighteen months after its IPO due to "[r]apidly disappearing cash reserves").

156. *See, e.g.*, Josh DuClos, *Key Considerations for Targets in Negotiating Purchase Terms with SPACs*, L.A. & S.F. DAILY J. (Sept. 16, 2020), https://www.sidley.com/-/media/publications/daily-journal--key-considerations--sept-2020.pdf?la=en [https://perma.cc/D9WP-WWD3].

157. SEC, INVESTOR BULLETIN, *supra* note 74.

SPACs began with the SEC's regulatory dispensation. As originally conceived, they featured a host of investor protections—including a true vote on the de-SPAC, one that combined the shareholders' economic and voting interests. But a crucial rule change in the wake of the 2008 financial crisis allowed SPACs to shed the protection that having a vote theoretically provided—and to do so with the SEC's explicit endorsement. This Part tells the story of how deregulation allowed SPACs to evolve into insider IPOs, driven by a few without the curb the shareholder vote was initially intended to provide.

A. First Generation

Blank check companies have a checkered past. They originated in the 1980s[158] and were often associated with "pump-and-dump" schemes, where an unscrupulous company would spread false reports about an upcoming merger ("pumping" the stock), and then after the value had risen, abruptly sell ("dumping" it) and leave investors with nothing.[159] Congress passed the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 to address these problematic issuances, and under that authority, the SEC promulgated Rule 419 and other rules to protect investors.[160]

Rule 419 allows blank check companies to raise money in a public offering for the purpose of acquiring a company in the future.[161] Crucially, however, both the money raised and the securities sold are placed in an escrow account.[162] Once the managers find a target, which must be valued at least 80% of the offering proceeds, the company sends each holder of escrowed securities a copy of a prospectus.[163] Holders have twenty to forty-five business days to notify the issuer in writing that they elect to remain holders of the new company; if the issuer does not receive this notice, it has five business days to return the investor's escrowed funds.[164] Thus, Rule 419 requires investors affirmatively to opt into investment into the newly public company.

The SPAC form arose in reaction to Rule 419's strictures but priced itself high enough to avoid penny stock regulation. SPAC organizers convinced regulators to loosen their grip a little and to allow

158. SU, *supra* note 6, at 1.

159. James Chen, *SPACs Look Like a Bubble Within a Bubble*, INVESTOPEDIA (Feb. 9, 2021), https://www.investopedia.com/spacs-look-like-a-bubble-within-a-bubble-5105202 [https://perma.cc/H77Z-C7KJ].

160. Rodrigues & Stegemoller, *supra* note 7, at 875-76 (citing Penny Stock Reform Act of 1990, Pub. L. No. 101-429, §§ 501-510, 104 Stat. 931, 951-58 (1990)); Riemer, *supra* note 82, at 941-42.

161. *See* Derek K. Heyman, Note, *From Blank Check to SPAC: The Regulator's Response to the Market, and the Market's Response to the Regulation*, 2 ENTREPRENEURIAL BUS. L.J. 531, 533-34 (2007).

162. *See* 17 C.F.R. § 230.419 (2022).

163. *Id.* § 230.419(e)(1).

164. *Id.* § 230.419(e)(2).

SPACs to IPO—even though they are a form of blank check company.[165] SPACs offered numerous investor protections—remember, the form had to cajole the SEC into allowing the offerings to go forward in the first place.[166]

Key to their persuasive efforts were significant investor protections in place at the acquisition level, many of which mirrored Rule 419 requirements. For example, acquisitions typically had to be 80% of the deal size, and the funds raised had to be placed in a trust account.[167] Two crucial differences were that the securities themselves were not escrowed but traded freely, and rather than an opt-in mechanism, SPACs put the onus on their shareholders to opt out of the merger.

Despite this change, there were considerable shareholder protections in place, at the outset, at least. SPAC shareholders could 1) vote on the deal and 2) redeem their shares—that is, get most of their money back from the company if they voted against the business combination.[168] As we have documented, if redemptions exceeded a specified "conversion threshold," typically 20%, the deal would not close.[169] That is, if more than 20% of shareholders asked for their money back, the deal failed.

Notice that there were effectively two votes on the acquisition. First was a shareholder vote on whether the transaction would go forward. Corporate law generally requires such a vote on the target side, to ensure that the target wants to move forward with the transaction.[170] We have detailed in other work that votes on the acquisition side are less common, and acquirers are sometimes at pains to avoid them.[171] Exchange rules dictate that if the merger requires the issuance of enough additional shares, then the acquiring firm's shareholders must vote on the deal.[172]

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165. Rodrigues & Stegemoller, *supra* note 7, at 876. EarlyBirdCapital and David Nusbaum filed for the first SPAC in 2003. *Id.* at 878; *see* Milan Lakicevic & Milos Vulanovic, *A Story on SPACs*, MANAGERIAL FIN., Apr. 2013, at 3.

166. Datar et al., *supra* note 72, at 19.

167. *See* James Murray, *Innovation, Imitation and Regulation in Finance: The Evolution of Special Purpose Acquisition Corporations*, 6 REV. INTEGRATIVE BUS. & ECON. RSCH. 1, 8-10 (2017).

168. Steven M. Davidoff, *Black Market Capital*, 2008 COLUM. BUS. L. REV. 172, 225 (2008).

169. Rodrigues & Stegemoller, *supra* note 7, at 910 (citing M. Ridgway Barker & Randi-Jean G. Hedin, *SPACs—Continuing to Grow and Evolve*, CORP. COUNS. BUS. J. (June 1, 2007), https://ccbjournal.com/articles/spacs-continuing-grow-and-evolve [https://perma.cc/7PYP-TN2P] (explaining the investor's "conversion right")); *see* Lakicevic & Vulanovic, *supra* note 165, at 14.

170. *See* Rodrigues & Stegemoller, *supra* note 7, at 856.

171. *See* Paul Mason, Usha Rodrigues, Michael Stegemoller & Steven Utke, *Does Shareholder Voting Matter? Evidence from the Takeover Market*, 53 WAKE FOREST L. REV. 157, 160-61 (2018). Technically, a merger requires a vote of both merging corporations. Corporate law created the triangular merger, where the acquirer creates a wholly-owned subsidiary that merges with the target, to obviate the need for a vote of the acquiring corporation.

172. *See id.* at 159.

Both of these mechanisms are safeguards that counterbalance managerial pressure to close a deal—even a bad deal for shareholders. Sponsors must convince at least a majority of the SPAC shareholders that the public target is worth, at minimum, what the SPAC is offering. But in many ways, the conversion threshold was the real vote—even though it was not nominally a vote at all. The original reasoning for allowing SPACs to go forward was because investors had a chance to evaluate the eventual deal and get their money back if they rejected it.[173] If enough investors rejected it, then the market had spoken, and the deal would not go forward, thus insulating the system against bad deals.[174] And a "bad deal" in such a context is not just a bad deal for the SPAC shareholders—it is a "bad deal" that becomes a public company through a less rigorous mechanism than the traditional IPO. We term this safeguard an economic vote: if shareholders redeemed their shares, they were voting with their wallets to exit the transaction.

What is more, the conversion threshold's economic vote made perfect economic sense. The trust account was a war chest, the purpose of which was specifically to fund an acquisition. If too many SPAC shareholders redeemed their shares, then the trust account would run dry—there would not be enough money to fund the acquisition.[175] The conversion threshold was thus a matter of economic necessity—so long, that is, as the trust account was the chief source of funds for the acquisition.

As we have seen, the rise of PIPEs made the trust account something of an irrelevancy. That is because the economic vote carried with it a hidden threat. As we wrote in *Exit, Voice, and Reputation: The Evolution of SPACs*, "[t]hese shareholder approval provisions were important in convincing the SEC to allow SPACs to go public, but they created . . . a holdout right."[176] During the financial crisis, SPACs' robust investor protections became a liability, as hedge funds began buying up SPAC shares and threatening to vote down any proposed merger unless they received concessions like additional shares or cash. This so-called "greenmailing"[177] was quite effective because, as we have

173. *See* Rodrigues & Stegemoller, *supra* note 7, at 875-79.

174. *See* Klausner et al., *supra* note 7, at 236-41.

175. *See* Rodrigues & Stegemoller, *supra* note 7, at 856.

176. *Id.* at 910 (citing Thomas Friedmann & D. Chad Larson, *Special Purpose Acquisition Companies: A SPAC Evolution*, HEDGE FUND J. (May 2008), https://thehedgefundjournal.com/special-purpose-acquisition-companies/ [https://perma.cc/SJY7-34S6] (citation omitted)).

177. *See* Noam Noked, *"Greenmail" Makes a Comeback*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 22, 2014), https://corpgov.law.harvard.edu/2014/01/22/greenmail-makes-a-comeback/ [https://perma.cc/FGV9-KGNS].

seen, SPAC managers are eager to close a deal and thereby secure a payday.[178] SPAC sponsors sought relief from this greenmailing threat, and the SEC obliged.

B. Empty Voting: Decoupling and Elimination of the Vote

With the SEC's consent, the market has done away with the investor protections that SPAC entrepreneurs initially used to persuade the agency into allowing the form's emergence. Today, most SPACs completely eliminate the conversion threshold.[179] Sometimes the target company negotiates a maximum redemption threshold as a closing condition, but the trust account, once the main source of funds for the eventual acquisition, is now almost an irrelevancy because of the PIPE.

At the time of our sample, from the time of announcement, the merger can sometimes be virtually a *fait accompli*. Our sample shows a mean yes vote of 89.1%.[180] Indeed, sometimes SPACs eliminate the vote entirely, using a tender offer mechanism—all with the blessing of the SEC, as this Section will recount.[181] While some announced deals were withdrawn, we found not a single case in the period where shareholders voted down a proposed merger. The vote is a rubber stamp. More recently, SPACs have encountered challenges, and some SPAC mergers have failed—a function, we believe, of economic and regulatory changes and proposed changes. It is hard to disentangle one from the other—anticipation of a less hospitable regulatory environment has made potential targets, and PIPE investors, more cautious—and there is certainly a glut of SPACs in the market today. Our point, however, is that there is little incentive on the part of the SPAC shareholders to vote down a proposed deal.

The elimination of the conversion threshold began, as with so much of the SPAC story, on the over-the-counter markets, away from the national exchanges.[182] But this Section will focus on the changes in the national exchanges because the SEC must approve any changes to exchange listing requirements—and explain its rationale for approval.[183]

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178. *See* Rodrigues & Stegemoller, *supra* note 7, at 872 (citing Order Approving Proposed Rule Change to the Special Purpose Acquisition Company Listing Standards, Exchange Act Release No. 34-63607, 2010 WL 5301044, at *5 (Dec. 23, 2010)).

179. *See* Rodrigues & Stegemoller, *supra* note 7, at 917.

180. *See infra* Section IV.C.

181. *See* Eric M. Fogel, *2011 M&A Outlook: Developments, Strategies, and Challenges*, *in* ADVISING CLIENTS IN MERGERS AND ACQUISITIONS: LEADING LAWYERS ON UNDERSTANDING RECENT LEGAL DEVELOPMENTS, HANDLING CROSS-BORDER M&A DEALS, AND NAVIGATING THE CURRENT ECONOMIC CLIMATE 7 (2011).

182. Rodrigues & Stegemoller, *supra* note 7, at 910-12.

183. 15 U.S.C. § 78s.

Thus, the evolution of these rules offers a window into the SEC's reasoning, first in approving SPACs and then in approving elimination of voting requirements.

1. The Camel's Nose

SPACs could not list on the NYSE or Nasdaq at first because of rules prohibiting blank check companies from doing so.[184] In 2008, however, the SEC allowed both national exchanges to change their listing requirements to allow SPACs.[185] In both cases, the agency stressed the importance of the power of shareholders to approve—or disapprove—the ultimate acquisition. First in time came the NYSE, which required both a majority vote and a conversion threshold of no more than 40%—that is, if more than 40% of shareholders redeemed their shares, then the acquisition would not proceed.[186] When the SEC approved changing the NYSE's listing standards to permit SPACs, it specifically stated that voting safeguards "help to ensure that public shareholders approve management's decision with respect to a Business Combination, and have remedies if they disagree."[187] And as to the economic vote, the approved listing standards provided conversion rights "for those public shareholders voting *against* the Business Combination."[188]

This is a key point: the initial NYSE listing standards approved by the SEC provided that shareholders who were opposed to the deal could exercise their conversion rights and redeem their shares to exit the firm, but it was silent as to the power of shareholders approving the transaction to redeem their shares.

