XIII. The Elimination of Safe Harbor for SPAC Projections

A. Introduction

Special purpose acquisition companies (SPACs) are shell companies that accumulate capital during an initial public offering with the intention of using the proceeds to acquire another company.[1] Since 2020, SPACs have drastically grown in popularity as an investment opportunity for retail investors.[2] This recent boom in retail SPAC investing, combined with the unique risks associated with SPACs, have compelled Congress to explore whether current rules pertaining to SPACs are appropriately protecting investors.[3]

One issue that Congress has paid special attention to is the "safe harbor" that SPACs are afforded under the Private Securities Litigation Reform Act (PSLRA) when making financial projections regarding the SPAC's merger with a private company.[4] Many SPACs provide overly optimistic projections about the future performance of the company in their SEC filings, without fear of future liability for making misleading disclosures.[5] To address this, in November of 2021, the U.S. House Committee on Financial Services passed H.R. 5910, the Holding SPACs Accountable Act.[6] H.R. 5910 would completely eliminate safe harbor for forward-looking statements by making SPACs liable for false or misleading projections.[7] The potential removal of safe harbor has driven legislators and academics

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[1] Max H. Bazerman & Paresh Patel, *SPACS: What You Need to Know,* HARV. BUS. REV., https://hbr.org/2021/07/spacs-what-you-need-to-know [https://perma.cc/W6AU-Y5QW] (last visited Feb. 6, 2022) (explaining the background of SPACs and how they function)
[2] *Id.*
[3] Jim Tyson, *U.S. House panel passes bills tightening SPAC oversight*, CFO DIVE (Nov. 17, 2021), https://www.cfodive.com/news/us-house-panel-passes-bills-tightening-spac-oversight/610224/ [https://perma.cc/7LUV-YJ4G] (discussing bills passed by The House Financial Services Committee).
[4] *Id.*; 15 U.S.C. § 78u-5.
[5] Michael Dambra et al., *Should SPAC Forecasts be Sacked?*, 23 (Jan. 24, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3933037 [https://perma.cc/GU4M-3T9J] (asserting the downsides of SPACs).
[6] Holding SPACs Accountable Act of 2021, H.R. 5910, 117th Cong. (2021).
[7] *Id.*

to debate whether the benefits of eliminating safe harbor outweigh the potentially harmful effects.

Part B of this paper will first provide a description of how SPACs operate and who the key players are in a de-SPAC transaction. Next, Part C will briefly explore why SPACs have grown so popular since 2020. Afterwards, Part D will highlight the unique risks of SPAC investing for retail investors, focusing on the dangers of granting SPACs safe harbor for forward-looking statements. Part E will then consider Congress's potential solution to the safe harbor issue, H.R. 5910. Ultimately, there will be a discussion on the debate surrounding the removal of safe harbor, and Part F will include predictions regarding the likely effects that the removal of safe harbor will have on SPAC sponsors, private companies aiming to go public, and retail investors.

B. How SPACs Operate and the Players Involved

A SPAC is created when a SPAC's sponsor, typically an LLC organized by a private equity firm or a hedge fund, creates a "blank-check" corporation with the intention of merging it with an unspecified target.[8] The SPAC then undergoes an IPO where it raises capital by selling units to the public.[9] The units typically consist of one share of common stock and a warrant.[10] The capital raised is then placed into a trust account where it will remain until the funds are used to consummate a merger.[11] If a merger is not consummated, the funds

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[8] Michael Klausner et al., *A Sober Look at SPACs* 10 (Stanford L. and Econ. Olin Working Paper No. 559, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3720919# [https://perma.cc/F27K-67MV] (discussing the structure and associated costs of a SPAC); *Blank Check Company,* SEC, https://www.investor.gov/introduction-investing/investing-basics/glossary/blank-check-company [https://perma.cc/9DYZ-QWB9] (last visited April 3, 2022) ("A type of blank check company is a 'special purpose acquisition company,' or SPAC for short.").

[9] Ramey Layne & Brenda Lenahan, *Special Purpose Acquisition Companies: An Introduction,* HARV. L. SCH. F. ON CORP. GOVERNANCE (July 6, 2018), https://corpgov.law.harvard.edu/2018/07/06/special-purpose-acquisition-companies-an-introduction/ [https://perma.cc/PC73-PEDS] ("Special Purpose Acquisition Companies ('SPACs') are companies formed to raise capital in an initial public offering ('IPO').").

