

October 2022

## Attack on the SPAC: The Push to Regulate Special Purpose Acquisition Companies as Investment Companies Under the Investment Company Act

Sean Meyer

Follow this and additional works at: <https://scholarship.law.uc.edu/uclr>



Part of the [Science and Technology Law Commons](#), [Secured Transactions Commons](#), and the [Securities Law Commons](#)

---

### Recommended Citation

Sean Meyer, *Attack on the SPAC: The Push to Regulate Special Purpose Acquisition Companies as Investment Companies Under the Investment Company Act*, 91 U. Cin. L. Rev. 230 (2022)  
Available at: <https://scholarship.law.uc.edu/uclr/vol91/iss1/7>

This Student Notes and Comments is brought to you for free and open access by University of Cincinnati College of Law Scholarship and Publications. It has been accepted for inclusion in University of Cincinnati Law Review by an authorized editor of University of Cincinnati College of Law Scholarship and Publications. For more information, please contact [ronald.jones@uc.edu](mailto:ronald.jones@uc.edu).

## ATTACK ON THE SPAC: THE PUSH TO REGULATE SPECIAL PURPOSE ACQUISITION COMPANIES AS INVESTMENT COMPANIES UNDER THE INVESTMENT COMPANY ACT

Sean Meyer\*

I. INTRODUCTION .....	230
II. BACKGROUND .....	233
A. <i>The Evolution of SPACs</i> .....	234
B. <i>Adoption of the ICA</i> .....	238
C. <i>The ICA's Definition of an Investment Company</i> .....	240
III. DISCUSSION .....	244
A. <i>SPACs Are Not Investment Companies Under the ICA</i> .....	245
B. <i>SPACs Present Unique Risks That Justify Regulatory Scrutiny</i> .....	248
C. <i>Solving the Problems with SPACs</i> .....	250
IV. CONCLUSION.....	251

### I. INTRODUCTION

Special purpose acquisition companies (“SPACs”) raised \$87.9 billion in the United States over the first three months of 2021.<sup>1</sup> Completely unused for a decade after being invented by a lawyer and banker duo in 1993, SPACs surpassed the traditional initial public offering (“IPO”) in 2021 as a vehicle for private companies to be listed on the public stock exchange (or “go public”) and raise capital.<sup>2</sup> When a private company merges with a publicly-listed SPAC, the successor company formed from the merger retains the benefits of the SPAC’s public listing.<sup>3</sup> High-profile companies that have gone public by merging with a SPAC include DraftKings, Virgin Galactic, Nikola Motor Co., WeWork,<sup>4</sup> 23andMe, and

---

\* Publications Editor, *University of Cincinnati Law Review*. I wish to thank Professor of Law Lynn Bai for her thoughtful guidance and my Notes and Comments Editor Carter Ostrowski for his diligent review of drafts of this Comment. Any views expressed herein are my own.

1. Yun Li, *SPACs Break 2020 Record in Just 3 Months, But the Red-Hot Industry Faces Challenges Ahead*, CNBC (Mar. 19, 2021, 10:34 AM), <https://www.cnbc.com/2021/03/19/spacs-break-2020-record-in-just-3-months.html> [https://perma.cc/8GSK-KMRZ].

2. See U.S. SEC, OFF. INV. EDUC. & ADVOC., *WHAT YOU NEED TO KNOW ABOUT SPACs – UPDATED INVESTOR BULLETIN* (2021) [hereinafter *WHAT YOU NEED TO KNOW ABOUT SPACs*]; Frank Holmes, *What Are SPACs, and Why Is Everyone Talking About Them Right Now?*, FORBES (Mar. 22, 2021, 12:54 PM), <https://www.forbes.com/sites/greatspeculations/2021/03/22/what-are-spacs-and-why-is-everyone-talking-about-them-right-now> [https://perma.cc/2Y69-FQFP].

3. See EVA SU, CONG. RSCH. SERV., IF11655, *SPAC IPO: BACKGROUND AND POLICY ISSUES 1* (2021).

4. Tom Huddleston, Jr., *What Is a SPAC? Explaining One of Wall Street's Hottest Trends*, CNBC (Jan. 30, 2021, 9:00 AM), <https://www.cnbc.com/2021/01/30/what-is-a-spac.html>

BuzzFeed.<sup>5</sup> Significantly fewer companies used SPACs to go public in the first quarter of 2022 than in the year before, but the future of SPAC usage remains uncertain.<sup>6</sup>

A SPAC raises funds through an IPO in order to facilitate the SPAC's merger with a target entity, typically a private company.<sup>7</sup> By merging with a SPAC, a private company can become a publicly-listed company without navigating the traditional IPO process.<sup>8</sup> In recent years, business sector experts have criticized the lengthy and onerous process that accompanies the IPO.<sup>9</sup> SPACs offer a legal workaround to the IPO, taking a private company public while avoiding the perceived delays and inefficiencies of the IPO.<sup>10</sup>

SPACs are sometimes referred to as blank check companies or shell companies because they typically make few expenditures before merging with a private company.<sup>11</sup> Once a SPAC has raised funds through an IPO, the funds are placed in an escrow account managed by a third party until the SPAC merges with a target company or liquidates.<sup>12</sup> SPACs typically employ no administrative staff, purchase no physical office space, and make no capital investments.<sup>13</sup> Instead, a SPAC's management team, frequently comprised of the SPAC's founders and sponsors, leads the initiative to identify and merge with a target company.<sup>14</sup> The management

---

[<https://perma.cc/R8US-RYSC>].

5. David Reichenberg, *Ready, Set, SPAC: Who Is Winning in This Latest Investment Trend?*, FORBES (Sept. 5, 2021, 10:38 AM), <https://www.forbes.com/sites/davidreichenberg/2021/09/05/ready-set-spac-who-is-winning-in-this-latest-investment-trend> [<https://perma.cc/6SPP-87NE>]. See also Jessica Bursztynsky & Alex Sherman, *BuzzFeed Shares Close Down 11% on First Day of Trading After SPAC Merger*, CNBC (Dec. 6, 2021, 11:08 AM), <https://www.cnbc.com/2021/12/06/buzzfeed-stock-falls-surge-on-first-day-of-trading-after-spac-merger.html> [<https://perma.cc/F237-ZRV9>].

6. Preston Brewer, *Analysis: Days of Future SPAC—How SPACs Might Be ReWorked*, BLOOMBERG L. (June 15, 2022, 5:00 AM), <https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-days-of-future-spac-how-spacs-might-be-reworked> [<https://perma.cc/N7HQ-3BSG>]. SPAC registrations sunk from 299 in the first quarter of 2021 to just 18 in the first quarter of 2022. *Id.*

7. SU, *supra* note 3, at 1.

8. Max H. Bazerman & Paresh Patel, *SPACs: What You Need to Know*, HARV. BUS. REV., July–Aug. 2021, <https://hbr.org/2021/07/spacs-what-you-need-to-know> [<https://perma.cc/TA9N-3Z5Z>].

9. Dave Erickson, *What's Wrong with the IPO Process and How to Fix It*, KNOWLEDGE WHARTON (Dec. 15, 2020), <https://knowledge.wharton.upenn.edu/article/whats-wrong-ipo-process-fix> [<https://perma.cc/98ZM-4UKQ>]. See also A.C. Pritchard, *Revisiting "Truth in Securities" Revisited: Abolishing IPOs and Harnessing Private Markets in the Public Good*, 36 SEATTLE U. L. REV. 999, 1013–14 (2013).

10. Jonathan Baer, *The Slow Death of the Traditional IPO*, NETWORK: BUS. BERKELEY L. (Oct. 3, 2020, 8:59 AM), <https://sites.law.berkeley.edu/thenetwork/2020/10/03/the-slow-death-of-the-traditional-ipo> [<https://perma.cc/EDG4-H2XU>].

11. WHAT YOU NEED TO KNOW ABOUT SPACs, *supra* note 2.

12. *How Special Purpose Acquisition Companies (SPACs) Work*, PWC, <https://www.pwc.com/us/en/services/audit-assurance/accounting-advisory/spac-merger.html> [<https://perma.cc/S9WK-NMMU>] (last visited Dec. 3, 2021).

