Georgia Law Review

Volume 57 | Number 1 Article 6

11-18-2022

Does it SPARC Joy? Cleaning Up the SPAC Space

G. Max Miseyko
University of Georgia School of Law

Follow this and additional works at: https://digitalcommons.law.uga.edu/glr

Part of the Law Commons

Recommended Citation

Miseyko, G. Max (2022) "Does it SPARC Joy? Cleaning Up the SPAC Space," *Georgia Law Review*: Vol. 57: No. 1, Article 6.
Available at: https://digitalcommons.law.uga.edu/glr/vol57/iss1/6

This Note is brought to you for free and open access by Digital Commons @ University of Georgia School of Law. It has been accepted for inclusion in Georgia Law Review by an authorized editor of Digital Commons @ University of Georgia School of Law. Please share how you have benefited from this access For more information, please contact tstriepe@uga.edu.

Does it SPARC Joy? Cleaning Up the SPAC Space

Cover Page Footnote

J.D. Candidate, 2023, University of Georgia School of Law; B.A., 2011, University of Florida. The author thanks Professor Usha Rodrigues for her insights, advice, and research that made this Note possible.

This note is available in Georgia Law Review: https://digitalcommons.law.uga.edu/glr/vol57/iss1/6

DOES IT SPARC JOY? CLEANING UP THE SPAC SPACE

G. Max Miseyko [*]

For the last few years, the special purpose acquisition company—SPAC—was one of the hottest investment trends on Wall Street. In a SPAC, an investment vehicle with a limited lifespan (usually two years), a sponsor raises money from investors up front with the goal of finding a target company to take public via a reverse merger with a publicly traded shell company. Once touted as a democratized way to access public markets that avoids the rigors associated with traditional initial public offerings (IPOs), those characterizations came under fire in 2021 as academics and regulators spotlighted the hidden costs and misaligned incentives that the SPAC structure precipitates. As a one-time deal that allows investors to opt out of a proposed merger, the SPAC lacks the "reputation" component that underpins private equity relationships by constraining agency costs and opportunism.

Enter the special purpose acquisition rights company—the SPARC—a reconceived SPAC model that would allow investors to opt in when the sponsor identifies a good deal. This Note highlights how the SPARC promises to reintegrate the reputational component that the SPAC lacks by facilitating repeat deals and reframing the sponsor-investor relationship as a long-term one.

For the SPARC model to become a reality, the Securities and Exchange Commission (SEC) needs only to pass a rule proposed by the New York Stock Exchange (NYSE) that would enable SPARC sponsors to issue tradeable Subscription Warrants before raising capital. Instead, the SEC issued a raft of proposed rules intent on killing the SPAC, prompting the NYSE to withdraw its proposal. This Note calls for the SEC to scrap the bulk of its proposed SPAC rules in favor of a revised rule allowing the issuance of Subscription Warrants for

[*] J.D. Candidate, 2023, University of Georgia School of Law; B.A., 2011, University of Florida. The author thanks Professor Usha Rodrigues for her insights, advice, and research that made this Note possible.

Published by Digital Commons @ University of Georgia School of Law, 2022

Georgia Law Review, Vol. 57, No. 1 [2022], Art. 6

compensation that incorporate an oversubscription privilege to match investor appetites with target company funding needs.

TABLE OF CONTENTS

I. INTRODUCTION 316

II. SPACGROUND.. 319
A. THE SPAC'S PLACE IN THE PUBLIC FUNDING MARKET 319
B. SPAC NUTS AND BOLTS 323
C. SPACS VERSUS TRADITIONAL IPOS AND PRIVATE EQUITY 325

III. THE SPARC OF AN IDEA 336
A. A SPARC IS BORN 336
B. HOW SPARCS WOULD WORK 341

IV. ADOPTING THE SPARC 344
A. REINTEGRATING REPUTATION: THE ADVANTAGE OF THE SPARC SERIES VS. THE LIMITED LIFESPAN SPAC 344
B. OTHER SPARC STRUCTURAL ADVANTAGES 348
C. COUNTERING THE SPARC CRITICS 351

V. CONCLUSION 356

I. INTRODUCTION

Many market commentators declared 2020 "the year of SPACs," but they were wrong—that honor goes to 2021.[1] By 2021's year-end, the U.S. IPO market raised more than $315 billion, nearly doubling 2020's record-total of $168.7 billion.[2] And it was the special purpose acquisition company (SPAC) that largely drove the growth, with SPAC IPOs accounting for sixty percent of all U.S. IPO filings and around fifty-one percent of all proceeds.[3] Despite experiencing a second quarter slowdown while investors digested the prospect of increased regulatory scrutiny,[4] the SPAC market eventually resumed its torrid pace even as SEC staff informally signaled that the Agency would propose new SPAC rules in the first quarter of 2022.[5] After a meteoric rise to prominence that was unimaginable pre-COVID,[6] the SPAC threatened to dethrone the traditional bookbuilding IPO method[7] as the dominant method of public

---

[1] Rubie Pearl Corales, *Q1 2021 Global Capital Markets Activity: SPAC IPOs, Issuance in Consumer Discretionary Sector Surge*, S&P GLOB. (May 3, 2021), https://www.spglobal.com/marketintelligence/en/news-insights/blog/q1-2021-global-capital-markets-activity-spac-ipos-issuance-in-consumer-discretionary-sector-surge.

[2] Luisa Beltran, *More Than 1,000 Companies Went Public in 2021, but Returns Are Worst in a Decade*, BARRON'S (Dec. 27, 2021), https://www.barrons.com/articles/companies-ipos-2021-returns-worst-decade-51640294878.

[3] *Id.*

[4] *See* Statement of John Coates, Acting Director, Division of Corporate Finance & Paul Munter, Acting Chief Accountant, U.S. Sec. Exch. Comm'n, Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies (Apr. 12, 2021), https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs (issuing guidance indicating that SPACs should account for warrants typically issued as part of the SPAC IPO process as liabilities rather than equity in certain cases).

[5] *See* Daniel Nussen & Elliott M. Smith, *A Rollercoaster Year for SPACs*, WHITE & CASE (Mar. 30, 2022), https://www.whitecase.com/publications/insight/global-ipos-blockbuster-year/rollercoaster-year-spacs ("It was noticeable that the fourth quarter of 2021 saw something of an acceleration, with [SPACs] raising US$35 billion, up from . . . US$19 billion in the third quarter.").

[6] *See* Alexander Osipovich, *Blank-Check Boom Gets Boost from Coronavirus*, WALL ST. J. (July 13, 2020, 4:49 PM), https://www.wsj.com/articles/blank-check-boom-gets-boost-from-coronavirus-11594632601 ("[T]he coronavirus has fueled a fresh wave of interest in an unusual investment vehicle with a shaky reputation: the [SPAC].").

[7] *See infra* notes 30–33 and accompanying text.

funding.[8] That is, until the SEC issued the SPAC's death warrant in March 2022.[9]

A SPAC is a type of blank check company listed on an exchange whose sole purpose is to acquire a target company seeking to become publicly traded.[10] When a SPAC buys a target firm and executes a reverse merger,[11] "the firm gets its spot on the exchange."[12] For the target firm, merging with a SPAC "is a backdoor way of doing an initial public offering."[13]

Several factors have driven the SPAC's recent popularity: the influence of high-profile backers (called sponsors), "a better understanding by the market of the SPAC structure, the well-established complementary private investment in the public equity (PIPE) financing market," and the SPAC model's potential attractiveness to companies wanting to go public while maximizing marketability and retaining "more control over valuation and share price" compared to a traditional IPO.[14] But 2021 also exposed

---

[8] *See* Stephen Guilfoyle, *Why SPACs Won't Replace Traditional IPOs—and Vice Versa*, THESTREET (Mar. 23, 2021, 8:00 AM), https://www.thestreet.com/investing/why-spacs-wont-replace-traditional-ipos (stating that SPACs have already replaced the traditional IPO to some degree but noting that both methods will likely vie for dominance in different market environments going forward).

[9] *See generally* Special Purpose Acquisition Companies, Shell Companies, and Projections, 87 Fed. Reg. 29,458, 29,481 (proposed May 13, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 230, 232, 239, 240, 249, 270) [hereinafter SEC Proposed Rules] (proposing sweeping rules that would substantively change how SPAC transactions are conducted); *see also* Commissioner Hester M. Peirce, *Damning and Deeming: Dissenting Statement on Shell Companies, Projections, and SPACs Proposal*, SEC (Mar. 30, 2022), https://www.sec.gov/news/statement/peirce-statement-spac-proposal-033022 (stating, as the lone dissenter who voted against the SEC Proposed Rules, that "[t]he proposal—rather than simply mandating sensible disclosures around SPACs and de-SPACs, something I would have supported—seems designed to stop SPACs in their tracks" and that the proposal "imposes a set of substantive burdens that seems designed to damn, diminish, and discourage SPACs because we do not like them"); Eliot Brown (@eliotwb), TWITTER (Mar. 30, 2022, 1:28 PM), https://twitter.com/eliotwb/status/1509221118917455881 (commenting about the SEC Proposed Rules that "a lot of bankers think this will effectively kill the SPAC listing process for startups, particularly for those with little or no revenue").

[10] *See infra* notes 51–53.

[11] *See infra* note 41.

[12] Osipovich, *supra* note 6.

[13] *Id.*

[14] Christopher M. Barlow, C. Michael Chitwood, Howard L. Ellin, P. Michelle Gasaway & Gregg A. Noel, *The Year of the SPAC*, SKADDEN (Jan. 26, 2021), https://www.skadden.com/insights/publications/2021/01/2021-insights/corporate/the-year-of-the-spac.

fissures in the SPAC structure.[15] Regulators focused on SPAC warrant classification and Private Securities Litigation Reform Act (PSLRA) disclosure issues.[16] Increased redemptions drew attention to structural flaws that tend to produce rampant shareholder dilution.[17] A lawsuit[18] pitted prominent academics and a former SEC Commissioner against the country's biggest M&A players, ultimately challenging the SPAC's entire investment model.[19]

A reconceptualized SPAC—the special purpose acquisition *rights* company (SPARC)—rose to meet those challenges.[20] Conceived by Pershing Square CEO Bill Ackman in response to a string of challenges that ultimately derailed his record-setting $4 billion Pershing Tontine (PSTH) SPAC,[21] the SPARC promises to reinvent the SPAC IPO process by eliminating the SPAC's two-year time limitation, replacing the SPAC's opt-out with an investor opt-in, and offering sponsors the ability to "chain" SPARC deals together.[22] By transforming the SPAC from a one-shot deal into a publicly traded instrument of ongoing concern, the SPARC would revitalize the role of reputation that constrains agency costs and curtails opportunism in private equity relationships—constraints that the SPAC desperately needs.[23]

To become a reality, the SPARC only required SEC approval of an NYSE Proposed Rule that would have allowed sponsors to issue tradable Subscription Warrants before raising any capital.[24] That once-expected approval never came, with the NYSE withdrawing its proposal in light of the SEC's decidedly anti-SPAC position.[25] But

---

[15] *See* Roger E. Barton, *Caution Ahead: SPAC Litigation Trends Provide a Road Map for Directors and Officers*, REUTERS (Sept. 2, 2021, 12:38 PM), https://www.reuters.com/legal/legalindustry/caution-ahead-spac-litigation-trends-provide-road-map-directors-officers-2021-09-02/ (highlighting the uptick in SPAC-related litigation in 2021 that some attribute to the "SPAC structure [being] inherently conducive to litigation").

[16] *See supra* note 4; *infra* notes 80–82 and accompanying text.

[17] *See infra* notes 127–137 and accompanying text.

[18] Assad v. Pershing Square Tontine Holdings, Ltd., 21-cv-06907 (S.D.N.Y. filed Aug. 17, 2021).

[19] *See infra* notes 165–175 and accompanying text.

[20] *See infra* Section III.A.

[21] *See infra* 150–177 and accompanying text.

[22] *See infra* Section III.B.

[23] *See infra* Section IV.A.

[24] *See infra* notes 181–184 and accompanying text.

[25] *See* Pershing Square Tontine Holdings, Ltd., Current Report (Form 8-K) Ex. 99.1 (Apr. 28, 2022) ("In view of the [SEC]'s recently proposed rule changes and policy guidance with

with the "ability for the approval of a revised rule" preserved, the SPARC concept remains viable.[26] Should the SEC eventually change its stance on SPACs and choose to empower investors, rather than paternalistically "damming up the SPAC river,"[27] the overwhelmingly positive comments to the NYSE Proposed Rule indicate that investors would welcome the SPARC with open arms.[28]

The SPARC's promise cannot be grasped without first understanding the SPAC's shortcomings. Part II of this Note situates the SPAC in today's public funding market, explores its relation to traditional IPO and private equity models, and raises questions about its structural viability. Part III chronicles the rise of the SPARC and examines how it could work in practice. Section IV.A explains how the SPARC could revitalize the role of reputation, enabling the SPARC model to succeed where the SPAC has failed. Section IV.B presents unique structural benefits offered by the SPARC. Section IV.C attempts to counter criticisms aimed at the SPARC. Finally, Part V concludes by calling for the SEC to abandon its SPAC rule proposal and instead approve a revised version of the NYSE Proposed Rule that would make SPARCs a reality.

II. SPACGROUND

A. THE SPAC'S PLACE IN THE PUBLIC FUNDING MARKET

"Going public is the process of offering securities—generally common stock—of a privately owned company for sale to the general

---

respect to [SPACs], we understand that the approval of the NYSE rule change as currently proposed would not likely have occurred at this time."); *infra* notes 183–184 and accompanying text.

[26] *Id.*

[27] Peirce, *supra* note 9 ("It is not our place to decide that SPACs are good or bad.").

[28] *See Comments on NYSE Rulemaking: Notice of Filing of Proposed Rule Change [Release No. 34-92876; File No. SR-NYSE-2021-45]*, SEC, https://www.sec.gov/comments/sr-nyse-2021-45/srnyse202145.htm (last updated Apr. 4, 2022) (drawing over 200 positive comments urging the NYSE Proposed Rule's adoption); *cf. Comments on Special Purpose Acquisition Companies, Shell Companies, and Projections [Release No. 33-11048; 34-94546; IC-34549; File No. S7-13-22]*, SEC, https://www.sec.gov/comments/s7-13-22/s71322.htm (last updated July 12, 2022) (registering eighty-five comments to the SEC's proposed SPAC rules, an overwhelming majority of which express concerns about the SEC's proposal).

public."[29] Typically, a private company issues its first shares of stock for public sale through a conventional IPO.[30] This process usually entails hiring an underwriter[31] (often an investment bank) to develop a registration statement to file with the SEC, underwrite certain risks, and coordinate special meetings with potential investors called roadshows.[32] The underwriter forms a syndicate of investment banks to gin up interest from retail and institutional investors, distribute a portion of the shares, and maintain investor enthusiasm once the company's shares begin to trade publicly.[33] While retail investors[34] are nominally able to partake in this process, the typical high demand for shares of a new IPO—largely due to the practice of underpricing[35]—incentivizes underwriters to allocate the majority of shares to regular institutional customers.[36]

---

[29] PwC DEALS, ROADMAP FOR AN IPO: A GUIDE TO GOING PUBLIC 3 (Nov. 2017) [hereinafter ROADMAP FOR AN IPO], https://www.pwc.com/us/en/deals/publications/assets/pwc-roadmap-for-an-ipo.pdf.