[10] *Id.*

[11] *Id.*

will be distributed pro rata to the SPAC's shareholders, and the SPAC dissolves.[12] SPACs will usually state in their charter that the SPAC has eighteen to twenty-four months to consummate a merger.[13]

After it has raised a sufficient amount of capital, the SPAC begins searching for a target.[14] After conducting financial and legal due diligence on the target, the SPAC will negotiate the merger with the potential target.[15] If a majority of the SPAC's shareholders vote in favor of the merger, the target will usually merge into the SPAC or a subsidiary of the SPAC.[16] The identification of the target and the consummation of the merger is known as the "de-SPAC process."[17]

The key players involved in a SPAC deal are the SPAC's sponsor, the target company, and retail investors. The sponsor is a

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[12] Lora Dimitrova, *Perverse incentives of special purpose acquisition companies, the "poor man's private equity funds",* J. OF ACCT. AND ECON. 8 (Oct. 12, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2139392 [https://perma.cc/EW9V-U6NX] ("If the SPAC does not acquire a target firm within the maximum period of two years, the company is required to liquidate and the escrowed IPO proceeds are distributed pro rata.").

[13] Michael Klausner & Michael Ohlrogge, *SPAC Governance: In Need of Judicial Review* 4 (Stanford L. and Econ. Olin Working Paper No. 564, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3967693# [https://perma.cc/3D2B-Q4FX].

[14] Peinsipp et al., *SPAC Transactions – Considerations for Target-Company CFOs,* COOLEY 5, https://www.cooley.com/-/media/cooley/pdf/reprints/2020/cobranded-spac-transactions--considerations-for-targetcompany-cfos-secured.ashx?la=en&hash=6346947744D0F11E6E38FFD58F9532CD [https://perma.cc/N9BB-EDJH] (last visited Feb. 9, 2022) ("The proceeds raised in the IPO are placed in a trust account while the SPAC's management team seeks to complete an acquisition of an existing operating company.").

[15] *Id.*

[16] SEC, WHAT YOU NEED TO KNOW ABOUT SPACS – UPDATED INVESTOR BULLETIN, (2021) https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin [https://perma.cc/5XUC-LF6U] (discussing an overview of the structure of SPACs from the viewpoint of potential investors).

[17] Layne & Lenahan, *supra* note 9 ("If the business combination is approved by the shareholders (if required) and the financing and other conditions specified in the acquisition agreement are satisfied, the business combination will be consummated (referred to as the 'De-SPAC transaction').").

large financial institution who operates the SPAC and leads the consummation of a merger with the target.[18] As compensation for operating the SPAC, the sponsor purchases "founder shares" prior to the SPAC's IPO.[19] The sponsor purchases these founder shares, which are equivalent to approximately 20% of the SPAC's post-IPO shares, in exchange for a miniscule amount that usually does not exceed $25,000.[20] Considering the sponsor only pays a few million dollars to operate the SPAC, SPACs typically generate very high returns for sponsors.[21]

A private company may elect to go public via a SPAC, as opposed to a traditional IPO, in order to reap the benefits of working with a sponsor.[22] Sponsors and a SPAC's management team usually either have a wealth of industry-specific knowledge or a large number of connections that can be leveraged to help the target grow.[23] Additionally, going public via SPAC is often quicker and cheaper because of the reduced regulatory filings compared to undergoing an IPO by itself.[24]

Dubbed "the poor man's private equity," retail investors invest in SPACs because SPACs provide them with a unique opportunity to invest in the early stage of a company's life cycle.[25]