13. See WHAT YOU NEED TO KNOW ABOUT SPACs, *supra* note 2.

14. *Id.*

team may have a specific target company in mind or focus on a narrow group of target companies that share a common business purpose.<sup>15</sup> Because the identity of a SPAC's target company is not shared outside the management team, prospective SPAC investors rely on the reputation of the management team to judge the SPAC's suitability for investment.<sup>16</sup> Each SPAC has a two-year time limit to complete the merger or risk liquidation, which returns the SPAC's IPO proceeds to investors.<sup>17</sup>

The sizeable influx of capital into SPACs has been accompanied by accelerating scrutiny from regulators and commentators. Congress, the Securities and Exchange Commission ("SEC"), and the Financial Industry Regulatory Authority ("FINRA"),<sup>18</sup> have expressed concerns about the risks SPACs pose for small investors, individual investors who purchase small quantities of stocks.<sup>19</sup> In recent years, some investors have filed class action lawsuits against SPACs, alleging that SPACs misrepresented facts that influenced investors' decision making.<sup>20</sup>

In August 2021, billionaire investor Bill Ackman's SPAC, Pershing Square Tontine Holdings, Ltd. ("PSTH"), was named in the most high-profile lawsuit involving SPACs to date, a shareholder derivative suit filed in the United States District Court for the Southern District of New York.<sup>21</sup> PSTH was the largest SPAC to have gone public at the time.<sup>22</sup> The plaintiff was a shareholder in PSTH who argued in his complaint that PSTH qualified as an investment company under the Investment Company Act of 1940 ("ICA").<sup>23</sup> By failing to accurately register PSTH as an investment company, the plaintiff alleged, PSTH was

15. *Id.*

16. *Investing in a SPAC*, FINRA (Mar. 29, 2021), <https://www.finra.org/investors/insights/spacs> [<https://perma.cc/QG43-ZPWW>].

17. See WHAT YOU NEED TO KNOW ABOUT SPACS, *supra* note 2. Some SPACs elect for an eighteen-month duration instead. *Id.*

18. *About FINRA*, FINRA, <https://www.finra.org/about> [<https://perma.cc/4TND-7B3B>] (last visited Nov. 18, 2021). FINRA is a private non-governmental organization authorized by Congress to oversee broker-dealer activity in the United States. *Id.*

19. See Corey I. Rogoff, *FINRA Lives up to Its Name, Announces Regulatory Inquiries into SPACs*, 11 NAT'L L. REV. 207 (2021), <https://www.natlawreview.com/article/finra-lives-to-its-name-announces-regulatory-inquiries-spacs> [<https://perma.cc/F5NL-3J4F>]; Gary Gensler, Chairman, SEC, Prepared Remarks Before the Small Business Capital Formation Advisory Committee (Sept. 27, 2021).

20. See WHAT YOU NEED TO KNOW ABOUT SPACS, *supra* note 2.

21. Yun Li, *Bill Ackman SPAC Sued, Plaintiffs Say Directors Were Promised 'Staggering Compensation'*, CNBC (Aug. 17, 2021, 10:10 AM), <https://www.cnbc.com/2021/08/17/bill-ackman-spac-sued-plaintiffs-say-directors-were-promised-staggering-compensation.html> [<https://perma.cc/JG43-Y2FG>].

22. Complaint at 1–2, *Assad v. Pershing Square Tontine Holdings, Ltd.*, No. 21-cv-06907 (S.D.N.Y. Aug. 3, 2022) [hereinafter *Assad Complaint*].

23. *Id.*; see also Li, *supra* note 20. The plaintiff was represented *pro hac vice* by New York University Law Professor Robert Jackson, Jr., and Yale Law School Professor John Morley. *Id.*

structured to illegally extract millions of dollars from investors.<sup>24</sup> Regardless of whether PSTH was improperly structured, the litigation presented the intriguing and consequential question: whether a SPAC should properly be classified as an investment company under the ICA.<sup>25</sup>

This Comment examines and addresses the main question presented by the complaint filed against PSTH: whether SPACs constitute investment companies under the ICA.<sup>26</sup> Investment companies are subject to filing requirements and operating restrictions that do not apply to other companies.<sup>27</sup> Part II of this Comment provides a brief history of SPACs, from invention to contemporary prevalence. Then, Part II continues with an overview of the circumstances and debates that preceded the adoption of the ICA, an analysis of the ICA's text, and one court's effort to bring clarity to that text. Part III evaluates positions for and against regulating SPACs as investment companies under the ICA. Ultimately, Part III argues that SPACs do not fit within the legal framework set up by the ICA, as evidenced by the ICA's text and Congress' legislative intent. Part III proposes solutions to the legal and economic quandaries involving SPACs that do not require regulating SPACs as investment companies. Part IV concludes this Comment by asserting that legislative action is preferable to judicial reinterpretation where SPACs are concerned, critiquing contemporary congressional repudiation of the power to legislate.

## II. BACKGROUND

The operations and prevalence of SPACs have changed considerably since the company type was initially invented. A holistic consideration of how SPACs and the ICA were created, evolved in usage, and are likely to be used in the future is required to understand how SPACs might fit into the ICA's framework. Accordingly, Section A of this Part describes the history of SPACs, from unused in the 1990s to gaining popularity in the 2010s. Section A next describes the SPAC boom of 2020 to 2021, during which SPAC issuance surpassed traditional IPOs, and the recent

---

24. See Assad Complaint, *supra* note 22.

25. Before the court could settle the matter, PSTH dissolved in July 2022 without selecting and merging with a target company, returning the \$4 billion raised to shareholders. Tom Zanki, *Ackman to Dissolve Massive \$4B SPAC, Refund Investors*, LAW360 (July 12, 2022, 5:01 PM), <https://www.law360.com/articles/1510739/ackman-to-dissolve-massive-4b-spac-refund-investors> [<https://perma.cc/883Y-89DR>]. Accordingly, the shareholder plaintiff dismissed his lawsuit against PSTH. Elaine Briseño, *Pershing Square Investor Drops Suit over SPAC Status*, LAW360 (July 13, 2022, 2:38 PM), <https://www.law360.com/articles/1511141/pershing-square-investor-drops-suit-over-spac-status> [<https://perma.cc/U4GH-DR9V>].

26. See Assad Complaint, *supra* note 22.

27. See *infra* text accompanying notes 109–15.

regulatory crackdown on SPACs. Section B details the historical circumstances that precipitated the ICA's enactment in 1940 to illuminate the drafters' intentions. Section B then describes the principles of legislative intent behind the ICA, gleaned from congressional debates and hearings, to consider whether these principles support the inclusion of SPACs within the ICA's framework. Section C identifies the most relevant portions of the ICA's definition of an investment company, as codified in the United States Code. Finally, Section C of this Part describes one case from the limited case law on the ICA that clarifies the definition of an investment company. This analysis facilitates later evaluation of whether and where SPACs fit within the ICA's scope.

### A. *The Evolution of SPACs*

SPACs were invented in 1993 by banker David Nussbaum and lawyer David Miller to give startups an alternative route by which to raise funds from individual investors.<sup>28</sup> At the time, the SEC was concerned about the proliferation of fraud in the corporate securities sector, especially penny stock fraud.<sup>29</sup> Investment brokers had been fraudulently selling penny stocks (corporate stocks sold for less than five dollars) to investors targeted as unlikely to research the stocks before investing.<sup>30</sup>

The year before SPACs were invented, the SEC adopted a regulation building on the Securities Act of 1933 (the "Securities Act") to crack down on blank check companies, entities frequently compared or equated with SPACs.<sup>31</sup> The SEC defined a blank check company as a company with "no specific business plan or purpose or [which] has indicated its business plan is to engage in a merger or acquisition with an unidentified company or companies, or other entity or person."<sup>32</sup> Accordingly, in the regulation adopted, the SEC defined a blank check company to include a company whose (1) "business plan is to engage in a merger or acquisition with an unidentified company" and (2) who is "issuing 'penny stock,' as

---

28. Amrith Ramkumar, *SPAC Pioneers Reap the Rewards After Waiting Nearly 30 Years*, WALL ST. J. (Mar. 9, 2021, 4:53 PM), <https://www.wsj.com/articles/they-created-the-spac-in-1993-now-theyre-reaping-the-rewards-11615285801> [<https://perma.cc/GYN2-725L>].

