St. John's Law Review

Volume 96, 2022, Number 3 Article 8

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SPACS, FORWARD-LOOKING STATEMENTS, AND RULE 419: IS SEC RULEMAKING NEEDED?

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INTRODUCTION

On October 8, 2020, FirstMark Horizon Acquisition Corp. ("FirstMark" or "Company") closed an initial public offering ("IPO") of 41,400,000 units.[1] Each unit was priced at $10.00 and "consist[ed] of one share of Class A common stock of the Company . . . and one-third of one redeemable warrant[2] of the Company."[3] Each whole warrant provided its holder with the right to purchase "one share of Class A [c]ommon [s]tock for $11.50 per share."[4] FirstMark generated $414,000,000 in connection with the IPO.[5] These funds were then placed in a trust account and maintained by a trustee.[6]

In a filing submitted to the Securities and Exchange Commission ("SEC"), FirstMark identified itself as "a blank check company [formed] for the purpose of effecting a merger."[7] While not mentioning a specific company in its prospectus, the Company shared its intent on merging with a business in the technology industry.[8] The management team of FirstMark

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[1] FirstMark Horizon Acquisition Corp., Current Report (Form 8-K) (Oct. 8, 2020).

[2] *Id.* A warrant is an agreement between a company and an investor giving the investor the right to buy a certain number of shares of the company "at a set price" over a certain period of time. Robin Kavanagh, *What Are Stock Warrants and Why Do Companies Offer Them?*, BUS. INSIDER (July 7, 2022, 1:08 PM), https://www.businessinsider.com/stock-warrants [https://perma.cc/J5VD-NFPJ].

[3] FirstMark Horizon Acquisition Corp., Current Report (Form 8-K) (Oct. 8, 2020).

[4] *Id.*

[5] *Id.*

[6] *Id.*

[7] FirstMark Horizon Acquisition Corp., Prospectus (424B4) 1 (Oct. 5, 2020).

[8] *Id.*

consisted of executives from FirstMark Capital, a technology venture capital firm with $2.2 billion in capital commitments.[9] The highly capable management team had backed entrepreneurs in investments such as Pinterest and Shopify.[10]

Nearly a year after FirstMark's IPO, on October 7, 2021, Starry, Inc. ("Starry"), a wireless technology developer and internet service provider, announced that it was being acquired by FirstMark, a special purpose acquisition company ("SPAC").[11] In connection with the transaction, Starry provided "rosy forecast[s],"[12] as it projected "annual revenues of over $1.1 billion in 2026" compared to its annual revenue of $13 million in 2020.[13] Moreover, the company expected to provide its services to over twenty-five million households by 2026 compared to the 4.7 million households it serviced as of its second quarter in 2021.[14] Upon completion of the merger, Starry would be listed and traded on a national exchange.[15]

Starry, like many other businesses, grew to such a size that it needed a new source of capital to expand its business operations. Market analysts noted that Starry had not "had the resources to scale as quickly as they would have liked" and that the SPAC deal "could be just what they need[ed]."[16] Starry plans to use the funds from its transaction to provide services across more cities in the United States and pay off existing debt.[17] Notably, instead of pursuing the traditional IPO route,[18] Starry

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[9] *Id.*

[10] *Id.*

[11] *Starry Inc. to Go Public in Business Combination with FirstMark Horizon Acquisition Corp. to Bring Its Transformative Broadband Service to Millions of Households* (Oct. 7, 2021), https://dyajmw2sca9cs.cloudfront.net/press/pdf/Starry+FMAC+Merger+Agreement+Announcement+Press+Release+vF+(10.07.21).pdf [https://perma.cc/PSX6-P3HT].

[12] Aaron Pressman, *Boston Internet Startup Starry Going Public via SPAC*, BOS. GLOBE (Oct. 7, 2021, 8:26 AM), https://www.bostonglobe.com/2021/10/07/business/boston-internet-startup-starry-going-public-via-spac/ [https://perma.cc/WVP3-55RG].

[13] Niket Nishant, *Broadband Firm Starry to Go Public in Near-$1.7 Bln SPAC Deal*, REUTERS (Oct. 7, 2021, 5:59 PM), https://www.reuters.com/technology/broadband-firm-starry-go-public-near-17-bln-spac-deal-2021-10-07/ [https://perma.cc/JD6L-2J4P].

[14] *Id.*

[15] *Id.*

[16] Pressman, *supra* note 12.

[17] Nishant, *supra* note 13.

[18] For an overview of the traditional IPO process, see *Roadmap for an IPO: A Guide to Going Public*, PWC, https://www.pwc.com/us/en/services/deals/library/roadmap-for-an-ipo-a-guide-to-going-public.html [https://perma.cc/D79K-UEVR] (last visited Jan. 7, 2023). A public offering provides many benefits to a company, such as

chose to enter the public markets by merging with FirstMark, a SPAC. The U.S. capital markets have seen the re-emergence of this type of transaction where private companies are taken public through acquisition by a SPAC.

A SPAC is a shell company[19] created by sponsors that "raise money through an IPO" and is publicly traded with the purpose of acquiring a private company, often called the target.[20] "[A] private equity fund or a team of experienced executives with a solid track record would raise a no-asset 'blank check' IPO on the market with a time frame of 18 to 24 months to acquire a company."[21] The cash raised through the IPO is placed into a trust account and used to purchase the target.[22] Before the

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liquidity for shareholders in the secondary markets and enhancement of a company's brand. *Benefits of Being a Public Company*, UPCOUNSEL, https://www.upcounsel.com/benefits-of-being-a-public-company [https://perma.cc/U9C2-V9HB] (last visited Jan. 7, 2023). There are significant disclosure requirements, however, associated with becoming a public company. For example, a company interested in any initial public offering will need to follow the registration requirements outlined in the Securities Act of 1933 (" '33 Act"). 15 U.S.C. § 77h. Once a company is public, its shares will be listed and traded on a stock exchange; as of July 2022, the New York Stock Exchange ("NYSE") "is the largest stock exchange in the world, with an equity market capitalization of just over [$]24.6 trillion." *Largest Stock Exchange Operators Worldwide, by Market Capitalization of Listed Companies*, STATISTA (Aug. 29, 2022), https://www.statista.com/statistics/270126/largest-stock-exchange-operators-by-market-capitalization-of-listed-companies/ [https://perma.cc/2L2D-VVJK]. The company will also be required to file period reports and annual reports under the Securities Exchange Act of 1934 (" '34 Act"). 15 U.S.C. § 78m.

[19] *See* 17 C.F.R. § 230.405 (2021). Because the SPAC is a shell company, there is no operating business or significant assets except for cash and limited investments. *What You Need to Know About SPACs – Updated Investor Bulletin*, SEC OFF. OF INV. EDUC. & ADVOC. (May 25, 2021) [hereinafter *What You Need to Know*], https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin [https://perma.cc/JQ7Z-ZB8W]. Therefore, an investor would be relying on the management team that created the SPAC, also known as the sponsors. *Id.*

[20] *Five Key Takeaways from the SEC's Evolving Response to the SPAC Boom*, MORRISON FOERSTER (Apr. 22, 2021) [hereinafter *Five Key Takeaways*], https://www.mofo.com/resources/insights/210422-five-key-takeaways.html#_ftn4 [https://perma.cc/RVC7-9Y5C].

[21] Efraim Chalamish, *SPACs Are Back,* GLOB. FIN. (Dec. 8, 2016), https://www.gfmag.com/magazine/december-2016/spacs-are-back [https://perma.cc/LLG7-HM5K].