Two months later, the SEC approved rules allowing SPACs to list on the Nasdaq.[189] Again, the SEC cited the protections that SPAC investors were afforded, including the fact that "each public shareholder voting against a business combination must have the right to convert his or her shares."[190] Additionally, at this same time, the Nasdaq required a vote by the majority of common stock shares.[191]

184. Order Approving Proposed Rule Change to Adopt New Initial and Continued Listing Standards to List Securities of Special Purpose Acquisition Companies, Exchange Act Release No. 34-57785, 73 Fed. Reg. 27597, 27597-601 (May 6, 2008) [hereinafter Order Approving Proposed Rule Change].

185. Lakicevic & Vulanovic, *supra* note 165, at 7.

186. Order Approving Proposed Rule Change, *supra* note 184, at 4.

187. *Id.* at 12.

188. *Id.* (emphasis added).

189. Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval to Proposed Rule Change, as modified by Amendment No. 1, to Adopt Additional Initial Listing Standards to list Securities of Special Purpose Acquisition Companies, 73 Fed. Reg. 44794 (July 25, 2008).

190. *Id.* at 44795.

191. *Id.* at 44796. The North American Securities Administrators Association had voiced reservations during the rulemaking process about "historical concerns regarding blank check

2. Eliminating Safeguards

Yet, two years later, the SEC would eliminate the conversion threshold for the NYSE as well as eliminate the requirement of a shareholder vote for both exchanges.[192] The impetus for the change was, as we have already described, to lessen the risk of greenmailing, and the account that the SEC gave of the problem is telling. After describing the risk of greenmailing, when certain investors use the threat of a no-vote to extort extra compensation from management, the SEC observed, "In other cases, the [greenmailing hedge funds'] withheld votes caused the proposed acquisition to fail altogether."[193]

This last quotation merits restating: "In other cases, the withheld votes caused the proposed acquisition to fail altogether."[194] The SEC missed a key point: there neither is nor *should* be a guarantee that every proposed de-SPAC merger go forward. After all, not every S-1 matures into an IPO, as we have seen. The vetting and winnowing process that occurs throughout the waiting period, road show, and book building stages necessarily results in some firms not making the cut and thus failing to go public.[195] In similar fashion, the voting down of a proposed acquisition is not an indictment of the voting mechanism—it merely indicates that more shareholders voted against the deal than for it. The potential for rejection of a proposed combination was, in fact, a chief investor protection heralded by both regulators and the exchanges just two years earlier as a means to help "ensure that public shareholders approve management's decision with respect to a Business Combination."[196]

Instead, the new SEC regulations permitted shareholders to "vote with their feet."[197] In lieu of holding a shareholder vote, the SPAC could

companies." *Id.* at 44795. The Nasdaq responded that it would "review each SPAC that applies to list and evaluate the reputation of the SPAC's sponsors and underwriters." *Id.*

192. Self-Regulatory Organizations, The NASDAQ Stock Market LLC; Order Approving Proposed Rule Change to Amend IM-5101-2 to Provide Special Purpose Acquisition Companies the Option to Hold a Tender Offer in Lieu of a Shareholder Vote on a Proposed Acquisition and Other Changes to the SPAC Listing Standards, Exchange Act Release No. 34-63607 at 1-2, 75 Fed. Reg. 82420 (Dec. 23, 2010).

193. Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Proposed Rule Change to Amend IM-5101-2 to Provide Acquisition Companies the Option to hold a Tender Offer in Lieu of a Shareholder Vote on a Proposed Acquisition, Exchange Act Release No. 34-63239 at 5, 75 Fed. Reg. 68846 (Nov. 3, 2010) [hereinafter Notice of Filing of Proposed Rule Change] ("As a result of the required vote, in a number of cases, hedge funds and other activist investors acquired an interest in an Acquisition Company and used their ability to vote against a proposed acquisition as leverage to obtain additional consideration not available to other shareholders. For example, they may negotiate the sale of their stake to an affiliate of the Acquisition Company's management for a price higher than their pro rata share of the deposit account.").

194. *Id.*

195. *See* PHILIPPE ESPINASSE, IPO: A GLOBAL GUIDE, EXPANDED 161-204 (2014).

196. Order Approving Proposed Rule Change, *supra* note 184, at 12.

197. Notice of Filing of Proposed Rule Change, *supra* note 193, at 5.

invite its shareholders to tender their shares in exchange for the redemption value. The Nasdaq argued that "this tender offer alternative would help prevent shareholders who support the acquisition and elect to retain their shares from being denied the benefits of the transaction by the actions of the activist investors."[198]

The regulators took their eye off the ball. The original SPAC mechanism of a vote and redemption right protected not only the investors who bailed on the proposed business combination, but *also those who remained and the markets as a whole.* As originally conceived, a SPAC's manager had to convince its shareholders of the proposed deal's supposed merits. Now, skeptics could cash out after the vote was eliminated, leaving only the believers—thus eliminating the market test of the transaction that was originally touted as a key safeguard for the SPAC form.

But regulators did not see it that way. In 2016, citing the lack of a vote requirement at Nasdaq and NYSE MKT, the NYSE proposed to eliminate both the vote and the conversion threshold, using language similar to the Nasdaq in identifying the greenmail threat and the protection offered by letting shareholders "vote with their feet" in a tender offer.[199] The SEC observed that the tender offer "would help prevent shareholders who support the acquisition and elect to retain their shares from being denied the benefits of the transaction by the actions of the activist investors."[200]

In approving these changes in early 2017, the SEC stated that it "believe[d] that the conversion right and the nature of SPAC securities pricing support the proposed amendment to treat securities of SPACs and operating companies differently."[201] Again, it failed to consider the protection that these negative votes provided, not for the exiting shareholders, but for the market itself against improvident deals.

With the tender offer, the SEC allowed SPACs to bypass the vote entirely. But in the majority of our sample, shareholders *do* hold a vote on the merger. We only find tender offers in 5% of our sample. The story of increasingly permissive SEC regulation of SPAC tender offers is mostly instructive for revealing the SEC's acceptance of the exchanges' argument regarding the protection from greenmailing of announced deals, even at the expense of the shareholders' voices. The

198. *Id.* at 6.

199. Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Proposed Rule Change Amending Its Listing Standards for Special Purpose Acquisition Companies, Exchange Act Release No. 34-79676 at 4, 81 Fed. Reg. 96150 (Dec. 22, 2016).

200. Notice of Filing of Proposed Rule Change, *supra* note 193, at 6.

201. Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 2, to Amend Listing Standards for Special Purpose Acquisition Companies to Modify the Initial and Continued Distribution Requirements, Exchange Act Release No. 34-81079 at 8, 82 Fed. Reg. 32022 (July 5, 2017).

more prevalent problem, rather than the shareholder vote being actually eliminated, is its utter impotence. Empty voting, the decoupling of the vote from economic interest, is the most common way that modern SPACs have effectively neutered the shareholder vote, making the result a foregone conclusion.

C. *The Problem of Empty Voting*

We saw in Section II.B that a theoretical check against the pressure to acquire even a poor prospective target is the shareholder vote on whether the transaction should go forward. The tender offer bypasses a vote entirely, but tender offers only occur in 5% of our sample. Even in the SPACs without tender offers, however, the vote is nearly irrelevant because SPACs have decoupled voting and economic interest in the de-SPAC. This decoupling renders the SPAC shareholder vote—when it even occurs—a mere fig leaf. A de-SPAC is a *fait accompli.*

Every SPAC in our sample gives shareholders the right to redeem their shares—regardless of their vote. We have been unable to ascertain the legal support for this position. The listing standards continue to require that SPAC shareholders who vote "no" have a redemption right.[202] We presume that the logic goes as follows: 1) the rules simply require SPACs to give the right of redeeming shares to shareholders who reject a transaction; 2) there is nothing to stop SPACs from *also* granting a redemption right to those who approve it; 3) therefore, shareholders who vote "yes" can also redeem their shares. Admittedly, this is merely conjecture—we have only the language of the listing requirements and the data, neither of which truly reveal the reasoning behind the policy discussed.

But the data is clear: SPAC shareholders can vote for a transaction while, at the same time, exercising their redemption right and getting their money back. The language explaining this curious state of affairs is relatively uniform among SPACs. The proxy will explain, often in bold, that "**Public stockholders may elect to redeem all or a portion of their public shares even if they vote for the Business Combination Proposal.**"[203] In the Q&A section, the common question "**Will how I vote affect my ability to exercise redemption rights?**" is met with the following answer: "No. You may exercise your redemption rights whether you vote your Public Shares for or against

202. *102.06 Minimum Numerical Standards—Acquisition Companies*, NYSE (July 5, 2017) [hereinafter *102.06 Minimum Numerical Standards*], https://nyse.wolterskluwer.cloud/document/09013e2c85545f2a [https://perma.cc/G2HQ-ZDRR] ("[I]f a shareholder vote on a Business Combination is held, each public shareholder voting against the Business Combination will have the right ('Conversion Right') to convert its shares of common stock into a pro rata share of the aggregate amount then on deposit in the trust account (net of taxes payable, and amounts disbursed to management for working capital purposes), provided that the Business Combination is approved and consummated."); NASDAQ Rule IM-5101-2 (2022).

203. Diamond Eagle Acquisition Corp. Proxy Statement, *supra* note 24.

the Business Combination Proposal or do not vote your shares."[204] This ability to vote for a transaction while divesting oneself of any economic interest in it renders the vote a nullity—an empty vote.

Empty voting is deeply problematic in corporate law. The power to vote is the linchpin of shareholder power. Contractarian theory posits that the vote gives shareholders, the residual claimants, final say over the managers of the firm as well as in important transactions such as mergers or amending the charter.[205] In simpler terms, in the standard economic theory, shareholders have the vote because they, as the residual claimants, are last in line and thus are the most motivated to maximize the value of the firm.[206]

The logic of giving the vote thus presupposes an economic interest in maximizing firm value. In their influential work in 2006, Professors Henry Hu and Bernard Black criticized the hypothetical possibility of decoupled voting and economic interest.[207] Among various distortions that can occur when voting rights are decoupled from economic rights, they term cases where shareholders hold more votes than they do shares as "empty voting."[208]

The ability of shareholders to vote "yes" and nevertheless jump ship in a de-SPAC is a species of empty voting. It is deeply troubling because, in mergers especially, voting interests typically accompany economic interests. This point bears emphasis, and an example will make it more concrete. Target shareholders in a typical merger have what are called dissenters' or appraisal rights, which protect them from a lowball offer.[209] If they vote against a proposed acquisition, they can go to court and ask the court to determine the fair value of the deal. And if the court says the fair value of the deal is more than the merger consideration, they receive the difference.[210]

In one noteworthy case, T. Rowe Price owned shares in Dell and wanted to claim dissenters' rights when Silver Lake Partners and Michael Dell took the company private.[211] The offer was $13.25 per share.[212] The court agreed with T. Rowe Price; its appraisal price was

204. VectoIQ Acquisition Corp., Proxy Statement, Prospectus and Information Statement (May 8, 2020).

205. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 67-69 (1996).

206. *See* Hu & Black, *supra* note 16, at 850.

207. *Id.* at 815.

208. *Id.*

209. Jonathan Kalodimos & Clark Lundberg, *Shareholder Rights in Mergers and Acquisitions: Are Appraisal Rights Being Abused?*, 22 FIN. RSCH. LETTERS 53, 53 (2017).

210. Steven J. Cleveland, *Appraisal Rights and "Fair Value,"* 43 CARDOZO L. REV. 921, 930 (2022).

211. *In re* Appraisal of Dell Inc., No. CV 9322-VCL, 2016 WL 3186538, at *48 (Del. Ch. 2016).

212. *Id.* at *32.

$17.62 a share, or 28% above the Silver Lake buyout price.[213] But it turned out that T. Rowe Price had neglected to actually vote against the merger before it went to court.[214] The court held that in order to exercise its economic rights and reject the deal, T. Rowe Price needed to have voted accordingly.[215] Thus, T. Rowe Price lost out on $194 million in dissenters' rights,[216] an example that emphasizes the importance that the law traditionally places on aligning shareholders' votes with their economic claims—on aligning a proxy vote with a shareholder's wallet.