29. O. Dennis Hernandez, Jr., *Broker-Dealer Regulation Under the New Penny Stock Disclosure Rules: An Appraisal*, 1993 COLUM. BUS. L. REV. 27, 30–32 (1993). The SEC is still concerned about the fraudulent sale of penny stocks today. See e.g., *Microcap Fraud*, INVESTOR.GOV, <https://www.investor.gov/additional-resources/spotlight/microcap-fraud> [<https://perma.cc/85TB-96U4>] (last visited Sept. 2, 2022).

30. Edward G. Lance, IV, *SEC Cracks Down on Penny-Stock Fraud*, 10 LOY. CONSUMER L. REV. 9, 9–10 (1998). See also *THE WOLF OF WALL STREET* (Paramount Pictures 2013) for an entertaining, semi-fictional illustration of the functioning of a penny stock boiler room.

31. 17 C.F.R. § 230.419 (2021). See WHAT YOU NEED TO KNOW ABOUT SPACs, *supra* note 2.

32. NASD Regulation, Inc., SEC Staff No-Action Letter, [1993–2001 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,681 (Jan. 21, 2000).

defined in Rule 3a51-1 under the Securities Exchange Act of 1934” (the “Exchange Act”).<sup>33</sup> In the SEC’s view, blank check companies present a special risk of fraud and manipulation in the penny stock market, which harms investor confidence and jeopardizes the stability of the blank check company as an entity type.<sup>34</sup> Given the SEC’s emphasis on investor protection and fraud reduction, Nussbaum and Miller worked with regulators when inventing SPACs to ensure these regulatory priorities were satisfied in the structure of SPACs.<sup>35</sup> Disclosure requirements for SPACs were increased as a result of these discussions.<sup>36</sup>

For a decade after the invention of SPACs in 1993, the SPAC structure went unused.<sup>37</sup> The first SPAC went public in the United States in 2003.<sup>38</sup> In the early days of SPAC formation, boutique law firms and investment banks sometimes supported SPAC sponsor groups which chose target companies in specialized industries.<sup>39</sup> Thirty-three SPACs went public over the years 2015 and 2016.<sup>40</sup> The New York Stock Exchange listed its first SPAC in May 2017.<sup>41</sup> In 2019, SPACs accounted for one-fourth of all IPOs for the year, as more experienced investors became SPAC sponsors and pursued target companies in a wider variety of market sectors.<sup>42</sup>

A “SPAC boom” began in 2020, when SPAC IPOs exceeded traditional IPOs for the first time.<sup>43</sup> During the first quarter of 2021,

33. 17 C.F.R. § 230.419 (2022). Rule 3a51-1 defines penny stock according to what it is not, excluding stock issued by a registered investment company, puts (rights to sell a stock), call options (rights to buy a stock), and most stocks sold for more than five dollars, among others. *Id.* § 240.3a51-1.

34. NASD Regulation, Inc., SEC Staff No-Action Letter, [1993–2001 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,681 (Jan. 21, 2000).

35. See Ramkumar, *supra* note 28.

36. *Id.* At this time, Nussbaum and Miller also added “the right for a SPAC’s investors to get their money back before [the] merger with a private company goes through” to the SPAC structure. *Id.*

37. Camila Domonoske, *The Spectacular Rise of SPACs: The Backwards IPO That’s Taking over Wall Street*, NPR (Dec. 29, 2020, 5:00 AM), <https://www.npr.org/2020/12/29/949257672/the-spectacular-rise-of-spacs-the-backwards-ipo-thats-taking-over-wall-street> [https://perma.cc/YS9C-QAAT].

38. 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, 404 (2020). The first European SPACs to go public did so in 2005. Of course, European SPACs face a different set of regulatory guidelines and stock exchange requirements than SPACs in the United States. *Id.* at 404–05.

39. Bazerman & Patel, *supra* note 8.

40. Mark Stricherz, *SPACs Overtake IPOs as Preferred Vehicle for Companies Going Public*, CQ ROLL CALL, Mar. 5, 2021, 2021 WL 836857.

41. Holmes, *supra* note 2.

42. Nicholas Jasinski, *2019 Was a Record Year for ‘Blank-Check’ Companies. Here Are the Biggest Trends.*, BARRON’S (Feb. 6, 2020, 2:13 PM), <https://www.barrons.com/articles/2019-was-a-record-year-for-blank-check-companies-here-are-the-biggest-trends-51581016401> [https://perma.cc/Y32D-72FK].

43. See Holmes, *supra* note 2.

SPACs made up 68.5 percent of all IPOs in the United States.<sup>44</sup> Observers continue to debate the causal factors behind the sudden uptick in the popularity of SPACs, but some scholars noted that many startup firms had high demand for access to capital at a pre-revenue point in the business life cycle that was not satisfiable through the traditional IPO process.<sup>45</sup> Additionally, the COVID-19 pandemic brought investor uncertainty and market volatility, which highlighted the risks of the IPO and led experienced, high-profile investors who were previously SPAC-hesitant to view SPACs as a viable alternative to the IPO.<sup>46</sup>

Amid this proliferation of SPACs, noteworthy instances of SPAC mismanagement dampened some investors' excitement. In March 2020, Nikola Corporation ("Nikola"), an American electronic automobile manufacturing company, publicly announced the intention to go public by merging with the publicly-traded SPAC VectoIQ Acquisition Corp.<sup>47</sup> After the merger, Nikola soared to a market capitalization of over \$30 billion, at the time surpassing automotive industry titan Ford Motor Company's valuation.<sup>48</sup> However, in September 2020, a short seller released an online report alleging that Nikola's founder and executive chairman Trevor Milton had made fraudulent statements about Nikola's proprietary technology and ability to produce gases required for the electronic automobiles' fuel cells.<sup>49</sup> An internal review of the company conducted by an outside law firm confirmed some of the short seller's

---

44. Anne Sraders, *Months After the SPAC Boom, Returns Have Been 'Weak,' Says Goldman Sachs*, FORTUNE (Sept. 16, 2021, 3:11 PM), <https://fortune.com/2021/09/16/spac-returns-ipos-goldman-sachs> [https://perma.cc/N92N-9C5X].

45. *Why SPACs Are Booming*, KNOWLEDGE WHARTON (May 4, 2021), <https://knowledge.wharton.upenn.edu/article/why-spacs-are-booming> [https://perma.cc/36WV-34J2]. The traditional IPO process is more favorable for companies at later stages of development than startup companies. *Id.*; see also Jessica Bai et al., *Segmented Going-Public Markets and the Demand for SPACs* 14–15 (Sept. 23, 2021) (unpublished manuscript), [https://scholar.harvard.edu/files/angelama/files/bai\\_ma\\_zheng\\_sep2021.pdf](https://scholar.harvard.edu/files/angelama/files/bai_ma_zheng_sep2021.pdf) [https://perma.cc/WQS3-ZW98].

46. Crystal Tse & Crystal Kim, *SPACs Were Hot in 2020 and Are Hotter Now. Here's Why*, BLOOMBERG PRO. SERVS. (Apr. 23, 2021), <https://www.bloomberg.com/professional/blog/spacs-were-hot-in-2020-and-are-hotter-now-heres-why> [https://perma.cc/92J9-B6A9].

47. Abhishek Manikandan, *Nikola Corp to Go Public at over \$3.3 Billion Valuation*, REUTERS (Mar. 3, 2020, 7:23 AM), <https://www.reuters.com/article/us-nikola-corp-vectoIQ/nikola-corp-to-go-public-at-over-3-3-billion-valuation-idUSKBN20Q1J5> [https://perma.cc/U37N-VNUP].

48. Ben Foldy, *Electric-Truck Startup Nikola Bolts Past Ford in Market Value*, WALL ST. J. (June 9, 2020, 10:50 PM), <https://www.wsj.com/articles/electric-truck-startup-nikola-bolts-past-ford-in-market-value-11591730357> [https://perma.cc/Z7Y9-E64J].

