WHAT'S BEHIND THE SPAC'S PHENOMENON: LEGAL ASPECTS OF AN INVESTMENT VEHICLE PROVIDING ACCESS TO THE US CAPITAL MARKET

by Daniil Sobolev

Global Business Law and Regulation LL.M. Final Thesis
SUPERVISOR: Professor Tibor Tajti
Central European University Private University
Quellenstrasse 51-55, 1100 Vienna
Austria

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List of Abbreviations

ADR	American Depositary Receipt
CEO	Chief Executive Officer
CFO	Chief Financial Officer
FINRA	Financial Industry Regulatory Authority
GAAP	Generally Accepted Accounting Principles
IPO	Initial Public Offer
NASDAQ	National Association of Securities Dealers Automated Quotations
NYSE	New York Stock Exchange
OTC	Over-the-Counter
PIPE	Private Investment in Public Equity
PSRA	Penny Stock Reform Act
PSLRA	Private Securities Litigation Reform Act
SEC	U.S. Securities and Exchange Commission
SPAC	Special Purpose Acquisition Company

Abstract

A special purpose acquisition company (SPAC) is one of the paths to become listed on a stock exchange in a short time by avoiding some of the regulatory hurdles connected with initial public offering (IPO) arrangements. This investment vehicle has proven to be quite successful during the market recovery in post-COVID times since it allows companies to raise significant capital. However, as time passed by, there was a sharp growth in the number of lawsuits and fraud charges against SPACs' sponsors. Considering that the SPACs' prototypes were notoriously famous for their abusive utilization, it is relevant to investigate the current state of SPACs' regulation as an investment vehicle and assess its efficiency and legitimacy from the perspective of its advantages, stakeholders' protection, and latent risks.

Accordingly, this thesis aims to explore and prove that albeit there are aspects of regulation that create an imbalance in ensuring the interests of stakeholders, this cannot constitute a final verdict for SPACs as such, since the value of this instrument for a growing market prevails. The US market is the origin of SPACs, and it represents the frontier for its regulation, therefore, this research will be solely devoted to the laws and regulations of the US. This thesis will cover the relevant provisions of the Penny Stock Reform Act that formed the legal basis for the current version of SPACs, then examine the principles of the Securities Act and the Securities Exchange Act relating to the going public requirements and disclosures. Further, this work will review SEC regulations, pay attention to the relevant rules of the main US Stock Exchanges, and touch upon the Private Securities Litigation Reform Act. Also, the mergers & acquisitions laws are of importance for this research.

INTRODUCTION

A special purpose acquisition company (SPAC) is an empty shell that has no previous operation records, a stripped-down staff of chief officers and board members[1], and no means to conduct any business activity other than the accumulation of a certain amount of funds through the general IPO procedure in order to subsequently merge with or acquire a private company (target)[2]. Such targets are represented by start-ups that have no sufficient resources to carry out the IPO process, but desire to gain access to the exchange listing, and therefore, are searching for such SPACs.

1.1 Why focus on Special purpose acquisitions companies?

IPOs have a positive effect on the economy. By getting broad access to capital markets and increasing their liquidity and attractiveness, companies can enlarge their wealth and finance more projects, manufacture more products, and provide more services – all of those results in the enrichment of investors, GDP growth, and job creation. A de-SPAC transaction is one of the alternatives to an IPO to go public. The SPAC's idea is not novel, shell companies and reversed mergers had been sought-after since the 1980s and were actively used until the US regulators approved several regulation reforms and imposed legal barriers, making de-SPAC transactions less attractive to small companies and investors. The main reason for that was the notorious association of SPACs with stock-market frauds[3]. Seasoning Rules imposed on the initiative of the SEC in 2011 drove the last nail into the SPAC's coffin lid, cooling the Chinees

[1] As SPACs exist for acquisition purposes only, they don't need broad personnel. Officers generally possess experience in finance, law, investments, accounting, which allows them to conduct SPACs on their own. However, in various scenarios, SPACs may hire professionals for outsourcing.
[2] Daniele D'Alvia, 'The International Financial Regulation of SPACs between Legal Standardised Regulation and Standardisation of Market Practices' (2020) 21 Journal of Banking Regulation 107, 107.
[3] Daniel S Riemer, 'Special Purpose Acquisition Companies: SPAC and SPAN, or Blank Check Redux?' (2007) 85 Washington University Law Review 931, 932.

merger intervention in the US market[4]. Although SPACs remained in use, their role in the economy continued to be insignificant. However, during the post-COVID recovery period unexpectedly this financial vehicle began to crowd out the traditional IPO and reached its apex in 2021 by raising $145 billion and becoming the most sought-after financing tool[5]. However, observations indicate a "dramatic" increase in the number of SPAC-related litigations[6] and specifically of class actions[7] in 2021. Such huge investments cannot be put at stake, especially when there is a probability of abusive practices. Therefore, this thesis will determine the regulatory aspects defining the simultaneous growth of SPACs' popularity and lawsuits, focusing on the envisaged legal framework for the protection of stakeholders and on its practical execution resulting in a shattered balance of interests.

1.2 The jurisdiction within the purview of the thesis

The contemporary version of SPAC is not the same as it was in the 1980s. Back then it was predominantly underregulated, more of a bug than a feature allowed by the securities regulation. Uncovered blind spots were utilized for circumvention of legal protection stipulated by the legislation to guard stakeholders of a going public company. At a certain point, blatant signs of abusive practice triggered the governmental intervention, since general terms couldn't be used to rely upon, a specific approach was needed. From that moment, the shaping of a modern SPAC type started.

SPAC is an invention of the US Stock Market and current versions which are used in many other countries derived from the rules adopted in the US, this is the benchmark. Therefore, in

[4] David N Feldman, *Regulation A+ and Other Alternatives to a Traditional IPO: Financing Your Growth Business Following the JOBS Act* (1st edn, Wiley 2018) 95–96.
[5] Phil Mackintosh, 'A Record Pace for SPACs in 2021' (*NASDAQ*, 6 January 2022) <https://www.nasdaq.com/articles/a-record-pace-for-spacs-in-2021> accessed 14 June 2023.
[6] '2021 Year-End-SPAC and De-SPAC Litigation Update' (*Brown & Brown*) <https://www.bbrown.com/insight/2021-year-end-spac-and-de-spac-litigation-update/> accessed 25 March 2023.
[7] Yelena Dunaevsky, 'SPAC Litigation Outlook: 2021 Trends Lead to 2022 Predictions' (*Woodruff Sawyer*, 20 January 2022) <https://woodruffsawyer.com/spac-notebook/spac-litigation-2021-trends/> accessed 14 June 2023.

order to study regulatory aspects of SPACs in the US, the rules governing the SPACs' formation, their IPOs, de-SPAC transactions, and the post-merger formalities shall be taken into consideration. The Penny Stock Reform Act of 1990 must be covered since it singled out the most speculative SPAC group and imposed strict observance of barriers that significantly increased the security of stakeholders and reduced the interest of unscrupulous market participants. Accordingly, the study requires to cover the Security Act of 1933 and the Security Exchange Act of 1934 that govern the requirements for offering and selling SPAC's securities, and the processes of trading and reporting by SPACs. Stock Exchanges may impose their own rules to enhance the protection of stakeholders, hence, attention shall be paid to the NYSE and NASDAQ listing requirements as the point of reference. Also, the SEC regulations of the registration process including filing, disclosure, and reports are relevant to depict the overall awareness of stakeholders, their protection, and to trace the differences in comparison to the standard going public process. Next to that, the border issue of forward-looking statements is related to the Private Securities Litigation Reform Act of 1995 and the safe harbor provided by it. Finally, since the de-SPAC transaction is a stage that represents a merger, Regulation M-A should also be addressed.

1.3 Research Methodology

This research is mostly based on primary and secondary sources of legal research. Respectively, the US laws, relevant regulations, legal cases, and decisions of the US courts, mainly of the Delaware Court of Chancery, are principally used, since this court has extensive experience and competence in resolving corporate disputes. In fact, the majority of SPACs are incorporated in Delaware today.[8] Apart from that, secondary sources such as books, scientific publications, and articles have been used to conduct the research.

With respect to the contemporary situation and the state of SPACs, it is relevant to mention that there is a lack of books and monographs reflecting the modern state of affairs since the issue of the abuse of modern SPACs is new, although the subject matter of SPACs is not. Consequently, just a few available sources are used. Also, albeit there are a lot of publications covering this topic, most of them are represented by non-traditional internet sources and law review articles. To overcome these problems, sufficient attention has been paid to interdisciplinary research, case studies, and government sources.

The applied methodology of this research comprises doctrinal, dialectical, and formal legal methods.

1.4 Literature Review

The doctrine pays sufficient attention to the study of the SPAC topic, both in terms of financial and economic features, and aspects of the legal regulation of this investment vehicle. The research is based on such works as 'SPAC Mergers, IPOs, and the PSLRA's safe harbor: Unpacking Claims of Regulatory Arbitrage' by Amanda M Rose, 'The Further Erosion of Investor Protection: Expanded Exemptions, SPAC Mergers, and Direct Listings' by Andrew F. Tuch and Joel Seligman, 'The International Financial Regulation of SPACs between Legal Standardised Regulation and Standardisation of Market Practices' by Daniele D'Alvia, 'Special Purpose Acquisition Companies: SPAC and SPAN, or Blank Check Redux?' by Daniel S Reimer. The study also refers to works of other scholars, lawyers, economists, and financiers, such as David N Feldman, Hal S Scott, Andrew W. Fine, John Pletz, Logan A

[8] 'Delaware Finds Stockholder Claims Against SPAC Fiduciaries Subject to Entire Fairness Review' (*Cooley M&A*, 10 January 2022) <https://cooleyma.com/2022/01/10/delaware-finds-stockholder-claims-against-spac-fiduciaries-subject-to-entire-fairness-review/> accessed 14 June 2023.

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Although we can see a lot of recent articles coming out in response to the rise of SPACs in the 2020s, covering investment vehicles' various aspects, there are few large-scale books covering the topic in its entirety. At the same time, there is a solid potential for future investigations. This thesis aims to reveal potential problems hidden in the contractual and regulatory facets of a SPAC and juxtapose them with its benefits. However, the issue of resolving these problems remains open, and its relevance will only increase, since despite the already large number of litigations, including class actions, a new wave is not far off. The vast majority of SPACs were created in 2021 and the time for their merger expires this year, and as we will see next, this is the starting point when disagreements arise. In addition, there are interdisciplinary perspectives, since the functioning of the SPAC covers a wide range of disciplines, where an integrated approach can benefit the development of the SPAC's regulatory framework. Finally, SPACs have become a widely used investment vehicle in other countries, hence, comparative legal analyses may provide new insights on this topic.

1.5 The Roadmap to the Thesis

This thesis consists of two chapters. In the **first chapter**, the thesis examines the evolution of regulatory responses that entailed the appearance of SPACs and then provides a general framework of this instrument and its distinctive features. Here, attention is paid to the US response against the abusive utilization of blank-check companies, including the Penny Stock Reform Act with SEC Rule 419, in order to address the question of why SPACs managed not only to survive these regulations but also to become one of the most popular investment vehicles. Also, regulatory aspects of SPAC mergers are covered, specifically what stands behind the merger process, what forms should be filed, and what information should be disclosed in order to trace how private companies can use the detour to the exchange listing.