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[18] Klausner et al., *supra* note 8, at 10 (discussing the structuring and formation of a SPAC).
[19] Layne & Lenahan, *supra* note 9.
[20] *Id.*
[21] Richard Beales, *Breakingviews – The house always wins with* SPACs, REUTERS (Feb. 26, 2021), https://www.reuters.com/article/us-usa-spacs-breakingviews/breakingviews-the-house-always-wins-with-spacs-idUSKBN2AQ2T8 [https://perma.cc/H5JP-GH7S]; Bazerman & Patel, *supra* note 1; Klausner et al., *supra* note 8 ("The most successful sponsors saw returns of over $500 million and 5000% . . . In percentage terms, mean sponsor returns are 549% on an absolute basis and 512% on a market-adjusted basis.").
[22] Dimitrova, *supra* note 12, at 10 ("The SPAC may be an attractive way for private companies to obtain access to additional capital without having to do an IPO.").
[23] *Id.* ("Target companies may value not only the access to additional capital but also the benefit they receive from the expertise of the SPAC's management team.").
[24] Mike Bellin, *Why companies are joining the SPAC boom*, PWC (Sept. 22, 2020), https://www.pwc.com/us/en/services/deals/blog/spac-boom.html [https://perma.cc/PBK6-CL9S].
[25] Dimitrova, *supra* note 12, at 1; Shuli Ren, *SPACs Are Hot Because They Are the 'Poor Man's Private Equity Funds'*, BLOOMBERG (Mar. 2, 2021)

Considering retail investors typically are not able to invest in private equity or IPOs, SPACs provide retail investors with the ability to invest in a promising company at a low price.[26] Additionally retail investors enjoy protections, such as redemption rights and the ability to vote against a merger, that allow them to receive money back from the SPAC if they do not want to continue owning shares post-merger.[27]

C. The SPAC Boom

Since 2020, the SPAC market has seen record growth in the number of SPACs formed, and the amount of capital invested in SPACs. In 2021, an unprecedented 613 SPACs went public.[28] This is a nearly 150% increase from 2020 and an over 900% increase from 2019.[29] Furthermore, SPACS raised a record $162 billion in capital through their IPOs in 2021, which was nearly double the amount raised in 2020, and was over ten times the amount raised in 2019.[30] Retail

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https://www.bloomberg.com/news/articles/2021-03-02/why-spacs-are-so-popular-they-re-the-poor-man-s-private-equity-funds ("In a 2016 paper, Lora Dimitrova . . . dubbed SPACs 'the poor man's private equity funds.' That's because they give ordinary investors a way to participate in the purchase of a hot company before it goes public – a perk usually reserved for the wealthy.").

[26] Jordan Strauss, *Special Purpose Acquisition Companies – A Blank Check for Success?,* WILMINGTON TRUST 7, https://wilmingtontrust.com/content/dam/wtb-web/wtb-migration/pdfs/Special-Purpose-Acquisition-Companies-A-Blank-Check-for-Success.pdf [https://perma.cc/9GMX-DSKJ] (last visited Feb. 8, 2021) ("Retail investors have typically been shut out of IPO allocations in the primary market.").

[27] Usha R. Rodrigues, *Financial Contracting with the Crowd*, 69 EMORY L. J. 397, 443 (2019).

[28] Phil Mackintosh, *A Record Pace for SPACs in 2021*, NASDAQ (Jan. 6, 2022), https://www.nasdaq.com/articles/a-record-pace-for-spacs-in-2021.

[29] *Id.*

[30] Riley de León, *Mark Cuban-backed banking app Dave begins trading on the Nasdaq after completing SPAC merger*, CNBC (Jan. 6, 2022), https://www.cnbc.com/2022/01/06/mark-cuban-backed-dave-begins-trading-on-nasdaq-after-completing-spac.html [https://perma.cc/9G7Q-EGBG]; Carmen Reinicke, *A SPAC frenzy earlier this year could lead to riskier deals. Here's why,* CNBC (June 2, 2021), https://www.cnbc.com/2021/06/02/a-spac-frenzy-this-year-could-lead-to-riskier-deals-heres-

investors in particular demonstrated a unique interest in SPAC offerings. According to a Bank of America report from early 2021, retail investors accounted for 40% of all trading in SPACs on its platform.[31]

The so-called "SPAC boom" largely occurred because of the historically volatile financial markets resulting from the COVID-19 pandemic. Private companies aiming to go public elected for the SPAC route believing it would save them capital and time during a period when markets were extremely unstable.[32] Additionally, private companies chose to go public via SPAC because of the increased price certainty that SPACs provide compared to a traditional IPO.[33] In a traditional IPO, a private company's valuation and amount of money raised is largely influenced by current market conditions.[34] However, in a de-SPAC transaction, the SPAC and private company negotiate a capital commitment and binding valuation, shielding the company

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why.html#:~:text=That's%20a%20jump%20from%20prior,raised%20more %20than%20%2413%20billion [https://perma.cc/EC2D-5DKM].