49. *Nikola: How to Parlay an Ocean of Lies into a Partnership with the Largest Auto OEM in America*, HINDENBURG RSCH. (Sept. 10, 2020), <https://hindenburesearch.com/nikola> [https://perma.cc/WGB3-3JGY].

claims.<sup>50</sup> Milton resigned from the company the same month.<sup>51</sup> Soon after, the SEC sued Milton for violating the anti-fraud provisions of the Securities Act and the Exchange Act, seeking a permanent injunction, civil penalties, and disgorgement of Milton's gains from his alleged misconduct.<sup>52</sup>

In 2021, as larger private companies increasingly chose to go public by SPAC merger rather than by traditional IPO, regulatory oversight of SPAC activity rose commensurately. In May 2021, the United States House Committee on Financial Services released draft legislation that would amend the Securities Act and the Exchange Act, changing the definition of a blank check company to include "a development stage company that . . . has indicated that its business plan is to acquire or merge with an unidentified company, entity, or person," language describing SPACs' business model.<sup>53</sup> By defining companies that operate like SPACs as blank check companies, the legislation would eliminate SPACs' safe harbor protections from lawsuits related to forward-looking statements, such as financial projections, opening SPACs up to increased risks of liability from misrepresentation claims.<sup>54</sup>

In July 2021, the SEC filed charges against another SPAC, Stable Road Acquisition Company ("Stable Road"), Stable Road's chief executive officer ("CEO"), and the target company for Stable Road's merger.<sup>55</sup> Stable Road, its CEO, and the target company settled with the SEC for over \$8 million.<sup>56</sup> The same month, the president and CEO of FINRA announced that the organization planned to intensify scrutiny of SPACs, given the risks for mismanagement and misrepresentation by SPAC managers.<sup>57</sup> In September 2021, SEC Chairman Gary Gensler expressed

50. Ben Foldy, *Nikola Internal Review Confirms Some Claims in Short Seller's Report*, WALL ST. J. (Feb. 26, 2021, 9:47 AM), <https://www.wsj.com/articles/nikola-internal-review-confirms-some-claims-in-short-sellers-report-11614350745> [<https://perma.cc/26DE-2K9V>].

51. Corey I. Rogoff, *Ex-Nikola Chairman Indicted for Securities Fraud*, 11 NAT'L L. REV. 242 (2021), <https://www.natlawreview.com/article/ex-nikola-chairman-indicted-securities-fraud> [<https://perma.cc/RC4T-AVLB>].

52. Brief for Plaintiff at 64–65, SEC v. Milton, No. 21-cv-06445 (S.D.N.Y. July 29, 2021).

53. H.R. \_\_\_, 117th Cong. (2021), [https://financialservices.house.gov/uploadedfiles/5.24\\_bills-117pih-hr\\_\\_\\_\\_.pdf](https://financialservices.house.gov/uploadedfiles/5.24_bills-117pih-hr____.pdf) [<https://perma.cc/55VR-TFLW>] (discussion draft legislation).

54. Ran Ben-Tzur & Jay Pomerantz, *House Releases Draft Legislation Eliminating SPAC Safe Harbor for Forward Looking Statements*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 7, 2021), <https://corpgov.law.harvard.edu/2021/06/07/house-releases-draft-legislation-eliminating-spac-safe-harbor-for-forward-looking-statements> [<https://perma.cc/8Y8F-8LCX>]. Losing safe harbor protections would likely compel SPAC management to take out additional directors and officers liability insurance to cover the resulting increased risk of litigation, an additional cost for affected SPACs to bear. *Id.*

55. Press Release, SEC, 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> [<https://perma.cc/4QPH-R6FK>].

56. *Id.*

57. Rogoff, *supra* note 19.

concern that some SPACs' practice of raising funds from private investments in public equity (transactions in which an issuer sells stocks to an investor at a discount from market rates) could be benefiting large institutional investors at the expense of small retail investors, in effect diluting the small retail investors' shares.<sup>58</sup> Chairman Gensler recommended increased disclosure requirements for SPACs to address this potential dilution and ensure investor protection.<sup>59</sup>

### *B. Adoption of the ICA*

Several decades before SPACs were invented, the American stock market crash of October 1929 marked the beginning of the Great Depression.<sup>60</sup> By June 1932, the value of the Dow Jones Industrial Average had fallen approximately two-hundred points from three years earlier.<sup>61</sup> When some banks failed, many Americans lost deposited life savings.<sup>62</sup> Unemployment rose to a rate of 23.6 percent in 1932.<sup>63</sup> Businessmen who had previously made money selling stocks began to sell investment advice instead.<sup>64</sup> Amid this economic disruption, an SEC investigation into investment sector practices discovered a pattern of abuses by investment advisers and investment company managers against the interests of the individual investors they served.<sup>65</sup>

In response, Congress drafted and passed the ICA and the Investment Advisers Act of 1940 ("IAA") as companion legislation to rein in these seemingly nefarious investment advisers.<sup>66</sup> Over the year preceding the passage of the ICA and IAA, Congress held committee and subcommittee hearings, received letters from the SEC, and issued reports to formulate an effective response to the ongoing problems in the country's investment sector.<sup>67</sup> Congressional documents from this period present the objectives

---

58. Gensler, *supra* note 19.

59. Gary Gensler, Chairman, SEC, Prepared Remarks Before the Investor Advisory Committee (Sept. 9, 2021).

60. John D. Harkrider, *Lessons from the Great Depression*, 23 ANTITRUST 6, 6–7 (2009). The Great Depression was a period of worldwide economic decline. *Id.*

61. *Id.*

62. *Americans React to the Great Depression*, LIBR. CONG., <https://www.loc.gov/classroom-materials/united-states-history-primary-source-timeline/great-depression-and-world-war-ii-1929-1945/americans-react-to-great-depression> [<https://perma.cc/2T82-95AK>] (last visited Oct. 9, 2022).

63. See Harkrider, *supra* note 60, at 6.

64. Arthur B. Laby, *Reforming the Regulation of Broker-Dealers and Investment Advisers*, 65 BUS. LAW. 395, 402–03 (2010).

65. 87 CONG. REC. 9815 (1940).

66. *75th Anniversary of the 1940 Acts*, U.S. SEC, <https://www.sec.gov/spotlight/75th-anniversary-iac-ica.shtml> [<https://perma.cc/W3RC-HKTZ>] (last visited Oct. 10, 2022). The ICA and IAA are frequently referred to jointly as the "1940 Acts."

67. 87 CONG. REC. 9807–08 (1940); H.R. DOC. NO. 70 (1939); H.R. DOC. NO. 707 (1938).

that motivated Congress to enact the ICA: (1) curbing the behavior of self-interested investment company managers; (2) protecting small investors; (3) reducing investment companies' misrepresentations; and (4) restoring the public reputation of the investment company, all without handicapping the investment sector.

First, the ICA was adopted to stop investment company managers from operating investment companies to further self-interest at investors' expense.<sup>68</sup> Congress sought to counter the abusive business practices the SEC investigation into investment companies uncovered.<sup>69</sup> For instance, some investment company managers withdrew funds for personal use from investment companies they managed and failed to return the funds.<sup>70</sup> Other managers arranged economically unsound loans and bailouts from investment company funds, unnecessarily disadvantaging investors.<sup>71</sup> By enacting the ICA, Congress sought to crack down on the investor-harming behavior of these self-aggrandizing investment company managers.

Second, the ICA was adopted to protect small investors.<sup>72</sup> In 1940, investment companies were fundamental to the national economy and enjoyed a broad appeal among members of the public.<sup>73</sup> Between 1927 and 1936, around one-fifth of all sales of corporate securities were by investment companies to members of the public.<sup>74</sup> Shares in investment companies were sometimes purchased by low-income individuals through installment plans, and protecting this vulnerable population from abuse was a special concern for Congress.<sup>75</sup> Congress found that investors were having difficulty gathering enough information about investment companies, especially those that had not registered securities, and hoped that passing the ICA would increase the amount of information that investment companies disclosed.<sup>76</sup>

Third, the ICA was adopted to police investment companies' public misrepresentations.<sup>77</sup> The ICA provides that an investment company is barred from making misrepresentations in the documents the company files with the SEC and from using a misleading company name when registering as an investment company with the SEC.<sup>78</sup> The SEC's

---

68. 87 CONG. REC. 9807.

69. *Id.*

70. *Id.* at 10072.

71. *Investment Trusts and Investment Companies: Hearings Before a Subcomm. of the Comm. on Banking & Currency, 76th Cong. 37, 285 (1940) [hereinafter *Investment Trusts*].*

72. 87 CONG. REC. 9815.

73. *Id.* at 10072.

74. *Id.*

75. *Id.* at 10071.

