NOT OUR CUP OF TEA: WHY THE SEC MUST REGULATE SPACs DIFFERENTLY THAN THE UNITED KINGDOM

Archie L. Wilson, Jr.[*]

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[*] J.D. Candidate, University of Georgia School of Law, 2023; M.A., Georgia State University, 2021; B.A., Wesleyan University (CT), 2018.

I. INTRODUCTION

Regulation is coming. U.S.-based Special Purpose Acquisition Companies have not seen significant regulatory reform since the investment structure was created in the 1990s.[1] The boom of Special Purpose Acquisition Company (SPAC) activity in the United States is influenced in part by the participation of celebrities and public figures like Shaquille O'Neal, Serena Williams, Alex Rodriguez, Colin Kaepernick, Steph Curry, Patrick Mahomes, Naomi Osaka, Peyton Manning, Andre Agassi, Steffi Graff, Ciara, Jay-Z, Sammy Hagar, Paul Ryan, and Wilbur Ross.[2] SPACs are now a mainstream investment option that "make up a significant and unusually high share of . . . [Initial Public Offerings]: 25% percent [sic] in 2018[,] 34.5% in 2019, 60% in 2020, and 66% in 2021."[3] U.S. SPAC market growth has caught the eye of government regulators, inspiring targeted statements and events.[4] For example, the Division of Corporation Finance within the Securities and Exchange Commission (SEC) issued a public statement specifically concerning SPACs.[5] Additionally, the Subcommittee on Investor Protection, Entrepreneurship and Capital Markets of the U.S. House Committee on Financial Services held a hearing titled *Going Public: SPACs, Direct Listings, Public Offerings, and the Need for Investor Protections*.[6] Beyond speaking about the investment vehicle more pointedly, recent activity in the U.S. SPAC market has inspired action from the SEC. The SEC put SPACs on its rulemaking agenda in 2022, and has proposed new rules to govern SPACs.[7] Additionally, the SEC has shown its interest in altering SPAC behavior by bringing charges against bad actors.[8] In July 2021, the SEC brought charges against a SPAC named Stable Road Acquisition Company, specifically against its leadership

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[1] *See* Usha Rodrigues & Mike Stegemoller, *Exit, Voice, and Reputation: The Evolution of SPACs*, 37 DEL. J. CORP. L. 849, 876 (2013); *see also* Daniel S. Riemer, Note, *Special Purpose Acquisition Companies: SPAC and SPAN, or Blank Check Redux?*, 85 WASH. U.L. REV. 931, 945–47 (2007).

[2] Usha Rodrigues & Michael Stegemoller, *Redeeming SPACs*, 6 (Univ. of Ga. Sch. of L., Legal Stud. Rsch. Paper No. 2021-09), https://ssrn.com/abstract=3906196.

[3] *Id.*

[4] *See id.* at 7–8.

[5] *Id.*

[6] *Going Public: SPACs, Direct Listings, Public Offerings, and the Need for Investor Protections Before the Subcomm. on Investor Protection, Entrepreneurship & Capital Markets of the H. Comm. on Fin. Services*, 117th Cong. (2021).

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

[8] *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges SPAC, Sponsor, Merger Target, and CEOs for Misleading Disclosures Ahead of Proposed Business Combination (July 13, 2021), https://www.sec.gov/news/press-release/2021-124.

team and CEO.[9] The agency also brought charges against the target company, Momentus Inc., and the target company's founder and former CEO.[10] These charges allege that the parties continued making misleading claims to investors after receiving numerous warnings.[11]

Pointed changes in how U.S. SPACs operate in the future are likely. Change is probably on the horizon because SPACs historically have not been as regulated as traditional initial public offerings (IPOs),[12] leaving more questions than answers about which rules govern SPACs, and if such rules even exist.[13] The norms of SPAC regulation in the U.S. permanently shifted in March 2022 with the proposal of new rules for U.S. based SPACs.[14]

Over the past few decades, the SEC has allowed "the market [to do] away with the investor protections that SPAC entrepreneurs initially used to persuade the agency into allowing the form's emergence."[15] SPACs were specifically created in response to the SEC's actions against misrepresentation and fraud that would mislead investors in penny stock deals.[16] The form was initially created with the promise of protecting investors and upholding market integrity. Now, SPACs mostly operate as nothing but a shell of those promises—a consequence of failing to hold key contributors in SPAC creation and operation accountable. The secrecy of empty voting in SPACs is a fatal flaw that creates a rigged game; the practice must be addressed for both moral and economic reasons. Empty voting creates a moral issue because it allows large investors to pursue beneficial merger deals to the detriment of other investor parties. Further, empty voting creates economic issues because investors—big and small—have an increased chance of being disadvantaged in the merger, thus harming their bottom lines over time. If empty voting is allowed to continue in its current state, distrust in the U.S. SPAC market will likely grow

[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] *See* Riemer, *supra* note 1, at 932.

[13] *See id.* at 933; Rodrigues & Stegemoller, *supra* note 1, at 873 ("No special legislation or administrative rules govern SPACs."); Brandon Schumacher, *A New Development in Private Equity: The Rise and Progression of Special Purpose Acquisition Companies in Europe and Asia*, 40 NW. J. INT'L L. & BUS. 391 n.3 (2020) (quoting 11 SIMON M. LORNE & JOY MARLENE BRYAN, ACQUISITIONS AND MERGERS: NEGOTIATED AND CONTESTED TRANSACTIONS § 3:11.20 (2019)) ("FINRA and stock exchange rules govern SPAC's. SEC Securities Act Rule 419 may also apply to a SPAC IPO if the IPO is not structured to avoid Rule 419's application . . . .").

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

[15] Rodrigues & Stegemoller, *supra* note 2, at 24.

[16] *See* Rodrigues & Stegemoller, *supra* note 1, at 875–76 (citing Riemer, *supra* note 1, at 941–42).

and investors will pursue other investment avenues, harming the growing sector.

This Introduction highlighted the dominant influence SPACs have gained in the United States over a short period of time. These investment vehicles affect every American because they help drive the economy, yet the form remains unknown to many. As the form has continued to gain prominence, the fatal flaw of empty voting has become more glaring. Moving forward, this Note is broken into four additional parts. Part II will include a full-bodied explanation of what SPACs are and their mechanics, the history and origins of the U.S. SPAC, the mechanics of a traditional IPO, and the differences between a SPAC and an IPO. Part II closes by discussing the SPAC's fatal flaw—empty voting—and explains how the process creates moral and economic pitfalls for the form.

Part III will discuss the oversight gap that exists in U.S. SPACs because of a lack of gatekeeping and provide a case study of steps the United Kingdom has taken to address similar issues in U.K. SPACs. Part III will argue that aggressive agency oversight like that seen in the U.K. is not the best solution for the U.S. SPAC market.

Part IV will discuss solutions to empty voting and issues of transparency in SPACs proposed by leading SPAC scholars. Part IV will then present a two-step SPAC confirmation system to address issues of empty voting and disclosure in U.S. SPACs. The recommendation is a new solution that draws upon the strengths of the previously mentioned scholars' work. Finally, Part IV anticipates and addresses potential critiques of the new recommendation. Part V will conclude the Note.

II. BACKGROUND

A. What is a SPAC? (U.S.)

In the United States, a SPAC is an entity with three distinguishable attributes. First, SPACs have no commercial operations, meaning they do not actively engage in the buying or selling of goods.[17] Second, SPACs are established by management or leadership teams called sponsors.[18] Third, SPACs are formed for the sole purpose of raising capital from the public in the form of an "IPO."[19] Before offering shares to the public, the sponsors of the newly formed SPAC own the SPAC's securities as original shareholders.[20] The SEC

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[17] *See* Julie Young, *Special Purpose Acquisition Company (SPAC) Explained: Examples and Risks*, INVESTOPEDIA, https://www.investopedia.com/terms/s/spac.asp (Dec. 22, 2022).

[18] *Id.*

[19] *Id.*

[20] *See* Riemer, *supra* note 1, at 950.

must first receive and approve a "registration statement (Form S-1)" from the SPAC before the SPAC sells shares to the public.[21] This statement discloses key aspects of the company for review, including the SPAC's blank check status, a general description of the industry in which the SPAC plans to execute an acquisition, and key metrics that are used to analyze the longevity and success of the acquisition.[22] The statement also formally announces the management team, designates the kinds of shares that will be offered to the public, and lists potential foreseeable risks for the acquisition.[23] Once approved by the SEC, the SPAC may sell its shares to the public. The SPAC vehicle is a unit offering, meaning that the company has "a combination of stock shares and warrants to purchase shares" which investors can purchase.[24] Purchasers of common stock buy equity in the company immediately at the time of purchase, while purchasers of warrants acquire the right to buy stock in the company "at a specific price and at a specific date" in the future.[25]

The funds from the capital raise serve one purpose for the SPAC: to acquire an existing, almost always private, company seeking to become public without its own IPO.[26] Most of the public fundraising proceeds must be placed in a trust account and the funds are released only after the successful completion of an acquisition.[27]

i. U.S. SPAC Mechanics

When the public offering concludes, the funds are placed in an escrow account, and the hunt for a target begins. The management team's primary purpose is to efficiently source an appropriate target because the search for a target is time-bound by the Code of Federal Regulations.[28] SPACs historically had a lifetime of two years, but recent data shows that the median lifetime is twenty-two months due to a growing number of SPACs allowing only eighteen months to close a deal.[29] If the management team fails to find a target in the time allotted, the SPAC shareholders can decide to extend the deal window

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[21] *Id.*

[22] *Id.* at 950–51.