Hu and Black focused in 2006 on the dangers of decoupling votes from economic ownership. Still, they explained that, because it is "seldom captured by disclosure rules," the scale of the empty voting phenomenon was unknown.[217] They did compile and document in three separate articles "a list of over twenty confirmed or publicly rumored examples."[218]

SPACs present empty voting on a much grander scale. Klausner et al.'s 2019-2020 study of successful de-SPACs found mean and median redemption rates at 58% and 73%, respectively, with a quarter showing redemption rates of over 95%.[219] Our data, reported in Section IV.D, shows that the total number of shares redeemed as a percentage of shares issued in the IPO is an average (median) of 54.2% (59.9%), with a quarter having redemption rates over 91%. Thus, the de-SPAC presents an unprecedentedly large-scale example of empty voting.

This is a staggering percentage when one considers that an early justification for SPACs hinged on the investor protection that the market tests provided. And the point of aligning voting and economic interests should be obvious. As the last Section described, all of the major SPAC participants are motivated to close a deal. The shareholder franchise once provided a market check on the pressure to close a deal. That check is now gone—in our sample time period, SPAC shareholders did not vote down a single proposed merger.

Decoupling voting and economic interests poses a particular danger to retail investors if we presume that the public markets are largely driven by big players like hedge funds and institutional investors.

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213. *Id.* at *168.

214. *In re* Appraisal of Dell Inc., 143 A.3d 20, 34 (Del. Ch. 2016).

215. *Id.* at 56.

216. Antoine Gara, *T. Rowe Price To Take $194 Million Charge Due to Voting Error On Dell LBO*, FORBES (Jun. 6, 2016, 3:27 PM), https://www.forbes.com/sites/antoinegara/2016/06/06/t-rowe-price-to-take-194-million-charge-due-to-voting-error-on-dell-lbo/?sh=5830ba3652b0 [https://perma.cc/G68A-RTSU].

217. Hu & Black, *supra* note 16, at 819.

218. *Id.*

219. Klausner et al., *supra* note 7, at 239. This study's data is from a more recent period, which could indicate a troubling trend toward a higher percentage of redemptions.

Typical market functioning allows smaller investors to ride the coattails of large investors.[220] Companies make many periodic filings, but generally, retail investors do not have the sophistication to analyze these documents themselves.[221] Large investors hire analysts to perform research on a company's industry and prospects, and they *do* read the firm's public filings.[222] Retail investors, even without consulting a single filing, benefit nonetheless from the diligence of the large investors because the market price will rise or fall depending on the actions of such big players.[223] Even if a retail investor does not read the 8-K that advises an unexpected stepping-down of the CEO, she will notice if the stock is dropping, and she can make an assessment as to whether she should continue to hold shares. Holger Spamann argues that in the public markets, these types of indirect investor protections safeguard retail investors.[224] The actions of sophisticated third parties such as hedge funds and other investment professionals naturally protect the smaller investors because the economic incentives of the big players and retail investors are usually aligned.[225]

But recall, empirical evidence suggests that institutional shareholders, including a substantial number of hedge funds, constitute a considerable portion of SPAC shareholders. Klausner et al. find evidence that institutional investors hold the clear majority of SPAC shares from the IPO until the merger.[226] Many of these SPAC shareholders decide to cash out at the de-SPAC.[227]

Yet, we have seen that these hedge funds are the very shareholders that have an incentive to vote for a deal and nevertheless redeem their shares because they hold warrants and rights. These instruments, remember, form a part of the unit offering in the IPO but can trade separately once they detach from the common shares. The rights and warrants only have value if the deal goes through—if the SPAC fails and returns its money to its investors, they are worthless.

Thus, we can see the effect of two decisions: the elimination of economic vote of the conversion threshold and the decoupling of the vote and economic interest. At least with a conversion threshold, there was a floor on the amount of money that the account would contain.

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220. Spamann, *supra* note 18.

221. *See generally* Lisa M. Fairfax, *The Securities Law Implications of Financial Illiteracy*, 104 VA. L. REV. 1065 (2018).

222. *See* Jill E. Fisch, *Does Analyst Independence Sell Investors Short?*, 55 UCLA L. REV. 39 (2007).

223. *See generally* Cary Martin Shelby, *Privileged Access to Financial Innovation*, 47 LOY. U. CHI. L.J. 315 (2015).

224. Spamann, *supra* note 18, at 20.

225. *Id.*

226. Klausner et al., *supra* note 7, at 241. They find median holdings of 85% immediately after an IPO and 87% immediately before the merger.

227. Klausner et al. find that almost 100% of IPO investors redeem or sell before the merger. *Id.* at 241-46.

With a conversion threshold of 30%, SPAC managers could count on having at least 70% of the trust account to fund the acquisition. If more than 30% of the shares were redeemed, there was no deal. But modern SPACs have removed this risk from the equation by eliminating the conversion threshold altogether.

Of course, elimination of the conversion threshold dropped the floor out from under the escrow as a funding mechanism—but only because a different funding mechanism had already begun to take its place. To replace the trust account as an amount certain to fund an acquisition, SPACs turned to the PIPEs we described in Section I.C. But the PIPE investors' incentives are not aligned with those of the SPAC shareholders who do not redeem.

In eliminating the vote via tender offers and allowing SPACs to decouple voting and economic interest, the regulators at the SEC made a mistake. The original SPAC mechanisms of holding votes and providing redemption rights protected not only the investors who opted out of the proposed business combination, but *also those who remained.* As originally conceived, a SPAC's managers had to convince the market of the proposed deal's merits. If too high a percentage of the shareholders were unconvinced and wanted to cash out, the deal failed. Bad deals could be halted before they reached the market. The sophisticated players who could comprehend byzantine de-SPAC disclosures protected the retail investors who could not.

With these voting protections gone, skeptics can now cash out, leaving only the convinced or the unwary—either way, the vulnerable—thus eliminating the market test of the transaction that SPAC originators touted as a key safeguard.[228] The harm extends beyond merely the SPAC shareholders who remain, however. The irrelevance of the redemption to the closing of the deal means that even deals abandoned by most of the shareholders nevertheless move forward and enter the public markets.[229] This state of affairs lets loose on the public market firms that have received neither the scrutiny of the traditional IPO nor the market test of the original SPAC mechanism.

Taking either our median redemption rate of 59.9% of IPO proceeds or the 73% median of the Klausner study of more recent SPACs,[230] SPACs' redemption rates are staggeringly high. In Part V, we recommend recoupling the shareholder vote and economic interest. If more than 50% of the shareholders ask for their money back—either by redeeming their shares or by tendering them in an offer—the deal should not go forward. But there is additionally one final danger that SPACs currently present, one we merely touch on here because it is the focus of a companion piece: the danger of illiquidity.

228. *See* Spamann, *supra* note 18, at 53 ("[R]edemption in a de-SPAC.").

229. *See infra* Section IV.C.

230. Klausner et al., *supra* note 7, at 240.

D. Liquidity Challenges

We find considerable evidence of liquidity challenges in SPACs, both before and after the announcement of a merger. A companion paper to this Article explores these findings and their ramifications in great detail. For the purposes of this Article, we will observe only that SPAC trading can be light to the point of nonexistence.[231] There are days, even around the announcement of a deal—the most important piece of information a SPAC can announce to the market, being that it has in fact found a target—when not a single SPAC share trades.

Illiquidity creates dual threats: that shareholders may not be able to get out of trades easily, and that they will have to do so by paying high transaction costs because so few shares trade. The worst-case scenario is that an unwary SPAC shareholder will remain in a SPAC that 80% or more of her fellow shareholders have forsaken. After the de-SPAC, if the company proves unable to demonstrate that it has 300 shareholders, it will be subject to delisting from a major exchange—a huge red flag that will trigger a selloff.[232] And the precise reason for delisting here is illiquidity; thus, by definition, shareholders will have little recourse as they seek to exit their trades even before actual delisting occurs.

III. LITERATURE

Having provided the necessary background for our study, we move to situate our empirical contribution in the literature. We have previously published two papers on SPACs, now almost a decade ago.[233] With the most recent SPAC surge, there has been a corresponding increase in interest in the form. We offer here a brief review of recent empirical literature, most of which has focused on problems with the acquisition process.

Recent empirical contributions to the literature include *Segmented Going-Public Markets and the Demand for SPACs* by Bai et al., which examines empirical data on SPAC issuance and comparison to traditional IPO firms.[234] Maria Lucia Passador examines SPACs as an investment phenomenon, with a focus on understanding institutional investors' participation and the impact of COVID-19.[235] Kanis Saengchote examines "mispriced SPACs" (SPACs that trade above $10)

231. *See* Usha Rodrigues & Michael Stegemoller, *The SPAC Market*, WASH. U. L. REV. (forthcoming) (on file with authors).

232. *See* Klausner et al., *supra* note 7, at 237 n.17.

233. Rodrigues & Stegemoller, *supra* note 7; Rodrigues & Stegemoller, *supra* note 124.

234. Jessica Bai et al., Segmented Going-Public Markets and the Demand for SPACs (Sept. 23, 2021) (unpublished manuscript) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3746490 [https://perma.cc/5FCU-L5AD]).

235. Maria Lucia Passador, *In Vogue Again: The Re-Rise of SPACs in the IPO Market*, 16 BROOK. J. CORP. FIN. & COM. L. 105 (2022).

in electric vehicle SPACs.[236] Gahng et al. examine one-year investment returns from an earlier period (January 2010-May 2020) of SPACs, specifically narrowing in on warrant-pricing practices and the increasing sponsor contributions that make SPACs less attractive investments at the IPO but lessen the dilutive effects at the de-SPAC while still contributing to better investments for post-merger shareholders.[237]

There have been several notable contributions in the legal literature for our purposes, including two empirical pieces. Klausner et al. argue for more standardized disclosure—and for more disclosure more broadly—at the time of acquisition, as well as for uniform rules regarding forecasting and liability between SPACs and traditional IPOs.[238] They contend that the SPACs represent a sweet deal for the IPO investors—largely hedge funds—that buy in the IPO but a poor deal for the retail investors who buy from those initial investors.[239] They focus their attention on the SPACs that completed acquisitions from January 2019-June 2020, which comprise a sample of forty-seven firms from the recent iteration of SPAC evolution.[240] A second Klausner & Ohlrogge paper examines sponsor payouts.[241]

Several law articles focus on the legal underpinning and structure of SPACs. John Coates describes the "myths" that surround SPACs, arguing against contentions made by SPAC promoters regarding the structures themselves and the SEC's response to them.[242] Amanda Rose carefully critiques claims that SPACs are little more than regulatory arbitrage.[243] Mira Ganor makes a generalized case for what she calls "non-binary, contingent" shareholder votes.[244] One of her main examples is the case of SPAC shareholders confronting whether to redeem their shares.[245] She argues that rather than voting blindly either for redemption or non-redemption, shareholders would be better served were they allowed to vote conditionally based on how their fellow shareholders vote.[246]

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236. *See* Kanis Saengchote, The Tesla Effect and the Mispricing of Special Purpose Acquisition Companies (SPACs) (Mar. 9, 2021) (unpublished manuscript) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3800323 [https://perma.cc/DP4A-SKQD]).

237. Minmo Gahng et al., *SPACs*, REV. FIN. STUD. (forthcoming) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3775847 [https://perma.cc/C892-2RVW]).

238. *See* Klausner et al., *supra* note 7, at 287-88.

239. *Id.* at 298-99.

240. *Id.* at 232.

241. Michael Klausner & Michael Ohlrogge, *Is SPAC Sponsor Compensation Evolving? A Sober Look at Earnouts* (Stan. L. & Econ. Olin, Working Paper No. 567, 2022).

242. Coates, *supra* note 88.

243. Rose, *supra* note 110.

244. Ganor, *supra* note 70, at 391.

245. *Id.* at 409-16.

246. *Id.* at 416. For example, a shareholder may decide that if at least 30% of the shares are redeemed, then she will redeem all of her shares, but if less than 20% redeem their shares, she will not redeem.