[30] *See* EVA SU, CONG. RSCH. SERV., IF11655, SPAC IPO: BACKGROUND AND POLICY ISSUES 2, https://crsreports.congress.gov/product/pdf/IF/IF11655 (last updated Apr. 5, 2021) ("IPOs are common methods for companies to raise funds and gain trading liquidity for their equity stakes."). The process described here is the bookbuilding method of distributing IPO shares, the dominant method by which a company becomes public in the U.S. *See* Francesca Cornelli & David Goldreich, *Bookbuilding and Strategic Allocation*, 56 J. FIN. 2337, 2337 (2001) (noting that bookbuilding "has been standard practice for a number of years" in the U.S.).

[31] *See* ROADMAP FOR AN IPO, *supra* note 29, at 42 ("Companies can go to market without an underwriter, but the process is so complex and the know-how so specialized that it is rarely done.").

[32] *See id.* ("The lead(s) or managing underwriter works with a company to develop the registration statement, coordinate the roadshow, underwrite certain risks and form a syndicate.").

[33] *See id.* (explaining that, as part of the syndicate, the selling group "solicits interest from its retail and institutional clients, sells stock once an IPO goes effective and provides aftermarket support").

[34] Retail investors are "non-professional market participants" who "purchase securities for their own personal accounts and often trade in dramatically smaller amounts" than institutional investors, who are "professional portfolio and fund managers who might manage a mutual fund or pension fund." Adam Hayes, *Retail Investor*, INVESTOPEDIA (Feb. 17, 2021), https://www.investopedia.com/terms/r/retailinvestor.asp.

[35] *See* Christine Hurt, *Moral Hazard and the Initial Public Offering*, 26 CARDOZO L. REV. 711, 715 n.15, 724–25 (2005) (contending that while various rationales seek to explain underpricing, i.e., "the fact that shares are priced less than the price the market would sustain," it is "often an intentional act designed to extract wealth for the few that receive original IPO allocations").

[36] *See id.* at 712 ("[U]nderwriters allocated the majority of original IPO shares to regular customers, mostly institutional investors . . . .").

As a result, retail investors are largely unable to purchase shares until the original buyer resells them and the predictable retail demand accompanying the first day of trading virtually guarantees a profit for investors fortunate enough to buy original IPO shares at the offering price.[37] As IPO shares frequently fail to maintain the retail-fueled price surges that characterize early trading, retail investors who bought shares in the open market often get the short end of the stick.[38] The traditional IPO process "has revealed itself to be undemocratic at best and manipulative at worst."[39]

Alternatively, firms may access the external capital available in public markets via non-traditional routes, "the most popular [being] a reverse merger."[40] "A reverse merger is a transaction in which a privately held company merges with a publicly held [entity]."[41] While private companies occasionally take over smaller public operating companies,[42] most reverse mergers are "shell mergers" involving publicly listed entities with little or no existing business operations.[43] These entities come in the form of "natural" shells ("listed companies that have either gone bankrupt or sold a large part of their assets") or "cash" shells (companies created from scratch for the sole purpose of acquiring a private company).[44] The private company becomes publicly listed upon merging, with contemporaneous prearranged financing providing capital.[45] A reverse merger thus allows a private company to go public without

---

[37] *See id.* at 712–13 (describing how this practice flourished during the 1999–2000 IPO boom).

[38] *See id.* at 713 ("Unfortunately, the majority of the shares issued in IPOs in the last few years did not retain that initial profit, and the share price eventually plummeted, resulting in a loss for the retail investor who purchased in the aftermarket.").

[39] *Id.* at 712.

[40] Johannes Kolb & Tereza Tykvová, *Going Public via Special Purpose Acquisition Companies: Frogs Do Not Turn Into Princes*, 40 J. CORP. FIN. 80, 80 (2016).

[41] DAVID N. FELDMAN, REVERSE MERGERS: AND OTHER ALTERNATIVES TO TRADITIONAL IPOS 24 (2d ed. 2009).

[42] *See id.* at 25 (citing a widely publicized example of the NYSE's merger with the much smaller public Archipelago Holdings in 2006).

[43] *See id.* at 24–25 ("[M]ost companies that go public through reverse mergers begin as penny stock companies . . . .").

[44] Kolb & Tykvová, *supra* note 40, at 80.

[45] *See* FELDMAN, *supra* note 41, at 24 ("Often financing arranged at the time of the merger provides needed capital, just as with an IPO.").

incurring the costs associated with the traditional IPO process[46] or depending on timing the IPO market for success.[47] Still, the reverse merger is not without its downsides: not only are many existing shells illiquid, but they also carry baggage associated with the less-than-sparkling operating history that led to their shell status.[48]

Enter—or, really, reenter—the SPAC, one type of cash shell[49] that has returned to the forefront of the public fundraising landscape.[50] A SPAC is a blank check company[51] that "raises capital through [an IPO] with the intention to use the proceeds to acquire other companies at a later time,"[52] usually within two years.[53] "You

[46] *See id.* at 28 ("A reverse merger usually costs significantly less than an IPO."). The cost of a traditional IPO can be substantial, both in terms of expense and time required. *See Considering an IPO? First Understand the Costs*, PWC, https://www.pwc.com/us/en/services/deals/library/cost-of-an-ipo.html (last visited Aug. 28, 2022) (indicating that underwriting costs alone typically range from 3.5% to 7.0% of gross IPO proceeds, depending on the total deal value). In addition, some consider "banks' underpricing of traditional IPOs"—evidenced by the "so-called 'IPO pop'"—an additional large cost. Michael Klausner, Michael Ohlrogge & Emily Ruan, *A Sober Look at SPACs*, 39 YALE J. ON REGUL. 228, 268 (2022) [hereinafter Klausner et al., *A Sober Look at SPACs*].

[47] *See* FELDMAN, *supra* note 41, at 31 ("Unlike IPOs, reverse mergers continue in all markets.").

[48] *See id.* at 209 (noting that, unlike most shells, the SPAC has a relatively active trading market and is "totally clean and not burdened . . . with a history from a prior operating business"); *see also* ROADMAP FOR AN IPO, *supra* note 29, at 9 (highlighting the "[d]ifficulty in finding the appropriate merger vehicle" as one disadvantage of the reverse merger route).

[49] *See* FELDMAN, *supra* note 41, at 206 (clarifying that, while industry professionals sometimes talk about SPACs and reverse mergers as if they are separate topics, a SPAC is simply a special type of shell company and should be considered part of the reverse merger landscape, not something separate from it).

[50] *See* SU, *supra* note 30 ("SPACs first appeared in the 1980s but have gained popularity in recent years, especially since 2020 during the Coronavirus Disease 2019 (COVID-19) pandemic."); *see also* Ivana Naumovska, *The SPAC Bubble Is About to Burst*, HARV. BUS. REV. (Feb. 18, 2021), https://hbr.org/2021/02/the-spac-bubble-is-about-to-burst (recounting the several waves of reverse mergers since the 1970s, with SPACs having surged to outnumber IPOs at times during the mid-2000s "before falling off a cliff in 2011"); *supra* notes 3, 8 and accompanying text.

[51] A blank check company is a developmental stage company that "has indicated its business plan is to engage in a merger or acquisition with an unidentified company or companies, other entity, or person." *Blank Check Company*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/glossary/blank-check-company (last visited Aug. 27, 2022).

[52] SU, *supra* note 30.

[53] *See* Usha Rodrigues & Michael Stegemoller, *Redeeming SPACs* 9 (Univ. of Ga. Sch. of L. Research Paper Series, Paper No. 2021-09, 2021) [hereinafter Rodrigues & Stegemoller, *Redeeming SPACs*] ("Initially, SPACs lasted two years; in our sample, the median SPAC

can think of it like: an IPO is basically a company looking for money, while a SPAC is money looking for a company."[54] When the money finds a company, the SPAC's key feature activates: shareholders who like the proposed deal can hold their investment in the soon-to-be public company, while less optimistic investors have a pre-acquisition right to cash out.[55]

B. SPAC NUTS AND BOLTS

A SPAC comes into being when a sponsor—often a private equity fund, although sponsors without any relevant investment background have become increasingly common as celebrities ride the recent wave of popularity to launch their own SPACs[56]—forms a corporation and partners with an underwriter to organize an IPO.[57] "In its IPO, a SPAC sells units consisting of a share, a warrant,[58] and in some cases, a right to acquire a fraction of a share at no cost when the merger closes."[59] The IPO proceeds are invested in U.S. Treasury notes that are then held in trust with the

---

allows for 24 months for completion, although the mean—22 months—is somewhat lower because a number of SPACs allow for only 18 months to close a deal.").

[54] Chris Metinko, *SPAC vs Traditional IPO: Investors See Benefits of Blank-Check Companies*, CRUNCHBASE NEWS (Dec. 3, 2020) (quoting Don Butler), https://news.crunchbase.com/news/spac-vs-traditional-ipo-investors-see-benefits-of-blank-check-companies/; *see also* Usha Rodrigues & Mike Stegemoller, *Exit, Voice, and Reputation: The Evolution of SPACs*, 37 DEL. J. CORP. L. 849, 871 (2013) [hereinafter Rodrigues & Stegemoller, *Exit, Voice, and Reputation*] ("The SPAC investor is essentially buying a management team.").

[55] *See* Klausner et al., *A Sober Look at SPACs*, *supra* note 46, at 237 ("A key feature of SPACs is that, when the SPAC proposes a merger, shareholders have the right to redeem their shares at a price equal to the $10.00 IPO price . . . plus interest . . . .").

[56] *See* Amrith Ramkumar, *The Celebrities from Serena Williams to A-Rod Fueling the SPAC Boom*, WALL ST. J. (Mar. 17, 2021, 5:32 AM), https://www.wsj.com/articles/the-celebrities-from-serena-williams-to-a-rod-fueling-the-spac-boom-11615973578 (chronicling a lengthy list of celebrity-backed SPACs, with endorsers including Shaquille O'Neal, Peyton Manning, Steffi Graf, Jay-Z, and Paul Ryan).

[57] *See* Klausner et al., *A Sober Look at SPACs*, *supra* note 46, at 236 ("The creation of a SPAC begins with a sponsor forming a corporation and working with an underwriter to take the SPAC public in an IPO.").

[58] "Warrants are like options, and they give the holder the right, but not the obligation, to buy shares (or a fraction of a share) at a certain price (for SPACs, $11.50 per share)." Stephen Deane, *SPACs May Feed the Public's Worst Fears About Wall Street*, BARRON'S (Apr. 22, 2021, 7:00 AM), https://www.barrons.com/articles/spacs-may-feed-the-publics-worst-fears-about-wall-street-51619034643.

[59] Klausner et al., *A Sober Look at SPACs*, *supra* note 46, at 236.

expectation that the trust assets will be used to acquire or merge with a target company.[60] At least eighty percent of the trust's net assets must go towards a merger.[61] If and when a SPAC's sponsor finds an acquisition target, the "de-SPAC" process begins—investors can "stay with the deal or redeem their SPAC common stock for a pro rata share of the funds in [the trust]."[62] "Importantly, shareholders that redeem their shares keep the warrants and rights that were in the units sold in the SPAC's IPO. The warrants and rights are used to attract IPO investors by compensating them for parking their cash in the SPAC for two years."[63] Whereas SPACs formerly gave stockholders a chance to vote both directly and indirectly on the acquisition,[64] a powerful form of "voice" not offered under traditional private equity vehicles, those investor protections have since largely gone the way of the dodo as deals proved too hard to close.[65] Nowadays, "[e]ven a SPAC with little cash remaining

[60] *See id.* at 237 ("[C]ash in the trust can be used only to (a) acquire a company, (b) contribute to the capital of the company formed by the SPAC's merger, (c) distribute to shareholders in liquidation if the SPAC fails to consummate a merger, or (d) redeem shares . . . .").

[61] Lora Dimitrova, *Perverse Incentives of Special Purpose Acquisition Companies, the "Poor Man's Private Equity Funds,"* 63 J. ACCT. & ECON. 99, 102 (2017).

[62] SU, *supra* note 30.

[63] Michael Klausner, Michael Ohlrogge & Emily Ruan, *A Sober Look at SPACs* 7 (Stan. L. Sch. John M. Olin Program in L. and Econ., Working Paper No. 559, 2022) [hereinafter Klausner et al., *A Sober Look at SPACs* Working Paper], https://securities.stanford.edu/academic-articles/20201028-a-sober-look-at-spacs.pdf. Following the de-SPAC, warrant holders "have a set period of time to exercise their warrants and increase their holdings in the new company if certain conditions are met (e.g., share price of at least $11.50)." Andrea Pawliczek, A. Nicole Skinner & Sarah L. C. Zechman, *Signing Blank Checks: The Roles of Reputation and Disclosure in the Face of Limited Information* 10–11 (unpublished study), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3933259.

[64] *See* Rodrigues & Stegemoller, *Exit, Voice, and Reputation*, *supra* note 54, at 856, 906 (highlighting that shareholders once had both "a formal vote on a proposed acquisition and a second de facto vote via the conversion threshold," where SPAC investor redemptions that exceeded a specified percentage (typically twenty percent in early SPACs) would prevent the acquisition from proceeding).

[65] *See id.* at 907 ("These powerful investor protections made the investment vehicle attractive to initial investors, but turned out to make it much harder to get a deal done (*i.e.*, to actually acquire a target)."). The development of different deal approval provisions occurred largely in response to "hedge fund vote gaming and greenmailing," *id.*, whereby large funds would require additional consideration in exchange for a "yes" vote, *id.* at 872. Now, "sponsors of latter-day SPACs . . . denied their investors any approval vote at all—at least as a matter of right." *Id.* at 924.

after redemptions can close a merger and bring a target company public."[66]

The sponsor's compensation, known as the promote, takes the form of a nominally-priced block of shares amounting to twenty-five percent of the IPO proceeds.[67] These shares are escrowed until a deal goes through, at which point the "sponsors wind up owning twenty percent of the post-acquisition company."[68] The sponsor will also purchase "SPAC warrants, shares, or both at prices the sponsor estimates to be their fair market value."[69] While the sponsor's investment "cover[s] the cost of the IPO and its operating expenses while searching for a merger target,"[70] equally important is the "skin in the game" the investment represents—"requiring the manager to invest his own money . . . aligns incentives by ensuring that he internalizes some downside costs if the fund fails to perform."[71] Should the SPAC fail to consummate a merger in time, it "must liquidate and distribute the funds in the trust to its public shareholders," resulting in the sponsor losing its investment.[72]

C. SPACS VERSUS TRADITIONAL IPOS AND PRIVATE EQUITY

The SPAC shares similarities with both traditional IPOs and traditional private equity.[73] As with a traditional IPO, the SPAC is a "public securities offering[] in which company ownership shares

---

[66] Klausner et al., *A Sober Look at SPACs*, *supra* note 46, at 237. When expected redemptions are high, SPACs can meet a target's minimum cash requirement in other ways: by securing additional investment by the sponsor or target shareholders, by making side payments to "investors that commit not to redeem their shares," or by attracting fresh "equity infusions [in] the form of private investments in public equity, or 'PIPEs.'" *Id.* at 237–38.

