SPAC MERGERS, IPOS, AND THE PSLRA'S SAFE HARBOR: UNPACKING CLAIMS OF REGULATORY ARBITRAGE

AMANDA M. ROSE*

ABSTRACT

Communications in connection with an initial public offering (IPO) are excluded from the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 (PSLRA). Unsurprisingly, IPO issuers do not share projections publicly—the liability risk is too great. By contrast, communications in connection with a merger are not excluded from the safe harbor, and special purpose acquisition companies (SPACs) routinely share their merger targets' projections publicly. Does the divergent application of the PSLRA's safe harbor in traditional IPOs and SPAC mergers create an opportunity for "regulatory arbitrage" and, if so, what should be done about it? This Article offers a framework for evaluating these timely questions and for evaluating claims of regulatory arbitrage more broadly. The analysis brings into sharp

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* Cornelius Vanderbilt Chair in Law, Vanderbilt University Law School; Professor of Management, Vanderbilt University, Owen Graduate School of Management. For helpful comments and conversations, I am grateful to Kenneth Ayotte, Adam Badawi, Robert Bartlett, Margaret Blair, Brian Broughman, Richard Buxbaum, Matthew Cain, John Coates, Paul Edelman, Stavros Gadinis, Harald Halbhuber, John Head, Robert Jackson, Michael Klausner, Amelia Miazad, Frank Partnoy, Alex Platt, Robert Reder, Morgan Ricks, Edward Rock, Usha Rodrigues, Steven Davidoff Solomon, Holger Spamann, Randall Thomas, Yesha Yadav, and numerous participants at the Bocconi-Oxford Junior Scholars Network Workshop in Corporate Law, the Law, Economics, & Business Workshop hosted by Berkeley Law, the Law & Business Workshop and Legal Scholarship Seminar hosted by Vanderbilt University Law School, the faculty workshop at the University of Kansas School of Law, the 24th Annual Law & Business Conference at Vanderbilt University Law School, the Corporate & Securities Litigation Workshop at the University of Illinois College of Law, the Enhancing Accountability in Corporate and Financial Governance Conference at Monash University's Prato Center, Italy, and the Law & Business Conference at Ghent Law School, Belgium.

focus the contestable policy choices that undergird the IPO exclusion to the PSLRA's safe harbor.

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INTRODUCTION

The year 2020 was memorable for many reasons, one of the brighter being the explosive growth in initial public offerings (IPOs) in the United States. IPOs more than doubled in number and amount of capital raised relative to 2019.[1] In 2021, the number of IPOs more than doubled *again*, with proceeds growing 187 percent relative to 2020's record high.[2] A big part of this story concerns the astronomical rise of IPOs by special purpose acquisition companies (SPACs). In 2020, the number of SPAC IPOs more than quadrupled, and proceeds from SPAC IPOs increased more than sixfold relative to 2019 (the previous high-water mark since the NASDAQ and NYSE first began listing SPAC securities in 2008).[3] In 2020, there were 248 SPAC IPOs (versus 202 traditional IPOs) that collectively raised over $83 billion (versus $96 billion for traditional IPOs).[4] SPAC IPOs in 2021 shattered 2020's figures, numbering at 613 (versus 355 traditional IPOs) and collectively raising over $162 billion (versus $172 billion for traditional IPOs).[5]

SPACs are shell companies organized by sponsors.[6] They sell units in an IPO with the stated intention of finding a private operating company to combine with, typically within a two-year period.[7] SPAC units are typically sold for $10 and consist of a common share in the SPAC and a warrant, or fraction of a warrant,

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1. The figures in this paragraph are based on data published by SPAC Analytics. *Summary of SPACs*, SPAC ANALYTICS, https://www.spacanalytics.com [https://perma.cc/LCE3-XSKF].

2. *See id.*

3. *See id.*

4. *See id.*

5. *See id.*

6. SPACs are typically sponsored "by either (1) well-known professionals in the specific industry or geography of focus for the SPAC or (2) financial sponsors seeking to expand their investment opportunities." DAVID A. CURTISS, MARKET TRENDS 2020/21: SPECIAL PURPOSE ACQUISITION COMPANIES (SPACS) 3, https://www.paulweiss.com/media/3981062/market-trends-spacs.pdf [https://perma.cc/P2DF-WS23]. In some instances, celebrities have become involved, either as sponsors or investors. *See Celebrity Involvement with SPACs—Investor Alert*, SEC (Mar. 10, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/celebrity-involvement-spacs-investor-alert [https://perma.cc/PC3B-VDCZ].

7. *See* CURTISS, *supra* note 6.

to buy additional shares at a set price (often $11.50);[8] soon after the IPO, the warrants trade separately, but they cannot be exercised until a business combination has been consummated.[9] The capital invested in SPACs by public investors is held in escrow while SPAC sponsors search for an acquisition target.[10] If a SPAC fails to complete a business combination in time, it is liquidated (unless an extension is obtained), and the sponsor gets nothing for its efforts; if the SPAC succeeds, the target company becomes a listed reporting company by virtue of its combination with the SPAC, and the sponsor typically gets a significant equity stake in the merged entity—referred to as the "promote."[11] In connection with the so-called "de-SPAC transaction," SPAC investors have the option to redeem their shares in exchange for their pro rata stake in the escrow account; most do, unless selling on the secondary market is

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8. *Id.*

9. *See id.*

10. The escrow account invests in either government securities or in money market funds that invest only in government securities, which many believe allows SPACs to avoid regulation under the Investment Company Act. *See* ANNA T. PINEDO, CARLOS JUAREZ & GEORGIA NICOLE VERU, WHAT'S THE DEAL?—SPECIAL PURPOSE ACQUISITION COMPANIES ("SPACS") 3-4 (2020), https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2020/08/whats-the-deal--spacs.pdf [https://perma.cc/4AKV-6ZSS]. After a series of lawsuits, spearheaded by law professors John Morley and Robert Jackson, were filed challenging this view, *see* Andrew Ross Sorkin, Jason Karaian, Sarah Kessler, Stephen Gandel, Lauren Hirsch, Ephrat Livni & Anna Schaverien, *A SPAC Counterattack*, N.Y. TIMES: DEALBOOK (Aug. 30, 2021), https://www.nytimes.com/2021/08/30/business/dealbook/spac-lawsuits.html [https://perma.cc/53NT-48UJ], the SEC proposed a safe harbor that would clarify the conditions under which SPACs would not be considered investment companies. *See* Special Purpose Acquisition Companies, Shell Companies, and Projections, Securities Act Release No. 33-11048, 87 Fed. Reg. 29,458, 29,458 (proposed May 13, 2022).

11. Prior to the IPO, SPAC sponsors typically purchase, "for a nominal amount, shares of a separate class of common stock (often referred to as 'founder shares'), that gives the sponsor the right to receive, upon consummation of the de-SPAC transaction, 20% of the post-IPO common stock (often referred to as the 'promote')." Andrew R. Brownstein, Andrew J. Nussbaum, Igor Kirman, Matthew M. Guest, David K. Lam & DongJu Song, *The Resurgence of SPACs: Observations and Considerations*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 22, 2020), https://corpgov.law.harvard.edu/2020/08/22/the-resurgence-of-spacs-observations-and-considerations/ [https://perma.cc/MX6U-3VKN]. SPAC sponsors also purchase warrants on terms similar to those offered to the public: "The purchase price for these warrants (typically 2% of the IPO size), will be added to the trust account and pay for IPO expenses and the SPAC's operating expenses before its business combination." *Id.* If the SPAC fails to consummate a business combination and liquidates, these warrants (referred to as the sponsor's "at risk capital") are rendered worthless. *Id.*

more profitable.[12] SPAC sponsors seek to fill the funding shortfall created by redemptions by selling new SPAC shares to themselves and other private investors (an example of private investment in public equity, or PIPE, financing).[13]

Given their number and size, SPACs today offer private companies a meaningful alternative to the traditional IPO as a pathway to publicness.[14] According to commentators, one of the features that makes a combination with a SPAC attractive relative to a traditional IPO concerns differences in disclosure-based liability exposure.[15] One such difference that has garnered significant attention concerns the applicability of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 (PSLRA), a provision that makes it harder for investors to win a lawsuit alleging that forward-looking statements were misleading. When SPACs share their target's growth projections with investors, those projections may enjoy the protection of the PSLRA's safe harbor, whereas any projections shared by a company doing a traditional IPO would fall within an exclusion from the safe harbor.[16]

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12. *See id.*

13. Sometimes SPACs will enter "forward purchase agreements ... with their sponsor, its affiliates, and other investors at the time of the IPO to provide the SPAC with greater certainty that any equity funding necessary to complete an initial business combination will be available." CURTISS, *supra* note 6.

14. Private companies looking for a liquidity event now often pursue what is referred to as a "Quad Track"—simultaneously preparing for an IPO, strategic sale, de-SPAC merger, and direct listing. *See* Roy Strom, *The SPAC Explosion Dimmed but Law Firms Are Still Cashing Checks*, BLOOMBERG L. (July 26, 2021, 6:01 AM), https://news.bloomberglaw.com/business-and-practice/the-spac-explosion-dimmed-but-law-firms-are-still-cashing-checks [https://perma.cc/3VHB-HWL5].

15. There are many other purported benefits of pursuing a de-SPAC merger over a traditional IPO that are not considered in this Article, such as the expertise that SPAC sponsors can offer to the merged entity, faster time to market, more deal certainty, and greater ability to negotiate earnout provisions. Whether de-SPAC mergers really carry these benefits and, if they do, whether the benefits outweigh the unique costs SPACs impose on target companies, is disputed. *See, e.g.*, Minmo Gahng, Jay R. Ritter & Donghang Zhang, *SPACs*, REV. FIN. STUD. (forthcoming) (manuscript at 10-13), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3775847 [https://perma.cc/4ALB-PUM6]; Michael Klausner, Michael Ohlrogge & Emily Ruan, *A Sober Look at SPACs*, 39 YALE J. ON REGUL. 228, 265-70 (2022).

16. *See, e.g.*, Stephen Amdur, Nathaniel Cartmell III, Bruce Ericson, Davina Kaile & Matthew Oresman, *Congressional SPACtivity Continues: Draft Legislation Proposes to Eliminate Safe Harbor Protection for Projections in SPAC Transactions*, JDSUPRA (June 1,

Although it is unclear how often the PSLRA's safe harbor has played a decisive role in private companies' chosen path to publicness,[17] the divergent application of the PSLRA's safe harbor is often characterized as a troubling opportunity for "regulatory arbitrage."[18] SEC officials and other lawmakers have thus called for law reform that would exclude communications in connection with a de-SPAC transaction from the safe harbor, which would purportedly place de-SPACs on a "level playing field" with traditional IPOs (at least as it concerns forward-looking statements).[19] As part of a broad package of proposed rules designed to "[a]lign[ ] [d]e-SPAC [t]ransactions [w]ith [i]nitial [p]ublic [o]fferings," the SEC in March answered these calls.[20] The proposed rules would, among other things, redefine terms in the PSLRA safe harbor such that the safe harbor

2021), https://jdsupra.com/legalnews/congressional-spactivity-continues-2513817/ [https://perma.cc/7CJK-YRS8] ("[O]ne factor that has contributed to the rise in SPACtivity has been the availability to SPACs of certain features unavailable to companies going public through traditional IPOs, most notably the Private Securities Litigation Reform Act (PSLRA) safe harbor for forward-looking statements.").

17. *See* Eliot Brown, *Startups Going Public via SPACs Face Fewer Limits on Promoting Stock*, WALL ST. J. (Jan. 3, 2021, 8:00 AM), https://www.wsj.com/articles/startups-going-public-via-spacs-face-fewer-limits-on-promoting-stock-11609678800 [https://perma.cc/J3L3-KT4C] (discussing "concerns about the regulatory differences between the two modes of going public" while noting that "[m]any of the companies going public through SPACs say they were drawn to the process by the readily available funding—not the regulatory differences").

18. *See* Cydney Posner, *The House Hears About SPACs*, COOLEY PUBCO (June 1, 2021), https://cooleypubco.com/2021/06/01/house-hears-spacs/ [https://perma.cc/2C5Q-T9BS] (reporting that all the witnesses at a recent congressional hearing on SPACs "agreed that, to prevent regulatory arbitrage, all IPO vehicles, whether traditional IPOs or SPACs, should operate on a level playing field and be subject to the same type of ... liability"); Klausner et al., *supra* note 15, at 283-85 (concluding that as a policy matter the differential treatment is difficult to justify); *see also* Georges Ugeux, *Regulating SPACs—Before It's Too Late*, CLS BLUE SKY BLOG (Mar. 31, 2021), https://clsbluesky.law.columbia.edu/2021/03/31/regulating-spacs-before-its-too-late/ [https://perma.cc/BR87-7NN9] (asserting that SPAC promoters "are simply exercising regulatory arbitrage detrimental to investors").

19. *See, e.g.*, Statement, John Coates, Acting Dir., Div. of Corp. Fin., SEC, SPACs, IPOs and Liability Risk Under the Securities Laws (Apr. 8, 2021), https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws [https://perma.cc/T35C-JD4Y] (suggesting that the IPO exclusion could be interpreted to extend to de-SPAC transactions and that the SEC use guidance or rulemaking "explaining its views on how or if at all the PSLRA safe harbor should apply to de-SPACs"); Posner, *supra* note 18 (reporting on draft legislation released on May 21, 2021, by the U.S. House Committee on Financial Services that would amend the Securities Act of 1933 and the Securities Exchange Act of 1934 to exclude SPACs from the safe harbor).

20. Special Purpose Acquisition Companies, Shell Companies, and Projections, Securities Act Release No. 33-11048, 87 Fed. Reg. 29,458, 29,476-87 (proposed May 13, 2022).

"would not be available to SPACs, including with respect to projections of target companies seeking to access the public markets through a de-SPAC transaction."[21] Whether such reform is a good idea is a complicated question that this Article seeks to unpack.

This Article is both narrow and broad in its ambitions. It is narrow insofar as it does not take a position on the social value of SPACs. This should not be interpreted as endorsement: SPACs clearly raise a host of investor protection concerns, which I outline in Part I.A. This Article is broad in two senses. First, it offers a framework for analyzing claims of regulatory arbitrage that can usefully be applied in other settings. Second, this Article brings into sharp focus the contestable policy choices that undergird the IPO exclusion to the PSLRA's safe harbor. Even if SPACs disappear tomorrow, this analysis will therefore remain important as policymakers consider adjustments to the regulatory framework for traditional IPOs.

How should charges that de-SPAC mergers allow companies to "arbitrage" liability rules be evaluated? The federal securities laws impose a web of different disclosure and liability standards that attach in different circumstances. Although these provisions are technically mandatory, in reality there is a large degree of optionality built in because companies can adjust their circumstances in a variety of ways to avoid the reach of particular rules.[22] Whether this optionality is normatively problematic requires a detailed analysis. Such an analysis must begin with an understanding of the "evaded" rule's purpose. What problem is it designed to solve? If companies can avoid the rule by structuring their transaction in an alternative way and the economic realities of that alternative do not present the same problem, then the differential regulatory treatment may be of no concern.[23] If the economic realities of the

21. *Id.* at 29,463.

22. *See* Alan R. Palmiter, *Toward Disclosure Choice in Securities Offerings*, 1999 COLUM. BUS. L. REV. 1, 3-4 ("[F]ederal regulation of securities offerings has come to accept party choice more than articulated regulatory policy and academic criticism acknowledge.").

23. *See, e.g.*, Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227, 230 (2010) (defining regulatory arbitrage as "the manipulation of the structure of a deal to take advantage of a gap between the economic substance of a transaction and its regulatory treatment"); Jordan Barry, Response, *On Regulatory Arbitrage*, 89 TEX. L. REV. 69, 73 (2010) ("Regulatory arbitrage can only happen if the rules of a regulatory regime do not match the economic substance of the transactions that the regime is intended to regulate.").

alternative do present the same problem, then the wisdom of the evaded rule should be considered before it is extended. Opportunities for regulatory arbitrage can be destructive when they allow companies to avoid optimal regulations,[24] but they can also serve a valuable function by alerting policymakers to potentially deficient regulations and prodding review—similar to sunset provisions.[25] Such review may lead to the conclusion that the evaded rule is indeed optimal and should be extended. It may reveal that the rule is suboptimal and should be changed. Or it might raise doubts about the optimality of the evaded rule, in which case allowing the divergence to persist might allow for regulatory learning.[26] The assumption here is not that companies will necessarily self-select the socially "better" regulatory regime in a virtuous race to the top but rather that observing the two contexts may provide useful data to policymakers as they seek to improve regulations.

Concluding that disclosures in connection with de-SPAC transactions should be excluded from the PSLRA's safe harbor thus requires significant analysis that has not been conducted to date. As a threshold matter, understanding what purpose the IPO exclusion serves is necessary. The legislative history of the PSLRA contains very little on the various safe harbor exclusions, and scant attention has been paid to them by academics. While serving as Acting Director of the SEC's Division of Corporation Finance, Professor John Coates sketched a rationale for the IPO exclusion that seemingly applies equally to the economic realities of a de-SPAC transaction.

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24. *See* Frank Partnoy, *The Law of Two Prices: Regulatory Arbitrage, Revisited*, 107 GEO. L.J. 1017, 1030-31 (2019) ("If regulatory costs are suboptimally high, regulatory arbitrage can be viewed as socially optimal; if regulatory costs are high for valid social purposes (for example, to internalize the costs of externalities), regulatory arbitrage can be viewed as socially suboptimal."); Fleischer, *supra* note 23, at 234 ("Whether a particular regulatory arbitrage technique is good or bad necessarily depends on a prior question of whether a particular regulation enhances social welfare."); Barry, *supra* note 23, at 73 ("[R]egulatory arbitrage can limit the harm of socially costly regulation as well as limit the effectiveness of socially beneficial regulation.").

25. *See, e.g.*, Jacob E. Gersen, *Temporary Legislation*, 74 U. CHI. L. REV. 247, 248 (2007) (explaining that legislation that sunsets "provides concrete advantages over its permanent cousin by specifying windows of opportunity for policymakers to incorporate a greater quantity and quality of information into legislative judgments" and also facilitates "experimentation and adjustment in public policy").

26. *Cf.* Kelli A. Alces, Essay, *Legal Diversification*, 113 COLUM. L. REV. 1977, 1982 (2013) (highlighting the learning that can occur due to "legal diversity").

He explained that when a private company is first introduced to public investors, heightened information asymmetries are present, warranting heightened judicial scrutiny of projections.[27] The unstated premise is that without such scrutiny, company officials would exploit the information asymmetry by offering overly optimistic projections, something that the specter of heightened judicial review will help deter. Other academics have similarly assumed that the IPO exclusion, as well as the other safe harbor exclusions, target situations where potential defendants are more likely to commit fraud.[28]

This account is oversimplified. To see why, it is necessary to step back and consider the purpose of the safe harbor itself. While much of the PSLRA was aimed at curbing perceived nuisance litigation, the safe harbor had a different motivation. It was designed to encourage otherwise reluctant companies to share their forecasts with investors.[29] Shielding such statements from liability risk was necessary to encourage voluntary disclosure. In an earlier era, the SEC was happy to let liability risk chill corporate release of forward-looking information. Indeed, the SEC affirmatively prohibited the inclusion of forward-looking information in SEC filings.[30] The SEC's position was based on a fear that unsophisticated investors would place undue reliance on even nonfraudulent forward-looking information, leading them to make poor investment decisions.[31] As you might imagine, reasonable investors rallied against the SEC's paternalistic position, emphasizing the importance of forward-looking information to their investment decisions and their ability to

27. *See* Statement, John Coates, *supra* note 19.

28. *See, e.g.*, Robert A. Prentice, *The Future of Corporate Disclosure: The Internet, Securities Fraud, and Rule 10b-5*, 47 EMORY L.J. 1, 42 (1998) ("[T]here are several notable exceptions contained in the PSLRA relating to situations where Congress apparently viewed the reliability of information as somewhat questionable and the availability of the safe harbor as unjustifiable."); Eric Talley, *Disclosure Norms*, 149 U. PA. L. REV. 1955, 1976 (2001) ("Congress specifically excluded from protection a number of potential defendants thought to pose particular risks of fraud or abuse.").

29. *See* Statement, John Coates, *supra* note 19.

30. Disclosure of Projections of Future Economic Performance, Securities Act Release No. 33-5362, 38 Fed. Reg. 7,220, 7,220 (Mar. 19, 1973).

31. *See* Bruce A. Hiler, *The SEC and the Courts' Approach to Disclosure of Earnings Projections, Asset Appraisals, and Other Soft Information: Old Problems, Changing Views*, 46 MD. L. REV. 1114, 1117-19 (1987).

discount management forecasts for bias.[32] The SEC in the 1970s began to listen, and seemingly changed position: instead of prioritizing the interests of *un*reasonable investors who might overreact to management forecasts, it began to take steps to encourage companies to share their forecasts for the benefit of reasonable investors.[33] (As explained more fully in Part II.A, the term "reasonable investor" has an established meaning in the federal securities law, and I use the term in that sense; I use its converse—"unreasonable investor"—to denote an investor who would not fit within the conception of a reasonable investor.)