The **second chapter** covers the current legal and contractual rules devoted to stakeholders' protection and assesses the balance between the hazards they prevent and the risks they pose. Here the work traces the interests of main stakeholders and evaluates how they were potentially distorted by the implemented rules that initially were meant to provide protection, and thus incentivize them to participate in de-SPAC transactions. Also, attention is given to the regulatory gaps that possibly cause the reason for the abusive practices' existence, and the study of them is based on cases and examples.

This two-chapter structure is used to contrapose: a) the basic legal framework of going public through the SPAC's road, determining the opportunities that this option provides, with b) the regulatory and contractual aspects of stakeholders' protection on this road that create grounds for the presence of an imbalance of actors' interests and its corresponding consequences.

CHAPTER 1: SPAC'S FEATURES DEFINED BY THE US REGULATION AND THE OPPORTUNITIES THEY PROVIDE

1.1 Introduction to the SPAC Mergers as an Alternative Investment Vehicle

1.1.1 The Essence of the SPAC and de-SPAC Transactions

The "SPAC" term was invented by lawyer David Nussbaum as a substitution for the notorious "blank check" definition.[9] This term became quite popular in business practice, however, it was not taken over by drafters of US laws, which still preserve the "blank check company" designation. Nevertheless, US governmental agencies increasingly recognize the term "SPAC" and constantly operate with this term[10]. Furthermore, in its regulation proposal[11], the SEC offered a new definition of "SPAC" as a company the business plan of which consists of three elements:

1. Undertaking an IPO that is not subject to SEC Rule 419 (this can create a borderline between SPACs and blank check ones);
2. Accomplishing a merger with a target company within a limited time; and
3. Returning funds to IPO investors upon failure to complete the merger[12].

This definition covers only some specific features of SPACs, so to gain the full picture it is better to look at the whole scheme.

[9] Antoine Gara, 'How Spacs Became Wall Street's Money Tree' (*Forbes*, 19 November 2020) <https://www.forbes.com/sites/antoinegara/2020/11/19/the-looming-spac-meltdown/> accessed 14 June 2023.
[10] 'SEC Proposes Rules to Enhance Disclosure and Investor Protection Relating to Special Purpose Acquisition Companies, Shell Companies, and Projections' (*U.S. Securities and Exchange Commission*, 14 June 2022) <https://www.sec.gov/news/press-release/2022-56> accessed 27 January 2023.
[11] SEC Release No. 33-11048; 34-94546; IC-34549; File No. S7-13-22.
[12] ibid.

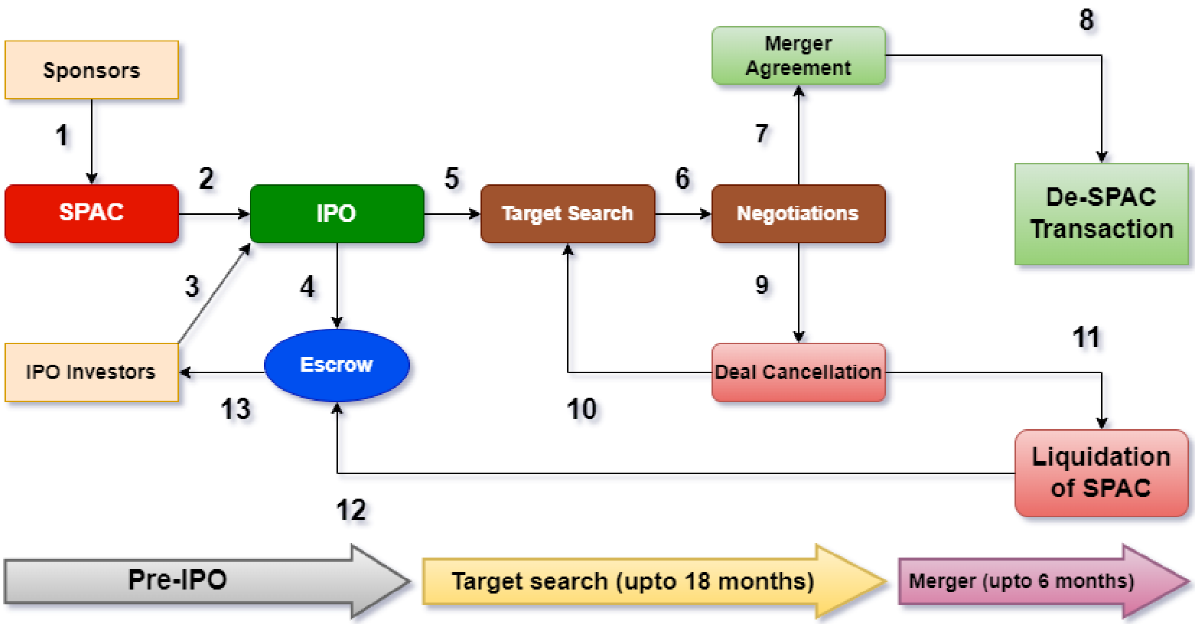

Figure 1: De-SPAC Transaction Scheme[13]

1) Creation of a SPAC by sponsors; 2) Conducting an IPO; 3) Purchase by investors of units consisting of shares and warrants; 4) Depositing funds into an escrow account; 5) Finding a start-up to merge; 6) Negotiation of terms and conditions; 7) Signing of the merger agreement; 8) Merger and closing of the transaction; 9) The parties do not come to an agreement; 10) If the SPAC is still within 18 months, it may continue searching; 11) If not, the SPAC must be liquidated; 12-13) IPO proceeds should be returned from an escrow account to IPO investors.

The team of professionals in the market navigation (experienced managers, financial analysts, former CEOs, or entrepreneurs) take a decision to organize a private shell company through a private placement. They are called sponsors since they invest their time and money to prepare this company for an IPO. In general, sponsors (unless they resort to self-underwriting) share these expenditures with underwriters – intermediaries that help with filing necessary documents, financial scrutinizing, and assist in raising funds for a future merger by means of attraction of investors.

The promotion campaign starts after the filing of Form S-1. During the primary offering IPO investors (PE, hedge funds, venture capital) have a right to buy $10 units that usually consist of a share and a fraction of a warrant. At that time there is no information about a target

13 'How special purpose acquisition companies (SPACs) work' (*PWC*) <https://www.pwc.com/us/en/services/consulting/deals/library/spac-merger.html> accessed 14 June 2023.

company, so investors evaluate SPACs based on the reputation and skills of sponsors in the detection and assessment of potentially successful start-ups. IPO funds are held on an escrow or trust account[14] in order to protect investors and guarantee that IPO proceeds will be used for the purpose of acquiring a target company (however, depending on the terms of a SPAC these funds can be invested in interest-bearing instruments[15]). Sponsors commonly have two years to merge with a target (18 months to find and the remaining six months to merge)[16].

After an IPO SPAC's shares are traded on a stock exchange and their price generally sticks to the nominal value of $10. Underwriters still lend the role of market and M&A financial advisors[17], and if funds are not sufficient to acquire a target, they can go after PIPEs. Private investment in Public Equity (PIPE) allows accredited (due to the higher risk) investors to purchase newly issued shares through the private deal and for a price below the market[18]. The role of PIPE investors is crucial since they can save the deal in cases of many unforeseen circumstances.

When sponsors detect a target, they enter into a series of negotiations to identify the terms of the merger. Upon the result sponsors make an announcement by filing Form 8-K, and after that shareholders can vote. At this stage, non-IPO investors get involved in financing (it could be funds, angel investors, or private traders), and the share price may start to fluctuate. If shareholders approve the transaction, companies submit required filings, undergo SEC scrutiny, and merge into a single entity that will be listed on an exchange under a new ticker.

[14] 17 CFR § 230.419(b)(1)(i)(A) (2022).

[15] 'What You Need to Know About SPACs – Updated Investor Bulletin' (*U.S. Securities and Exchange Commission*, 25 May 2021) <https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin> accessed 14 June 2023.

[16] Nitusha Anup, 'SPACs: An Alternative Investment Vehicle' (Master Dissertation, University of Porto 2016), 4.

[17] Anna T Pinedo, 'What's the Deal? – Special Purpose Acquisition Companies' (*Mayer Brown*, 10 August 2020) <https://www.mayerbrown.com/en/perspectives-events/publications/2020/08/whats-the-deal-special-purpose-acquisition-companies> accessed 14 June 2023.

[18] Anurag Agarwal, 'A Primer on SPACs and PIPEs: How They Work' (*MENAbytes*, 1 August 2021) <https://www.menabytes.com/spac-pipe/> accessed 14 June 2023.

This final merge step is also called the de-SPAC transaction[19]. If sponsors didn't manage to conduct a de-SPAC transaction within the specified time limit, their SPAC would be liquidated, and IPO investors will receive their funds from an escrow or trust account.

1.1.2 Blank Check (Shell) Companies and Reverse Mergers as SPAC Prototypes

When a private company doesn't possess sufficient funds, or expertise, fails to conform to the regulatory requirements for going public, suffers from liquidity issues, or has had several unsuccessful IPO attempts, it can resort to the so-called "Back Door Listing"[20]. Under this term, along with SPACs, shell (blank check) companies and reverse mergers are combined.

A reverse merger means that the business combination initiative goes from a private company, therefore, the target is a public one, and a private company pays to conduct a stock swap (takeover)[21]. In this scenario the target may not be "blank", since start-ups are searching for existing public companies which in general have an operational history, but an unsuccessful one with no incentives to continue business.

A blank check company is a variation that allows both companies to operate under a single "shell"[22]. A private company purchases shares of a public company and strikes an agreement

[19] Lerong Lu and Ci Ren, 'Special Purpose Acquisition Companies (SPACs): The Global Investment Mania, Corporate Practices, and Regulatory Responses' (2022) Journal of Business Law 22, 27. <https://1.next.westlaw.com/Document/I2957A4606F8011ED91D2B6339D267609/View/FullText.html?originationContext=docHeader&rs=cblt1.0&vr=3.0&contextData=(sc.Search)&transitionType=Document&needToInjectTerms=False&__lrTS=20230113214838459> accessed 14 June 2023.
[20] 'BACKDOOR LISTING Definition & Meaning - Black's Law Dictionary' (*The Law Dictionary*, 12 October 2012) <https://thelawdictionary.org/backdoor-listing/> accessed 14 June 2023.
[21] Samiksha Ojha, Richa Maheshwari and Star Jain, 'Reverse Mergers: The Way Forward' (2013) IOSR Journal of Business and Management 21, 21.
[22] Rebecca Lake, 'What Is a Backdoor Listing? How It Works & Examples' (*SoFi*, 30 July 2021) <https://www.sofi.com/learn/content/backdoor-listing/> accessed 14 June 2023.

on restructuring the latter, making the private company a subsidiary. After that a stock exchange takes place and shareholders of a private entity gain a controlling stake.

However, the variation of a reverse merger – reverse triangular merger – is almost identical to the blank check company scheme with the difference that the subsidiary is specifically created in advance, and the merger is conducted with this subsidiary.