[67] *See id.* at 236 ("Prior to the IPO, the sponsor acquires a block of shares at a nominal price that will be adjusted to amount to 25% of IPO proceeds or, equivalently, 20% of post-IPO equity.").

[68] Rodrigues & Stegemoller, *Exit, Voice, and Reputation*, *supra* note 54, at 871.

[69] Klausner et al., *A Sober Look at SPACs*, *supra* note 46, at 236.

[70] *Id.*

[71] Rodrigues & Stegemoller, *Exit, Voice, and Reputation*, *supra* note 54, at 852–53 (noting that SPACs mimicked this contractual feature of traditional private equity to alleviate investor concerns given the potential for manager opportunism).

[72] Klausner et al., *A Sober Look at SPACs*, *supra* note 46, at 237.

[73] *See* SU, *supra* note 30 ("A SPAC IPO and a traditional IPO have similarities."); Rodrigues & Stegemoller, *Exit, Voice, and Reputation*, *supra* note 54, at 851 ("[T]he creators of SPACs attempted to translate key private equity features to the public markets . . . .").

are sold to the public for the first time."[74] "Both types of IPOs involve underwriting and SEC registration and disclosure processes" and result in a privately held company becoming a public one that trades on a major stock exchange.[75] SPACs too must file a prospectus (S-1) with the SEC prior to the IPO.[76] However, SPACs differ from traditional IPOs in a number of important ways: SPAC investors do not know the details of a future investment at the time of IPO, "SPAC IPOs are faster and face less regulatory scrutiny," and the SPAC sponsor offers a fixed price for the target company's equity shares as opposed to a flexible, market demand-based price that arises under the traditional IPO regime.[77] SPACs do not depend on the strength of the IPO market[78] and may avoid underpricing issues associated with traditional IPOs.[79]

Additionally, because the de-SPAC process is not itself an IPO, "practitioners and commentors have claimed that an advantage of SPACs over traditional IPOs is lesser securities law liability exposure for targets and the public company itself."[80] This perception relies on a reading of the PSLRA that suggests the PSLRA's safe harbor for forward-looking statements[81] "applies in

---

[74] SU, *supra* note 30.

[75] *Id.*

[76] *See* Pawliczek et al., *supra* note 63, at 2 (noting that the prospectus "can reduce information asymmetry between managers and investors by shedding light on the firm's prior performance as well as assets and obligations," but with substantially less information available for a SPAC IPO, "the traditional IPO perspective on disclosure is less applicable").

[77] SU, *supra* note 30; *see also* Rodrigues & Stegemoller, *Redeeming SPACs*, *supra* note 53, at 12 ("A SPAC goes through the traditional IPO process, but sidesteps many of the burdens of the traditional IPO.").

[78] *See* FELDMAN, *supra* note 41, at 31 ("A SPAC's IPO can take place even in a weak IPO market because of many protections offered to investors purchasing equity in the SPAC.").

[79] *See* Carol Boyer & Glenn Baigent, *SPACs as Alternative Investments: An Examination of Performance and Factors That Drive Prices*, 11 J. PRIV. EQUITY 8, 11 (2008) ("SPACs exhibit much less underpricing than regular IPOs."); Archishman Chakraborty, Simon Gervais & Bilge Yilmaz, *Security Design in Initial Public Offerings*, 15 REV. FIN. 327, 328 (2011) (positing that the SPAC's unit offering structure, with warrants that are less sensitive to low cash flow realizations, "can limit, and possibly even eliminate, the amount of money that new issuers must leave on the table to ensure the success of their offering").

[80] John Coates, *SPACs, IPOs and Liability Risk Under the Securities Laws*, SEC (Apr. 8, 2021), https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws.

[81] The PSLRA's safe harbor provision insulates issuers from liability for making forward-looking statements that are "accompanied by meaningful cautionary statements identifying

the context of de-SPAC transactions but not in conventional IPOs."[82] Safe from the threat of strict liability that accompanies forward-looking statements made during the traditional IPO process, dealmakers prize the "freedom to make forward projections" that the SPAC offers.[83]

The relationship between SPACs and traditional private equity is more nuanced.[84] "Almost every SPAC feature borrows from the playbook of the traditional private equity firm."[85] Like private equity funds, SPAC sponsors ultimately must convince investors to fork over funds "despite considerable information asymmetries (i.e., the managers know much more about the value of their talents and the venture's prospects for success than investors do) coupled with the familiar risk of agency costs (i.e., the goals of self-interested agents necessarily diverge from the interests of the principals they represent)."[86] Indeed, SPAC sponsors are "equivalent to specialized private equity general partners (GPs) with deep pockets working as ad-hoc underwriters."[87]

But in actual private equity arrangements, where managers and investors have long-term relationships in mind, reputation provides a powerful constraint against opportunism.[88] In a seminal article on venture capital, Professor Ron Gilson identified that the fund manager-portfolio company and investor-fund manager

---

important factors that could cause actual results to differ materially from those in the forward-looking statement." 15 U.S.C. § 78u-5(c)(1).

[82] Coates, *supra* note 80.

[83] Rodrigues & Stegemoller, *Redeeming SPACs*, *supra* note 53, at 4 n.19, 50. While this "freedom" is a draw for many SPAC players, others consider it a threat to investor protections. *See* Chris Bryant, *Why Chamath Palihapitiya Loves SPACs So Much*, BLOOMBERG (Jan. 28, 2021, 1:30 AM), https://www.bloomberg.com/opinion/articles/2021-01-28/why-chamath-palihapitiya-loves-spacs-so-much?sref=uC073IKU (arguing that "[i]nvestors shouldn't rely on the optimistic financial projections published by blank check companies" and that "[t]his practice needs attention from the SEC").

[84] *See* Pawliczek et al., *supra* note 63, at 1–2 (noting that, while "SPACs are similar to traditional private equity in many regards including investors providing up-front funding for unknown, future investments[,]" "there are several key differences" ranging from greater investor liquidity to "a larger incentive misalignment between investors and managers").

[85] Rodrigues & Stegemoller, *Exit, Voice, and Reputation*, *supra* note 54, at 851.

[86] *Id.* at 852.

[87] Minmo Gahng, Jay R. Ritter & Donghang Zhang, *SPACs*, (Oct. 10, 2022) (forthcoming) (manuscript at 8) https://site.warrington.ufl.edu/ritter/files/SPACs.pdf.

[88] *See* Rodrigues & Stegemoller, *Exit, Voice, and Reputation*, *supra* note 54, at 868 ("[T]he long-term relationship between investor and manager comforts the entrepreneur who fears opportunistic behavior from the [venture capital firm].").

relationships are structurally intertwined: "contracting problems posed by extreme uncertainty, information asymmetry, and agency costs . . . [are moderated] through the *braiding* of the two contracts."[89] Braiding describes the way that both relationships "provide an implicit term that supports the other . . . thereby increasing the contractual efficiency of both."[90] Scale and scope economies,[91] central to the private equity model, create "an emphasis on reputation that has ripple effects for both targets and fund investors."[92] "SPACs, in contrast, are one-shot deals" between sponsors and largely anonymous public investors.[93] Unable to employ scale or scope economies, SPAC sponsors must instead rely on managerial or operational expertise to differentiate themselves.[94] So while reputation influences the SPAC market to some extent,[95] given that repeat sponsors can tap into learning-

[89] Ronald J. Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 STAN. L. REV. 1067, 1091 (2003) (emphasis added).

[90] *Id.* According to Professor Gilson's braiding theory, fund managers recognize that "behav[ing] opportunistically towards entrepreneurs in connection with previous portfolio company investments" will sully their reputation in the eyes of other entrepreneurs seeking investments. *Id.* at 1092. "[Losing] access to the best new investments . . . . will make raising successor funds more difficult." *Id.* The manager thus has a strong incentive to treat current portfolio companies well because acting in the best interest of the portfolio company and the investors (rather than maximizing the manager's own interest in the present deal) "results in higher returns to investors," encouraging them to reinvest in the manager's future deals. *Id.* The fund manager-portfolio company and investor-fund manager relationships are thus "braided": reputation and behavior in one relationship influence and are influenced by the other. *See id.* ("Again, the interaction between the two contracts supports the efficiency of each.").

[91] "Scale economies exist if the unit cost of production and distribution of a product or service declines as volume increases. . . . Scope economies exist if unit costs decline if multiple products or services are produced simultaneously (for example, if more than one fund is managed at a time)." William A. Sahlman, *The Structure and Governance of Venture-Capital Organizations*, 27 J. FIN. ECON. 473, 500 (1990). "Operating different funds within the same family creates scope economies. . . . [M]anaging multiple funds takes advantage of any scale or scope economies." Rodrigues & Stegemoller, *Exit, Voice, and Reputation*, *supra* note 54, at 869.

[92] Rodrigues & Stegemoller, *Exit, Voice, and Reputation*, *supra* note 54, at 868–69.

[93] *Id.* at 901.

[94] *See* Rodrigues & Stegemoller, *Redeeming SPACs*, *supra* note 53, at 12 ("SPACs seek to differentiate themselves by managerial expertise, industries they will target, operational expertise, and the like.").

[95] *See* Pawliczek et al., *supra* note 63, at 3 ("[I]nvestors may consider the reputation of the sponsors in assessing the likelihood a SPAC will execute a profitable acquisition."); Crystal Kim, *Serial SPAC Sponsors Hunt Bigger Game, Draw Greater Confidence*, BLOOMBERG (Sept.

curve effects,[96] reputation's *structural* absence from the SPAC transaction limits the role it plays in constraining agency costs.[97] Whereas SPAC participants once looked to "voice"[98] to fill that role, incentive structures and time constraints now largely bear that burden.[99]

SPACs and traditional private equity models both employ managerial incentive compensation structures, with the twenty percent promote received by SPAC sponsors mirroring the twenty percent carried interest common to both venture capital and leveraged buyout fund managers.[100] However, two key differences

---

21, 2021, 10:23 AM), https://www.bloomberg.com/news/articles/2020-09-21/serial-spac-sponsors-hunt-bigger-game-draw-greater-confidence (stating that "multi-generation SPACs are the most sought after among investors because they are proven commodities" and attributing the "relative bigness" of recent SPACs to "investor confidence in serial sponsors such as [Chamath] Palihapitiya, Michael Klein, and Bill Foley").

[96] "Learning-curve effects exist if the unit cost of a process declines over time with accumulated volume." Sahlman, *supra* note 91, at 500. In the private equity context, "venture-capital firms become repositories of useful institutional knowledge" and "benefit from learning-curve effects as . . . . [t]hey cultivate a deal flow based on networks of contacts and relationships," thus developing "a reputation that has economic value." *Id.; cf.* Chen Lin, Fangzhou Lu, Roni Michaely & Shihua Qin, *SPAC IPOs and Sponsor Network Centrality* 3, 7 (June 8, 2021) (unpublished manuscript) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3856181 (finding that SPACs organized by sponsors with high-quality networks "are associated with larger IPO proceeds, higher M&A success probability, higher long-run stock return, and better operational performance," where SPAC sponsor network quality "takes time to build and assumes some trust and recognition of success" to signal a sponsor's "maturity and reputation in a more general sense").

[97] *See* Rodrigues & Stegemoller, *Exit, Voice, and Reputation*, *supra* note 54, at 919 ("The 'one-shot deal' nature of the SPAC removed the reputation constraint on fund managers, and the public nature of the markets eliminated the reputational constraint on investors."); *see also* Andrew Ross Sorkin, *How to Fix SPACs: Keep Their Backers Locked in Longer*, N.Y. TIMES (Mar. 3, 2021), https://www.nytimes.com/2021/03/31/business/dealbook/spac-sponsors.html (highlighting that even serial sponsors, like Palihapitiya, structure SPAC deals that "suggest they don't intend to be long-term investors," allowing them to "exit long before any of [the projections they make to attract investors] are ever realized or, in many cases, missed").

[98] *See supra* notes 64–65 and accompanying text.

[99] *See* Rodrigues & Stegemoller, *Exit, Voice, and Reputation*, *supra* note 54, at 922, 924 (concluding that, "[w]hile [voting] rights may have seemed good in theory," their rejection by "a highly competitive market" evidenced their expendability in light of other SPAC features, including "the short timeline" and the "80% in trust account requirement" that provides investors a safe exit).

[100] *See id.* at 892 ("As originally conceived, SPAC sponsors, like traditional private equity managers, received around 20% of the venture's profits.").

materially shift the resulting incentives. First, while private equity managers receive the bulk of their compensation via carried interest, they also receive salaries and management fees; SPAC managers do not.[101] Second, private equity managers only receive their "Magic 20"—the typical promote—[102] "upon realization of profit (i.e. upon sale or IPO of that company)," whereas "SPAC sponsors are rewarded for the mere fact of acquisition[,]" which triggers the release of their shares from escrow.[103] As a result, SPAC sponsors are motivated "to pursue a business combination at all costs."[104] Further, empirical evidence shows that this "at all costs" mentality may be multiplicative when SPAC IPO underwriter fees are only paid upon the successful completion of a merger.[105]

While SPACs and traditional private equity each have "a built-in fund life,"[106] their terms differ dramatically: private equity funds usually originate with a ten-year lifespan,[107] while SPAC lifespans are typically limited to two years.[108] This disparity likely exists because "the time limit constraint necessarily functions differently in the SPAC, where ownership is liquid, than in the private venture or buyout fund."[109] Whereas traditional private equity funds are time constrained "both to discipline managers and to provide liquidity," the term limit on publicly traded (and thus fully liquid)

---

[101] *See id.* at 893 (noting that, unlike private equity managers, SPAC managers "receive nothing unless and until a deal is consummated").

[102] *See supra* note 67–68 and accompanying text.

[103] Rodrigues & Stegemoller, *Exit, Voice, and Reputation*, *supra* note 54, at 893–94.

[104] *Id.* at 892; *see also* SU, *supra* note 30 ("Some believe that because of the pressure to construct a de-SPAC within a specified period of time, some SPAC sponsors, in order to book the promote, may be more interested in getting any deal done (rather than getting a good deal done)."); Rodrigues & Stegemoller, *Redeeming SPACs*, *supra* note 53, at 4 ("Every major player in the SPAC is incentivized to find a target and take it public, *even if it is a value-destroying transaction*.").

[105] *See* Dimitrova, *supra* note 61, at 100 (finding that SPACs perform worse when underwriter fees are deferred and paid upon merger completion, "suggesting that underwriters with an interest in a deal being completed, regardless of its quality, are more likely to pitch bad deals to SPAC sponsors").

[106] Rodrigues & Stegemoller, *Exit, Voice, and Reputation*, *supra* note 54, at 898.