[22] *What You Need to Know*, *supra* note 19. "The SPAC holds ninety-five percent of the gross IPO offering proceeds in trust until an acquisition is consummated; five-percent of the gross IPO offering proceeds can be used for routine operating expenses, but not for salaries or commissions for management." Brandon Schumacher, *A New Development in Private Equity*: *The Rise and Progression of Special Purpose Acquisition Companies in Europe and Asia*, 40 NW J. INT'L L. & BUS. 391, 398 (2020).

acquisition, SPAC investors "have a pre-acquisition choice either to get their money back, or to remain as shareholders of the now-public firm."[23] If the SPAC identifies and purchases the target through a business combination, "the target merges with the SPAC" ("de-SPACing" or "de-SPAC transaction") and "becomes a public company."[24]

There has been an explosive growth of SPACs over a short period of time. For example, in 2019, there were fifty-nine SPAC IPOs that raised $13.6 billion.[25] In 2021, there were 613 SPAC IPOs that raised $162.5 billion.[26] The public's perception of SPACs has also shifted as athletes and celebrities from Alex Rodriguez to Jay-Z have helped SPACs gain popularity.[27] These investment vehicles have become such a phenomenon that the SEC issued an investor alert warning investors to avoid investing solely because of a celebrity endorsement.[28]

With this meteoric rise has come increased guidance from the SEC related to accounting and financial reporting considerations for SPACs, among other matters.[29] The Private Securities Litigation Reform Act,[30] ("PSLRA" or "the Act") and the application of its provisions related to forward-looking

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[23] Usha Rodrigues & Mike Stegemoller, *Exit, Voice, and Reputation: The Evolution of SPACs*, 37 DEL. J. CORP. L. 849, 851 (2013). In the event "the SPAC does not complete a business combination, shareholders are beneficiaries of the trust and entitled to their *pro rata* share of the aggregate amount then on deposit in the trust account." *What You Need to Know*, *supra* note 19.

[24] *Five Key Takeaways*, *supra* note 20.

[25] SPAC RESEARCH, https://www.spacresearch.com [perma.cc/3B58-KB8T] (last visited Jan. 7, 2023).

[26] *Id.*

[27] 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/2QPA-5U5X].

[28] SEC Off. of Inv. Educ. and Advoc., *Celebrity Involvement with SPACs – Investor Alert*, INVESTOR.GOV (Mar. 10, 2021), https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-alerts/celebrity [https://perma.cc/395K-FYD4].

[29] *Staff Statement on Select Issues Pertaining to Special Purpose Acquisition Companies*, SEC DIV. OF CORP. FINANCE (Mar. 31, 2021), https://www.sec.gov/news/public-statement/division-cf-spac-2021-03-31 [https://perma.cc/A76E-QSYS]; Statement from Paul Munter, Acting Chief Acct., Financial Reporting and Auditing Considerations of Companies Merging with SPACs, SEC (Mar. 31, 2021), https://www.sec.gov/news/public-statement/munter-spac-20200331 [https://perma.cc/3T8A-QZG7].

[30] Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995).

statements, have also garnered some attention.[31] The PSLRA permits some issuers, through its safe harbor provisions, to make forward-looking statements regarding revenue, projections, and other metrics without risk of liability from private plaintiffs if certain conditions are met.[32] However, the Act also specifies exemptions to the safe harbors where the issuer cannot receive the Act's safe harbors' protections and, therefore, may be subject to liability.[33] For example, there are exemptions to the safe harbor provisions for forward-looking statements made in connection with an IPO or an offering of securities by a blank check company.[34] The former Acting Director of the SEC's Division of Corporation Finance, John Coates, addressed SPAC IPOs and liability risk under U.S. securities law noting that "the PSLRA [exempts] from its safe harbor 'initial public offerings,' and that phrase may include de-SPAC transactions."[35] Four days later, on April 12, 2021, Coates and Acting Chief Accountant Paul Munter addressed accounting and reporting considerations for warrants issued by SPACs.[36] Given the importance of forward-looking statements in de-SPAC transactions,[37] the explosive growth of SPACs, and the SEC staff's attention to the matter, the PSLRA's provisions warrant further review.[38] Namely, the question is whether the PSLRA's exemptions to the safe harbor provisions apply to the de-SPAC transaction, and, if so, whether the PSLRA needs to be amended to meet this goal.

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[31] *E.g.,* Statement from John Coates, SEC Div. of Corp. Fin., 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/S3LU-DEDF].

[32] *See infra* Part II for a detailed discussion of the PSLRA's provisions related to forward-looking statements.

[33] *Id.*

[34] *Id.*

[35] Coates, *supra* note 31.

[36] Statement from John Coates & Paul Munter, Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies, SEC (Apr. 12, 2021), https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs [https://perma.cc/2DH3-9P2A].

[37] *See infra* notes 113–21.

[38] The SEC is purportedly considering whether to issue guidance to "rein in growth projections made by listed blank-check companies." Anirban Sen, et al., *U.S. Watchdog Mulls Guidance to Curb SPAC Projections, Liability Shield*, REUTERS (Apr. 28, 2021, 5:46 PM), https://www.reuters.com/business/exclusive-us-watchdog-weighs-guidance-aimed-curbing-spac-projections-liability-2021-04-27/ [https://perma.cc/4FWY-WXL8].

This Note argues that PSLRA's exemptions to the safe harbor provisions *should* apply to forward-looking statements made in connection with the de-SPAC transaction, and the PSLRA needs to be amended to achieve this goal. Part I provides a historical overview of blank check companies, the precursor to SPACs, and briefly addresses how this history shaped SPAC use today. Part II discusses forward-looking statements, the PSLRA's safe harbors for such statements, and Congress' recent legislation to amend such provisions. Part III argues that this legislation is insufficient because the proposed language is ambiguous as to whether it subjects firms to liability for forward-looking statements by SPACs made in the IPO stage or the de-SPAC transaction stage. Part III considers two alternative routes. The first is that the SEC should amend Rule 419(a)(2) by striking its reference to "penny stock" and issuing guidance that clarifies whether the safe harbor exemption for forward-looking statements made in connection with offerings by blank check companies refers to the de-SPAC transaction. The second route contemplates no SEC involvement and recommends legislation that subjects forward-looking statements made in connection with a private operating company becoming a '34 Act reporting company to be exempted from the PSLRA's safe harbor. This second route, Part III argues, should be the preferred method. Part III concludes with a discussion of protections still in place for issuers regardless of whether either of these routes is successfully pursued.

I. BLANK CHECK COMPANIES AND THE CREATION OF SPACS

The precursor to the modern day SPAC was a blank check company, or a "a development stage company that [had] no specific business plan . . . or [had] indicated its business plan [was] to engage in a merger or acquisition with an unidentified company or companies."[39] These companies had a troubled history and were often used in the 1980s to defraud investors at a time when fraud in the securities markets was rampant.[40] Often

[39] SEC Off. of Inv. Educ. & Advoc., *Blank Check Company*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/glossary/blank-check-company [https://perma.cc/4GZV-2JPW] (last visited Jan. 7, 2023).