Toward this end, the SEC adopted two regulatory safe harbors from liability for forward-looking statements.[34] After these safe harbors proved ineffective at encouraging disclosure, Congress stepped in with the more robust PSLRA safe harbor.[35] The PSLRA safe harbor, however, does not reach all forward-looking statements. It contains a hodgepodge of exclusions.[36] Some can easily be justified as advancing goals orthogonal to those that motivated the safe harbor's adoption. In this category is a variety of "bad boy" disqualifiers that apply to companies that have violated certain provisions in the securities laws in the past three years; such disqualifiers appear in many places throughout the securities laws and are meant to deter and punish the underlying offense.[37] A second category of exclusions cover situations—like tender offers, roll-up, and going private transactions—in which companies are compelled by law to share projections with investors;[38] in such situations, there is less risk that liability will chill disclosure, and the safe harbor exclusion can be understood as an effort to increase the accuracy of such disclosures. The remaining exclusions each cover situations in which a company is not compelled to share projections with investors. The IPO exclusion falls in this category,[39]

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32. *See* Disclosure of Projections of Future Economic Performance, 38 Fed. Reg. at 7,220.
33. *See id.*
34. *See* Safe Harbor Rule for Projections, Securities Act Release No. 33-6084, 44 Fed. Reg. 38,810, 38,810 (July 2, 1979); 17 C.F.R. § 230.175(a)-(b) (2011).
35. *See* H.R. REP. NO. 104-369, at 32 (1995).
36. 15 U.S.C. §§ 77z-2(b), 78u-5(b).
37. *See* Urska Velikonja, *Waiving Disqualification: When Do Securities Violators Receive a Reprieve?*, 103 CALIF. L. REV. 1081, 1090-93 (2015).
38. *See infra* notes 185-87.
39. *See* Spencer Feldman, *Growth Cos. Should Disclose Projections in IPO Prospectuses*,

as do the exclusions for communications by investment companies and penny stock issuers, and in connection with an offering by a blank check company, among others.

What ties the situations covered in this third category together? Perhaps they involve a heightened risk of fraud due to greater information asymmetries. But, at least in situations in which liability risk is meaningful (and hence the safe harbor's applicability of significance), denying voluntary management forecasts the protection of the safe harbor does not merely deter dishonest forecasts, it operates to silence *all* forecasts. If given the choice, reasonable investors would rather risk an occasional fraud by a bad actor than be denied access to valuable forward-looking information across the board. A better answer is that these exclusions each involve cases in which the potential defendant's securities are unlikely to trade in an efficient market. As Holger Spamann has observed, efficient markets provide a critical indirect protection to investors, including unreasonable investors.[40] Unreasonable investors are just as likely to overweight management projections in connection with a seasoned offering as with an IPO, but in the former case, competition between the smart money will set the price the investor pays, protecting the investor from his or her own foolishness. In the latter case, by contrast, unreasonable investors' undue reliance on management forecasts may cause them real harm.

When understood in this light, these exclusions reveal that the safe harbor's seeming prioritization of the informational needs of reasonable investors is in fact very circumscribed: the safe harbor operates to encourage the release of forward-looking statements for the benefit of reasonable investors only when unreasonable investors are unlikely to be harmed; in situations in which they may be harmed, the safe harbor continues to prioritize unreasonable investor protection at the expense of reasonable investors—using

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LAW360 (Apr. 9, 2021, 6:02 PM), https://www.law360.com/articles/1372725/growth-cos-should-disclose-projections-in-ipo-prospectuses [https://perma.cc/9HYY-CXCF].

40. Holger Spamann, *Indirect Investor Protection: The Investment Ecosystem and Its Legal Underpinnings*, 14 J. LEGAL ANALYSIS 16, 25-26 (Harvard L. Sch. John M. Olin Discussion Paper, Paper No. 1046, 2022) (arguing that although "[t]he vast majority of retail investors lack the financial expertise to value a security or to vote sensibly," these investors are nevertheless protected when they trade in efficient markets that, due to the trading behavior of more sophisticated investors, produce informed and unbiased prices).

the cudgel of liability risk to silence corporate forecasts. It has succeeded brilliantly in the case of IPOs. Much to the chagrin of reasonable investors who would find such information extremely useful, IPO issuers almost never issue projections publicly.[41] In the pre-filing period, this is dictated by the gun-jumping rules, but in the waiting and post-effective periods, it is the byproduct of liability risk and the PSLRA safe harbor exclusion for communications in connection with an IPO.[42]

This more nuanced account of the IPO exclusion sharpens the analysis that is required to assess whether a similar exclusion should be created for de-SPAC mergers. To assess whether the economic realities of de-SPAC mergers present the same regulatory concern that animates the IPO exclusion, policymakers should assess whether unreasonable SPAC investors are indirectly protected by an efficient market for SPAC shares. As will be explained in Part IV.A, they are not. Thus, unreasonable SPAC investors could be harmed by forward-looking statements just like unreasonable aftermarket IPO investors. But unlike companies doing an IPO, SPACs are compelled by a combination of federal securities regulation and state corporate law to share target projections with shareholders.[43] Thus, excluding de-SPAC mergers from the safe harbor would not operate to silence projections the way the IPO exclusion does, although it might operate to foster more accuracy in their presentation (or on the margins to discourage de-SPAC mergers). To truly place de-SPAC transactions on a "level playing field" with IPOs as it concerns forward-looking statements, the SEC would have to change its disclosure demands in connection with de-SPAC transactions and somehow override the state fiduciary obligations that compel disclosure of projections.

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41. *See infra* note 213 and accompanying text. Master limited partnerships may be an exception to this generalization. *See* John C. Coates, SPAC Law and Myths 18-19 (Feb. 11, 2022) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4022809 [https://perma.cc/BZ49-DMNR].

42. *See infra* notes 213-15 and accompanying text.

43. *See* George Casey, Adam Hakki & Roger Morscheiser, *SEC Considering Heightened Scrutiny of Projections in De-SPAC Transactions*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 17, 2021), https://corpgov.law.harvard.edu/2021/05/17/sec-considering-heightened-scrutiny-of-projections-in-de-spac-transactions/ [https://perma.cc/6MGH-3MAZ].

Assuming this could be done, should it? To state the question more broadly: *Is it sound public policy to discourage management forecasts in retail-accessible markets that do not provide unreasonable investors the protection of efficient pricing?* If the answer is no, then policymakers should consider either eliminating the IPO safe harbor exclusion or mandating disclosure of projections by IPO issuers. The SEC possesses the authority to take either action through rulemaking.[44] Whether it is wise policy to discourage the disclosure of management forecasts in such markets requires grappling with some difficult empirical and normative questions. Does the policy in fact protect unreasonable investors? Is prioritizing the interests of unreasonable investors over the interests of reasonable investors justified, on either fairness or efficiency grounds? Would more systemic regulatory interventions better protect unreasonable investors, given that they are likely to be harmed through their participation in these markets even in the absence of forward-looking disclosures? If so, what type of interventions are appropriate? While this Article signals the author's tentative views on some of these matters, it does not attempt to settle debate. Rather, its primary contribution is to clarify the questions that need probing. Given the recent growth in retail participation in our capital markets spurred by zero-commission trading platforms like Robinhood, Inc., these questions require thoughtful engagement more than ever.

This Article makes two additional contributions. First, it assesses whether the SEC might learn something about the efficacy of the IPO safe harbor exclusion by allowing the divergent treatment of IPOs and de-SPAC mergers to persist. Second, assuming it *is* sound policy to discourage management forecasts in retail-accessible markets that do not afford the unsavvy the protection of efficient pricing, it considers whether safe harbor exclusions are the best way to accomplish that goal. It argues that a flat prohibition on the public release of forecasts by any company whose stock trades (or

44. Under either approach, the gun-jumping rules would continue to chill public disclosure of projections in the pre-filing period of an IPO. *See infra* notes 213-14 and accompanying text. For discussion of the possibility of applying IPO-style publicity restrictions to de-SPAC mergers, see Harald Halbhuber, An Economic Substance Approach to SPAC Regulation 21-23, 28-29 (Jan. 10, 2022) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4005605 [https://perma.cc/6JWC-AEL9].

will soon trade) in such a market would be a superior way to achieve this goal but for two significant practical problems. First, such a prohibition might run afoul of the First Amendment. Second, a rule that expressly prohibited companies from publicly releasing information that is desired by reasonable investors, in order to protect unreasonable investors who venture into markets that are unsuitable for them, would be a hard sell politically. Filtering the policy objective through an obscure exclusion from a liability safe harbor conceals the true intention and avoids the scrutiny it would otherwise invite.

The remainder of this Article proceeds as follows. Part I outlines the investor protection concerns raised by SPACs' recent rise in popularity and potential solutions. Part II explains the history leading to the safe harbor's adoption and outlines the costs and benefits of the safe harbor as it relates to voluntary and mandatory forward-looking disclosures. Part III offers a theory of the safe harbor's exclusions. Part IV analyzes whether the IPO exclusion should be extended to de-SPAC mergers and in so doing challenges the IPO exclusion's underlying wisdom. This Article then briefly concludes, emphasizing the need for the SEC to engage in a more holistic review of the safe harbor and its existing exclusions before rushing to carve a new one for SPACs.

I. THE PROBLEMS WITH SPACS

This Part discusses the investor protection concerns that SEC officials and others have voiced regarding SPACs—concerns that extend far beyond the integrity of management projections. It also outlines potential solutions.

A. Regulatory Concerns

The United Kingdom recently liberalized its rules to compete for SPAC listings, and other jurisdictions are considering similar moves.[45] Meanwhile, U.S. regulators have increasingly expressed

45. *See* Tom Zanki, *UK Lawyers Prep for More SPAC Work After Rules Change*, LAW360 (Aug. 20, 2021, 9:38 AM), https://www.law360.com/articles/1413257/uk-lawyers-prep-for-more-spac-work-after-rules-change [https://perma.cc/SF8N-23TG] (describing the UK rule changes

concerns about retail investor participation in SPACs,[46] culminating in the SEC's proposal of sweeping new rules governing SPACs in March 2022.[47]

Recent empirical studies focused on SPACs that have completed a business combination suggest that SPAC IPO investors almost universally redeem their shares or sell them on the secondary market after a de-SPAC transaction is announced.[48] These studies also show that SPAC IPO investors following this strategy have earned outstanding returns whereas returns for SPAC investors who do not redeem or who purchase shares on the secondary market after the announcement (collectively, "de-SPAC period investors") have been extremely poor.[49] The former group consists overwhelmingly of institutional investors, including a collection of repeat-player hedge funds referred to as the "SPAC Mafia,"[50] whereas the latter group

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and noting that "Asian financial hubs Hong Kong and Singapore are also reviewing their SPAC rules").

46. *See* Statement, Gary Gensler, Chair, SEC, Statement on Proposal on Special Purpose Acquisition Companies (SPACs), Shell Companies, and Projections (Mar. 30, 2022), https://www.sec.gov/news/statement/gensler-spac-20220330 [https://perma.cc/S4GW-TWAH]. The International Organization of Securities Commissions (IOSCO) has also indicated concern, recently announcing the creation of an IOSCO SPAC Network "to facilitate information sharing about SPACs and monitor developments in this area." Media Release, Int'l Org. of Sec. Comm'ns, New IOSCO SPAC Network Discusses Regulatory Issues Raised by SPACs (July 27, 2021), https://www.iosco.org/news/pdf/IOSCONEWS614.pdf [https://perma.cc/55H3-8B7L].

47. Press Release, SEC, SEC Proposes Rules to Enhance Disclosure and Investor Protection Relating to Special Purpose Acquisition Companies, Shell Companies, and Projections (Mar. 30, 2022), https://www.sec.gov/news/press-release/2022-56 [https://perma.cc/GCC9-2SM9].

48. *See* Klausner et al., *supra* note 15, at 232.

49. Klausner, Ohlrogge, and Ruan report mean annualized returns for redeeming shareholders in a sample of forty-seven SPACs that merged between January 2019 and June 2020 of 11.6%—for an essentially risk-free investment. *Id.* at 248. By contrast, they report that one year following a merger, the average SPAC had underperformed against the IPO index by 50.9%, against the Nasdaq by 17.9%, and against the Russell 2000 by 4.4%. *Id.* at 256. Gahng, Ritter, and Zhang found, based on a study of 152 SPAC IPOs from January 2010 to December 2020, that redeeming investors earned on average an annualized return of 23.9% per year, whereas de-SPAC period investors earned an equally-weighted (EW) average one-year return of -11.3%. Gahng et al., *supra* note 15, at 18, 20. They emphasized, however, that because there are relatively few de-SPAC period investors due to large redemption levels, the public cash-weighted return is higher. *See id.* at 4, 20-21. Gahng, Ritter, and Zhang also reported that the EW average one-year buy-and-hold return of the merged companies' warrants in their sample was an astounding 72.2%. *Id.* at 42.

50. Klausner et al., *supra* note 15, at 242.

likely includes more retail investors.[51] Thus, it appears that de-SPAC period investors are systematically overvaluing SPAC shares. What might explain this self-destructive behavior?[52] Several possibilities are outlined below.[53]

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51. Retail investor interest in SPACs naturally ebbs and flows. Klausner, Ohlrogge, and Ruan examined a cohort of forty-seven SPACs that engaged in a merger between January 2019 and June 2020 and found that median shareholdings of SEC Form 13F filers (*viz.*, institutional investment managers with at least $100 million in assets under management, *see* 17 C.F.R. § 240.13f-1(a)(1) (2011)) slightly *increased* between the time of the SPAC IPO and immediately before the de-SPAC merger closed, rising from 85% to 87%, although the authors inferred a nearly 100% turnover of shares held by 13F filers between the time of a merger announcement and closing. Klausner et al., *supra* note 15, at 235, 241-42. This suggests little direct retail participation in absolute terms between merger announcement and closing and fails to support a narrative that institutional investors were dumping shares on retail investors (rather than on other large institutional investors) in the wake of a merger announcement. *See* COMM. ON CAP. MKTS. REGUL., NOTHING BUT THE FACTS: RETAIL INVESTORS AND SPECIAL PURPOSE ACQUISITION COMPANIES 1 (2021), https://www.capmktsreg.org/wp-content/uploads/2021/10/CCMR-NBTFSPACs-Retail-Investors.pdf [https://perma.cc/3CMN-FK59] (pointing to this data and low secondary market trading volume to conclude that "although investments in SPACs are available to retail investors, such investments are minimal"). Unpublished research by Harald Halbhuber suggests higher levels of retail participation during the height of the SPAC boom in Q4 2020 and Q1 2021. *See* Halbhuber, *supra* note 44, at 22 n.139 (referring to this research). Halbhuber collected 13F data for the 231 SPAC mergers announced between July 2020 and June 2021. E-mail from Harald Halbhuber, Rsch. Fellow, Inst. for Corp. Governance & Fin., N.Y.U., to Amanda Rose, Professor of L., Vanderbilt Univ. L. Sch. (Feb. 10, 2022, 4:14 AM) (on file with author). After eliminating thirty mergers for various reasons that affected data usability, he found that the mean and median percentages of SPAC shares held by 13F filers dropped significantly in Q4 2020 and Q1 2021—from 86.94% and 89.27%, respectively, as of the last quarter end before the merger announcement, to 64.13% and 68.84%, respectively, as of the first quarter end thereafter. *Id.* Looking at the entire twelve months, his findings show a less pronounced but still statistically significant drop of -14.70 percentage points on average. *Id.* Of course, retail investors may also be exposed to SPACs through SPAC-themed mutual funds and ETFs.

52. *See* Klausner et al., *supra* note 15, at 234, 282 (questioning whether this is a "sustainable situation" and noting that "it is hard to believe that SPAC shareholders will continue volunteering to bear losses"); Ross Greenspan, Money for Nothing, Shares for Free: A Brief History of the SPAC 25 (Apr. 23, 2021) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3832710 [https://perma.cc/5TML-DQC6] ("The risk-adjusted returns for SPAC IPO investors are excellent. The returns for investors in the post-merger company are not. What is less clear is why anyone would invest capital in post-merger SPACs when performance in the second generation was objectively terrible.").

53. The list is not exhaustive.

1. Conflicts of Interest

It is possible that these investors are placing unwarranted faith in the SPAC sponsor's recommendation of a merger and/or mistakenly viewing a favorable shareholder vote in favor thereof as a signal of merger quality because they fail to appreciate the significant conflicts of interest at play. SPAC sponsors, as well as their financial advisors, face a structural conflict of interest relative to other SPAC investors when it comes to the choice to engage in a de-SPAC transaction.[54] SPAC sponsors' promote and their warrants will be rendered worthless if the SPAC liquidates, so they have an incentive to recommend de-SPAC transactions even if they are value destroying for SPAC investors.[55] SPAC sponsors may also have situational conflicts of interest, such as when they or their affiliates have a financial interest in a de-SPAC target. Financial institutions that underwrite SPAC IPOs will also typically lose part of their compensation if a de-SPAC transaction is not consummated and so have skewed incentives in connection with de-SPAC-related advice.[56] SPAC mergers are likely to clear a shareholder vote regardless of the merits of the deal: SPAC shareholders are permitted to redeem even if they vote to approve the merger,[57] and shareholders wishing to redeem have a strong incentive to so vote in order to preserve the value of their warrants.[58] De-SPAC period investors might also mistakenly view sophisticated PIPE investment as a

54. *See What You Need to Know About SPACs—Updated Investor Bulletin*, SEC (May 25, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin [https://perma.cc/Y78G-KZH6] [hereinafter *What You Need to Know About SPACs*].

55. *See id.*

56. *See* PINEDO ET AL., *supra* note 10, at 6-8 (discussing this and other conflicts that financial intermediaries involved with SPACs may face).

57. *See* Usha Rodrigues & Michael Stegemoller, *Redeeming SPACs* 28, 52 (Univ. of Ga. Sch. of L. Rsch. Paper, Paper No. 2021-09, 2021), https://papers.ssrn.com/so13/papers.cfm?abstract_id=3906196 [https://perma.cc/M5P8-HH8H] (finding that every SPAC in their sample of 183 SPACs that filed Form S-1s between 2010 and 2018 gave "shareholders the right to redeem their shares—regardless of their vote").

58. *See* Mira Ganor, *The Case for Non-Binary, Contingent, Shareholder Action*, 23 U. PA. J. BUS. L. 390, 411-14 (2021) (discussing these and other reasons why a redeeming SPAC investor might vote in favor of a merger).

signal of merger quality, without appreciating that the terms of the PIPE investment might vary from the terms of their investment.[59]

2. Inadequate Due Diligence

In addition to failing to appreciate these conflicts of interest, de-SPAC period investors might also be placing undue faith in the amount of due diligence done in connection with the deal. Because their role in a de-SPAC transaction is not, as it would be in a traditional IPO, as formal underwriters, financial institutions offering guidance in connection with de-SPAC transactions likely do not face § 11 liability and thus may have less incentive to conduct rigorous due diligence.[60] The SPAC and its directors and top officers are exposed to § 11 liability if new shares are registered as part of the de-SPAC transaction (a common occurrence[61]), but the damages exposure is much lower than in a traditional IPO—unlike in most IPOs, secondary market purchasers will usually be unable to "trace" their shares to the offending registration statement, and thus will lack § 11 standing.[62] The speed with which de-SPAC transactions come to market may also constrain due diligence efforts in ways that de-SPAC period investors are failing to appreciate.[63]

59. For further discussion of these conflicts, see Rodrigues & Stegemoller, *supra* note 57, at 17-22.

60. *See generally* 15 U.S.C. § 77k(a) (listing who is a proper defendant in a § 11 lawsuit).

61. *See* Graubard Miller, Comment Letter on Proposed Rule Change to Amend Nasdaq Listing Interpretation IM-5101-2 to Provide Acquisition Companies the Option to Hold a Tender Offer in Lieu of a Shareholder Vote on a Proposed Acquisition (Nov. 22, 2010), https://www.sec.gov/comments/sr-nasdaq-2010-137/nasdaq2010137-2.pdf [https://perma.cc/2EAY-Y9SS]; McDermott Will & Emery, Comment Letter on Proposed Rule Change to Amend IM-5101-2 to Provide Acquisition Companies the Option to Hold a Tender Offer in Lieu of a Shareholder Vote on a Proposed Acquisition (Nov. 30, 2010), https://www.sec.gov/comments/sr-nasdaq-2010-137/nasdaq2010137-3.pdf [https://perma.cc/8FX3-7RR8].

62. Klausner et al., *supra* note 15, at 286; Andrew F. Tuch & Joel Seligman, *The Further Erosion of Investor Protection: Expanded Exemptions, SPAC Mergers and Direct Listings* 29-31 (Wash. Univ. in St. Louis Sch. of L. Legal Stud. Rsch. Paper, Paper No. 22-01-03, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4020460 [https://perma.cc/MF4L-GJBT].

63. *See* Tuch & Seligman, *supra* note 62, at 38.

3. Dilution

Another possibility is that de-SPAC period investors are failing to appreciate the level of dilution that the post-merger entity will experience. The dilutive impact of a de-SPAC transaction can be significant.[64] Dilution results from the sponsor's promote, the exercise of warrants, and the fees that must be paid to financial advisors.[65] To the extent that the amount of funds delivered in the de-SPAC transaction is reduced due to redemptions that have not been offset by new PIPE investment, it will heighten the amount of dilution per share.[66] Investors may have difficulty anticipating the level of dilution that will occur, given that they will not know how many investors have redeemed their shares until after the transaction has occurred. Moreover, the concept of dilution may be too complex for unsophisticated investors to understand even if well disclosed.

4. Pre-Filing Publicity

It is also possible that de-SPAC period investors are overpaying because they are overly swayed by pre-filing publicity. In a traditional IPO, an issuer must avoid any communications that would condition the market for its offering prior to the filing of a registration statement.[67] Animating this prohibition is a concern that pre-filing publicity might cause investors to form a sticky premature opinion as to the value of the offering.[68] No similar prohibition applies to private companies contemplating a de-SPAC merger, and their managers routinely engage with the media prior to the filing of the company's merger documents.[69]

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64. *See* Klausner et al., *supra* note 15, at 246-53 (describing sources of dilution and quantifying them).

65. *See id.* at 246.

66. *See id.* at 252 n.37, 253.

67. *See* 15 U.S.C. § 77e(c). *See generally* Carl M. Loeb, Rhoades & Co., Securities Act Release No. 8-279, 38 SEC Docket 843 (Feb. 9, 1959).

68. *See* Halbhuber, *supra* note 44, at 21.

69. *See id.* at 22 (observing that these media appearances invariably paint a positive picture of the target); *see also, e.g.*, Philippe Maupas & Luc Paugam, CFA Soc'y France, Regulatory Arbitrage on Narrative Steroids: The Case of SPACs 20 (Dec. 15, 2021) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3985936 [https://perma.cc/4DEY-ALZ6].