As we see, the differences between all three types (including SPACs) are relatively arbitrary, they all have the same "core". The idea behind it is to grant a private company access to the exchange listing using a public "shell" by means of merger, acquisition, or restructuring. Therefore, when the US regulation utilizes the term "blank check" (or shell) companies[23], it first of all, identifies its purpose ("core"), but not an exact procedure, and as a result, covers all "back door listing" variations. In section 2.2.2 we will see that it may cause a legal problem.

1.1.3 Emergence of SPACs as a Reaction to the Penny Stock Reform Act

In the 1980s blank check companies were quite popular, however, they possessed a toxic reputation[24]. Various fraudulent schemes were organized using this instrument. One of the most notorious practices was known as the "pump-and-dump" scheme[25] when founders of a blank check company announced and spread rumors about a potential merger with a "successful" entity. Cheap shares issued by this blank check company allured unsophisticated investors who put their funds in the empty shell, and volatility driven by a small capitalization allowed to accelerate the price. At the time when investors realized that the merger apparently wouldn't

[23] SEC Rule 419 singles out "blank check company" according to two characteristics: a) it has no business plan other than to merger with an unidentified target, and b) it issues penny stock (will be discussed in the next section). See 17 CFR § 230.419(a)(2).
[24] Derek K Heyman, 'From Blank Check to SPAC: The Regulator's Response to the Market, and the Market's Response to the Regulation' (2007) 2(1) Entrepreneurial Business Law Journal 531, 534 <https://kb.osu.edu/handle/1811/78301> accessed 12 January 2023.
[25] 'Pump and Dump Schemes' (Investor.Gov) <https://www.investor.gov/introduction-investing/investing-basics/glossary/pump-and-dump-schemes> accessed 14 June 2023.

take place, founders had already successfully gotten rid of their shares at a fabulous price, leaving others with no market for “garbage” securities[26]. In the 1980s annual losses of unfortunate investors were up to $2 billion[27].

The blank check company fraud was part of a common problem called the “penny stock”[28] – shares that had a low value (below $5), were excluded from listing on national security exchanges (and therefore, they were unregistered), and were traded via the broker-dealer system with lower disclosure requirements[29]. Lack of information, small capitalization, aggressive promotion campaigns, and absence of severe control made penny stocks subject to high volatility speculation.

To fend off this problem the US Congress enacted the Penny Stock Reform Act (PSRA) in 1990. This piece of legislation amended the Securities Act of 1933 by declaring the determinant characteristics of blank check companies: absence of business plan except for the merger and issuance of penny stocks[30]. Likewise, the PSRA set criteria for a “penny stock” with an exemption based on a minimum price and net assets[31]. Also, Congress endowed the Securities and Exchange Commission (SEC) to adopt rules on the registration of blank check companies[32]. For the stated purpose, the SEC devised Rule 3a51-1, which enhances the “penny stock” definition by specifying that companies issuing shares for at least $5 each and

[26] Feldman (n 4) 82.
[27] Peter Yeoh, ‘Special Purpose Acquisition Companies (SPACs): Innovative Finance under Scrutiny’ (2022) 43(5) Company Lawyer 138, 139 <https://1.next.westlaw.com/Document/IAACDBD90B60311ECB277D9EF38E333C6/View/FullText.html?originationContext=docHeader&rs=cblt1.0&vr=3.0&contextData=(sc.Search)&transitionType=Document&needToInjectTerms=False&__lrTS=20230113213149404> accessed 14 June 2023.
[28] Heyman (n 24) 535.
[29] ‘What Are Penny Stocks?’ (*Investopedia*) <https://www.investopedia.com/terms/p/pennystock.asp> accessed 12 February 2023.
[30] 15 U.S.C. § 77g(b)(3) (2018).
[31] 15 U.S.C. § 78c(a)(51)(A) (2018).
[32] Feldman (n 4) 82.

possessing assets of $5 million, or planning to raise this sum through an IPO, are excluded from the "penny stock" coverage[33].

The second step was the adoption of SEC Rule 419 which established requirements for an IPO of blank check companies. The most crucial were:

1. The obligation to hold all IPO proceedings and corresponding investors' shares together on an escrow account;
2. The time limit of 18 months to find a target and complete the transaction, otherwise return funds to the investors;
3. At least 80% of shareholders should approve the merger; and
4. An opt-out right for the investors voting against the merger allows them to get funds back even if the merger will still take place.

These restrictions provided significant protection to investors and a burden for founders. Indeed, the abuses have been eradicated, but so have the blank check companies themselves. In the 1987-1990 period, approximately 2700 shell companies were registered, but after the adoption of the abovementioned rules, there were less than 15 at the beginning of the 1990s[34].

Despite the infamous blank check companies' reputation, a lot of decent and well-known companies utilized that instrument, let alone the fact that the NYSE itself conducted a reverse merger with the publicly traded Archipelago[35]. Therefore, the market still strived for this back-

[33] 17 C.F.R. § 240.3a51-1 (2022).
[34] Heyman (n 24) 532.
[35] 'NYSE Members Ratify Archipelago Merger' (*NBC News*, 6 December 2005) <https://www.nbcnews.com/id/wbna10350119> accessed 14 June 2023.

door listing opportunity and investment banker David Nussbaum and lawyer David Miller came up with an acceptable solution: SPAC[36].

SPAC's securities didn't fall within the category of penny stocks, since their par value was $10, and its IPO proceedings, in general, exceed $40 million[37]. The latter fact allowed SPACs to bypass Seasoning Rules later adopted by several exchanges that required companies after the merger to be traded over-the-counter (OTC) via the broker-dealer network for a year before it could get access to large exchanges[38]. Although SPACs were free from the Rule 419 requirements, the idea was to change the investors' attitude, provide them with reasonable protection, and conduct a decent merger deal, thus, SPAC's sponsors decided to voluntarily impose restrictions on themselves[39]. This action showed that SPACs recognized and followed the purpose of Rule 419, and therefore, the SEC admitted their registration[40].

However, SPAC's rules slightly modify the Rule 419 requirements. For instance, the limitation period for de-SPAC transactions is now 24 months instead of 18 (but this term can be set voluntarily longer or shorter by filing From 424-b), shares are not blocked on an escrow account and can be traded after the expiration of a lock-up period which is in general from three months to one year[41]. Rule 419 allowed to exercise warrants (which were included in IPO units) at will, but in SPACs it is prohibited until the merger (but the lock-up period can be even months and years after the merger) to avoid dilution[42]. Only professionals with sufficient

[36] Amrith Ramkumar, 'SPAC Pioneers Reap the Rewards After Waiting Nearly 30 Years' (*Wall Street Journal*, 9 March 2021) <https://www.wsj.com/articles/they-created-the-spac-in-1993-now-theyre-reaping-the-rewards-11615285801> accessed 14 June 2023.
[37] Feldman (n 4) 84.
[38] ibid 95.
[39] Tim Castelli, 'Not Guilty by Association: Why the Taint of Their "Blank Check" Predecessors Should Not Stunt the Growth of Modern Special Purpose Acquisition Companies' (2009) 50 Boston Coll. Law Rev. 237, 254.
[40] Heyman (n 24) 541.
[41] 'SPAC Transactions — Considerations for Target-Company CFOs' (Deloitte) <https://dart.deloitte.com/USDART/pdf/70bc19ee-01c6-11eb-90e3-f323486578a5> accessed 14 June 2023.
[42] Heyman (n 24) 542.

background and reputation can be SPAC's managers[43]. The articles of incorporation in general determine the economic sectors of investment where targets are operated[44].

Therefore, the idea behind blank check companies was reasonable, but the lack of proper regulation allowed them to be used as a tool for speculation and abuses. The governmental intervention put an end to blank check companies in that form. Nevertheless, the market adjusted itself to the new reality, and from the ashes, the "new phoenix arose": SPAC[45].

1.1.4 Advantages of SPAC Public Offerings versus Traditional IPOs

The idea of the SPAC merger is that the target company refrains from conducting an IPO, and consequently financial, registration, and disclosure responsibilities lie with the acquirer. Moreover, these responsibilities are significantly facilitated due to the concept of blank check companies that pursue no economic activity.

One of the crucial requirements for every company to go public is the SEC approval of the registration statement[46]. However, there are significant differences in the amount of information that must be disclosed by SPACs and general companies in Form S-1[47], as reflected in the ensuing Table 1.

Table 1: Comparison of Information Disclosed in Form S-1 in the Traditional IPO and the de-SPAC Transaction

Type of information	**Traditional IPO**	**SPAC**
Financial information	According to the Securities Act of 1933, every company should file Form S-1[48] covering net revenues,	SPAC is an empty shell, hence, this section is almost empty. It is mostly obliged to disclose the supposed use of proceeds from

[43] D'Alvia (n 2) 112.
[44] Riemer (n 3) 946.
[45] D'Alvia (n 2) 111.
[46] 'Form S-1' (*LII / Legal Information Institute*) <https://www.law.cornell.edu/wex/form_s-1> accessed 16 February 2023.
[47] Form S-1 is a registration statement filed with the SEC by going public companies. See 17 CFR § 239.11.
[48] 17 CFR § 239.11 (2022).

	costs, expenses, sales, research, and marketing.	its IPO, describing the part that will be held on an escrow, and estimate expenses on underwriters, administrative services, SEC registration payments, and Financial Industry Regulatory Authority (FINRA) filing fees.
Information about possible risks	Generally, companies should disclose all factors, such as competitors, diversification, debt ratio, conflict of interests, product-related risks, and dependence on currency volatility[49]	In the SPAC scenario, there is no information about the future field of activity, thus, it only provides template information about the absence of operational history, limited time to merge, and absence of information about a target.
Business information	It covers the goals of the company, its assets, IP rights, marketing strategy, utilized technology, labor questions, plans, programs, litigations, and many more.	During this period a SPAC for the previously mentioned reasons cannot have such information, thus, it generally covers only the purpose to find and acquire a target, describing the criteria of the latter.
Auction process information	Here a company describes the underwriter's strategy to determine the incipient share price and the processes of qualification, bidding, and allocation.	In the case of SPACs, the initial price is fixed ($10), thus the strategy information is absent.

Therefore, both traditional IPOs and SPACs are subject to the same disclosure requirements, but due to the essence of SPACs as empty shells, they just cannot have the full range of information that is available to ordinary companies, and thus, the filling out Form S-1 requires a less scrupulous approach which clearly affects the timing of the registration process.

Among other distinctions, the SPAC's management team is the cornerstone since IPO investors solely rely on their skills and background (in the absence of any data about the target). They will likely operate the future surviving company more professionally, as they had experience

[49] 17 CFR § 229.305 (2022).

of conducting projects and surviving in market turbulences. Moreover, sponsors have foundation shares, and therefore, have “skin in the game”[50].

Locked IPO proceedings on a SPAC’s escrow account allow investors to freely cash out incurring only transaction costs, but in a traditional IPO this process is obstructed by market conditions and lock-up barriers[51], hence, the venture capitalists can possibly prefer SPACs even more[52]. This is also a crucial protection in case of liquidation.