These papers are excellent contributions to the literature. We seek to consider a fuller picture by focusing on a broader sample of SPACs that IPO from 2010 to 2018 (concluding their acquisitions in 2020), before SPACs exploded in popularity. What is more, we focus on problems of empty voting and illiquidity and the repercussions those have, not just for the post-merger SPAC shareholders, but also for the economy at large as poorly vetted private firms access the public markets.

IV. DATA

A. *Methodology*

Our sample construction begins with the advanced search function of Nexis Uni.[247] We search under "Company and Financial" and "SEC Filings" to find all S-1 filings on EDGAR from January 1, 2010, to December 31, 2019. We include all SPACs that attempt to undertake an IPO, and we do so in order to show the broadest scope possible with respect to the SPAC form—how it begins and how it ends. We use the SDC Merger and Acquisitions (M&A) database, FactSet, EDGAR filings, and Nexis Uni to collect specific data related to the proposed IPO, the actual IPO, and any business combination. We use CRSP and FactSet to acquire price, volume, trading, shares outstanding, and some deal values. For example, price and volume data for SPACs trading on the lesser regarded over-the-counter bulletin board (OTCBB) are almost exclusively found in FactSet.

Importantly, our ending date of S-1s filed by December 31, 2019, gives each SPAC sufficient time to complete both an IPO and the contractual length of the search for a target. As of January 2022, there are eight firms in our sample with an uncertain final outcome: six have announced, but not completed, a deal, and two completed their IPO in July of 2019 but have yet to announce a transaction. Extending the date to include 2020 transactions would leave an incomplete picture, since many of these SPACs have yet to either acquire a target or, if ultimately unsuccessful in their acquisition bid, to fully redeem their

247. We find that there is no standard way to collect the SPAC data from SDC, through either its IPO database or its M&A data. SDC is a well-known source for both equity offerings and business combinations, but we do not rely on it because it does not uniformly classify the SPACs in our sample by a particular industry or even by the SIC code listed in the S-1. Indeed, the EDGAR database produces the same set of problems—usually once a SPAC acquires a target, all historical data of the SPAC is updated to reflect the target's industry. Thus, we use SDC as only a supplemental source of data and search the EDGAR database through Nexis Uni, not the EDGAR search function. It is our opinion that this lack of standardization with respect to data on SPACs leads to significant difficulty in researching the form and may even cause researchers to see only a portion of the SPAC universe. We do not claim to see the entire SPAC universe in our sample period but have gone to particularly extensive lengths to do so.

shares. Including in our sample S-1s filed in 2019 means that part of our sample may exhibit characteristics of a "bubble,"[248] so we report both data over the full sample period and data broken out by time. Even some SPAC enthusiasts concede that there are too many SPACs in the 2020-2021 timeframe,[249] attributing problematic features of the form to macroeconomic factors such as low interest rates.[250]

In our Nexis Uni search of EDGAR filings, we specify that the filing must be done by a company with an SIC code of 6770, which is the code for blank check companies, of which SPACs are a subset.[251] We add the restriction that "6770" must be near the term "Standard," which will appear in the phrase "Primary Standard Industrial Classification Code Number." This restriction eliminates instances of 6770s that appear but are not related to the SIC. Further, our search restricts results from containing both amended S-1 filings (S-1/A) and commodity pools. This word search produces 264 results. From this set of companies, we delete both 1) firms subject to Rule 419, and thus by definition not SPACs,[252] and 2) firms that are operating companies, but somehow retain the 6770 SIC due to a past transaction involving a SPAC. These screens produce a sample of 241 firms that file an S-1 as a blank check company from 2010 to 2019.

In much of the analysis that follows, we provide data for the whole period and also examine the 2010-2016 and 2017-2019 sub-periods. We split the sample for two reasons: 1) because of the increasing popularity of SPACs over time—these two periods each make up roughly half

248. David Erickson, *Will 2020 Be Seen as the Year of the SPAC Bubble?*, KNOWLEDGE WHARTON (Jan. 12, 2021), https://knowledge.wharton.upenn.edu/article/will-2020-seen-year-spac-bubble/ [https://perma.cc/QDF6-AHEP].

249. *See* James Mackintosh, *Wall Street's Hottest Financing Tool Makes Me Worry About the Market*, WALL ST. J. (Oct 17, 2020, 5:30 AM), https://www.wsj.com/articles/wall-streets-hottest-financing-tool-makes-me-worry-about-the-market-11602927001 [https://perma.cc/H42K-LVKU]; *see also* David Brancaccio & Rose Conlon, *The SPAC Craze, Explained*, MARKETPLACE (Mar. 5, 2021), https://www.marketplace.org/2021/03/05/spacs-blank-check-companies-public-offering-ipos-stock-market-low-interest-rates/ [https://perma.cc/Z4WV-6YN7].

250. *See* Klausner et al., *supra* note 7, at 230-36; The Editorial Board, *The Making of an Electric-Vehicle Fiasco*, WALL ST. J. (June 14, 2021, 6:36 PM), https://www.wsj.com/articles/the-making-of-an-electric-vehicle-fiasco-11623710171 [https://perma.cc/56N3-5F9K].

251. We rely on Nexis Uni because an EDGAR search leaves out valid transactions, since the SEC reclassifies the SPAC SIC into the SIC of the target after acquisition. For example, Social Capital Hedosophia Holdings Corp. was a blank check company with SIC code 6770 until it acquired Virgin Galactic Holdings, Inc. After the acquisition, the name of the SPAC became the target's name and is reclassified under Transportation Services (SIC 4700).

252. Rule 419 defines a "blank check company" as one that is both issuing penny stock and "[i]s a development stage company that has no specific business plan or purpose or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies, or other entity or person." 17 C.F.R. § 230.419 (2022). SPACs avoid being penny stock by having a market value of over $5 million.

our sample; and 2) SPACs' evolutionary trajectory means that SPACs late in our sample may be sufficiently distinct from those early on to merit separate treatment.

B. Descriptive Statistics

Table 1 shows the number, size, and exchange characteristics of SPACs by the year in which the firm files its initial S-1. Because the time between an initial S-1 filing and IPO can span two calendar years, the data in each row cannot be read to comprise the same set of firms. We classify our sample by "classes," with each "class" designating the year that a firm went public. If a SPAC filed its initial S-1 filing in December of 2017, completed an IPO in February of 2018, and completed an acquisition in November of 2019, it would fall into the 2017 class.

For the first three years of our sample, less than two-thirds of the firms that file an S-1 ever actually complete an acquisition. 2012 represents the most lackluster class—only two SPACs filed for an IPO, and neither even made it to the public market. The last row of columns (2) through (4) document that, of the 241 SPACs that file an S-1 intending to undertake an IPO, only 216 actually accomplish an IPO, and only 188 acquire a target. Thus, if the acquisition of a target is a measure of SPAC success, then approximately 78% of SPACs are successful by this most basic and value-neutral of measures.

In 2011, the average time between the initial S-1 and the IPO was almost half a year (176 days), which is an exceptionally long wait before IPO. After 2012, most SPACs that accomplish an IPO get to the public markets within two months or less from the time of their initial S-1 filing. In the final two periods of our sample, this length of time is reduced to approximately one month—thirty-one days for 2018 and 2019, respectively. This trend is consistent with both a more standardized and efficient IPO process for SPACs and also an increasing rush to market for a new going-public form.

Most SPACs that begin the IPO process—filing an initial S-1—accomplish their stated objective of acquiring a firm. The completion rate ranges from a low of 42.9% in 2010 to a high of 91.9% in 2017 (excluding 2012, when only two SPACs tried to IPO, and both failed). Moreover, success in terms of completing the process—moving from the filing of an S-1 to the completion of an acquisition—generally improves over our sample period.

Similar upward trends are also present in the number SPACs filing S-1/As (amendments to the S-1 form), the proceeds raised in the IPO, and the size of the targets purchased. Excluding 2012, the lowest year for number of SPAC IPOs is 2010 (with six) and the highest frequency of SPAC IPOs is 2019 (with fifty-six). Over the sample period, the amount raised in the IPO more than doubled, moving from less than $90 million in each of the first three years of our sample (2010-2012) to over $200 million in each of the last four years of the sample (2016-2019). The value trend is even more striking when we examine the amount paid for targets. In 2010 and 2011, the aggregate amount paid for targets is less than $3 billion. By 2019, the aggregate amount paid by SPACs to purchase a target increases to approximately $88 billion.

Finally, Table 1 documents a marked trend of listings moving from primarily the OTCBB to the major national exchanges, the NYSE and Nasdaq. The OTCBB is the exchange of choice for the majority of SPAC IPOs in the first three years of our sample. For the middle years in our sample, 2014-2016, SPAC IPOs listed exclusively on the Nasdaq. In the last three years of our sample, the Nasdaq maintained a majority position in listing SPACs, but the NYSE attracted about 25% of the SPAC IPOs in each of the three years. This move away from over-the-counter trading to the national exchanges shows SPACs entering the mainstream over the course of our sample period.

In Table 2, we detail some of the main characteristics of the 216 SPACs that complete an IPO, and we show how those characteristics changed from the periods of 2010-2016 to 2017-2019. The mean proceeds raised from an offering is $196.5 million; the second period is characterized by mean proceeds of $221.3 million versus $151.7 million in the first period. While the IPO offering proceeds increase across the two periods, the amount raised through the private placement that occurs simultaneously to the IPO remains fairly stable at $5.6 million and $6.7 million.

SPACs evolve into a standard unit offering by the second period. First, the ubiquitous unit price of $10.00 appears in 2017, with lower prices only being observed in the first part of our sample. Second, warrants are part of the unit in every SPAC observed in the second period but are absent in some SPAC IPOs from 2010 to 2016. Some SPACs in this first period were straight issues of common stock. Third, by the 2017 to 2019 period, the warrant strike price is always derived from a price of $11.50. The mean reported in this period obscures the fact that some units offered one-half of a warrant and have a $5.75 strike price. Of course, the holder of the

warrant could not obtain fractional shares, so any warrant exercise would be $5.75 times 2, yielding the standard $11.50 strike price. In the earlier 2010 to 2016 period, in contrast, Table 2 shows variation in warrant pricing. Last, the majority of SPACs begin using a dual-class share structure (89 of the 139 SPACs) in the 2017 to 2019 period. This structure provides anti-dilutive protection and sometimes voting privileges for sponsors/founders. As to the first, the sponsor/founder class shares consistently exhibit an anti-dilutive provision allowing their class to convert into 20% of the IPO class of shares at the time of the business combination. Moreover, some allowed only the sponsor/founder class to vote for directors and one allowed 10:1 super voting for the founder class.

The final five rows show little variation across the two periods but document a few additional characteristics about the SPAC form. Months allowed for SPAC managers to find and purchase a target range from eighteen to twenty-seven months in both subperiods. In a change from our initial study spanning 2003-2008, the trust account had swelled to average above 100% of the IPO proceeds—providing a guarantee that a redeeming SPAC shareholder will receive all her money back. The trust amount, with no exception in the later period, does not fall below 100% of the offering proceeds. The sponsor/founders own roughly 20% of the SPAC after IPO with very little variation in the later period. Finally, apart from some unique solutions to underwriting spreads, the mean underwriting expense for the IPO is 5.5% of IPO proceeds, with 3.5% of the gross amount deferred until the de-SPAC.

In sum, Tables 1 and 2 show the increasing standardization and growth of the SPAC form over time.

C. Redemptions and Voting

We now turn to the experience of SPACs with respect to redemptions and voting. Table 3 documents both shareholder voting on the proposed acquisition by the SPAC as well as the concomitant redemptions made by those same shareholders around the vote date. In Panel A, we document the characteristics of voting and redemptions, and we compare the two subperiods of our sample in Panel B.

The average (median) ratio of shares outstanding that vote "yes" for the acquisition is 76.6% (75.5%), while "no" votes comprise, for the median SPAC, less than 2% of the outstanding shares. For more than a quarter of the votes we observe, there are virtually no "no" votes. This overwhelming approval of the acquisition by shareholder vote would be more impressive if it were consistent with what we observe of shareholder economic behavior.

One open question is how many shares vote for the merger while still redeeming—that is, the extent of the empty voting. We cannot answer this question directly, but we can provide an approximation. The complication is that sponsors' shares have the power to vote—and indeed, are sometimes contractually obligated to vote for a proposed merger—but their shares do not carry a redemption right. Thus, a simple comparison of redeemed shares to yes votes will not work.