5. Projections

Another possibility is that projections that are provided to investors in the various disclosure documents that the SPAC files in connection with the de-SPAC may be causing investors to overvalue the merged entity. Unless the SPAC conducts a tender offer (a rare occurrence[70]), the projections it shares as part of its explanation for its decision to recommend the transaction are likely eligible for the protection of the PSLRA safe harbor. The PSLRA safe harbor does nothing to affect litigation brought by the SEC or brought by private plaintiffs under state law, but it does make it harder to challenge projections in private litigation brought under the federal securities laws.

In suits challenging present-looking statements, most courts hold that plaintiffs need only prove negligence in suits brought under Section 14(a) of the Exchange Act[71] (prohibiting material misrepresentations and omissions in proxy statements) and only recklessness in cases brought under the SEC's Rule 10b-5[72] (a general antifraud rule targeting misstatements and omissions in connection with the purchase or sale of any security). If forward-looking statements protected by the safe harbor are challenged, by contrast, plaintiffs bringing either type of claim must prove that the defendant *knew* the projections were false, and many courts hold that plaintiffs cannot prevail regardless of their scienter showing if the challenged forward-looking statement was accompanied by meaningful cautionary language.[73] In an IPO, by contrast, the safe harbor is unavailable. This may embolden sponsors to share poorly diligenced, or even knowingly false, target projections with investors.[74] Unsophisticated retail investors might also place undue faith in even honestly prepared, well-diligenced financial forecasts—allowing themselves to get "whipped up" into a speculative "frenzy."[75]

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70. *See infra* note 89.

71. 15 U.S.C. § 78n(a); 17 C.F.R. § 240.14a-9 (2021).

72. 17 C.F.R. § 240.10b-5.

73. *See infra* text accompanying notes 154-64.

74. The PSLRA safe harbor would not protect the target or its managers from liability for pre-merger statements because the safe harbor only applies to reporting companies. 15 U.S.C. § 78u-5(a).

75. *See Going Public: SPACs, Direct Listings, Public Offerings, and the Need for Investor*

6. Irrational Exuberance

Finally, de-SPAC period investors may be driven by a speculative fervor or irrational exuberance that is independent of any disclosures provided by SPAC sponsors or target companies.[76] Some investors may choose to invest in a SPAC because a celebrity they like has associated herself with it or because it is merging with a company in a "hot" sector, such as electric vehicles. Others may be swayed by what they have read in online chat rooms or based on media accounts of other successful SPACs.[77] The availability of zero-commission online trading platforms with gamelike features may draw in gamblers who are disinterested in, or incapable of, processing SPAC disclosures.[78] Irrationally exuberant over SPACs, retail investors might also purchase shares in SPAC-themed mutual funds and ETFs, indirectly fueling demand for de-SPAC shares and inflating prices.

B. Potential Solutions

As discussed below, policymakers are considering reforms to address many of the foregoing possibilities,[79] and the SEC and the

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Protections: Virtual Hearing Before the Subcomm. on Inv. Prot., Entrepreneurship, & Cap. Mkts. of the H. Comm. on Fin. Servs., 117th Cong. 68 (2021) (testimony of Usha R. Rodrigues, Law Professor, University of Georgia School of Law) ("Ever since the passage of the 1933 Act, a key concern has been that the public will be whipped up into a frenzy and will overbid for new offerings untested in the public markets.").

76. *See, e.g.*, David Erickson, *Will 2020 Be Seen as the Year of the SPAC Bubble?*, KNOWLEDGE AT WHARTON (Jan. 12, 2021), https://knowledge.wharton.upenn.edu/article/will-2020-seen-year-spac-bubble/ [https://perma.cc/4BM4-YS7B]; James Mackintosh, *Wall Street's Hottest Financing Tool Makes Me Worry About the Market*, WALL ST. J. (Oct. 17, 2020, 5:30 AM), https://www.wsj.com/articles/wall-streets-hottest-financing-tool-makes-me-worry-about-the-market-11602927001 [https://perma.cc/4VHB-CBND].

77. *See* Klausner et al., *supra* note 15, at 230-31.

78. *See* Greenspan, *supra* note 52, at 30 ("With many Americans at home social distancing during the pandemic, Americans' predisposition to gamble appears to have made financial speculation in stocks, and to a lesser extent SPACs, a source of entertainment.").

79. The SEC has issued a flurry of public statements regarding SPACs since late 2020. *See* DIV. OF CORP. FIN., *Special Purpose Acquisition Companies, CF Disclosure Guidance: Topic No. 11*, SEC (Dec. 22, 2020), https://www.sec.gov/corpfin/disclosure-special-purpose-acquisition-companies#_ednref2 [https://perma.cc/DW5R-V7G6] [hereinafter *Special Purpose Acquisition Companies*]; *Celebrity Involvement with SPACs—Investor Alert*, *supra* note 6; DIV. OF CORP. FIN., *Staff Statement on Select Issues Pertaining to Special Purpose Acquisition Companies*, SEC (Mar. 31, 2021), https://www.sec.gov/news/public-statement/division-cf-spac-2021-

plaintiffs' bar have begun targeting de-SPAC transactions with greater frequency.[80] This has caused law firms to advise stepped-up compliance and litigation-risk reduction strategies, which may lead

03-31 [https://perma.cc/QJZ7-96EK] [hereinafter *Staff Statement on Select Issues*]; Statement, Paul Munter, Acting Chief Acct., SEC, Financial Reporting and Auditing Considerations of Companies Merging with SPACs (Mar. 31, 2021), https://www.sec.gov/news/public-statement/munter-spac-20200331 [https://perma.cc/N8FK-HSKU]; Statement, John Coates, *supra* note 19; Statement, John Coates, Acting Dir., Div. of Corp. Fin., SEC & Paul Munter, Acting Chief Acct., SEC, Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies ("SPACs") (Apr. 12, 2021), https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs [https://perma.cc/RHC7-KLL9]; *What You Need to Know About SPACs*, *supra* note 54; INV. AS PURCHASER & INV. AS OWNER SUBCOMMS., SEC INV. ADVISORY COMM., RECOMMENDATIONS OF THE INVESTOR AS PURCHASER AND INVESTOR AS OWNER SUBCOMMITTEES OF THE SEC INVESTOR ADVISORY COMMITTEE REGARDING SPECIAL PURPOSE ACQUISITION COMPANIES (2021); *see also* Kevin LaCroix, *Guest Post: SPACs and SPAC-Related Litigation: A Primer on Reducing Litigation and Enforcement Risk*, D&O DIARY (May 23, 2021), https://www.dandodiary.com/2021/05/articles/securities-litigation/guest-post-spacs-and-spac-related-litigation-a-primer-on-reducing-litigation-and-enforcement-risk/ [https://perma.cc/6U9D-S9MJ] ("The SEC's Enforcement Division has ... shown an interest in SPACs and appears to have opened several inquiries/investigations.").

80. *See, e.g.*, Robert Malionek & Ryan Maierson, *SPAC-Related Litigation Risks and Mitigation Strategies*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 9, 2021), https://corpgov.law.harvard.edu/2021/08/09/spac-related-litigation-risks-and-mitigation-strategies/ [https://perma.cc/C2PP-YCQ5] (noting a "surge in SPAC litigation since 2020"); Zanki, *supra* note 45 ("SPACs are also increasingly magnets for investor litigation in the U.S."); Glen A. Kopp, Jason Linder, Glenn K. Vanzura & Bradley A. Cohen, *Mitigating SPAC Enforcement and Litigation Risks*, MAYER BROWN (Apr. 26, 2021), https://www.mayerbrown. com/en/perspectives-events/publications/2021/04/mitigating-spac-enforcement-and-litigation-risks [https://perma.cc/3833-U7CB] ("The recent SPAC boom is ... beginning to create a wave of SPAC-related litigation in state and federal courts."); Caitlyn M. Campbell, *Surge in SPACtivity Leads to Litigation and Regulatory Risks*, NAT'L L. REV. (Apr. 5, 2021), https://www.natlawreview.com/article/surge-spactivity-leads-to-litigation-and-regulatory-risks [https://perma.cc/XY8V-AQDA] (describing the increase in litigation and regulatory interest); Press Release, Robbins Geller Rudman & Dowd LLP, Robbins Geller Rudman & Dowd LLP Launches SPAC Task Force (Apr. 12, 2021), https://www.rgrdlaw.com/news-press-Launches-SPAC-Task-Force.html [https://perma.cc/FV5K-QM3F] (announcing that the class action plaintiffs' firm has formed "a dedicated SPAC Task Force comprised of experienced securities and M&A lawyers"). For an empirical review of this litigation, see generally Emily Strauss, *Suing SPACs*, 95 S. CAL. L. REV. (forthcoming 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4030815 [https://perma.cc/A6FY-HEE6].

to better practices.[81] Market innovations in SPAC design may also mitigate problems going forward.[82]

1. Conflicts of Interest

The SEC has been focused on enhancing the disclosures related to SPAC conflicts of interest. It issued disclosure guidance on point in December 2020.[83] In August 2021, the SEC Investor Advisory

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81. *See, e.g.*, John Patrick Clayton, Kerry E. Berchem, Jacqueline Yecies & Stephanie Lindemuth, *Liability Risk in De-SPAC Transactions*, AKIN GUMP STRAUSS HAUER & FELD LLP (Apr. 14, 2021), https://www.akingump.com/en/experience/practices/corporate/ag-deal-diary/liability-risk-in-de-spac-transactions.html [https://perma.cc/9G6C-EGC6] (advising SPACs to, inter alia, carefully document their due diligence efforts, to disclose and mitigate conflicts of interest, and to follow recent SEC disclosure guidance related to de-SPAC transactions); *see also* Malionek & Maierson, *supra* note 80 (discussing a recent event hosted by Latham & Watkins and FTI Consulting focused on potential litigation risks associated with SPACs and exploring the mitigation measures investors and target companies should consider before pursuing a SPAC or de-SPAC deal, such as avoiding rushed due diligence, clearly disclosing conflicts of interest, using special independent committees to negotiate the de-SPAC merger, and "the use of cautionary language and clearly presented base case projections, rather than only bullish financials"); Frank M. Placenti, *Recent Claims SPAC Board Structures Are a "Conflict-Laden" Invitation to Fiduciary Misconduct*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 4, 2021), https://corpgov.law.harvard.edu/2021/06/04/recent-claims-spac-board-structures-are-a-conflict-laden-invitation-to-fiduciary-misconduct/ [https://perma.cc/6QRD-ARRA] (based on Squire Patton Boggs's memorandum and outlining measures SPAC boards should consider taking to reduce risk of fiduciary duty litigation over de-SPAC transactions, including proper board compensation, use of a special negotiation committee, use of an independent financial advisor, securing of an appropriate fairness opinion, creation of a strong record of due diligence, and careful review of projections); Kopp et al., *supra* note 80 (post based on a Mayer Brown memorandum outlining "proactive steps" that SPAC market participants should consider "to mitigate the regulatory and litigation risk associated with these investment vehicles"); Eric Rieder & Amy Wilson, *Avoiding Litigation Risks as SPAC Popularity Explodes*, LAW360 (Apr. 26, 2021, 6:37 PM), https://www.law360.com/articles/1378780/avoiding-litigation-risks-as-spac-popularity-explodes [https://perma.cc/6H7M-Z8M6] (Bryan Cave Leighton Paisner LLP partners providing similar advice); Caroline Bullerjahn & Morgan Mordecai, *Limiting SPAC-Related Litigation Risk: Disclosure and Process Considerations*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 14, 2021), https://corpgov.law.harvard.edu/2021/03/14/limiting-spac-related-litigation-risk-disclosure-and-process-considerations/ [https://perma.cc/MX6G-F7ZY] (recommending strategies for reducing litigation risk); Matthew Catalano, Gregory Markel, Daphne Morduchowitz, Vincent Sama & Catherine Schumacher, *Considering a SPAC Transaction? Keep Securities Litigation Risk at Top-of-Mind*, JDSUPRA (Mar. 4, 2021), https://www.jdsupra.com/legalnews/considering-a-spac-transaction-keep-2626931/ [https://perma.cc/ECX7-JBK3] (Seyfarth Shaw LLP partners providing similar advice).

82. *See infra* note 106 and accompanying text.

83. *Special Purpose Acquisition Companies*, *supra* note 79.

Committee recommended enhanced scrutiny by the SEC of SPAC disclosures on a variety of topics, including conflicts of interest.[84] In congressional testimony in September 2021, Chairman Gensler emphasized the importance of clear disclosures regarding conflicts of interests inherent in SPACs and suggested enhanced disclosure obligations may be forthcoming.[85] In March 2022, the SEC followed through, proposing new rules that would augment disclosures related to conflicts of interest.[86] In April 2021, Professor John Coates (then Acting Director of the Division of Corporate Finance) also issued a public statement warning of the litigation risks associated with material misstatements and omissions in the communications surrounding a de-SPAC transaction,[87] and private litigants are increasingly suing to challenge de-SPAC transactions in which conflicts were allegedly inadequately disclosed.[88] Although § 11 liability exposure is more limited in de-SPAC transactions than in traditional IPOs, the parties involved in such transactions do face potential negligence-based liability for misleading proxy statements under Section 14(a) of the Securities Exchange Act of 1934.[89] Rule

84. INV. AS PURCHASER & INV. AS OWNER SUBCOMMS., *supra* note 79, at 1-2.

85. Gary Gensler, *Testimony Before the United States Senate Committee on Banking, Housing, and Urban Affairs*, SEC (Sept. 14, 2021), https://www.sec.gov/news/testimony/gensler-2021-09-14 [https://perma.cc/262Y-MXUK] ("[G]iven the surge in special purpose acquisition companies (SPACs), I have asked staff for recommendations about enhancing disclosures in these investments. There are a lot of fees and potential conflicts inherent within SPAC structures, and investors should be given clear information so that they can better understand the costs and risks."); *see also* Klausner et al., *supra* note 15, at 289 (suggesting a requirement that any side payments to public shareholders in return for commitments not to redeem their shares be fully disclosed).

86. Special Purpose Acquisition Companies, Shell Companies, and Projections, Securities Act Release No. 33-11048, 87 Fed. Reg. 29,458, 29,468 (proposed May 13, 2022).

87. Statement, John Coates, *supra* note 19.

88. *See* Catalano et al., *supra* note 81.

89. If the de-SPAC is structured as a tender offer rather than a merger, plaintiffs can sue under Section 14(e) of the Exchange Act. 15 U.S.C. § 78n(e). There is a circuit split regarding whether negligence suffices in such suits, which the Supreme Court recently declined to resolve. Thomas Ryerson, *Supreme Court Declines to Resolve Circuit Split over Liability in Tender Offer Suits*, PERKINS COIE: WHITE COLLAR BRIEFLY (May 10, 2019), https://www.whitecollarbriefly.com/2019/05/10/supreme-court-declines-to-resolve-circuit-split-over-liability-in-tender-offer-suits/ [https://perma.cc/WG4Y-J5TF]. Recent empirical work suggests that de-SPACs are rarely structured as tender offers, Rodrigues & Stegemoller, *supra* note 57, at 28, which is not surprising given that: (1) a shareholder vote often cannot be avoided, *see infra* notes 185-87 and accompanying text, and (2) communications in connection with tender offers—but not mergers—are excluded from the PSLRA's safe harbor, *see infra* note 182 and accompanying text.

10b-5 can likewise be used to attack undisclosed conflicts of interests.[90] In addition, state fiduciary duty law has an important role to play in de-SPAC transactions that it does not have in connection with traditional IPOs: SPAC sponsors owe their shareholders fiduciary duties, and inadequately disclosing the conflicts they face when requesting shareholder action may result in rigorous entire fairness review of the transaction.[91] With fiduciary duty lawsuits targeting SPAC boards on the rise,[92] law firms are increasingly advising their SPAC clients not only to beef up proxy disclosures regarding conflicts of interest but also to create independent special committees to negotiate de-SPAC mergers and, as part of the process, to solicit fairness opinions from independent financial institutions (something that, apparently, has not heretofore been the norm[93]).[94]

90. *See* 17 C.F.R. § 240.10b-5 (2021).

91. *See In re* Multiplan Corp. Stockholders Litig., 268 A.3d 784, 815-16 (Del. Ch. 2022); *see also* Michael Klausner & Michael Ohlrogge, *SPAC Governance: In Need of Judicial Review* 8-9 (Stanford L. Sch., John M. Olin Program in L. & Econ. Working Paper, Paper No. 564, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3967693 [https://perma.cc/4XPD-CEPJ]. It should be noted that the viability of the type of lawsuits described in the text has yet to be fully tested. If courts construe Rule 10b-5 suits attacking undisclosed conflicts as "half-truth" rather than pure omission cases, reliance and class certification may stand as an obstacle to success. This is because, as discussed *infra* Part IV.A, SPAC shares are unlikely to trade in an efficient market around the time of the de-SPAC merger, precluding invocation of the presumption of reliance recognized in *Basic Inc. v. Levinson*. 485 U.S. 224, 245-47, 250 (1988). Moreover, § 14(a) suits require a showing that "the proxy solicitation was an essential link in effecting the proposed corporate action." Vides v. Amelio, 265 F. Supp. 2d 273, 276 (S.D.N.Y. 2003) (quoting Halpern v. Armstrong, 491 F. Supp. 365, 378 (S.D.N.Y. 1980)). Given the dynamics that surround the shareholder vote in a de-SPAC transaction—the majority of SPAC shareholders vote in favor only to have the chance to redeem—whether this element can be met is questionable. *See supra* notes 48-49 and accompanying text. The same logic, however, might benefit plaintiffs attacking the fairness of a de-SPAC merger under Delaware law because arguably a shareholder vote motivated by a desire to redeem should not have cleansing effect under *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304 (Del. 2015). *See* Delman v. GigAcquisitions3, LLC, No. 2021-0679-LWW, 2023 WL 29325, at *19-20 (Del. Ch. Jan. 4, 2023) (holding that *Corwin* cleansing was unavailable for this reason).

92. For a recent example, see Leslie A. Pappas, *SPAC Shareholder Sues over Loss on $1B XL Fleet Merger*, LAW360 (Sept. 21, 2021, 9:29 PM), https://www.law360.com/articles/1423733/spac-shareholder-sues-over-loss-on-1b-xl-fleet-merger [https://perma.cc/2HX5-22FD].

93. Rodrigues & Stegemoller, *supra* note 57, at 18-19.

94. *See supra* note 81 and accompanying text.

2. Inadequate Due Diligence

Increased private and SEC enforcement has also targeted instances of allegedly inadequate due diligence.[95] Moreover, according to Reuters, the SEC has opened an inquiry into how Wall Street banks are managing deal risks.[96] This has led law firms to advise their banking clients to review and, as necessary, strengthen their due diligence efforts surrounding a de-SPAC transaction. For example, in an alert issued earlier this year Loeb & Loeb advised clients to:

- Perform comprehensive background checks of sponsor personnel; confirm qualifications.
- Establish standards for due diligence, risk assessment and valuation (in connection with both the de-SPAC transaction and any related PIPE).
- Confirm that management assumptions for projections are reasonably based.
- Ensure that all compensation and incentives to advisers are clearly disclosed.
- Avoid rote management and auditors' due diligence calls.

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95. *See, e.g.*, 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/9GC5-EPD9] (noting charges against SPAC sponsor based on inadequate due diligence); Kopp et al., *supra* note 80 ("Over the past year, SPAC shareholders have filed several lawsuits alleging material statements in or omissions from proxy statements and other disclosures issued in connection with de-SPAC transactions, with shareholders claiming, for example, that SPACs and their managers fraudulently misrepresented due diligence efforts with respect to target companies.").

96. Anirban Sen, Chris Prentice & Joshua Franklin, *EXCLUSIVE U.S. Watchdog Mulls Guidance to Curb SPAC Projections, Liability Shield—Sources*, REUTERS, Apr. 28, 2021, 5:46 PM, https://www.reuters.com/business/exclusive-us-watchdog-weighs-guidance-aimed-curbing-spac-projections-liability-2021-04-27/ [https://perma.cc/PH6R-7JNT]; Mitchell S. Nussbaum, David C. Fischer, Tahra T. Wright & Giovanni Caruso, *SEC Begins Informal Inquiry into Investment Bank SPAC Practices*, LOEB & LOEB LLP (Mar. 2021), https://www.loeb.com/en/insights/publications/2021/03/sec-begins-informal-inquiry-into-investment-bank-spac-practices [https://perma.cc/YT8S-ZX8B].

- Ensure that management incentives and compensation are clearly disclosed.[97]

SEC officials and commentators have also suggested legal reforms to enhance the liability risk faced by financial advisors in de-SPAC transactions,[98] and in March 2022, the SEC formally proposed such reforms.[99] If adopted, the rule changes may create greater incentives for rigorous due diligence.

3. Dilution

Commentators have called for enhanced disclosures that would provide greater clarity on the level of dilution to expect after a business combination based on various redemption scenarios.[100] The SPAC rules the SEC proposed in March 2022 answer these calls.[101] Professor Mira Ganor has suggested that SPAC investors be given contingent redemption rights—allowing them to, for example, elect redemption conditional on a certain percentage of other investors

97. Nussbaum et al., *supra* note 96.

98. *See, e.g.*, Statement, John Coates, *supra* note 19 (asking whether there are "sufficient incentives to do appropriate due diligence on the target and its disclosures to public investors, especially since SPACs are designed not to include a conventional underwriter at the de-SPAC stage" and posing the question: "Should the SEC reconsider the concept of 'underwriter' in these new transactional paths?"); Rodrigues & Stegemoller, *supra* note 57, at 49-50 (suggesting that investment banks advising on de-SPAC mergers should face "strict liability in the de-SPAC analogous to that in the IPO"); Klausner et al., *supra* note 15, at 287 (concluding that, to the extent that requiring an IPO underwriter to assume liability for the accuracy of statements in a prospectus adds meaningful investor protection, banks advising SPACs on their mergers should face the same liability). *But see* Jessica Bai, Angela Ma & Miles Zheng, Segmented Going-Public Markets and the Demand for SPACs 35 (Sept. 2021) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3746490 [https://perma.cc/K8B5-AJXB] ("[E]levated litigation risk for intermediaries may undermine one economic role of the SPAC market that bypasses the downside-averse financial intermediaries and enables risk-taking but potentially value-creating firms to go public.").