Section 11 of the 1933 Securities Act stipulates the right of shareholders (who participated in the public offering) to sue anyone responsible for preparing a registration statement[53]. However, the absence of a significant part of the information in Form S-1, the right to make looking-forward statements, and the exchange of shares in a merger, all make it difficult for plaintiffs to trace their shares all the way up to the registration statement. This factor significantly decreases the risk of litigation under the IPO rules since the transaction is more covered by the M&A law[54]. We will see an example of this in section 2.3.

1.1.5 Mergers with SPACs versus ADRs for Foreign Issuers

Not only US private companies can benefit from de-SPAC transactions, but also companies from every corner of the world can become a target of a US-registered SPAC. For the vast majority of start-ups, even from developed countries, the US Market is still the most desirable

[50] Riemer (n 3) 959.
[51] Lock-up covenants aim to temporarily restrict the sale of shares after an IPO to stabilize the stock price.
[52] Valerie Ford Jacob, Sebastian Fain and Michael Levitt, ‘Clogged PIPE Market Leading to Alternative Financing Structures in Some De-SPAC Business Combinations’ (*Freshfields*, 16 July 2021) 84, 85 <https://blog.freshfields.us/post/102h38w/clogged-pipe-market-leading-to-alternative-financing-structures-in-some-de-spac-b> accessed 14 June 2023.
[53] 15 U.S.C. § 77k (2018).
[54] Michael Klausner, Michael Ohlrogge and Emily Ruan, ‘A Sober Look at SPACs’ (2021) Harvard Law School For Corp. Governance <https://corpgov.law.harvard.edu/2020/11/19/a-sober-look-at-spacs/> accessed 14 June 2023.

destination since this is an opportunity to get access to the highest possible liquidity. However, this is not the only way.

The US depositary, which can be a bank or trust, may buy shares of a foreign company and store them. Upon such possession, the depositary issues American Depositary Receipts (ADRs) that can be traded on US Stock Exchanges if a company-issuer fulfills certain regulatory requirements[55]. ADRs also endow holders with the right to receive dividends[56]. One form is sponsored ADRs that involve the financial and informational participation of issuers[57]. Another form is unsponsored – the issuer isn't involved, and the depositary uses withdrawal and conversion fees, and investor's payments to maintain a facility[58].

However, ADRs have several disadvantages in comparison to SPACs:

1. Issuing ADRs can require higher costs for a company since it has to prepare financial statements and file Forms F-6 and in general F-1[59]. The latter is analogous to Form S-1 that a SPAC should submit at the time of an IPO, and although during de-SPAC transactions other filings are required, they are the burden of a SPAC team;
2. Fees to the depositary should be paid;
3. A foreign issuer becomes subject to both jurisdictions which impose a higher regulatory burden, let alone taxes considerations and the possibility of double taxation;
4. Problems with liquidity can be associated with ADRs, and in this case, a US broker will have to contact foreign brokers to sell shares and afterward require the depositary to cancel issued ADRs[60];

[55] Guy P Lander, 'American Depositary Receipts' (1995) 29 The International Lawyer 897, 898–899.
[56] Hal S Scott, *International Finance: Transactions, Policy, and Regulation* (7th edn, Foundation Press 2010) 65.
[57] ibid 66.
[58] ibid 66.
[59] Richard A. Cole, 'American depositary receipts' (1991) 6(12) Journal of International Banking Law 521, 523.
[60] Lander (n 55) 904.

5. Currency rates can cause a devaluation of ADRs[61].

Consequently, ADRs are decent tools to get access to the US Market, however, there are certain considerations that may shift the choice to the SPAC direction.

1.2 Listing on the US Stock Exchanges through de-SPAC Transactions

1.2.1 General SEC Requirements and NASDAQ, NYSE Rules

Before even considering a possible future target, SPACs need to conduct an IPO. Although target identification is not prohibited, it would require disclosure of information about that company too, which would make obtaining a SEC approval harder. As was mentioned earlier, the framework of the SPAC's regulation was established by Rule 419, and although "modern SPACs" are not obliged to match it, the voluntary adoption has been disincentivizing the SEC to intervene for many years. The main requirements were provided in section 1.1.3, however, there are other rules and provisions that are relevant. The most important are the following ones.

1. Rule 482 under the Securities Act of 1933 stipulates the obligation to disclose material information such as qualifications of the management team, the general framework for the future target allocation, and information about issuing securities. The idea is to inform potential stakeholders about future plans and possible risks. However, compliance with this obligation allows SPACs to apply "testing-the-waters"[62] communications before a registration statement[63] (in section 2.3 we will see how sponsors can use this opportunity). Such type of advertisement allows to spark interest

[61] Mark Saunders, 'American Depository Receipts: An Introduction to U.S. Capital Markets for Foreign Companies' (1993) 17 Fordham International Law Journal 48, 57.
[62] 'Testing-the-Waters' (*LII / Legal Information Institute*) <https://www.law.cornell.edu/wex/testing-the-waters> accessed 28 March 2023.
[63] 17 CFR § 230.482 (2022).

and raises reputation through channeling the information using various sources (not only broker-dealers). Hence, SPACs can save money and time, and reduce the regulatory hurdles by avoiding filing and reviewing procedures.

2. Another Rule 13a-11 requires every company to report any material changes by filing Form 8-K[64] within four days after the IPO[65] and Form 10-K annually[66] under the Securities Exchange Act of 1934.
3. Rule 10A-3 stipulates the requirement for all going public companies to have an audit committee that consists of board members[67]. This committee is required to appoint an independent auditor and oversee the correctness of the abovementioned financial reports.
4. Under the Sarbanes Oxley Act the CEO and CFO are responsible for the accurate completion of Forms 8-K and 10-K[68]. However, prior to the completion of the combination SPACs commonly has no operational activity, and thus, we can assume that the audit process is more of a formal fulfillment of a generally established requirement and that the SPAC's audit is cheaper and requires less due diligence.

Therefore, all these rules have a primary goal to enhance the awareness of potential investors and other stakeholders and help them make a weighted choice.

Above the general SEC framework, the additional requirements are envisaged by the US Stock Exchanges. Initially, SPACs were excluded from a listing on NASDAQ and NYSE, since these exchanges required all companies to have an operation history. However, in 2008 the SEC

[64] 17 CFR § 240.13a-11 (2022).
[65] 'Exchange Act Form 8-K' (*U.S. Securities and Exchange Commission*, 22 March 2022) <https://www.sec.gov/divisions/corpfin/guidance/8-kinterp> accessed 14 June 2023.
[66] 17 CFR § 240.15d-1 (2022).
[67] 17 CFR § 240.10A-3 (2022).
[68] 18 U.S.C. § 1350 (2018).

explained that the absence of operational activity is the essence of SPACs and adopted new rules for NASDAQ[69] and NYSE[70].

Currently, some NASDAQ rules impose higher listing standards. For instance, the SEC requires $5 million in net tangible assets to avoid the “penny stock” label[71], and although NASDAQ qualifies this as one of the binding requirements[72], it is not enough. The Exchange also demands the fulfillment of at least one standard, such as equity, market value, or net income standards[73]. Further, NASDAQ allows up to 36 months to conduct a merger[74] in comparison to the 18 stipulated by Rule 419[75]. In addition to the alternative condition of 1,000,000 shares required by Rule 419[76], NASDAQ requires 300 round lot holders[77] without any alternatives.

NYSE has even more stringent requirements for going public companies. For instance, it requires at least 400 round lot holders, a minimum $40 million market value of publicly held shares[78], but for acquisition companies this barrier was raised to $80 million[79]. NASDAQ requires $50 million, however, it is an alternative requirement and can be overcome by a net income of $750,000[80].

Therefore, on the one hand, by imposing higher standards, exchanges allow access to more stable SPACs, on the other – exchanges provide conforming SPACs with more comfortable conditions, such as a longer lifetime.

[69] SEC Release No. 34-58228; File No. SR-NASDAQ-2008-013.
[70] SEC Release No. 34-57785; File No. SR-NYSE-2008-17.
[71] 17 CFR § 240.3a51-1(g)(1) (2022).
[72] The NASDAQ Stock Market Rules, 5505(a)(1)(B).
[73] The NASDAQ Stock Market Rules, 5505(b).
[74] The NASDAQ Stock Market Rules, IM-5101-2(b).
[75] 17 CFR § 240.3a51-1(e)(2)(iv) (2022).
[76] 17 CFR § 240.3a51-1(a)(2)(i)(E) (2022).
[77] The NASDAQ Stock Market Rules, 5505(a)(3)(i).
[78] NYSE Listed Company Manual, 102.01A-B.
[79] NYSE Listed Company Manual, 102.06.
[80] The NASDAQ Stock Market Rules, 5505(b)(3).

1.2.2 Mergers & Acquisitions in the SPAC World

After the IPO the merger stage commences, which includes three steps: target identification, shareholder voting, and closing the deal. The result of the combination completion is the appearance of a new ticker on exchanges, hence, de-SPAC transactions can be treated as a "second-time listing".

This culmination stage starts with the identification of a target. Once it is done, parties become involved in negotiations, the result of which is the proxy statement shaped and reviewed by the SEC under Regulation 14A[81]. This also could be a joint statement on Form S-4 if additional securities are to be issued[82]. Generally, this Form includes financial statements, identification of any associated risks, and description of the target business[83].

Form S-4 aims to provide shareholders with relevant information and avoid conflicts of interest. However, the terms and conditions are included in the business combination agreement where parties determine all warranties, relevant covenants, and the shape of the future company. Both these documents are subject to the SEC review, but before that the approvals of the boards are required.

The second step is the shareholders' approval. On the target side, this approval cannot be obtained before the signing of the S-4 and merger agreement. The problem is that the target then can obstruct the deal after all preliminary steps. The SEC in such a situation allows to draft a voting agreement to lock up the vote, allowing to close the de-SPAC transaction

[81] E Ramey Layne and K Stancell Haigwood, 'SPAC Regulation - Past, Present and Future' (2022) 45(2) The UA Little Rock Law Review 7 <https://www.jdsupra.com/legalnews/spac-regulation-past-present-and-future-6422445/> accessed 14 June 2023.

[82] '20-6, Accounting and SEC Reporting Considerations for SPAC Transactions' (*Deloitte*, 2 October 2020) <https://dart.deloitte.com/USDART/home/publications/deloitte/financial-reporting-alerts/2020/spac-transactions> accessed 14 June 2023.

[83] 'Domestic SPAC mergers - financial reporting and accounting considerations' (*PWC*, 25 January 2021) <https://viewpoint.pwc.com/dt/us/en/pwc/in_depths/2021/domestic_spac_mergers/domesticspacmergers/domesticspacmergers.html> accessed 14 June 2023.

afterward[84]. Further, a SPAC has to go through the SEC reviewing process, which includes communications in the form of comments, corrections, and clarifications. Afterward, upon the results, shareholders will vote for the merger.

The last step is the filing of Form 8-K within 4 days after the shareholders meeting[85]. The content of this form is similar to annual financial reports (Form 10-K), and since the majority of the financial information has already been submitted on Form S-4, SPAC can just update and correct the information and some floating indexes[86]. As a result, a shell company ceases to exist and the start-up which has an operation history becomes a surviving publicly traded company with a new ticker symbol.