[40] *See* S. REP. NO. 101-337, at 1–2 (1990) ("The legislation addresses the disturbing levels of financial fraud, stock manipulation and other illegal activity in the U.S. markets . . . ."). Blank check companies were also quite prevalent, with blank check companies filing twenty percent of the IPO registration statements with

involved in offerings of penny stock,[41] these blank check companies benefited management teams at the expense of investors with limited information.[42] Instead of following its stated purpose of acquiring an operating company, black check company promoters and insiders would dump their shares of the blank check company after upward manipulation of the share price based on rumors of a merger.[43] Management teams would be "involved [in] the manipulation of the market price of a small-cap company's securities primarily for the benefit of the stock's promoters."[44]

"In 1988 the SEC formally recognized blank check offerings as a tool for conducting fraud and deception in the penny stock market . . . ."[45] In 1989, The North American Securities Administrators Association opined that the most prominent threat of fraud facing small investors was penny stock swindles.[46] Congress responded in 1990 with the passing of the Securities Enforcement Remedies and Penny Stock Reform Act ("PSRA").[47] This legislation implemented special rules for registration statements filed by blank check companies,[48] and it authorized the SEC to promulgate rules regulating blank check companies

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the SEC in fiscal year 1990. *See* Blank Check Offerings, Securities Act Release No. 33-6891, Exchange Act Release No. 34-29096, 48 SEC Docket 962 (Apr. 17, 1991).

[41] *See* 15 U.S.C. § 78c(a)(51).

[42] Daniel S. Riemer, *Special Purpose Acquisition Companies: SPAC and SPAN, or Blank Check Redux?*, 85 WASH. U. L. REV. 931, 936 n.30 (2007).

[43] *Id.* at 936 n.26.

[44] *Id.* at 936. Promoters are individuals or organizations that encourage investors to purchase stock by advertising the stock and providing investors with information. Marshall Hargrave, *Promoter*, INVESTOPEDIA, https://www.investopedia.com/terms/p/promoter.asp#criticism-of-promoters, [https://perma.cc/MX7R-L2JX] (May 17, 2022). The SEC continues to be concerned with the activity of promoters. *Updated Investor Alert: Fraudulent Stock Promotions*, SEC OFF. OF INV. EDUC. & ADVOC. (Mar. 29, 2016), https://www.sec.gov/oiea/investor-alerts-bulletins/ia_promotions.html [https://perma.cc/6Q2N-2XJW].

[45] Riemer, *supra* note 42, at 936; *see also* Mary L. Schapiro, Commissioner, Sec. and Exch. Comm., Address at the 10th Annual Northwest Securities Institute: Seeking New Sanctions: Comments on Developments in the Commission's Enforcement Program 5 (Mar. 9, 1990), http://www.sec.gov/news/speech/1990/030990schapiro.pdf [https://perma.cc/2Y9T-APJN0] ("[E]xperience has shown that many other penny stocks are used in fraudulent schemes which involve 'shell' companies with no operating history, few employees, few assets, . . . and markets that are manipulated to the benefit of the promoters . . . .").

[46] H.R. REP. NO. 101-617, at 8 (1990), *as reprinted in* 1990 U.S.C.C.A.N. 1408, 1410.

[47] Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931.

[48] *Id.* § 508(2).

as "necessary or appropriate in the public interest or for the protection of investors."[49] The SEC responded with Rule 419, which narrowed Congress' definition of a "blank check company" by requiring such company to issue penny stock.[50] Various protections for investors in blank check companies that issued penny stock were created, such as the requirement that "the promoters [of blank check companies] deposit the proceeds of the offering in escrow until the blank check company identifies a company to acquire."[51] This provision ensures that funds from the public offering could not be used by management for personal or other inappropriate use.[52] Rule 419 also requires management to file an initial registration statement with the SEC outlining the terms of the offering, provisions of the escrow agreement, and the right of purchasers to receive information regarding an acquisition.[53] Furthermore, in the event an agreement for the acquisition of a target company is executed, management must file a post-effective amendment providing the financial statements of the target company, the current amount of funds in the escrow account, and the terms of the acquisition.[54] If an acquisition is not consummated within eighteen months of the effective date of the initial registration statement, the funds in escrow must be returned to the purchaser within five business dates.[55]

Rule 419 also makes the acquisition process "more cumbersome and tedious" and "it became unlikely, if not impossible, for management to hijack the company for its own gain."[56] Once a target is identified, investors have a choice of whether to redeem their shares before the offering proceeds can be used in an acquisition.[57] "Because shareholders were given

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[49] *Id.*

[50] Riemer, *supra* note 42, at 941–42. See *infra* note 124 for a more detailed discussion of how the SEC defines "blank check company."

[51] Proposed Rule: Use of Form S-8 and Form 8-K by Shell Companies, Securities Act Release No. 33-8407, Exchange Act Release No. 34-49566, 82 SEC Docket 2277 (Apr. 15, 2004).

[52] Riemer, *supra* note 42, at 943.

[53] 17 C.F.R. § 230.419(c) (2022).

[54] *Id.* § 230.419(e).

[55] *Id.* § 230.419(e)(2)(iv).

[56] Riemer, *supra* note 42, at 943–44.

[57] 17 C.F.R. § 230.419(e)(2)(ii). Rule 419 stipulates that "each purchaser"—defined as an investor in the SPAC IP—"shall have no fewer than 20 business days and no more than 45 business days . . . to notify the registrant"—the blank check company—"that the purchaser elects to remain an investor." *Id*.

the right to rescind their investment once a combination was announced, management could not know exactly how much capital was available to the company until the refund period passed."[58] With this uncertainty regarding the amount of available capital, "it became extremely difficult for blank check companies to effectively negotiate the acquisition of a business."[59] Accordingly, management could not just pump and dump their shares when news of the acquisition was made public. Moreover, the requirement that the fair value of the business or net assets of the business represent at least eighty percent of IPO proceeds limits the target companies that management can pursue.[60] The SEC believed that Rule 419 was "successful in deterring fraud and abuse in public blank check offerings."[61]

In the wake of the enactment of the PSRA and the adoption of Rule 419, blank check companies not issuing penny stocks, and thus not subject to Rule 419, still voluntarily complied with the rule.[62] "These blank check companies were the first generation of SPACs."[63] Between 1993 and 1994, David Nussbaum, credited with the first use of SPACs, used blank check companies that did not offer penny stock but voluntarily complied with Rule 419 provisions through "contractual arrangements and charter agreements" to complete twelve acquisitions.[64] The hope was to "renew[ ] investor confidence in blank check offerings"[65] after the rampant fraud of blank check offerings and to provide private firms with access to more investors.[66] "To further enhance their legitimacy, Nussbaum aimed to attract prominent and well-respected managers to head these early SPACs."[67] Notwithstanding the vehicle's volatile history, Nussbaum proved that "blank check offerings could still provide investors with an innovative, potentially profitable, and reasonably safe

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[58] Riemer, *supra* note 42, at 943.

[59] *Id.*

[60] 17 C.F.R. § 230.419(e)(1).

[61] Proposed Rule: Use of Form S-8 and Form 8-K by Shell Companies, *supra* note 51.

[62] Riemer, *supra* note 42, at 944.

[63] *Id.*

[64] *Id.* at 945.

[65] *Id.* at 944.

[66] Amrith Ramkumar, *SPAC Pioneers Reap the Rewards After Waiting Nearly 30 Years*, WALL ST. J., https://www.wsj.com/articles/they-created-the-spac-in-1993-now-theyre-reaping-the-rewards-11615285801 [https://perma.cc/44AW-VRVE] (Mar. 9, 2021, 4:53 PM).