[23] *Id.* at 951.

[24] Rodrigues & Stegemoller, *supra* note 1, at 871.

[25] Chizoba Morah, *How Do Stock Warrants Differ From Stock Options?*, INVESTOPEDIA (May 3, 2021), https://www.investopedia.com/ask/answers/08/stock-option-warrant.asp.

[26] *See How Special Purpose Acquisition Companies (SPACs) Work,* PWC, https://www.pwc.com/us/en/services/audit-assurance/accounting-advisory/spac-merger.html (last visited Jan. 15, 2023).

[27] Rodrigues & Stegemoller, *supra* note 1, at 854.

[28] Riemer, *supra* note 1, at 952; *see also* Rodrigues & Stegemoller, *supra* note 2, at 9; 17 C.F.R. § 230.419(e)(2)(iv).

[29] Rodrigues & Stegemoller, *supra* note 2, at 9.

or, alternatively, redeem their shares, kill the SPAC, and recoup their money.[30] If SPAC shareholders decide to kill the SPAC by redeeming enough shares, the sponsors receive nothing for their time and efforts.[31]

The ideal target company is "large enough to sustain a public company but small enough not to either interest private equity investors or be a viable IPO candidate."[32] If the management team is able to identify a viable target, negotiations for the acquisition begin.[33] If the negotiations end well, the SPAC will publicly announce the proposed deal to acquire the target company.[34] The SPAC then makes public disclosures explaining the merger and the approval process for the SPAC's shareholders.[35]

The target company is then presented to the SPAC's shareholders for approval.[36] Shareholders have three options: (1) shareholders who are in favor of the acquisition will maintain their investment and become shareholders in the acquired company if there are enough affirmative votes;[37] (2) shareholders who vote against the acquisition can redeem their shares and pull their investment;[38] (3) shareholders can paradoxically vote in favor of the acquisition, but also redeem their shares.[39] If enough SPAC shareholders vote to approve the acquisition, "the private company merges with the public SPAC shell and begins trading, usually under a new trading symbol."[40] This acquisition is referred to as the "de-SPAC," and "the functional equivalent of an IPO, effected via merger rather than public offering."[41] Successful SPACs are considered true public companies, despite undergoing a nontraditional IPO process. The differences in process between an emerging SPAC company and a traditional private company on the path to going public are important to contextualize the recent critiques of U.S. SPACs.

The following section will explain the history and development of U.S. SPACs. It is important to understand the form's historic trajectory to fully

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[30] *Id.* at 10.

[31] *Id.* at 10–11.

[32] Riemer, *supra* note 1, at 952 (quoting Sarah Hewitt, *Specified Purpose Acquisition Companies*, 1 BLOOMBERG CORP. L.J. 97 (2006)).

[33] *See* Rodrigues & Stegemoller, *supra* note 2, at 10.

[34] *Id.*

[35] *Id.*

[36] *Id.*

[37] *See* Rodrigues & Stegemoller, *supra* note 1, at 871.

[38] *Id.*

[39] *Id.* at 872.

[40] Usha Rodrigues & Michael Stegemoller, *Why SPACs: An Apologia*, 19 (Univ. of Ga. Sch. of L., Legal Stud. Rsch. Paper No. 2022-04), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4072834.

[41] Rodrigues & Stegemoller, *supra* note 2, at 2.

appreciate its current state and to ultimately imagine an improved future. Additionally, to understand the gravity of the current issues in U.S. SPACs, one must understand the foundation the form was meant to stand on.

B. How SPACs Developed in the United States

SPACs in the United States were created in response to prohibitions against "pump and dump" schemes within blank check companies during the 1980s.[42] A blank check company is a company "whose stated purpose is to merge with a yet-to-be-identified target."[43] The blank check company became a powerful vehicle for fraudulent misrepresentation because the company would disseminate most of its stock to an underwriter and "in problematic cases, the brokerage would disseminate false reports about a profitable upcoming merger, thereby 'pumping up' the stock."[44] After the stock value has been successfully "pumped up," those with the knowledge and control of the company would "'dump' the stock, leaving it virtually worthless when the vaunted merger failed to materialize."[45]

To curb the growing acts of fraud committed through blank check companies and to protect investors, Congress enacted the Securities Enforcement Remedies and Penny Stock Reform Act of 1990.[46] The Act required the SEC to promulgate rules regulating the conduct of blank check companies.

i. Rule 419

Pursuant to the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, the SEC promulgated Rule 419, which protected blank check company investors on the losing end of the dump.[47] Rule 419 protected blank check company investors because it required that at least 90% of the money made from offering stock to the public "be deposited in an escrow account or '[a] separate bank account established by a broker or dealer . . . in which the broker or dealer acts as trustee for persons having the beneficial

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[42] *See* Rodrigues & Stegemoller, *supra* note 1, at 875 (citing William K. Sjostrom, Jr., *The Truth About Reverse Mergers*, 2 ENTREPRENEURIAL BUS. L.J. 743, 756 & n.87 (2008)).

[43] *Id. See also* Sjostrom, *supra* note 42, at 756 (quoting H.R. REP. NO. 101-617, at 9 (1990)) (defining "blank check company").

[44] Rodrigues & Stegemoller, *supra* note 1, at 875 (citing Sjostrom, *supra* note 42, at 756 n.87 (quoting H.R. REP. NO. 101-617, at 9 (1990))).

[45] *Id.*

[46] *See* Penny Stock Reform Act of 1990, Pub. L. No. 101-429, §§ 501–10, 104 Stat. 931, 951–58 (1990).

[47] *See id.*; *see also* Riemer, *supra* note 1, at 941–45; Rodrigues & Stegemoller, *supra* note 2, at 22.

interests in the account.'"[48] The new rule made blank check companies a less desired vehicle for fraud because of the new protections provided by the SEC.[49] In response to Rule 419, a banker named David Nussbaum created SPACs in the 1990s as "a new business form that melded the basic structure of the blank check company with the protective principles of Rule 419." Nussbaum took twelve of his first thirteen SPACs public with completed mergers on a small scale. Soon, organizers of new SPACs began to push the SEC to grant SPACs the ability to IPO, arguing that SPACs are not penny stocks because "if [an] IPO is successful, the proceeds are comfortably over the $5 million threshold," ensuring that the price per share is always higher than $4 despite also seeking a unknown future target.[50] The guarantee of having a share price in excess of $4 is a key difference between SPACs and penny stocks because a penny stock is "defined as stock that has a price of less than $4 per share, and whose company market value is less than $5 million, among other criteria."[51]

When the SEC eventually granted SPAC organizers the ability to take SPACs public via IPO, it was largely because of the additional investor protections included in Rule 419. It is important to note that Rule 419 does not directly regulate SPACs. Remember, SPAC proceeds from selling shares of stock are over the $5 million threshold, and each share is priced over $4 per share, distinguishing SPACs from penny stocks.[52] Additionally, Rule 419 strictly states that penny stock shares cannot publicly trade until there is full disclosure and an acquisition.[53] SPACs operate differently. SPAC shares trade "as soon as the vehicle [goes] public" and do have the ability to trade, but as a blank check company.[54] Despite Rule 419 not directly regulating SPACs, the contours of Rule 419 were rigidly followed when creating the business form because SPACs are widely considered to be a form of blank check company.

SPACs attempted to align themselves with Rule 419 in three ways. First, Rule 419 requires 90% of the IPO capital to be held in escrow, but most U.S. SPACs today typically "hold between ninety-seven and ninety-eight percent of offering proceeds in escrow."[55] Second, Rule 419 requires the money that

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[48] Riemer, *supra* note 1, at 953 (quoting 17 C.F.R. §§ 230.419(b)(1), (2)(vi) (2007)).

[49] *See* Rodrigues & Stegemoller, *supra* note 1, at 875.

[50] *Id.*; *see also* Sjostrom, *supra* note 42, at 757–58 ("[P]ost-IPO, SPACs easily exceed the $5,000,000 net tangible assets threshold given they have no operations and therefore minimal liabilities.").

[51] Rodrigues & Stegemoller, *supra* note 1, at 876 (citing 17 C.F.R. § 240.3a51-1(a) (2011)).

[52] *Id.*

[53] *Id.* at 877.