76. *Id.* at 10073.

77. *Id.* at 10077.

78. *Id.* at 9813.

investigation discovered that one investment company sold shares to low-income individuals by convincing the individuals that money invested was being put into a savings plan.<sup>79</sup> Other low-income individuals were persuaded that funds invested in the investment company could be retrieved at any time, like a bank account.<sup>80</sup>

Fourth, the ICA was adopted to restore the beleaguered public reputation of investment companies.<sup>81</sup> Between 1929 and 1940, small investors in investment companies had experienced significant losses.<sup>82</sup> Members of Congress considered what proportion of these losses was due to the overall decline in the value of stocks over that period and what proportion was due to mismanagement of investment companies by investment company managers.<sup>83</sup> Regardless, reputational damage to investment companies had solidified.<sup>84</sup> Congress hoped the ICA would rebuild small investors' confidence in investment companies, which in turn would stimulate capital flow into the investment sector and mitigate the economic downturn the country was experiencing.<sup>85</sup> Congress predicted that the ICA's protections would encourage venture capital investment in investment companies.<sup>86</sup>

Simultaneously, Congress sought to establish these protections without unduly handicapping the investment sector.<sup>87</sup> One member of Congress who spoke during the congressional debate over early versions of the ICA emphasized that the bill should be crafted in a manner that would not discourage investment activity.<sup>88</sup> While supporting the investigation into improper conduct related to investment companies, the congressman expressed the "need . . . [for] the removal of every unnecessary handicap to business, whether of governmental or economic character" to support the economic wellbeing of the country, seemingly an aim to draft the ICA without burdensome overinclusiveness.<sup>89</sup>

### *C. The ICA's Definition of an Investment Company*

The ICA has remained largely unchanged since initial enactment in

---

79. *Investment Trusts*, *supra* note 71, at 42–43.

80. *Id.* at 168.

81. 87 CONG. REC. 9808, 9815.

82. *Id.* at 10072.

83. *Id.* at 9815.

84. *Id.*

85. *Id.* at 9807.

86. *Id.* at 9808.

87. *Id.* at 9815.

88. *Id.* at 9816.

89. *Id.*

1940, notwithstanding being amended by Congress in 1970.<sup>90</sup> The portion of the ICA defining “investment company” for the purposes of the statute is codified in Title 15, Section 80a-3, of the United States Code.<sup>91</sup> Subsection (a) includes generally applicable definitions for entities that qualify as investment companies.<sup>92</sup> Subsections (b) and (c) provide an extensive list of exemptions for entities that would otherwise be considered investment companies under subsection (a).<sup>93</sup> Throughout, the statute emphasizes that an entity’s primary business purpose is a main determinant of whether the entity is an investment company.<sup>94</sup>

Under subparagraph (a)(1)(A), an investment company is an entity that “is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities.”<sup>95</sup> Subparagraph (a)(1)(B) provides that face-amount certificate companies are investment companies.<sup>96</sup> Subparagraph (a)(1)(C) establishes that entities whose business involves or plans to involve “investing, reinvesting, owning, holding, or trading in securities,” and who own or plan to own “investment securities” (securities purchased as an investment) with a value greater than forty percent of the entity’s value in total assets, are investment companies.<sup>97</sup> The forty percent rule excludes cash and government securities (such as government bonds and treasury notes) from the entity’s total asset value.<sup>98</sup> Paragraph (b)(1) makes clear that an entity “primarily engaged . . . in a business or businesses other than that of investing, reinvesting, owning, holding, or trading in securities” is not an investment company for the purposes of the ICA.<sup>99</sup>

Next, Section 80a-4 divides investment companies into three categories: (1) face-amount certificate companies; (2) unit investment trusts; and (3) management companies.<sup>100</sup> Face-amount certificate companies raise money by issuing debt securities to investors.<sup>101</sup> Unit

---

90. See Gerard H. Manges, *The Investment Company Amendments Act of 1970 – An Analysis and Appraisal After Two Years*, 14 B.C. L. REV. 387 (1973).

91. 15 U.S.C.A. § 80a-3 (Westlaw through Pub. L. No. 117-179).

92. *Id.* § 80a-3(a).

93. *Id.* §§ 80a-3(b)–(c).

94. *Id.* § 80a-3.

95. *Id.* § 80a-3(a)(1)(A).

96. *Id.* § 80a-3(a)(1)(B).

97. *Id.* § 80a-3(a)(1)(C).

98. *Id.*

99. *Id.* § 80a-3(b)(1).

100. *Id.* § 80a-4.

101. *Id.* Face-amount certificate companies are also mentioned in Section 80a-3, subparagraph (a)(2). *Id.* See *Face Amount Certificate Company: Everything You Need to Know*, UPCOUNSEL, <https://www.upcounsel.com/face-amount-certificate-company> [<https://perma.cc/P4LF-Q6LM>] (last visited Dec. 3, 2021).

investment trusts raise money by buying a group of securities, often stocks and bonds, and offering them to investors as redeemable units for a set time period.<sup>102</sup> The ICA designates all investment companies that do not qualify as face-amount certificate companies or unit investment trusts as management companies.<sup>103</sup> Management company managers decide what the company will invest in.<sup>104</sup>

Additionally, SEC Chief Counsel David Schenker described, at a Senate subcommittee hearing on the ICA, two subclassifications of management companies that fall within the ICA's regime: (1) open-end management companies; and (2) closed-end management companies.<sup>105</sup> Investors in open-end management companies have the right to compel the company to redeem (buy back) the investor's shares.<sup>106</sup> Investors in closed-end management companies, in contrast, do not have the right to compel the company to redeem shares.<sup>107</sup> Beyond these categorizations, Schenker noted that management investment companies were subclassified with an eye to the structure of the company and the "nature of [the company's] activities," (i.e., what the company does with the money received from investors).<sup>108</sup>

The metrics used to determine what constitutes an investment company are consequential because a company deemed an investment company must register as such with the SEC.<sup>109</sup> Should SPACs be categorized as investment companies, they would need to satisfy investment company registration requirements. Registration as an investment company requires disclosure of company information, including the company's investment policies and statements on the company's plans to borrow money, buy and sell real estate, and make loans.<sup>110</sup> The ICA imposes extensive restrictions on registered investment companies, limiting how the companies may name themselves,<sup>111</sup> the classes of securities the companies may offer,<sup>112</sup> the process by which the companies may choose an accountant<sup>113</sup> or adviser,<sup>114</sup> and the penalties that apply to those who

---

102. *Unit Investment Trusts (UITs)*, INVESTOR.GOV, <https://www.investor.gov/introduction-investing/investing-basics/glossary/unit-investment-trusts-uits> [<https://perma.cc/NJ8U-HB3A>] (last visited Oct. 10, 2022).

103. 15 U.S.C.A. § 80a-4(3) (Westlaw through Pub. L. No. 117-179).

104. *Investment Trusts*, *supra* note 71, at 186.

105. *Id.* at 186–87.

106. *Id.* at 43.

107. *Id.*

108. *Id.* at 186–87.

109. 15 U.S.C.A. § 80a-8 (Westlaw through Pub. L. No. 117-179).

110. *Id.*

111. *Id.* § 80a-34.

112. *Id.* § 80a-18.

113. *Id.* § 80a-31.

114. *Id.* § 80a-15.

steal from the companies.<sup>115</sup> Registered investment companies are also subject to regulations that build on the ICA, which include requirements that certain types of investment companies provide periodic reports to investors and list certain information in sales literature.<sup>116</sup>

Over the decades since the ICA's enactment, courts have attempted to clarify ambiguities in the ICA's definition of an investment company, expounding on when a company is "engaged *primarily*, or proposes to engage *primarily*, in the business of investing, reinvesting, or trading in securities."<sup>117</sup> SPACs were invented relatively recently, so post-ICA enactment case law does not focus on SPACs. Nonetheless, analyzing courts' application of the ICA to comparable non-SPAC companies proves informative.