[107] *See id.* (establishing that "[v]enture funds are usually ten years in length" with optional annual extensions available for up for to three years and that "[p]rivate equity funds follow this pattern").

[108] *See* Dimitrova, *supra* note 61, at 102 ("The founders normally have only 18 months from the date of the IPO to make an acquisition, plus a six-month grace period if a deal is announced but not completed by then.").

[109] Rodrigues & Stegemoller, *Exit, Voice, and Reputation*, *supra* note 54, at 899.

SPAC shares serves only to "limit the amount of time managers have the trust account at their disposal."[110] "Without [these limits], investors might worry that managers will simply sit on the money indefinitely; a limited lifespan thus increases the value of the trust fund to investors."[111] Still, the ticking clock naturally creates incentives—potentially perverse ones.[112] Coupled with the requirement that a SPAC sponsor use at least eighty percent of assets on prospective deals,[113] sponsors may not just rush deals but also overpay for them.[114]

One perceived difference between SPACs and traditional private equity is the SPAC's accessibility to retail investors.[115] Whereas most private equity and venture capital funds "typically only allow participation from individuals who are accredited investors,"[116]

---

[110] *Id.* at 899–900.

[111] *Id.* at 900.

[112] *See* Dimitrova, *supra* note 61, at 113 ("Knowing that they have to close an acquisition to collect their compensation, and being pressured under the two-year time constraints, SPAC founders might be encouraged to make unsuitable acquisitions."); William D. Cohan, *SPACs Are an Inside Joke on Wall Street, and the Joke Is on You*, FAST COMPANY (Mar. 4, 2021), https://www.fastcompany.com/90610373/spacs-are-an-inside-joke-on-wall-street-and-the-joke-is-on-you ("The ticking SPAC clock creates a number of perverse incentives, the worst of which is that SPAC sponsors may end up competing for increasingly immature companies to take public."); *cf.* Ulf Axelson, Per Strömberg & Michael S. Weisbach, *Why Are Buyouts Levered? The Financial Structure of Private Equity Funds*, 64 J. FIN. 1549, 1551 (2009) (arguing that private equity general partners sitting on untapped funds towards the end of the investment horizon are incentivized "to 'go for broke' and take bad deals").

[113] *See supra* text accompanying note 61. In some rare cases, SPACs may attempt to simultaneously acquire multiple targets, but "the most common approach is the acquisition of a single target." Dimitrova, *supra* note 61 at 102.

[114] *See* Dimitrova, *supra* note 61, at 113 (highlighting that sponsors may use the eighty percent threshold "as an anchor in their decision when they evaluate potential target" or may find it more convenient to overpay for a smaller target instead of bidding to acquire a large target and risk diluting their ownership).

[115] *See* Steven M. Davidoff, *Black Market Capital*, 2008 COLUM. BUS. L. REV. 172, 227–28 ("[T]he SPAC phenomenon has been publicly attributed and promoted as a private equity substitute, one the public can now freely access."); Andrew Ross Sorkin, *The Poor Man's Private Equity: Gambling on Unknown IPOs*, N.Y. TIMES (Feb. 12, 2008), https://www.nytimes.com/2008/02/12/business/worldbusiness/12iht-deal.1.9962658.html (describing a SPAC as a "publicly traded buyout fund" where "Average Joes finally get access to Masters of the Universe—at least that is the sales pitch").

[116] To qualify as an accredited investor, an individual must have "a net worth over $1 million or an individual income of $200,000 in the past year, with a reasonable expectation of the same in the coming year." Rodrigues & Stegemoller, *Exit, Voice, and Reputation*, *supra* note 54, at 861.

publicly traded SPACs invite investment by "non-accredited mom-and-pop investors."[117] Thus, SPACs have been billed as the "poor man's private equity"[118]—a way to democratize capitalism by breaking the chokehold of the investment banks on the traditional IPO.[119] Indeed, references to SPACs as the "poor man's private equity funds" have proliferated,[120] even as that characterization has come under fire.[121] But recent research paints a far less egalitarian picture, revealing that large funds tend to dominate the pre-acquisition SPAC market and crowd out retail participation.[122] Even the major exchanges have recognized that the SPAC's "intrinsic features . . . limit the number of retail investors interested in the vehicle."[123] Regardless of the extent of retail participation at the SPAC IPO stage, it is now clear that the majority of recent SPAC IPO investors are not investing in SPACs as a form of private equity.[124] Investors who buy shares following a merger announcement are simply "investing in the target company, just as

---

[117] *Id.* at 861, 866, 870.

[118] *Id.* at 874.

[119] Rodrigues & Stegemoller, *Redeeming SPACs*, *supra* note 53, at 2 ("Proponents tout [the SPAC's] ability to allow early-stage companies to access the public capital markets while simultaneously democratizing capitalism.").

[120] *See* Sorkin, *supra* note 115 (calling SPACs "the poor man's private equity" first); Shuli Ren, *SPACs Are Hot Because They Are the "Poor Man's Private Equity Funds*,*"* BLOOMBERG BUSINESSWEEK (Mar. 2, 2021, 5:00 AM), https://www.bloomberg.com/news/articles/2021-03-02/why-spacs-are-so-popular-they-re-the-poor-man-s-private-equity-funds (stating that "[t]hese 'poor men,'" i.e., retail investors, "account for about 40% of SPAC trading on BofA Securities Inc.'s trading platforms").

[121] *See* Deane, *supra* note 58 (noting that Professor Klausner and his co-authors' finding—that there is minimal overlap between a SPACs initial investors and those who stay invested in the post-merger company—"in itself challenges the idea that SPACs are a poor man's private equity").

[122] *See* Klausner et al., *A Sober Look at SPACs*, *supra* note 46, at 241 ("Investors in SPAC IPOs are almost entirely large institutional investment managers affiliated with hedge funds . . . .").

[123] SEC Notice of Filing of NYSE Proposed Rule Change, Securities Act Release No. 82180, 82 Fed. Reg. 57,632, 57,633 (Dec. 6, 2017); *accord* Notice of Filing of NASDAQ Proposed Rule Change, Securities Act Release No. 81816, 82 Fed. Reg. 47,269, 47,269 (Oct. 11, 2017) (reporting substantially similar observations by the NASDAQ).

[124] *See* Klausner et al., *A Sober Look at SPACs*, *supra* note 46, at 245 ("This pattern of IPO investment and subsequent divestment, followed by the attraction of new equity investment at the time of a merger shows that SPAC IPOs and SPAC mergers are essentially independent of one another."); Deane, *supra* note 58 ("[P]rivate equity investors typically have five-to-seven-year holding periods, while recent history suggest SPACs are a trader's vehicle.").

any investor would invest in any other public company. The 'private equity' element is no longer present."[125]

It is the post-announcement, pre-merger investor—more likely to be a retail participant at this stage[126]—who pays the substantial hidden cost of the SPAC: dilution.[127] This dilution flows from three primary sources: the sponsor's promote,[128] underwriting costs,[129] and the warrants retained by SPAC IPO investors who redeem their shares pre-merger.[130] While SPAC underwriting fees ("typically 5.5% of IPO proceeds") are nominally lower than fees charged for a traditional IPO of comparable size, they are not discounted for share redemptions in any way.[131] Share redemptions strip the merger target of the very cash benefits the underwriting fees are charged to provide.[132] Accounting for redemptions, SPAC underwriting fees can be comparatively high.[133] But the real kicker comes from the warrants retained by redeeming shareholders: for every share redeemed, a warrant is effectively given out for free.[134] While all warrants are ultimately dilutive in the SPAC structure, it is the redemptions that "amplify the effects of dilution" by leaving fewer

[125] Klausner et al., *A Sober Look at SPACs* Working Paper, *supra* note 63, at 18.

[126] *See* SEC, INVESTOR ADVISORY COMMITTEE, DRAFT RECOMMENDATIONS OF THE INVESTOR AS PURCHASER AND INVESTOR AS OWNER SUBCOMMITTEES OF THE SEC INVESTOR ADVISORY COMMITTEE REGARDING SPECIAL PURPOSE ACQUISITION COMPANIES 4 (Aug. 26, 2021), https://www.sec.gov/spotlight/investor-advisory-committee-2012/draft-recommendation-of-the-iap-and-iao-subcommittees-on-spacs-082621.pdf (noting that the SPAC market has recently seen "[i]ncreased participation of retail investors prior to the de-SPAC transaction").

[127] Klausner et al., *A Sober Look at SPACs*, *supra* note 46, at 253 ("[N]onredeeming SPAC shareholders tend[] to bear most of the cost [of dilution] embedded in SPACs.").

[128] *See supra* notes 67–68 and accompanying text.

[129] Underwriting costs include inducements in the form of "new private placement deals on attractive terms, including discounted prices, side payments, or both" that SPACs often pay to replenish the cash stripped by redemptions. Deane, *supra* note 58.

[130] *See* Klausner et al., *A Sober Look at SPACs*, *supra* note 46, at 246–54 (describing and quantifying these costs "extracted by parties other than the principals to the SPAC's ultimate investment transaction"—i.e., "the SPAC shareholders[] and the target and its shareholders"—that "reduce the amount of net cash per share that a SPAC will contribute in its merger").

[131] *Id.* at 250.

[132] *See id.* at 250–51 ("[T]o the extent SPAC shares have been redeemed and the cash has been returned, the underwriting fee represents depleted cash that has generated no benefit for the post-merger company.").

[133] *See id.* at 250 ("For example, if 50% of a SPAC's public shares are redeemed, the effective fee is 11%.").

[134] *See id.* at 298. ("Warrants and rights are issued for free to IPO investors . . . .").

SPAC investors to bear the cost of the dilution "on a per-share basis."[135] Given the extent of typical redemptions,[136] the ultimate costs of dilution borne by post-announcement, pre-merger investors can be staggeringly high.[137]

We are left with a portrait of the modern SPAC that is messy at best and possibly downright bleak—a far cry from the "pretty picture" some SPAC participants paint.[138] SPACs may grant faster access to public markets[139]—or they may not.[140] SPACs may offer greater price and deal certainty compared to IPOs[141]—or they may

---

[135] *Id.* at 232–33.

[136] *See* Deane, *supra* note 58 ("The 'Sober Look' study [by Professor Klausner and his co-authors] . . . analyz[ing] all 47 SPACs with mergers from January 2019 to June 2020 . . . found that a median of 73% of IPO proceeds were returned to investors who redeemed their shares (but kept their warrants).").

[137] *See id.* (contrasting Professor Klausner and his co-authors' study's findings of an 11.6% mean annualized return for redeeming IPO investors versus a *negative* thirty-five percent twelve-month mean return for post-merger investors, significantly lagging the Russell 2000 and IPO Index benchmarks); Klausner et al., *A Sober Look at SPACs*, *supra* note 46, at 269 ("The median SPAC cost as a percent of cash delivered is 62%—more than twice as high as the median IPO cost of 28%.").

[138] *See The Art of the SPAC: From Sublime to Ridiculous*, REUTERS (May 6, 2021, 9:45 AM), https://www.reuters.com/breakingviews/art-spac-sublime-ridiculous-2021-05-06/ ("If beauty is in the eye of the beholder, those with a hand in the SPAC market are seeing quite a pretty picture.").

[139] *See supra* note 77 and accompanying text; FELDMAN, *supra* note 41, at 29 (explaining that the reverse merger process "is much faster than a typical IPO, which usually takes nine to twelve months from start to finish, and can easily take longer" because "they are accomplished in fewer steps and with virtually no regulatory interference").

[140] *See* GERRY SPEDALE & ERIC PACIFICI, LAW360, 9 FACTORS TO EVALUATE WHEN CONSIDERING A SPAC (Mar. 11, 2019, 2:13 PM), https://www.gibsondunn.com/wp-content/uploads/2019/03/Spedale-Pacifici-9-Factors-To-Evaluate-When-Considering-A-SPAC-Law360-03-11-2019.pdf (explaining that there is typically no significant timing difference between a traditional IPO and a SPAC because, "[w]hile the IPO of a SPAC is considerably faster than an operating company" due to minimal disclosures necessary, "the acquisition by a SPAC of a target company takes a similar period of time as an IPO of the same entity would"); *see also* Klausner et al., *A Sober Look at SPACs*, *supra* note 46, at 278 ("[I]f different types of firms are going public via SPACs versus IPOs, then differences in speed may have more to do with the specifics of the firms rather than the SPAC versus IPO process."); Kolb & Tyková, *supra* note 40, at 93 ("[O]ur findings suggest that SPAC acquisitions may take longer to execute than IPOs . . . .").

[141] *See supra* note 47 and accompanying text; *see also* Rodrigues & Stegemoller, *Redeeming SPACs*, *supra* note 53, at 15 (comparing the de-SPAC, where a signed merger agreement assures the target it will go public at a specific price, versus traditional IPOs, where the underwriting bank controls the process and may abort an IPO if doubts arise during the due-diligence process, during the book-building and roadshow stage, or "through no fault of the

not.[142] SPACs may avoid underpricing issues[143]—or they may simply obscure them.[144] SPACs may offer promoters greater regulatory freedom by allowing forward-looking projections that fall under the PSLRA's safe harbor provision[145]—but perhaps not for much longer.[146] SPACs may provide entrepreneurs a cheaper alternative by which to take their company public than the traditional IPO[147]—with any cost savings likely coming at the SPAC investor's expense.[148] The only thing clear about the modern SPAC's value proposition is that it is unclear.[149]

---

company, the IPO 'window' closes (that is, if market conditions are judged not to be receptive)").

[142] *See* Klausner et al., *A Sober Look at SPACs*, *supra* note 46, at 274–77 (finding claims that SPACs deliver greater price and deal certainty compared to IPOs overstated); Matt Levine, Opinion, *Morgan Stanley Lost Some Hard Drives*, BLOOMBERG (Sept. 20, 2022, 1:25 PM), https://www.bloomberg.com/opinion/articles/2022-09-20/morgan-stanley-lost-some-hard-drives (noting that "[w]ith SPACs . . . you get certainty of price but not of proceeds" because "SPAC deals often involve very high redemption rates"; by contrast, "[i]f you do an IPO you might get a worse price, but you have better odds of getting the money").

[143] *See supra* note 79 and accompanying text.

[144] *See* Matt Levine, Opinion, *SPACs Aren't Cheaper Than IPOs Yet*, BLOOMBERG (July 27, 2020, 11:59 AM), https://www.bloomberg.com/opinion/articles/2020-07-27/spacs-aren-t-cheaper-than-ipos-yet (positing that after accounting for warrant dilution, "SPACs do not avoid the underpricing effect of IPOs; they probably exacerbate it"); Gahng et al., *supra* note 87, at 7 (establishing that SPACs suffer from "the indirect costs of underpricing" just like traditional IPOs do).

[145] *See supra* notes 80–83 and accompanying text

[146] *See* SEC Proposed Rules, *supra* note 9, at 29,481–83, 29,567 (proposing a rule eliminating PSLRA safe-harbor protections as they apply to the de-SPAC transaction and substantially extending underwriter liability to cover any party who "takes steps to facilitate" or "otherwise participates (directly or indirectly) in the de-SPAC transaction").