99. Special Purpose Acquisition Companies, Shell Companies, and Projections, Securities Act Release No. 33-11048, 87 Fed. Reg. 29,458, 29,483-86 (proposed May 13, 2022).

100. *See* Klausner et al., *supra* note 15, at 288. A bill recently introduced in the Senate would require the SEC to adopt such enhancements, as well as require disclosure of "any side payments or agreements to pay sponsors, [SPAC] investors, or [PIPE] investors ... for their participation in the merger, including any rights or warrants to be issued post-merger and the dilutive impact of those rights [and] warrants." S. 1504, 117th Cong. § 2(b)(1)(B) (2021).

101. Special Purpose Acquisition Companies, Shell Companies, and Projections, Securities Act Release No. 33-11048, 87 Fed. Reg. 29,458, 29,468-70.

choosing to redeem.[102] This would allow investors to control their exposure to dilution, which—as noted above—rises with redemption levels.[103] Professors Rodrigues and Stegemoller have suggested that de-SPAC mergers be prohibited if 50 percent or more of shareholders choose to redeem.[104] These last two proposals would help not only to control dilution risk but also to screen out value-destroying de-SPAC mergers more generally by reducing the likelihood that they will be consummated.[105] Market pressures may also be working to mitigate dilution, as well as conflicts of interest,[106] but whether market-driven changes will prove lasting or significant is a disputed issue.[107]

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102. Ganor, *supra* note 58, at 409-16.

103. *See supra* Part I.A.3.

104. *See* Rodrigues & Stegemoller, *supra* note 57, at 47-49.

105. *See id.* at 48 (explaining that a 50 percent conversion threshold would establish a "crucial check on the momentum to close a deal").

106. Gahng, Ritter, and Zhang report that as investors came to realize that SPAC IPOs provide outsized returns, demand for SPAC IPO shares increased. Gahng et al., *supra* note 15, app. at 8. In response, they report that "sponsors started to structure SPAC IPOs with fewer warrants and less dilution." *Id.* These trends, however, "began to reverse in the second quarter of 2021." *Id.* Gahng, Ritter, and Zhang also observed "an upward trend in the frequency of earnout provisions," which condition the release of the sponsor's promote on the share price of the merged entity staying above a threshold price. *Id.* app. at 9. This both limits dilution and may help to mitigate the incentive the promote otherwise creates for a sponsor to pursue even value-destroying mergers. *See also* Bai et al., *supra* note 98, at 32-34 (suggesting other alterations to sponsor compensation structure that could mitigate sponsor incentives to recommend value-destroying transactions); CURTISS, *supra* note 6 (noting a trend in accelerating the speed with which warrants can be exercised, which among other things, allows "the combined company to accelerate the redemption of warrants following the initial business combination and address ... dilution from the exercise of warrants on an expedited basis"). Recently, Bill Ackman created a SPAC with many innovative features that serve to limit dilution in the de-SPAC period. *See* Kenneth Squire, *Bill Ackman and Tontine Holdings Rewrite the Terms for SPACs*, CNBC (July 23, 2020, 4:31 AM), https://www.cnbc.com/2020/07/22/bill-ackman-and-tontine-holdings-rewrite-the-terms-for-spacs.html [https://perma.cc/6ERK-MHUK]; *see also* Brownstein et al., *supra* note 11. Ackman's SPAC also got creative with respect to the structure of a proposed de-SPAC transaction, which led the SEC to kill the deal. *See* Michelle Celarier, *SEC Abruptly Kills Ackman's Controversial SPAC Plans*, INSTITUTIONAL INV. (July 19, 2021), https://www.institutionalinvestor.com/article/b1ss2mf6t534v2/SEC-Abruptly-Kills-Ackman-s-Controversial-SPAC-Plans[https://perma.cc/XR9L-32W5].

107. *See* Klausner et al., *supra* note 15, at 292-98 (observing that some positive developments in Q4 2020 and Q1 2021, such as lower redemption rates and fewer warrants, have begun to reverse); *see also* Michael Klausner & Michael Ohlrogge, *Is SPAC Sponsor Compensation Evolving? A Sober Look at Earnouts* 6, 8-9, 14 (Stanford L. Sch., John M. Olin Program in L. & Econ., Working Paper, Paper No. 567, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4022611 [https://perma.cc/A488-ZNDC] (contending that sponsor

4. Projections

As noted in the Introduction, the role of projections has also become a major area of regulatory focus, with many urging that the IPO exclusion to the PSLRA's safe harbor be extended to de-SPAC mergers in order to place the two pathways to publicness on a "level playing field."[108] In March 2022, the SEC proposed new rules

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earnouts do little to either reduce SPAC costs or to align sponsor interests with shareholder interests).

108. Letter from Ams. for Fin. Reform & Consumer Fed'n of Am. to Maxine Waters, Chairwoman & Patrick McHenry, Ranking Member, H. Fin. Servs. Comm. (Feb. 16, 2021), https://ourfinancialsecurity.org/wpcontent/uploads/2021/02/AFR-Letter-on-SPACs-to-HFSC-FINAL.pdf [https://perma.cc/X4NT-UVXT] ("Congress should amend Section 27A of the 1933 Act and Section 21E of the Securities Exchange Act to exclude SPAC disclosures from the safe harbor for forwarding-looking statements. Those amendments would put SPAC mergers on a level playing field with IPOs and reduce incentives for private companies to access the public markets via SPACs."); *see also, e.g.*, Zanki, *supra* note 45 (observing that the SEC "is stepping up scrutiny of SPACs, including examining whether target companies of SPACs are abusing the ability to discuss forward-looking projections with investors, a practice largely avoided in traditional IPOs"); Roger E. Barton & Michael C. Ward, *SPACs and Speculation: The Changing Legal Liability of Forward-Looking Statements*, REUTERS, July 7, 2021, 12:40 PM, https://www.reuters.com/legal/legalindustry/spacs-speculation-changing-legal-liability-forward-looking-statements-2021-07-07/ [https://perma.cc/ZR4B-56KH] (observing that much of the regulatory scrutiny SPACs are receiving "revolves around forward-looking statements and their perceived impact on investor protections"). While serving as Acting Director of the SEC's Division of Corporate Finance, Professor Coates suggested that the courts could interpret the IPO exclusion broadly to include de-SPAC mergers because a de-SPAC merger is *like* an IPO in the sense that it results in the target's shares becoming available to public investors for the first time. Statement, John Coates, *supra* note 19. He suggested that "the Commission could use the rulemaking process to reconsider and recalibrate the applicable definitions, or the staff could provide guidance explaining its views on how or if at all the PSLRA safe harbor should apply to de-SPACs." *Id.* Later that same month, Reuters published an article stating that the SEC is "considering new guidance to rein in growth projections made by [SPACs], and clarify when they qualify for certain legal protections," citing "three people with knowledge of the discussions." Sen et al., *supra* note 96. The article went on to note that according to these sources, this guidance would, in part, be "aimed at clarifying when a key liability protection for such forward-looking statements applies to SPACs." *Id.* In May 2021, the Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets of the United States House Committee on Financial Services held a hearing titled "Going Public: SPACs, Direct Listings, Public Offerings, and the Need for Investor Protections." *Going Public: SPACs, Direct Listings, Public Offerings, and the Need for Investor Protections: Virtual Hearing Before the Subcomm. on Inv. Prot., Entrepreneurship, & Cap. Mkts. of the H. Comm. on Fin. Servs.*, 117th Cong. (2021). Draft legislation was introduced in connection with the hearing that, if enacted, would exclude communications in connection with de-SPAC mergers from the safe harbor's ambit (at least if the SPAC issued new shares in connection therewith). H.R. 5910, 117th Cong. (2022).

designed to accomplish this.[109] It also proposed to augment existing SEC guidance on the disclosures that should accompany the inclusion of financial projections in any filing, and proposed the creation of a new SPAC-specific Item 1609 in Regulation S-K.[110] Proposed Item 1609 would require "additional disclosures intended to assist investors in assessing the bases of projections used in de-SPAC transactions and determining to what extent they should rely on such projections," including the disclosure of

> [a]ll material bases of the disclosed projections and all material assumptions underlying the projections, and any factors that may materially impact such assumptions (including a discussion of any factors that may cause the assumptions to be no longer reasonable, material growth rates or discount multiples used in preparing the projections, and the reasons for selecting such growth rates or discount multiples).[111]

5. Irrational Exuberance

In response to more generalized concerns about irrational exuberance, the SEC has employed investor education campaigns. For example, it issued an investor alert on celebrity involvement with SPACs, warning that it "is never a good idea to invest in a SPAC just because someone famous sponsors or invests in it or says it is a good investment."[112] The alert also warns against investing in a SPAC "based solely on other information you receive through social media, investment newsletters, online advertisements, email, investment research websites, internet chat rooms, direct mail, newspapers, magazines, television, or radio."[113] The SEC's broader efforts to address the rise of unintermediated retail participation in the capital markets, including its focus on payment for order flow (which has contributed to the availability of zero-commission brokerage accounts) and the "gamification" of investing through

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109. *See* Special Purpose Acquisition Companies, Shell Companies, and Projections, Securities Act Release No. 33-11048, 87 Fed. Reg. 29,458, 29,481-82 (proposed May 13, 2022).

110. *Id.* at 29,494-96.

111. *Id.* at 29,496.

112. *Celebrity Involvement with SPACs—Investor Alert*, *supra* note 6.

113. *Id.*

digital platforms, can also be seen as part of an effort to combat speculative fervor that may be fueling retail interest in SPACs.[114]

* * *

One's intuition as to what is driving de-SPAC period investors' seeming overvaluation of SPAC shares will necessarily color one's view on which of the responses discussed above, if any, are likely to help. A full assessment of all the various possibilities is beyond the scope of this Article. Instead, the remainder of this Article analyzes whether excluding communications in connection with de-SPAC mergers from the PSLRA's safe harbor is a good idea and, relatedly, whether the safe harbor's exclusion for communications in connection with a traditional IPO makes sense. The next two Parts provide needed background for this analysis, explaining the origins and purpose of the safe harbor as well as offering a rationale for its existing exclusions.

II. THE PSLRA SAFE HARBOR

A. A Note on Terminology

The discussion that follows uses the terms "reasonable investor" and "unreasonable investor" to help explain the motivation behind the PSLRA safe harbor. The federal securities laws allow *any* kind of investor to invest in securities sold in a registered public offering and to trade securities listed on a national securities exchange.[115]

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114. *See, e.g.*, Statement, Gary Gensler, Chairman, SEC, Statement on Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches (Aug. 27, 2021), https://www.sec.gov/news/public-statement/gensler-dep-request-comment [https://perma.cc/37DU-NV5Q]; Maggie Fitzgerald, *Robinhood Tanks After SEC Chair Tells Barron's that Banning Payment for Order Flow Is a Possibility*, CNBC (Aug. 30, 2021, 8:15 PM), https://www.cnbc.com/2021/08/30/robinhood-tanks-after-sec-chair-tells-barrons-banning-payment-for-order-flow-is-a-possibility-.html [https://perma.cc/T4QP-KZ63].

115. By contrast, only "accredited" and, under more limited conditions, "sophisticated" investors can invest in private offerings exempt under Rule 506 of Regulation D. *See* 17 C.F.R. § 230.506(c)(2) (2021). Securities issued in a Rule 506 private placement can be sold to an unlimited number of "accredited investors" with no disclosure obligations and no marketing restrictions. *See id.* § 230.506(a). Accredited investors include certain defined institutions, as well as natural persons who are high-ranking insiders of the issuer or who (alone or with their

But the disclosure mandates that the securities laws impose on public companies, as well as the antifraud provisions designed to protect the integrity of disclosures in the public capital markets, are targeted at "reasonable investors." For example, many line-item disclosure items in Regulation S-K contain a "materiality" qualifier,[116] and misstatements and omissions are not actionable in suits brought under the federal securities laws unless they are "material."[117] What counts as "material" is defined objectively as information that a "reasonable investor" would consider important when making an investment decision.[118] It is also the case that "whether a statement is 'misleading' depends on the perspective of a reasonable investor: The inquiry (like the one into materiality) is objective."[119]

The term "reasonable investor" is not defined in the securities laws.[120] Judicial guidance paints a picture of the reasonable investor as a rational actor, possessing at least a basic level of financial

spouse) meet an objective income or net worth test. *Id.* § 230.501(a). The definition was recently expanded to include natural persons holding in good standing a professional certification or designation or credential from an accredited educational institution that the Commission has approved. *Id.* § 230.501(a)(10). Currently, the SEC has approved only holders in good standing of the Series 7, Series 65, and Series 82 licenses, which are awarded to individuals who pass certain Financial Industry Regulatory Authority (FINRA)-administered exams. *Amendments to Accredited Investor Definition*, SEC (Mar. 29, 2021), https://www.sec.gov/corpfin/amendments-accredited-investor-definition-secg [https://perma.cc/BL6U-T3RN]. Rule 506 offerings can also be sold to a very limited number of "sophisticated investors," with certain attendant disclosure obligations and marketing restrictions. *See* 17 C.F.R. § 230.506(b)(2)(I) (2021). Sophisticated investors are defined as purchasers who are not accredited investors that, either alone or with their "purchaser representative(s), ha[ve] such knowledge and experience in financial and business matters that [they are] capable of evaluating the merits and risks of the prospective investment." *Id.* § 230.506(b)(2)(ii).

116. *See, e.g.*, 17 C.F.R. § 229.303(a)(1) (2020).

117. *See, e.g.*, 17 C.F.R. § 240.10b-5 (2021) (rendering it unlawful to "make any untrue statement of a *material* fact or to omit to state a *material* fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading ... in connection with the purchase or sale of any security" (emphasis added)); 15 U.S.C. § 77k(a) (creating a private cause of action against specified defendants for any "untrue statement of a *material* fact" contained in a registration statement, or omission of "a *material* fact required to be stated therein or necessary to make the statements therein not misleading" (emphasis added)).

118. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 443-49 (1976).

119. Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund, 575 U.S. 175, 186-87 (2015).

120. *See generally* Amanda M. Rose, *The "Reasonable Investor" of Federal Securities Law: Insights from Tort Law's "Reasonable Person" & Suggested Reforms*, 43 J. CORP. L. 77 (2017).

sophistication.[121] Case law instructs that "the reasonable investor grasps market fundamentals—for example, the time value of money, the peril of trusting assumptions, and the potential for unpredictable difficulties to derail new products."[122] In addition, the "Supreme Court tells us that courts should not treat reasonable investors like 'nitwits' and ascribe to them 'child-like simplicity,'" and "courts have stated disclosure should not be tailored to 'what is fit for rubes.'"[123] Moreover, certain materiality doctrines that have developed in the lower courts assume that reasonable investors: discount sales talk; if given certain pieces of information, can and will perform mathematical calculations to determine the bottom line; and consider the context surrounding a statement in determining its import.[124] Reasonable investors are not, however, required to possess skills rising to the level of a trained investment analyst.[125]

When I use the phrase "reasonable investors" in the discussion that follows, I mean investors who, at a minimum, possess this level of investment acumen. I will sometimes use the term "sophisticated investors" interchangeably. I will, conversely, use the term "unreasonable" or "unsophisticated" investors when referring to investors

121. *See, e.g.*, Tom C.W. Lin, *Reasonable Investor(s)*, 95 B.U. L. REV. 461, 466-67 (2015) (observing that "[i]n the many decades since the birth of the modern financial regulatory framework, regulators, scholars, and courts have not universally agreed upon the identity and defining characteristics of the reasonable investor," but that the "leading paradigm" views the reasonable investor as "the idealized, perfectly rational actor of neoclassical economics"); David A. Hoffman, *The "Duty" to Be a Rational Shareholder*, 90 MINN. L. REV. 537, 542 (2006) ("This Article finds evidence that courts implicitly equate investors' 'reasonableness' with economic rationality, and irrationality as unreasonableness." (footnote omitted)).

122. Margaret V. Sachs, *Materiality and Social Change: The Case for Replacing "the Reasonable Investor" with "the Least Sophisticated Investor" in Inefficient Markets*, 81 TUL. L. REV. 473, 475-76 (2006) (first citing Levitin v. PaineWebber, Inc., 159 F.3d 698, 702 (2d Cir. 1998); then citing Harris v. Ivax Corp., 182 F.3d 799, 807 (11th Cir. 1999); and then citing Hillson Partners Ltd. v. Adage, Inc., 42 F.3d 204, 213 n.7 (4th Cir. 1994)).

123. Barbara Black, Essay, *Behavioral Economics and Investor Protection: Reasonable Investors, Efficient Markets*, 44 LOY. U. CHI. L.J. 1493, 1494 (2013) (first quoting Basic Inc. v. Levinson, 485 U.S. 224, 234 (1988); and then quoting Flamm v. Eberstadt, 814 F.2d 1169, 1175 (7th Cir. 1987)).

124. *See id.* at 1494-95.

125. *See* Va. Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1097 (1991) (observing, in the proxy fraud context, that publishing accurate facts can negate the materiality of a false statement, but also observing that "not every mixture [of] the true will neutralize the decept[ion]"—"[i]f it would take a financial analyst to spot the tension between the one and the other, whatever is misleading will remain materially so, and liability should follow" (citing Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1297 (2d Cir. 1973))).

who do not fall within this conception. I do not mean these labels to track the institutional investor-retail investor divide; while institutional investors are presumed to be reasonable, retail investors can be reasonable or unreasonable depending on their individual characteristics. Nor do I mean these labels to be derogatory. An individual can be an unreasonable, unsophisticated investor while being a highly reasonable and sophisticated individual in other walks of life. Many unreasonable investors are likely self-aware enough to eschew stock picking in favor of investing in an intermediated, diversified portfolio. Most reasonable investors who are not financial professionals will make the same choice. Importantly, however, the federal securities laws do not require this of either group.

Although the concept of materiality is geared toward reasonable investors,[126] this does not mean that the SEC ignores the fate of unreasonable investors. The SEC is charged to "protect investors," without distinction.[127] Moreover, the SEC is charged with maintaining "fair, orderly, and efficient markets,"[128] something that trading activity by unreasonable investors can interfere with.[129] Because unreasonable investors can and do participate in the public capital markets, the SEC must take them into account. As the following discussion illustrates, sometimes the interests of reasonable and unreasonable investors are in conflict, and the SEC must choose whose interests to prioritize.

B. The SEC's Change of Heart on the Value of Management Projections

Before 1973, the SEC affirmatively prohibited the inclusion of financial projections in SEC filings.[130] Because projections require subjective judgments about an unknown future and thus often prove

126. *See* Rose, *supra* note 120, at 86.
127. *About the SEC*, SEC, https://www.sec.gov/about.shtml [https://perma.cc/3CQV-7BC6].
128. *Id.*
129. *See* Hoffman, *supra* note 121, at 548-49.
130. *See* Disclosure of Projections of Future Economic Performance, Securities Act Release No. 33-5362, 38 Fed. Reg. 7,220, 7,220 (Mar. 19, 1973) ("It has been the Commission's long-standing policy generally not to permit projections to be included in prospectuses and reports filed with the Commission.").

to be wrong, the SEC feared that investors might place more faith in their accuracy than warranted. As Bruce Hiler, an SEC official during this time period, has chronicled:

> [T]he SEC was concerned that inclusion in [Commission filings] of predictions of future economic performance, such as projections of an issuer's sales and earnings or of the future value of its securities, would lead to undue reliance by investors who would tend to attribute an unjustifiable degree of certainty to any statement contained in a filing reviewed by the SEC, regardless of caveats. This fear was exacerbated by the potential for manipulation of such information by those creating the data, and by the difficulty of SEC and judicial review of information not objectively verifiable.[131]

In 1973, the SEC signaled a shift away from this view of investors as undiscerning consumers of information requiring protection from management projections. The SEC acknowledged that even if management projections might unduly influence the unsophisticated, they can be very helpful to reasonable investors and securities analysts.[132] The value of a company depends on its future, not past, performance.[133] Corporate managers have access to information about their company's prospects that other market participants do not. Management forecasts therefore convey important information that investors and securities analysts can use to improve their own, independent valuations.[134] The SEC's policy

131. Hiler, *supra* note 31, at 1118-19 (footnote omitted).

132. *See id.* at 1119.

133. *See* ASWATH DAMODARAN, INVESTMENT VALUATION: TOOLS AND TECHNIQUES FOR DETERMINING THE VALUES OF *ANY* ASSET 11 (3d ed. 2012) (explaining that discounted cash flow valuation—"the foundation on which all other valuation approaches are built"—"has its foundation in the present value rule, where the value of any asset is the present value of expected future cash flows on it").

134. It is important to recognize that analysts and investors prepare their own forecasts and do not feel bound by management's projections while at the same time potentially deriving useful information therefrom. *See* John M. Hassell, Robert H. Jennings & Dennis J. Lasser, *Management Earnings Forecasts: Their Usefulness as a Source of Firm-Specific Information to Security Analysts*, 11 J. FIN. RSCH. 303, 303 (1988) (explaining that "[a]nalysts are presumed to combine general economic, sector/industry, and firm-specific data to produce earnings forecasts" and that management's beliefs about future earnings constitute a piece of firm-specific data that may be informative); Gary F. Goldring, Note, *Mandatory Disclosure of Corporate Projections and the Goals of Securities Regulation*, 81 COLUM. L. REV. 1525, 1532

prohibiting the inclusion of forward-looking financial information in SEC filings prevented one method for making such forecasts generally available to market participants and was criticized on this basis. An influential article by Professor Homer Kripke during this time period captures the sentiment well:

> If there is any hope that the public or even the professionals can make an informed investment judgment, it must start from a crystallization of all of the plethora of information into a projection for the future. The management is in the best position to make the initial estimate; on the basis of it the professional or investor could then make his own modifications. No other single change could add as much meaning to the unmanageable and unfocussed flood of facts in present Commission documents.[135]

After conducting a series of public hearings on financial projections, the SEC announced in 1973 that it had "determined that changes in its present policies with regard to the use of projections would assist in the protection of investors and would be in the public interest."[136] After two additional years of study, the SEC proposed elaborate guidelines for the inclusion of projections in SEC filings.[137] The proposed rules were poorly received by the business community and were withdrawn in 1976; in lieu of a formal rulemaking, the SEC issued a policy statement in which it acknowledged that the

> Commission's long standing policy generally not to permit projections in Commission filings may have served as an impediment to the disclosure of projections to investors. Since investors appear to want management's assessment of a company's future

(1981) ("[A]nalysts consider management projections vital only because they may be used to evaluate why the company expects to achieve its goals, not because they are necessarily accurate predictors of future performance."); *see also* Kimberly Till, Comment, *The SEC Safe Harbor for Forecasts—a Step in the Right Direction?*, 1980 DUKE L.J. 607, 616-17 (explaining that even inaccurate forecasts can convey information that is valuable to investors). As explained *infra*, notes 168-75 and accompanying text, the market is quite discerning when it comes to management forecasts.