In *SEC v. Fifth Avenue Coach Lines, Inc.*, the United States District Court for the Southern District of New York endeavored to identify what constitutes an investment company under the ICA's definition.<sup>118</sup> The City of New York had acquired a bus company, Fifth Avenue Coach Lines, Inc. ("Fifth"), through condemnation.<sup>119</sup> At the condemnation proceeding, Fifth sought remuneration for property taken by the city, triggering a flurry of litigation.<sup>120</sup> The SEC brought an action for injunction against Fifth based on Section 42(e) of the ICA.<sup>121</sup> Section 42(e) permits the SEC, upon uncovering a violation of a subchapter of the ICA or associated regulations, to "bring an action in a United States district court to seek . . . a civil penalty to be paid by the person who committed such violation."<sup>122</sup>

Discovery uncovered a web of misbehavior on the part of Fifth executives.<sup>123</sup> In 1962, Fifth borrowed \$9 million (valued at the time of writing at approximately \$88 million) to satisfy the company's financial obligations, including debts, judgments from personal injury claims related to operation of the buses, and former employees' pensions.<sup>124</sup> Then, Fifth stopped all business practices, reduced its staff to a handful of employees whose sole job was to eliminate tort claims against the company, and sold its office space to instead work out of the second floor

---

115. *Id.* § 80a-36.

116. 17 C.F.R. §§ 270.34b-1, 270.30e-1 (2021).

117. 15 U.S.C.A. § 80a-3(a) (emphasis added).

118. *SEC v. Fifth Ave. Coach Lines, Inc.*, 289 F. Supp. 3, 26–29 (S.D.N.Y. 1968).

119. *Id.* at 9.

120. *Id.*

121. *Id.* at 7–8.

122. 15 U.S.C.A. § 80a-41(e). Section 42(e) also permits the SEC to bring such a suit in response to the violation of an SEC cease-and-desist order. *Id.*

123. *Fifth Ave. Coach Lines, Inc.*, 289 F. Supp. at 41.

124. *Id.* at 10.

of a garage in a suburb of the city.<sup>125</sup>

The SEC's complaint against Fifth hinged on the allegation that Fifth operated as an investment company, as defined in the ICA, without properly registering as an investment company with the SEC.<sup>126</sup> To determine whether Fifth was an investment company, the court considered what constituted Fifth's primary business when Fifth began to spend accumulated company funds.<sup>127</sup> Fifth spent most of the funds purchasing stock in other companies to gain control of those companies, while minimally operating buses on the side.<sup>128</sup> The court, noting that the ICA does not define the term "invest" for the purposes of the legislation, set out to clarify the meaning.<sup>129</sup> According to the court, "[t]hat word must be given its normal meaning, i.e., to put out money at risk in the hope of gain. . . . Those who seek control obviously do so in the hope of ultimate gain."<sup>130</sup> Acknowledging the legislative intention behind the ICA to stem the abuses of investment company managers who oversaw large pools of funds, the court held that Fifth's spending of company funds to gain control of other companies was the sort of conduct Congress intended to be regulated under the ICA.<sup>131</sup> Thus, Fifth erred in failing to register as an investment company.<sup>132</sup> In sum, the court emphasized that a primary business purpose of buying and selling stocks in hope of profit indicates that a company is likely an investment company for the ICA's purposes.<sup>133</sup>

### III. DISCUSSION

SPACs do not fit within the ICA's definition of investment companies because a SPAC's primary business purpose is completing a merger, not dealing in stocks. Furthermore, regulating SPACs as investment companies would not serve the congressional intentions behind the ICA. Fortunately, legitimate concerns about SPACs can be addressed without requiring SPACs to register as investment companies. Accordingly, Section A of this Part argues against the inclusion of SPACs as investment companies, asserting that SPACs do not fit within the ICA's definition of investment companies and that mandating otherwise would contradict the

---

125. *Id.*

126. *Id.* at 8.

127. *Id.* at 29–30.

128. *Id.*

129. *Id.* at 30.

130. *Id.*

131. *Id.*

132. *Id.*

133. *Id.*

ICA's legislative principles. Section B argues that, nonetheless, SPAC-related misconduct and SPACs' insider trading risks justify heightened regulatory scrutiny. Section C of this Part posits solutions to the problems with SPACs: congressional investigation into SPAC-related misrepresentations, congressional promotion of a regulatory environment that encourages small and young companies to go public, and heightened disclosure requirements for SPACs.

#### A. SPACs Are Not Investment Companies Under the ICA

The typical SPACs formed or conceivably likely to be formed do not fit within the definition of investment company provided in Title 15, Sections 80a-3 and 80a-4. Unlike other company types, such as mutual funds, SPACs do not usually “engage[] primarily . . . in the business of investing, reinvesting, or trading in securities.”<sup>134</sup> That is, a SPAC's primary business purpose is not dealing in securities. A SPAC does not typically sell face-amount certificates, invest in or hold securities equal to more than forty percent of the SPAC's value in total assets, or have management choose an entity in which to invest.<sup>135</sup> These primary business purposes exhaust the list that would give rise to classification as an investment company.<sup>136</sup>

Case law affirms this interpretation. In *SEC v. Fifth Avenue Coach Lines, Inc.*, where the district court classified the company in question as an investment company, that company's primary business was *investing* in other companies' stocks to gain control of those companies.<sup>137</sup> In contrast, a SPAC's primary business purpose is to select and *merge* with a target company within a specified, limited duration.<sup>138</sup> Standard language for a SPAC's prospectus (a disclosure document companies file with the SEC) states that the SPAC is “a newly incorporated blank check company formed for the purpose of effecting a merger, capital stock exchange, asset acquisition, stock purchase, reorganization or similar business combination.”<sup>139</sup> A SPAC has the ability to purchase stocks, but SPAC investment in stocks during the process of selecting and merging with a target company is incidental to the primary business purpose of the merger. Under the ICA, a company “primarily engaged . . . in a business . . . other than that of investing, reinvesting, owning, holding, or trading

---

134. 15 U.S.C.A. § 80a-3(a)(1)(A) (Westlaw through Pub. L. No. 117-179).

135. See *supra* text accompanying notes 100–04.

136. *Id.*

137. See *supra* text accompanying notes 131–32.

138. See *supra* text accompanying notes 7, 17.

139. Churchill Capital Corp III, Amendment to Registration Statement (Form S-1/A) (Feb. 12, 2020).

in securities” is not an investment company.<sup>140</sup> Selecting and merging with a target company is a separate primary business purpose from dealing in securities, so a SPAC is not an investment company.

Moreover, SPACs are not a logical fit amongst the ICA’s subclassifications of investment companies. Consider the three types of investment companies listed under Section 80a-4: face-amount certificate companies, unit investment trusts, and management companies.<sup>141</sup> SPACs do not qualify as face-amount certificate companies or unit investment trusts because SPACs neither sell face-amount certificates nor raise funds by buying groups of securities and offering them to investors as redeemable units.<sup>142</sup> The only subclassification remaining is the management company, but SPACs do not fit within this category. Compare a SPAC to the prototypical Section 80a-4 management company, the mutual fund. Both SPACs and mutual funds file prospectuses and pool funds from investors, but similarities end there.<sup>143</sup> A SPAC takes investors’ pooled funds and places the funds in escrow, per SEC regulations, where the funds must remain until the SPAC’s merger with a target company has completed or the SPAC has liquidated.<sup>144</sup> In the case of a SPAC liquidation, in which a SPAC does not complete a merger within the approved period, each SPAC investor receives his or her pro rata share of the escrow.<sup>145</sup> Mutual funds, in contrast, take the investors’ pooled funds and invest them in securities.<sup>146</sup> Unlike SPACs, mutual funds have no requirement to set a date by which they must complete some task or risk liquidation.<sup>147</sup> Both open-end and closed-end mutual funds, with the primary business purpose to invest pooled investor funds into securities, fit comfortably within the management company subclassification of investment companies.<sup>148</sup> SPACs, however, do not as a rule invest pooled investor funds in securities.<sup>149</sup> Accordingly, SPACs

---

140. 15 U.S.C.A. § 80a-4 (Westlaw through Pub. L. No. 117-179).

141. *Id.* See *supra* text accompanying notes 100–04.

142. 15 U.S.C.A. § 80a-4.

143. *Mutual Funds*, INVESTOR.GOV, <https://www.investor.gov/introduction-investing/investing-basics/investment-products/mutual-funds-and-exchange-traded-1> [https://perma.cc/F3NS-DJXN] (last visited Nov. 18, 2021).