[147] *See* Kolb & Tykvová, *supra* note 40, at 83 (citing studies that show "reverse mergers may offer the firm they acquire a faster public listing at lower costs than an IPO would" and "that underpricing is substantially lower for reverse mergers than for IPOs").

[148] *See supra* notes 126–137 and accompanying text; *see also* Gahng et al., *supra* note 87, at 8 ("[A] SPAC is substantially more expensive than pursuing a traditional IPO, both in terms of the total cost as a fraction of the cash raised and as a fraction of the post-issuance market capitalization.").

[149] *See* Klausner et al., *A Sober Look at SPACs*, *supra* note 46, at 274 (arguing that while some SPAC-facilitated "price discovery mechanisms may be attractive," alternative structures could achieve those benefits "without the costs embedded in SPACs").

III. THE SPARC OF AN IDEA

A. SPARC IS BORN

Bill Ackman had a tough summer in 2021.[150] A year earlier, in July 2020, Ackman was riding high, having just raised $4 billion for his PSTH SPAC—by far the largest SPAC in history.[151] PSTH was not your typical SPAC.[152] Wholly foregoing the typical twenty percent promote, Ackman's hedge fund, Pershing Square Capital Management (Pershing Square) invested $65 million[153] in PSTH for warrants that were twenty percent out of the money[154] and not saleable or exercisable for three years following a merger.[155] Ackman essentially flipped the script: normally, it is the SPAC shareholders who "do not receive any [compensation] until after the company receives a 20% return," but under PSTH's "warrant-only compensation structure," it was Pershing Square who would receive nothing until shareholders registered a twenty percent gain.[156]

Ackman's next move was no more conventional. After nearly a year of searching for a merger target, PSTH announced "a SPAC deal like no other" in early June 2021: PSTH would put $4 billion towards a ten percent stake in Universal Music Group (UMG), home of artists like Taylor Swift, Ariana Grande, and Lady Gaga.[157] Not content with merely executing the largest SPAC merger ever, Ackman's deal was highly complex, with PSTH set to "fission into

---

[150] *See Out of Bill Ackman's SPAC Woes Comes Innovation*, ECONOMIST (Aug. 28, 2021), https://www.economist.com/finance-and-economics/out-of-bill-ackmans-spac-woes-comes-innovation/21803915 (chronicling the "bevy of ghosts"—including regulators and litigious shareholders—that chased Ackman following the proposed merger announced by his SPAC in June 2021).

[151] *Id.*

[152] *See* Kenneth Squire, *Bill Ackman and Tontine Holdings Rewrite the Terms for SPACs*, CNBC (Jul. 22, 2020, 7:05 AM), https://www.cnbc.com/2020/07/22/bill-ackman-and-tontine-holdings-rewrite-the-terms-for-spacs.html ("The structure of [PSTH] is unique on many different levels.").

[153] Pershing Square Tontine Holdings, Ltd., Current Report (Form 8-K) Ex. 4.3 at 2 (July 21, 2020).

[154] *Id.* Ex. 4.3 at 5.

[155] *Id.* Ex. 4.3 at 4.

[156] Squire, *supra* note 152.

[157] Andrew Ross Sorkin et al., *Bill Ackman's SPAC May Have Found a Dance Partner*, N.Y. TIMES (June 4, 2021), https://www.nytimes.com/2021/06/04/business/dealbook/ackman-spac-universal.html.

three SPAC-like things": a distribution of Universal shares; the creation of a new SPAC, dubbed Remainco, with the $1.5 billion of remaining PSTH capital;[158] and a warrant that would grant existing investors rights to buy into yet another future deal.[159] Perhaps the most bizarre facet of the deal was that Vivendi, UMG's parent company, was in the process of spinning off the subsidiary later that year, meaning Ackman planned to use SPAC capital to purchase a company that was already going public on its own.[160] Once-excited investors[161] were not enthused as PSTH shares plummeted on the heels of the deal announcement.[162] Nor was the SEC, who "privately took issue with several elements of the proposed deal," including whether the transaction met NYSE SPAC rules, which Ackman called "a deal killer."[163] In light of the regulatory concerns, Ackman nixed the Universal proposal in a letter to shareholders on July 19, 2021, and pledged to return PSTH to the straight and narrow path followed by a typical SPAC.[164]

But the dog days of summer were not yet over for Ackman—on August 17, 2021, PSTH was hit with a lawsuit.[165] Backed by Yale

[158] Squire, *supra* note 152 (explaining that Pershing Square invested $1.5 billion in PSTH upon formation, bringing its total capitalization to $5.5 billion).

[159] Matt Levine, Opinion, *SPACs Can Shoot Out SPARCs*, BLOOMBERG (June 7, 2021, 12:44 PM) [hereinafter Levine, *SPACs Can Shoot Out SPARCs*], https://www.bloomberg.com/opinion/articles/2021-06-07/spacs-can-shoot-out-sparcs.

[160] *See Out of Bill Ackman's SPAC Woes Comes Innovation*, *supra* note 150 ("This was an unusual use of SPAC capital: it would spend only some of the vehicle's funds, and planned to buy shares in a firm that was already going public.").

[161] *See* Klausner et al., *A Sober Look at SPACs*, *supra* note 46, at 53 ("Shortly after its IPO, [PSTH]'s shares rose to about 15% above their IPO price and have remained there—something exceptionally rare among other SPACs.").

[162] *See* Andrew Ross Sorkin et al., *Bill Ackman's Deal Machine Must Try Again*, N.Y. TIMES (July 19, 2021), https://www.nytimes.com/2021/07/19/business/dealbook/ackman-spac-universal.html (noting that PSTH shares had lost nearly a fifth of their value since the deal was announced, with Ackman commenting, "[w]e underestimated the reaction that some of our shareholders would have to the transaction's complexity and structure").

[163] *Bill Ackman on Pulled SPAC: New SEC Concerns Killed Universal Music Deal*, CNBC (July 19, 2021, 8:30 AM), https://www.cnbc.com/video/2021/07/19/bill-ackman-on-pulled-spac-new-sec-concerns-killed-universal-music-deal.html.

[164] *See* Letter from William A. Ackman, CEO, Pershing Square Tontine Holdings, Ltd., to Pershing Square Tontine Holdings, Ltd. S'holders (July 19, 2021) ("In light of our recent experience, our next business combination will be structured as a conventional SPAC merger.").

[165] *See* Lauren Silva Laughlin, *Bill Ackman's SPAC Is a Treat That Is Going Moldy*, REUTERS (Aug. 19, 2021, 1:50 PM), https://www.reuters.com/breakingviews/bill-ackmans-

securities law Professor John Morley and former SEC Commissioner Robert Jackson (now of New York University School of Law)[166], plaintiff George Assad claimed PSTH violated the Investment Company Act of 1940[167] (ICA) and the Investment Advisers Act of 1940[168] (IAA).[169] Assad asserted that by "invest[ing] all of its assets in securities of the United States government and shares of money market mutual funds," which was "all the Company [had] ever done," "PSTH is an investment company under the ICA because its primary business is to invest in securities."[170] Professors Morley and Jackson stated that the suit targeted PSTH because of its "uniquely byzantine compensation structure" and "the striking commonality between the SPAC and Ackman's hedge fund business, which is regulated as an investment company."[171] In reality, the suit targeted the entire SPAC universe by implication given that the alleged wrongful conduct (holding Treasuries from inception until merger consummation) is standard industry practice.[172] Had the suit succeeded, SPACs would have likely had to register as

---

spac-is-treat-that-is-going-moldy-2021-08-19/ (reporting on the suit targeting PSTH for "act[ing] like an investment vehicle rather than an acquisition company").

[166] On Jan. 16, 2020, Professor Jackson announced his resignation as SEC Commissioner "on Feb. 14 to teach at New York University School of Law." Paul Kiernan, *SEC Commissioner Jackson Resigns to Return to Law School Teaching Position*, WALL ST. J. (Jan. 16, 2020, 9:00 AM), https://www.wsj.com/articles/sec-commissioner-jackson-resigns-to-return-to-law-school-teaching-position-11579183208.

[167] 15 U.S.C. § 80a–1 to –64.

[168] *Id.* § 80b–1 to –21.

[169] *See* Laughlin, *supra* note 165 (identifying the parties behind the suit).

[170] Complaint at 4, Assad v. Pershing Square Tontine Holdings, Ltd., 21-cv-06907 (S.D.N.Y. filed Aug. 17, 2021).

[171] Breanna Bradham & Scott Deveau, *Ackman SPAC Hit with Investor Suit Questioning Its Legality*, BLOOMBERG (Aug. 17, 2021, 10:35 AM), https://www.bloomberg.com/news/articles/2021-08-17/pershing-square-spac-hit-with-suit-questioning-its-legality?sref=1kJVNqnU.

[172] *See id.* ("Usha Rodrigues, a professor of securities law at the University of Georgia, called the lawsuit's argument 'bold' and said it challenged the very model on which SPACs are premised."). Indeed, the major players in M&A took this lawsuit (along with two follow-up suits against three more conventional SPACs, E.Merge Technology Acquisition Corporation. And GO Acquisition Corporation) as a challenge to the entire SPAC model, with forty-nine BigLaw firms cosigning a joint statement rebutting the plaintiff's proposed legal theory. *See* Alison Frankel, *49 Firms in 72 Hours: How the SPAC Bar United Against Law Profs' Splashy Lawsuits*, REUTERS (Aug. 30, 2021, 4:30 PM), https://www.reuters.com/legal/litigation/49-firms-72-hours-how-spac-bar-united-against-law-profs-splashy-lawsuits-2021-08-30/ (detailing the "shockingly fast SPAC defense rally" by the "SPAC bar").

investment funds—"[g]iven the resulting onerous disclosure requirements and fee caps, this could [have] kill[ed] SPACs altogether."[173] While Assad has since dropped the suit,[174] the legal attack on the SPAC structure presaged the SEC's disclosure-related rules proposal aimed at taking out the SPAC's knees with a different blunt instrument.[175]

At the very least, the lawsuit killed PSTH.[176] But out of the ashes jumped a SPARC.[177] Ackman moved full speed ahead with the third

---

[173] *Out of Bill Ackman's SPAC Woes Comes Innovation*, *supra* note 150; *see also* Bradham & Deveau, *supra* note 171 (quoting Professor Rodrigues as stating "[i]t could be a very big deal, if the court accepts the arguments").

[174] *See* Elaine Briseño, *Pershing Square Investor Drops Suit over SPAC Status*, LAW360 (July 13, 2022, 2:38 PM), https://www.law360.com/articles/1511141 (reporting that Assad agreed to dismiss the complaint on July 12, 2022, after PSTH decided to cease operations and return investor capital).

[175] *See* SEC Proposed Rules, *supra* note 9, at 29,573–74 (proposing rules that would create a safe harbor that exempts SPACs that meet certain conditions from "be[ing] deemed to be an investment company" under the 1940 Act); *see also* Peirce, *supra* note 9 (questioning whether requiring SPACs to "adhere[] to the conditions of the safe harbor, some of which will add expense or decrease the SPAC's negotiating leverage and increase conflicts, [will] benefit investors or harm them"); PAUL A. SWEGLE, COMMENT, COMMENTS ON PROPOSED RULES REGARDING SPECIAL PURPOSE ACQUISITION COMPANIES, SHELL COMPANIES, AND PROJECTIONS 4 (Apr. 9, 2022) [hereinafter Swegle Comment], https://www.sec.gov/comments/s7-13-22/s71322-20124063-280193.pdf ("Contrary to statements suggesting that the SEC simply wants to level the playing field between traditional IPOs and SPACs, the SEC's proposed blunt instruments seem closer in design and intent to the baton wielded by Tonya Harding's crew against Nancy Kerrigan."). Professors Morley and Jackson continued their anti-SPAC crusade by submitting one of the lone comments calling for the SEC to "promptly finalize the rule," by adding that the SEC "should further clarify that noncompliant SPACs are investment companies," and by shaking their fists at existing SPACs that have not complied with the not-yet-effective proposed safe harbor conditions. ROBERT J. JACKSON, JR. & JOHN MORLEY, COMMENT, COMMENTS ON SPECIAL PURPOSE ACQUISITION COMPANIES, SHELL COMPANIES, AND PROJECTIONS 1–2 (June 13, 2022), https://www.sec.gov/comments/s7-13-22/s71322-20131092-301127.pdf.

[176] *See* Letter from William A. Ackman, CEO, Pershing Square Tontine Holdings, Ltd., to Pershing Square Tontine Holdings, Ltd. Shareholders 1 (Aug. 19, 2021) [hereinafter Aug. 2021 Ackman Letter] (calling the lawsuit "meritless," but admitting that "the nature of the suit and our legal system make it unlikely that it can be resolved in the short term" and that "our ability to complete a transaction in the required time frame has been impaired by the lawsuit"); Pershing Square Tontine Holdings, Ltd., Current Report (Form 8-K) Ex. 99.2 (July 11, 2022) ("[W]e are returning our $4 billion of capital in trust to shareholders as we have been unable to consummate a transaction that both meets our investment criteria and is executable.").

[177] *See* Aug. 2021 Ackman Letter, *supra* note 176 ("All is not lost, however . . . . [W]e have been working on obtaining approval for the launch of Pershing Square SPARC Holdings, Ltd.

part of his fission experiment,[178] characterizing his proposed special purpose acquisition rights company as "a modified opt-in (rather than the current opt-out) SPAC structure where investors in PSTH would receive long-dated, transferable SPARC warrants to acquire common stock in SPARC[,]" which he expects to be traded on the NYSE.[179] "The SPARC warrants would not be exercisable, and warrant holders would not need to invest their capital, until SPARC has identified a merger target, completed due diligence, entered into and approved a transaction, and cleared a registration statement with the SEC . . . provid[ing] full disclosure . . . ."[180] Ackman advised that, because "current NYSE listing rules for warrants require that the shares into which the warrants are exercisable be listed," issuance of SPARC warrants requires an SEC-approved NYSE rule change.[181] To that end, Ackman indicated he was working closely with the NYSE, which had already drafted a new rule[182] that Ackman was confident would earn the SEC's approval.[183] On August 24, 2021, the NYSE filed the proposed rule change that would have permitted the listing of Subscription Warrants with a ten-year lifespan.[184]

('SPARC')."). And despite the roadblocks that the SEC has put in his way in the interim, "Ackman is still trying to launch his SPARC" having "filed a revised registration statement with the SEC on June 16," 2022. Michelle Celarier, *Bill Ackman's Long-Running SPAC Drama Is Finally Over. Or Is It?*, INSTITUTIONAL INV. (July 13, 2022), https://www.institutionalinvestor.com/article/b1ywsnp631118z/Bill-Ackman-s-Long-Running-SPAC-Drama-Is-Finally-Over-Or-Is-It.

[178] *See supra* text accompanying note 159.

[179] Aug. 2021 Ackman Letter, *supra* note 176.