Therefore, we can compare de-SPAC transactions in two dimensions. The first is a comparison with a general IPO, and here the SPAC way obviously provides a target company with benefits. A merger with a SPAC is definitely faster than an IPO, especially with reliance on a professional SPAC team. There is no need to spend significant funds on the IPO procedure, underwriters, legal assistance, huge paperwork, and advertisement. Also, a target company preserves leverage to promote its terms, since SPACs are limited in a lifetime. Second, is the comparison with a general merger, and in the case of a de-SPAC transaction conceptually the same obligations are imposed, however, for private companies, there are more regulatory hurdles, since they've never been subject to the additional requirements that are imposed by the SEC (regular financial reports, disclosures, or independent audit). So, this is a new experience for a private company, despite that, with the signing of the merger agreement parties

[84] Sean Donahue, Jeffrey Letalien and Brian Soares, 'Going Public Through a SPAC: Legal Considerations for SPAC Sponsors and Private Companies' (2020) 34(11) The Corporate & Securities Law Advisor 28, 29-30.
[85] 'Exchange Act Form 8-K' (n 65).
[86] 'Merging with a SPAC' (*Grant Thornton*, 13 May 2021) 10–11 <https://www.grantthornton.com/insights/newsletters/audit/2021/new-developments-summary/merging-with-a-spac> accessed 14 June 2023.

exchange all relevant documents and information, hence, a target can again rely on the support of the SPAC's team.

Conclusion

SPACs went on a 40 years-long road from being a fraudulent method to becoming a most demanding investment aggregator which provides private companies with an opportunity to enhance their reputation and to enter the market with the highest possible capitalization and liquidity without preventive regulatory obstacles connected with the IPO path. For private start-ups the SPAC way is incomparably easier, faster, imposes fewer obligations, and is less costly. For both sides of the deal, this is more effective since the de-SPAC transaction itself represents the combination of ideas with professionally managed capital. A SPAC's team can intelligently utilize various instruments, such as private deals, redeemable shares, warrants, or other sweeteners to allure potential investors with miscellaneous demands. Further, evenly distributed across the SPAC's lifetime regulatory requirements for filings and disclosures serve for the awareness and protection of stakeholders at the same level as an IPO, but don't overwhelm them at a single time point. Also, companies from all around the world can become a target for the US SPACs, and it is a beneficial situation for everyone. Lastly, SPACs are definitely useful for the US economy, insofar as more companies can be attracted to the US Market, more start-ups can become huge companies upon access to such investments, and through that more jobs can be created, and more taxes paid. Moreover, increased competition can lead to higher standards of goods and services, innovations, and technological breakthroughs.

CHAPTER 2: CURRENT STATE OF THE STAKEHOLDERS' PROTECTION AND THE RISKS IT POSSESSES

2.1 Origins and Consequences of the Conflict of Interests

2.1.1 Justification of Enhanced Protection

As was mentioned previously, there were two main reasons why SPACs were doomed to a long exile from the markets. The first was extensive regulatory requirements stipulated by Rule 419, preventing small companies from initiating that business, and the second was the notorious reputation of this investment vehicle, more recognizable as a fraudulent "pump-and-dump" instrument. In order to overcome these hurdles and allure potential investors, SPACs' founders voluntarily applied even higher standards of investors protection than SEC Rule 419 envisaged. However, it seems that the protection framework doesn't apply to all stakeholders. And as we will see further, the current system balances at some point of equilibrium, and the shift of rights and obligations in favor of ones casts a detrimental effect on others. Moreover, it turns out that it distorts patterns of participants' behavior, departing from the original idea of SPACs.

2.1.2 Inconsistency of Short-Term Interests

In this section, we will focus on three participants of de-SPAC transactions: IPO investors, sponsors, and PIPE investors. All of them are granted either higher legal or contractual protection that renders their interests incompatible with the original idea of SPACs. Here we will address the sources of interest distortion, and in section 2.3 we will see how this manifests itself in practice.

2.1.2.1 Economic Interests of IPO Investors

As we remember from section 1.1.1, IPO investors are required to accumulate sufficient funds on an escrow account to acquire a target. Being the major players at the pre-merger stage, they are endowed with the right to buy $10 units consisting of redeemable shares and warrants. Both of them have become the subject of controversy since these shares now allow investors to redeem even if they vote for the combination, and warrants incentivize investors to do so.

2.1.2.1.1 Redeemable Shares

Generally, IPO investors can redeem their shares upon two conditions. First, if investors don't want to participate in a de-SPAC transaction for any reason, they can vote against the merger and receive their funds pro rata share of trust (escrow) account. The same result shall happen automatically if a SPAC fails to find a suitable target[87]. The idea was to protect IPO investors' funds by blocking them on an escrow account and prevent SPAC's management from spending them on anything except an acquisition. Moreover, investors can evaluate the target precisely and leave the deal if the target isn't worth it.

Nonetheless, starting in 2010 SPAC's sponsors decided to incentivize IPO investors with higher discretion, allowing them to redeem their shares even if they vote for the merger[88]. Current legislation is silent on this, the listing standards just require redemption in case of a negative vote[89], but nothing constrains the possibility of granting the same right in case of a positive vote. However, that possibility has led to the decoupling of economic interests and voting rights. It means that, on the one hand, investors approve the deal as well-founded and worth striking, but on the other, they declare a lack of interest in further participation, making

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[87] 'What You Need to Know About SPACs – Updated Investor Bulletin' (n 15).
[88] Maria Lucia Passador, 'In Vogue Again: The Re-Rise of SPACs in the IPO Market' (2022) 16 Brooklyn Journal of Corporate, Financial & Commercial Law 105, 134 <https://papers.ssrn.com/abstract=3820957> accessed 14 June 2023.
[89] The NASDAQ Stock Market Rules, IM-5101-2(d); NYSE Listed Company Manual, 102.06(b).

the vote itself devoid of economic significance (empty vote)[90]. Therefore, the initially envisaged market testing upon the merits of a de-SPAC transaction in which sponsors had to persuade investors became obsolete[91].

This situation raises three questions. The first one is, who suffers? Immanently, SPACs are venture investments as they are associated with start-ups, although the difference from venture capital is that here the management is solely focused on acquiring a single target, so the approach is more selective. However, 2021 and 2022 statistics show that on average SPACs lost their value after de-SPAC transactions, and their shares were traded 67% and 59% lower than their par value in these years respectively[92]. Therefore, unsophisticated IPO and non-IPO investors who rely on the judgment of sophisticated IPO investors remain in the deal, being deprived of "market price protection". In doctrine, this is called the "SPAC trap", when non-IPO investors buy $10 shares of SPACs, although this price solely reflects the redemption right, and proceed with the merger trusting the vote results[93].

The second question is, why do sponsors give IPO investors the right to do this? As was mentioned earlier, this is an additional incentive to allure more capital, but what's the meaning of this if eventually, this capital will leak? They buy votes. A SPAC's management has its own interests, some of the members can occupy positions in several SPACs and this allows to create a network that will facilitate SPACs IPO fundraising. And this is crucial for SPAC's sponsors

[90] Henry T C Hu and Bernard S Black, 'The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership' (2006) 79 Southern California Law Review 811, 836 <https://papers.ssrn.com/abstract=904004> accessed 14 June 2023.
[91] Usha Rodrigues and Mike Stegemoller, 'Redeeming SPACs' (2021) 2021-09 Legal Studies Research Paper 27 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3906196> accessed 14 June 2023.
[92] 'SPAC Market Update: Who Turned on the Lights?' (*Valuation Research*, 13 September 2022) <https://www.valuationresearch.com/pure-perspectives/spac-market-update-who-turned-on-the-lights/> accessed 14 June 2023.
[93] Holger Spamann and Hao Guo, 'The SPAC Trap: How SPACs Disable Indirect Investor Protection' (2022) 40 Yale Journal on Regulation Bulletin 75, 77.

since they are vitally interested in closing the de-SPAC transaction. We will return to this point in section 2.1.2.2.

The last question is, why do IPO investors actually redeem? Different studies show high redemption rates. For example, Roger E. Barton found that within the period from July to November 2021, the average redemption rate was almost 60%, and in some cases, such as Virgin Orbit, it exceeded 80%[94]. Another empirical study focused on Form 13F filers (holders of more than $100 million in securities) shows the 90% mean divestment rate. These investors either sell or redeem their shares prior to the de-SPAC transaction[95]. The main reason for this behavior is warrants.

2.1.2.1.2 Warrants

Exercising redemption rights doesn't mean that IPO investors fully quit the game, they still preserve warrants as parts of $10 units. In general, these warrants are executable after 30 days from the de-SPAC transaction and their strike price is $11.50, meaning that investors are allowed to buy shares of the surviving company for this price at any time[96]. Considering that the initial price of units is $10, some SPACs show remarkable results in a relatively short period. For instance, Adapthealth reached the $41.58 price, Skillz's shares were traded at $46.30, Draftkings went beyond $70[97]. This is the reason why IPO investors are inclined to adopt the "approve and redeem" scheme[98]. In other words, investors safely reserve their money

[94] Roger E. Barton, 'High Redemption Rates See SPACs Relying on Alternative Financing' (*Reuters*, 14 January 2022) <https://www.reuters.com/legal/transactional/high-redemption-rates-see-spacs-relying-alternative-financing-2022-01-14/#:~:text=For%202021%2C%20SPAC%20redemptions%20were,rate%20during%20these%20four%20months.> accessed 14 June 2023.

[95] Roberto Moshammer, 'What defines high-quality SPACs and are they future proof?' (Bachelor Thesis, Vienna University of Economics and Business 2021), 19.

[96] Andrew F. Tuch and Joel Seligman, 'The Further Erosion of Investor Protection: Expanded Exemptions, SPAC Mergers, and Direct Listings' (2022) 108 Iowa L. Rev. 303, 325 <https://ilr.law.uiowa.edu/print/volume-108-issue-1/the-further-erosion-of-investor-protection-expanded-exemptions-spac-mergers-and-direct-listings> accessed 14 June 2023.

[97] Tezcan Gecgil, '7 of the Most Successful SPACs of the Past Year' (*InvestorPlace*, 6 May 2021) <https://investorplace.com/2021/05/seven-most-successful-spacs-past-year/> accessed 14 June 2023.

[98] Spamann and Guo (n 93) 79.

for the right to exercise warrants in the future. Hence, this is a completely riskless participation, only lost profit from a better investment can cause a negative effect. However, if the company does well after the merger, IPO investors can multiply their investments. That is why the distortion of interests happens. When investors don't have "skin in the game", they are only interested in closing the deal as soon as possible to take their investments back (so they prefer not to wait for the best target, but the first), and then just see if their bet goes in.

The problem is that warrants also become a burden on the remaining shareholders, as exercising them leads to the issuance of new shares and stock watering. SEC Chairman Gary Gensler raised this problem of dilution, quoting an academic study that shows the possibility of a stock value diminishing, causing a poor market performance of companies' securities[99].

Therefore, the decoupling of economic interests and voting rights as a cumulative problem of redeemable shares and warrants distorts the interests of IPO investors, changing their pattern of behavior and affecting less protected non-IPO investors.

