Americans for Financial Reform Education Fund

Vanessa A. Countryman
Securities and Exchange Commission
100 F St NE
Washington, DC 20549-1090

June 13, 2022

Re: Special Purpose Acquisition Companies, Shell Companies, and Projections (File No: S7-13-22)

Dear Secretary Countryman,

The Americans for Financial Reform Education Fund appreciates this opportunity to comment on the Securities and Exchange Commission's ("the Commission") proposals to close the ongoing loopholes being exploited by the issuers of Special Purpose Acquisition Companies (SPACs) and better align them with the more stringent standards that apply to Initial Public Offerings (IPOs).

The Commission's proposals would address the regulatory loopholes for SPACs and better protect investors

Given the assortment of conflicts and problems with SPACs, we strongly support the Commission's proposals to add a new Subpart 1600 to Regulation S-K that would:

- Redefine "blank check companies" to end the safe harbor for forward looking projections provided during the de-SPAC
- Provide clearer guidance on forward looking statements via amendments to Item 10(b) as well as the addition of Item 1609 to Regulation S-K
- Subject the financial advisors of the de-SPAC to underwriter liability under Section 11 and Section 12 of the Securities Act of 1933
- Treat the target company as a co-registrant to ensure that the private company and its executives are subject to the same Section 11 liability as in IPOs
- Provide greater disclosures through Form S-4 on the assumptions and board sign-off on forward looking projections

Background

Unlike other public market investments, a SPAC initially has no assets outside of the cash investors provide during the initial offering, when they bet solely on the sponsor's ability to

identify a company to merge with ("de-SPAC") within two years. It is perhaps for this reason that sponsors have resorted to hiring celebrities with little financial expertise to help market their SPACs to the public, in a development that e led the Commission to issue a warning.[1]

In the typical SPAC structure, the initial investors buy into units of a SPAC. Each unit consists of one share priced at $10 and a warrant, a derivative similar to a call option that entitles the holder to buy additional shares (or fractions thereof) at $11.50. Minimal substantive disclosures are required at the IPO stage beyond a vague description of the types of industries in which the proceeds may be used to acquire a company. Initial investors who receive the warrants for free are typically large players like hedge funds. Retail investors typically come in after that and purchase regular shares, without warrants, or warrants for a price in the secondary market.

Shareholders have no ability to evaluate the companies they are potentially investing in until a merger is announced, at which time they receive a joint proxy statement and Form S-4 and are asked to quickly vote to approve or reject the merger. Shareholders who choose not to participate in the post-merger entity can either sell their shares in the open market or redeem their shares at the original purchase price of $10.

Upon consummation of a merger (de-SPACing) the sponsor usually receives (or vests in) 20% of the SPAC's shares as compensation (the "promote"); this means that issuing SPACs exceeds the costs of a "traditional" IPO. Hedge fund Pershing Square's Bill Ackman has called SPACs more of a "compensation scheme."[2]

The SPAC surge appears to be driven in part by private companies' desire to exploit the perceived speed, greater negotiating power to get a higher price for themselves than in the private markets, streamlined disclosures, reduced liability, and reduced shareholder rights offered by the SPAC process. Given these features, it is not surprising that highly speculative companies are looking to access the public markets via SPAC mergers.

Yet, SPACs are far from new. In fact, they date back to the 1980s when they were called blank check companies and often associated with scams, bilking unsuspecting investors out of billions of dollars.[3]

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[1] SEC's Office of Invest Education and Advocacy. Celebrity Involvement with SPACs – Investor Alert. Mar 10, 2021. https://www.sec.gov/oiea/investor-alerts-and-bulletins/celebrity-involvement-spacs-investor-alert

[2] Celarier, Michelle. Institutional Investor. Egregious Founder Shares. Free Money for Hedge Funds. A Cluster***k of Competing Interests. Welcome to the Great 2020 SPAC Boom. Sep 21, 2020. https://www.institutionalinvestor.com/article/b1ngx7vttq33kh/Egregious-Founder-Shares-Free-Money-for-Hedge-Funds-A-Cluster-k-of-Competing-Interests-Welcome-to-the-Great-2020-SPAC-Boom

[3] Hinden, Stan. Washington Post. In For A Penny, Out Of A Pound. Dec 24, 1989. https://www.washingtonpost.com/archive/business/1989/12/24/in-for-a-penny-out-of-a-pound/29febe0c-8b94-4006-9722-4a4ae155ea35/

Fraud was so pervasive in these blank check companies that Congress passed the Penny Stock Reform Act (PSRA) in 1990[4] to address some of the problems, which was followed by the SEC putting in place Rule 419 for blank check companies.