[180] *Id.*

[181] *Id.*

[182] *See* Pershing Square Tontine Holdings, Ltd., Current Report (Form 8-K) Ex. 99.1 (Aug. 24, 2021) ("[T]he NYSE has already drafted a new rule that if approved by the SEC would allow the SPARC warrants to be listed on the Exchange.").

[183] *See id.* ("We believe that the investor-friendly features of SPARC should facilitate SPARC's approval within a reasonable time frame, that is in months, not years."); Svea Herbst-Bayliss, *Ackman Seeks SPAC Relaunch to Fix Lawsuit's "Harm,"* REUTERS (Aug. 19, 2021, 11:08 PM), https://www.reuters.com/business/ackman-seeks-spac-relaunch-fix-lawsuits-harm-2021-08-20/ (quoting Ackman about the SPARC's approval: "I am confident that we will get it done").

[184] Notice of Filing of NYSE Proposed Rule Change, Securities Act Release No. 9287686 Fed. Reg. 50,748, 50,748–49 (Sept. 10, 2021) [hereinafter NYSE Proposed Rule]. The proposed rule defined a Subscription Warrant as "a warrant issued by a company organized solely for the purpose of identifying an acquisition target and exercisable into the common stock of such company upon entry into a binding agreement with respect to such acquisition." *Id.* at 50,748.

B. HOW SPARCS WOULD WORK

If an IPO is essentially a company looking for money, and a SPAC is money looking for a company,[185] then a SPARC is *potential* money looking for a company.[186] Rather than selling units in a SPAC IPO, keeping the proceeds in trust, and requiring investors who disapprove of a prospective deal to *opt out* via redemption, a SPARC would gift subscribers the right to *opt in* to a future deal, holding no shareholder money in the interim while the sponsor searches for an acquisition target.[187] A target company that inks a deal to go public with a SPARC does not dive into a (potentially evaporative) pool of cash but instead casts a vote of confidence in the sponsor's ability to quickly raise funds from SPARC warrant holders.[188]

As originally conceived, a SPARC would emit from a traditional SPAC.[189] Once a SPAC finds an acquisition target and goes through the de-SPAC process, investors would not only receive shares of the new public company but would also receive a Subscription Warrant in a new SPARC venture.[190] The SPARC, free of the SPAC's two-

---

At the time of initial listing, Subscription Warrants would have been required to have an aggregate exercise price of at least $250 million, of which, at least $200 million is accounted for by a minimum of 1.1 million publicly held warrants by no less than 400 round lot holders. *Id.* After the SEC designated a longer period for Commission action on the NYSE Proposed Rule, solicited two rounds of comments, and extended the period for consideration to extend until May 8, 2022—almost nine months after the original proposal—the NYSE withdrew the proposed rule on April 26, 2022. Notice of Withdrawal of NYSE Proposed Rule, Securities Act Release No. 94810, 87 Fed. Reg. 26,384, 26,384–85 (May. 4, 2022).

[185] *See supra* text accompanying note 54.

[186] *See* Matt Levine, Opinion, *SPAC Suit Leads to SPARCs*, BLOOMBERG (Aug. 23, 2021, 2:11 PM) [hereinafter Levine, *SPAC Suit Leads to SPARCs*], https://www.bloomberg.com/opinion/articles/2021-08-23/spac-suit-leads-to-sparcs ("A SPARC is a SPAC without the pool of money.").

[187] *See id.* (contrasting the SPAC process where "shareholders put their money in up front" with the "opt-in" SPARC process).

[188] *See id.* (establishing that, for the target company, the SPARC "doesn't come with any guaranteed money," but instead comes with "the sponsor's ability to *raise* money, to go out to the retail investors holding SPAC shares or SPARC rights and convince them to fund the deal").

[189] *See* Aug. 2021 Ackman Letter, *supra* note 176, at 2 ("Originally, SPARC intended to issue the SPARC warrants to PSTH shareholders after PSTH's initial business combination.").

[190] Under the proposed rule, the Subscription Warrant itself would not have come from the SPAC or the newly public company, but it would have instead been issued by the SPARC, an independent private company setup to issue Subscription Warrants and consummate an

year time limitation, offers the freedom to find a new acquisition target at the sponsor's own pace.[191] Once the SPARC finds a prospective merger and enters a binding agreement with the acquisition target,[192] the Subscription Warrant's exercise period opens—investors who like the proposed merger can opt in (by paying the warrant's exercise price), while those who do not can opt out (by selling the warrant in the open market).[193] Once the SPARC closes its deal, investors would receive a share in the SPARC-to-market public company along with a new Subscription Warrant in another SPARC.[194] Thus, "the SPARC works as sort of a chain-SPARCing mechanism: You raise a SPAC, and when the SPAC terminates in a successful deal[,] you spin out a new SPARC; when that terminates in a successful deal[,] it spins out another SPARC; etc."[195] The sponsor's current SPARC warrant, then, becomes a proverbial membership card granting direct access to the SPARC sponsor's next deal as well as subsequent deals via future SPARC warrant issuance.[196]

---

acquisition. *See* NYSE Proposed Rule, *supra* note 184, at 50,748 ("The issuer of the Subscription Warrants must be a company formed solely for the purpose of issuing the Subscription Warrants and consummating the acquisition of one or more operating businesses . . . .").

[191] *See* Levine, *SPAC Suit Leads to SPARCs, supra* note 186 (noting that because the SPARC structure would have "no time limits," there would be an "emphasis on the sponsor's ability to do a good deal, sell the deal, and raise money").

[192] Ackman's comment on the NYSE Proposed Rule described this process more fully: "Once SPARC has identified a transaction, completed due diligence, negotiated the transaction terms, signed a definitive agreement, and its independent directors have approved the transaction, SPARC will file a post-effective amendment to its initial S-1 which will describe the target company in detail, provide detailed risk factors, audited financial statements and footnotes, MD&A, and all of the other disclosures that one would find in a traditional IPO prospectus." WILLIAM A. ACKMAN, COMMENT, PROPOSED RULE CHANGE PROPOSING TO ADOPT LISTING STANDARDS FOR SUBSCRIPTION WARRANT 4 (Sept. 26, 2021) [hereinafter Ackman Comment], https://www.sec.gov/comments/sr-nyse-2021-45/srnyse202145-9287412-259149.pdf.

[193] *See* NYSE Proposed Rule, *supra* note 184, at 50,749 ("The Subscription Warrants may not be fully exercisable . . . until after [the target acquisition] company enters into a binding agreement with respect to the Acquisition and may not limit the ability of holders to exercise such warrants in full prior to the closing of such Acquisition.").

[194] *See* Levine, *SPACs Can Shoot Out SPARCs*, *supra* note 159 (identifying that the SPARC allows sponsors to "launch a new vehicle automatically and without having to raise money for it up front").

[195] *Id.*

[196] *See id.* ("[T]he SPARC spin could be an interesting variant, one that lets [SPAC sponsors] launch a new vehicle automatically and without having to raise money for it up

While Ackman's prototype SPARC, Pershing Square SPARC Holdings, would issue free Subscription Warrants to PSTH holders,[197] the Proposed Rule did not dictate that Subscription Warrants must be distributed for no consideration.[198] The Proposed Rule recognized that the Subscription Warrants would have a market value—in fact, they would have to maintain a minimum value to remain listed.[199] At a minimum, this price would reflect the expected value added by a sponsor to the ensuing SPARC deal, but with the "chain-SPARCing" approach in mind,[200] it would also likely include the residual value of potential future SPARC warrant rights and deal values.[201] The market price of the warrants, then, would represent a pure bet on the sponsor's future deal-making prowess.[202] If "a SPAC investor is essentially buying a management team,"[203] a SPARC warrant purchaser is buying a direct securitization of that manager's ongoing ability to find underpriced companies and bring

front."); Jacob Wolinsky, *Odey's Courtenay: The SPARC Conversion of Bill Ackman's SPAC Is a Wise Move*, FORBES (Dec. 16, 2021, 9:55 AM), https://www.forbes.com/sites/jacobwolinsky/2021/12/16/odeys-courtenay-the-sparc-conversion-of-bill-ackmans-spac-is-a-wise-move/?sh=23a83b811bcb ("[T]he benefit of the SPARC structure is that [a sponsor] will 'always have an evergreen entity that [the sponsor] can use to complete a transaction.'").

[197] *See* Ackman Comment, *supra* note 192, at 4 ("[Pershing Square SPARC Holdings, Ltd.] is distributing SPARC warrants for no consideration to PSTH shareholders . . . .").

[198] *See* NYSE Proposed Rule, *supra* note 184, at 50,749 ("The *sale* of the Subscription Warrants and the issuance of the common stock of the issuer in exchange for the Subscription Warrants must both be registered under the Securities Act [of 1933]." (emphasis added)).

[199] *See id.* (establishing that the NYSE would suspend and delist Subscription Warrants if total market capitalization fell below $15 million for thirty consecutive trading days, the number of publicly held warrants decline below 100,000, or the number of public holders drop below 100).

[200] *See supra* text accompanying note 195.

[201] *See* Levine, *SPACs Can Shoot Out SPARCs*, *supra* note 159 (positing that the SPARC warrant's market price would be linked to the sponsor's "continuing interest in finding a deal" or deals); Wolinsky, *supra* note 196 (explaining that Subscription Warrant valuation "must include the valuation of a stream of successor warrants"). There will, of course, be cases where the SPARC sponsor signals a clear intent to only do a single deal (e.g., when a corporate sponsor issues a SPARC to spin off a subsidiary or bring a private partner company public), in which case the residual value associated with potential future SPARC deals will be minimal.

[202] *See* Levine, *SPACs Can Shoot Out SPARCs*, *supra* note 159 (positing that the SPARC warrants would trade on the stock market "as pure bets on your success as a SPAC sponsor and your continuing interest in finding a deal[] (or deals)").

[203] Rodrigues & Stegemoller, *Exit, Voice, and Reputation*, *supra* note 54, at 871.

Georgia Law Review, Vol. 57, No. 1 [2022], Art. 6

them public. This securitization would allow the SPARC to succeed where the SPAC has failed.

IV. ADOPTING THE SPARC

A. REINTEGRATING REPUTATION: THE ADVANTAGE OF THE SPARC SERIES VS. THE LIMITED LIFESPAN SPAC

In Section II.C, this Note highlights the pivotal role reputation plays constraining agency costs in the private equity context.[204] With the SPAC, reputation's role is limited.[205] The SPARC promises to reinstitute the role of reputation through the Subscription Warrant's market pricing mechanism, which effectively securitizes the sponsor's future deal-making abilities. Securitization would essentially infix the sponsor's reputation as a structural component of the SPARC that beneficially guides the sponsor-target company and sponsor-public investor relationships.

Section III.B establishes that the open market value of a SPARC Subscription Warrant would be a sum of: (1) the expected value-add by the sponsor to a forthcoming deal, and (2) any residual value based on an expectation that the sponsor will issue more SPARC warrants upon completion of that deal and future deals thereafter.[206] Investors receiving a SPARC warrant who had a good experience with a sponsor's previous deal and expect the sponsor to add value to future deals will likely hold on to the warrant. If a SPARC warrant holder's experience with the sponsor's prior deal was unfavorable, or the investor does not think the sponsor's future deal prospects are strong, or the investor simply decides they do not want to invest more capital in the type of company typically involved in a reverse merger transaction, they may sell the warrant to an investor who values the sponsor's ongoing deal-making capabilities more highly.[207] The SPARC warrants thus end up in the hands of those who are the most enthusiastic about a sponsor's deal prospects.

When the sponsor returns with a prospective target acquisition, those enthusiastic warrant holders will already be predisposed to

---

[204] *See supra* notes 88–92 and accompanying text.
[205] *See supra* notes 93–97 and accompanying text.
[206] *See supra* notes 200–202 and accompanying text.
[207] *See supra* note 202 and accompanying text.

opt in to the deal. If some of those warrant holders determine that they do not want to exercise once the binding agreement is publicized, they will sell it to someone who likely will, either at a lower price (if the market largely shares the investor's negative sentiments about the deal) or a higher price (if the market is enthusiastic about the merger). Either way, if the deal is viable—i.e., enough investors think the warrants would be worth exercising at the exercise price to fund the deal—the warrants will trade hands in the direction of investors ready to fund the deal. Only if a proposed merger is so onerous that opting-in would generate an expected loss exceeding the expected value of the sponsor's future SPARC deals would the price of the warrants trade towards zero and scuttle the deal's funding.[208] Barring extraordinary circumstances, so long as the sponsor maintains a positive reputation for deal-making, the SPARC deal they bring to the table will receive all the opt-ins necessary to fund it—without having to offer dilutive warrants to attract investors.

Unlike the typical SPAC sponsor, the SPARC sponsor whose ability to close deals relies on maintaining a positive reputation will have substantially more agency-friendly incentives guiding their decisions. While the Proposed Rule still mandated that any SPARC acquisition involve "one or more operating business or assets with a value . . . equal to at least 80% of the aggregate exercise price of the Subscription Warrants,"[209] that requirement would uncouple from the time limit constraint imposed by the SPAC. This would free SPARC sponsors from the SPAC's ticking clock pressure that can induce ill-suited acquisitions or bad deals resulting from a lack of negotiating leverage.[210] It would also mitigate the threat that a

[208] For example, if investors expect that the proposed merger will only generate $8 per share of post-merger value, the deal will still get funded at $10 per share so long as the expected value of the sponsor's future deals exceeds $2 (ignoring some premium that investors would require to compensate for warrant delisting risk).

[209] NYSE Proposed Rule, *supra* note 184 at 50,748. This Proposed Rule term is analogous to the SPAC's requirement that at least eighty percent of trust assets go towards a merger. *See supra* note 61.

[210] *See supra* note 112 and accompanying text; *see also* Ackman Comment, *supra* note 192, at 5 ("[T]he [SPARC's] 10-year term will effectively eliminate any perceived or real negotiating leverage for a transaction counterparty compared with the two-year shot clock of the typical SPAC.").

sponsor will overpay for a target company just to meet the eighty percent threshold and consummate a deal in time.[211]

Helpfully, the direct relationship between a sponsor's reputation and their ability to close a deal greatly minimizes the impetus to pursue a business combination at all costs.[212] While SPARC sponsors may very well still receive a promote like their SPAC counterparts, the reward received for the mere fact of acquisition[213] must be weighed against the prospect that an ill-suited acquisition would negatively affect the market price of their SPARC warrants.[214] With that price bearing a direct relationship to the SPARC sponsor's ability to fund future deals, they could not act opportunistically without jeopardizing their ability to field and close those deals. Thus, reputation would constrain the SPARC sponsor in much the same way as it constrains private equity managers.[215]

The sponsor's SPARC warrant price, as a representation of their ability to publicly fund a deal without having to seek alternative capital sources, would also provide an important signal to the target company. One of the SPAC's perceived advantages over the traditional IPO—one that may be more theoretical than material—is greater price and deal certainty.[216] By securitizing the sponsor's deal-making prospects, the SPARC could surely deliver that advantage. As mentioned, a reputable sponsor with in-demand SPARC warrants who brings a viable deal to the table should face no issues garnering enough opt-ins to fund a deal. This remains true even if the proposed deal fails to live up to the market's expectations because investors would fund even a negative-value deal if the value of the SPARC warrant emitted from the deal (i.e., the expected value of the sponsor's future deal-making efforts) exceeds the loss on the deal. Investors would still want to hold that sponsor's membership card[217] so long as they can rationally view a less-than-stellar deal as atypical of that sponsor. With that in mind, a private company negotiating a merger with a sponsor could simply look to

---

[211] *See supra* note 114 and accompanying text.