[67] Riemer, *supra* note 42, at 946.

investment."[68] After some initial success in the early 1990s, the dot-com boom of the late 1990s increased the popularity of traditional IPOs and reduced the need for SPACs.[69] An increase in SPAC use across various industries re-emerged in the mid-2000s, but was quickly interrupted by the financial recession in 2008.[70]

Modern SPACs continue to voluntarily comply with the provisions of Rule 419.[71] The NYSE and NASDAQ also have listing requirements that require SPACs to comply with conditions that are substantially similar to Rule 419.[72] At the IPO stage, SPACs will file a disclosure statement—an initial registration statement—with the SEC, which will disclose the terms of the offering and an industry for their target business.[73] Proceeds of the SPAC IPO are held in a trust account, subject to a trust agreement, to fund the business combination or to return funds to public shareholders who wish to redeem their shares.[74] Moreover, some modern SPACs have chosen to comply with the eighteen month period to consummate a merger,[75] while some have even chosen shorter periods such as twelve months.[76]

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[68] *Id.* at 946–47.

[69] *Id.* at 946.

[70] *Id.* at 947–49; Ramkumar, *supra* note 66.

[71] Daniele D'Alvia, *The International Financial Regulation of SPACs Between Legal Standardised Regulation and Standardisation of Market Practices*, 21 J. BANKING REG. 107, 121 (2020).

[72] For example, Section 102.06 of the NYSE Listed Company Manual requires at least ninety percent of SPAC IPO funds to be held in a trust account and for the target's business to be at least eighty percent "of the net assets held in trust." *102.06 Minimum Numerical Standards – Acquisition Companies*, NYSE, https://nyse.wolterskluwer.cloud/listed-company-manual/document?treeNodeId=csh-da-filter!WKUS-TAL-DOCS-PHC-%7B0588BF4A-D3B5-4B91-94EA-BE9F17057DF0%7D—WKUS_TAL_5667%23teid-10 [https://perma.cc/3F82-RVE4] (last visited Jan. 7, 2023). NASDAQ also requires both conditions. CLIFFORD CHANCE, GUIDE TO SPECIAL PURPOSE ACQUISITION COMPANIES 5 (2021), https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2021/09/guide-to-special-purpose-acquisition-companies.pdf [https://perma.cc/H5ZC-DCUF].

[73] *See* 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/W7V7-6UVD].

[74] *Id.*

[75] 17 C.F.R. § 230.419(e)(2)(iv) (2022); Layne & Lenahan, *supra* note 73, n.7.

[76] Layne & Lenahan, *supra* note 73, n.7.

II. FORWARD-LOOKING STATEMENTS AND THE PSLRA

When describing their business to the public, companies sometimes make forward-looking statements instead of making statements of historical fact. A forward-looking statement includes "statement[s] containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, . . . or other financial items."[77] Up until the early 1970s, the SEC prohibited the disclosure of forward-looking statements "in connection with public offerings of and trading in securities of all issuers whose securities are registered"[78] under the '33 Act or '34 Act or otherwise publicly traded.[79] The SEC believed that such statements were unreliable and investors were placing too much emphasis on them.[80] However, the SEC began considering whether to lift the prohibition on such statements and determined, based on public hearings and staff recommendations, that changing its policies with respect to forward-looking information could still protect investors and the public interest.[81]

In 1975, the SEC issued proposals to permit voluntary disclosure of forward-looking statements and to protect such statements from civil liability.[82] After these proposals were withdrawn in 1976,[83] an Advisory Committee on Corporate Disclosure was formed to analyze the SEC Division of Corporation Finance's policy on forward-looking information.[84]

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[77] 15 U.S.C. § 78u-5(i)(1)(A).

[78] *See* Estimates, Forecasts, or Projections of Economic Performance, Exchange Act Release No. 34-9844, 1972 WL 125348 (Nov. 1, 1972).

[79] *Id.*; *see also* Statement by the Commission on the Disclosure of Projections of Future Economic Performance, Securities Act Release No. 33-5362, Exchange Act Release No. 9984, 1 SEC Docket 11 (Feb. 2, 1973) ("It has been the Commission's long-standing policy generally not to permit projections to be included in prospectuses and reports filed with the Commission.").

[80] Safe Harbor for Forward-Looking Statements, Securities Act Release No. 2324, Exchange Act Release No. 7101, 57 SEC Docket 1999 (Oct. 13, 1994). This view towards forward-looking statements stemmed from a Disclosure Policy Group formed by the SEC which found that the "risk of undue investor reliance on this information outweighed any countervailing benefits." *Id.*

[81] Statement by the Commission on the Disclosure of Projections of Future Economic Performance, *supra* note 79.

[82] Notice of Proposed Rule 132 and Proposed Amendments to Rule 405, Securities Act Release No. 33-5581, Exchange Act Release No. 34-11374, 6 SEC Docket 711 (Apr. 28, 1975).

[83] Withdrawal of the Other Proposals Contained in Release No. 33-5581, Securities Act Release No. 33-5699, Exchange Act Release No. 34-12371, 9 SEC Docket 472 (Apr. 23, 1976).

[84] *Id.*

The committee analyzed commentary from security law practitioners, professors, and other commentators and recognized the usefulness of forward-looking information to price securities and standardize the evaluation of the quality of management.[85] The committee found that forward-looking statements were relevant when making an informed investment decision and concluded in its report that the SEC should encourage forward-looking disclosures.[86] Among other recommendations, the committee proposed safe harbors for forward-looking statements made in good faith, with a reasonable basis, and accompanied by cautionary language.[87] In 1979, the SEC adopted a safe harbor provision that combined proposals from both the Advisory Committee on Corporate Disclosure and the SEC itself.[88] This safe harbor provision applied to forward-looking statements made in filings with the commission or in an annual report to shareholders only by issuers subject to the reporting requirements of the '34 Act or where the statements were made in a registration statement filed under the '33 Act.[89] Under those circumstances, any forward-looking statement would not be a fraudulent statement[90] unless the statement was made without a reasonable basis and not in good faith.[91] Virtually identical safe harbor provisions were codified in Rule 175[92] under the Securities Act and Rule 3b-6[93] under the Exchange Act.[94]

Notwithstanding these safe harbors, the "threat of mass shareholder litigation . . . had a chilling effect on disclosure of forward-looking information."[95] Critics of the safe harbors

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[85] ADVISORY COMM. ON CORP. DISCLOSURE, 95TH CONG., REP. ON CORPORATE DISCLOSURE TO THE SECURITIES AND EXCHANGE COMMISSION, 351–52 (Comm. Print 1977).

[86] *Id.* at 353.

[87] *See id.* at 345.

[88] Safe Harbor Rule for Projections, Securities Act Release No. 33-6084, Exchange Act Release No. 34-15944 (June 25, 1979).

[89] *Id.*

[90] A fraudulent statement "shall mean a statement which is an untrue statement of a material fact, a statement false or misleading with respect to any material fact, [or] an omission to state a material fact necessary to make a statement not misleading" as these terms are used in the '33 Act. *Id.*

[91] *Id.*

[92] 17 CFR § 230.175 (2022).

[93] 17 CFR § 240.3b–6 (2022).