[54] *Id.*

[55] Riemer, *supra* note 1, at 953.

was made from offering stock be held in "an account constituting a 'deposit' under the Federal Deposit Insurance Act," a money market fund, or "[s]ecurities that are direct obligations of, or obligations guaranteed as to principal or interest by, the United States."[56] Today, SPAC sponsors put the money raised from selling stock into a trust account that invests the money "in government-backed securities" that earn interest.[57] Third, Rule 419 requires that target companies "be equal to or greater than eighty percent of all proceeds,"[58] and U.S. SPACs mimic this requirement by requiring target companies to be equal to or greater than eighty percent of net assets at the time of acquisition.[59]

This self-imposed practice by SPACs serves the purpose of "assur[ing] investors that managers will not circumvent the other SPAC protections by entering into a small transaction, triggering the release of IPO funds from escrow."[60] Further, Rule 419 states that investors have the ability to approve or reject the target acquisition "between twenty and forty-five days after the filing of a post-effective amendment."[61] If there is not "'a sufficient number of purchasers [to] confirm their investment,' the fund is dissolved and investors are entitled to a pro rata share of the Rule 419 Account."[62] SPACs today send proxy statements that explain the details of the proposed target acquisition, and the investors vote on the proposed action with similar stakes.[63] If a majority of shareholders do not approve the acquisition and the timeline is not extended, the SPAC is dissolved and invested funds are returned.[64] Finally, Rule 419 gives a deadline of eighteen months for an acquisition deal to be completed.[65] Though all Rule 419 processes are not required of SPACs, today many SPACs hold themselves to the same standard.[66]

The following section will explain how an IPO works in the United States. SPACs are the focus of this Note, but it is also important to understand IPOs. IPOs and SPACs are similar in many ways but have key differences that must be highlighted. As this Note discusses how to correct issues inherent in SPACs, the distinction between IPOs and SPACs becomes relevant because the issues currently facing SPACs are unique to the SPAC form.

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[56] *Id.* at 953–54 (quoting 17 C.F.R. §§ 230.419(b)(2)(iv)(A)–(C) (2007)).
[57] Rodrigues & Stegemoller, *supra* note 2, at 9.
[58] Riemer, *supra* note 1, at 953–54.
[59] *Id.*
[60] Riemer, *supra* note 1, at 954 n.155.
[61] *Id.*
[62] *Id.* at 954–55 (quoting 17 C.F.R. § 230.419(e)(2)(ii)).
[63] *Id.*
[64] *Id.*
[65] *Id.* at 955.
[66] *See* Rodrigues & Stegemoller, *supra* note 2, at 9.

C. U.S. IPO Mechanics

When a private company looks to take itself public, it must register the stock offering (the ability to offer or sell shares of the company) through a registration statement (Form S-1) with the SEC in accordance with Section 5 of the Securities Act of 1933.[67] Companies must register with the SEC so that it can be assured that investors in the company have "adequate information upon which to base [their] investment decision[s]."[68]

The Form S-1 has two main components: the prospectus and other key information.[69] The prospectus must include all information required by relevant SEC guidelines, "the most important of which are Regulation S-K, which details comprehensive disclosure requirements, and Regulation S-X, which lists financial statement requirements."[70] Specific information that must be disclosed in the prospectus includes (1) elements that make investment in the company risky; (2) the primary purpose of the net proceeds from the offering; (3) prior years of income statements and balance sheets; (4) the "MD&A," or management's discussion and analysis, which includes the financial health of the company, resources available, and arrangements that are off the balance sheet; (5) a description of the "company strategy, intellectual property, applicable government regulations, and ongoing legal proceedings"; and (6) the compensation of the executives.[71] Over the years, as more disclosure requirements have been created, naturally the prospectus has grown. The prospectus provides a holistic audit of the company for the interested investor. Important information that is not contained in the prospectus is likely included in the second part of the Form S-1. This section includes "the company's offering expenses, sales of unregistered securities over the past three years, exhibits required by Regulation S-K, and financial statement schedules required by Regulation S-X."[72]

After Form S-1 is filed, it is made public while the SEC reviews and comments on the submitted statement.[73] The post-filing period before SEC approval is known as the "waiting period" because the company must wait for approval before it can officially be declared a public company.[74] During this

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[67] *See* Patrick J. Gallagher, *Going Public Secretly: The SEC's Unavailing Effort to Increase Initial Public Offerings Through Confidential Registration*, 2019 COLUM. BUS. L. REV. 305, 318 (2019).

[68] *Id.*

[69] *Id.*

[70] *Id.*

[71] *Id.* at 318–19.

[72] *Id.* at 319.

[73] *Id.* at 320.

[74] Rodrigues & Stegemoller, *supra* note 2, at 14.

time, instead of quietly waiting for the SEC, the company goes on a "roadshow to tell the company's 'story' to the market."[75]

When the SEC approves the offering, the underwriting investment bank will analyze data gathered during due diligence and the roadshow.[76] After building a case for the IPO, the bankers working with the company will try to determine whether conditions are right for the IPO to go forward, given that "the bank's own money and reputation is also on the line."[77] If the bankers are successful, the bank will decide the price of the offering and sell shares to the investors who committed throughout the process of the IPO.[78] After around six months, the company is officially publicly traded.[79] It is important to note that failure of any of these steps means that IPO will not go forward.[80]

i. SPAC v. IPO

One of the major differences between the process of a U.S. SPAC and a traditional IPO is the role of an underwriter, which is an investment bank that manages and sells the IPO on behalf of the company.[81] In a traditional IPO, the company looking to go public must find an underwriter. Banks have historically operated as institutions that seek to derisk financial situations. The role of the underwriter is not only managerial but is also a gatekeeping role that seeks to protect everyday investors. For traditional IPOs, "Section 11 of the Securities Act of 1933 assigns the banks strict liability . . . for any material misstatements or omissions."[82] The strict liability standard informs the level of scrutiny banks apply to disclosure documents for traditional IPOs, and "[i]f doubts arise during the due-diligence process as to the accuracy or completeness of the statements, the bank may not let the IPO go forward."[83] The important gatekeeping role of underwriters is not found in the U.S. SPAC process, removing a critical "check on the momentum . . . [to] take the firm public."[84]

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[75] *Id.* at 11.
[76] *Id.*
[77] *Id.* at 15.
[78] *Id.* at 16.
[79] *See US IPO Guide*, LATHAM & WATKINS LLP, at 4–8 (June 15, 2022), https://www.lw.com/thoughtLeadership/lw-us-ipo-guide.
[80] Rodrigues & Stegemoller, *supra* note 2, at 15.
[81] U.S. SEC. & EXCH. COMM'N, SEC PUB. NO. 133, INVESTOR BULLETIN: INVESTING IN AN IPO 2 (Feb. 1, 2013).
[82] Rodrigues & Stegemoller, *supra* note 2, at 4 n.19.
[83] *Id.* at 15.
[84] *Id.* at 4.

Investment banks serve an important gatekeeping function in the traditional IPO process that is absent in SPACs.[85] While some have praised "the ability to simplify the process of accessing the public markets and democratize capitalism," in reality, SPACs have created new questions around gatekeeping, regulation, and investor protection.[86] Without banks verifying disclosure documents during the SPAC process, an important "check on the momentum for the SPAC to complete an acquisition and take the firm public" has been removed.[87] This lack of check is problematic because "[e]very major player in the SPAC is incentivized to find a target and take it public, *even if it is a value-destroying transaction*."[88]

Early SPACs did have an ability to keep bad investments from going public through its nontraditional process.[89] If sponsors, investment banks, and other players tried to push through a bad deal, SPAC shareholders could redeem their shares.[90] "[I]f too many shareholders wanted their money back, the deal was off."[91] Today, the power to redeem shares and stop a merger is essentially gone. "The elimination of the redemption threshold in the wake of the financial crisis created the empty voting perversity we have now, where the economics of the transaction are misaligned with the formal vote."[92] Currently, aspects of empty voting create both moral and economic problems that must be solved if SPACs will continue to effectively operate in the United States.

D. The Fatal Flaw (Empty Voting)

Empty voting is "a practice favored by some [institutional investors] to boost their voting power in a company without putting up much money."[93] Institutional shareholders participate in empty voting in two ways. First, institutional shareholders purchase shares in a public company with a special option to sell those shares while retaining voting rights.[94] Second, institutional

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[85] *Id.*
[86] *Id.* at 1.
[87] *Id.* at 4.
[88] *Id.*
[89] *Id.* at 5.
[90] *Id.*
[91] *Id.*
[92] *Id.*
[93] Stephen Taub, *SEC to Address 'Empty Voting'*, INSTITUTIONAL INV. (July 27, 2010), https://www.institutionalinvestor.com/article/b150qg2zl5904b/sec-to-address-empty-voting.
[94] *Id.*

shareholders "sell[] [their] shares after the record date of a shareholder meeting, but before the meeting."[95] This practice allows institutional shareholders to "decouple economic ownership of shares from voting rights,"[96] creating a disparity in voting power and economic input that is often hidden from the public. In other words, some investors are not putting their money where their mouths are. The secrecy of empty voting in SPACs creates a rigged game.

i. The Game (Empty Voting) Explained

First, "[t]ypical market functioning allows smaller investors to ride the coattails of large investors" and mimic the investment behaviors of large hedge funds and institutional investors that drive the U.S. public markets.[97] For example, if a hedge fund decides to invest in a SPAC and pay millions of dollars for units and voting power, smaller investors will mimic the fund's actions and invest smaller amounts of capital to acquire fewer units and voting power.