[212] *See supra* note 104 and accompanying text.

[213] *See supra* text accompanying note 103.

[214] Indeed, the sponsor must also pay greater consideration to the dilutive effect any promote received will have on the deal's success because that will directly affect the sponsor's future SPARC warrant price.

[215] *See supra* notes 88–92 and accompanying text.

[216] *See supra* notes 141–142 and accompanying text.

[217] *See supra* note 196 and accompanying text.

the sponsor's current SPARC warrant price as a measure of that sponsor's reputation and ability to successfully fund a deal completely with public money. All else being equal, a private firm would thus be more willing to accept a deal at a lower valuation from a highly reputable SPARC sponsor as the cost of ensuring the deal gets full public funding. Or, if faced with similar offers from multiple SPARC sponsors, the private firm would have a substantial incentive to choose the one with the highest SPARC warrant value.

A cycle thus emerges. With private firms more willing to make good deals with SPARC sponsors with in-demand warrants, the sponsor's reputation directly impacts the sponsor's ability to find and deliver higher-value deals. The better the deals the SPARC sponsor can negotiate because of their good reputation, the more investors would be willing to pay for the sponsor's current and future SPARC warrants. The more investors would be willing to pay for a sponsor's SPARC warrants, the more likely it becomes that the sponsor's next deal would receive full public participation. The more likely it is that a sponsor's next deal would receive full public participation, the more likely a merger target would be to make a good deal with that sponsor. Hence, the securitization of a sponsor's reputation will reduce deal uncertainty for private companies, internalize the cost of opportunism for the sponsor, and minimize information asymmetries. This cycle closely resembles the reputational braiding Professor Gilson observes in the venture capital context[218] as the sponsor-target company and investor-sponsor relationships influence each other, thus increasing the efficiency of both. The braiding effect could prove even more beneficial in the SPARC context where an efficient market quantifies the sponsor's reputational value via publicly disclosed price data.[219]

---

[218] *See supra* notes 89–90 and accompanying text.

[219] This is not to say that the price of the sponsor's SPARC warrants will efficiently value the sponsor's future dealmaking efforts. Given the nature of the sponsor's work, not even the most informed market participants can answer certain questions integral to the valuation (for example, how long the sponsor plans to remain in the SPARC business). But with many market participants trading a given SPARC warrant, the future value portion of the warrant's price would effectively trade like a prediction market. *See* Daniel E. O'Leary, *Prediction Markets as a Forecasting Tool*, *in* 8 ADVANCES IN BUSINESS AND MANAGEMENT FORECASTING 169, 170 (Kenneth D. Lawrence ed., 2011) ("Prediction markets provide an information gathering and aggregation mechanism across the population of traders to

B. OTHER SPARC STRUCTURAL ADVANTAGES

The Proposed Rule's terms would have offered SPARC sponsors significantly more flexibility than a traditional SPAC provides. The Proposed Rule did not require a pre-existing SPAC to issue a SPARC; any reputable entity could set up a SPARC and issue Subscription Warrants.[220] The SPARC thus offers new avenues for public companies to unlock shareholder value. For example, consider a public company with a close relationship to some private firm ready to go public. Tesla immediately jumps to mind given how investors champ at the bit for the opportunity to fund Tesla CEO Elon Musk's other ventures.[221] Musk could, in anticipation of taking SpaceX public (or spinning off SpaceX's subsidiary Starlink),[222] set up a SPARC and issue Subscription Warrants to Tesla shareholders. Not only would Tesla shareholders receive either (1) the opportunity to be an initial public investor in the next Musk venture or (2) the proceeds from selling the warrant to someone who wants that opportunity, they would further realize a bump to Tesla's share price from investors hoping for future Tesla-emitted SPARCs. And Musk would efficiently spin off one of his private ventures and place it directly into the hands of his already loyal

generate a price on some stock, where that stock being traded typically is a prediction or forecast of some event."). Substantial literature indicates that prediction markets provide highly accurate forecasts even where substantial informational asymmetries exist while also "increas[ing] the flow of information, encourag[ing] truth telling . . . and creating incentives for agents to act in the interest of their principals." *Id.* at 176–77. So, there is good reason to believe that the public market can provide a more accurate assessment of a SPARC sponsor's reputation than the more insulated private equity world can for a given fund manager. Higher quality information provides greater assurances for investors and target companies.

[220] *See supra* note 190. The entity must be "reputable" inasmuch as its reputation with the investing public must be positive enough that the Subscription Warrants it would issue would meet the Proposed Rule's $15 million minimum market capitalization listing requirement.

[221] *See* Chris Katje, *Could a SpaceX IPO Happen? Elon Musk's Tweet Gets Investors Excited*, BENZINGA (Nov. 30, 2021, 11:45 AM), https://www.benzinga.com/news/21/11/24360198/could-a-spacex-ipo-happen-elon-musks-tweet-gets-investors-excited ("Fans of Musk and Tesla have wanted to get in on a SpaceX or Starlink IPO for years.").

[222] Musk has stated that he plans to take Starlink public once the company's revenue "is reasonably predictable," and that he "[w]ill do [his] best to give long-term Tesla shareholders preference." Elon Musk (@elonmusk), TWITTER (June 23, 2021, 9:44 PM), https://twitter.com/elonmusk/status/1407877220543180800?s=20.

base of shareholders while boosting the value of Tesla's shares. Everybody wins.[223]

Unlike the SPAC, where the public capital available for an acquisition is fixed before the target search begins[224] (thus requiring a sponsor to turn to alternative sources for funding a larger-than-expected deal), the SPARC could flexibly fund a deal of any size with all public money. Because the Proposed Rule does not expressly limit issuance of Subscription Warrants to a single series,[225] a SPARC could issue multiple series of Subscription Warrants to match the funding needs of the acquisition target. For example, a SPARC could issue Subscription Warrant series "A" to current stakeholders (investors in a previous SPAC or SPARC) with an aggregate exercise price of $500 million. Should the sponsor then find an acquisition target seeking $1.5 billion in public capital, the SPARC could then issue Subscription Warrant series "B" and "C," each with an aggregate exercise price of $500 million. The warrant holders could exercise as many or as few of the three warrants as they desire, selling any they do not intend to exercise to someone who will. Not only has the SPARC sponsor given the preexisting stakeholders three bites of the apple, but they have also increased the public capital raise to match the acquisition target's needs without having to turn to private investors.

Alternatively, a modification to the Proposed Rule that would allow for warrant holders to exercise an oversubscription privilege[226] would achieve the same goals more cleanly. Under this approach, warrant holders would be given the option to oversubscribe to a proposed deal—that is, to opt in to purchase additional shares available once the first round of shares allocated

---

[223] "Everybody," that is, save for the favored institutional investors who would normally receive allocations under the traditional IPO model. *See supra* notes 36–39 and accompanying text.

[224] *See supra* notes 59–60 and accompanying text.

[225] *See* NYSE Proposed Rule, *supra* note 184, at 50,748–49 (allowing "a company organized solely for the purpose of identifying an acquisition target" to issue Subscription Warrants subject to minimum initial listing requirements with no restriction on subsequent issuance prior to "enter[ing] into a binding agreement with respect to the [a]cquisition").

[226] *See* James Chen, *Oversubscription Privilege*, INVESTOPEDIA (July 8, 2021), https://www.investopedia.com/terms/o/oversubscriptionprivilege.asp (defining an oversubscription privilege as a privilege "extended to a company's shareholders on the issuance of a rights or warrants offering" that "allows shareholders to purchase any shares remaining after other shareholders have had an opportunity to purchase them").

to the Subscription Warrants are accounted for.[227] This approach would avoid the potential administrative and regulatory headaches that listing additional SPARC warrant series could create[228] and would promote SPARC warrant liquidity by focusing trading on a single series of warrants.[229] For these reasons, this Note argues that the Proposed Rule should be revised to allow for an oversubscription privilege as an efficient way for sponsors to match public investor appetites with the target's public funding needs.

Finally, the SPARC's structure could provide a boon for private equity. The finance world has long recognized the SPAC's potential to offer private equity or venture capital funds an expedient way to cash out of their holdings.[230] Private equity and venture capital fund managers, however, have largely preferred traditional IPOs to SPACs because the former allows them to "increase their reputational capital in the new issue market" and reduce agency costs.[231] Given the SPARC's promise to reintroduce reputational factors and reduce agency costs in the reverse merger context,[232] the SPARC could yet make good on the SPAC's promise as a private equity divestiture vehicle. Private equity firms ready to take an

---

[227] For proposed deals with a positive expected value, a rational warrant holder would either always purchase the maximum number of shares available or sell the warrant to another investor who would (as the right to purchase additional shares with an expected value above the exercise price makes the warrant more valuable to the full exerciser).

[228] Each series of warrants would have to meet the Proposed Rule's $250 million aggregate exercise price, 1.1 million in issuance, and 400 round lot holder requirements. *See supra* note 184. Each series would also be independently required to exceed the minimum thresholds established to avoid suspension and delisting. *See supra* note 199.

[229] The series approach to pairing warrant holder appetite with the merger company's public funding needs could produce additional information that the oversubscription approach would not provide. By comparing the price of a series "A" Subscription Warrant (the warrant series that encapsulates both the value of the present deal and the sponsor's future deal-making potential) with later series warrants issued to fund the present deal alone, investors could deduce the market value of the sponsor's future SPARC endeavors. However, potential illiquidity for later series warrants could distort that information, and the value of such information is likely minimal (beyond what it might provide arbitrageurs).

[230] *See* Kolb & Tykvová, *supra* note 40, at 84 (contrasting how venture capital firms typically keep most of their holdings during an IPO and lock up shares for a specified post-IPO period to avoid sending negative signals about the value of a portfolio firm, whereas the readily available liquidity offered by a SPAC acquisition allows for an immediate cash-out); *see also* FELDMAN, *supra* note 41, at 239 (conceding that the author's 2006 prediction that private equity interest in reverse mergers would continue to grow had not materialized).

[231] Kolb & Tykvová, *supra* note 40, at 82.

[232] *See supra* Section III.A.

investment public could distribute SPARC warrant rights to existing investors as special dividends. Alternatively, the firms could turn to some public entity sitting on extra cash and propose a deal whereby the private equity firm issues SPARC warrants to the public entity's stockholders in exchange for funding the future SPARC divestiture. The private equity firm retains full price control as it efficiently brings the private investment public, while the public company can offer its shareholders a dynamic dividend.[233] In sum, the SPARC structure could grant public investors the opportunity to opt in to a private equity-nurtured IPO. The SPARC, then, could come quite close to fulfilling the SPAC's promise as the "poor man's private equity."[234]

C. COUNTERING THE SPARC CRITICS

Critics may contend that the NYSE Proposed Rule enabling SPARC Subscription Warrant issuance did not do enough to protect the retail investor from many of the same practices that have plagued the SPAC: the dilutive effect of the sponsor promote,[235] sponsor opportunism,[236] and exploitation of the PSLRA's safe harbor provision.[237] The SEC voiced its concerns in more general terms, arguing that the Proposed Rule did "not explain how it would effectively address the risk the price of subscription warrants could be manipulated, or how its proposal otherwise would be designed to prevent fraudulent and manipulative acts and practices."[238] The securitization of the SPARC sponsor's reputation, however, naturally limits the extent to which a sponsor can engage in these practices. As Section IV.A explains, the threat that a SPARC

[233] Assuming the aggregate value of the Subscription Warrants exceeds the investment required to underwrite the SPARC merger, the company will have created shareholder value. The private equity firm has the incentive to make this a positive expected value transaction for the public company (by proposing the ensuing SPARC deal at a conservative valuation) to maintain the private equity firm's reputation for providing shareholder value for future deals. Again, reputation constrains opportunism and agency costs.

[234] *See supra* notes 118–119 and accompanying text. Of course, no *public* funding vehicle could ever truly offer the *private* equity experience.

[235] *See supra* notes 127, 130 and accompanying text.

[236] *See supra* notes 104–105 and accompanying text.

[237] *See supra* notes 81–83 and accompanying text.

[238] SEC Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change, Securities Act Release No. 93741, 86 Fed. Reg. 71,111, 71,114 (Dec. 14, 2021) [hereinafter SEC Order].

sponsor's warrants will be delisted incentivizes the sponsor to produce positive expected value deals for warrant holders.[239]

No, the Proposed Rule did not limit the sponsor's ability to take the SPAC's traditional twenty percent promote as part of any negotiated deal.[240] Indeed, the SPARC sponsor could still have issued themselves a hefty proportion of the SPARC Subscription Warrants.[241] But because the SPARC's warrant pricing mechanism would naturally constrain opportunism, the Proposed Rule did not need to demarcate the limits of SPARC sponsor compensation to retain investor protections. If the SPARC sponsor wants to dilute the post-merger equity by taking a large promote or dilute their own Subscription Warrant pool, they would do so at the expense of their own reputational capital as embodied in the Warrant's market price. To the extent that the sponsor has earned enough reputational capital to take blocks of stock or warrants without risking their ability to secure future deal funding and can produce a SPARC acquisition that provides positive value despite the dilution, they should be free to compensate themselves accordingly.

Initial SEC pushback against the Proposed Rule focused on two perceived investor risks: informational asymmetry—"how market participants would effectively value this novel listed security"—and sponsor opportunism—that Subscription Warrants would be "susceptible to rumors about potential acquisition targets and [transaction] terms" that "permit a bad actor to efficiently manipulate these securities with little upfront cost."[242] Notwithstanding that these stated "grounds for disapproval under consideration"[243] are far more applicable to SPACs and the highly

---

[239] *See supra* Section IV.A.

[240] Ackman acknowledges that "[t]he massively dilutive nature of founder shares often makes it difficult to complete a deal on attractive terms for [SPAC] shareholders," and even former SEC chairman Jay Clayton (who had taken a laissez-faire approach to SPAC regulation) expressed concerns about the promote's impact on ordinary investors. Ortenca Aliaj, Sujeet Indap & Miles Kruppa, *The SPAC Sponsor Bonanza*, FINANCIAL TIMES (Nov. 13, 2020), https://www.ft.com/content/9b481c63-f9b4-4226-a639-238f9fae4dfc.

[241] Or, alternatively, a SPARC sponsor could potentially issue warrants for an exercise price that is a fraction of the exercise price offered to public investors, so long as that exercise price is at least $10. *See* NYSE Proposed Rule, *supra* note 184, at 50,748–49 (establishing $10 as the minimum issuance price).

[242] SEC Order, *supra* note 238, at 71,113–14.