135. Homer Kripke, *The SEC, the Accountants, Some Myths and Some Realities*, 45 N.Y.U. L. REV. 1151, 1199 (1970).

136. Disclosure of Projections of Future Economic Performance, Securities Act Release No. 33-5362, 38 Fed. Reg. 7,220, 7,220 (Mar. 19, 1973).

137. *See generally* Future Economic Performance Projections, Securities Act Release No. 33-5581, 40 Fed. Reg. 20,316 (proposed May 9, 1975).

> performance, and since some managements may wish to furnish their projections through Commission filings, the Commission will not object to disclosure in filings with the Commission of projections which are made in good faith and have a reasonable basis, provided that they are presented in an appropriate format and accompanied by information adequate for investors to make their own judgments.[138]

In 1978, the SEC moved from a policy of *nonobjection* to the disclosure of financial projections in Commission filings to a policy of active *encouragement* of the disclosure of financial projections in Commission filings, and in general.[139]

C. Policymakers' Efforts to Encourage Voluntary Disclosure of Projections

Encouraging corporations to disclose financial projections is easier said than done. Even when prepared reasonably and in good faith, financial projections will often prove inaccurate. The fact that a company's financial results deviate from management's earlier projections does not mean that the projections were unreasonable when made, let alone fraudulent.[140] But companies might nevertheless rationally fear liability based on projections, chilling disclosure to the detriment of reasonable investors. The concern is that if a company's actual performance ends up falling short of projections, investors will sue the company and its officials alleging that the defendants knew, or were reckless in not knowing, that the predictions were unreasonable when made. It is traditionally difficult to dismiss this sort of claim on a motion to dismiss and taking the case to trial would not only be expensive but would risk

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138. Future Economic Performance Projections: Withdrawal of Notice of Proposed Rulemaking, Securities Act Release No. 33-5699, 41 Fed. Reg. 19,982, 19,982-83 (proposed May 14, 1976) (footnote omitted).

139. *See* Guides for Disclosure of Projections of Future Economic Performance, Securities Act Release No. 33-5992, 43 Fed. Reg. 53,246, 53,247 (Nov. 15, 1978) ("[T]he Commission ... wishes to encourage companies to disclose management projections both in their filings with the Commission and in general.").

140. *See* Future Economic Performance Projections, 41 Fed. Reg. at 19,983 ("The Commission realizes that even the most carefully prepared and thoroughly documented projections may prove inaccurate.").

an erroneous finding of liability. The risk of erroneous liability is higher in suits challenging projections than in those challenging misrepresentations of present fact because the act of judging whether a projection that turned out to be wrong was unreasonable and made with knowledge, or reckless disregard, of its unreasonableness introduces a significant risk of hindsight bias—the well-documented human tendency to ascribe a higher ex ante probability to an event simply because it happened ex post. Put simply, knowledge that a company ended up performing poorly at time *T* makes one assume that the company's poor performance was more predictable at time *T-1* than it was in reality. This can lead to the erroneous conclusion that a projection was unreasonable at the time it was made and that the speaker must have known this (or was reckless not to).[141]

The SEC recognized as early as 1973 that "one of the primary deterrents to a rational and open disclosure system for projections is the fear of liability for inaccurate projections,"[142] and in 1979 it adopted Rule 175 under the Securities Act of 1933 and Rule 3b-6 under the Securities Exchange Act of 1934 in an attempt to deal with the problem.[143] These safe harbor rules insulate financial projections from liability if they are contained in SEC filings and were made in good faith and with a reasonable basis.[144] A major point of debate surrounding the rules' adoption concerned who should bear the burden of proof on the issues of good faith and reasonableness; the SEC ultimately decided to place the burden on the plaintiff to negate that the projections were made in good faith and with a reasonable basis.[145] As explained in the release adopting

141. *See* Christopher R. Leslie, *Hindsight Bias in Antitrust Law*, 71 VAND. L. REV. 1527, 1532-35 (2018) (discussing hindsight bias); *see also* Ann Morales Olazábal, *Safe Harbor for Forward-Looking Statements Under the Private Securities Litigation Reform Act of 1995: What's Safe and What's Not?*, 105 DICK. L. REV. 1, 5 (2000) ("Due to their inherently predictive nature, forward-looking statements are particularly vulnerable to investor-plaintiff 'Monday-morning quarterbacking,' or the so-called 'fraud-by-hindsight' lawsuit." (footnotes omitted)).

142. Disclosure of Projections of Future Economic Performance, Securities Act Release No. 33-5362, 38 Fed. Reg. 7,220, 7,221 (Mar. 19, 1973).

143. *See* 17 C.F.R. §§ 230.175, 240.3b-6 (2022); Safe Harbor Rule for Projections, Securities Act Release No. 33-6084, 44 Fed. Reg. 38,810 (July 2, 1979).

144. Safe Harbor Rule for Projections, Securities Act Release No. 33-6084, 44 Fed. Reg. at 38,810.

145. *See id.* at 38,811.

the final rule, the SEC was persuaded by commentators who believed that placing the burden on the defendant would deter companies from making projections.[146]

Rules 175 and 3b-6 proved ineffective. In 1994, the SEC acknowledged that, contrary to its original intent, "the safe harbor is currently invoked on a very limited basis in a litigation context."[147] It is easy to understand why. A projection is not a misstatement of fact if it was made in good faith and with a reasonable basis—it is simply an honest opinion about the future that turned out to be wrong; if plaintiffs cannot disprove good faith or reasonableness, they will lose regardless of the safe harbor.[148] Moreover, nothing in Rules 175 and 3b-6 requires courts to resolve issues of good faith and reasonableness earlier in the litigation than would otherwise be called for. Because the rules offered no real protection, companies remained reluctant to issue projections. The SEC revisited the rules in 1994. In a Concept Release issued that year, the SEC noted survey evidence showing that fear of litigation had had a chilling effect on the disclosure of forward-looking information.[149] It sought comment on a variety of proposed alternatives to Rules 175 and 3b-6.[150]

The SEC's efforts to revise Rules 175 and 3b-6 were eclipsed by Congress's adoption of the PSLRA in 1995.[151] Among other provisions designed to deter strike suit litigation, the PSLRA contains a statutory safe harbor for forward-looking statements made by or on behalf of reporting companies that applies in private litigation brought under the federal securities laws.[152] Congress was motivated by the same policy concerns that led the SEC to adopt Rules 175 and 3b-6: the Conference Committee Report emphasizes that a company's own assessment of its future potential is among the most valuable information shareholders and potential investors could have about a firm and surmises that "[f]ear that inaccurate

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146. *Id.*

147. Safe Harbor for Forward-Looking Statements, Securities Act Release No. 33-7101, 57 SEC Docket 1,999, 2,007 (Oct. 13, 1994).

148. *See id.* at 2,006 (discussing the judicial approach to the question of when predictions or other opinions constitute false statements of fact under the securities laws).

149. *Id.* at 2,007.

150. *Id.* at 2,009-12.

151. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C. and 18 U.S.C.).

152. 15 U.S.C. §§ 77z-2, 78u-5.

projections will trigger the filing of a securities class action lawsuit has muzzled corporate management."[153]

The PSLRA's safe harbor provides greater relief from liability risk than Rules 175 and 3b-6 do, as well as broader coverage.[154] It insulates covered forward-looking statements from liability in private suits brought under the federal securities laws if

> (A) the forward-looking statement is—
> (i) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement; or
> (ii) immaterial; or
> (B) the plaintiff fails to prove that the forward-looking statement—
> (i) if made by a natural person, was made with actual knowledge by that person that the statement was false or misleading; or
> (ii) if made by a business entity, was—
> (I) made by or with the approval of an executive officer of that entity, and
> (II) made or approved by such officer with actual knowledge by that officer that the statement was false or misleading.[155]

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153. H.R. REP. NO. 104-369, at 43 (1995) (Conf. Rep.).

154. "Forward-looking statement" is defined to mean:

> (A) a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items;
> (B) a statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer;
> (C) a statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the Commission;
> (D) any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C);
> (E) any report issued by an outside reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or
> (F) a statement containing a projection or estimate of such other items as may be specified by rule or regulation of the Commission.

15 U.S.C. §§ 77z-2(i)(1), 78u-5(i)(1).

155. *Id.* §§ 77z-2(c)(1), 78u-5(c)(1).

The PSLRA further requires courts to stay discovery during the pendency of a motion for summary judgment based on the safe harbor, other than discovery that is specifically directed to the applicability of the safe harbor,[156] and during the pendency of a motion to dismiss on any ground, unless the court finds that particularized discovery is necessary to preserve evidence or to prevent undue prejudice.[157]

Prongs A and B of the PSLRA's safe harbor are written in the disjunctive, meaning that if either prong is met, the suit must be dismissed. The second prong effectively requires proof of actual knowledge in suits challenging forward-looking statements; proof of recklessness does not suffice.[158] The Conference Committee Report instructs that "[t]he first prong of the safe harbor requires courts to examine only the cautionary statement accompanying the forward-looking statement" and warns that courts "should not examine the state of mind of the person making the statement."[159] This reading of the safe harbor was critiqued by some as giving rise to a "right to lie" on the part of defendants,[160] but it can be defended from a public policy perspective in light of the broader goals of the legislation. As explained above, mistaken scienter determinations are a real risk in suits challenging forward-looking statements due to the phenomenon of hindsight bias, and the need to fight over this fact-laden issue may preclude early termination of the case, inviting strike suit litigation.[161] If the safe harbor allows defendants to avoid judicial inquiries into scienter if the challenged forward-looking

156. *Id.* §§ 77z-2(f), 78u-5(f).

157. *Id.* §§ 77z-1(b), 78u-4(b)(3).

158. *See id.* §§ 77z-2(c)(1)(B), 78u-5(c)(1)(B).

159. H.R. REP. NO. 104-369, at 44 (1995) (Conf. Rep.).

160. *See* Allan Horwich, *Cleaning the Murky Safe Harbor for Forward-Looking Statements: An Inquiry into Whether Actual Knowledge of Falsity Precludes the Meaningful Cautionary Statement Defense*, 35 J. CORP. L. 519, 534-37 (2010) (providing an overview of this debate).

161. Jennifer O'Hare, *Good Faith and the Bespeaks Caution Doctrine: It's Not Just a State of Mind*, 58 U. PITT. L. REV. 619, 644 (1997) ("[I]t appears that the Conference Committee was concerned that a good faith requirement would reduce the effectiveness of the statutory safe harbor by permitting plaintiffs to abuse the discovery process."). The PSLRA also addresses this concern by requiring plaintiffs to plead with particularity facts giving rise to a strong inference of scienter. *See* § 78u-4(b)(2). By virtue of the second prong of the safe harbor, this requires pleading particularized facts giving rise to a strong inference that the defendant had actual knowledge that a challenged projection lacked a reasonable basis in fact; recklessness regarding the projection's reasonableness does not suffice.

statement was accompanied by objectively meaningful cautionary language (something that most federal courts are willing to decide on a motion to dismiss[162]), it should operate to encourage a greater amount of forward-looking disclosures, in line with Congress's policy objectives.

Many decisions hew to the instructions in the Conference Committee Report and "ignore allegations or even proof of actual knowledge that the projection was incorrect if the defendant's conduct satisfied the first prong of the safe harbor; that is, the defendant identified the forward-looking statements as such and accompanied them with what the court found to be meaningful cautionary statements."[163] But other cases have held "that an allegation of undisclosed actual knowledge of falsity of the forward-looking statement means, ipso facto, that the cautionary statements were not meaningful" and thus that the first prong is not satisfied.[164]

D. The Costs and Benefits of Safe Harbor Protection

Accompanying a projection with meaningful cautionary language gives investors and analysts insight into the assumptions that underlie the projection, allowing them to evaluate the soundness of those assumptions and determine what weight, if any, to assign to the projection in light thereof.[165] In this regard, it is important to recognize that reasonable investors would not view any management projection—whether accompanied by meaningful cautionary language or not—as a *guarantee* that the predicted results will

162. *See, e.g.*, Richard A. Rosen & Jessica S. Carey, *The Safe Harbor for Forward-Looking Statements After Twenty Years*, 30 INSIGHTS 8, 16 (2016) ("[T]he overwhelming majority of cases continue to determine the adequacy of cautionary statements at the pleading stage.").

163. Horwich, *supra* note 160, at 539; *see also id.* at 539, 541 & nn.118-20, 542 & n.121 (citing cases in this line).

164. *Id.* at 542; *see also id.* at 542 & nn.124-27, 543 & nn.128-31, 544 & nn.132-41, 545 & nn.142-45 (citing cases in this line).

165. To the extent that disclosure of specific forecast components limits managers' ability to rationalize unexpected results in the future, it might also encourage investors to view the forecast as more credible. *See* Molly Mercer, *How Do Investors Assess the Credibility of Management Disclosures?*, 18 ACCT. HORIZONS 185, 191-92 (2004) ("[S]upplementary statements should increase disclosure credibility [because] these statements increase the *ex post* verifiability of the disclosure.").

occur. Such a view would be highly unreasonable, given how often forecasts turn out to be wrong[166] and the well-known biases believed to infect managerial forecasting.[167] The influence a projection will

166. *See, e.g.*, Grace Pownall, Charles Wasley & Gregory Waymire, *The Stock Price Effects of Alternative Types of Management Earnings Forecasts*, 68 ACCT. REV. 896, 897 (1993) (finding that range forecasts of earnings per share "tend to be quite inaccurate *ex post*").

167. Successful executives are particularly likely to suffer from what scholars call egocentric bias, a behavioral bias that "readily takes the form of excessive optimism and overconfidence, coupled with an inflated sense of ability to control events and risks." Donald C. Langevoort, *Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (and Cause Other Social Harms)*, 146 U. PA. L. REV. 101, 139 (1997); *see also id.* at 140 ("[T]here is good reason to believe that the tournament-like competition for promotion up the executive ladder overweights optimism and its associated behavioral traits, inflating such behavior toward the top of the hierarchy."); Robert Libby & Kristina Rennekamp, *Self-Serving Attribution Bias, Overconfidence, and the Issuance of Management Forecasts*, 50 J. ACCT. RSCH. 197, 198 (2012) ("Prior research in psychology and finance suggests that senior managers as a group overestimate their ability."). This bias would tend to lead executives to overestimate their firm's future profitability in financial projections. *See* Paul Hribar & Holly Yang, *CEO Overconfidence and Management Forecasting*, 33 CONTEMP. ACCT. RSCH. 204, 223 (2016) (empirical study finding evidence "consistent with the notion that managerial overconfidence manifests itself as excessive optimism about future earnings"). What scholars call the self-serving bias—*viz.*, the tendency to construe ambiguous information in a way that is personally beneficial, Langevoort, *supra*, at 144—would tend to compound this tendency in situations in which increasing market expectations about the firm's performance is in the firm's or executives' self-interest, as is often the case. *See, e.g.*, Amy P. Hutton, Gregory S. Miller & Douglas J. Skinner, *The Role of Supplementary Statements with Management Earnings Forecasts*, 41 J. ACCT. RSCH. 867, 869 (2003) ("Managers benefit from higher stock prices in the short run if they have stock-based compensation, wish to use their firms' shares as currency for acquisitions or defend their firms against takeovers, or are evaluated based on the performance of their firms' stock." (footnote omitted)); Guojin Gong, Laura Yue Li & Hong Xie, *The Association Between Management Earnings Forecast Errors and Accruals*, 84 ACCT. REV. 497, 501 (2009) (listing studies proposing various incentive-related factors that could motivate managers to bias earnings forecasts). In certain situations, lowering market expectations may better serve executives' self-interest; for example, the market punishes firms that miss quarterly earnings guidance, so it may be beneficial for managers to lower expectations as quarter end approaches to decrease the likelihood of an earnings miss. Consistent with these observations, empirical studies reveal that longer-term management forecasts tend to be optimistically biased whereas quarterly forecasts tend to be pessimistically biased. *See* Jong-Hag Choi & David A. Ziebart, *Management Earnings Forecasts and the Market's Reaction to Predicted Bias in the Forecast*, 11 ASIA-PAC. J. ACCT. & ECON. 167, 189 (2004). The pessimistic bias in quarterly management forecasts is often explained "as the result of management's desire to use its earnings forecasts as a device to walk-down market earnings expectations." D. Eric Hirst, Lisa Koonce & Shankar Venkataraman, *Management Earnings Forecasts: A Review and Framework*, 22 ACCT. HORIZONS 315, 326 (2008). Empirical studies also suggest that the market is aware of the optimistic bias in long-horizon forecasts and is not influenced by it. *See* Choi & Ziebart, *supra*, at 186, 190; *see also* Jonathan L. Rogers & Phillip C. Stocken, *Credibility of Management Forecasts*, 80 ACCT. REV. 1233, 1252, 1254 (2005) (empirical study finding that the market

actually have on reasonable investors will depend on the interaction of a variety of factors—including, but not limited to, the nature of the risk disclosures that accompany it.

The circumspect approach reasonable investors take to management forecasts is evidenced in a substantial body of empirical literature testing the market impact of such forecasts, as measured either by stock price reactions or analyst forecast revisions (which in turn influence stock prices). Studies suggest, for example, that the ability of a management forecast to influence the market varies depending on whether the forecast conveys good or bad news, with the market much more skeptical of good news forecasts than bad news forecasts.[168] Studies also suggest that the horizon and form of the management forecast matters, with annual forecasts less likely to influence the market than interim forecasts (presumably because managers are assumed to have better information about nearer-term outcomes),[169] and range estimates less likely to influence the market than point estimates (presumably because more precise estimates suggest greater certainty on the part of management).[170]

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filters out predictable bias in good news forecasts).

168. *See, e.g.*, Hutton et al., *supra* note 167, at 883 (reporting empirical results consistent with the prediction that bad news forecasts are inherently more believable to investors than good news forecasts and indicating that "good news forecasts are only informative when accompanied by verifiable forward-looking statements" about earnings components); Robert Jennings, *Unsystematic Security Price Movements, Management Earnings Forecasts, and Revisions in Consensus Analyst Earnings Forecasts*, 25 J. ACCT. RSCH. 90, 109 (1987) (reporting empirical results consistent with the notion that investors are more likely to believe bad news presented to them by management than good news); Hassell et al., *supra* note 134, at 313 (finding empirical support "consistent with the conjecture that management has more difficulty in convincing investors of the accuracy (or objectivity) of good news forecasts than of bad news forecasts").

169. *See* Pownall et al., *supra* note 166, at 907 (empirical study concluding that "forecasts of interim earnings are significantly more price-informative than annual earnings projections"). As one scholar has explained, "short-horizon disclosures such as interim earnings forecasts generally should be perceived as more credible than longer-horizon disclosures such as annual earnings forecasts" because "[m]anagers presumably have better information about more immediate outcomes." Mercer, *supra* note 165, at 191-92.

170. *See* Stephen P. Baginski, Edward J. Conrad & John M. Hassell, *The Effects of Management Forecast Precision on Equity Pricing and on the Assessment of Earnings Uncertainty*, 68 ACCT. REV. 913, 924 (1993) (empirical study supporting a direct relation between forecast precision and the importance of management forecasts for security pricing); Mercer, *supra* note 165, at 191 (discussing empirical studies supporting the supposition that "imprecise disclosures signal management's uncertainty and will be viewed as less credible than more precise disclosures"); *cf.* Hirst et al., *supra* note 167, at 317 (citing two studies finding no variation in stock price reactions conditional on forecast form and positing that the

Numerous studies also suggest that the influence a management forecast will have on the market, if any, further depends on the firm's forecasting reputation—that is, on its track record of issuing accurate guidance (or relatively more accurate guidance than analysts) in the past.[171] The extent to which a management forecast will influence the market will also logically depend on the informativeness of the financial metric forecast, as well as on various company- and industry-specific factors—such as the presence or absence of an operating history on which to base assumptions[172] and the volatility of returns in the sector in which the firm operates.[173] Reasonable investors can also be expected to take into account the situational incentives of the firm and managers issuing the forecast,[174] as well as the forecast's inherent plausibility.[175] To the extent that cautionary language apprises meaningfully of otherwise

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mixed empirical results might be explained by prior forecast accuracy, with forecast form relevant only when prior forecast accuracy is high).

171. *See, e.g.*, Patricia A. Williams, *The Relation Between a Prior Earnings Forecast by Management and Analyst Response to a Current Management Forecast*, 71 ACCT. REV. 103, 104 (1996) (empirical study suggesting "that management acquires a forecasting 'reputation' among analysts which affects their response to subsequent forecasts by management"); Amy P. Hutton & Phillip C. Stocken, *Prior Forecasting Accuracy and Investor Reaction to Management Earnings Forecasts*, 6 J. FIN. REPORTING 87, 88 (2021) (finding empirical evidence that stock price reaction to management forecasts increases with prior forecast accuracy and predicting that investor responsiveness to management forecasts is increasing in both the accuracy and number of the firm's prior forecasts); *see also* D. Eric Hirst, Lisa Koonce & Jeffrey Miller, *The Joint Effect of Management's Prior Forecast Accuracy and the Form of Its Financial Forecasts on Investor Judgment*, 37 J. ACCT. RSCH. 101, 120 (Supp. 1999) (experimental study finding greater investor reliance on management disclosures when management provided accurate forecasts in earlier periods); Jeffrey Ng, İrem Tuna & Rodrigo Verdi, *Management Forecast Credibility and Underreaction to News*, 18 REV. ACCT. STUD. 956, 958 (2013) (reporting empirical results that imply that the market *overly* discounts less credible management forecasts, with credibility proxied by a variety of factors, including prior management forecast accuracy and bad as opposed to good forecast news).