[94] Safe Harbor for Forward-Looking Statements, *supra* note 80. These safe harbor provisions applied to forward-looking information "made, reaffirmed, or later published" in filings with the SEC. *Id.*

[95] *Id.*

argued that the safe harbors were too narrow because they were limited to forward-looking statements made in filings with the SEC.[96] Others argued that the safe harbors were not applied by courts in a way that resulted in efficient and inexpensive adjudication of frivolous lawsuits,[97] and that it was unclear whether a company was liable "for statements made by third parties."[98] Congress addressed these issues in 1995 with the PSLRA.[99]

The PSLRA became law on December 22, 1995, after passing the House of Representatives and Senate by supermajority vote after President Clinton's veto.[100] Many provisions of the Act were implemented to act as "a check against abusive litigation by private parties" in securities fraud actions."[101] With Congress finding that "[a]busive litigation severely impacts the willingness of corporate managers to disclose information to the marketplace,"[102] the Act developed safe harbor provisions that shielded issuers, and certain third parties such as "a person acting on behalf of [an] issuer," from liability for forward-looking statements, "whether written or oral," subject to certain conditions.[103] For example, the safe harbors are only applicable

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[96] *Id.*

[97] *Id.*

[98] *Id.*

[99] *See generally* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737.

[100] *Id.*; Robert A. Rosenblatt & Gebe Martinez, *Senate Completes First Override of Clinton Veto: Congress: Measure Restricts Investors' Ability to Sue For Securities Fraud. It's a Victory for GOP 'Contract'*, L.A. TIMES (Dec. 23, 1995, 12:00 AM), https://www.latimes.com/archives/la-xpm-1995-12-23-mn-17039-story.html [https://perma.cc/3MPQ-68Q8].

[101] Tellabs, Inc. v. Makor Issues & Rts., Ltd., 551 U.S. 308, 308 (2007). Congress was particularly concerned with plaintiff's lawyers who filed a complaint on behalf of a plaintiff with "minimal stake in the outcome of the case, [with an aim to] impos[e] on defendants burdensome and costly discovery requests in the hopes of extracting a settlement." David M. Rein, et al., *Securities Litigation Involving the Private Securities Litigation Reform Act*, THOMSON REUTERS PRAC. L.: J. LITIG. (2017), https://www.sullcrom.com/files/upload/ThomsonReutersJournal_Litigation_PSLRA_OctNov17.pdf [https://perma.cc/NZ34-4GTH]. Under the Act, plaintiffs who file a complaint alleging: a false or misleading statement must: (1) "specify each statement alleged to have been misleading [and] the reason or reasons why the statement is misleading," and (2) "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." *Tellabs*, 551 U.S. at 321 (alteration in original) (citing 15 U.S.C. § 78u–4(b)).

[102] S. REP. NO. 104-98, at 16 (1995).

[103] 15 U.S.C. § 78u–5.

to issuers subject to the reporting requirements of the '34 Act.[104] These issuers can fall under the safe harbor if any of three circumstances are met. First, the safe harbor is available if the forward-looking statement is "identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement."[105] Second, the safe harbor is available if the forward-looking statement is "immaterial."[106] Third, the safe harbor is available if the plaintiff fails to prove that the forward-looking statement made by a natural person or executive officer of a business entity was made with "actual knowledge . . . that the statement was false or misleading."[107] The safe harbor provisions are meant to "enhance market efficiency by encouraging companies to disclose forward-looking information."[108] More specifically, these provisions are to apply only "to companies with an established track record [who are] seasoned issuers."[109]

However, the House of Representatives Conference Committee reviewing the PSLRA noted that "the statutory safe harbor should not apply to certain forward-looking statements" and "certain types of transactions and issuers may not be

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[104] *Id.* § 78u–5(a)(1). The reporting requirements of the '34 Act require public companies to file annual, quarterly, and current reports on Forms 10-K, 10-Q, and 8-K, respectively. *Exchange Act Reporting and Registration*, SEC, https://www.sec.gov/smallbusiness/goingpublic/exchangeactreporting [https://perma.cc/7HLG-E7MV] (Apr. 28, 2022). The annual reports will include information such as a description of the business, risk factors, legal proceedings, and outstanding securities. *How to Read a 10-K/10-Q*, SEC (Jan. 25, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/how-read-10-k10-q [https://perma.cc/G5AJ-NA5X]. The quarterly reports filed with the SEC each fiscal quarter contain a similar, "but more abbreviated disclosure" compared to the annual report. *Id.* Current reports are filed at various times throughout the year whenever certain material events trigger disclosure. SEC Off. of Inv. Educ. & Advoc., *How to Read an 8-K*, INVESTOR.GOV (Jan. 26, 2021), https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins/how-read-8 [https://perma.cc/23F8-B7NG].

[105] 15 U.S.C. § 78u-5(c)(1)(A)(i).

[106] *Id*. § 78u-5(c)(1)(A)(ii). The materiality threshold is whether "from the perspective of a reasonable stockholder, there is a substantial likelihood that [the information] 'significantly alter[s] the "total mix" of information made available.' " *In re* Solera Holdings, Inc. S'holder Litig., No. 11524-CB, 2017 WL 57839, at *9 (Del. Ch. Jan. 5, 2017) (second alteration in original) (quoting Arnold v. Soc'y for Sav. Bancorp, 650 A.2d 1270, 1277 (Del. Dec. 28, 1994)).

[107] 15 U.S.C. § 78-u5(c)(1)(B)(i)–(ii).

[108] H.R. REP. NO. 104-369, at 43 (1995) (Conf. Rep.).

[109] 141 CONG. REC. S190602 (daily ed. Dec. 21, 1995) (statement of Sen. Feinstein).

suitable for inclusion in a statutory safe harbor absent some experience with the statute."[110] As a result, the Act, as relevant to SPACs, provides that the safe harbor is not available for forward-looking statements made "in connection with an offering of securities by a blank check company"[111] or "in connection with an initial public offering."[112]

This statutory scheme is uniquely important and has legal implications for companies incorporated under Delaware law, to which "[m]ore than half of public and Fortune 500 companies" are subject.[113] In the context of any business combination, "projections of [a] target company's future financial performance" are significant in negotiating the transaction's terms.[114] Delaware law requires that when a company's board of directors "solicit[s] stockholder action, they must 'disclose fully and fairly all material information within the board's control.' "[115] The materiality threshold is whether "from the perspective of a reasonable stockholder, there is a substantial likelihood that [the information] 'significantly alter[s] the "total mix" of information made available.' "[116] So, if the company's board relies on a target company's financial projections in a business combination, they are generally considered material and disclosed to shareholders. In de-SPAC transactions, the target company's financial

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[110] H.R. REP. NO. 104-369, at 46. Many, if not all, of the exclusions in the Act "ended up in the legislation because the SEC asked for them." Arthur Levitt, Chairman, Sec. and Exch. Comm., Remarks at the 23d Annual Securities Regulation Institute (Jan. 24, 1996).

[111] 15 U.S.C. § 78u-5(b)(1)(B).

[112] *Id.* § 78u-5(b)(2)(D).

[113] Nikki Nelson, *Why Incorporate in Delaware or Nevada?*, WOLTERS KLUWER (July 11, 2020), https://www.wolterskluwer.com/en/expert-insights/why-incorporate-in-delaware-or-nevada [https://perma.cc/6WA4-HSZ7].

[114] *SEC Considering Heightened Scrutiny of Projections in De-SPAC Transactions*, SHEARMAN & STERLING (Apr. 30, 2021), https://www.shearman.com/Perspectives/2021/04/SEC-Considers-Heightened-Scrutiny-of-Projections-in-De-SPAC-Deals [https://perma.cc/78NJ-EARP]. "[T]he target company's management [team is typically] in the best position to prepare . . . financial projections" given the team's familiarity with the business. Samuel S. Nicholls, *Flawed M&A Deal Processes That Can Lead to Litigation*, A.B.A. BUS. L. TODAY (Oct. 13, 2020), https://www.americanbar.org/groups/business_law/publications/blt/2020/10/ma-deal-processes/ [https://perma.cc/F4AT-WVUS]. There may also be involvement from a special committee at the company purchasing the target or from the investment bank serving as financial adviser on the deal. *Id.*

[115] *In re* Solera Holdings, Inc. S'holder Litig., No. 11524-CB, 2017 WL 57839, at *9 (Del. Ch. Jan. 5, 2017) (quoting Stroud v. Grace, 606 A.2d 75, 84 (Del. Apr. 9, 1992)).