Using total redeemable shares provides an additional metric that allows us to remove the shareholders such as founders/sponsors, who by contract cannot redeem their shares. In the last two rows of Table 3's Panel A, we document the proportion of redemptions at the vote date only (not including previous redemptions). First, we scale the number of redemptions by the number of redeemable shares outstanding as of the quarterly report prior to the vote date. For example, if the vote date is November 17th, then we would use shares from the September 30th 10-Q (or 10-K). The median percentage of redeemable shares redeemed at the vote date is 50.0%. We estimate the number of redeemable shares that vote yes by applying the proportion of redeemable shares to all shares to the total number of actual votes—yes, no, abstentions, and broker non-votes. Using this metric, we find that SPACs experience an average redemption of 74.2% of votes cast by shareholders able to redeem their shares. That is, these results show that over half of the shareholders that can redeem do so, even though the mergers are overwhelmingly approved.

The variability of the measures of redemptions at the vote is also telling. The lowest quartile is practically zero redemptions, while the highest quartile exhibits massive redemptions, all greater than 85% of the vote no matter which measure used. For the measure that compares redemptions to actual votes cast, the highest quartile is above 100%, indicating shareholders that do not vote but redeem their shares. Overall, these characteristics are indicative of empty voting, the problem caused by the divergence of cash flow rights and control rights, described in Section II.B.

Thus far, we have examined redemptions at the vote, but focusing on this number can radically distort the true economic picture of the SPAC. This is because almost 45% of our sample SPACs successfully amended their certificates of incorporation to allow for an extension of time to complete a merger. Recall that the original SPAC promise was a time-limited hunt for a target, which was to expire generally within eighteen to twenty-four months. Several of our sample firms only successfully closed a merger after four or even more extensions of this initial promised time period.

Any amendment to a corporation's certificate of incorporation requires both the recommendation of the board of directors and the approval of the shareholders, so each time the SPAC managers sought an extension, they asked for a shareholder vote. In exchange, they offered the shareholders a choice: they could redeem their shares at the extension or continue to invest in the SPAC.[253] To sweeten the pot for those shareholders that remained, the sponsors generally contributed more money, often millions of dollars more, into the trust account.[254]

Sometimes, these extension redemptions dwarfed the final redemption at the merger vote. For example, Pensare Acquisition Corporation had only 91,637 shares redeemed at closing.[255] However, it had initially promised shareholders it would take eighteen months to complete a merger[256] and wound up taking well over two years. Along the way, Pensare successfully asked shareholders for four extensions, and shareholders redeemed a total of 12,517,836 shares[257]—a number that is over 136 times the number of redemptions at closing. So, while there were 6,030,888 positive votes for Pensare's acquisition of American Virtual Cloud Technologies, Inc., and only 91,637 shares redeemed,[258] this snapshot would not reveal that over 12 million shares had already jumped ship by the time of the vote.

When we examine the total number of shares redeemed leading up to, and including, the redemptions around the vote date, we observe a significant exodus from SPACs. Most SPACs experience a redemption by more than half of their shareholders as measured by the number of units sold in the IPO (in Row 3 of Panel A) and the number of redeemable shares outstanding after the IPO (in Row 4 of Panel A). For more than a quarter of the SPACs we observe, the redemption rate is close to 90%.

In Panel B of Table 3, we see a significant reduction in the number of "yes" votes across the two subperiods, although the mean proportion of affirmative vote remains high—moving from 88.1% to 71.6%. Though there appears to be some worsening (increase) in empty voting

253. *See, e.g.*, Global Partner Acquisition Corp., Current Report (Form 8-K) (Aug. 4, 2017) (exhibiting extension redemptions of $34.3 million from the trust account).

254. *See, e.g.*, Jensyn Acquisition Corp., Schedule 14A Information ("Jensyn Capital, LLC, a company controlled by certain of the initial stockholders of the Company, has agreed to contribute to Jensyn Acquisition $0.09 for each public share that is not converted into cash at Jensyn Acquisition's special meeting of stockholders.").

255. Am. Virtual Cloud Technologies, Inc., Annual Report (Form 10-K) (June 29, 2020).

256. Pensare Acquisition Corp., Prospectus (July 27, 2017).

257. Pensare Acquisition Corp., Current Report (Form 8-K) (Feb. 1, 2019) (2,796,290 shares); Pensare Acquisition Corp., Current Report (Form 8-K) (Apr. 30, 2019) (3,831,985 shares); Pensare Acquisition Corp., Current Report (Form 8-K) (Aug. 6, 2019) (5,754,273 shares); Pensare Acquisition Corp., Current Report (Form 8-K) (Nov. 26, 2019) (135,288 shares).

258. Pensare Acquisition Corp., Current Report (Form 8-K) (Feb. 28, 2020).

and an improvement (decrease) in total redemptions across the two periods, none of these changes are statistically significant. Thus, the evidence in Table 3 is consistent with the average SPACs exhibiting significant empty voting.

Table 4 examines how well SPACs keep their promises. We speculate that SPACs that stray from the terms of their deal with shareholders by extending their timeline beyond the period stated in the IPO prospectus also tend to do poorly along a number of measures—i.e., firms who "go back on their word" by overextending the time they initially promised may bend the rules in other areas as well.

In terms of frequency, column (3) shows the 97 firms in our sample that do not stray from the terms of the original agreement (and thus complete an acquisition or liquidate the SPAC within the period specified in IPO prospectus), and column (2) shows the 111 firms that do stray from the original terms (and thus do not complete an acquisition in the requisite time period). The first two rows of the table are mechanical in nature given how the two categories are constructed, but these columns show the degree to which SPACs overextend. Notably, SPACs that overextend their terms, on average, announce their acquisition two weeks (13.9 days) before the search is originally set to expire. Quite a coincidence. The average time by which the effective date eclipses the expiration date is 162 days.

Listing standards vary between the exchanges and the OTCBB, and we explore whether listing choice has any relationship with fulfilling the original search term parameters. We find that the NYSE is the only exchange that has a greater proportion of SPACs honoring the original search terms than not, with the difference between those that extend, and those that do not, significant at the 5% level (p-value from a difference in means t-test of .0151). The Nasdaq and OTCBB exchanges have more SPACs that extend than those that do not, though the difference is not significant.

Underwriters, like exchanges, may lend a certification mechanism for a SPAC firm, and so we rank all of the lead (lead left in the prospectus) underwriters using a one-year lagged market share of equity underwriting among investment bankers. We divide the rankings between top-ten and not-top-ten underwriters and find that those SPACs that do not meet the search term specified, on average, have statistically significantly lower underwriter rankings than those that do meet their search terms. A third of extenders use a top-ten underwriter versus half of non-extenders.

Table 4 shows that while "yes" votes do not significantly differ between groups, the redemption rate does. For SPACs that do not meet

their contractual search term, the average total redemption rate is 66.3%, which is 2,430 basis points higher than the 42.0% rate for firms that do meet their promised search time period. This difference is significant at the 1% level.

Thus, the evidence in Table 4 is indicative of the majority of SPACs not fulfilling their original promises communicated to SPAC shareholders. Moreover, these same SPACs compare unfavorably to SPACs that meet their search terms in the following ways: they tend to be underwritten by lower reputation underwriters and take longer to get from initial prospectus to IPO and have much higher redemption rates with no difference in "yes" vote rates. Taken with the general evidence on liquidity and empty voting, a reasonable conclusion is that the majority of these firms are simply not on par with exchange-listed firms that have gone through the rigors of a normal IPO process.

Finally, in Table 5, we examine the relation that redemption rates have on value. If there is a problem with decoupling cash flow rights and control rights, as is the case with empty voting, then we should expect to see some value implication associated with higher rates of redemption. Thus, we examine the relation between value and total redemptions in a multivariate setting, which allows us to control for SPAC and deal characteristics as well as period.

The main issue with an analysis of value in this context is tied up with one of the other problems associated with SPACs: illiquidity. In a companion piece, we describe this issue in greater detail; here, we merely acknowledge both the widespread problem of illiquidity in SPACs and the difficulty in measuring value because of the subpar price data that stems from that illiquidity.

In Table 5, we use two different dependent variables that measure value in a regression setting. First, in the models shown in columns (1) through (4), we use the simple return from thirty trading days prior to the acquisition announcement to ten trading days after the effective date. Specifically, this value is the share price at ten trading days after the effective date minus the share price thirty trading days prior to the acquisition announcement; this difference is then scaled by the share price thirty trading days prior to the acquisition announcement. In the models in columns (5) and (6), we use the simple return from ten trading days prior to the effective date to ten trading days after the effective date. Specifically, this value is the share price at ten trading days after the effective date minus the share price ten trading days prior to the effective date; this difference is scaled by the share price ten trading days prior to the effective date. In column (6), the model

uses the premium that the share price, at ten trading days after the effective date, represents over and above the redemption price at the vote date. This is calculated as the share price at ten trading days after the effective date scaled by the product of the trust amount (as a percentage of the proceeds from the IPO) and the share price of common stock at the IPO.

In the first model, seen in column (1) of Table 5, we observe a significant negative relation between the total shares redeemed (as a percentage of shares at the IPO) and returns. This result is consistent with larger redemption rates signaling negative acquisition outcomes. In column (2), we introduce independent variables to control for other factors that may influence these returns. We control for the size of the acquisition, the reputation of the SPAC underwriter, and the subperiod that contains the SPAC. The coefficient on total redemptions remains negative and significantly related to returns.[259]

We measure only ten trading days, or roughly fifteen calendar days, from the de-SPAC for two reasons. First, fifteen days was the length of the grace period the exchanges sought from the SEC to prove that recent de-SPACs met the 300 shareholder minimum requirement.[260] Second, because de-SPAC'd companies will often issue more shares in the months after the de-SPAC, as well as experience other confounding events, we choose to evaluate returns at a date close in time to the de-SPAC to see if there is any near-term relationship between the percentage of redemptions on price. As reported above, we indeed find statistically significant correlations.

There are a few large outliers with respect to returns in our sample. For example, at the tenth trading day after the effective date, Phunware, which was purchased by Stellar Acquisition III, is trading at about $157 a share—a "stellar" return of over 1000%. Thus, in column (3), we truncate the upper tail of our returns, setting the maximum return to 100%. This modification applies to ten firms in our sample. When we rerun the model from column (2) with this modification, the results become more statistically significant, though obviously the coefficients are reduced. The results in column (3) are consistent with the previous results.

For the dependent variable of the models shown in columns (5) and (6), we introduce an alternative measure of return that is not influenced by any prices prior to ten trading days after the effective date. Thus, all independent variables occur prior to the measure used

259. We assume that a reduction in the trust account does not induce a reduction in stock price given that rational investors will only redeem their shares when the price is at or below the redemption value and the price of SPAC shares will not, on average, trade below $10.00.

260. *See supra* note 201 and accompanying text.

as the dependent variable. The measure is effectively what an investor would experience if they purchased SPAC shares at the trust amount and then sold the shares at the price of those shares on the tenth day after the de-SPAC. Also, in model (6), we introduce the proportion of "no" votes observed as an additional means of shareholders showing their disapproval of the de-SPAC. In each model, there is always a significantly negative relation between the total shares redeemed and value. Further, performance is also negatively related to the proportion of "no" votes.

In sum, these results are consistent with redemption rates being indicative of acquisition success (or lack thereof). This result then points to the importance of tying voting to redemptions. Moreover, it also points to the fact SPACs are not like other public firms, where price availability is largely not a problem.

V. IMPLICATIONS AND REFORM

SPACs are an increasingly popular form and accordingly the subject of increasing regulatory scrutiny.[261] This Article first described this burgeoning form, highlighting differences between it and the traditional IPO, and emphasized how—unlike in the IPO, and problematically—everyone's incentives are aligned towards making a deal. Part II described the evolution of SPACs, explaining the rise of empty voting in the de-SPAC and the problem it poses. Part III presented a brief summary of the relatively sparse literature, particularly legal literature on SPACs, which has not focused on the questions of illiquidity, empty voting, and lack of vetting that we treat here. Part IV presented original data on SPACs. Section IV.C turned to redemptions and found correlation with other problematic behavior and with negative stock returns as soon as ten days after trading. This Part discusses implications and proposed reforms. Section A of this Part summarizes the harms to the retail investors in SPACs. Section B pulls back to address broader risks that SPACs pose to the public markets. Section C proposes reforms and addresses counterarguments.