144. FIN. INDUS. REGUL. AUTH., REGULATORY NOTICE NO. 08-54, GUIDANCE ON SPECIAL PURPOSE ACQUISITION COMPANIES (2021).

145. *Id.*

146. See *Mutual Funds*, *supra* note 143.

147. *Id.*

148. 15 U.S.C.A. § 80a-4 (Westlaw through Pub. L. No. 117-179).

149. See Ramey Layne & Brenda Lenahan, *Special Purpose Acquisition Companies: An Introduction*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 6, 2018), <https://corpgov.law.harvard.edu/2018/07/06/special-purpose-acquisition-companies-an-introduction> [https://perma.cc/VGJ6-32R2] (describing how SPACs typically keep funds raised from an IPO in a trust account).

are not management companies within Section 80a-4's definition.<sup>150</sup>

Small investors in SPACs are adequately protected under the existing regulatory regime, so regulating SPACs as investment companies under the ICA is not required to ensure investor protection. Given that SPACs go public without announcing a target company or having a lengthy business history to consider, investors widely understand that SPACs are a riskier investment than other company types.<sup>151</sup> Helpfully, a prolific educational campaign on behalf of federal government agencies has instructed the public about the risks and rewards of SPACs.<sup>152</sup> A SPAC must also disclose information upon going public that helps potential investors decide whether to buy shares.<sup>153</sup> While small investors were defrauded into buying investment company shares prior to the ICA,<sup>154</sup> SPAC investors are predominantly large institutional investors who are aware of the risk-and-reward calculus involved with SPAC investment.<sup>155</sup>

Furthermore, retail investor ownership of SPAC stocks is "minimal."<sup>156</sup> Investors in a SPAC retain a degree of control over that SPAC's trajectory. Once a SPAC has selected and announced a merger with a target company, that SPAC's investors must vote to approve the merger or the merger cannot proceed.<sup>157</sup> SPAC investors have the freedom to vote down the merger and compel the SPAC to buy back their shares.<sup>158</sup> Since SPAC investors can exert these levers of control, small investors in SPACs are less vulnerable to SPAC mismanagement than were small investors in investment companies before the ICA. Therefore, the investor protection concerns prior to 1940 that motivated the ICA's enactment are not analogous to the conditions that small investors in SPACs experience today.

Contrary to the legislative intention behind the ICA to restore the public reputation of investment companies, the public perception of SPACs needs no boost.<sup>159</sup> Even though SPAC IPO frequency has been volatile in recent years, SPACs have been generally well-received by

---

150. *Id.*

151. *See supra* text accompanying notes 11–17.

152. *See* FIN. INDUS. REGUL. AUTH., *supra* note 144.

153. *See* 15 U.S.C.A. § 80a-8 (Westlaw through Pub. L. No. 117-179).

154. *See supra* text accompanying notes 79–80.

155. *Nothing But the Facts: Retail Investors and Special Purpose Acquisition Companies*, COMM. ON CAP. MKTS. REGUL. (Oct. 19, 2021), <https://www.capmktreg.org/wp-content/uploads/2021/10/CCMR-NBTF-SPACs-Retail-Investors.pdf> [<https://perma.cc/2VKM-UHYY>].

156. *Id.* (“[T]he entire SPAC lifecycle, from SPAC IPO to merging with a private company, consists of initial investments by institutional investors with little (if any) involvement from retail investors.”).

157. *See How Special Acquisition Companies (SPACs) Work*, *supra* note 12.

158. *Id.*

159. *See* 8 CONG. REC. 9808, 9815.

investors.<sup>160</sup> Some commentators apprehensively viewed SPACs' uptick in popularity as a bubble set to burst.<sup>161</sup> Certainly, some investors in SPACs expressed disappointment with the rate of return on initial investment.<sup>162</sup> However, these critiques of SPACs are moderate and measured compared to the damaged reputation that investment companies endured prior to the ICA's enactment. At that time, investment companies were publicly perceived to be run by fraudsters, and that reputation seems at least partially deserved in retrospect.<sup>163</sup> By 2022, SPACs' popularity as a vehicle for going public had dropped from the heights of the SPAC boom, but this drop was not accompanied by the wholesale public skepticism that had been directed toward investment companies.<sup>164</sup> Regulating SPACs under the ICA's framework is not needed to rehabilitate SPACs' reputation because, unlike investment companies in the 1940s, SPACs have not been repudiated by the public.<sup>165</sup>

### *B. SPACs Present Unique Risks That Justify Regulatory Scrutiny*

Even though SPACs do not fit neatly into the ICA regime, some concerns about SPACs justify regulatory scrutiny. The incidence of high-profile misrepresentations by executives connected to SPACs warrants investigation, just as the misrepresentations by investment company managers did prior to the ICA. Between January 1 and August 1, 2021, twenty-one of the twenty-two securities class action suits filed against

160. See *Why SPACs Are Booming*, *supra* note 45.

161. 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> [<https://perma.cc/W9MV-DRZG>].

162. See Amrith Ramkumar, *SPAC Selloff Bruises Individual Investors*, WALL ST. J. (May 19, 2021, 9:32 AM), <https://www.wsj.com/articles/spac-selloff-bruises-individual-investors-11621396808> [<https://perma.cc/99GM-YW88>].

163. See *supra* text accompanying notes 79–80.

164. Jemima McEvoy, *Take Back the SPAC: More and More Companies Are Canceling High-Profile Deals to Go Public*, FORBES (Dec. 22, 2021, 12:36 PM), <https://www.forbes.com/sites/jemima-mcevoy/2021/12/22/take-back-the-spac-more-and-more-companies-are-canceling-high-profile-deals-to-go-public> [<https://perma.cc/SZE9-RDXS>]. Observers have debated the reasons behind the precipitous drop in SPAC issuance from 2021 to early 2022. Posited factors include (1) rising inflation; (2) a mismatch in the ratio of SPACs to desirable target companies; and (3) investor concerns about increasing regulatory scrutiny of SPACs. See *Once Wall Street's Darling, SPACs Fall from Favor*, MD. SMITH: SMITH BRAIN TR. (May 20, 2021), <https://www.rhsmith.umd.edu/research/once-wall-streets-darling-spacs-fall-favor> [<https://perma.cc/U44K-S2RT>]; Matthew Goldstein, *SPACs Were All the Rage. Now, Not So Much.*, N.Y. TIMES (June 2, 2022), <https://www.nytimes.com/2022/06/02/business/spacs-inflation-regulation.html> [<https://perma.cc/L9ZM-KK4J>].

165. The decline of SPAC IPOs in early 2022 was accompanied by a simultaneous decline in the traditional IPO market. Accordingly, the drop-off in SPAC IPOs may reflect macroeconomic conditions, not investors' rejection of SPACs in particular. See Noah Higgins-Dunn, *The IPO Market Went from 'Boom to Bust' in 2022. Here's What's Driving the Massive Slowdown*, CNBC (Sept. 23, 2022, 1:34 PM), <https://www.cnbc.com/2022/09/23/stock-market-ipos-went-from-boom-to-bust-in-2022.html> [<https://perma.cc/YFJ2-ML2U>].

SPACs in the United States included Rule 10b-5 claims, alleging that individuals involved with SPACs made “untrue statements, misleading statements, or omissions regarding material facts connected to the purchase or sale of securities.”<sup>166</sup> The SEC’s suit against SPAC Stable Road alleged that the CEO of Stable Road’s target company had made misrepresentative claims about the target company’s technology.<sup>167</sup> The SEC alleged the same of Trevor Milton, the erstwhile CEO of Nikola, which was SPAC VectoIQ Acquisition Corp’s target company.<sup>168</sup> According to SEC Chairman Gary Gensler, the short-term profitability of SPAC mergers sometimes causes SPAC management teams to fail to conduct adequate due diligence (factual investigations into a company, typically involving review of financial statements) on merger target company candidates under the belief that a thorough due diligence process would delay the merger and, thus, delay the profits for the SPAC’s management team and investors.<sup>169</sup> The accumulation of misrepresentations resembles a trend, which should be addressed.

By nature, SPACs lack an evaluable business history, which creates an investment risk for investors. The pooled funds a SPAC raises from investors essentially present a blank check for the SPAC management team.<sup>170</sup> SPAC investors cannot know or predict with certainty the identity of the SPAC’s target company for the merger. The target company’s secret identity is a main determinant of whether investment in that SPAC will be profitable over time.<sup>171</sup> Accordingly, investors must judge the remunerative prospects of a SPAC by the reputation of the management team, attempting to estimate how effectively the managers will select a suitable target company and carry out the merger.<sup>172</sup> SPACs’ lack of an extensive record of business successes and failures to evaluate increases the vulnerability of SPAC investors.