[116] *Id.* at *9 (second alteration in original) (quoting Arnold v. Soc'y for Sav. Bancorp, 650 A.2d 1270, 1277 (Del. Dec. 28, 1994)).

projections are often included in S-4 filings or proxy statements delivered to shareholders,[117] as the board typically relies on such projections to anticipate the target's growth.[118]

This structure creates competing interests between the management team that created the SPAC and the investors in the initial SPAC IPO. Because the IPO investors can redeem their shares pending the de-SPAC transaction, they are relying on the target company's financial projections in the S-4 filings and proxy statements to determine whether to continue to be an investor. However, because management is incentivized to complete a transaction,[119] "freedom from liability for forward-looking statements . . . could de-incentivize due diligence into target companies and permit the use of overly optimistic projections, [which] potentially mislead[ ] investors."[120] On the other hand, commentators, such as former Facebook, Inc. executive Chamath Palihapitiya, argue that the use of financial projections in the de-SPAC transaction constitutes an advantage over the traditional IPO: "[B]ecause the SPAC is a merger of companies, you're all of a sudden allowed to talk about the future . . . and when you do that, you have a better chance of being more fully valued."[121]

On April 8, 2021, John Coates, the former Acting Director of the SEC's Division of Corporation Finance, expressed concern that some practitioners and commentators claim that although the PSLRA safe harbor does not apply to conventional IPOs, it

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[117] The SEC requires a publicly traded company, such as a SPAC, to file a Form S-4 with the SEC when the company is involved in a merger or acquisition. *Chapter 12: Follow-On Offerings and Shelf Registrations*, PERKINS COIE, https://www.perkinscoie.com/en/pch-chapter-12.html [https://perma.cc/9PEU-X2Y6] (last visited Jan. 7, 2023). Once the S-4 is deemed effective by the SEC, the target company will file the same document as proxy materials, which contains information about the merger that shareholders will vote on. *Id.*

[118] *See* DELOITTE & COOLEY, SPAC TRANSACTIONS – CONSIDERATIONS FOR TARGET-COMPANY CFOS 5 (2020), 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/Y4NC-DDMH].

[119] *See* Layne & Lenahan, *supra* note 73 (explaining that the sponsor will typically have twenty percent of the shares after the completion of the IPO).

[120] Roger E. Barton & Michael C. Ward, *SPACs and Speculation: The Changing Legal Liability of Forward-Looking Statements*, REUTERS (July 7, 2021, 12:40 PM), https://www.reuters.com/legal/legalindustry/spacs-speculation-changing-legal-liability-forward-looking-statements-2021-07-07/ [https://perma.cc/KV6G-9ETV].

[121] Haystack, *Alignment Summit Chats: SPACs (w/ Chamath Palihapitiya)*, YOUTUBE (Dec. 2, 2020), https://www.youtube.com/watch?v=sC3Q5eJjGgw [https://perma.cc/KTK3-FEHS] (statement of Chamath Palihapitiya).

does apply to de-SPAC transactions.[122] Coates opined that given that the de-SPAC transaction is the target company's initial public offering, "the PSLRA safe harbor should not be available for any unknown private company introducing itself to the public markets."[123] This left open the question of whether the de-SPAC transaction falls under the exemption to the safe harbor for forward-looking statements made in connection with an offering of securities by a blank check company or in connection with an IPO. Regarding the former exemption to the safe harbor, the answer must be no because the PSLRA incorporates the definition of "blank check company" contained in Rule 419, meaning the company must issue penny stock.[124] Thus, blank check companies that do not issue penny stocks, which include SPACs, are not included in this definition of blank check company.[125] Regarding IPOs, the de-SPAC transaction is not an

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[122] Coates, *supra* note 31.

[123] *Id.*

[124] Under the PSLRA, "blank check company" has the "meaning[ ] given . . . by rule or regulation of the Commission." 15 U.S.C. § 78-u5(i)(5). "Blank check company" is defined in Securities Act Rule 419 and requires the company to be "issuing 'penny stock,' as defined in Rule 3a51-1 . . . under the ['34 Act]." 17 C.F.R. § 230.419(a)(2)(ii) (2022). The only other requirement under Rule 419 is that the company "[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." *Id.* § 230.419(a)(2)(i). Most SPACs are structured so they do not qualify as issuing "penny stock" to ensure they do not lose the Act's safe harbor protections. *Guidance on Special Purpose Acquisition Companies*, FINRA, https://www.finra.org/rules-guidance/notices/08-54 [https://perma.cc/5ZVH-L35Y] (last visited Jan. 7, 2023). However, the SEC has said that pricing stocks above $5 per share is not sufficient to ensure the company is not issuing penny stock. Penny Stock Definition for Purposes of Blank Check Rule, Securities Act Release No 33-7024, Exchange Act Release No. 34-33095, 55 SEC Docket 722 (Oct. 25, 1993). So, the SPAC instead must have "$5 million in net tangible assets subsequent to the IPO." Derek K. Heyman, *From Blank Check to SPAC: The Regulator's Response to the Market, and the Market's Response to the Regulation*, 2 ENTREPRENEURIAL B.L.J. 531, 541 (2007). The SPAC will file a Form 8-K with the SEC after the IPO with an audited balance sheet reflecting this net tangible asset amount. SOUMYA SHARMA, ET AL., SPAC LIFECYCLE AND CONSIDERATIONS FOR PRIVATE COMPANIES 3 (2020), https://www.troutman.com/images/content/2/7/272572/2020-November-Bloomberg-SPAC-Lifecycle-and-Considerations-fo.pdf [https://perma.cc/WH6W-57C9].

[125] Blank check companies were limited in Rule 419 to offerings of penny stock because of the abuse that was prevalent in penny stock offerings. *See supra* notes 40–47 and accompanying text. Rule 419 was implemented in the wake of the PSRA and aimed to address the fraudulent penny stock offerings by blank check companies, which the legislative history of the PSRA directly contemplates. H.R. REP. NO. 101-617, at 10–13 (1990) ("A common method or [sic] perpetrating penny stock fraud is through the marketing of . . . 'blank check companies' with no operating history . . . and no legitimate likelihood of success in the future.").

IPO in the traditional sense where a private company issues new shares with the help of an underwriter; a de-SPAC transaction essentially "reverses the normal IPO procedure" because "[i]nstead of the operating company seeking investors, investors seek an operating company."[126] A broader issue, as Coates put it, is that the "PSLRA's exclusion for 'initial public offering' does not refer to any definition of 'initial public offering.' "[127] Moreover, "[n]o definition can be found in the PSLRA [or] any SEC rule."[128] So, unlike the PSLRA's exemption to the safe harbor for offerings of a "blank check company," which is defined in Rule 419, there is no applicable definition for the exemption for those issuers which engage in an "initial public offering." In short, as the PSLRA is currently written, SPACs are likely able to take advantage of the Act's safe harbor, meaning forward-looking statements made in connection with the de-SPAC transaction are not actionable.