After making the initial investment, hedge funds and institutional investors do not remain stagnant. Large players in the game continue to investigate their decision throughout the SPAC's hunt for a target company through analysts that "perform research on a company's industry and prospects" and "read the firm's public filings."[98] Smaller retail investors generally do not execute the same level of due diligence after investing and will likely base their decisions to stay in an investment on market price fluctuations caused by bigger players.[99]

It is at this juncture where the game becomes unfair for smaller retail investors. If hedge funds and institutional investors find a concern with the target company during due diligence, they can redeem their shares and get their cash back like any other shareholder.[100] Withdrawn investments from mammoth investors could understandably signal a vote of no confidence for the deal, but not in a SPAC investment. In fact, SPAC shareholders vote "yes" on target acquisitions an average of 76.6% of the time, but median redemption rates range from 59.9% to as high as 73%.[101] The empty "yes" vote is the historically popular choice among large investors because these investors hold warrants that have value "if—and only if—they complete an acquisition."[102]

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[95] *Id.*
[96] Henry Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 76 S. CAL. L. REV. 811, 811 (2006).
[97] Rodrigues & Stegemoller, *supra* note 2, at 31.
[98] *Id.*
[99] *Id.*
[100] *Id.*
[101] *Id.* at 32, 38.
[102] *Id.* at 4–5.

Currently, the most influential players in the game are able to effectively say "yes" to the deal because they may get paid if the acquisition is successful, but "no" to putting any skin in the game, while the other players' signal or notification of this decision is limited to a natural fluctuation in the market price.[103]

The game currently allows for the deception of smaller investors. Due to the secrecy of empty voting, smaller investors are "underequipped and restricted economically"[104] to be considered "informed and educated"[105] when making crucial decisions like approving a SPAC target acquisition. Since smaller investors follow the coattails of big players, if a big player says "yes" to an acquisition, a smaller investor is likely to follow, or simply abstain from voting. Smaller investors "are assumed to rely on disclosed information when making investment decisions,"[106] and without publicly disclosing big players' empty voter status before an acquisition vote, smaller investors "may not realize that they, as well, will be better off if they redeem their shares even though the transaction received the approval of the majority of the shareholder vote."[107]

The lack of investment bank gatekeeping and the failure to require hedge funds and institutional SPAC investors to publicly disclose their empty voter status before an acquisition vote is a moral and economic issue that circumvents the stated mission of the SEC.[108] The SEC's "touchstone"[109] and core principles include "protect[ing] investors, [and] maintain[ing] fair, orderly, and efficient markets"[110] while "requiring sellers of securities to make material disclosures to facilitate informed decision-making."[111] In SPAC investments today, empty voter status should be considered a material disclosure because knowing how many people are voting empty would likely change investor behavior. SPACs in the U.S. operate under the purview of the SEC alone and do not have additional outside entities like investment banks to verify that the actions taken by hedge funds and institutional investors will ultimately "protect [all] investors, [and] maintain fair . . . markets."[112] Smaller investors have no legitimate opportunity to understand the full scope of the

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[103] *Id.* at 5.

[104] Mira Ganor, *The Case for Non-Binary, Contingent, Shareholder Action*, 23 U. PA. J. BUS. L. 390, 391 (2021).

[105] *Id.*

[106] *Id.*

[107] *Id.*

[108] U.S. SEC. & EXCH. COMM'N, STRATEGIC PLAN FISCAL YEARS 2018–2022 1, 4 (2018), https://www.sec.gov/files/SEC_Strategic_Plan_FY18-FY22_FINAL.pdf.

[109] *Id.*

[110] *Id.*

[111] *Id.*

[112] *Id.*

actual shareholder vote before deciding whether to continue their investment in a SPAC. If left unaddressed, this lawful deception of smaller investors can, and eventually will, compound into a general attitude of distrust in the SPAC market. The SEC must act appropriately to establish guardrails that will ensure market integrity while avoiding off-putting, paternalistic behavior to maintain overall market health through the growth of the burgeoning U.S. SPAC market.

III. ANALYSIS

A. The SPAC Oversight Gap

While the lack of investment bank gatekeeping in the traditional IPO appears to be a contributing factor to SPACs losing their way, aggressive agency oversight is not the solution for U.S. SPACs.

Gatekeeping through investment banks is effective in the traditional IPO because "Section 11 of the Securities Act of 1933 assigns the banks strict liability in the IPO for any material misstatements or omissions."[113] The fear of legal penalty combined with the desire to maintain its reputation "deputize[s] the investment bank to police the offering documents and ensure their accuracy."[114] Investment banks are not bound by the same liabilities in U.S. SPACs because "the de-SPAC is technically not an IPO."[115] In fact, in SPAC deals, investment banks are highly motivated to see target acquisitions regardless of the shareholders' best interests.[116] Most investment banks in their roles as underwriters have deferred "a portion of their compensation until the acquisition," and get paid this portion *if and only if* an acquisition occurs.[117]

One could argue that since investment bank gatekeepers are not a good fit for SPAC oversight, an increase in aggressive agency oversight is the best approach for SPAC disclosure issues. This argument is rooted in the belief that appropriate oversight involves someone or something filling the gap of actively "certifying," "vetting," and "second-guessing"[118] U.S. SPAC disclosures and market overall. As the SEC considers how to regulate U.S. SPACs in the future, it is tempting to formally fill the apparent oversight gap with a new market supervisor like investment banks in traditional IPOs—the SEC itself. The decision would be appealing for several reasons.

[113] Rodrigues & Stegemoller, *supra* note 2, at 4 n.19.
[114] *Id.* at 13.
[115] *Id.* at 4.
[116] *Id.* at 17–18.
[117] *Id.* at 18.
[118] *Id.* at 18, 21, 27.

First, the SEC could consider its new function in U.S. SPAC oversight as a logical extension of the agency's vision.[119] The SEC has already taken action to protect investors against harmful U.S. SPAC behavior by issuing a public statement aimed at SPACs and through enforcement actions against bad actors in the SPAC market.[120] Under *Strategic Objective 3.1* of a recent strategic plan, the SEC could empower itself to become the official "investment bank" presence for SPAC oversight through its stated goal of "[d]esign[ing] and implement[ing] new disclosure regimes for specialized categories of issuers so that investors in these products have relevant and useful information to make informed investment decisions."[121] By stepping into the gatekeeping role and requiring every SPAC deal to go through an approval process (similar to the role of investment banks in traditional IPOs), the SEC could ensure that the moral and economic dangers posed by the fatal flaw (empty voting) do not create a rigged game. The SEC would essentially serve as the game's commissioner, deciding who is eligible to participate in SPAC investments. By picking the "qualified" players, the SEC could feel secure in its mission of protecting investors and maintaining fair, orderly, and efficient markets.[122] Additionally, by assuming the new role, the SEC would not have to wait until U.S. public market integrity is blatantly disregarded to make its influence known through enforcement actions.

Positioning the SEC in this way would be a logical solution that could be immediately implemented with likely swift results. However, these results would likely jumpstart the unfortunate beginning of the U.S. SPAC market's end. Evidence from our friends across the pond in the United Kingdom shows that enhanced agency oversight in the SPAC market would be a heavy-handed approach in the U.S. This option would fix the rigged parts of the game, but simultaneously make the game no longer enticing to play.

B. Case Study: The United Kingdom

A contemporary example of a SPAC market grappling with the tension between strong agency oversight and desired market growth can be seen in the United Kingdom. As recently as August 2021, the U.K. has been active in adjusting its laws and policies to bolster its position in the international SPAC

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[119] *See* U.S. SEC. & EXCH. COMM'N, *supra* note 108, at 4 (explaining the agency's goal to promote capital markets that inspire public confidence and provide a diverse array of financial opportunities to retail and institutional investors, entrepreneurs, public companies, and other market participants).

[120] *See* Rodrigues & Stegemoller, *supra* note 2, at 7–8; Press Release, *supra* note 8.

[121] U.S. SEC. & EXCH. COMM'N, STRATEGIC PLAN FISCAL YEARS 2014-2018 1, 39 (2014).