[31] Ken Sweet, *EXPLAINER: What's a SPAC, the latest craze on Wall Street?,* AP NEWS (Mar. 26, 2021), https://apnews.com/article/financial-markets-charlotte-705dbc9454023c64daf41e2024086c77 [https://perma.cc/W94N-6S6G]. ("According to a recent report from BofA Global Research, 40% of SPAC trading on BofA's platform was driven by retail investors.").

[32] John Lambert, *Why so many companies are choosing SPACs over IPOs*, KPMG, https://advisory.kpmg.us/articles/2021/why-choosing-spac-over-ipo.html [https://perma.cc/73KW-L748] (last visited Feb. 16, 2022) (comparing the pros and cons of choosing a SPAC compared to an IPO).

[33] CONG. RSCH. SERV., SPAC IPO: BACKGROUND AND POLICY ISSUES (2021) ("Private target companies can also find SPACs because SPACs provide price certainty and faster access to funding (relative to a traditional IPO), factors that are especially important during periods of market volatility.").

[34] Joe Conte, *Going Public? Why Companies Are Considering SPACs Instead of Traditional IPOs,* EQUINITI (Oct. 6, 2020), https://equiniti.com/us/news-and-views/eq-views/going-public-why-companies-are-considering-spacs-instead-of-a-traditional-ipo/ [https://perma.cc/K26A-MZB8] ("With traditional IPO pricing, the volatility of the markets (measured by the VIX) has a significant influence on how accurately pre-IPO shares are priced in the initial market. . . Even with price stabilization measures put in place by the lead underwriter, the share price in a traditional IPO could drop beyond the company's comfort zone and the company could risk embarrassment.").

from the dangers of market uncertainty.[35] Finally, the notable growth of novice investors utilizing commission-free trading platforms, such as Robinhood, during the pandemic allowed a new wave of retail investors to access the SPAC market.[36]

D. Dangers of SPAC Investing and the Desire to Eliminate Safe Harbor

Although SPACs can provide unique benefits to retail investors, there are risks in SPAC investing that have led Congress to consider enhanced regulations for SPACs. Most notably, Congress has considered eliminating so-called "safe harbor" for SPACs when making projections regarding a de-SPAC merger.[37] To understand the need for this legislation, it is important to understand two key dangers that retail SPAC investors face.

First, there is an inherent conflict of interest that exists between SPAC sponsors and investors.[38] If a de-SPAC merger is not consummated, the sponsor's founder shares are worthless and the sponsor suffers a net loss from forming and operating the SPAC.[39] Therefore, sponsors are heavily incentivized to consummate a merger, even if the target company is not promising or has not been thoroughly

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[35] CONG. RSCH SERV., *supra* note 33, ("The SPAC sponsor offers a fixed price for a target operating company's equity shares. . . Thus, SPAC targets may enjoy more certainty for funding and price than would be the case in traditional IPOs."); Bellin, *supra* note 24 ("Unlike traditional IPOs, target companies can negotiate the price of their stock with the SPAC sponsor as part of their merger agreement . . . helping shield its value from market uncertainty.")

[36] *What is a SPAC and Why are They Suddenly so Popular?* EXCELSIOR CAP., https://www.excelsiorgp.com/resources/what-is-a-spac-and-why-are-they-suddenly-so-popular/ [https://perma.cc/3XCN-KECQ] (last visited Feb. 15, 2022) (discussing the popularity of SPACs amongst retail investors).

[37] Davina K. Kaile et al., *Congressional SPACtivity Continues: Draft Legislation Proposes to Eliminate Safe Harbor Protection for Projections in SPAC Transactions*, PILLSBURY (May 28, 2021), https://www.pillsburylaw.com/en/news-and-insights/draft-legistlation-eliminate-safe-harbor-protection-spac-transactions.html [https://perma.cc/95YU-D999] (discussing the Private Securities Litigation Reform Act and its effect on the safe harbor of SPAC projections).

[38] Klausner, *supra* note 8, at 74.

[39] *Id.* at 8.

evaluated.[40] In other words, in some situations, sponsors are better off making a decision that hurts the financial interest of the retail investors.