Blank check company issuers, however devised the modern-day SPAC structure to get around those rules, reminding us that properly regulating new assets requires continuing attention and action.

There are two main ways SPACs escape from coverage by PRSA and Rule 419. First, the $4/share "penny stock" threshold, and second the extremely low standard of $5 million in net tangible assets.[5] Every SPAC holds much more than $5 million in cash and they are deliberately issued at $10/share.[6]

SPACs also rely on a safe harbor from being held accountable for forward looking statements under the Private Securities Litigation Reform Act of 1995.

Whereas in an IPO, issuers and underwriters are liable for making false and misleading forward-looking statements, SPACs are not subject to that same standard. That has emboldened many pre-revenue companies, particularly in highly speculative industries such as cryptocurrency, and space exploration to make utterly absurd forward-looking projections

A very notable example of that is the SPAC Holicity Inc. who merged with space exploration company Astra Space in July 2021. As part of its documents provided ahead of a de-SPAC combination, Holicity projected that Astra Space would have daily rocket launches by 2025.[7] A year since its combination, the company has yet to launch a single rocket, and it collected $3.9 million in revenue in the first three months of 2022[8] compared to its originally projected annual revenue for this year of $67 million.

The Commission urgently needs to close the loopholes that have enabled SPAC sponsors to make misleading forward-looking statements during the initial de-SPAC

We strongly support the Commission's proposal to amend the definition of a "blank check company" under Item 1601 and define a "Special Purpose Acquisition Company" to mean a company:

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[4] Securities Enforcement Remedies and Penny Stock Reform Act of 1990. https://www.congress.gov/bill/101st-congress/senate-bill/647

[5] 17 U.S.C. §240.3a51-1 (1992). Definition of "penny stock". https://www.law.cornell.edu/cfr/text/17/240.3a51-1

[6] Heyman, Derek K. Entrepreneurial Business Law Journal. From Blank Check to SPAC. 2007. https://core.ac.uk/download/pdf/159610375.pdf

[7] Securities and Exchange Commission EDGAR. Holicity Inc. Form S-4. May 3, 2021. https://www.sec.gov/Archives/edgar/data/1814329/000121390021024003/ea138694-s4_holicity.htm

[8] Securities and Exchange Commission EDGAR. Astra Space, Inc. Form 10-Q. May 5, 2022. https://www.sec.gov/ix?doc=/Archives/edgar/data/0001814329/000095017022007882/astr-20220331.htm

1. Whose business plan is to primarily offer securities not subject to Rule 419
2. That will complete a de-SPAC transaction within a certain timeframe
3. That will return the remaining proceeds from its registered offering or concurrent offerings if a de-SPAC transaction is not conducted within a certain timeframe

These amendments would address the limits in Rule 419 that exclude most modern SPACs due to the definition of "penny stock" and end the safe harbor for forward-looking statements under the Private Securities Litigation Reform Act of 1995.

Many SPAC sponsors have clearly abused the safe harbor. In many instances actual revenues have come nowhere near their original projections and, sponsors should not be shielded from liability.

Post-merger investors in SPACs, who are predominantly retail investors, are often lured by ambitious projections of growth - made with the protection of the safe harbor - and unfortunately have already lost significant amounts of money as a result.

In addition to the Astra Space example discussed above, Virgin Galactic provides another illustrative example of overly lofty initial revenue projections.[9]

The SPAC, Social Capital Hedosophia Holding Corp. provided to its investors, as part of its proposed de-SPAC in 2019 to Virgin Galactic, projections that it would generate $210 million in 2021.[10] The space exploration company went on to only generate $3.3 million in revenue instead.