[122] *See* U.S. SEC. & EXCH. COMM'N, *supra* note 108, at 4.

marketplace, while maintaining strong consumer protections and market integrity.[123]

i. The Presumption of Suspension

The U.K. has sought to achieve balance in their goals for agency oversight and SPAC market growth by removing a key component of its oversight process for SPACs. Before it changed its law in August 2021, the U.K. used a tool called the presumption of suspension.[124] This tool required SPACs to meet specific criteria and follow the U.K.'s supervisory approach.[125] When employing the presumption of suspension, the U.K. "suspend[ed] [the] listing [of a SPAC] when it announce[d] a potential acquisition target."[126] Historically, the U.K. adopted the presumption of suspension for U.K. SPACs "to protect investors from disorderly markets as a result of insufficient information being publicly available at that stage, which could impair the process of proper price formation."[127] While suspension was not automatic, the suspending of securities occurred often enough for there to be a "presumption of suspension" because of explicitly stated goals of the U.K. to protect public markets from harms that could affect "smooth operation of the market,"[128] even temporarily.

The presumption of suspension kept activity in the sector "limited"[129] and created an ecosystem where U.K. SPACs had "a very small market capitalisation, broad investment strategies and relatively few investors (both professional and some retail)."[130] As a result, the process for SPAC creation in the U.K. was less attractive than in other jurisdictions around the world. Before August 2021, the U.K.'s strong commitment to market integrity and investor protection was not well balanced with the market's need for flexibility and the data revealed results of a plodding, non-competitive market. For reference, in 2020 the United States produced and listed 248 SPACs, collectively raising over $80 billion, while the U.K. only produced and listed 4 SPACs with a

[123] *See* FIN. CONDUCT AUTH., INVESTOR PROTECTION MEASURES FOR SPECIAL PURPOSE ACQUISITION COMPANIES: CHANGES TO THE LISTING RULES, 2021, PS21/10, at 2, 5–7, https://www.fca.org.uk/publication/policy/ps21-10.pdf.

[124] *Id.*

[125] *Id.* at 3–6.

[126] *Id.* ¶ 1.2.

[127] *Id.*

[128] *Id.* ¶ 1.3.

[129] FIN. CONDUCT AUTH., INVESTOR PROTECTION MEASURES FOR SPECIAL PURPOSE ACQUISITION COMPANIES: PROPOSED CHANGES TO THE LISTING RULES, 2021, CP21/10, ¶ 3.4, https://www.fca.org.uk/publication/consultation/cp21-10.pdf.

[130] *Id.*

collective worth of £0.03 billion. Lord Hill, a prominent politician who recommended changes in U.K. SPAC policy that were eventually enacted, described the U.K. SPAC market as "dormant"[131] and noted that it carried the perception that the U.K. is "not a viable location to list a SPAC."[132] Further data collection also showed that despite the slowdown of new SPAC formation in the U.S. in 2021 and 2022, "the common US SPAC model does appear to be leading to greater interest in similar listings in the UK if the issue of the presumption of suspension was resolved."[133] This data collection supports an argument that the residual effects of the presumption of suspension coupled with the U.K.'s overall protective attitude of the SPAC market have contributed to the U.K. market being labeled unattractive globally. Consequently, as the U.S. SPAC model becomes more common throughout the world, the U.K.'s most recently adopted model, while deviating from the previous regime, continues to highlight more restrictions than freedoms for sponsors and investors. According to the data, the U.K. is not a preferred destination to list a SPAC, even with the presumption of suspension removed.

The U.K. has taken a major step towards more flexibility in the market, despite the current data and global attitude toward the U.K. SPAC market. In this new system, larger SPACs that have raised £100 million or more must have "structural features embedding important investor protections" and must provide "adequate disclosures to mitigate key risks for investors"[134] for the presumption of suspension to not apply.[135] The adequate features and disclosures that remove suspension can be separated by (1) duties of the SPAC itself, (2) duties of the Board, and (3) shareholder rights.

First, the SPAC must use the money raised for an acquisition within two years or the money returns to the shareholders; a twelve month extension can delay that time to three years if granted.[136] Second, the Board must approve any proposed acquisitions and provide a "'fair and reasonable' statement" if any of the Board members have a conflict of interest in the transaction.[137] Third, any proposed acquisitions require shareholder approval via a vote, and shareholders now enjoy the option to redeem their shares before the completion of the transaction if desired.[138] The changes implemented for the various actors within U.K. SPACs closely parallel the current rights and obligations

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[131] HM TREASURY, UK LISTING REVIEW, 2021, at 2, 29, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/966133/UK_Listing_Review_3_March.pdf.
[132] *Id.* at 30.
[133] FIN. CONDUCT AUTH., *supra* note 123, ¶ 1.10.
[134] FIN. CONDUCT AUTH., *supra* note 129, ¶ 1.8.
[135] *Id.*
[136] FIN. CONDUCT AUTH., *supra* note 123, ¶ 1.14.
[137] *Id.*
[138] *Id.*

of actors developing U.S. based SPACs, and these changes are enforced by the U.K.'s SEC equivalent, the Financial Conduct Authority (FCA).

One major difference that remains between the U.S. and U.K. SPAC markets is what the U.K. describes as its "supervisory approach."[139] In this supervisory approach, the FCA takes an active role in overseeing SPACs seeking to waive the presumption of suspension by serving as the point of contact at established checkpoints throughout the process. The checkpoints include contacting the FCA "before announcing a transaction which has been agreed or is in contemplation, or where details of the proposed target have leaked"; providing the FCA with written Board confirmation that the Board has met the conditions for the new process, "and that it will continue to do so post the announcement until the acquisition is completed";[140] and notifying the FCA to request suspension if a SPAC seeking to use the new process "makes changes to, or removes, any of the specified investor protection measures such that the criteria are no longer met at any point after the Board provides its confirmation."[141]

The FCA's new process to disapply suspension combined with its supervisory approach supports the goal of providing "more flexibility to larger SPACs" while simultaneously "setting robust, credible standards."[142] Additionally, the FCA has clearly articulated its desire to make the U.K. a more attractive and competitive destination for SPACs, but it will not "aim[] to engage in a regulatory 'race to the bottom' on standards."[143]

ii. The Supervisory Approach and the United States

The supervisory approach—or anything with the same heavily restrictive features—would not bode well for the SPAC market in the U.S. for three reasons.

First, to implement a supervisory approach in the U.S., the SEC would need to fundamentally change how it has approached transactions under its purview. Historically, the Division of Corporation Finance has "selectively review[ed] filings made under the Securities Act of 1933 and the Securities Exchange Act of 1934 to monitor and enhance compliance with the applicable disclosure and accounting requirements."[144] To implement an approach like the U.K., the SEC would no longer be "selective," but would be active in their

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[139] *Id.* ¶¶ 3.1–3.7.
[140] *Id.* ¶ 3.2.
[141] *Id.*
[142] *Id.* ¶ 1.5.
[143] *Id.*
[144] *Filing Review Process*, U.S. SEC. & EXCH. COMM'N (Sept. 27, 2019), https://www.sec.gov/divisions/corpfin/cffilingreview.htm.

efforts to "monitor and enhance compliance"[145] with the law. Additionally, if the SEC were to create a size threshold trigger like the U.K. did with SPACs valued over £100 million, the mandatory checkpoints would fundamentally contradict the SEC's policy against no-merit-based review. The SEC "does not evaluate the merits of any transaction or determine whether an investment is appropriate for any investor."[146] Deviation from this standard would not only be unattractive to those who participate in the SPAC market, but the change could feel particularly targeted if the additional agency oversight was applied exclusively to U.S. SPACs.

Second, implementing a supervisory approach would take away a major attracting feature of U.S. SPACs: efficiency. SPACs have been perceived as a more efficient investment vehicle because of the shorter timeline to complete a transaction.[147] As SPAC IPOs have increased in size throughout the U.S., "a more standardized and efficient IPO process for SPACs" has naturally developed.[148] While the amount of time can vary depending on the type of transaction, after finding a target company to merge with, a SPAC transaction closes within "3–6 months on average, while an IPO usually takes 12–18 months."[149] Replicating the heavy-handed supervisory approach of the U.K. (or a similar approach) would harm the process that has been developing naturally in the United States. Creating overbearing checkpoints along the path to IPO for SPACs would slow the transaction process, even if the supervisory approach operates perfectly. The additional points of clearance from the SEC, compounded with the sheer size of the growing U.S. SPAC market, would likely create a complicated system that requires sponsors and investors to wait in line behind other SPACs seeking approval from the SEC at different stages of the transaction. The long process of perfecting the checkpoints requiring SEC rubberstamping would likely lead to a period of extended experimentation to find the Goldilocks "just right" standard. Impatient investors looking to list SPACs on terms that are less fluid could simply pursue a traditional IPO or a SPAC IPO in another jurisdiction with less regulation such as Amsterdam, creating an investor vacuum.[150] The mass exodus of institutional investors would leave a gap in the U.S. SPAC market that would likely be filled by increased numbers of unsophisticated investors. Without guidance in the

[145] *Id.*
[146] *Id.*
[147] Rodrigues & Stegemoller, *supra* note 2, at 36.
[148] *Id.*
[149] John Lambert, *Why So Many Companies are Choosing SPACs over IPOs*, KPMG (2021), https://advisory.kpmg.us/articles/2021/why-choosing-spac-over-ipo.html.
[150] *See Why Amsterdam Is the Capital of Europe's SPAC Frenzy,* VELOCITY GLOB. (Mar. 19, 2021), https://velocityglobal.com/blog/amsterdam-capital-europe-spac.