[243] *Id.* at 71,112.

volatile, often illiquid SPAC options[244] that investors regularly trade on the exchanges with the SEC's blessing,[245] securitization of the SPARC sponsor's future deal-making capabilities would mitigate both risks. Even without hard data on "underlying assets or business operations"[246] for investors to use for valuation purposes, extensive research on the efficacy of prediction markets supports the idea that investors will be able to adequately price the expected value of a sponsor's future SPARC deals.[247] Indeed, some investors quickly provided value estimates of Pershing Square's SPARC using familiar financial modeling methods.[248] And because the expected value of the sponsor's future deals represents a material portion of the Subscription Warrant's price, that price will be less susceptible to influence from rumors relating to a single forthcoming deal. Further, securitization of the sponsor's reputation incentivizes the sponsor to quash rumors and prevent manipulation that would threaten to harm investors and, in turn, threaten to harm the sponsor's ongoing ability to find and fund quality deals.

Securitizing the SPARC sponsor's reputation would not only limit sponsor opportunism towards public investors but also towards acquisition targets. The recent SPAC market frothiness speaks to just how powerful the draw of an offer of a (seemingly) guaranteed pile of cash can be for a private company, even one

---

[244] *See* Brian O'Connell, *SPACs Are Seeing More Volatility Tied to Gamma Squeezes*, THESTREET (Sept. 20, 2021, 4:44 PM), https://www.thestreet.com/investing/spacs-are-seeing-more-volatility-tied-to-gamma-squeezes (drawing attention to the "very high risk" posed by recent "[l]arge movements in SPACs" triggered by aggressive options traders targeting thinly traded SPACs that now often experience "a very high amount of redemptions").

[245] *See* Michelle Celarier, *Bill Ackman Gets More Pushback from the SEC*, INSTITUTIONAL INV. (Dec. 13, 2021) [hereinafter Celarier, *Bill Ackman Gets More Pushback*], https://www.institutionalinvestor.com/article/b1vw1rx6spnrtr/Bill-Ackman-Gets-More-Pushback-From-the-SEC ("Of course, the same could be said about any of the hundreds of SPACs in the market. Moreover, investors trade weekly options on SPACs, leading to losses as SPACs have tanked this year.").

[246] SEC Order, *supra* note 238, at 71,113.

[247] *See supra* note 219 and accompanying text.

[248] *See* Wolinsky, *supra* note 196 (explaining how Odey Special Situations Fund manager Adrian Courtenay arrived at a $13.82 SPARC warrant valuation by taking PSTH's SPAC warrant price, applying the Black-Scholes option-pricing model to account for the increased time until expiration, and adding "the valuation of a stream of successor warrants" based on "an assumption about the amount of time between each deal" of three years and a fifteen percent "annual discount factor to represent the time value of money and the execution risk of a multi-year series of [prospective] mergers").

poorly suited for public markets.[249] SPARC sponsors, by contrast, must be doubly sure the acquisition company is ready for the public spotlight because their ability to guarantee that future deals receive full funding depends on it. SPARC sponsors, then, will serve as the first line of defense for investors rightfully concerned with the SPAC market's tendency to take companies public that would be better off staying private.[250] Yes, there will be fewer reverse merger deals, but they will undoubtedly be higher quality ones nurtured by accomplished sponsors.[251] This is exactly what the SPAC market needs right now.[252]

The SEC Proposed Rules aggressively target the long-standing SPAC sponsor practice of making forward-looking statements to public investors under the assumption that SPACs fall under the PSLRA's safe harbor provision.[253] Having never addressed SPAC safe-harbor applicability until the Agency abruptly expressed misgivings in April 2021,[254] the SEC's proposal opted for the nuclear option, seeking to completely eliminate the safe harbor by rewriting

[249] *See* Rodrigues & Stegemoller, *Redeeming SPACs*, *supra* note 53, at 21–22 (identifying that there is "little incentive for second-guessing the suitability of the private company for the public markets"—"[i]ndeed, the less attractive targets are presumably most eager to close a deal that will bring them liquidity," so it is "[n]o wonder there have been some highly publicized flameouts such as Nikola and Lordstown").

[250] *See* Luke Clancy, *Refuge of "Chancers": SPACs Draw Criticism from Big Investors*, RISK.NET (Mar. 31, 2021), https://www.risk.net/investing/7816551/refuge-of-chancers-spacs-draw-criticism-from-big-investors ("Institutional investors are distrustful of [SPACs] which they say encourage immature businesses to go public too soon . . . .").

[251] By concentrating viable reverse mergers in the hands of accomplished SPAC sponsors, a greater proportion of such deals will benefit from learning-curve effects, further leveraging the benefits of reputation. *See supra* note 96.

[252] *See* Naumovska, *supra* note 50 (arguing that the same "institutionally driven dynamics" that eventually led the last reverse merger wave to crash in 2011—"rapid proliferation of a controversial financial innovation, plagued by poor-quality players, bad publicity and regulatory concern"—have reemerged, threatening to burst the SPAC bubble).

[253] *See supra* notes 80–82 and accompanying text.

[254] *See* Paul Swegle, *Won't SPAC Down*, LEXBLOG (Mar. 14, 2022), https://www.lexblog.com/2022/03/14/wont-spac-down/ (stating that, "[a]fter years of passivity and regulatory neglect regarding SPACs," the April accounting statement "exemplified the SEC's tendency to '*lead from behind*,'" and that the SEC's "blunt force approach, presumably well-meaning, was also disingenuous, poorly tailored to the situation, and extremely harmful" as they used "a fake issue to kill the SPAC market").

the definition of blank check company to include SPACs.[255] Asserting that there is "no reason to treat forward-looking statements made in connection with de-SPAC transactions differently" than those for traditional IPOs,[256] the SEC would presumably also seek to prohibit SPARC sponsors from making forward-looking statements. But the SPARC's ability to self-fund based on the sponsor's reputation would alleviate many of the SEC's PSLRA-related concerns. The reputable SPARC sponsor should not need to employ overly ambitious forward-looking projections to "help 'sell' the deal."[257] Questions about whether sponsors have "sufficient incentives to do appropriate due diligence on the target and its disclosures to public investors"[258] are resolved when reputation dictates that the SPARC sponsor must bring viable deals to the table every time (or else jeopardize future deals). The SPARC represents a safe-harbor happy medium that would allow the SEC to continue letting early-stage companies publicly make projections that their traditional IPO counterparts only make behind closed doors,[259] with SPARC sponsor reputational factors reining in the prospects for abuse.

---

[255] *See* Peirce, *supra* note 9 (characterizing the SEC's move to change "the definition Congress looked to when it wrote the PSLRA" as "a regulatory sleight of hand": "Look over there, Congress, while we rewrite the statute!").

[256] SEC Proposed Rules, *supra* note 9, at 29,482. A number of "SPACademics" and numerous commenters to the SEC Proposed Rules recognize that there are indeed reasons to allow safe harbor to SPACs and not traditional IPOs. *See, e.g.*, Klausner et al., *A Sober Look at SPACs*, *supra* note 46, at 284 (recognizing that "[f]or companies that face challenges bridging information asymmetries with potential shareholders . . . providing projections and other forward-looking statements may be an effective means of communicating value," especially where targets are "'pre-revenue' or low-revenue").

[257] Coates, *supra* note 80.

[258] *Id.*

[259] *See* Matt Levine, Opinion, *The SEC Is Coming for SPACs*, BLOOMBERG (Mar. 31, 2022, 1:23 PM), https://www.bloomberg.com/opinion/articles/2022-03-31/the-sec-is-coming-for-spacs#xj4y7vzkg (explaining that "*companies that do IPOs make projections, and those projections find their way to investors*[, b]ut gingerly, carefully, and not in the official SEC filings," and that "[i]t is kind of *nice* that in SPACs the projections go into the public filing for everyone to read, instead of being filtered through research analysts' conversations with big institutional investors—[i]n SPACs, everyone gets to read the same projections; in IPOs only the institutional investors get them"); Swegle Comment, *supra* note 175, at 8 (commenting that "the Projection Proposals create increased risks of the very types of 'asymmetric information' flows they are purportedly designed to correct" by effectively shuttering de-SPAC projections behind "closed-door roadshow presentations" like traditional IPOs).

The SPARC consideration question looms: "Could you launch a SPARC not with a free distribution to existing shareholders of something (a SPAC, a SPARC, a public company), but with an initial public offering of the rights for cash?"[260] Understandably, the thought of sponsors issuing securities backed by nothing but the sponsor's raw potential as a dealmaker strikes some as unseemly.[261] But again, the reputation factor—the requirement that a SPARC sponsor deliver value each time to ensure future deals get funded—would serve as the natural regulator. Few potential SPARC sponsors would have the clout to issue a paid SPARC offering out of the gates. Those that do are unlikely to risk the very reputation that would allow them to do so for a one-time payday.[262] The SPARC sponsor who sells warrants has a lot less leeway than the one who gives them away for free. To the extent that a SPARC sponsor is confident that they can deliver a future SPARC deal with value that exceeds the cost of the deal to investors—a confidence investors must share—they should be able to do so. As Ackman correctly points out in his Proposed Rule comment, retail investors paying premiums for SPARC warrants would be less exposed than those who currently purchase SPAC shares at a premium to net asset value: "SPARC warrants will have a much longer[ ]term than a typical SPAC, [making them] inherently less speculative" and simultaneously "much less capital intensive."[263] To that end, a reformulated Proposed Rule should not incorporate limitations on SPARC sponsor compensation, either directly via warrant issuance or through some form of a promote.

V. CONCLUSION

Having reemerged as an attractive alternative to the traditional IPO, the SPAC enjoyed a breathtaking increase in popularity in the wake of the coronavirus pandemic.[264] But with the brighter spotlight came increased attention on the SPAC's structural

---

[260] Levine, *SPACs Can Shoot Out SPARCs*, *supra* note 159.

[261] *See id.* ("[D]oing a paid SPARC offering would probably go a bit too far.").

[262] A SPARC sponsor who issued paid Subscription Warrants only to let them expire worthless after a decade would not only lose all public investor trust but also would surely find themselves defending a securities fraud class action to boot.

[263] Ackman Comment, *supra* note 192, at 5.

[264] *See supra* notes 6–8, 50 and accompanying text.

deficiencies. Academics, litigators, and regulators all took aim at the SPAC market in 2021,[265] revealing it to be overcluttered with bad deals involving companies ill-suited for public markets, sponsors driven by misaligned incentives, and retail investors left holding the bag.[266] This culminated with SEC Proposed Rules intent on killing the SPAC in favor of the traditional IPO.[267] The SPAC space needs reorganization, not a complete teardown.[268]

The SPARC promises to remodel the SPAC structure to the benefit of all involved. By eliminating the SPAC's two-year time limitation[269] and the dilutive opt-out process, the SPARC realigns sponsor incentives with investor aims.[270] By securitizing the sponsor's future dealmaking efforts as a component of the Subscription Warrant's price, the SPARC reintegrates reputation as a structural component that the limited lifespan SPAC inherently lacks.[271] By braiding reputation through the sponsor-target company and sponsor-investor relationships, the SPARC promises to increase reverse merger efficiency by reducing deal uncertainty for target companies, internalizing the cost of opportunism for the sponsor, and minimizing information asymmetries for investors.[272] Last, by offering reputable sponsors more flexibility than the SPAC structure can provide, the SPARC would not only ensure that public money will meet target company funding needs but also provide new avenues for both public companies and private equity firms to unlock shareholder value.[273]

---

[265] *See supra* notes 4, 83, 127–137, 165–173 and accompanying text.

[266] *See* Cohan, *supra* note 112 (identifying that the financial press has picked up on "SPAC excess as 'rife with misaligned incentives between the sponsor and other investors'" that causes sponsors to compete "for increasingly immature companies to take public" at the expense of "unsophisticated investors").

[267] *See* Swegle Comment, *supra* note 175, at 4 ("[T]here seems to be a desire on the [SEC's part] to not only eliminate SPACs as a viable financing option, but also to possibly apply certain of the proposed rules retroactively to punish SPAC industry participants for their involvement in SEC-reviewed SPAC transactions.").

[268] *See id.* at 11 ("SPACs clearly have a role to play. Otherwise, they would not have eclipsed traditional IPOs in 2021.").

[269] *See supra* note 191 and accompanying text.

[270] *See supra* Section IV.A.

[271] *See supra* Section IV.A.

[272] *See supra* Section IV.A.

[273] *See supra* Section IV.B.

To realize the SPARC's promise to reorganize the SPAC space, the SEC must scrap the bulk of its proposed SPAC rules[274] and instead lend its support to the NYSE Proposed Rule that would allow SPARC sponsors to issue Subscription Warrants.[275] This Note calls for that course correction. Additionally, this Note recommends amending the Proposed Rule to allow for an oversubscription privilege as an optimal way for sponsors to match public investor appetites with target company funding needs.[276] With the SEC "in the midst of a crackdown on SPACs"[277] when the NYSE submitted its Proposed Rule, the Agency's reluctance to approve another SPAC-like product came as no surprise. An "inevitable 'blowout'" loomed following a glut of SPACs sponsored by celebrities and others with no clear business "advising SPACs or investing other people's money,"[278] and the SEC's concern with sponsor opportunism is sensible. But the best way to rein in SPAC sponsorship run amok is not by targeting de-SPAC projections and sponsor promotes, but instead by refashioning the sponsor-investor arrangement as a long-term relationship. By reframing the investor question from "will this sponsor make me money on this *trade*?" to "is this sponsor a worthy *investment*?," the SPARC format would only reward sponsors who deliver net value over the long run. Securitizing sponsor reputation ultimately incorporates a market-based form of management fee disclosure, giving "investors better information about what they're getting into."[279] This Note recommends that a revised Proposed Rule should reject limitations on the sponsor's ability to earn a promote or receive consideration

---

[274] Discussion of all aspects of the SEC Proposed Rules is beyond the scope of this Note. The Author applauds the SEC for proposing enhanced disclosure related to, amongst other things, "the nature and amount of compensation . . . and the extent to which this compensation may result in material dilution" and compensation structures ripe for potential conflicts of interest. SEC Proposed Rules, *supra* note 9, at 29,523. But beyond approving the SPARC, the SEC could better serve investors by consistently employing existing enforcement tools to reign in SPAC market excesses instead of entirely rewriting the rules governing SPACs.

[275] *See supra* note 184 and accompanying text.

[276] *See supra* Section IV.B.

[277] Celarier, *Bill Ackman Gets More Pushback*, *supra* note 245.

[278] Cohan, *supra* note 112.

[279] Editorial Board, Opinion, *Investors in SPACs Need to Know the Real Deal*, BLOOMBERG (Feb. 11, 2021, 8:00 AM), https://www.bloomberg.com/opinion/articles/2021-02-11/investors-in-spacs-need-to-know-the-real-deal.

for issuing Subscription Warrants. In other words: "Shed light, then let the market decide."[280]

---

[280] *Id.*

Georgia Law Review, Vol. 57, No. 1 [2022], Art. 6

https://digitalcommons.law.uga.edu/glr/vol57/iss1/6