On November 9, 2021, Congressman Michael F.Q. San Nicolas introduced in the House of Representatives a bill, H.R. 5910, titled "Holding SPACs Accountable Act of 2021."[129] The bill would strike the term "blank check company" from the PSLRA safe harbor exemption[130] and replace it 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."[131] In other words, by removing the PSLRA's reference to "blank check company" as defined by the SEC, there would be no requirement that the development stage company, the SPAC, issue penny stock to fall under the definition of blank check company. Any offering of securities by a development stage company such as a SPAC would thus be excluded from the safe harbor whether or not the entity is issuing penny stock.[132]

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[126] Daniele D'Alvia & Milos Vulanovic, *A Rethinking of U.S. Forward-Looking Statements in SPACs*, FORDHAM J. CORP. & FIN. L. (July 13, 2021), https://news.law.fordham.edu/jcfl/2021/07/13/a-rethinking-of-u-s-forward-looking-statements-in-spacs/ [https://perma.cc/2WWD-DTBS].

[127] Coates, *supra* note 31.

[128] *Id.*

[129] H.R. 5910, 117th Cong. (2021). This bill has not yet been introduced in the 118th Congress.

[130] *See* 15 U.S.C. § 78u-5(b)(1)(B).

[131] H.R. 5910. This language is substantively equivalent to Rule 419(a)(2)(i). 17 C.F.R. § 230.419(a)(2)(i) (2022).

[132] Carlos Juarez, *SPACs Face Legislative Scrutiny: House Financial Services Committee Advances Two SPAC-Related Bills*, JD SUPRA (Nov. 29, 2021),

III. PROPOSED AMENDMENTS OF THE PSLRA

H.R. 5910 comes at a time when SPACs "are significantly more likely . . . to compete against other SPACs than in prior years."[133] Hundreds of SPACs with significant capital are still looking for targets.[134] Given this backdrop, it is important that the legislation appropriately remove SPACs from the PSLRA safe harbor. However, the SEC may also take action to redefine the term "blank check company" itself. These two routes are presented below, the first being through SEC rulemaking.

A. SEC Rulemaking: Amending Rule 419's Definition of Blank Check Company

The legislative history of the PSLRA contemplates the SEC expanding the exemptions to the safe harbor under the Act,[135] and the same power is articulated in the PSLRA itself.[136] Coates even noted that "there may be advantages to providing greater clarity on the scope of the safe harbor in the PSLRA."[137] To remove SPACs from the PSLRA safe harbor, the SEC could do so by, first, amending Rule 419, [138] through the redefining of blank check companies and removing the requirement that a blank check company issue "penny stock" as defined in the '34 Act. This amendment would strike the following language, which is the entirety of Rule 419(a)(2)(ii): "[I]s issuing 'penny stock,' as

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https://www.jdsupra.com/legalnews/spacs-face-legislative-scrutiny-house-7208832 [https://perma.cc/EKV9-UGGJ].

[133] Richard Hall, et al., *SPAC Transactions in the United States*, THE LEGAL 500 (July 4, 2021), https://www.cravath.com/a/web/eG4N3ka9wzEeZ8sSEBgeMB/2tooH1/the-legal-500-2021-hot-topic-country-comparative-guide-b.pdf [https://perma.cc/9UD9-DTGG].

[134] Jason Ye, *Record-Breaking Popularity for IPOs and SPACs During the Pandemic*, A.B.A. BUS. L. TODAY (Oct. 6. 2021), https://businesslawtoday.org/2021/10/record-breaking-popularity-for-ipos-and-spacs-during-the-pandemic/ [https://perma.cc/GTD8-E4A8].

[135] H.R. REP. NO. 104-369, at 46 (1995) ("The Committee intends for its statutory safe harbor provisions to serve as a starting point" and "[t]he SEC should . . . promulgate rules or regulations to expand the statutory safe harbor by providing additional [protections] from liability.").

[136] 15 U.S.C. § 78u-5(g) ("[T]he Commission may, by rule or regulation, provide exemptions from or under any provision of this chapter . . . if and to the extent that any such exemption is consistent with the public interest and the protection of investors . . . .").

[137] Coates, *supra* note 31.

[138] For an overview of the SEC rulemaking process, see *Investor Bulletin: An Introduction to the U.S. Securities and Exchange Commission – Rulemaking and Laws*, SEC. AND EXCH. COMM. (Aug. 20, 2015), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_rulemaking.html [https://perma.cc/43X4-GXXG].

defined in Rule 3a51-1 . . . under the Securities Exchange Act of 1934."[139] This amendment would have essentially the same effect as the House's legislation. SPACs would then be captured by the definition of a blank check company contained in Rule 419, and forward-looking statements made in connection with an offering of securities by a SPAC would be exempt from the safe harbor's protections.[140] In addition, any company that issues penny stock would still be subject to another exemption to the safe harbor provisions within the PSLRA.[141] As with any SEC rule, the process will involve concept releases, proposing releases, and rule adoption.[142]

However, there would need to be an additional step by the SEC and that would be to issue guidance as to whether the exemption to the safe harbor for blank check offerings would apply to the de-SPAC transaction. The exemption currently applies "to a forward-looking statement . . . if the issuer . . . makes the forward-looking statement *in connection with an offering of securities* by a blank check company."[143] It is not clear whether the "offering of securities" language would apply to the de-SPAC transaction, or only to the initial offering of the SPAC itself.

While there is an "offering of securities" at the SPAC's IPO stage,[144] there is ambiguity as to whether there is an "offering of securities" at the de-SPAC stage. During the de-SPAC process,

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[139] Blank Check Offerings, Securities Act Release No. 6932, 51 SEC Docket 284 (Apr. 13, 1992).

[140] *See supra* note 124 and accompanying text.

[141] 15 U.S.C. § 78u-5(b)(1)(C).

[142] *Rulemaking, How It Works,* INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/glossary/rulemaking-how-it-works [https://perma.cc/F9M9-PYT6] (last visited Jan. 7, 2023). On March 30, 2022, the SEC issued a detailed proposed rule relating to SPACs that, as it relates to forward-looking statements and the PSLRA, largely follows the amendments discussed above. Special Purpose Acquisition Companies, Shell Companies, and Projections, 87 Fed. Reg. 29458 (proposed May 13, 2022) (to be codified at 17 C.F.R. pts. 210, 229–30, 232, 239–40, 249, 270). The proposed rule would amend the definition of blank check company in Rule 419 by "remov[ing] the 'penny stock' condition." *Id.* at 29481–82. The SEC saw "no reason to treat forward-looking statements made in connection with de-SPAC transactions differently than forward-looking statements made in traditional initial public offerings." *Id.*

[143] 15 U.S.C. § 78u-5(b)(1)(B) (emphasis added).

[144] Layne & Lenahan, *supra* note 73 ("In a typical SPAC IPO, the public investors are sold units, each comprised of one share of common stock and a fraction of a warrant to purchase a share of common stock in the future.").

the SPAC may "offer" shares to the target company.[145] This stage is important because "the PSLRA safe harbor should not be available for any *unknown private company* introducing itself to the public markets."[146] In other words, the concern is on the target company's introduction to the public markets, not the initial offering of the SPAC which has no operating business or significant assets.[147]

There may also be an argument that the offering at the SPAC IPO stage is so intertwined with the de-SPAC transaction because of Rule 419 that an "offering of securities" does occur at the de-SPAC stage. For example, funds from the SPAC IPO are held in a trust account to fund the acquisition of the target, the SPAC typically has between eighteen to twenty-four months to locate a target, and IPO shareholders have the ability to redeem shares when the target is announced.[148] In other words, these limitations on SPACs reflect that the *sole purpose* of the initial IPO is to engage in the de-SPAC transaction, which supports the argument that the IPO "offering" would include the de-SPAC transaction.