172. *See, e.g.*, Donald C. Langevoort, *Disclosures that "Bespeak Caution,"* 49 BUS. LAW. 481, 502 (1994) ("[R]eliance on projections and forecasts in new ventures seems almost manifestly unwise.").

173. *See* Hutton & Stocken, *supra* note 171, at 88 ("A management team's ability to forecast accurately depends on many factors including the firm's complexity and volatility of its earnings, the quality of its accounting and information systems, its industry specific accounting policies and practices, as well as the level of management's own talent.").

174. *See* Mercer, *supra* note 165, at 187 (explaining that "people are less likely to believe messages that are consistent with the source's incentives" and thus that "investors should be less likely to believe management disclosures when management has high incentives to be misleading or untruthful").

175. *See id.* at 192-93.

unknown risks that may cause actual results to differ from projected results, reasonable investors will further take those risks into account in deciding what weight, if any, to assign to the projection.

Because the context surrounding the issuance of a projection, including, but not limited to, any accompanying cautionary language, impacts the way reasonable investors interpret and respond to management projections, it also necessarily impacts the viability of a fraud claim premised on such projections. Whether a projection is in fact misleading, and whether it is materially so, is judged from the vantage point of a reasonable investor; if a reasonable investor would not misunderstand or be influenced by a projection in its full context, a plaintiff cannot establish essential elements of a fraud claim. It is also the case that the full context in which a projection is issued might render an inference that the defendant acted with scienter unreasonable. As one securities law expert has noted, "the greater the disclosure of risks, the less the inference can be drawn that the maker was acting in an intentionally deceptive manner."[176] As already noted, courts will not usually determine the fact-laden questions of scienter and materiality at the motion to dismiss phase, but early dismissals based on the presence of meaningful cautionary language may involve cases where the plaintiffs would have difficulty proving these elements.[177]

This will not always be the case, however, and some incidents of fraud will not be remedied in private litigation brought under the federal securities laws because of the safe harbor. The safe harbor may not only encourage companies to disclose projections prepared reasonably and in good faith (its intended effect), it might also embolden companies to issue projections that are negligent, reckless, or even knowingly false (though the specter of SEC enforcement, potential litigation under state law, and reputational injury should operate to constrain such behavior). Some may not believe that the costs are worth the benefits the safe harbor provides. But the safe harbor is premised on an assumption that they are, and it reflects the belief that reasonable investors would rather suffer the occasional unremedied fraud by a bad actor than be denied access to valuable forward-looking information by all companies.

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176. Langevoort, *supra* note 172, at 500-01.
177. *See, e.g.*, *id.* at 488.

Whereas much of the PSLRA's other provisions were focused on reducing strike suit litigation, that was not the primary motivation for the safe harbor. That is because when forward-looking statements are voluntary, the absence of a safe harbor does not result in strike suit litigation. It results in silence.[178] If no forward-looking statements are volunteered, there are none to sue over. This leads to an important point: the SEC has another tool in its toolkit if it wants issuers to provide forward-looking information to investors—mandatory disclosure. At the time the PSLRA was adopted, there were fewer situations in which companies were required to disclose forward-looking statements than there are today, and the primary goal of the safe harbor was to encourage voluntary disclosure.[179]

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178. While it is possible that some forward-looking information would be volunteered in the absence of the safe harbor, that would occur only if liability risk was low to begin with—making the safe harbor somewhat irrelevant.

179. After the SEC changed its position on forward-looking statements in 1973, some advocated for mandatory disclosure of corporate projections. *See, e.g.*, Note, *Disclosure of Future-Oriented Information Under the Securities Laws*, 88 YALE L.J. 338, 338 (1978) ("[T]he SEC should require formal disclosure of financial forecasts by management."); *cf.* Goldring, *supra* note 134 (arguing against mandatory disclosure of projections). In 1980, the SEC augmented the disclosures required in the Management Discussion & Analysis (MD&A) section of registrants' SEC filings to require "a discussion of three financial aspects—liquidity, capital resources, and results of operations" and "within each of these, required disclosure of favorable or unfavorable trends and identification of certain material events or uncertainties." Concept Release on Management's Discussion and Analysis of Financial Condition and Operations, Securities Act Release No. 33-6711, 52 Fed. Reg. 13,715, 13,716 (Apr. 24, 1987). It indicated, however, that this did not mandate disclosure of forward-looking statements. *Id.* Indeed, until 2003, the instructions to item 303 explicitly stated that registrants were not required to supply forward-looking information. *See id.* at 13,717; *see also* Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Securities Act Release No. 33-6835, 54 Fed. Reg. 22,427, 22,429 (May 24, 1989) ("Required disclosure is based on *currently known trends, events, and uncertainties that are reasonably expected to have material effects* .... In contrast, optional forward-looking disclosure involves *anticipating a future trend or event or anticipating a less predictable impact of a known event, trend or uncertainty*."); Disclosure in Management's Discussion and Analysis About Off-Balance Sheet Arrangements and Aggregate Contractual Obligations, Securities Act Release No. 33-8182, 68 Fed. Reg. 5,982, 5,992 n.143 (Feb. 5, 2003) (noting the elimination of this instruction in light of the adoption of new disclosure mandates related to off-balance sheet arrangements that call for forward-looking information). In 1982, the SEC adopted Item 10(b) of Regulation S-K, which provides guidelines on the SEC's "views on important factors to be considered in formulating and disclosing such projections" in SEC filings. 17 C.F.R. § 229.10(b) (2022). The instructions state that the SEC "*encourages* the use [in such filings] ... of management's projections of future economic performance that have a reasonable basis and are presented in an appropriate format." *Id.* (emphasis added).

With respect to *mandated* forward-looking disclosures, the costs and benefits of offering safe harbor protection are different. Taking an ex ante perspective first, there is no risk of liability chilling such disclosures because, by definition, they are mandatory. Offering such disclosures safe harbor protection may decrease their accuracy relative to a world in which safe harbor protection were not available, if companies emboldened by the liability shield approach the preparation of such disclosures with less care or honesty than they otherwise would. But it could also *increase* the quality of the disclosures by reducing an incentive that might otherwise exist to negatively bias projections or obfuscate them, which has the twin effects of making them less vulnerable to attack in litigation *and* less useful to investors. Offering mandatory forward-looking disclosures safe harbor protection could also reduce incentives to overinvest in the disclosure's preparation, or to stay private or otherwise modify transactions to avoid or reduce litigation risk. It might also work to lower liability insurance premiums. Ex post, the costs and benefits of offering safe harbor protection to mandatory forward-looking disclosures are more obvious: it will allow some frauds to go unremedied in private litigation under the federal securities laws, but it will also reduce the amount of nuisance litigation and its associated costs.

The nature of the mandated forward-looking information, and whether it is subjected to scrutiny by the SEC, may influence these costs and benefits. For example, if the mandated disclosure is detailed and circumscribed, or if the SEC routinely scrutinizes the disclosure, it may cabin companies' ability to use obfuscation as a way to mitigate their liability risk. The nature of the information sought may also influence how much companies would invest in its preparation in the absence, or presence, of a liability shield.

The magnitude of the costs and benefits of extending safe harbor protection to voluntary and mandatory forward-looking statements, and how they net out, is of course difficult to calculate. In the face of empirical uncertainty, intuitions reign. The expressed intuitions of both reporting companies and the plaintiffs' bar will always be tainted by self-interest. This discussion has not resolved any debates over the social value of the PSLRA's safe harbor, but it adds analytical clarity to that debate. As the next Part shows, understanding the purpose and effect of the safe harbor, and how they differ depending on whether the safe harbor applies to voluntary or mandatory forward-looking disclosures, helps to explain the statutory exclusions.

Table 1. The Costs and Benefits of Safe Harbor Protection

	Voluntary Statements		**Mandatory Statements**	
	Costs	**Benefits**	**Costs**	**Benefits**
Ex Ante	May embolden companies to make negligent, reckless, or knowingly false forward-looking statements (though other sources of deterrence exist)	Encourages disclosure that would otherwise not occur	May embolden companies to make negligent, reckless, or knowingly false forward-looking statements (though other sources of deterrence exist)	Reduces incentives to negatively bias or obfuscate forward-looking disclosures; reduces incentives to overinvest in disclosure preparation; lowers insurance premiums; reduces incentives to stay private or otherwise modify transactions to mitigate liability risk
Ex Post	Allows some frauds to go unremedied in private litigation under the federal securities laws		Allows some frauds to go unremedied in private litigation under the federal securities laws	Reduces strike suit litigation and its associated costs

III. A THEORY OF THE SAFE HARBOR EXCLUSIONS

The PSLRA's safe harbor for forward-looking statements contains several exclusions. Specifically, the PSLRA provides that the safe harbor shall not apply to forward-looking statements made with respect to the business or operations of an issuer that in the past three years has been convicted of a crime, or subjected to a judicial or administrative decree, related to certain violations of the federal securities laws—what I will refer to as the "bad boy" disqualifiers.[180] It also excludes a forward-looking statement made with respect to the business or operations of the issuer if the issuer: makes the forward-looking statement in connection with an offering of securities by a blank check company; issues penny stock, makes the forward-looking statement in connection with a rollup transaction, or makes the forward-looking statement in connection with a going private transaction.[181] Furthermore, it excludes any forward-looking statement that is: included in a financial statement prepared in accordance with generally accepted accounting principles (GAAP); contained in a registration statement of, or otherwise issued by, an investment company; made in connection with a tender offer; made in connection with an initial public offering; made in connection with an offering by, or relating to the operations of, a partnership, limited liability company, or a direct participation investment program; or made in a disclosure of beneficial ownership in a report required to be filed with the Commission pursuant to Section 13(d) of the 1934 Act.[182] What explains this apparent hodgepodge of exclusions? The legislative history provides little insight, and the exclusions have attracted only passing academic mention.[183]

This Article is the first to offer a coherent theoretical explanation of them. Recall that the PSLRA's safe harbor, similar to the ineffective SEC safe harbors that preceded it, reflected policymakers' changed attitude on the value of forward-looking disclosures to investors and a changed policy objective: instead of protecting

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180. 15 U.S.C. §§ 77z-2(b)(1)(A), 78u-5(b)(1)(A).

181. *Id.* §§ 77z-2(b)(1)(B)-(E), 78u-5(b)(1)(B)-(E).

182. *Id.* §§ 77z-2(b)(2), 78u-5(b)(2). The PSLRA grants the SEC authority to make exceptions to the exclusions—that is, to broaden but not narrow the scope of the safe harbor. *See id.* § 78u-5(g). The SEC possesses the authority to define certain terms used in the safe harbor, however, and its exercise of this authority may have the practical effect of narrowing the safe harbor's scope. *See id.* § 78u-5(i)(5). For example, in March 2022, the SEC proposed excluding communications in connection with de-SPAC transactions from the scope of the safe harbor by redefining the term "blank check company" to include SPACs. Special Purpose Acquisition Companies, Shell Companies, and Projections, Securities Act Release No. 33-11048, 87 Fed. Reg. 29,458, 29,463 (proposed May 13, 2022); §§ 77z-2(i)(7), 78u-5(i)(5).

183. *See supra* notes 27-28 and accompanying text.

vulnerable, unreasonable investors from the "threat" that they would overreact to forward-looking statements, the new policy prioritized the interests of reasonable investors, who were demanding access to forward-looking information. These exclusions are best understood in relation to that goal. Specifically, they can be grouped into the following three categories: those that are orthogonal to that goal, those that are consistent with it, and those that seemingly stand in tension with it.

Table 2. PSLRA Safe Harbor Exclusions

A. Orthogonal	**B. Consistent**	**C. In Tension**
Bad boy disqualifiers	Statements in connection with a rollup transaction, a going private transaction, or a tender offer; statements included in a financial statement prepared in accordance with GAAP; statements made in a disclosure of beneficial ownership in a report required to be filed under Section 13(d) of the 1934 Act	Statements made in connection with an initial public offering; statements made by issuers of penny stock or in connection with an offering of securities by a blank check company; statements issued by an investment company; statements made in connection with an offering by, or relating to the operations of, a partnership, limited liability company, or a direct participation investment program

A. Exclusions that Are Orthogonal to the Safe Harbor's Purpose

The bad boy disqualifiers are best explained as driven by a desire to deny benefits to securities law violators as a way to deter such violations in the first place and punish them after the fact. Such disqualifiers are prevalent throughout the securities laws,[184] and

184. *See* Velikonja, *supra* note 37, at 1090-93 (describing the many disqualifiers in the federal securities laws).

their appearance in the PSLRA is not directly related to the underlying goals that drove Congress's adoption of the safe harbor.

B. Exclusions that Are Consistent with the Safe Harbor's Purpose

It might seem that any exclusion to the safe harbor would stand in tension with the goal of ensuring greater access to forward-looking information for the benefit of reasonable investors. But that ignores the role of mandatory disclosure, discussed in the last Part. All of the exclusions listed in Column B of Table 2 cover situations in which the law compels disclosure of the forward-looking information that reasonable investors could be expected to most desire.

Reporting companies engaged in roll-up transactions, going private transactions, and tender offers are usually *compelled* to disclose to shareholders the projections that their boards relied upon in deciding to pursue the transaction. This stems from a combination of formal SEC disclosure rules,[185] informal SEC demands when the staff reviews and approves the disclosure documents that must be filed in connection with these transactions,[186] and the effect of state corporate law.[187] Thus, these exclusions do not meaningfully

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185. *See, e.g.*, 17 C.F.R. §§ 229.910-.911 (2022) (roll-up transactions); *id.* § 240.13e-100, Items 8-9 (going private transactions); *id.* §§ 229.1013-.1014 (going private transactions).

186. *See, e.g.*, John Jenkins, *Disclosure of Projections: Will Delaware's Approach Still Rule the Roost?*, 13 DEAL LAWS., Sept.-Oct. 2019, at 7, 8, https://www.hoganlovells.com/-/media/hogan-lovells/pdf/2019/dl-sep-oct-2019.pdf [https://perma.cc/N4N7-L6Q3] (explaining that the position of the staff of the SEC's Division of Corporation Finance "virtually ensures that public company M&A disclosure documents will include some financial projections"); NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS § 5.03(2)(b) (Law J. Press 2022) (explaining that, although the SEC has not made by rulemaking the disclosure of projections in proxy statements or prospectuses mandatory, "in any given case the SEC, through its review and comment process, might insist upon their disclosure," and noting that "[d]isclosure of third party appraisals materially related to a going private transaction is required" (emphasis omitted)).

187. *See, e.g.*, George Casey, Adam Hakki & Roger Morscheiser, *SEC Considering Heightened Scrutiny of Projections in De-SPAC Transactions*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 17, 2021), https://corpgov.law.harvard.edu/2021/05/17/sec-considering-heightened-scrutiny-of-projections-in-de-spac-transactions/ [https://perma.cc/6MGH-3MAZ] (explaining that "Delaware law requires the board of directors to disclose fully and fairly all material information when seeking shareholder action," so "if the board of directors relies on projections when approving a transaction, which is often the case, then those projections are typically considered at least potentially 'material' and thus disclosed to shareholders"); MICHAEL B. TUMAS & MICHAEL K. REILLY, POTTER ANDERSON & CORROON LLP, THE DISCLOSURE OF PROJECTIONS UNDER DELAWARE LAW 2-6 (2008), https://www.potteranderson.com/

deny reasonable investors access to forward-looking information. The same can be said for disclosures in § 13(d) reports: the forward-looking information that matters to investors in that context—the future intentions of the party acquiring more than 5 percent of the company's stock—must be disclosed.[188] Similarly, GAAP dictates what must be included in financial statements prepared in accordance with its principles.[189]

To say that these exclusions are not inconsistent with a goal of providing reasonable investors with the forward-looking information they desire is not to say that they represent good policy choices. One's view on that question will depend on how one thinks the costs and benefits outlined in Column B of Table 1 net out. If one were to evaluate the wisdom of excluding financial statements prepared in accordance with GAAP, there is an important cost of exclusion (benefit of safe harbor extension) that is not captured in Column B. That is the distorting role that the safe harbor exclusion has likely played in the development of financial reporting standards.[190]

With respect to the tender offer exclusion, any evaluation of its wisdom would likewise have to consider that its existence may distort a reporting company's decision whether to structure a transaction as a one-step merger or a two-step tender offer. The differential treatment by the PSLRA of these two transaction forms may have made sense when the PSLRA was adopted, as I am told by practitioners that at that time the SEC staff did not usually

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media/publication/155_TheDisclosureofProjectionsUnderDelawareLaw.pdf [https://perma.cc/LK4L-M9BG] (discussing recent case law on point).

188. *See* 15 U.S.C. § 78m(d)(1)(C).

189. *See US GAAP: Generally Accepted Accounting Principles*, CFA INST., https://www.cfainstitute.org/en/advocacy/issues/gaap#sort=%40pubbrowsedate%20descending [https://perma.cc/4MLF-8JYW].

190. *See* CFA INST., FORWARD-LOOKING INFORMATION: A NECESSARY CONSIDERATION IN THE SEC'S REVIEW ON DISCLOSURE EFFECTIVENESS 4, 6-7 (2014), https://www.cfainstitute.org/-/media/documents/article/position-paper/forward-looking-information-a-necessary-consideration-in-sec-review.ashx [https://perma.cc/34SQ-ETTH] (explaining that "[i]n the United States, the common refrain used to exclude decision-useful forward-looking information from financial statements is that such information should, or must, be disclosed outside the financial statements under the Private Securities Litigation Reform Act of 1995 (PSLRA, or Reform Act) and the protections it provides for such forward-looking statements" and noting that this "has been used to object to and forestall improvements in financial statement disclosures regarding liquidity and interest rate risks proposed by the FASB in late 2012 and early 2013, which might provide investors in financial institutions with more decision-useful forward-looking information" (footnote omitted)).

demand disclosure of projections in connection with mergers whereas it did with respect to tender offers. Excluding mergers from the safe harbor's ambit would therefore have created a bigger risk of chilling voluntary disclosure. But today the SEC treats the two transactions alike, typically demanding disclosure of projections in both contexts.[191] The SEC itself has acknowledged that the safe harbor's distinction between mergers and tender offers no longer makes sense. When it adopted rule changes in 1999 designed to eliminate regulatory inconsistencies between mergers and tender offers, the SEC considered harmonizing their treatment under the PSLRA safe harbor by exercising its authority to override exclusions.[192] It ultimately chose to leave the status quo in place, not because the disparate treatment made regulatory sense, but because the "relative infancy of the body of law interpreting the PSLRA generally and the safe harbor in particular" left the SEC with qualms about extending its protection.[193]

The merger example leads to a broader observation: every time the SEC creates new mandates for forward-looking disclosure, it should consider the costs and benefits of extending or denying safe harbor protection to those disclosures. The SEC has often done so. In 1997, the SEC created new disclosure requirements about market risk exposures which appear in Item 305 of Regulation S-K.[194] In recognition of the heightened liability risk the new mandates created, it chose to extend safe-harbor protection "with respect to the specified information, regardless of whether the issuer providing it or the type of transaction otherwise is excluded from the

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191. Regulation of Takeovers and Security Holder Communications, Securities Act Release No. 33-7760, 64 Fed. Reg. 61,408, 61,421-25 (Nov. 10, 1999).

192. The SEC wrote in its proposing release:

> Currently, the safe harbor provisions in the Private Securities Litigation Reform Act of 1995 ("PSLRA") for forward-looking statements do not apply to statements made in connection with a tender offer, although they do apply to statements made in connection with mergers. We solicit comment on whether we should extend the provisions of the PSLRA to forward-looking statements issued in connection with a tender offer. Just as with mergers, there are other policing mechanisms to protect against false and misleading forward-looking statements in the tender offer context.

Regulation of Takeovers and Security Holder Communications, Securities Act Release No. 33-7807, 63 Fed. Reg. 67,331, 67,360 (proposed Dec. 4, 1998) (footnotes omitted).

193. Regulation of Takeovers and Security Holder Communications, 64 Fed. Reg. at 61,425.

194. 17 C.F.R. § 229.305 (2021).

statutory safe harbors."[195] With respect to the quantitative market risk disclosures mandated in paragraph (a) of Item 305, the SEC further specified that "the *meaningful cautionary statements* prong of the statutory safe harbors will be satisfied if a registrant satisfies all requirements of that same paragraph."[196] When it adopted new rules in 2003 requiring a registrant to provide an explanation of its off-balance sheet arrangements in a separately captioned subsection of the MD&A, it made clear that the safe harbor applied to these new requirements and included a "provision that the 'meaningful cautionary statements' element of the statutory safe harbor[ ] will be satisfied if a registrant satisfies all of its off-balance sheet arrangements disclosure requirements."[197]

C. Exclusions that Are (Seemingly) in Tension with the Safe Harbor's Purpose

If forward-looking information is neither protected by the safe harbor nor mandated, the predictable result is that companies will not publicly release it, at least in environments in which there is significant litigation risk (and hence the safe harbor is of import). Issuers and underwriters conducting IPOs face extraordinary liability risk under Sections 11 and 12(a)(2) of the Securities Act of 1933.[198] Unsurprisingly, as a matter of practice, IPO issuers do not disclose projections, instead limiting their forward-looking disclosures to the few that are required to be included in their registration statements.[199] This is hardly a secret, and I posit that this is the

195. Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments and Disclosure of Quantitative and Qualitative Information About Market Risk Inherent in Derivative Financial Instruments, Other Financial Instruments, and Derivative Commodity Instruments, Securities Act Release No. 33-7386, 62 Fed. Reg. 6,044, 6,052 (Feb. 10, 1997).

196. § 229.305(d)(2)(ii).

197. Disclosure in Management's Discussion and Analysis About Off-Balance Sheet Arrangements and Aggregate Contractual Obligations, Securities Act Release No. 33-8182, 68 Fed. Reg. 5,982, 5,993 (Feb. 5, 2003).

198. 15 U.S.C. §§ 77k(a), 771(a).