Beyond this, SPACs inherently involve an insider trading risk. For most of a SPAC’s life cycle, the management team keeps the identities of probable merger candidates secret. Should a SPAC investor learn the secret identity of a publicly-listed SPAC’s target company, trading stocks in that SPAC based on that knowledge presumably contravenes insider

---

166. 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> [https://perma.cc/6JKC-YAG4].

167. Press Release, *supra* note 55.

168. *See supra* text accompanying notes 49–52.

169. Press Release, *supra* note 55.

170. *See* Bazerman & Patel, *supra* note 8.

171. *Investing in a SPAC*, *supra* note 16.

172. *Id.*

trading laws.<sup>173</sup> Each new SPAC involves a consequential secret, the identity of the likely target company, so regulators have good reason to scrutinize SPACs' insider trading risks.

### *C. Solving the Problems with SPACs*

Rather than judicially shoehorn SPACs into regulation under the ICA by stretching the definition of an investment company beyond logic, Congress should investigate the high-profile instances of misconduct by SPAC management teams and SPAC target company executives. Furthermore, Congress should enact legislation that specifically addresses foreseeable problems with SPACs related to misrepresentations. Congress followed a similar process to address self-interested investment company manager behavior, establishing a suitable blueprint to address the contemporary concerns raised by SPACs.<sup>174</sup> If the issue of inadequate investor protection for SPAC investors has a sufficiently urgent national character to necessitate intervention, the matter should be addressed by congressional inquiry and legislative action, not a judge's reinterpretation of a statute enacted in 1940 to curb Great Depression-era investment sector abuses.

Furthermore, the inefficiencies perceived to be permeating the IPO process that have driven investors to revive a decades-old, long-neglected company structure rather than pursue a traditional IPO should be examined. Especially during periods of economic instability, such as the challenges the United States endured due to the COVID-19 pandemic, Congress should take initiative to promote innovation and economic flourishing in the country's investment sector. If contemporary IPO requirements have become a bottleneck that dissuades private companies from pursuing IPOs, Congress should take steps to promote new entrants to the stock exchange without compromising the protections that encourage investors to participate.<sup>175</sup> Small-to-mid market sector companies who seek to go public via SPAC due to burdensome IPO requirements should not be shut out of the public exchange by regulating SPACs into economic non-viability based on an imaginative legal interpretation of the definition of an investment company.

---

173. Glenn Kopp et al., *Mitigating SPAC Enforcement and Litigation Risks*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 18, 2021), <https://corpgov.law.harvard.edu/2021/05/18/mitigating-spac-enforcement-and-litigation-risks> [<https://perma.cc/AC8X-FSAB>] ("It is just a matter of time before the SEC . . . bring[s] an insider trading case related to a SPAC transaction in which insiders trade ahead of a transaction or are the source for a tippee who trades on material non-public information.")

174. See *supra* text accompanying notes 68–71.

175. To be clear, making any changes to the IPO rules governed by the Securities Act would be extremely complicated, risky, and controversial. Congress is likely better prepared to serve the interests of the public through legislative action of another sort.

Due to SPACs' manager-focused structure, the disclosure requirements for information about the individuals who make up SPAC management teams should be rigorous. When disclosures about the business background of SPAC managers and sponsors are accurate and detailed, prospective investors in SPACs will be better informed and protected.<sup>176</sup> Indeed, the SEC has proposed strengthening disclosure requirements for SPACs, citing the concern that inaccurate disclosures from SPACs may be misleading SPAC investors.<sup>177</sup>

#### IV. CONCLUSION

A SPAC is not an investment company under the ICA because a SPAC's primary business purpose is to merge with a target company, not to invest in or hold stocks. Congress adopted the ICA in 1940 to protect small investors in investment companies who were being defrauded by self-interested investment company managers, but small investors are not systemically harmed by SPACs. Most investors in SPACs are sophisticated institutional investors who are aware of the risks of investing in shell companies like SPACs. Imposing burdensome regulatory rules and restrictions for SPACs would impede the main vehicle that took companies public in recent years of market volatility.

However, even though SPACs are not investment companies, SPACs present risks for investors that should be addressed. An apparent pattern of misrepresentations by SPAC management teams and target company executives has emerged, potentially incentivized by SPACs' structure. The target company for a SPAC's merger must be kept secret among the SPAC managers, and this consequential secret gives each SPAC a unique insider trading risk compared to other company types.<sup>178</sup> By the middle of 2022, commentators widely agreed that the SPAC boom had ended,<sup>179</sup>

---

176. *But see* Tamar Frankel, *The Failure of Investor Protection by Disclosure*, 81 U. CIN. L. REV. 421, 435–38 (2013) (arguing disclosure statements do not effectively protect investors because they are too complex and go unread).

177. Greg Iacurci, *SEC Is Scrutinizing SPAC Projections, Seeks Clearer Disclosures*, CNBC (Apr. 30, 2021, 5:37 AM), <https://www.cnbc.com/2021/04/09/sec-is-scrutinizing-spac-projections-seeks-clearer-disclosures.html> [<https://perma.cc/GP5B-K6EN>].

178. *See* Alex Wyman et al., *SPAC-Related Enforcement and Litigation*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 13, 2022), <https://corpgov.law.harvard.edu/2022/04/13/spac-related-enforcement-and-litigation-what-to-expect-in-2022> [<https://perma.cc/DH34-9SZ2>] (“Information that [a] SPAC is pursuing a business combination agreement with a target, before that agreement is announced, could constitute material non-public information . . . [T]rading in the SPAC based on that information could be considered insider trading.”).

179. Bansari Mayur Kamdar & Medha Singh, *SPAC Boom Fizzles as Investors Cash Out on Big Names*, REUTERS (Dec. 31, 2021, 6:37 AM), <https://www.reuters.com/markets/europe/spac-boom-fizzles-investors-cash-out-big-names-2021-12-17> [<https://perma.cc/CN6M-ZHUK>]; *see also* Ortenca Aliaj et al., *SPAC Boom Dies as Wary Investors Retreat*, FIN. TIMES (June 9, 2022), <https://www.ft.com/content/2a560343-69eb-4e36-9833-cc579a7dc8ad> [<https://perma.cc/J3HF-Z2KD>];

and Bill Ackman's massive SPAC PSTH dissolved without selecting a target company, so many investors seemed to have decided that SPACs' inherent risks outweigh the potential rewards.<sup>180</sup>

Market efficiency and investor protection should be balanced, such that neither aim is abandoned. Congress is the supreme lawmaking body in the United States, though Congress has at times abdicated the power to legislate.<sup>181</sup> However, as recently as 2012, Congress passed the Jumpstart Our Business Startups Act, which eased securities regulations for smaller companies and led to a rise in the number of companies to go public over the years that followed.<sup>182</sup> Congress should overcome internal divisions and return to the legislative function to continue to support the success of small and young companies, investigate SPAC and target company misrepresentations, and heighten disclosure requirements for SPACs.

---

Bailey Lipschultz & Katherine Burton, *SPAC Era Comes to a Whimpering End as Wall of Redemption Nears*, BLOOMBERG L. (June 24, 2022, 5:00 AM), [https://www.bloomberglaw.com/bloomberglawnews/securities-law/XFHQIVQ000000?bna\\_news\\_filter=securities-law#jcite](https://www.bloomberglaw.com/bloomberglawnews/securities-law/XFHQIVQ000000?bna_news_filter=securities-law#jcite) [<https://perma.cc/85BP-79QF>].

180. See Zanki, *supra* note 24.

181. Derek Willis et al., *How Congress Stopped Working*, PROPUBLICA (Nov. 5, 2018, 10:00 AM), <https://www.propublica.org/article/how-congress-stopped-workin> [<https://perma.cc/GNV6-72AC>].

182. Michael J. Zeidel, *The JOBS Act: Did It Accomplish Its Goals?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 18, 2016), <https://corpgov.law.harvard.edu/2016/07/18/the-jobs-act-did-it-accomplish-its-goal> [<https://perma.cc/MW2X-CKZS>].