The second key danger relates to SPACs' "safe harbor" for forward-looking statements under the PSLRA. In its S-4 public filing regarding the merger, a SPAC will typically include projections for revenue, earnings, or other key metrics to inform investors about the future prospects of the company.[41] The PSLRA provides safe harbor—essentially a liability shield—for public companies from private liability claims related to a company's forward-looking statements in its public filings.[42] This safe harbor makes it virtually impossible for investors to win a lawsuit claiming the projections were misleading.[43] The PSLRA was created by Congress to encourage public companies to disclose information about the company's future prospects by providing those companies with a defense against frivolous securities lawsuits related to the projections.[44]

An important distinction is that SPACs traditionally have been afforded safe harbor for forward-looking financial projections, whereas IPOs have not.[45] The PSLRA explicitly excludes safe harbor

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[40] *Id.*

[41] Dambra et al., *supra* note 5, at 4; George Casey et al., *SEC Considering Heightened Scrutiny of Projections in De-SPAC Transactions*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 17, 2021), https://corpgov.law.harvard.edu/2021/05/17/sec-considering-heightened-scrutiny-of-projections-in-de-spac-transactions/ ; Greg Iacurci, *SEC is scrutinizing SPAC projections, seeks clearer disclosures*, CNBC (April 9, 2021), https://www.cnbc.com/2021/04/09/sec-is-scrutinizing-spac-projections-seeks-clearer-disclosures.html [https://perma.cc/KH3R-GGDG].

[42] Amanda Rose, *SPAC Mergers, IPOs, and the PSLRA's Safe Harbor: Unpacking Claims of Regulatory Arbitrage*, 3 (Oct. 19, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3945975 [https://perma.cc/5C48-9M6J] (elaborating on the role of the PSLRA providing safe harbor and liability protection for SPACs).

[43] *Id.*

[44] John Coates, *SPACs IPOs and Liability Risk under the Securities Laws,* SEC (Apr. 8, 2021), https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws [https://perma.cc/4DE5-BX7T] ("PSLRA was passed by Congress in 1995 to stem what was considered to be a rising tide of frivolous or unwarranted securities lawsuits").

[45] Mike Hacket et al., *SPAC Procedural Issues & Risks,* PROSKAUER 2 (Aug. 2021), https://prfirmpwwwcdn0001.azureedge.net/prfirmstgacctpwwwcdncont0001/uploads/54fc0bb8bc03aafc053988ef6b46ce97.pdf [https://perma.cc/TCU2-

statements in connection with IPOs and "blank check companies."[46] Yet, SPACs traditionally have not been considered an IPO or a blank check company.[47] Therefore, SPACs have been afforded safe harbor, while IPOs have not.[48] It is worth noting that there is some debate as to whether SPACs fall into one of these categories, and therefore should not have safe harbor. Most notably, in April of 2021, John Coates, Acting Director of the SEC's Division of Corporate Finance, publicly stated his belief that the IPO exception "may include de-SPAC transactions."[49]

The danger that safe harbor creates for investors is that SPACs will create overly-optimistic forecasts without fear of liability. A SPAC would do this to lure retail investors into investing in the SPAC and voting in favor of the de-SPAC merger, allowing the sponsor to generate large returns.[50] Unfortunately, there is evidence to suggest that SPACs engage in such deceptive behavior. For example, one study of SPAC mergers from 2004 to 2021 found that only 35% of SPACs meet or beat their forward-looking projections.[51] Furthermore, "while 42% of firms met their one-year forecast, this percentage declines to 21%, 10%, and 0% of their two-, three-, and four-year forecasts."[52] This is especially concerning given that there is also evidence to suggest that SPACs that provide higher, overly-optimistic revenue projections tend to generate significantly more retail investor attention and investment.[53]

UCP4] ("The consensus view has been that such disclosures, unlike similar disclosures made during an IPO, SPACs are subject to safe harbor provided by the Private Securities Litigation Reform Act.").

[46] Coates, *supra* note 44.

[47] Rose, *supra* note 42, at 3.

[48] Hacket et al., *supra* note 45, at 2.

[49] Coates, *supra* note 44.

[50] Dambra et al., *supra* note 5, at 2 ("However, since FLS are covered by the Safe Harbor provision, SPAC targets and their acquirers may exploit the provision as a 'license to lie' to convince investors to vote favorably on the de-SPAC transaction.").