199. *See, e.g.*, Feldman, *supra* note 39 ("Based on our review of IPO filings over the past three years, no IPO company has actually provided financial projections, other than vague narrative disclosure in response to the SEC's management discussion and analysis rules regarding trends in liquidity and financial condition. This is largely due to the SEC's decision to exclude IPOs from the liability safe harbor for forward-looking statements contained in

very *point* of the IPO exclusion, as well as the other exclusions listed in Column C of Table 2.

The safe harbor's prioritization of the interests of reasonable investors over those of unreasonable investors is a contingent one. It does not extend to IPOs or to the situations covered by the other exclusions listed in Column C of Table 2. Reasonable investors are just as interested in forward-looking information in these contexts as they are in any other, and they are just as capable of discounting that information for bias. For example, reasonable investors will be as interested in management's predictions, and the assumptions that underlie them, when they invest in a new issue as when they invest in a seasoned one—probably more so because there will be fewer alternative sources of information about the company. This is borne out in market practice: underwriters regularly ask for financial projections from IPO companies,[200] as do PIPE investors.[201] Investors in the initial distribution of an IPO, who tend to be sophisticated institutions, also privately demand access to projections.[202] While corporate agents have strong incentives to hype their company's prospects in new offerings, this is also true in seasoned offerings, and again reasonable investors will understand these incentives and discount the information accordingly. By contrast, to the extent they actually read corporate disclosures, unreasonable investors may be more likely to be overly swayed by forward-looking

Securities Act Section 27A."); *see also* LATHAM & WATKINS LLP, US IPO GUIDE 9 (2022), https://www.lw.com/thoughtLeadership/lw-us-ipo-guide [https://perma.cc/VD7P-LKTF] ("You will not share projections with potential IPO investors during the road show.").

200. Feldman, *supra* note 39.

201. *See* LATHAM & WATKINS LLP, *supra* note 199, at 22-23 (explaining that, "[g]iven that the IPO process can take many months, an IPO issuer may want, or need, to pursue a private offering that is not registered with the SEC on the same schedule as the IPO" and that "private investors may expect information that is not typically part of the IPO disclosure package, *particularly projections*" (emphasis added)).

202. While neither the company or underwriters will provide projections to these investors directly (due to liability risk), the company will provide projections to analysts who work them into their models and then verbally discuss them with these investors. *See id.* at 9. It is also common for venture capital firms to demand projections when deciding whether to invest in a start-up. *See* Martin Zwilling, *5 Rules of Thumb for Startup Financial Projections*, BUS. INSIDER (May 28, 2013, 9:30 AM), https://www.businessinsider.com/5-rules-of-thumb-for-startup-financial-projections-2013-5 [https://perma.cc/B46B-ECZ8] ("[M]aking no projections, or non-credible projections will get your startup marked as unfundable.").

information. But this, too, is true whether the issue is new or seasoned.

What is different is that in the case of an IPO, unreasonable investors are unlikely to enjoy what Holger Spamann has dubbed the "indirect investor protection" that efficient markets provide.[203] Unreasonable investors are usually protected from overpaying on the secondary market for stock in a company that is a seasoned issuer because the trading activity of reasonable investors will determine the price; in IPO aftermarket trading, by contrast, such protection is not robust. This is due, in part, to low liquidity attributable to lock-up agreements and practical limitations on arbitrage.[204] Efficient markets are similarly unlikely to offer protection to unreasonable investors in the situations covered by the other exclusions listed in Column C of Table 2.

When viewed in conjunction with these exclusions, it becomes clear that the safe harbor aims to prioritize the interests of reasonable investors, who want access to management forecasts, over those of unreasonable investors, who may over rely on such forecasts, only in situations in which unreasonable investors are not at serious risk of self-harm. In certain situations in which unreasonable investors do stand to get hurt because they are not protected by efficient markets, such as in aftermarket IPO trading, the safe harbor prioritizes their interests over those of reasonable investors by drawing an exclusion. To be sure, the PSLRA's safe harbor does not explicitly prohibit companies from making public forward-looking statements in connection with an IPO. Instead, its non-applicability means that any such statements are more vulnerable to attack in securities litigation, litigation that would call for application of the "reasonable investor" standard: there is no formal shift to an "unreasonable investor" standard when courts deal with

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203. Spamann, *supra* note 40, at 3 (emphasis omitted). I use the term "efficient market" to refer to a market in which prices are unbiased and informed. I do not mean to suggest prices always, instantaneously, and perfectly reflect all public information. Clearly, they do not. *See id.* at 16-19.

204. *See generally* Eli Ofek & Matthew Richardson, *The IPO Lock-Up Period: Implications for Market Efficiency and Downward Sloping Demand Curves* (N.Y.U., Stern Sch. of Bus., Working Paper, Paper No. FIN-99-054, 2000), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1298279 [https://perma.cc/2YRB-5P6K]; Jonathan A. Shayne & Larry D. Soderquist, *Inefficiency in the Market for Initial Public Offerings*, 48 VAND. L. REV. 965 (1995).

statements made in connection with an IPO.[205] But the practical—and I posit intended—effect is to chill the disclosure altogether, which *does* shield unreasonable investors from the risks forward-looking statements are thought to pose to them when they trade in inefficient markets.

The history surrounding the adoption of the PSLRA offers circumstantial support for this interpretation. When the SEC originally shifted its perspective on forward-looking statements in the early 1970s, it anticipated permitting a company to include projections in SEC filings only if it "[had been] a reporting company for a reasonable period of time and ha[d] a history of earnings and internal budgeting."[206] The SEC ultimately chose not to impose such a requirement or to otherwise exclude communications in IPO registration statements, instead trusting that reasonable investors would take the lack of a history of earnings and internal budgeting into account when determining what weight to place on a projection.[207] When it issued its request for comment on how to strengthen Rules 175 and 3b-6 in 1994, it reconsidered its approach, asking: "Should all issuers be eligible for the safe harbor or only certain issuers that satisfy specified conditions, such as sufficient reporting history and/or public float to ensure a market following?"[208] The Association of Publicly Traded Companies (APTC) thought the latter. It suggested a very strong safe harbor, but one that extended only to statements made in connection with a listed security issued by a company with at least a six-month reporting history.[209] The APTC explained that the proposed safe harbor for "seasoned issuers" was "[a]vailable only to companies which by virtue of their publicly traded history, stock price, need for continuing market capital and other relevant factors, are fully subject to the

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205. *But see* Sachs, *supra* note 122, at 502 (arguing that courts should replace the "reasonable investor" standard with a "least sophisticated investor" standard when suits are brought in connection with securities traded in inefficient markets).

206. STAFF OF H. COMM. ON INTERSTATE & FOREIGN COM., 95TH CONG., APPENDIX TO THE REP. OF THE ADVISORY COMM. ON CORP. DISCLOSURE TO THE SEC, A-387 (Comm. Print 1977).

207. *See, e.g.*, *supra* Part II.D.

208. Safe Harbor for Forward-Looking Statements, Securities Act Release No. 33-7101, 57 SEC Docket 1,999, 2,013 (Oct. 13, 1994).

209. *See Securities Litigation Reform Proposals S.240, S.667, and H.R. 1058: Hearings Before the Subcomm. on Sec. of the Comm. on Banking, Hous., & Urb. Affs.*, 104th Cong. 75 (1995) (statement of the Association of Publicly Traded Companies).

disciplining forces of the marketplace, analysts and financial press."[210]

Others disagreed, showing deference to reasonable investors. A Task Force on Forward-Looking Statements appointed by the Committee on Federal Regulation of Securities of the Section of Business Law of the American Bar Association was of the view that the safe harbor should extend to IPO registrants, explaining that "[w]e see no benefit to so restricting the availability of the safe harbor, and believe that such issuers should be encouraged to provide forward-looking information *and that their investors are entitled to it*."[211] In congressional hearings on the PSLRA, the Securities Industry Association expressed support for extending the safe harbor to all market participants, citing the importance of informed analysis to well-functioning markets.[212]

The SEC's behavior also strongly corroborates this interpretation. The SEC has long known that IPO issuers do not share management forecasts publicly, yet it has never sought to either extend safe harbor protection to IPO issuers or mandate disclosure of projections in IPO registration statements. Moreover, when it reformed the gun-jumping rules in 2005, it chose to continue prohibiting forward-looking statements by IPO issuers during the pre-filing period while freeing seasoned issuers to release such statements.[213] The gun-jumping rules prohibit forward-looking statements by IPO issuers during the pre-filing period—not just fraudulent, reckless, or even negligent forward-looking statements but *all* forward-looking statements—because the SEC fears unreasonable investors will get whipped up into a speculative frenzy if confronted with them.[214] While that prohibition officially ends with the filing of the

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210. *Id.* at 77.

211. *Common Sense Legal Reform Act: Hearings Before the Subcomm. on Telecomms. & Fin. of the Comm. on Com.*, 104th Cong. 260 (1995) (statements of the American Bar Association) (emphasis added).

212. *See id.* at 272 (statement of Daniel Goelzer, Counsel, Securities Industry Association).

213. *Compare* 17 C.F.R. § 230.168 (2021), *with id.* § 230.169.

214. Section 5 of the Securities Act of 1933 prohibits all "offers" of securities prior to the filing of a registration statement, as well as written offers after the filing of a registration statement, unless they comply with Section 10. *See* 15 U.S.C. § 77e. The SEC has long taken the view that forward-looking statements constitute "offers" within the meaning of Section 5. *See, e.g.*, Guidelines for Release of Information by Issuers Whose Securities Are in Registration, Securities Act Release No. 33-5180, 36 Fed. Reg. 16,506, 16,507 (Aug. 21, 1971).

registration statement, it effectively continues throughout the offering process by virtue of the chilling effect created by liability risk coupled with the PSLRA's safe harbor exclusion.[215]

IV. Should De-SPAC Mergers Be Excluded from Safe Harbor Protection?

Let us now return to the question of whether projections issued in connection with de-SPAC mergers should be excluded from safe-harbor protection. Many have argued that the fact that such projections enjoy safe harbor protection, whereas those issued in connection with IPOs do not, presents a problematic opportunity for "regulatory arbitrage."[216] This has led some to call for the creation of a safe harbor exclusion for de-SPACs to mirror the one that applies to IPOs, and in March 2022, the SEC proposed rule changes that would have this effect.[217] Others agree that de-SPAC transactions and IPOs should be placed on a "level playing field" with respect to forward-looking statements but have stopped short of saying whether this leveling should involve denying de-SPAC transactions the safe harbor's protection or extending the safe harbor's protection to traditional IPOs.[218]

As noted in the Introduction, the securities laws are replete with "mandatory" rules that can be evaded by an issuer's choice of transaction design. Most basically, an issuer can avoid almost all

215. The PSLRA's language is vague, excluding statements "in connection with an initial public offering" without defining when exactly the exclusion ends, and the author has been unable to find any authority on point. 15 U.S.C. §§ 77z-2(b)(2)(D), 78u-5(b)(2)(D). The most logical reading is that it extends through the post-effective period. If it ended with effectiveness, then the exclusion would largely be redundant because the safe harbor only extends to reporting issuers, thus any statements made by an IPO issuer prior to effectiveness would not qualify regardless (unless the issuer hit another trigger for reporting company status prior to its IPO). It would also be strange from a policy perspective—those investors invited to be part of an initial IPO distribution are overwhelmingly institutional investors and well-advised wealthy individuals, the prototypical investors who are capable of handling forward-looking disclosures. The concern around IPOs is that aftermarket retail purchasers will overpay, and a de facto quiet period for forward-looking statements post-effectiveness addresses this concern.

216. *See supra* note 18.

217. *See supra* notes 108-11 and accompanying text.

218. *See, e.g.*, Klausner et al., *supra* note 15, at 234-35, 283-87, 299; Rodrigues & Stegemoller, *supra* note 57, at 49-50.

the federal securities laws' mandatory disclosure obligations and most of its liability provisions by raising money privately and keeping its equity closely held and off exchange, thereby avoiding "reporting company" status.[219] A company's conscious choice to stay private to avoid these rules is not viewed as problematic "regulatory arbitrage," however, because (with few exceptions) the law limits who can invest in private companies to those who can "fend for themselves" and thus do not require the protection of the evaded rules.[220]

To assess the normative desirability of any particular instance of the securities laws' optionality requires, as a first cut, an assessment of the evaded rule's purpose and whether the economic realities of the alternative path present the same problem. Moreover, the economic realities of the alternative path may indicate that simple extension of the evaded rule will not have the intended results due to other contextual differences. If the economic realities of the alternative do present the same regulatory concern that the evaded rule is designed to address, and if extension of the evaded rule will work to address that concern, policymakers still should not reflexively favor extension without first pausing to assess the wisdom of the evaded rule.

The last Part sought to explain the purpose of the IPO exclusion. It posits that the IPO exclusion is designed to silence management forecasts based on a concern that unreasonable investors may place undue reliance on such forecasts and—due to inefficiencies in aftermarket trading for IPO stock—therefore overpay for IPO stock and potentially suffer losses as a result. The discussion that follows asks whether the economic realities of de-SPAC mergers present the same regulatory concern (to which it answers "yes") and whether extension of the IPO safe harbor exclusion to de-SPAC mergers would effectively address it (to which it answers "no"). It also questions the wisdom of seeking to protect unreasonable investors

219. *See* 15 U.S.C. § 78l.

220. SEC v. Ralston Purina Co., 346 U.S. 119, 124-25 (1953); *see also supra* note 115. Of course, even in the absence of regulatory arbitrage, regulation-induced changes in behavior may be cause for concern depending on the social welfare implications. *See, e.g.*, Robert Blecher, Private Inequity: Private Markets and the Death of the Micro-Cap Stock (Feb. 5, 2021) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3649753 [https://perma.cc/LZW8-UVQ3].

by silencing management forecasts and argues that even if this were a wise policy goal, the IPO safe harbor exclusion is a poor (albeit politically convenient) method for achieving it.

A. Economic Realities

The economic realities of de-SPAC mergers do present the same problem that the last Part argues the IPO exclusion is designed to address. Unreasonable SPAC investors around the time of a de-SPAC merger are unlikely to enjoy the protections of an efficient market. Prior to the merger, SPAC shares will not persistently trade below ten dollars irrespective of the expected value of the shares post-merger, because the price will be set by sophisticated investors who intend to redeem;[221] and after the merger, as in early aftermarket IPO trading, the supply of shares available to trade will be artificially restricted due to lock-up agreements.[222] Professors Usha Rodrigues and Michael Stegemoller have examined SPAC liquidity and report that "SPAC trading can be light to the point of non-existence," with "days ... when not a single SPAC share trades."[223] Moreover, arbitrage opportunities are limited. While short interest in de-SPAC shares is on the rise,[224] this is a risky strategy given the low inventory available. Indeed, some SPAC short sellers have recently been squeezed.[225] All of this means that stock price

221. Holger Spamann & Hao Guo, *The SPAC Trap: How SPACs Disable Indirect Investor Protection*, 40 YALE J. ON REGUL. BULL. 75, 82 (2022).

222. *See, e.g.*, SEAN DONAHUE, JEFFREY LETALIEN & BRIAN SOARES, MORGAN LEWIS, GOING PUBLIC THROUGH A SPAC: CURRENT ISSUES FOR SPAC SPONSORS AND PRIVATE COMPANIES 10 (2020), https://www.morganlewis.com/-/media/files/publication/presentation/webinar/2020/morganlewisgpcaspacpresentation12022020.pdf [https://perma.cc/DCW7-HHQJ] (explaining that sponsors and target shareholders typically agree to a 180-day lock-up period in order to provide a clear market for the PIPE investors); *see also* Complaint at 13, SEC v. Milton, No. 21-cv-6445 (S.D.N.Y. July 29, 2021) ("Nikola had a relatively small float following the Business Combination due, in part, to a significant portion of the stock being subject to lock-up agreements, resulting in stock price movements being largely driven by retail investors and algorithmic trading firms.").

223. Rodrigues & Stegemoller, *supra* note 57, at 33 (footnote omitted).

224. *See, e.g.*, Michelle Celarier, *The SPAC Short Boom Is on Its Way*, INSTITUTIONAL INV. (Dec. 18, 2020), https://www.institutionalinvestor.com/article/b1pqwl3dm2dxgf/The-SPAC-Short-Boom-Is-on-Its-Way [https://perma.cc/P82U-UYQA]; Matt Wirz & Juliet Chung, *Short Sellers Boost Bets Against SPACs*, WALL ST. J. (Mar. 14, 2021, 5:30 AM), https://www.wsj.com/articles/short-sellers-boost-bets-against-spacs-11615714200 [https://perma.cc/6VZ9-RYFN].

225. Matthew Fox, *A Handful of Heavily Shorted SPACs Are Being Squeezed Higher as*

movements in the wake of a de-SPAC merger may largely be driven by retail investors, many of whom may be unreasonable investors vulnerable to placing undue reliance on management forecasts.

However, creating a new safe harbor exclusion for communications in connection with de-SPAC transactions will not solve this perceived "problem," at least not without further regulatory reform making the release of projections in connection with de-SPAC transactions voluntary. Unlike the IPO exclusion, a de-SPAC safe harbor exclusion would not have the de facto effect of eliminating the public release of projections, because disclosure of projections relied upon by a board proposing a transaction for a shareholder vote is compelled by state corporate law,[226] and the SEC staff typically demands such projections be included in the merger and tender offer documents reporting companies are required to file and provide to shareholders in connection with those transactions.[227] Indeed, the SEC's proposed new rules would require a SPAC to discuss in its de-SPAC-related filings "the material factors upon which a reasonable belief regarding the fairness of a de-SPAC transaction and any related financing is based," including "the consideration of any financial projections."[228] Because IPO issuers can (and almost uniformly do) avoid liability exposure for management projections through silence whereas companies going public via a de-SPAC merger would not be able to, carving a new safe harbor exclusion for de-SPAC transactions would not place them on a "level playing field" with IPOs. It would instead disadvantage de-SPAC mergers relative to traditional IPOs.

For SPAC critics, this may be a welcomed outcome, but it would fail to address the investor protection concerns that I posit animate the IPO exclusion and would clearly conflict with the SEC's stated goal of "aligning" de-SPAC transactions with traditional IPOs.[229] Exposing the projections SPAC sponsors share to heightened

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Investors Redeem Shares Ahead of Final Merger, BUS. INSIDER: MKTS. INSIDER (Aug. 26, 2021, 11:35 AM), https://markets.businessinsider.com/news/stocks/spac-short-squeeze-investors-redeem-shares-mergers-complete-2021-8 [https://perma.cc/6B6D-R2XQ].

226. *See supra* notes 185-87 and accompanying text.

227. *See supra* notes 185-87 and accompanying text.

228. Special Purpose Acquisition Companies, Shell Companies, and Projections, Securities Act Release No. 33-11048, 87 Fed. Reg. 29,458, 29,473 (proposed May 13, 2022).

229. *Id.* at 29,476.

liability risk might increase their accuracy and lead to a better discussion of their qualifications; it might also reduce the number of frauds that go unpunished—benefits that might outweigh the costs of the heightened liability exposure. (The costs and benefits of excluding mandatory forward-looking statements from the ambit of the safe harbor are simply the inverse of the cost and benefits of extending safe harbor protection reflected in Column B of Table 1.) But insofar as unreasonable investors may be harmed by even honest, well-diligenced projections, de-SPAC period investors would remain vulnerable in a way aftermarket investors in a traditional IPO are not.

B. The Wisdom (or Not) of the IPO Exclusion

Assuming reforms could be adopted which would effectively eliminate public disclosure of projections in connection with de-SPAC mergers, should they be? To state the question more broadly: *Is it sound public policy to discourage management forecasts in retail-accessible markets that do not provide unreasonable investors the protection of efficient pricing?* This is a question worth asking even if SPACs disappear tomorrow. After all, if the answer is "no," it would mean that the SEC's current approach to IPOs is indefensible, and the SEC should either: (1) eliminate the IPO safe-harbor exclusion or (2) keep it, but mandate public disclosure of any projections provided by IPO issuers to their underwriters in connection with the offering. The SEC possesses the authority to take either action through rulemaking.[230] Given the rising pressure on the traditional IPO—not only by SPACs but also by the advent of direct

230. *See supra* note 44 and accompanying text. The second approach would place traditional IPOs on more of an equal footing with how SPACs would be treated if the rules the SEC proposed in March 2022 were to become law—the IPO exclusion and the de-SPAC exclusion would both belong in Column B of Table 2. Other aspects of the proposed rules would continue to disadvantage SPACs relative to traditional IPOs, however. For example, as noted above, the proposed rules mandate that SPACs include in their merger filings a detailed discussion of the fairness of a proposed de-SPAC transaction, whereas underwriters in a traditional IPO have no similar obligation. *See also supra* notes 110-11 and accompanying text (discussing proposed Item 1609).

listings and robust private market alternatives[231]—it is an apt time to reflect on the wisdom of the IPO safe harbor exclusion.

Shielding unreasonable investors from forward-looking statements is not without distributional effect. It comes at the expense of reasonable investors, who want and need forward-looking information to make informed investment decisions. To be sure, a *subset* of reasonable investors get access to this coveted information in the context of an IPO—the underwriters and those lucky enough to get invited to participate in the initial distribution. While issuers do not directly provide this information to ground-floor IPO investors (due to liability fear), they do convey their forecasts to analysts with the knowledge that the analysts will then convey information about their forecasts to potential IPO investors in private conversations.[232] PIPE investors that invest alongside an IPO (an increasingly common occurrence) also demand and receive management forecasts.[233] But reasonable investors that do not stand in these privileged positions are denied access to this information and are disadvantaged as a result. Is this distributional effect justified, either as a matter of fairness or efficiency?

It is hard to characterize punishing reasonable investors—except those who are well-connected—to protect the unreasonable from their own foolish behavior as "fair." How concerned one is with this injustice will depend, of course, on one's intuition as to the ratio of reasonable versus unreasonable investors who seek (or, if given access to management forecasts, would seek) to invest in IPO aftermarkets. As Donald Langevoort has observed, the SEC "has

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231. *See generally* Aswath Damodaran, Disrupting the Disruptors? The 'Going Public Process' in Transition (July 14, 2021) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3892419 [https://perma.cc/5AXT-H9LS].