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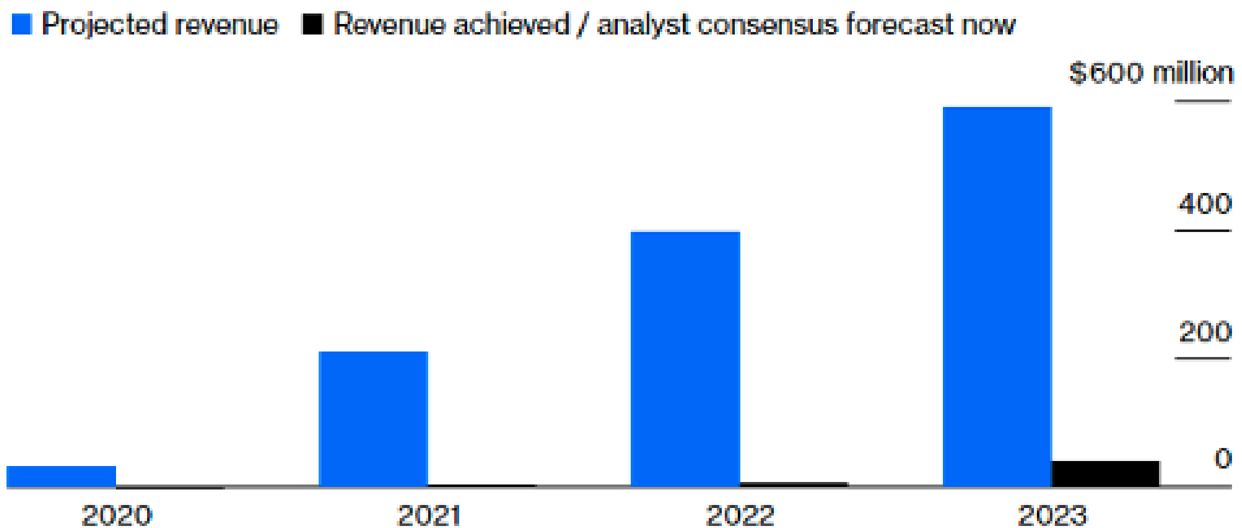
[9] Bryant, Chris. Bloomberg Opinion. SPACs, the 'Poor Man's Private Equity,' Made Investors Poorer. Feb 25, 2022. https://www.washingtonpost.com/business/spacs-the-poor-mans-private-equitymade-investors-poorer/2022/02/25/251410c4-9613-11ec-bb31-74fc06c0a3a5_story.html

[10] Securities and Exchange Commission EDGAR. Social Capital Hedosophia Holding Corp, Form S-4. Aug 7, 2019. https://www.sec.gov/Archives/edgar/data/1706946/000119312519215509/d785777ds4.htm

Virgin Galactic's Failed Projections



Source: Bloomberg, Virgin Galactic slide deck
Projected revenue is as of the 2019 prospectus

Many companies that went public through SPACs using lofty initial expectations are now being purchased well below their original $10/share price. Insurance company MetroMile Inc. and virtual therapist Talkspace Inc. for example are being purchased for $1/share and $1.70/share respectively, while telemedicine firm SOC Telmed Inc. has received an offer to be taken over at $3/share.[11]

In some cases, SPACs have lost up to 75% of their value since 2021. Retail investors are estimated to have lost about $4.8 billion, or 23% of the $21.3 billion of their total $21.3 billion in SPACs.[12]

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[11] Lipschultz, Bailey. Bloomberg News. SPAC Fire Sales Stick Investors With Deeply Discounted Buyouts. Jun 9, 2022. https://www.bloomberg.com/news/articles/2022-06-09/spac-fire-sales-stick-investors-with-deeply-discounted-buyouts

[12] DiNapoli, Jessica. Reuters News. Special Report: How Wall Street banks made a killing on SPAC craze. May 11, 2022. https://www.reuters.com/business/finance/how-wall-street-banks-made-killing-spac-craze-2022-05-11/

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Amending the definition of a "blank check company" and ensuring that the forward-looking projections of SPACs are subject to the same level of legal liability that currently exists for IPOs is an important step to protect investors.