A. Harms to the SPAC Investor

1. Those Left Behind

The risk to the SPAC investor flows from a combination of two factors: first, as Section I.C described, every major SPAC player has an incentive to close a deal; second, SPACs are illiquid and provide untimely information to the market. As to the first, Section II.B described how the shareholder vote and conversion threshold, originally intended to provide real checks on managerial pressure to

261. *See supra* notes 50-52 and accompanying text.

close a deal, no longer serve that function. Empty voting exists, with the shareholder vote divorced from the economic vote. Part IV showed that redemptions at the vote totaled, on average, 61.5% of public votes for the merger in the sample as a whole.[262] This means that, even with mean "yes" votes of 76.6%, over half of the shareholders got their money back.[263] Over time, the percentage has diminished, but even in the later period, redemptions were 63.9% of the public votes. Klausner et al. find even higher percentages in a more recent period.[264]

In an ordinary merger, large institutional shareholders would vote "no" on a deal they see as value-destroying. In a SPAC, at least 20% of the vote is already a sure thing because the sponsor will vote—indeed, is contractually obligated to vote—for the deal. And warrant holders who still hold shares will likewise vote for a deal because warrants only have value if there is a successful de-SPAC. In our sample period, we saw only fourteen cases where SPACs announced deals and were unable to complete them—and none of them came to a vote. Thus, unwary retail shareholders are uniquely at risk in the de-SPAC—they cannot depend on larger market forces to protect them.

Putting together these facts with the data described in Part IV, we find a perilous situation for the shareholders that do not elect to redeem their shares. Klausner et al. have documented that these shareholders face substantial dilution.[265] As reform measures, Klausner et al. have called for improved disclosure about sponsors' side payments to public shareholders in return for commitments not to redeem shares and the amount of cash it will deliver under a range of redemption scenarios.[266] We argue below in Section V.C that, given the perverse economics of the empty vote, disclosure is not enough.

But two counterarguments to any regulatory intervention need attention. One is that the data suggest that only relatively few investors are harmed. Hedge funds dominate the SPAC market, and generally, relatively few retail investors venture into these waters. The second is that unwary SPAC shareholders have assumed the risk by investing in SPACs, a novel form of investment. These points have real resonance; in one sense, our response is the companion paper. The market and regulators alike have failed to account for the novelty of SPACs' contribution—that at least it theoretically lets the public into waters typically governed by private market rules. The underexplored ramifications of that simple insight are the focus of our second piece.

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262. *See supra* Part IV.

263. *See supra* Part IV.

264. *See* Klausner et al., *supra* note 7, at 239.

265. *See id.* at 248-49.

266. *See id.* at 288-89.

Our second response is that the harm posed to investors ripples beyond the small number of SPAC retail investors. Regulatory policy has allowed SPACs to trade, cheek by jowl, with publicly traded operating companies as if they are equivalent. They are not—not with respect to liquidity, not with respect to alignment of incentives between large and small shareholders, and not with respect to the vetting and disclosure practices the next Section will discuss. Current SPACs claim all the benefits of public markets without providing the liquidity and disclosure we expect from them.

B. The Harm to the Public Markets

As we have seen, de-SPACs are a form of regulatory arbitrage, allowing firms to circumvent the traditional IPO process to obtain the same result through de-SPACs. Investment banks serve as gatekeepers in traditional IPOs, but in a de-SPAC, they are incentivized to close a deal to obtain the full measure of their fees. The sponsor's 20% cut is contingent on the closing of a deal, as is any profit from the warrants. The PIPE and target have likewise concluded that the deal is worth making—but their interests run counter to those of the current SPAC shareholders. The shareholder vote, an empty vote, is a rubber stamp. There is no player structurally incentivized to second-guess the decision to go public. Thus, SPACs allow unvetted firms to enter the public markets unprepared for the rigorous requirements of actually being public.

The case mentioned in Section I.B.1.b makes the point. Stable Road Acquisition Corp. announced the acquisition of Momentus, which purported to use water propulsion thruster technology to power rockets in space.[267] According to the SEC, both Stable Road and Momentus were liable for misstatements regarding the viability of the technology and the national security risks posed by its CEO.[268] These misstatements occurred in three separate filings in 2020 and 2021.[269] In a June 2021 filing, the companies corrected these misstatements and reduced the firm's financial projections and valuation "from more than $1.1 billion to less than $600 million."[270]

The extent to which these events were the work of naivete or outright fraud is both debatable and orthogonal to a key point: in a traditional IPO, the bank's arduous due diligence process likely would have *caught* these problems and *corrected* them—if not before the S-1 was filed publicly, then at least in subsequent filings *before* the offering went to market. And even if the bank had missed warning signs,

267. In the Matter of Momentus, *supra* note 104.

268. *Id.* at 2-3.

269. *Id.* at 7.

270. *Id.* at 12.

the SEC would have scrutinized the filings and asked questions in several rounds of comments. But because this was a de-SPAC, any investors who bought Stable Road at above $10 per share suffered a loss when the value dropped after the SEC investigated.

Some of these newly public companies are doubtless good investments. But on average and over time, the intermingling of ex-SPACs with traditional IPO firms risks lowering the quality of the public markets.[271] Over time, everyday investors may lose trust in the markets if the quality of public firms is diluted. For that matter, this risk is compounded when SPACs themselves trade as public companies even though they lack the liquidity and regular disclosure practices that we expect from companies of such a standing. The next Section considers reforms that will level the playing field but still preserve SPACs' ability to serve as an alternative way for firms to access the public markets.

C. Reforms

1. Disclosure

Disclosure in SPACs indeed requires reform. We have personally combed through SPACs' filings, and they are complex and suffer from a lack of standardization. Particularly in need of attention are disclosures surrounding the nature of the sponsors' investment in the SPAC. Sponsors sometimes invest mere thousands of dollars in exchange for 20% of the shares, but they contribute millions of dollars in warrants in order to build up the trust amount. They may participate in private placements either at the IPO or later on, often using investment vehicles that make it hard to identify and track beneficial interests. Indeed, we began to research this information and gave it up as too complicated. The fact that two academic researchers, experts in securities, finance, and corporate law and well-versed in SPACs, struggled to document this information indicates a problem.

Thus, we support enhanced disclosure as a means of SPAC reform. Still, a major takeaway of our Article is that disclosure is not protective enough, given the current disjuncture that empty voting creates between the incentives of large and small investors. Retail participation in the stock market has soared in recent years, and SPACs occasionally have been a specific focus of retail interest.[272] For

271. *See, e.g.*, Krystal Hur, *'You Have No Home Here'—Cramer Blasts Speculative SPACs for Taking Down the Stock Market*, CNBC (Jan. 26, 2022, 12:13 PM), https://www.cnbc.com/2022/01/26/you-have-no-home-here-cramer-blasts-speculative-spacs-for-taking-down-the-stock-market.html [https://perma.cc/6UK2-JEQD].

272. Erin Griffith, *No End to Whiplash in Meme Stocks, Crypto, and More*, N.Y. TIMES (Nov. 23, 2021), https://www.nytimes.com/2021/06/23/technology/no-end-to-whiplash-in-meme-stocks-crypto-and-more.html [https://perma.cc/WC22-8Y22].

disclosure to protect retail investors, they must either themselves read and assimilate the information or have intermediaries like stockbrokers do it for them. With the advent of zero-cost trading, and the democratization of investing that has accompanied it, fewer and fewer retail investors are using intermediaries. That leaves as the only feasible option investing the time to pore over the filings—filings which, as mentioned previously, suffer greatly from a lack of clarity and cohesion.

The ultimate question for the SPAC retail investor to answer is whether to hold their shares, and thus become a shareholder in the newly public target, or to redeem their shares and jump ship. We believe retail investors systematically fail to understand SPACs in general and the importance of the redemption decision in particular. We have argued consistently for almost a decade that exit rights are SPACs' most important investor protection,[273] but there is a high risk that investors do not understand the redemption right nor appreciate what it represents—not only an opportunity to get their money out, but also a risk that their fellow shareholders will leave them in the lurch.

Indirect evidence for this risk lies in the early 2021 phenomenon of multiple adjournments for SPACs that could not reach the requisite quorum requirement to hold a valid vote. Redemptions require a de-SPAC, and a de-SPAC requires a successful vote, so regardless of whether shareholders want to redeem or remain, rationally they should vote. Multiple adjournments became more common as retail investors failed to grasp the importance of the vote.[274]

Section II.C already described the threat that empty voting posed: the vote provides no shareholder protection because it is divorced from any economic significance. As Section I.C described, each party to this question other than the retail investor—the target, SPAC, investment bank, and PIPE investor—has every incentive to talk up the merits of the deal. Faced with this array of pressures and a lack of countervailing sources of caution, disclosure alone, while necessary, cannot suffice.

2. *Require 50% of the Shares to Accept the Deal*

The second reform logically flows from our findings on empty voting and our data on post de-SPAC performance: the SEC should encourage the NYSE and Nasdaq to require redemption thresholds of at least

273. Rodrigues & Stegemoller, *supra* note 7.

274. Ortenca Aliaj & James Fontanella-Khan, *Retail Investor Apathy Threatens to Derail Spac Deals*, FIN. TIMES (Mar. 10, 2021), https://www.ft.com/content/7554fead-6784-421a-8659-79afc8fbeeed [https://perma.cc/4TUF-DFCX]; Asher Dewhurst et. al., *The Evolution of SPACs: New Challenges and Opportunities*, ICR WESTWICKE BLOG (May 20, 2021), https://westwicke.com/2021/05/the-evolution-of-spacs-new-challenges-and-opportunities/ [https://perma.cc/JNQ2-J28T].

50% in order for a deal to go forward. That is, if more than half of shareholders ask for their money back, the deal should fail. This recoupling of economic and voting interests gives the target some certainty of price (by guaranteeing at least a certain amount in the trust account) and allows public shareholders a meaningful voice in the going-public transaction. Without some kind of vote, dissenters depart the SPAC and only the true believers remain. What the SEC failed to grasp at a pivotal point in the SPAC evolution, however, was the importance of dissenters in protecting *all* investors from the information asymmetries and concomitant market frenzy that can distort the efficiency of capital markets. Instituting a 50% threshold would counter these forces, reinstating the indirect investor protections that exist in the typical public markets.

Moreover, our data in Table 5, described in Section IV.D, make clear that redemptions have a statistically significant relationship with shareholder returns. Firms with larger redemption rates and firms with larger "no" votes suffer from lower stock prices, measured ten trading days later. These findings suggest that the shareholders actually may be relatively adept at discerning good deals, that is, at identifying targets that will perform well—at least in the short term—thus lending empirical support to our proposal for making the economic vote count. Implementing a 50% redemption threshold demonstrably will save the market from bad deals.

Mira Ganor's intriguing suggestion of a contingent vote is another, perhaps more market friendly way to achieve a similar end. As described in Part III, she advocates allowing a shareholder the ability to vote her shares conditional upon certain circumstances.[275] So if the majority of the shareholders vote unconditionally to redeem, then she could redeem—but if the majority voted unconditionally to remain, then she could follow the crowd and remain as well.[276] The problem with this solution is that it presumes shareholder sophistication and attention—shareholders must *understand* SPACs and the importance of redemption for it to be a viable solution. The quorum problems from early 2021 cast doubt on the retail shareholder's understanding of these basic SPAC features.[277]

Requiring 50% approval can be effectuated in one of two ways. First, the SEC could recouple voice and economic interest by no longer permitting shareholders who vote for a deal to redeem their shares. Second, the SEC could recognize that the true measure of a transaction's merits is the redemption and require not only that a

275. *See* Ganor, *supra* note 70, at 409-16.

276. *Id.*

277. *See supra* note 274 and accompanying text.

majority of SPAC shareholders vote for a deal, but also (and more importantly) that a majority of SPAC shareholders remain invested in the de-SPAC'd firm.

It is true that the cost of this reform measure is a decrease in deal certainty. Targets will enter into merger agreements with SPACs not knowing until the redemption date whether the acquisition will be accomplished. But that is entirely appropriate. The present deal certainty stems from the current SPAC being an insider IPO—a *fait accompli*, accomplished on the back of the public markets. Letting a meaningful vote occur returns the SPAC to its original conception and reestablishes a crucial check on the momentum to close a deal.