2.1.2.2 Sponsor's Remuneration

As we remember, sponsors are professionals who control a SPAC and search for a target to make a successful combination[100]. And as was previously mentioned, sponsors are vitally interested in closing the deal, hence, they allow investors to redeem and preserve warrants in exchange for the affirmative vote. The reason behind that "unspoken agreement" is the founder shares.

[99] Tom Zanki, '4 Points To Watch As Regulators Revamp SPAC Rules' (*Law360*, 1 October 2021) <https://www.law360.com/articles/1426155/4-points-to-watch-as-regulators-revamp-spac-rules> accessed 14 June 2023.
[100] See section 1.1.1.

Upon the creation of a SPAC sponsors get shares at par value, and logically it happens before a public offering, so the price is derived from the value of an empty shell. Typically, they cumulatively invest $25 000, less than one cent per share[101], but there are cases with a far lower nominal consideration, such as $0.0003 per share[102]. After the de-SPAC transaction sponsors' shares will be converted to surviving company shares at a one-to-one ratio[103] and will constitute 20% of outstanding shares. Therefore, these shares only have value after the merger, but the issue is complicated by limited time. The "drop-dead date" is an incentive to find a target within 18 months (or two years) period, otherwise, these shares will be worthless and time wasted[104]. Also, the endeavor of sponsors to recklessly search for a combination is higher closer to the deadline[105].

The conflict of interest arises in connection with the question of the suitability of the company. Sponsors are overprotected and don't suffer from the price decline, so they can tolerate almost any merger that cannot be said about investors. Average sponsors' returns exceed $100 million[106], and their median profit in 2019-2021 was 958%[107], while non-redeeming investors see negative outcomes, for instance, the average returns of the 199 SPACs group were -43% in 2021[108]. Therefore, we can see grounds for the agency problem when the breach of fiduciary

[101] John Pletz, 'Why SPACs Are a Better Deal for Insiders than Public Investors' (*Crain's Chicago Business*, 12 March 2021) <https://www.chicagobusiness.com/finance-banking/why-spacs-are-better-deal-insiders-public-investors> accessed 14 June 2023.
[102] GS Acquisition Holdings Corp. II, Registration Statement (Form S-1) (June 11, 2020) <https://www.sec.gov/Archives/edgar/data/1809987/000119312520166541/d915164ds1.htm> accessed 14 June 2023.
[103] Logan A Krulish, 'Defending the de-spac merger: what standard of review applies?' 74 Baylor Law Review 491, 492.
[104] ibid 493.
[105] Wendy Gerwick Couture, 'Top Ten Issues in De-SPAC Securities Litigation' (2022) 44 The UA Little Rock Law Review 5.
[106] Travis Corban, 'Not So Fast, SPACs: Disloyalty, Emerging Delaware Corporate Law, and How to Protect SPAC Management and Shareholders Alike' (2023) 4 Corporate & Business Law Journal 1, 10.
[107] 'What Are SPACs & The Trend in 2022' (*CB Insights Research*) <https://www.cbinsights.com/research/report/what-is-a-spac/> accessed 14 June 2023.
[108] 'Special Report: SPAC Merger Returns Crumble, Upending the 2022 SPAC Market' (*Renaissance Capital*, 20 April 2022) <https://www.renaissancecapital.com/IPO-Center/News/92125/Special-Report-SPAC-merger-returns-crumble-upending-the-2022-SPAC-market> accessed 14 June 2023.

duty for SPAC's managers becomes too profitable. As sponsors already have 20% of the SPAC voting rights, and in general 37.5% is required to conduct a de-SPAC transaction[109], they incentivize IPO investors to vote for the deal and leave, if they think that it isn't worth proceeding.

The problem is exacerbated by the previously mentioned fact that managers can occupy positions in several SPACs and that the vast majority of SPACs are incorporated in Delaware, which laws allow to utilize corporate opportunity waivers. It means that directors are protected from liability for disclosure of confidential information about suitable targets to a "rivalry" SPAC, and this information can circulate through the net of interlocking directors' channels. As a result, directors are relieved from the obligation to bring every option to its SPAC[110]. We can only assume what unspoken agreements between managers of various SPACs and sophisticated IPO investors can be struck. Hence, the conflict of interest between non-IPO investors striving for the best option and sponsors willing to merge with any low-quality start-up is obvious.

2.1.2.3 Role of PIPEs

Exercise of redemption rights leads to depletion of the trust account which is required to purchase the target. To compensate for this sponsors resort to private investment in public equity (PIPE) if the participation of non-IPO investors is not enough[111].

PIPE investors are sophisticated and well-versed in researching the financial performance of start-ups, so their participation is earned by the significantly lower price of shares and

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109 Ramey Layne and Brenda Lenahan, 'Special Purpose Acquisition Companies: An Introduction' (2018) Harvard Law School For Corp. Governance <https://corpgov.law.harvard.edu/2018/07/06/special-purpose-acquisition-companies-an-introduction/> accessed 14 June 2023.

110 Michael Gofman and Yuchi Yao, 'SPACs' Directors Network: Conflicts of Interest, Compensation, and Competition' (*SSRN*, 28 June 2022) 8 <https://papers.ssrn.com/abstract=4148668> accessed 14 June 2023.

111 William K Sjostrom, 'PIPEs' (2007) 2 Entrepreneurial Business Law Journal 381, 391.

additional sweeteners (warrants and rights) at the expense of non-redeeming shareholders[112]. Moreover, the latter also relies on the PIPE investors' participation in making decisions. For unsophisticated shareholders, it is a "stamp of approval"[113] showing that qualified investors did their research on the target (or the SPAC's management).

PIPE investors' return is positive, on average they did 72% in 2019-2020[114], contrary to non-redeeming investors who experienced negative returns[115]. According to the study, SPAC managers, in order to raise the necessary capital and compensate for the redemption, distribute 34% of their founders' shares and 42% of warrants, the main recipients of which are PIPE investors[116]. Also, a more latent goal is to secure additional votes, and these investors can act aggressively bargaining more generous offers[117] through alleged "greenmailing"[118].

2.2 Financial and Forward-Looking Statements

The SPAC construction implies information asymmetry between sponsors and target shareholders on the one side and investors on the other. This means that investors can only rely on public statements and projections of both sides of a de-SPAC transaction. In general IPO underwriters lend the role of inspectors in scrutinizing the company's documents, and its public statements are subject to the PSLRA. However, in the case of SPACs underwriters are exempt from liability, which clearly affects their motivation, and moreover, SPACs projections can fall under safe harbor's protection.

[112] Snehal Banerjee and Martin Szydlowski, 'Harnessing the overconfidence of the crowd: A theory of SPACs' (*SSRN*, 28 September 2021) 29 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3930346> accessed 14 June 2023.
[113] Robert Berger, 'SPACs: An Alternative Way to Access the Public Markets' (2008) 20 Journal of Applied Corporate Finance 68, 68–70.
[114] Spamann and Guo (n 93) 11.
[115] Klausner, Ohlrogge and Ruan (n 54) 74.
[116] Minmo Gahng, Jay R. Ritter and Donghang Zhang, 'SPACs' (2021) The Review of Financial Studies 33.
[117] Rodrigues and Stegemoller (n 91) 24.
[118] Noam Noked, '"Greenmail" Makes a Comeback' (2014) Harvard Law School For Corp. Governance <https://corpgov.law.harvard.edu/2014/01/22/greenmail-makes-a-comeback/> accessed 14 June 2023.

2.2.1 Role and Liability of Underwriters

Underwriters help sponsors prepare relevant documents, raise capital through IPO, and conduct M&A processes (participating as advisors). Their primary interest is fees that amount to 5.5% of the IPO proceedings, which is typically lower than in a traditional IPO[119]. However, taking into account redeeming investors, this commission can be evaluated much higher from the perspective of remaining proceedings. The ordinary scheme is the upfront payment of 2% and the rest upon the de-SPAC transaction[120]. This incentivizes underwriters to promote any possible combination[121], and they can do it by omitting due diligence.

The problem is that after the IPO and during the de-SPAC transaction the real disclosures take place, but at that moment underwriters are exempt from liability under Section 11 of the Securities Act 1933 since they don't purchase shares from the issuer and don't sign the registration statement[122]. Therefore, they aren't obliged to verify the accuracy of disclosures and may not require comfort letters from auditors, which exempts the latter from liability to underwriters for potential material misstatements and omissions[123].

2.2.2 PSLRA Regulation and Safe Harbor Provision

The more non-redeeming investors will stay after the de-SPAC transaction, the higher returns sponsors will gain. One of the instrumental promotional sources are projections. These

[119] Klausner, Ohlrogge and Ruan (n 54) 30.
[120] 'The Special Purpose Acquisition Company (SPAC) or Private to Public Equity (PPE)™ Initiative' (*GigCapital*) <https://www.gigcapitalglobal.com/resource/the-special-purpose-acquisition-company-spac-or-private-to-public-equity-ppetm-initiative/> accessed 14 June 2023.
[121] 'Special Purpose Acquisition Companies (SPACS): an Introduction' (*Ropes & Gray*) 3, 21 <https://www.ropesgray.com/en/practices/special-purpose-acquisition-companies> accessed 14 June 2023.
[122] Scott Mascianica and Michael W. Stockham, 'Writing on the Wall for SPAC Underwriters? New SEC Rule Increases Exposure and Risks' (*Holland & Knight*, 15 April 2022) <https://www.hklaw.com/en/insights/publications/2022/04/writing-on-the-wall-for-spac-underwriters> accessed 14 June 2023.
[123] Tuch and Seligman (n 96) 333.

forward-looking statements are legally defined and may include financial forecasts, future economic performance, or management objectives[124], and due to their highly speculative nature they are heavily regulated by the Private Securities Litigation Reform Act 1995[125].

The PSLRA contains a safe harbor provision that excludes forward-looking statements under certain conditions, such as the application of caution ("bespeak caution language"[126]). However, blank-check and going-public companies are excluded from this protection[127]. The idea of Congress was to encourage voluntary disclosure of forecasts[128], but exclude "unseasoned" companies that cannot back their projections with previous records of performance[129].

The forward-looking statement is part of the proxy disclosure or registration statement, and as we understand, underwrites have no incentive to verify the accuracy of provided information[130], hence, the risk of misleading statements increases and can give rise to securities violations[131]. However, the problem here is that SPACs don't fall into the excluded categories. As was stated in the first chapter, although SPACs are technically the same investment vehicles as blank-check companies, legally to be categorized as the latter, a company must issue penny stocks[132], which SPACs do not. And de-SPAC transactions are not IPOs, although they have

[124] 15 U.S.C. § 78u-5(i)(1) (2018).
[125] John Coates, 'SPACs, IPOs and Liability Risk under the Securities Laws' (*U.S. Securities and Exchange Commission*, 8 April 2021) <https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws> accessed 14 June 2023.
[126] Andrew W. Fine, 'A Cautionary Look at a Cautionary Doctrine', 10 Brooklyn Journal of Corporate, Financial & Commercial Law 521, 528-529.
[127] 15 U.S.C. § 78u-5(b) (2018).
[128] Amanda M Rose, 'SPAC Mergers, IPOs, and the PSLRA's Safe Harbor: Unpacking Claims of Regulatory Arbitrage' (*SSRN*, 14 December 2021) 6 <https://papers.ssrn.com/abstract=3945975> accessed 14 June 2023.
[129] Kimberlyn George, Michael Dambra and Omri Even-Tov, 'Special Purpose Acquisition Companies: An Introduction' (2021) Harvard Law School For Corp. Governance <https://corpgov.law.harvard.edu/2021/10/11/should-spac-forecasts-be-sacked/> accessed 14 June 2023.
[130] See section 2.2.1.
[131] Jean-Claire Perini, 'Don't Get Burned: Why the DE-SPAC Transaction Must Be Excluded From the PSLRA's Safe Harbor Provision For Forward-Looking Statements' (2022) 67 Villanova Law Review. 411, 437.
[132] See section 1.1.3.

similarities, and the former can be called "second-time listing"[133]. Thus, we can see a conflict between the Congress idea and the wording of the law, which can potentially allow SPACs to avoid liability.