The Commission's proposed disclosures for SPACs on forward looking statements will help investors understand the basis for these statements.

We support the Commission's proposals to require firms to show a reasonable basis for forward looking projections so that investors have more information to evaluate them. Proposed amendments to Item 10(b) under Regulation S-K that would require firms to:

- State any projections that are not based on historical financial results or operational history
- Provide definitions of projections that include non-Generally Accepted Accounting Principles (non-GAAP) measures
- Describe of which GAAP measure a non-GAAP measure is most related to
- Explain why non-GAAP measures were used over GAAP measures

And the addition of Item 1609 under Regulation S-K that would require SPACs to:

[13] Lipschultz, Bailey. Bloomberg News. SPAC Fire Sales Stick Investors With Deeply Discounted Buyouts. Jun 9, 2022. https://www.yahoo.com/now/spac-fire-sales-stick-investors-150012161.html

- Disclose the purposes behind forward-looking projections and the entity that provided such projections
- Disclose all material bases and assumptions behind such projections
- Disclose whether the projections reflect the views of the board or management of the target company

These items would make it much more possible for investors to assess whether forward-looking projections provided to them during the de-SPAC process are being made in good faith while also holding the board and management more accountable for their claims.

The Commission's proposal to require the management of SPAC targets to become co-registrants would add needed accountability

We support the Commission's proposal to require the target company of a SPAC merger and its officers to serve as co-registrants over the Form S-4 and Form F-4 so that they cannot escape liability for any misstatements or omissions.

The Commission's proposals to treat financial advisors to de-SPACs as underwriters to address what are otherwise misaligned incentives

We support the Commission's proposals that would treat all advisors to de-SPAC transactions similarly to underwriters under the current securities laws.

There are seriously misaligned incentives between advisors and retail SPAC investors. Advisors on SPAC mergers, which have often been the major Wall Street banks, collect an extensive assortment of fees including:

- 5.5% to 6.0% of the SPAC share offering
- 5.5% of the over-allotment option
- 3.0% fee of a follow-on Private Investments in Public Equities (PIPEs)
- Additional advisory fees[14]

These fees create substantial incentives to get as many deals done as possible, even if the deals do not make sense for most investors. SPAC issuance was an astounding $162.5 billion in 2021 or over 15-times the total in 2018.[15]

The Commission's proposed Rule 140a and Rule 145a would subject advisors on de-SPAC transactions to the same Section 11 liability and due diligence requirements as apply to other securities offerings, better protecting investors.

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[14] Office of Senator Elizabeth Warren. The SPAC Hack: How SPACs Tilt the Playing Field and Enrich Wall Street Insiders. May 24, 2022. https://www.warren.senate.gov/imo/media/doc/SPACS.pdf

[15] SPAC Insider. SPAC IPO Transactions: Summary by Year. https://spacinsider.com/stats/

We note that concerns about the appropriate liability associated with the Commission's proposal has led banks such as Goldman Sachs[16], Citi[17], and Bank of America[18] to withdraw from issuing new SPACs.

We appreciate this opportunity to comment on this important matter. For any additional questions do not hesitate to contact Andrew Park at andrew@ourfinancialsecurity.org

Sincerely,

Americans for Financial Reform Education Fund

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[16] Li, Yun. CNBC. Goldman Sachs is shrinking its SPAC business amid regulatory crackdown and market turmoil. May 9, 2022. https://www.cnbc.com/2022/05/09/goldman-sachs-is-shrinking-its-spac-business-amid-regulatory-crackdown-and-market-turmoil.html

[17] Tan, Gillian. Bloomberg News. Citi to Pause New SPAC Issuance as SEC Signals Crackdown. Apr 4, 2022. https://www.bloomberg.com/news/articles/2022-04-04/citi-said-to-pause-new-spac-issuance-as-sec-signals-crackdown

[18] Hammond, Ed et al. Bloomberg News. BofA Scales Back on SPAC Work as Bank Retreat Accelerates. May 9, 2022. https://www.bloomberg.com/news/articles/2022-05-09/bofa-scales-back-on-spac-work-as-wall-street-retreat-accelerates