One potential objection is that either requirement would prompt companies seeking to go public via SPAC to demand higher valuations to reflect the uncertainty of a deal closing. This objection might have more merit if target companies were considering IPOs and de-SPACs as fungible alternatives to accessing the public markets. We believe, however, imposing a 50% requirement will likely make de-SPACs unattractive to companies that can avail themselves of a traditional IPO. We believe that SPACs function best as an alternative path for companies that have trouble gaining traction in this traditional market—and that the 50% requirement can serve as an alternate path to validation for these firms.

Another potential objection is that this reform will merely cause PIPE investors to invest directly in SPAC shares on the public market rather than in a separate private investment. But this change would be all for the good. Our concern is about the current state of play, where PIPE investors invest separately from SPAC investors, raising the possibility of "sweetheart" deals. If interested PIPE investors committed to the target were instead forced to invest side by side with the rest of SPAC investors in order to guarantee a redemption rate of less than 50%, then PIPE investors would in fact be providing a true validation of the deal. If a PIPE investor is willing to put its money where its mouth is, on the public market, and gets the deal past the 50% threshold, then there has been a true economic vote on the merits of the deal.

Finally, reintroducing a threshold concomitantly reintroduces the risk of the self-same greenmail that led to its elimination in the first place. Recall that the greenmail threat arose from the requirement in the earlier generations of SPACs that that no more than 20% of SPAC shareholders redeem—effectively imposing a supermajority requirement when it came to redemptions, since if more than 80% of shareholders redeemed, the deal would fail. The simple answer is an

80% supermajority requirement is very different from a 50% majority requirement. Any supermajority requirement creates substantial holdout risk by giving power to relatively small shareholder groups. These holdouts can frustrate the will of the majority by preventing a de-SPAC even when more than half of the SPAC shareholders are in favor of a deal.

More fundamentally, if a SPAC is unable to get across the 50% threshold, that means that most shareholders would rather get their money back than participate in the new firm. While a 50% threshold creates something of a holdout risk—if 45% of the shares redeem, then it empowers the remaining 6% shareholder or a collection of smaller holders to extract concessions—this risk is present with any majority-vote transaction. Not every merger—in the SPAC context or outside it—should go forward, and the cost of potential holdup at the 50% level is preferable to the status quo, where SPAC shareholders suffer losses after being stranded in illiquid firms that have lost much of their value after the majority of shareholders redeemed. Preventing deals where more than 50% of shareholders redeem does not frustrate the will of the majority of shareholders—it effectuates it. Moreover, there are mechanisms that can lessen the threat of greenmail. For example, so-called "bulldog" provisions limit redemptions to 10 or 15% of total shares outstanding. We find these provisions in 79% of our sample. We speculate that they are a holdover from early SPAC deals, but nonetheless they serve the function of reducing the risk of holdout.

3. Level the Playing Field?

Regulatory arbitrage is a problem because it undermines efficiency and, ultimately, "fosters a lack of transparency and accountability that undermines the rule of law."[278] The SEC's proposed rules attempt to level the playing field between IPOs and SPACs, aligning the rules for de-SPAC transactions with those of IPOs.[279] Initially, we were in favor of a blanket policy of conforming the rules applying to de-SPACs to those governing IPOs.

We have reconsidered this position in light of data reported in this Article and in a companion paper, at least with respect to imposing Section 11 liability on underwriting banks at the de-SPAC, for two reasons. First, and perhaps most importantly, our data show that another path is possible. When a majority of SPAC shareholders redeem at the de-SPAC, the remaining shareholders experience significantly negative returns. But if a majority does not redeem, then shareholders fare

278. Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227, 229 (2010).

279. Special Purpose Acquisition Companies, Shell Companies, and Projections, 87 Fed. Reg. 29458 (proposed Mar. 30, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 230, 232, 239, 240, 249, and 270).

better. This finding suggests that the market itself might serve as a gatekeeper equivalent to the role that the underwriter plays in a traditional IPO. Second, investment banks simply do not play a consistent role in marketing and selling the de-SPAC—imposing liability does not jibe with current practice. Finally, we note that the IPO's Section 11 liability carries with it a tracing requirement—any shareholders making a claim must be able to trace their shares to those sold at the IPO. Such a tracing would be difficult to implement in the de-SPAC, so some other type of strict liability would need to be imposed, likely by Congress.

As for forward-looking statements, because these are not per se prohibited in the IPO, it appears that the banks, in their current role, forbid them due to their risk. We presume that, if they were subject to strict liability in the de-SPAC analogous to that in the IPO, they would similarly restrict the use of forward-looking statements in the merger. The PSLRA already excludes IPOs from its safe harbor. The SEC proposes revising (or interpreting[280]) to exclude forward-looking statements in the de-SPAC as well.

It may be that leveling the playing field in this regard is easier said than done, or that the only feasible leveling is to allow forward projections in traditional IPOs. Amanda Rose points out that state law rules may compel SPACs to make certain disclosures, including these kinds of forward-looking statements.[281] More importantly, she argues for careful consideration of the policy reasons behind the rules, the similarities and differences in the efficiency of SPAC and post-IPO markets, and the degree to which the safe harbor's exceptions are actually helping to protect investors.[282]

Alternatively, it may be that Congress finds that the investment banks play too much of a gatekeeping role in the IPO. The lesson of SPACs may be that their speed, their certainty as successful offering and offering price, and their freedom to make forward projections all coax private firms into the public sphere in a manner that is overall beneficial for our markets. If that is the case, then Congress should eliminate Section 11 liability for investment banks in IPOs.

D. Broader Implications

We remain quite optimistic about the promise of SPACs. Clearly, there is a hunger for new ways to access the public markets. Indeed, markets have also been experimenting with a third path to being

280. The interim director of the SEC's Division of Corporation Finance suggested this broadened interpretation of the PSLRA. *See* Public Statement, Coates, *supra* note 23.

281. Rose, *supra* note 110, at 34-35.

282. *Id.* at 41-43, 47.

public: direct listings. Slack and Spotify went public in this manner,[283] as have a handful of other companies, where the company sells its shares directly to the public.[284] Banks typically act as advisors but do not buy the shares as they would in a firm commitment offering.[285]

One prominent hedge fund manager has innovated twice in the SPAC arena. Bill Ackman first introduced a "tontine" style SPAC, which incentivized shareholders to remain with the company by giving them additional warrants.[286] Ackman's SPAC foundered,[287] but he has petitioned the SEC to allow the NYSE to list a new kind of security, a so-called special purpose acquisition rights company (SPARC), which creates a tradeable right to participate in a future acquisition.[288] Ackman touts the SPARC as an improvement on the SPAC because investors do not put up any money at the outset.[289] Indeed, in some sense a SPARC marks a return to Rule 419's concept of allowing investors to opt into an acquisition, after learning its details, rather than the SPAC opt-out.

Whether these particular innovations succeed or not, there is increasing pressure on the traditional IPO process. SPACs provide vital evidence of the problems that regulators must consider as they contemplate reforming the ways that private firms transition to the public markets.

CONCLUSION

After explaining SPACs, we traced the form's evolution. That evolution is crucial in understanding how SPACs ended up with the perversity of an empty vote, whereby its shareholders could vote for a merger while simultaneously exiting the business. The empty vote creates two harms. First, it strands unwary shareholders who fail to appreciate the significance of the redemption choice. Second, it allows private firms to enter the marketplace almost unchecked. We provide data showing that firms where over half the shares redeem experience significant negative returns, even ten days

283. RUPA BRIGGS, DIRECT LISTINGS: THE IPOS OF THE NEW DECADE OR A PASSING PHASE? (2020).

284. *Id.*

285. *Id.*

286. Kenneth Squire, *Bill Ackman and Tontine Holdings Rewrite the Terms for SPACs*, CNBC (July 23, 2020, 4:31 AM), https://www.cnbc.com/2020/07/22/bill-ackman-and-tontine-holdings-rewrite-the-terms-for-spacs.html [https://perma.cc/6Z7R-NW9L].

287. *See* Alison Frankel, *In Setback for Ackman, Proposed Investment Vehicle 'SPARCs' More SEC Scrutiny of NYSE Rule*, REUTERS (Dec. 15, 2021, 6:33 PM), https://www.reuters.com/legal/transactional/setback-ackman-proposed-investment-vehicle-sparcs-more-sec-scrutiny-nyse-rule-2021-12-15/ [https://perma.cc/2FS6-LSE2].

288. *See id.*

289. *See* Nicholas Jasinski, *Bill Ackman Wants to Liquidate His SPAC. Hello, SPARC*, BARRON'S (Aug. 20, 2021), https://www.barrons.com/articles/bill-ackman-spac-51629477062 [https://perma.cc/J3ET-MG6S].

after the de-SPAC. The proof is in the pudding: these are bad deals for SPAC shareholders and for the markets as a whole. We prescribe a simple remedy: return to first principles and require that a majority of SPAC shareholders express meaningful approval of a proposed acquisition by putting their money where their mouths are. Restoring economic substance to the now-empty vote will go a long way toward redeeming SPACs.

* * *

Table 1. Time Variation of SPACs That File Their Initial Prospectus from 2010 to 2019

This table displays our sample firms by the year they file their original S-1. Column (2) shows the number of S-1s filed per year. Columns (3) and (4) display the number of SPACs from column (2) that accomplish an IPO and complete the de-SPAC process, respectively. The mean number of days elapsed from the S-1 to the IPO is in column (5). Column (6) is column (4) scaled by column (2). IPO offering proceeds in column (7) is the product of the number of units and the price per unit offered in the IPO. Column (8) shows the mean amount raised in the private placement occurring simultaneous to the IPO. Column (9) is the sum of column (7) and (8). The mean amount paid for the target in the de-SPAC is shown in column (10). Columns (11) through (13) show the percentage of firms that IPO on the OTCBB, Nasdaq, and NYSE, respectively. In 2018, there was one listing on the NYSE American exchange, which we assign to the OTCBB.

(Table 1 continued on next page)

(Table 1 continued from previous page)

(1)	(2) # of SPACs with initial S-1 filing	(3) SPACs in column (2) that IPO	(4) SPACs in column (2) that compl. acqu.	(5) Mean days from S-1 to IPO	(6) % of initial filings that compl. acq.	(7) Mean IPO offering proc. ($mil)	(8) Mean private plcmnt. proc. ($mil)	(9) Total proc. at IPO ($mil)	(10) Total value paid for targets ($mil)	(11) Listed on OTCBB	(12) Listed on Nasdaq	(13) Listed on NYSE
2010	7	6	3	107	42.9%	$88.1	$3.4	$548.8	$1,499.3	83.3%	16.7%	0%
2011	22	15	12	176	54.5%	$68.3	$3.9	$1,083.6	$6,065.2	46.7%	53.3%	0%
2012	2	0	0	-	0.0%	$0.0	$0.0	$0.0	$0.0	0%	0%	0%
2013	12	12	9	50	75.0%	$121.7	$6.6	$1,538.6	$3,552.5	8.3%	91.7%	0%
2014	15	14	10	84	66.7%	$148.4	$5.1	$2,148.2	$6,484.8	0%	100.0%	0%
2015	21	16	14	53	66.7%	$186.8	$6.3	$3,090.4	$13,793.4	0%	100.0%	0%
2016	18	14	13	57	72.2%	$257.4	$7.4	$3,706.4	$10,029.4	0%	100.0%	0%
2017	37	37	34	34	91.9%	$262.2	$7.6	$9,982.2	$33,537.8	0%	73.0%	27.0%
2018	49	46	44	31	85.7%	$206.2	$6.8	$9,797.8	$43,039.8	2.2%	71.7%	26.1%
2019	58	56	49	31	89.8%	$206.7	$6.1	$11,916.3	$88,311.2	0%	75.0%	25.0%
Total	241	216	188	52	84.5%	$196.5	$6.3	$43,812.2	$206,313.5	6.5%	76.9%	16.7%

Table 2. Descriptive Statistics for All SPAC IPOs with Initial S-1 Filings from 2010 to 2019

This table describes the basic characteristics of SPAC IPOs, which are represented in column (3) of Table 1. The statistics of all IPOs in our sample are in Panel A, while Panels B and C divide the sample into the subperiods of 2010-2016 and 2017-2019, respectively. *Unit price* is the price paid for one unit of the SPAC at the IPO. *Warrants per unit* is the number of warrants contained in each unit. *Shares per warrant* is the number of shares that each warrant can be exercised for. *Warrant strike price* is the price the warrant holder must pay to obtain a share if exercising his unit. *Warrant redemption price* is the amount the firm may redeem the warrants for. *Dual-class shares* is an indicator variable equal to one if the SPAC has two separate classes of stock. The number of rights per unit is shown as *Rights per unit. Maximum months allowed for acquisition* is the number of months stated in the IPO prospectus that the SPAC has to close an acquisition. *% of offering proceeds in trust* is the amount of cash held in trust scaled by the amount raised in the IPO. *Shares of SPAC owned by "initial shareholders"* is the number of shares owned by stockholders prior to the IPO scaled by the total number of shares outstanding after the IPO. *Gross underwriter discount* is the proportion of the IPO proceeds paid to the underwriter(s) in the IPO. *Deferred portion of underwriter discount* is the proportion of the IPO proceeds paid to the underwriter(s) that is contingent upon completing an acquisition. All other variables are defined in the caption to Table 1.