SPAC market, unsophisticated investors could negatively impact the American public markets overall through their investment decisions in the SPAC market.

Third, the goals of the U.S. and U.K. are not the same for SPACs in their public markets. The U.K. has been explicit in their apprehension towards SPACs, emphasizing the "complex" nature of the investment and the "highly varied"[151] returns for investors. The purpose of their supervisory approach is to allow the FCA to have a strong hand in investor protection and market integrity. The FCA has gone so far as to say that the "proposed changes may not necessarily lead to high numbers of SPAC issuers listing in the U.K., or to increased investor demand."[152] The priority in the U.K. appears to be investor protection at all costs, even if it affects market growth. SPACs seem to present a threat to the stability of the U.K. public markets, and while there is now more flexibility, SPAC actors in the U.K. must be heavily supervised to play in the game. Until recently, the U.S. has taken a more ambivalent stance towards SPACs in public markets. John Coates, then-Acting Director for Corporation Finance at the SEC, wrote in April 2021 that he was "not pro- or anti-SPAC."[153] Coates, along with other regulators, focused on ensuring that SPACs, like any other investment vehicle in the U.S. public markets, are providing the necessary disclosures and information to investors so they can make "informed investment and voting decisions."[154] The SEC, like the FCA, desires to maintain market integrity and stability by creating highly informed investors. However, the SEC has not shown a particular need or desire for micromanaging the U.S. SPAC market. In fact, the growth of the SPAC market furthers the SEC's stated goal of "provid[ing] a diverse array of financial opportunities to retail and institutional investors, entrepreneurs, public companies, and other market participants."[155] The SEC understands the importance of SPACs in the U.S. public markets; 60% of all IPOs in the U.S. were SPACs in 2020.[156] The U.S. and the U.K. not only began the balancing act of agency oversight and maintaining the SPAC market from different places, but the economic policy interests of the countries are different regarding SPACs. A supervisory approach in the U.S. would be an overzealous remedy to an issue that can be resolved through the promulgation of a rule.

[151] FIN. CONDUCT AUTH., *supra* note 129, ¶ 1.3.

[152] *Id.* ¶ 1.16.

[153] U.S. SEC. & EXCH. COMM'N, ACTING DIR., DIV. CORP. FIN., SPACS, IPOS AND LIABILITY RISK UNDER THE SECURITIES LAWS 1 (Apr. 8, 2021), https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws.

[154] *Id.*

[155] U.S. SEC. & EXCH. COMM'N, *supra* note 108, at 3.

[156] *See* Rodrigues & Stegemoller, *supra* note 2, at 2.

U.S. SPACs do not suffer from a lack of aggressive agency oversight and a supervisory approach like the U.K.'s would go too far. If implemented, the U.S. SPAC market would likely grind to a halt because investors would seek new locations in which to go public, circumventing the new "[s]upervisory approach"[157] of the U.S. SPAC market. Alternatively, they may pursue a traditional IPO. This is not to say that the SEC has no role in SPAC reform; in fact, the contrary is true. There must be another way for the U.S. government to regulate SPACs that preserves the strengths of the current market—flexibility and speed—while furthering American values of free markets and equal opportunity. The SEC must implement a twofold approach, focused on (1) promulgating rules that change sponsor and investor behavior and (2) protecting public markets by intervening only when prudent.

IV. RECOMMENDATIONS

U.S. SPACs have disclosure issues that must be addressed, and which are currently an area of focus for regulators in the United States.[158] This section will first focus on recommendations that previous scholars have proposed to correct empty voting in SPACs to solve key points of tension in the SPAC process. In their recommendations, these scholars balance corrective interests with the goal of market growth. Next, this Note will propose a different approach: a two-step SPAC confirmation system. The "two-step" is a new structure created to address issues of empty voting and disclosure in U.S. SPACs and which synthesizes the best features of previous recommendations.

A. SPAC Scholar Recommendations

i. Integrated Ownership Disclosure

"Integrated ownership disclosure" is an idea first proposed by Professors Henry Hu and Bernard Black.[159] In summary, integrated ownership disclosure adjusts existing SEC disclosure rules to create a new system that addresses empty voting loopholes.[160] The new system would operate in four main ways. First, the system would work "toward common standards for triggering disclosure and for disclosing positions once disclosure is required."[161] Second, the system would provide "a single set of rules for which ownership positions

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[157] FIN. CONDUCT AUTH., *supra* note 123, ¶ 3.1.

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

[159] *See* Hu & Black, *supra* note 96, at 864.

[160] *Id.* at 876.

[161] *Id*. at 875.

to disclose and how to disclose them."[162] Third, the professors proposed that the system require "disclosure of all positions conveying voting or economic ownership, arising from shares or coupled assets."[163] Finally, the system would require "symmetric disclosure of positive and negative economic ownership," meaning that the same disclosures would occur whether the return on shares were in the same direction (positive) or not (negative).[164] The goal behind creating this regime in 2006 was to improve disclosure of empty voting and hidden ownership, while also simplifying disclosure rules.[165] The professors reasoned that disclosure would be "likely to reduce the incidence of empty voting" and could function as a light that could shine in places that have been cloudy because "[e]ven hedge funds may sometimes hesitate to do publicly what they might do in the dark."[166] This proposal was created primarily to help investors, along with "corporations, Delaware judges, banking and securities regulators, and legislators."[167] Both Professors Hu and Black believed their proposed changes, among others, could begin to resolve the "unregulated and often unseen" empty voting that "[c]orporate case law . . . does not touch."[168] This proposal would likely succeed because there is a desire for more transparency in SPAC investments and in public markets today. When Professors Hu and Black proposed this idea, there were private sector and international efforts in motion to address vote buying and coordination so that standards would be more similar internationally.[169] Today, not much has changed, as there are still domestic (The Financial Industry Regulatory Authority[170]) and international groups (International Corporate Governance Network) seeking to accomplish goals of "long-term value creation, contributing to sustainable economies, societies, and the environment."[171]

ii. Empty Voting Threshold

Professors Usha Rodrigues and Michael Stegemoller proposed a more focused approach in 2021 that addresses empty voting mechanisms in U.S. SPACs. The professors are considered leading experts in U.S. SPACs, having

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[162] *Id.*
[163] *Id.*
[164] *Id.*
[165] *See id.*
[166] *Id.* at 886.
[167] *Id.* at 875.
[168] *Id.* at 818.
[169] *See generally id.* (discussing existing efforts to address vote buying and coordination).
[170] *See About FINRA*, FINRA https://www.finra.org/about (last visited Jan. 16, 2023).
[171] *Welcome to the ICGN*, INT'L CORP. GOVERNANCE NETWORK https://www.icgn.org (last visited Jan. 16, 2023).

studied and written about the investment vehicle for over a decade.[172] In a joint paper released in 2021, among other recommendations to improve issues in SPACs, the professors suggest the creation of an empty voting threshold.[173] Under this proposal, the empty voting threshold would be set at 50%, meaning that "if more than half of shareholders ask for their money back, the deal should fail."[174] The professors argue throughout the paper that this recommendation can benefit most parties to the transaction because requiring at least 50% of investor funds to remain in a SPAC gives "the target some certainty of price (by guaranteeing at least a certain amount in the trust account), and [it] allows public shareholders a meaningful voice in the going-public transaction."[175] The empty voting threshold would be established by the SEC, "encourag[ing] the NYSE and Nasdaq to require redemption thresholds of at least 50% in order for a deal to go forward."[176] By establishing an empty voting threshold, the professors believe that the SEC would achieve the crucial goal of "protecting *all* investors from the information asymmetries and concomitant market frenzy that can distort the efficiency of capital markets."[177] Further, the empty voting threshold would benefit multiple parties to a SPAC investment because it would "give[] . . . public shareholders a meaningful voice in the going-public transaction."[178] This proposal would likely succeed because the changes that would be required for implementation would be minimal and feasible. The SEC strongly encouraging the New York Stock Exchange (NYSE) and Nasdaq to implement an empty voting threshold, as Professors Rodrigues and Stegemoller prescribe, is a relatively insignificant action for the SEC to take. Action by the SEC does not require the passing of new laws, and the SEC has the singular power to create and implement new rules if necessary.[179] Ultimately, the change could likely be made because the SEC has significant influence in the public markets.