[51] Elizabeth Blankespoor et al., *A Hard Look at SPAC Projections*, MGMT. SCI. (forthcoming) (manuscript at 10) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3961848 [https://perma.cc/HF8D-K424].

[52] *Id.* at 10.

[53] Dambra et al., *supra* note 5, at 23.

E. Holding SPACs Accountable Act of 2021

Congress has taken special note of the safe harbor problem and is devising a way to fix it. In November of 2021, the U.S. House Committee on Financial Services passed H.R. 5910, the Holding SPACs Accountable Act.[54] Sponsored by Representative Michael San Nicolas (D-GU), H.R. 5910 would exclude SPACs from safe harbor for forwarding-looking statements, making them liable for misleading projects.[55] Although there was notable debate about whether SPACs should have safe harbor prior to the Act, H.R. 5910's passage has further caused legislators and academics to question safe harbor for SPACs.

The primary arguments that have been made in favor of H.R. 5910 and removing safe harbor for SPACs include: (1) removal of safe harbor would ensure the integrity of the information provided to SPAC investors, leaving them better protected,[56] and (2) there is no valid policy reason for SPACs to differ from traditional IPOs when it comes to safe harbor under the PSLRA.[57]

The main argument for the removal of safe harbor is that such a removal would ensure that deceptive information is not provided to SPAC investors. Advocates for removal of safe harbor claim that it

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[54] H.R. 5910.

[55] *Id.* (Replacing a "blank check company" with "a development stage company that has no specific business plan or purpose or has indicated that its business plan is to acquire or merge with an unidentified company, entity, or person"; Tom Zanki, *Congress Adds Fuel to SEC's Ambitions to Regulate SPACs*, LAW360 (Nov. 19, 2021), https://www.law360.com/articles/1442137/congress-adds-fuel-to-sec-s-ambitions-to-regulate-spacs.

[56] Rose, supra note 42, at 31 ("Offering such disclosures safe harbor protection may decrease their accuracy relative to a world in which safe harbor protection were not available."); Ran Ben-Tzur & Jay L. Pomeranz, *House Releases Draft Legislation Eliminating SPAC Safe Harbor for Forward Looking Statements,* FENWICK (May 21, 2021), https://www.fenwick.com/insights/publications/house-releases-draft-legislation-eliminating-spac-safe-harbor-for-forward-looking-statements?utm_source=Mondaq&utm_medium=syndication&utm_campaign=LinkedIn-integration [https://perma.cc/BB2Y-HP8D].("The increased risk of liability associated with forward-looking statements will likely result in companies and other market participants, including SPAC sponsors and financial advisors, applying additional rigor to projections.")

[57] Klausner, *supra* note 8, at 66.

would cause SPACs to provide more accurate projections due to fear of liability for potentially misleading forward-looking statements.[58] To provide these more pragmatic projections, SPACs would need to conduct more rigorous due diligence on the financial history of target companies to ensure that the projections can be reasonably justified.[59] More accurate projections would allow investors to make more informed decisions about whether to vote in favor of a merger with a target, exercise their redemption right, or invest in the SPAC. Considering that sponsors are not incentivized to provide practical forward-looking statements, ensuring that investors receive sensible projections would be an upgrade on the current regime.

Another argument in favor of safe harbor removal is that SPACs should not be treated differently than IPOs under the PSLRA. Advocates of this theory point out that de-SPAC mergers and IPOs involve the exact same type of transaction, the introduction of a private company to the public markets.[60] This is when the federal securities laws are most needed because very little is often known about the private company turning public.[61] Therefore, because there is so little information to base an investment decision on, it is crucial that the information investors do receive is accurate so they can make as informed an investment decision as possible.[62] Without being bound by the securities laws, SPACs are not incentivized to provide such accurate information. Furthermore, the legislative history of the PSLRA indicates that it was designed to protect "seasoned issuers" with an "established track-record," which SPACs are not.[63]

The primary arguments that have been made against the Act's passage and removing safe harbor for SPACs include: (1) removal of safe harbor will result in SPACs making fewer, if any, projections, unfairly depriving reasonable investors of valuable information,[64] and (2) SPACs already have an existing obligation not to make false or misleading statements, rendering the Act unnecessary.[65]