In any case, SEC guidance would need to supplement the amendment of Rule 419. There is, however, an important limitation on SEC guidance. Any guidance through interpretive releases,[149] or staff statements are "nonbinding and create no enforceable legal rights or obligations of the [SEC] or other parties."[150] Any binding action would have to be taken through the rulemaking process.[151]

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[145] "The term . . . 'offer' shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." 15 U.S.C. § 77b(a)(3). Stock exchange rules contemplate a vote by SPAC shareholders "if more than 20% of the voting stock of the SPAC is being issued in the De-SPAC transaction (to the seller of the target business, to PIPE investors or to a combination)." Layne & Lenahan, *supra* note 73.

[146] Coates, *supra* note 31 (emphasis added).

[147] *What You Need to Know*, *supra* note 19.

[148] *See supra* notes 53–76 and accompanying text.

[149] *See Researching the Federal Securities Law Through the SEC Website*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/role-sec/researching-federal-securities-laws-through-sec [https://perma.cc/69EU-FN3E] (last visited Jan. 7, 2023) ("Interpretive releases . . . are not enforceable laws and regulations but provide useful guidance as to the position of the Commission on various issues.").

[150] Statement from Chairman Jay Clayton Regarding SEC Staff Views (Sept. 13, 2018), https://www.sec.gov/news/public-statement/statement-clayton-091318#_ftn2 [https://perma.cc/8PYX-3F9P].

[151] *Id.*

B. Amending the PSLRA: A New Safe Harbor Exemption

The second route for exempting SPACs from the safe harbor is through legislation. The House legislation, as currently written, suffers from the same issue discussed above, meaning, it is unclear if the "offering of securities" language captures liability for forward-looking statements by SPACs made in the IPO stage only, or also in the de-SPAC transaction.[152] The history of blank check companies makes it clear that the exemption to the safe harbor for blank check companies would apply to the SPAC IPO. The PSLRA was passed in 1995, only five years after the PSRA and in the wake of fraudulent blank check offerings.[153] Thus, Congress must have been at least aware of the nature of these fraudulent blank check offerings when the PSLRA was implemented. Importantly, "most blank check companies did not actually complete a combination. Instead, the securities' market price was subjected to upward manipulation by stock promoters by means of rumors of a pending merger."[154] Rumors of a pending merger, not an actual business combination, or a de-SPAC transaction as it relates to SPACs, were the catalyst for the fraudulent "pump-and-dump scam."[155] In other words, blank check companies were engaged in fraud before there was an identified target company to acquire let alone the completion of the business combination. This historical perspective of blank check companies supports the conclusion that the PSLRA's language referencing such entities refers to offerings *before* the business combination.[156] Therefore, the PSLRA's language would unquestionably apply to the SPAC's IPO. However, it is not clear whether the language would also capture the de-SPAC transaction.

Given this historical perspective, legislation amending a different provision of the PSLRA is better suited to meet Congress' goals. Instead of amending the already existing PSLRA exemption to the safe harbor that contemplates an offering of securities, Congress could add a new exemption to the safe harbor under 15 U.S.C. 78-u5(b)(2).[157] The new exemption

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[152] *See generally* H.R. 5910, 117th Cong. (2021).

[153] For an explanation of the fraudulent blank check offerings that preceded SPACs, see *supra* notes 40–47, 100.

[154] Riemer, *supra* note 42, at 936 n.26 (citation omitted).

[155] *See id*. at 932 n.8.

[156] *See* 15 U.S.C. § 78u-5(b)(1)(B), (h)(5).

[157] *See id.* § 78u-5(b)(2).

would apply to any forward-looking statements made in connection with any transaction in which 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 in fact combines, directly or indirectly, with an operating company that becomes an Exchange Act reporting company.[158] This language is preferable compared to the House's legislation for three reasons. First, there is no guidance needed from the SEC (albeit non-binding) on whether the "offering of securities" language applies to the de-SPAC transaction because this language is simply not included in the proposed amendment. Second, the SEC will not have to use the rulemaking procedure to amend Rule 419. Third, the proposed amendment unambiguously applies to the de-SPAC transaction by referencing the combination of a "development stage company" as used in Rule 419,[159] the SPAC, and an operating company that enters the public markets by *becoming* an Exchange Act reporting company, the target company. Congress also believed that the "development stage company" language from Rule 419 covered SPACs when it used that language to exempt SPACs from the safe harbor in H.R. 5910.[160] Although the SEC rulemaking process[161] is likely more efficient than the process for the House legislation as proposed in this Note,[162] the clarity of the latter makes it the preferred method to support the public interest and protect investors.

Regardless of whether changes are made to SEC rules or the PSLRA, SPAC sponsors and the target company may still avail themselves of other protections for forward-looking statements. The "bespeaks-caution doctrine" is still available, which is a

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[158] This language is used in NASDAQ's definition of "Reverse Merger" in Rule 5005(a)(39) of its listing requirements. *5000. NASDAQ Listing Rules*, NASDAQ, https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/nasdaq-5000-series [https://perma.cc/Y3RF-8YE2] (last visited Jan. 7, 2023).

[159] *See supra* note 124.

[160] As discussed, the issue with Congress' approach was its choice to amend a provision of the PSLRA that included the "offering of securities" language and the uncertainty whether the de-SPAC transaction was covered. *See supra* notes 143–47 and accompanying text.

[161] The SEC rulemaking process is governed by the Administrative Procedure Act, which proscribes different methods for federal agencies to implement rules which have the force of law. *See generally* Todd Garvey, *A Brief Overview of Rulemaking and Judicial Review*, CONG. RSCH. SERV. (Mar. 27, 2017), https://sgp.fas.org/crs/misc/R41546.pdf [https://perma.cc/QKM4-52FA].

[162] H.R. 5910 will have to pass both Houses of Congress and be signed into law by the President. U.S. CONST. art. I, § 7, cl. 2.

judicially created doctrine providing that "[a] forward-looking statement accompanied by sufficient cautionary language is not actionable because no reasonable investor could have found the statement materially misleading."[163] The legislative history of the PSLRA indicates that Congress intended for the doctrine to continue developing notwithstanding the Act's provisions.[164]

CONCLUSION

Although the increased use of SPACs has garnered the attention of the SEC, there has been no formal rulemaking or passed legislation regarding whether target companies in a de-SPAC transaction should be permitted to provide forward-looking statements under the PSLRA. The PSLRA's safe harbor can be amended through two routes. The first is through SEC rulemaking that removes the term "penny stock" from the definition of "blank check company" in Rule 419 and subsequent SEC guidance that clarifies that "offering of securities" applies to de-SPAC transactions. The second route contemplates legislation that exempts from the PSLRA's safe harbor forward-looking statements made in connection with a private operating company becoming a '34 Act reporting company through the merger with a development stage company. This second route is preferable and better meets Congress's goals of protecting investors. Notwithstanding such legislation, companies will still have protection under the judicially created "bespeaks-caution" doctrine.

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[163] Iowa Pub. Emp.'s Ret. Sys. v. MF Glob., Ltd., 620 F.3d 137, 141 (2d Cir. 2010).

[164] H.R. REP. NO. 104-369, at 46 (1995) ("The Conference Committee does not intend for the safe harbor provisions to replace the judicial 'bespeaks caution' doctrine or to foreclose further development of that doctrine by the courts.").