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[172] *See, e.g.*, Rodrigues & Stegemoller, *supra* note 1.
[173] *See* Rodrigues & Stegemoller, *supra* note 2, at 5–6.
[174] *Id.* at 47.
[175] *Id.*
[176] *Id.*
[177] *Id.* at 48.
[178] *Id.* at 47.
[179] U.S. SEC. & EXCH. COMM'N, AUDIT NO. 347, RULEMAKING PROCESS (July 12, 2002), https://www.sec.gov/oig/reportspubs/aboutoigaudit347finhtm.

iii. Contingent Shareholder Action

Contingent shareholder action, proposed by Professor Mira Ganor in 2021, is an innovative idea that addresses new ways to think about empty voting.[180] A cornerstone philosophy that Ganor introduces is a "non-binary approach" to empty voting.[181] Professor Ganor states that historically, a binary system has existed for shareholder action, meaning shareholders have had only two options: they "vote either to approve a proposal or to reject it."[182] Ganor's non-binary approach rejects the artificial limitation placed upon shareholders to choose one of these two options. Professor Ganor argues that a third, non-binary option can and should exist in the context of empty voting: contingent shareholder action. Contingent shareholder action allows retail investors to "choose to redeem their shares if a certain percentage of shareholders choose to redeem shares unconditionally, thus withdraw[ing] their support of the company regardless of the outcome of the shareholder vote about the De-SPAC transaction."[183]

Contingent shareholder action rests on two relevant principles. The first principle is that "[c]ontingent shareholder action allows retail investors to piggyback on the sophisticated investors' knowledge and research."[184] This free-riding principle is an important element for retail investors in SPACs because free-riding is how many investors navigate the public markets. Institutional investors and hedge funds are industry leaders in the public markets. These actors set the trends and give insights into investment practices that other smaller investors, including individual retail investors, follow. The second principle is that "contingent shareholder action can take many forms and use different thresholds."[185] The flexibility afforded by Ganor's proposal allows retail investors to self-determine what empty voting/redemption threshold is the trigger for exiting a deal. The current system only allows "shareholder[s] to vote, or act, based on the actions of others."[186] In her writing, Professor Ganor provides an example of contingent shareholder action at work:

> Consider the scenario in which a group of people is voting by show of hands. The sequence starts with a few people who raise their hands first, which reveals who supports the proposal strongly, and thus votes immediately with no hesi-

[180] Ganor, *supra* note 104.
[181] *See id.* at 391.
[182] *Id.* at 390.
[183] *Id.* at 415–16.
[184] *Id.* at 416.
[185] *Id.*
[186] *Id.*

> tation. After a short delay, additional hands are raised following the lead of those who voted first. However, participating in a shareholder meeting in person is costly, so shareholders may refrain from doing so, and thus will not be able to follow the lead of those who raise their hand first.[187]

Contingent shareholder action places traditionally non-existent power into the hands of shareholders by helping shareholders have the "benefits of acting as a group at a lower cost."[188] Contingent shareholder action benefits all shareholders, especially unsophisticated investors, because unsophisticated shareholders now have an opportunity "to see through the shareholder approval of the merger transaction and follow the sophisticated investors' choice to redeem their shares."[189] The ability to know when shares are redeemed by fellow shareholders does not currently exist for unsophisticated investors, but is made possible by contingent shareholder action. Professor Ganor's proposal is an equitable remedy to the fatal flaw in SPACs and would be a strong proposal if enacted. This system can lead to more transparency and trust because in this system, "every shareholder may choose to follow rather than to lead, or vice versa."[190] Additionally, contingent shareholder action is a strong proposal because "contingent shareholder action can be by proxy or in writing and still account for the information about the simultaneous votes of other shareholders even without attending the meeting in person."[191] This is an important feature because under contingent shareholder action, investors who miss shareholder meetings and would traditionally be left unaware of the votes of other shareholders may now learn about the collective support or disregard of proposals and make more informed decisions.

B. A New Proposal: A SPAC Two-Step

A new, two-step SPAC confirmation system could effectively address empty voting in U.S. SPACs without ruining the market's growth. This recommendation incorporates many of the proposals that the previously mentioned scholars consider in their work, the newly proposed rules put forward by the SEC, and new ideas for the ever-changing SPAC market today.[192] If regulation must occur, this process allows the game to remain worth playing.

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[187] *Id.* at 401–02.
[188] *Id.* at 402.
[189] *Id.* at 408.
[190] *Id.* at 403.
[191] *Id.* at 402.
[192] *See* Special Purpose Acquisition Companies, Shell Companies, and Projections, 87 Fed. Reg. 29458 (May 13, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 230, 239, 240, 249, & 270).

First, as recommended by Professors Hu and Black, the SEC should revisit its rules.[193] However, instead of manipulating current disclosure rules to close loopholes like Hu and Black recommend, the SEC should promulgate rules directly for SPACs. SPACs have established themselves as a staying force in U.S. public markets. New rules concerning empty voting and disclosure specific to the SPAC market would provide long-term guardrails for the industry. The promulgation of new SPAC disclosure rules would establish this Note's recommended two-step SPAC confirmation system. The new two-step SPAC confirmation system would involve aspects of what Professors Rodrigues, Stegemoller, and Ganor propose, with alterations to order and timing.

First, this Note proposes that the SEC should work in tandem with the NYSE and Nasdaq to require redemption thresholds.[194] However, this Note differs from Rodrigues and Stegemoller's recommendation in how the redemption threshold would work in U.S. SPACs. This Note recommends that the SEC propose rules that require the NYSE and Nasdaq to notify all SPAC investors of a 35% redemption rate after the shareholder de-SPAC approval vote. This 35% trigger would not require investors to state who voted empty by redeeming their shares and who kept their money in the deal, but it would make retail investors aware that this investment contains increased removal of funds despite its approval. The 35% redemption threshold proposal is a strong fit with both the policy and practice of the SEC's newly proposed rules for SPAC regulation. One of the proposed rules considers a "minimum 20-calendar day dissemination period for prospectuses and proxy and information statements . . . so that [investors] have sufficient time to consider the disclosures and to make more informed voting, investment and redemption decisions."[195] The rate of redemption for a SPAC is an invaluable data point that should be provided to investors. The twenty-day dissemination period and the 35% redemption threshold proposal fit well together because both mechanisms are focused on supporting investors' ability to make informed decisions concerning their investment by making available critical information about any SPAC in a timely manner. While this Note will argue for a ten-day window, the paramount interest of giving investors the time and ability to consider important disclosures before committing fully to a SPAC transaction is aligned with the SEC's goals.

Next, this Note argues that new rules by the SEC should allow all SPAC investors, upon notice of the initially approved SPAC's 35% redemption status, a ten-day window to decide how to proceed.[196] This ten-day window

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[193] *See* Hu & Black, *supra* note 96.

[194] *See* Rodrigues & Stegemoller, *supra* note 2, at 47.

[195] Special Purpose Acquisition Companies, Shell Companies, and Projections, 87 Fed. Reg. 29458, 29478–79 (May 13, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 230, 239, 240, 249, & 270).

[196] This ten-day window would be ten business days.

would directly address the issues that Ganor describes.[197] The ten-day window would allow shareholders an opportunity to participate in a form of contingent shareholder action because they would have an opportunity to decide the finality of their actions based on important data, such as whether other investors are maintaining their investments.[198] Upon notification, every shareholder would have the ability to either keep their investment in the SPAC, or to redeem their shares. This Note proposes that after the ten-day window closes, the SPAC deal faces two options of finality based on shareholder decisions in the ten-day window. If the redemption rate of the SPAC rises to 50%, this Note aligns with the positions of Rodrigues and Stegemoller: "the deal should fail."[199] If the redemption rate does not rise to 50% or higher within ten days, the SPAC is confirmed, and shareholder approval is finalized. Investors receiving notice when the SPAC has reached a 35% redemption rate is a more restrictive measure that can help influence SPAC practices towards greater disclosure for investors.

One must remember two key points when thinking about the 35% threshold. The first is that that current data shows that median redemption rates for U.S. SPACs range from 59.9% to as high as 73% with SPAC shareholders voting "yes" on target acquisitions an average of 89.1% of the time.[200] The second is that investors do not know the rates of redemption at any point of their investment.[201] The previous two points demonstrate the growing norm of redemption while voting "yes" and highlight the need for notice for all SPAC investors to make informed decisions with their investments. By proposing that the SEC give notice to all investors at a 35% redemption rate, SPACs would provide valuable information that has historically been withheld at a position that is 19.4% below the average redemption rate for a U.S. SPAC. Additionally, through the power of contingent shareholder action, investors can exercise their power by doing the opposite of Professor Ganor's hand raising analogy.[202] In this recommendation, shareholders can collectively put their hands *down* to stop SPAC investments that are not supported by most investors. This Note recognizes that reasons for redemption vary among investors but takes the position that issues concerning SPAC approval should be democratic. A SPAC investment without majority investor support should not continue.