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[58] Rose, *supra* note 42, at 42; Ben-Tzur & Pomeranz, *supra* note 56.
[59] Kaile et al., *supra* note 37.
[60] Coates, *supra* note 44.
[61] *Id.*
[62] *Id.*
[63] *Id*.
[64] *Id.*
[65] Letter from Tom Quaadman, Executive Vice President, U.S. Chamber Ctr. For Cap. Mkts. Competitiveness, to Maxine Waters and Patrick McHenry, U.S. House of Representatives (Nov. 15, 2021), https://www.uschamber.com/assets/documents/211115_Markup_HouseFina

If safe harbor is eliminated, SPACs may elect to make fewer or no projections out of fear of liability for those projections.[66] Consequently, some argue that safe harbor would deprive SPAC investors of valuable information that can be used to make an informed decision.[67] This is especially troubling given the little information that SPACs investors have access to due to the already limited disclosure requirements for SPACs.[68] Furthermore, reasonable investors who are capable of incorporating the potential bias of the projections into their evaluations are effectively punished in order to protect unreasonable investors who have not considered the conflicts inherent in SPACs.[69]

Another argument against the removal of safe harbor is that the elimination of safe harbor is unnecessary to protect against misleading forward-looking statements. Although safe harbor does protect SPACs against frivolous lawsuits, SPAC transactions do not get a "free pass for material misstatements or omissions."[70] John Coates has pointed out that safe harbor does not protect SPACs against false or misleading statements when those statements are made with the actual knowledge that they were false or misleading.[71] Furthermore, filing registration or proxy solicitations with material misstatements violates certain sections of both the Securities Act of 1933 and the Securities Exchange Act of 1934.[72] Therefore, the SEC

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ncialServices.pdf [https://perma.cc/MYZ9-8EA4] ("Companies have an existing responsibility not to make false or misleading statements.")

[66] *SPAC Update: Congress's Proposal To Eliminate Forward-Looking Statement Safe Harbor for SPACs*, BAKER BOTTS (June 11, 2021), https://www.bakerbotts.com/thought-leadership/publications/2021/june/spac-update-congress-proposal-to-eliminate-forwardlooking-statement-safe-harbor-for-spacs [https://perma.cc/H4AE-WD4A] ("If the PSLRA's safe harbor expressly became unavailable to SPACs, we expect that SPACs, their targets and underwriters may be more hesitant to share financial projections . . . and other forward-looking statements with investors even when that information is valuable to investors.").

[67] Quaadman, *supra* note 65.

[68] Layne & Lenahan, *supra* note 9 ("SPAC financial statements in the IPO registration statement are very short and can be prepared in a matter of weeks (compared to months for an operating business). There are no historical financial results to be disclosed or assets to be described, and business risk factors are minimal.")

[69] Rose, *supra* note 42, at 42.

[70] Coates, *supra* note 44; Baker Botts, *supra* note 66.

[71] Coates, *supra* note 44.

[72] *Id.*

can conduct an enforcement investigation and punish a SPAC that the commission believes is in violation of these laws.

F. The Impact of the Bill: A Potential End to the SPAC-Boom

A potential consequence of removing safe harbor is that the SPAC boom could be brought to a screeching halt. The removal of safe harbor for projections would make the lives of sponsors more difficult by preventing them from making faulty projections to induce a merger and exposing them to potential liability for projections.[73] Furthermore, sponsors would have to conduct a more in-depth search for a viable target company and perform more rigorous due diligence when making public filings about the target.[74] Additionally, removal of safe harbor would make it more expensive to operate a SPAC because the price of a SPAC's director and officers liability insurance would drastically increase.[75] Given all of the newfound dangers from the elimination of safe harbor, it is entirely possible that the large financial institutions who formulate SPACs may look elsewhere to generate profits.[76]

One group that would be negatively affected by a decreased number of SPAC formations would be private companies aiming to go public. Currently, private companies can either go public via a merger with a SPAC or a traditional IPO.[77] However, if the number of SPACs to merge with decreases due to the removal of safe harbor, that could eliminate the SPAC option for private companies. Consequently, these private companies would miss out on the benefits of working with a SPAC, and force them to undergo a traditional IPO if they still wish to go public. Considering the additional filing requirements, longer timeframe, greater costs, and increased exposure to market volatility