2.3 SPAC Litigation

Now, in terms of all of the above, we can evaluate how this happens in practice.

AP Services, LLP v. Lobell case demonstrates the sponsor's incentives to merge and increased pressure closer to the "drop-dead date". The SPAC "Paramount" went public and raised more than $53 million, and sponsors were entitled to receive upon a transaction a 20% package of shares, which cost $12 million several weeks before the merger[134], in exchange for their sponsors' shares which they bought for $25.000[135].

Approximately three months before the deadline, the potential target exited the deal, and sponsors eagerly commenced shopping for a target, signed more than 20 non-disclosure agreements, and through intermediaries found Chem RX[136]. Although after proper consideration of the Chem RX's management intermediaries decided to withdraw, Paramount sponsors decided to close the deal no matter what. Eventually, five days prior to the deadline the de-SPAC transaction was conducted for $130 million, and 18 months later the new entity announced that the merger was based upon a false financial statement (the company was already insolvent) and filed for bankruptcy[137].

Clearly, sponsors chased their remuneration and willingly refused to conduct a diligent investigation of Chem RX. The US Supreme Court stated that the presence of financial interest

[133] See section 1.2.2. See also section 1.1.1.
[134] AP Services., LLP v. Lobell, No. 651613/12, 2015 WL 3858818, at *1 (N.Y. Sup. Ct. June 19, 2015).
[135] Krulish (n 103) 507.
[136] Lobell (n 134) at *2.
[137] ibid at *3.

is enough to rebut the business judgment rule and shift the burden of proof to sponsors[138] (entire fairness standard). The fact that they were also interested in the highest price of shares cannot be considered in that scenario, let alone the fact that in the proxy statement, it was clearly mentioned that sponsors' interests may differ from those of shareholders since founder shares can become worthless without a merger[139].

A similar situation can be seen in the *In re Multiplan* litigation. The SPAC "Churchill" raised $1.1 billion through an IPO, and its sponsors received for $25.000 the package of shares whose closing price was about $305 million (1.219.900%)[140]. SPAC directors reported an extensive investigation of Multiplan and after a while shareholders approved the deal[141].

One month after an independent report was published stating that Multiplan was heavily dependent on one client, who withdrew and formed a competing company, but even before that the company's revenue was declining for several years[142]. The share price went down, and while sponsors could tolerate any decline, investors claimed a breach of fiduciary duty[143]. The Delaware Court of Chancery found enough evidence to trace the conflict of interests and to apply the entire fairness standard shifting the burden of proof to sponsors; the latter's motion to dismiss was denied[144].

The *Laidlaw v. Ledecky* class action is an example of the alleged duty of candor's breach. Ledecky through a chain of companies controlled various SPACs, one of which was "Pivotal" where he appointed the same cohort of directors and officers as in other SPACs[145]. Ledecky

138 ibid at *4.
139 ibid at *5.
140 In re MultiPlan Corp. 268 A.3d 784, 794, 798, 810 (Del. Ch. 2022).
141 ibid at 797, 798.
142 Krulish (n 103) 512.
143 MultiPlan (n 141) 798, 799.
144 ibid at 812, 819.
145 Laidlaw et al., v. Ledecky et al., No. 2021-0808, 2021 WL 4352956, at *6 (Del. Ch. 2021).

incentivized these directors by giving them founder shares, and the board was staggered preventing any change of control[146].

Pursuing the goal to give their founder shares a real value, the defendants failed to disclose potentially material information, including a stock dilution (anticipated decline of price from $10 to $7), and substantial flaws of a target business[147]. Consequently, shareholders vote for the merger, and the share price went down afterward, which gave rise to the class action[148].

This case is still pending, but we can assume that the Delaware Court of Chancery when determining the materiality of omitted information, will refer to two decisions of the US Supreme Court. First, in the case of *TSC Industries v. Northway*, where the court stated that omitted fact is material if there is a "substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote"[149]. Second, in the case of *Basic v. Levinson,* where the concept of "integrity of the market price" was taken into account, meaning that the market price of shares didn't reflect their true value, but plaintiffs relied on the market price.[150]

The *Delman v Gigacquisitions3* case, among other problems, shows the danger of dilution in combination with the execution of redemption rights. Gigacquisition3 upon failure to raise additional capital through PIPE entered into 30 undisclosed agreements with the same investors for selling more than eight million convertible notes with the same number of additional warrants as sweeteners[151]. Moreover, although 98% voted for the merger, almost 29% redeemed their shares[152]. The Delaware Court of Chancery found that the proxy statement was materially misleading, since it attributed $10 per share price, omitting the dilution and

146 ibid at *6, *9.
147 ibid at *12, *13, *15.
148 ibid at *18, *59, *93.
149 TSC Industries et. al. v. Northway, 96 S.Ct. 2126, 2132 (S. Ct. 1976).
150 Basic v. Levinson 485 U.S. 224, 251, 255, 256 (S. Ct. 1988).
151 Delman v. Gigacquisitions3 et al. 288 A.3d 692, 704, 705 (Del. Ch. 2023).
152 ibid at 706.

dissipation of assets[153]. Also, we can remember that PIPE investors have leverage in such negotiations and may resort to "greenmail"[154], and this may be the reason why they were granted such a generous offer (got debt instruments (notes) to be protected in case of downfall, and equity (warrants) to gain profits in case of success).

The *Moradpour v Velodyne* shows a successful defense against a claim of Section 10(b) violation based on financial forecasts by application of a PSLRA's safe harbor provision to SPAC's forward-looking statements. Graf (SPAC) and Velodyne (target) issued several Press Releases and Proxy Statements indicating the expectations of more than $100 cash flow in 2024 based on the signed contracts[155]. These projections didn't come true, but the District Court for N.D. of California stated that the defendants applied cautious language in all their statements[156].

A peculiar securities ruling was adopted in the *Menora v Frutarom* case. SPAC IFF acquired Frutarom for $7.1 billion due to its performance in Russia and Ukraine, but after several months IFF issued a report stating below the expected results[157]. After a while, IFF announced the results of an investigation showing that Frutarom was involved in a bribery activity making unlawful payments to its customers' representatives[158]. The class action was brought against Frutarom claiming violation of anti-fraud Rule 10b-5 by issuing misleading statements about compliance with anti-fraud laws[159].

The U.S. Court of Appeals for the Second Circuit ruled that in order to sue the issuer under § 10(b), plaintiffs must stand the "purchaser-seller" rule, meaning that they have to buy or sell

153 ibid at 725.
154 See section 2.1.2.3.
155 Moradpour et al. v. Velodyne et al., No. 21-cv-01486-SI, 2022 WL 2391004, at *1, *6, *7 (N.D.Cal. 2022).
156 ibid at *16.
157 Menora v. Frutarom 19 Civ. 7536 (NRB), 1, 14, 15 (S.D.N.Y. 2021).
158 ibid at 19.
159 ibid at 20, 39.

shares of a defendant[160]. However, in this case, plaintiffs bought shares of the SPAC, and misstatements were made by the target. At first glance, this approach conflicts with the "*ubi ius, ibi remedium*" principle, depriving investors of the effective remedy. Thus, according to lawyers, this can encourage securities fraud[161].

The *SEC v Morgenthau* case can be seen as an interpretation of SPAC's Ponzi scheme. Cooper Morgenthau was the CFO of African Gold Acquisition Corp. (SPAC). He embezzled $5 million from the company's accounts and used them to trade in cryptocurrencies. Furthermore, Cooper forged financial documents to hide the deficit[162]. It seems that his investments weren't successful, so he launched another SPAC Strategic Metals Acquisition Corp. I, and then another one. Cooper used their proceedings to cover the deficit in African Gold, but eventually his "funds' juggling" failed, and the SEC brought a civil action against him, and in parallel the U.S. Attorney's Office for the Southern District of New York (SDNY) commenced criminal charges against Cooper[163]. This is an example of the effective "dual-remedy" approach to address securities violations[164]. Eventually, he was sentenced to three years of imprisonment and ordered to pay restitution[165].

[160] Menora v. Frutarom 54 F.4th 82, 86 (2d Cir. 2022).
[161] Carol Villegas, Jake Bissell-Linsk and Danielle Izzo '2nd Circ. Securities Ruling May Encourage Fraud' (*Law360*, 14 October 2022) <https://www.law360.com/insurance-authority/articles/1539318/2nd-circ-securities-ruling-may-encourage-fraud> accessed 14 June 2022.
[162] 'SEC Charges Former SPAC CFO for Orchestrating $5 Million Fraud Scheme' (*U.S. Securities and Exchange Commission*, 4 January 2023) <https://www.sec.gov/litigation/litreleases/2023/lr25605.htm> accessed 14 June 2023.
[163] Katryna Perera, 'SPAC Exec Admits Taking $5M For Meme Stock, Crypto Trades' (*Law360*, 3 January 2023) <https://www.law360.com/articles/1562132/spac-exec-admits-taking-5m-for-meme-stock-crypto-trades> accessed 14 June 2023.
[164] Tibor Tajti, 'What Makes the Securities Criminal Law System of the United States Work? 'All-Embracing' 'Blanket' Securities Crimes and the Linked Enforcement Framework' (2021) XII(1) Pravni Zapisi 146, 155 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3888993> accessed 14 June 2023.
[165] 'Former Chief Financial Officer Of Two SPACs Sentenced To 36 Months In Prison For Fraud Scheme' (*U.S. Attorney's Office, Southern District of New York*, 27 April 2023) <https://www.justice.gov/usao-sdny/pr/former-chief-financial-officer-two-spacs-sentenced-36-months-prison-fraud-scheme#:~:text=MORGENTHAU%2C%2036%2C%20of%20Fernandina%20Beach,to%20pay%20restitution%20of%20%245%2C111%2C335.> accessed 14 June 2023.

Another example of the "dual-remedy" approach is the case of *Nikola Motors*. The possibility to solicit and promote shares ("testing-the-waters"[166]) is one of the SPACs' advantages, which allegedly was decisive for Nikola to go public through a de-SPAC transaction[167]. During the pre-filing period, companies are prohibited to perform any communication in connection with the sale of securities[168]. Violations of this rule are considered "gun jumping" and prohibited by the law, as was stated in the *Diskin v Lomasney* case[169]. The founder of "Nikola" Trevor Milton used the SPAC's way and accelerated investments in his company by issuing totally misleading statements about the functioning of electronic cars and forefront technologies. When these facts had been disclosed, investors suffered huge losses[170]. The U.S. Attorney's Office for the SDNY commenced criminal charges against Milton[171], and he was found guilty[172]. At the same time, the SEC brought claims against Nikola Motors, and the parties agreed to settle the case for $125 million[173].