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[197] Rodrigues & Stegemoller, *supra* note 2, at 48.

[198] *Id.*

[199] *Id.* at 47.

[200] *Id.* at 25, 30, 32 (noting that "the total number of shares redeemed as a percentage of shares issued in the IPO is an average (median) of 54.2% (59.9%), with a quarter having redemption rates over 91%").

[201] *See id.*

[202] *See* Ganor, *supra* note 104, at 401–02.

This recommendation is more narrowly tailored than the previous scholars' proposals in two ways. First, this proposal's notification requirement is a key addition that differs from the Rodrigues & Stegemoller recommendation. Rodrigues & Stegemoller prescribe waiting until the SPAC has reached a 50% redemption rate to pull the plug, without any prior notice to shareholders that the redemption rate is rising.[203] In contrast, this proposal seeks to create more transparency surrounding U.S. SPAC redemption rates by notifying shareholders of the changes in the investment environment before stopping the deal. The notification requirement of this proposal builds upon Rodrigues & Stegemoller's work by embedding transparency into the process of creating a U.S. SPAC instead of allowing up to 49.9% of SPAC shareholders to consistently hide their hands.

Second, this recommendation takes a closer look at SPACs with redemption rates between 35–49%. Not every SPAC deal should survive because certain companies cannot or should not be a target in a SPAC deal. The current norm is that a redemption rate under 50% is acceptable, but this allowance permits potentially bad deals to see the public markets. While bad deals may individually benefit some insiders, in the aggregate these deals dilute the quality of the market. Determining the appropriate rate of redemption for SPACs is beyond the scope of this Note, but by flagging SPACs with redemption rates of 35%, this recommendation has uniquely highlighted a segment of SPACs that have typically flown under the radar of most investors and SPAC scholars.

The goals of this recommendation are directly aligned with those of previous scholars whose work this proposal is built upon. This recommendation is also aligned with the stated and implied goals of the SEC as evidenced by some of the proposed rules that already exist.[204] SPACs are a relatively new mainstream investment vehicle, so case law and rules specific to the form are lean. Like the changes Professors Hu and Black propose in their paper, this proposal hopes to bring pointed regulation to an area of empty voting that is quickly developing. Additionally, this proposal hopes to protect the young U.S. SPAC market from distrust. Like the stated goals of Professors Rodrigues and Stegemoller, the two-step SPAC confirmation system seeks to "protect[] *all* investors from the information asymmetries and concomitant market frenzy that can distort the efficiency of capital markets"[205] by providing material information at inflection points of the investment lifecycle to better inform *every* investor. Finally, inspired by the work of Professor Ganor, one of the final goals of this recommendation is to give every investor, big or

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[203] Rodrigues & Stegemoller, *supra* note 2, at 32.

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

[205] *See* Rodrigues & Stegemoller, *supra* note 2, at 48.

small, a fair opportunity to learn and react to group activity within the investment environment in which they operate. Under the two-step system, major happenings that affect any investor's bottom line within the investment vehicle are timely disclosed. By proposing the breaking of the binary norm in SPAC shareholder action, this recommendation hopes to see more investor involvement in SPACs because in the two-step SPAC confirmation system, investors can trust that they have a legitimate opportunity to change their mind based on data and risk tolerance.

i. Potential Critiques

The newly proposed two-step confirmation process for U.S. will likely be met with challenges and critiques. This section contemplates and addresses some of these challenges. For example, though the proposed two-step confirmation process adds complexity and time to the U.S. SPAC process, the recommendation could improve the overall experience for every SPAC investor and the success of the market. When considering this critique, two elements must be considered. The first element is that U.S. SPACs have disclosure issues. As previously discussed, issues around empty voting and transparency is not a new concern; however, the frequency and influence of SPACs in the U.S. economy is new. The SEC likely would not have proposed new SPAC rules if this was not an area of concern and growing influence. SPACs have generally been unregulated, and the lack of regulation enables bad behavior that has required SEC action and inequitable practices in the public markets. If left unchecked, the results can be detrimental to both the public trust in the market and overall market efficiency. This past and recent history has led to the second element that must be considered. Regulation is coming. Again, it must be remembered that the SEC already has U.S. SPACs in its sights by proposing rules, some of which directly address issues of disclosure. The U.S. SPAC process is trending towards having added steps to be taken and additional complexity after the rulemaking is final that will likely add time to the current SPAC process as we know it. The two-step confirmation recommendation of this Note explores and recommends a best option for what a new disclosure process may look like that balances the needs of the SEC, the growth of the SPAC market, and its current stakeholders. This proposed process requires limited additional action from shareholders, while providing more notice and transparency to the SPAC process than currently exists. Finally, this proposed two-step confirmation process can be executed without alienating shareholders while only extending the original timeline by ten days.

Another fair critique that this new proposal likely faces is that the proposed ten-day window for investors' redemption decisions is too short. Ten days is not enough time for smaller or less sophisticated investors to appropriately analyze how other shareholders have voted and contemplate the best decision for themselves. In typical voting situations, the strong and informed would protect the weak and inexperienced because their financial interests are more intertwined. However, in a SPAC investment, investors are not tied together in the same way. This gives rise to the vulnerable being left to fend for themselves. This is one of the core issues addressed in this Note. It is prudent to be concerned for the investors left behind because those at risk are likely everyday people. While a longer amount of time could be offered for investors, SPACs are widely known as "complex investment[s]" that require advanced investor participation.[206] The goal of the proposed window of time is to allow every investor, regardless of their sophistication level, sufficient time to reassess their investment to determine if redemption is necessary. The proposed window of time should not arbitrarily elongate the finalization of a SPAC deal because one of the key features of a SPAC is its perceived speed.[207] For investors who should be keen on their investments, especially complex investments for sophisticated shareholders, ten days should be an adequate amount of time. If a SPAC shareholder cannot receive the redemption status notification, analyze the best interests of their portfolio, and either do nothing or redeem their shares within ten days, it is likely that the issue is not caused by the government's amount of time provided, but rather the overall awareness of the investor. Candidly, risk is an element of every financial investment. Every investor must beware of risks taken, especially with SPACs. While this recommendation does not call for total investor protection, it does call for automatic cancelation of a SPAC when it reaches a 50% redemption rate. This feature serves two roles. First, it protects everyday investors from being uninformed or misguided about the ten-day window. Second, this feature protects the public markets from bad transactions that should never be open to the public.

V. CONCLUSION

SEC regulation is coming. The growth of the U.S. SPAC market has highlighted the importance of the form in U.S. public markets, but it has also highlighted issues of disclosure that must be addressed. It is clear from the growth of the market that SPACs have potentially strong staying power because SPACs have benefitted the market in a collection of ways in a short period of time. 60% of all IPOs in 2020 were SPAC companies, and SPACs injected $87.9 billion into the economy in the first quarter of 2021 alone.[208] Additionally, SPACs have cracked open doors that have historically been completely

[206] FIN. CONDUCT AUTH., *supra* note 129, ¶ 1.3.
[207] *See* Rodrigues & Stegemoller, *supra* note 2, at 50.
[208] *Id.* at 2, 6.

closed to everyday investors. While SPACs are not currently the perfect vehicle for equity in investing, there are opportunities to democratize the market through the form that are being explored. The 2022 U.S. SPAC market is at one of the most critical times in its relatively short history. This Note contributes to the salient U.S. SPAC discussion.

By first exploring what a SPAC is and examining their history, readers are equipped with key information that lays a strong foundation to contemplate the current issues facing SPACs in America and in the United Kingdom. It is through the lens of a basic understanding of SPACs, their history, and differences in their operation globally that this Note seeks to focus readers on the issue of empty voting. Empty voting in SPACs is the fatal flaw addressed in this Note. Empty voting allows a rigged game to be played that equips some to always enjoy a form of victory, while others must truly roll the dice. To resolve issues of transparency, trust, and long-term market efficiency in the SPAC market, changes in empty voting must—and are likely to—happen. As the SEC directly regulates SPACs for the first time, this Note hopes to emphasize that while more transparency is needed, a heavy-handed approach involving paternalistic regulation can dissolve the growing market. An example of this type of regulation can be seen in the United Kingdom, and this approach is not America's "cup of tea" based on the goals of the two countries. The proposed two-step SPAC confirmation system is a solution for the SEC that is grounded in the scholarship of some of the best legal minds in the SPAC discussion, and it accommodates the multiple influential interests of the SEC, the U.S. SPAC market, and interested players in the SPAC game.

Finally, this Note helps stock the scarce cupboard that is legal scholarship about SPACs. The SPAC will continue to grow and evolve around the world, and it is the hope that international comparative scholarship like this will inform future scholars and thinkers to create actionable proposals for SPACs in their jurisdiction by reading about what is being attempted globally. This global perspective will hopefully allow for more innovative and curated SPAC solutions to be found and applied as the form works to become perfect over time.