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[73] Baker Botts, *supra* note 66.
[74] Kaile et al., *supra* note 37.
[75] Ben-Tzur & Pomeranz, *supra* note 56 ("These increased risks may. . . result in an increase in the already significant costs associated with directors and officers (D&O) liability insurance for a SPAC transaction.").
[76] Joseph Williams & Joshua Rasay, *Tech and SPACs: SEC regulation could result in fewer, but better SPACs*, S&P GLOBAL (May 13, 2021), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/tech-and-spacs-sec-regulation-could-result-in-fewer-but-better-spacs-64000801 [https://perma.cc/PMW6-JU4S] (discussing the potential changes to the SPAC market as a result of potential regulations).
[77] SEC, *supra* note 16.

that the IPO process presents, private companies may elect to stay private, resulting in fewer companies going public.[78]

Interestingly enough, a decreased number of SPAC formations may actually benefit SPAC investors. If fewer SPACs were to form, there would be a higher likelihood that a SPAC could match with a viable target due to there being less competition from other SPACs for those targets.[79] SPACs could therefore become a safer investment for retail investors because the likelihood of a poor SPAC would decrease.[80] Reducing the number of SPACs to invest in may also be beneficial to retail investors because, historically, SPACs produce mixed returns and tend to be outperformed by the broader market. For example, a study of all forty-seven SPACs that merged between January 2019 and June 2020 shows that the average SPAC amongst that group was outperformed by the NASDAQ and Russell 2000.[81] Furthermore, the average return of the 38 SPAC acquisitions between 2016 and 2018 was -32.6%.[82] Therefore, reducing the availability of these historically poor investments could cause retail investors to shift their investments to safer assets with historically higher returns. Ultimately, a reduction in the number of SPACs would likely either make SPACs a safer investment, or, at the very least, reduce the availability of these historically poor investment opportunities. Under either scenario, retail investors would be in a better position than they are under the current SPAC regulatory regime.

G. Conclusion

The future of H.R. 5910 is uncertain. Since the House Financial Services Committee voted in favor of the bill in November of 2021,

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[78] Lambert, *supra* note 32.
[79] Williams & Rasay, *supra* note 76.
[80] *Id.* ("Are SPACs dead? No. But there will be a new breed that comes into place, and that breed is going to be better for investors and better for the market.")
[81] Klausner, *supra* note 8, at 35.
[82] Lauren Helen Chamberlain, *Dispelling the Hype: An Examination of SPAC Common Equity Performance,* DIGITAL COMMONS CAL POLY 7 (2021), https://digitalcommons.calpoly.edu/cgi/viewcontent.cgi?article=1002&context=econsp [https://perma.cc/4972-Y4ND] ("While the maximum three-year return on SPACs was a lucrative 182.48%, the returns were highly variable and the average SPAC returned -32.60%.").

no further progress has been made toward implementing the bill into law. If the Committee vote is any indication, the bill may face opposition from the Republican side of the aisle. All Republican members of the House Financial Services Committee voted against the bill, indicating that it likely does not have bipartisan support.[83] Therefore, the bill likely would advance in the Democratically-controlled House, but it is unclear whether H.R. 5910 would receive approval in the Senate.[84]

Passage of H.R. 5910 would undoubtedly cause a massive shift in the SPAC market. No longer would SPACs freely make unrealistic projections to manipulate retail investors into approving a merger. Instead, sponsors would have to conduct more thorough due diligence to make more accurate projections, elect not to include projections at all, or choose not to form a SPAC out of fear of liability. Regardless of which option is picked, that sponsor would not be able to lie to investors without paying for it afterwards.

Timothy Kolankowski[85]

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[83] *Markup – H.R. 2411; H.R. 2620; H.R. 5910; H.R. 5911; H.R. 5913 and H.R. 5914,* U.S. HOUSE COMM. ON FIN. SERVS (Nov. 16, 2021), https://financialservices.house.gov/events/eventsingle.aspx?EventID=408598 [https://perma.cc/W7VB-3PN4].

[84] Akayla Gardner, *SPAC Bill Curbing Marketing Advanced by Key U.S. House Panel*, BLOOMBERG (Nov. 16, 2021), https://www.bloomberg.com/news/articles/2021-11-16/spac-bill-curbing-marketing-set-for-vote-by-key-u-s-house-panel [https://perma.cc/7Y2R-FW73] ("The bills are likely to advance in the House mostly on Democratic party lines.").

[85] Student, Boston University School of Law (J.D. 2023).