Conclusion

In order to have a better comprehension of all the subtleties that are embedded into the SPAC's structure and that cause conflicts of interest, it is better to depict the cycle schematically.

[166] See section 1.2.1.

[167] Edward Imperatore, '4 Public Co. Lessons From Nikola Founder Fraud Conviction' (*Law360*, 2 November 2022) <https://www.law360.com/articles/1545409/4-public-co-lessons-from-nikola-founder-fraud-conviction> accessed 14 June 2023.

[168] 15 U.S.C. § 77e (2018).

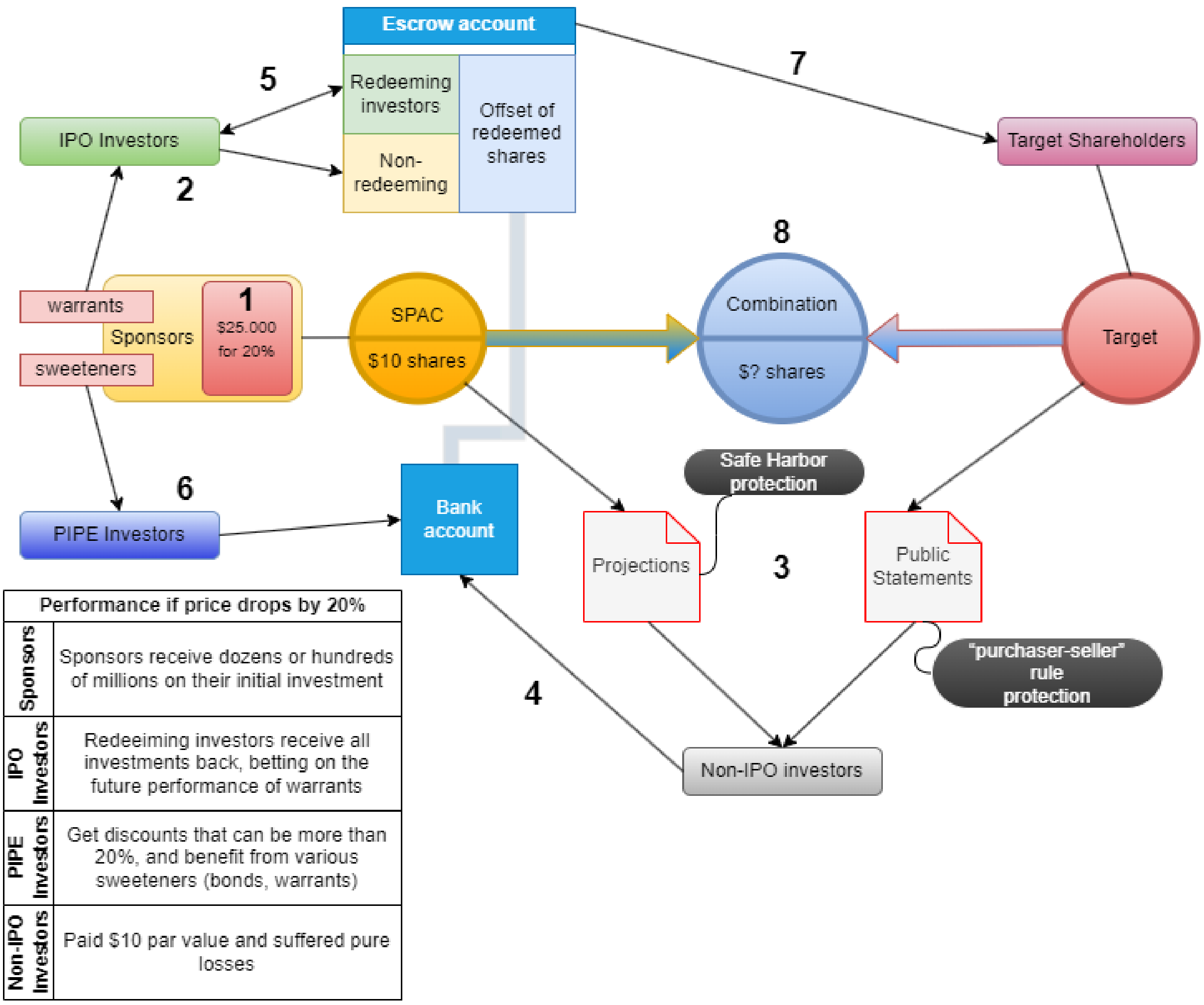
[169] Diskin v. Lomasney Co. 452 F.2d 871 (2d Cir. 1971).

[170] 'Former Nikola Corporation CEO Trevor Milton Charged In Securities Fraud Scheme' (*U.S. Attorney's Office, Southern District of New York*, 29 July 2021) <https://www.justice.gov/usao-sdny/pr/former-nikola-corporation-ceo-trevor-milton-charged-securities-fraud-scheme> accessed 14 June 2023.

[171] ibid.

[172] 'Nikola founder's sentencing on fraud convictions delayed until June 21' (*Freight Waves*, 23 January 2023) <https://www.freightwaves.com/news/nikola-founders-sentencing-on-fraud-convictions-delayed> accessed 14 June 2023.

[173] 'Nikola Corporation to Pay $125 Million to Resolve Fraud Charges' (*U.S. Securities and Exchange Commission*, 21 December 2021) <https://www.sec.gov/news/press-release/2021-267> accessed 14 June 2023.



Performance if price drops by 20%	
Sponsors	Sponsors receive dozens or hundreds of millions on their initial investment
IPO Investors	Redeeiming investors receive all investments back, betting on the future performance of warrants
PIPE Investors	Get discounts that can be more than 20%, and benefit from various sweeteners (bonds, warrants)
Non-IPO Investors	Paid $10 par value and suffered pure losses

Figure 2: Financial and Informational Flows in the SPAC's Life Cycle

1) Sponsors receive for $25.000 shares convertible into 20% of surviving company's shares; 2) IPO investors purchase units comprising shares and warrants per $10, and all proceedings are locked on an escrow account; 3) When the target is identified both sides start to solicit the deal and in several scenarios they can be protected even if distributed information was incorrect; 4) based on the distributed information other investors take a decision to invest into the SPAC; 5) IPO investors may redeem their shares and preserve warrants even if they vote for the transaction; 6) If sponsors see that they haven't enough funds to close the deal, they can entice PIPE investors providing them with a significant discounts and additional sweeteners; 7) Proceedings from the trust account are transferred to target's shareholders; 8) Companies merge.

In order to regain the reputation of SPACs, sponsors had to change the approach and offer higher protection with additional incentives to pre-transactional investors, since they were the most vulnerable participants relying only on target and sponsor's statements and promises. The consequences of that perfectly aligned with the short-term goals of sponsors but gave rise to a conflict of interest. Decoupling of economic interests and voting rights distorts the incentives of IPO investors that now can decide the fate of the transaction, but have no financial stake in this company, solely betting on the warrants' performance. Sponsors use this to buy votes, and if the redemption rate is too high, they can make a private deal with PIPE investors providing them with discounts and sweeteners. Therefore, only non-IPO investors (and non-redeeming IPO investors) who trust in the combination suffer, relying on biased statements and projections. Sponsors may be so eager to close the deal that they place an unbearable financial burden on the surviving company and at the same time neglect due diligence in investigating the target.

CONCLUSION

The thesis examined the US regulation of special purpose acquisition companies as investment vehicles, assessing their efficiency and legitimacy from the perspective of their advantages, stakeholders' protection, and latent risks. The examination demonstrates that a SPAC has unique features which allow it to outperform a traditional IPO's route by providing an effective and less costly shortcut to the US Capital Market. However, at the same time, its current framework comprises several flaws enabling various stakeholders to use SPACs in a dishonest way.

Current SPACs have changed significantly in comparison to their prototypes and have become the most sought-for investment vehicle in the US Market. Their emergence has changed the strategy of going public by segregating participants based on their absolute advantages, allowing start-ups to focus solely on their ideas and programs, and sponsors on conducting due diligence and solving all regulatory hurdles. Life of investors also has become easier since they can rely on the professional judgment of sponsors without the necessity of proper and costly investigations. High legal standards coupled with an abundant set of financial instruments and sweeteners facilitate the fundraising process.

However, that was the ideal scenario. In reality, the current rules of the game do not align with the SPAC's primary goal, moreover, it distorts the incentives of almost all participants. The following problems were identified:

1. Conflict of interests. Providing IPO investors with the right to vote for the deal and leave creates a problem of empty votes. They don't need to spend time and resources on proper investigation, they just leave with free warrants. At the same time, sponsors

are blinded by the huge profits that can only be achieved after the merger, so they use every tool to incentivize investors to come and vote for.

2. Unreliable signals and lack of due diligence. As we can see, the vote is empty and cannot really validate the deal. Sophisticated PIPE investors are crucial in covering redeeming investors, so they have the leverage to impose their own private game, and their participation now cannot be counted as a “stamp of quality”. Underwriters are also protected from liability, so they have no incentive to perform stringent due diligence.
3. Dilution. In the pursuit of the merger, sponsors may issue too many securities of various sorts, the exploitation of which may result in dilution. This problem has been typically identified after de-SPAC transactions.
4. Forward-looking statements. Terminological inaccuracy of the PSLRA and nuances of Section 10(b) in specific scenarios allow sponsors to publish exaggerated projections and allow target shareholders to misrepresent some facts in their statements.

All of the above problems place a burden on the shoulders of non-IPO and non-redeeming investors since they retain shares that after the merger begin to lose value due to dilution and decrease in available funds after redemption, and also due to the poor performance of the target company, which was previously hidden or not revealed by SPAC management. However, in most cases, courts can understand what is going on and punish perpetrators. Technically, there is no opportunity to eliminate fraud, every fundraising scheme theoretically can be used for deceit, and any multi-level marketing platform can be transformed into a pyramid, but they aren’t prohibited. The point is that SPAC’s problems are artificial, but not immanent. Sponsors masked controversial features under the pretense of "protecting" investors.

Solving these problems requires a separate investigation. But without in-depth research, we can assume that several steps can definitely increase the reliability of SPACs. The first one is obvious – the prohibition of empty votes, investors should economically approve the merger. The second one is a lock-up provision, for instance, allowing sponsors to sell their shares only if their price will be above a certain threshold for a definite period. This is not a panacea, but it will definitely increase the prudence of sponsors in choosing the target. As we can see, underwriters technically can receive even higher fees working with SPACs, so there is no need to reduce their liability. Also, it is important to exclude SPACs from the safe harbor protection of the PSLRA. Nonetheless, these questions are left for another paper.

Therefore, SPACs are currently in the process of building their reputation, and many years of being in the shadows from the gaze of law enforcement allowed the scammers to adapt and use this tool again for personal gain. Nevertheless, some regulatory changes may bring this investment vehicle into line with its original purposes and make its performance substantially beneficial to the US economy.

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