(Table 2 continued on next page)

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	Mean	Median	Minimum	Maximum	N
Panel A. All years					
Offering proceeds ($mil)	$196.5	$175.0	$16.5	$900.0	216
Private placement proceeds at IPO ($mil)	$6.4	$5.9	$0.9	$20.0	216
Unit price ($)	$9.89	$10.00	$5.00	$10.00	216
Warrants per unit (208 units w/warrant)	0.74	1.00	0.25	1.00	208
Shares per warrant	0.89	1.00	0.33	1.00	208
Warrant strike price ($)	$10.78	$11.50	$5.00	$12.50	208
Warrant redemption price ($)	$18.54	$18.00	$8.50	$24.00	206
Dual-class shares					105
Rights per unit (44 units w/right)	0.10	0.10	0.14	0.05	44
Maximum months allowed for acquisition	22	24	18	27	216
% of offering proceeds in trust	100.5%	100.0%	99.5%	105.5%	216
Shares of SPAC owned by "initial shareholders"	20.2%	20.0%	9.4%	75.7%	216
Gross underwriter discount	5.6%	5.5%	0.0%	7.5%	216
Deferred portion of underwriter discount	3.3%	3.5%	0.0%	5.0%	216

(Table 2 continued from previous page)

	Mean	Median	Minimum	Maximum	N
Panel B. 2010-2016					
Offering proceeds ($mil)	$151.7	$100.0	$16.5	$600.0	77
Private placement proceeds at IPO ($mil)	$5.6	$5.0	$0.9	$14.1	77
Unit price ($)	$9.71	$10.00	$5.00	$10.00	77
Warrants per unit (69 units w/warrant)	0.87	1.00	0.33	1.00	69
Shares per warrant	0.80	1.00	0.33	1.00	69
Warrant strike price ($)	$9.77	$11.50	$5.00	$12.50	69
Warrant redemption price ($)	$19.42	$18.00	$8.50	$24.00	67
Dual-class shares					16
Rights per unit (13 units w/right)	0.10	0.10	0.10	0.14	13
Maximum months allowed for acquisition	22	24	18	27	77
% of offering proceeds in trust	101.0%	100.0%	99.5%	105.5%	77
Shares of SPAC owned by "initial shareholders"	20.7%	20.0%	9.4%	75.7%	77
Gross underwriter discount	5.6%	5.5%	0.0%	7.5%	77
Deferred portion of underwriter discount	3.2%	3.5%	0.0%	5.0%	77

(Table 2 continued from previous page)

	Mean	Median	Minimum	Maximum	N
Panel C. 2017-2019					
Offering proceeds ($mil)	$221.3	$200.0	$40.0	$900.0	139
Private placement proceeds at IPO ($mil)	$6.7	$6.5	$1.2	$20.0	139
Unit price ($)	$10.00	$10.00	$10.00	$10.00	139
Warrants per unit (139 units w/warrant)	0.67	0.50	0.25	1.00	139
Shares per warrant	0.94	1.00	0.50	1.00	139
Warrant strike price ($)	$11.29	$11.50	$5.75	$11.50	139
Warrant redemption price ($)	$18.11	$18.00	$16.00	$24.00	139
Dual-class shares					89
Rights per unit (31 units w/right)	0.10	0.10	0.05	0.10	31
Maximum months allowed for acquisition	22	24	18	27	139
% of offering proceeds in trust	100.2%	100.0%	100.0%	102.5%	139
Shares of SPAC owned by "initial shareholders"	20.0%	20.0%	17.2%	30.1%	139
Gross underwriter discount	5.5%	5.5%	0.7%	7.0%	139
Deferred portion of underwriter discount	3.4%	3.5%	0.0%	4.5%	139

Table 3. Voting and Redemption Characteristics of SPACs

Rows (1) and (2) of Panels A and B describe the number of yes and no votes, respectively, cast at the acquisition vote scaled by the number of redeemable and non-redeemable shares outstanding as of the 10-Q or 10-K immediately preceding the effective date. Row (3) reflects all shares redeemed leading up to, and including, the vote date. This value is scaled by the number of units issued in the IPO according to the final prospectus. Row (4) reflects all shares redeemed leading up to, and including, the vote date scaled by the number of redeemable and non-redeemable shares outstanding as of the 10-Q or 10-K immediately after the IPO date. Row (5) shows only those redemptions that occur at the vote date scaled by the number of redeemable shares outstanding as of the 10-Q or 10-K immediately preceding the effective date. Row (6) shows only those redemptions that occur at the vote date scaled by the following: the product of the proportion of total shares that are redeemable as of the 10-Q or 10-K immediately preceding the effective and the total number of votes cast. Panel A displays the mean and quartiles for each variable. Panel B provides the means for each subperiod (2010-2016 and 2017-2019) along with both the differences between each subperiod and the p-value from a t-test for the difference in means. The number of observations is in brackets for Panel B.

Panel A.					
	Mean	25th	50th	75th	N
(1) Yes votes / Shares outstanding	76.6%	66.0%	75.5%	84.5%	182
(2) No votes / Shares outstanding	2.7%	0.0%	1.2%	3.8%	180
(3) Total shares redeemed / # units at IPO	54.2%	0.4%	59.9%	91.9%	184
(4) Total shares redeemed / Redeemable shares out. after IPO	52.7%	3.8%	61.3%	89.8%	183
(5) Shares redeemed at vote / Redeemable shares out. prior to effective date	61.5%	0.1%	50.0%	85.2%	181
(6) Shares redeemed at vote / (Votes cast * Prop. of redeemable shares)	74.2%	0.1%	55.5%	104.8%	172

(Table 3 continued from previous page)

Panel B.				
	(1) 2010-2016	(2) 2017-2019	(3) Col. (1) minus Col. (2)	(4) p-value from t-test of diff.
(1) Yes votes / Shares outstanding	88.1% [56]	71.6% [126]	16.5%	.0265
(2) No votes / Shares outstanding	3.7% [54]	2.2% [126]	1.5%	.1147
(3) Total shares redeemed / # units at IPO	54.8% [60]	53.8% [124]	1.0%	.8809
(4) Total shares redeemed / Redeemable shares out. after IPO	56.1% [59]	51.1% [124]	4.9%	.4659
(5) Shares redeemed at vote / Redeemable shares out. prior to effective date	56.4% [58]	63.9% [123]	-7.6%	.6960
(6) Shares redeemed at vote / (Votes cast * Prop. of redeemable shares)	63.2% [50]	78.7% [122]	-15.5%	.5054

Table 4. Characteristics of SPACs That Announce an Acquisition

The division in this table is between SPACs that do not extend the terms of the originally stated expiration (in column (3)) and those that do (in column (2)). Column (4) reports the differences between column (2) and (3) and the p-value from a t-test for the difference in means is reported in column (5). The number of observations for column (2) and (3) are in column (6). *Days from annc. to expiration* is the number of days from the acquisition announcement to the stipulated expiration date from the IPO prospectus. We add the product of thirty and the number of months stipulated to the IPO date to arrive at the expiration date. *Days from effect. to expiration* is the number of days from the effective date of the acquisition to the expiration date. *Top 10 underwriter* is a binary variable equal to one if the lead left underwriter is in the top ten of underwriter market share using a one-year lagged market share of equity underwriting among investment bankers. *Days from annc. to effective date* is the average number of days from acquisition announcement to the effective date. *Days from initial S-1 to IPO* is the average number of days from the time of the initial S-1 filing until the final IPO prospectus. All other variables have been defined in the captions of previous tables. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively.

(Table 4 continued from previous page)

(1)	(2) Ex-tend Terms	(3) Do Not Ex-tend Terms	(4) Diff. of Means *(2) – (3)*	(5) p-value from t-test	(6) Number of Obs. in *(2)* | *(3)*
Days from annc. to expiration	13.9	301.0	-287.0***	.0001	111 | 97
Days from effect. to expiration	-161.5	170.2	-331.8***	.0001	91 | 97
% on NYSE	10.8%	23.7%	-12.9%**	.0151	111 | 97
% on Nasdaq	81.9%	73.2%	8.8%	.1290	111 | 97
% on OTCBB	7.2%	3.1%	4.1%	.1766	111 | 97
Top 10 underwriter	33.3%	50.5%	-17.2%**	.0119	111 | 97
Days from annc. to effective date	169.7	130.7	39.0***	.0001	91 | 97
Days from initial S-1 to IPO	62.0	38.1	23.9***	.0043	111 | 97
Yes votes / Shares outstanding	79.8%	73.8%	6.0%	.2292	86 | 96
Total shares redeemed / # units at IPO	66.3%	42.0%	24.3%***	.0001	100 | 94

Table 5. Cross-Sectional OLS Regressions with SPAC Performance as Dependent Variable

This table presents coefficients from an OLS model in which SPAC performance is the dependent variable. The dependent variable in columns (1) through (4) is the share price at ten trading days after the effective date minus the share price thirty trading days prior to the acquisition announcement; this difference is scaled by the share price thirty trading days prior to the acquisition announcement. The models in columns (3) and (4) truncate the dependent variable at 100%. The dependent variable in columns (5) and (6) is share price at ten trading days after the effective date scaled by the product of the trust amount (as a percentage of the proceeds from the IPO) and the share price of common stock at the IPO (usually, $10.00), which is then truncated at 100%. *Log (target value)* is the natural log of the value paid for the target in FactSet. *2017-2019* is a binary variable equal to one if the original S-1 is filed in 2017, 2018, or 2019 and is zero otherwise. All other variables have been defined in the captions of previous tables. The p-values from t-statistics using White's heteroskedastic-consistent standard errors are reported in parentheses. *** and ** denote significance at the 1% and 5% levels, respectively.

(Table 5 continued from previous page)

Dependent variable = Return from -30 before announcement to +10 after effective	(1)	(2)	(3)	(4)
Intercept	0.392 (.000)	-0.263 (.569)	-0.137 (.568)	-0.062 (.808)
Total shares redeemed / # units at IPO	-0.474*** (.000)	-0.404*** (.000)	-0.348*** (.000)	-0.319** (.000)
Log (target value)	-	0.112 (.141)	0.050 (.204)	0.042 (.307)
Top 10 underwriter	-	-0.097 (.579)	0.063 (.319)	0.089 (.157)
2017-2019	-	-0.088 (.652)	0.046 (.464)	0.035 (.575)
No votes / Shares outstanding	-	-	-	-1.379* (.093)
F value	9.31 (.003)	2.88 (.025)	10.84 (.000)	9.86 (.000)
Adj. R^2	4.9%	4.5%	19.7%	22.2%
Number of obs.	162	162	162	156

(Table 5 continued from previous page)

Dependent variable = Premium at +10 after effective	(5)	(6)
Intercept	-0.160 (.503)	-0.099 (.694)
Total shares redeemed / # units at IPO	-0.377*** (.000)	-0.354*** (.000)
Log (target value)	0.056 (.141)	0.049 (.212)
Top 10 underwriter	0.068 (.280)	0.093 (.135)
2017-2019	0.041 (.513)	0.036 (.580)
No votes / Shares outstanding	-	-1.247* (.089)
F value	13.39 (.000)	11.64 (.000)
Adj. R^2	22.1%	24.0%
Number of observations	176	170