232. *See supra* note 202 and accompanying text; *see also Selective Disclosure in Facebook IPO?*, INTEGRITY RSCH. ASSOCS. (May 29, 2012), http://www.integrity-research.com/selective-disclosure-in-facebook-ipo/ [https://perma.cc/9G6F-35QT] (explaining that "analysts involved in IPOs usually develop their company forecast models in collaboration with company management" and "[t]hese estimates are seen by institutional investors as having been reviewed by the company, and are therefore targets that management feels confident they will hit"; the "estimates are not published anywhere" but "are communicated verbally to institutional investors who are considering investing in the IPO").

233. *See supra* note 201 and accompanying text. Regulation Fair Disclosure does not mandate disclosure of material, nonpublic information provided by a reporting company to anyone who owes a duty of trust or confidence to the company or who expressly agrees to maintain the disclosed information in confidence. *See* 17 C.F.R. § 243.100(b)(2)(i)-(ii) (2021).

never studied investor behavior deeply enough to say, publicly at least, what percentage of investors read or understand [SEC disclosure] documents, or what influence the fundamental analysis-oriented disclosure has on their investment decisions."[234] He suspects the SEC does not really want to know, because a finding that retail investors are overwhelmingly unreasonable would contradict the SEC's "brand message," which "is about its role in empowering retail investors as a class."[235] SEC initiatives, such as Regulation Fair Disclosure and the Plain English Rules, as well as the judicial approach to the concept of materiality, presume that there is a class of reasonable retail investors who do engage in fundamental analysis and deserve equal access to digestible disclosures that can aid in this endeavor. However large this group is in reality, the IPO exclusion subordinates the best interests of its members to protect unreasonable investors from themselves.

Might the approach, however unfair, nevertheless promote efficient outcomes? Silencing management forecasts *might* help dampen frenzy-induced inflation in securities that trade in an inefficient market, but this is more an article of faith than a proven fact. While it appears that de-SPAC period investors have on average paid inflated prices for SPAC shares after the announcement of a merger,[236] it is a leap to attribute this to an overreliance on management projections rather than, for example, investor lack of comprehension regarding the dilution that the merged entity will experience, or of the conflicts of interest that SPAC sponsors and financial advisors face, or irrational exuberance unrelated to the SPAC's disclosures.[237] IPO issuers currently provide *no* forecasts to

234. Donald C. Langevoort, *Taming the Animal Spirits of the Stock Markets: A Behavioral Approach to Securities Regulation*, 97 NW. U. L. REV. 135, 173 (2002); *cf.* Spamann, *supra* note 40, at 10 ("The vast majority of retail investors lack the financial expertise to value a security or to vote sensibly (e.g., on a merger or an executive pay package)."); Jill E. Fisch, *GameStop and the Reemergence of the Retail Investor*, 102 B.U. L. REV. 1799 (2022) (painting a more positive picture of retail investors).

235. Langevoort, *supra* note 234, at 174; *see also* Jacob Hale Russell, *Which Investors to Protect? Evolving Conceptions of the American Shareholder, 1990-Present*, CAMBRIDGE HANDBOOK ON INV. PROT. (forthcoming 2023) (manuscript at 39), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3861999 [https://perma.cc/RE7G-SBK2] (noting the Commission wants to help "main street" investors).

236. *See supra* note 49 and accompanying text.

237. *See supra* Part I.A. One recent empirical study finds that retail SPAC investors are more influenced than institutional investors by the release of forecasted revenue compounded

the market, and yet there are still large runups in IPO share prices when aftermarket trading commences.[238] While the causes of this "IPO underpricing" phenomenon are disputed,[239] one theory posits that irrational "sentiment" investors drive up the price of the stock beyond fundamental value.[240] Perhaps Professor Aswath Damodaran is correct when he warns that "markets abhor vacuums, and preventing companies from forecasting the future only allows others, less scrupulous and informed, to fill in the empty spaces with their own details."[241]

This leads to an important point: if unreasonable investors misvalue stocks when exposed to management forecasts, they will also misvalue stocks for a myriad of other reasons, including a basic lack of financial acumen. In the words of the great musical icon Taylor Swift, "Band-Aids don't fix bullet holes."[242] Whether accurate pricing or unreasonable investor protection is the goal, there are a variety of policy options that would address the threat that unreasonable investors present to themselves, and to the capital markets, in a more systemic way than a PSLRA safe harbor exclusion.

For example, to the extent possible, regulators could adopt reforms designed to increase the efficiency of the relevant market. Reforms in this vein might identify ways to increase liquidity,

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annual growth rates, that these forecasts are biased overall, and that the stocks of firms with high projections underperform stocks of comparable firms during the two-year span following the SPAC merger. *See* Michael Dambra, Omri Even-Tov & Kimberlyn George, Are SPAC Revenue Forecasts Informative? 4-8 (June 2022) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3933037 [https://perma.cc/8NPE-HRE3]. Another empirical study looking at more recent data, however, finds that SPACs' release of their targets' forecasted growth rates is not related to return reversals post-merger and may help to reduce information asymmetry. *See* Kimball Chapman, Richard Frankel & Xiumin Martin, SPACs and Forward-Looking Disclosure: Hype or Information? 4-5 (Oct. 21, 2021) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3920714 [https://perma.cc/4FAD-ARYM]; *see also* Tuch & Seligman, *supra* note 62, at 47 n.214 (describing the evidence on whether forecasts harm de-SPAC period investors as "mixed").

238. *See* Alexander Ljungqvist, *IPO Underpricing*, *in* 1 HANDBOOK OF CORPORATE FINANCE: EMPIRICAL CORPORATE FINANCE 375, 381-83 (B. Espen Eckbo ed., 2007).

239. For an overview of the theories and the evidence in support, see generally *id.*

240. *Id.* at 414-16.

241. Damodaran, *supra* note 231, at 30; *see also* Brian Bushee, Matthew Cedergren & Jeremy Michels, *Does the Media Help or Hurt Retail Investors During the IPO Quiet Period?*, 69 J. ACCT. & ECON. 1, 1-3 (2020).

242. TAYLOR SWIFT, *Bad Blood*, *on* 1989 (Big Mach. Recs. 2014).

remove barriers to arbitrage, and foster greater analyst coverage.[243] As another example, retail investor access to designated markets in which efficient pricing does not protect the unsavvy could be restricted to those individuals who either pass an investment exam[244] or invest based on the advice of an investment adviser or broker-dealer.[245] Both investment advisers and broker-dealers owe their customers a duty to recommend only suitable investments that are in the customer's best interest.[246] Digital brokerage platforms like Robinhood do not typically offer advice and thus usually have no obligation to screen their customers' trades for suitability;[247] under this proposal, investors could not use such platforms to access designated markets without professional guidance unless they demonstrated their financial acumen through passage of the investment exam.[248] A lighter touch approach would be for the SEC to more tightly regulate (or require FINRA to more tightly regulate)

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243. This would not help unreasonable investors who invest in SPAC shares prior to the de-SPAC, however, as the market price of such shares will continue to be set at a floor of ten dollars due to the redemption right. *See* Spamann & Guo, *supra* note 221, at 82 (explaining that the market for SPAC shares prior to the de-SPAC is efficient, but the market price "reflects the cash flows that will accrue to sophisticated investors who know they can and should redeem").

244. *See* Stephen Choi, *Regulating Investors Not Issuers: A Market-Based Proposal*, 88 CALIF. L. REV. 279, 310-12 (2000).

245. *See, e.g.*, *id.* at 290-92.

246. *See generally* Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Investment Advisers Act Release No. IA-5248 (July 12, 2019); 17 C.F.R. § 240.15l-1 (2021). When the exchanges first began listing SPAC shares in 2008, FINRA released guidance on SPACs, warning brokerage firms of their suitability and disclosure obligations when participating in this market. *See* FIN. INDUS. REGUL. AUTH., REGULATORY NOTICE 08-54, GUIDANCE ON SPECIAL PURPOSE ACQUISITION COMPANIES 5 (2008), https://www.finra.org/sites/default/files/NoticeDocument/p117208.pdf [https://perma.cc/9343-H9V8] (noting, inter alia, that "[p]urchasing warrants in the aftermarket is a highly speculative investment that is generally suitable only for sophisticated investors who can assume and understand the risk that an acquisition will not be completed and the warrants will expire worthless" and warning that "FINRA research indicates that most SPAC share prices significantly lag the market after the acquisition is completed").

247. *See, e.g.*, ROBINHOOD SEC., DISCLOSURE STATEMENT 3, https://cdn.robinhood.com/assets/robinhood/legal/rhs-carrying-agreement.pdf [https://perma.cc/4SVH-EVG3].

248. FINRA rules create a comparable regime for options trading. *See* FIN. INDUS. REGUL. AUTH., RULE 2360(b) (requiring broker approval of accounts for options trading only after conducting due diligence to determine that options trading is appropriate for the account). There have long been calls to make access to private markets turn on tests of financial sophistication, and the SEC's recent amendments to the definition of an accredited investor take a step in this direction. *See supra* note 115.

brokerage platforms by requiring more prominent warnings with respect to investments that trade in such markets or by prohibiting techniques that "gameify" investing.[249] While this would not dissuade all unreasonable investors from participating in markets that are unsuitable for them, it may discourage some.[250] Moreover, allowing unreasonable investors to suffer the consequences of their choices may be good medicine in the long run, as such experiences might encourage them to avoid markets that they are unsuited for—which in turn would both limit their future losses and decrease the disruptions to the market that their trading behavior may cause.[251]

My purpose here is not to advocate for any of these particular reforms, and a full consideration of the issues they raise is beyond the scope of this Article. The point is simply that more systemic responses such as those outlined above may do better than a safe harbor exclusion at mitigating the risk that unreasonable investors pose to themselves, and to society more broadly, when they trade in markets that do not protect them through efficient pricing.

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249. *See supra* note 114 and accompanying text. *But see* Vlad Tenev, Opinion, *Robinhood Users Come Under Attack*, WALL ST. J., Sept. 28, 2021, at A17 (opinion piece by Robinhood CEO responding to claims that features on the company's platform "gamif[y]" investing by explaining that "[w]e designed these features, many of which are common in our industry, to make it easier and more delightful for users to stay informed," and observing that "[i]nvesting isn't a game, but must it be grim and difficult to understand?"); Kyle Langvardt & James Fallows Tierney, *On "Confetti Regulation": The Wrong Way to Regulate Gamified Investing*, YALE L.J.F. 717, 720-21, 728, 731-34 (2022) (warning that SEC attempts to regulate app design would be vulnerable to First Amendment challenge). In connection with Regulation Crowdfunding offerings and nonlisted "tier II" Regulation A offerings, the SEC has taken the approach of limiting the amount of personal wealth or income non-accredited investors can put at risk. *See* 17 C.F.R. § 227.100(a)(2) (2018); *id.* § 230.251(d)(2). Unless and until the definition of "accredited investor" includes all reasonable investors, this approach continues to disadvantage reasonable investors in order to protect unreasonable investors. *See supra* note 115.

250. *Cf.* Luigi Zingales, *The Future of Securities Regulation*, 47 J. ACCT. RSCH. 391, 417 (2009) (favoring "regulation that dissuades (rather than prevents) unsophisticated households from investing directly in securities markets" and observing that "[i]f 'widows and orphans' are discouraged from investing in the market directly, there is no justification for securities regulation specifically aimed at protecting them").

251. *But see* Langevoort, *supra* note 234, at 159 (discussing literature indicating that the biases online traders suffer "do[ ] not easily wash out via the school of hard knocks").

C. An Opportunity for Learning?

When there is uncertainty as to the optimality of a rule, instances of regulatory arbitrage can provide an opportunity for learning. Do de-SPAC mergers present such an opportunity vis-à-vis the IPO safe harbor exclusion? The answer—at least at present—is uncertain. As already alluded to, there is little evidentiary basis for attributing the poor performance of de-SPAC period investments to investor reliance on management projections rather than to the many other potential causes discussed in Part I. If reforms addressing these other causes were implemented and proved successful, it would allow for a more apples-to-apples comparison between de-SPAC mergers and traditional IPOs. But even then, inferring a causal link between the availability of management forecasts and the relative performance of aftermarket IPO investments and de-SPAC period investments would be complicated due to selection bias. As Gahng, Ritter, and Zhang have observed, "[c]ompanies choosing SPACs might be fundamentally different from companies opting for traditional IPOs."[252] Nevertheless, researchers have begun examining the relationship between the use of projections in de-SPAC transactions and post-merger performance, and this work may prove informative in evaluating the wisdom of the IPO safe harbor exclusion.[253]

D. An Alternative Approach

If management forecasts *should* be discouraged in retail-accessible markets that do not protect unreasonable investors through efficient pricing, there is a much more direct way to achieve this goal than a PSLRA safe harbor exclusion: a flat prohibition on the

252. Gahng et al., *supra* note 15, app. at 12. Companies that face special difficulties bridging information asymmetries with potential investors—*viz.*, smaller, riskier firms—may be drawn to de-SPAC mergers precisely because they may share projections while enjoying the safe harbor's protection. *See* Klausner et al., *supra* note 15, at 271-72; *see also* Bai et al., *supra* note 98, at 4-5, 7 (developing a theoretical framework of segmented going-public markets where SPACs play the role of matching yield-seeking investors with smaller and riskier operating firms while investment banks take larger and safer operating firms public in the traditional IPO market).

253. *See supra* note 252.

public release of forecasts by any company whose stock trades (or will soon trade) in such markets.[254] A flat prohibition would be superior to a safe harbor exclusion because the effectiveness of the latter approach turns on the happenstance of whether the issuer faces liability risk great enough to chill disclosure. That condition certainly holds in a traditional IPO, but it may not hold in all situations in which unreasonable investors are vulnerable to management forecasts. Having the prohibition turn on whether the company's stock trades in a retail-accessible market that fails to protect unreasonable investors through efficient pricing, rather than turning on organizational form or transaction characteristics (the way the safe harbor exclusions in Category C of Table 2 do), similarly mitigates underinclusion problems and would make regulatory arbitrage more difficult.

While such a standard would introduce ambiguity, there are ways the law could address this. For example, the law could deem a market to be efficient for purposes of the prohibition if certain objective and easily trackable criteria are satisfied (these criteria might relate to, inter alia, an issuer's reporting history, public float, average daily trading volume, and filing status). The law could also specify markets that presumptively trigger the prohibition (for example, IPO aftermarkets until *X* number of days following the effective date of the registration statement; markets for SPAC shares until *X* number of days following a de-SPAC transaction).

While a flat prohibition on the public issuance of management forecasts by companies whose stocks trade (or will soon trade) in retail-accessible markets that do not protect unreasonable investors through efficient pricing would be a more direct and effective way to protect unreasonable investors than a PSLRA safe harbor exclusion, it is hardly surprising that neither the SEC nor Congress have suggested it. That is because the approach would make obvious two major problems with the underlying policy objective.

First, a flat prohibition on an issuer's release of forecasts would be vulnerable to attack under the First Amendment in a way that

254. The focus should be on the efficiency of the market for a company's stock, given that "debt requires no or less indirect investor protection because it is less information sensitive and less governance intensive than equity, reducing both the opportunity and the need for smart money intervention." Spamann, *supra* note 40, at 8.

the current approach is not.[255] According to the Supreme Court's contemporary commercial speech jurisprudence, government may prohibit commercial speech that is misleading.[256] Moreover, the Supreme Court has indicated that laws regulating commercial speech are not subject to overbreadth challenge.[257] This means that the disclosure-based liability provisions in the federal securities laws—all of which require a showing that the challenged statement would mislead a reasonable investor—are likely insulated from First Amendment attack, notwithstanding that they (in conjunction with the IPO safe harbor exclusion) operate to chill essentially *all* public disclosure of management projections in connection with IPOs.[258] By contrast, a direct prohibition on corporate forecasts would likely be subjected to intermediate scrutiny under the commercial speech test articulated by the Supreme Court in *Central Hudson Gas & Electric Corporation v. Public Service Commission of New York*.[259] To pass muster under this test, prohibitions on commercial speech must (1) be based on a substantial governmental interest, (2) directly advance that interest, and (3) not be more extensive than necessary to serve that interest.[260] The Supreme

255. While the Supreme Court has made some oblique comments suggesting that the securities laws' regulation of commercial speech is immune from First Amendment scrutiny, it has never so held, and there is no principled justification for this position. *See* Michael R. Siebecker, *Corporate Speech, Securities Regulation, and an Institutional Approach to the First Amendment*, 48 WM. & MARY L. REV. 613, 641-45 (2006).

256. *See, e.g.*, Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of N.Y., 447 U.S. 557, 563 (1980) ("[T]here can be no constitutional objection to the suppression of commercial messages that do not accurately inform the public about lawful activity.").

257. *See* Bates v. State Bar of Ariz., 433 U.S. 350, 381 (1977) (declining to apply overbreadth analysis to professional advertising, a form of commercial speech).

258. In *Bates*, the Supreme Court wrote that "the justification for the application of overbreadth analysis applies weakly, if at all, in the ordinary commercial context" because "advertising is linked to commercial well-being," rendering it "unlikely that such speech is particularly susceptible to being crushed by overbroad regulation." *Id.* at 380-81. Clearly this empirical assumption is wrong as it concerns management forecasts and IPO-related liability risk.

259. *See* 447 U.S. at 566. The SEC would be on surer footing if it required companies issuing forecasts to accompany them with disclaimers or explanations. *See In re* R.M.J., 455 U.S. 191, 203 (1982) (explaining that while misleading advertising may be prohibited entirely, the government "may not place an absolute prohibition on certain types of *potentially* misleading information ... if the information also may be presented in a way that is not deceptive.... [T]he remedy in the first instance is not necessarily a prohibition but preferably a requirement of disclaimers or explanation" (emphasis added)).

260. *See Cent. Hudson Gas & Elec. Corp.*, 447 U.S. at 564-66.

Court has not been shy to strike down legislation when the government has failed to satisfy its burden under *Central Hudson*, and has viewed with particular skepticism arguments that speech restrictions are justified by a paternalistic concern that members of the public will make poor decisions if given truthful information.[261]

Second, a rule expressly prohibiting companies from publicly communicating information that is not inherently misleading to reasonable investors (to the contrary, that is incredibly important to, and desired by, reasonable investors), in order to protect unreasonable investors who venture into markets that are unsuitable for them, would be a hard sell politically. This is because, for the reasons discussed above, it is not just constitutionally suspect but also—many will think—bad policy. Filtering this objective through an obscure exclusion from a liability safe harbor conceals the true intention and avoids the scrutiny it would invite if made clear to the American public.

CONCLUSION

Whatever the fate of SPACs, their meteoric rise in recent years has served a valuable function insofar as it has focused regulatory

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261. *See, e.g.*, Thompson v. W. States Med. Ctr., 535 U.S. 357, 374 (2002) ("We have previously rejected the notion that the Government has an interest in preventing the dissemination of truthful commercial information in order to prevent members of the public from making bad decisions with the information."); 44 Liquormart, Inc. v. Rhode Island, 517 U.S. 484, 503 (1996) ("[B]ans against truthful, nonmisleading commercial speech ... usually rest solely on the offensive assumption that the public will respond 'irrationally' to the truth. The First Amendment directs us to be especially skeptical of regulations that seek to keep people in the dark for what the government perceives to be their own good." (citation omitted)); *see also* Greater New Orleans Broad. Ass'n v. United States, 527 U.S. 173, 189, 195-96 (1999) (striking down a ban on casino advertising justified in part by governmental concerns that such advertising would increase demand for gambling). Many scholars have questioned the constitutionality of the SEC's gun-jumping rules, which prohibit the release of truthful information during the pre-filing period of a public offering and regulate the manner in which communications may be made throughout the offering process. *See, e.g.*, Lloyd L. Drury III, *Disclosure Is Speech: Imposing Meaningful First Amendment Constraints on SEC Regulatory Authority*, 58 S.C. L. REV. 757, 780-85 (2007); Aleta G. Estreicher, *Securities Regulation and the First Amendment*, 24 GA. L. REV. 223, 287-91 (1990); Burt Neuborne, *The First Amendment and Government Regulation of Capital Markets*, 55 BROOK. L. REV. 5, 61 (1989); *cf.* Arthur R. Pinto, *The Nature of the Capital Markets Allows a Greater Role for the Government*, 55 BROOK. L. REV. 77, 95-96 (1989) (arguing that the gun-jumping rules represent reasonable time, place, and manner restrictions on speech).

attention on the PSLRA's safe harbor exclusion for IPOs. Before reflexively extending that exclusion to capture communications in connection with de-SPAC mergers, the SEC should pause to understand its purpose and evaluate its wisdom. Indeed, a broader review of the safe harbor—now over a quarter-century old—is well overdue.[262] This Article provides a theoretical account of the safe harbor and its existing exclusions that will prove useful to such an undertaking.

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262. As explained above, the distinction the safe harbor currently draws between tender offers and mergers is nonsensical, and the exclusion for forward-looking statements appearing in financial statements may operate to distort financial reporting standards. *See supra* note 190 and accompanying text. When the SEC sought comment in early 2021 on how to modernize and update Regulation S-K, the Chamber of Commerce "recommended harmonizing the [safe harbor's] treatment of forward-looking information in MD&A and the financial statements." Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information, Securities Act Release No. 33-10890, 86 Fed. Reg. 2,080, 2,104 (Jan. 11, 2021). The Securities Industry and Financial Markets Association also asked the SEC to "expand the statutory safe harbors to apply to all forward-looking statements ... for all transactions and registrants" as well as to "expand the ... statutory safe harbors to cover any forward-looking critical accounting estimates disclosure for all types of companies and transactions (including IPOs)." *Id.* (footnote omitted). The final release adopting amendments to Regulation S-K noted that an expansion of safe harbor protection "would warrant a broader review of the statutory and regulatory safe harbors and any areas where expansion may be necessary or appropriate" and was "therefore beyond the scope of the current rulemaking." *Id.* Any modifications to the safe harbor to address de-SPAC mergers should be part and parcel of such a broader review.