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What's in the Forecast for the SPAC Boom & the PSLRA?

Nick Krone*

In July 2021, Trevor Milton was freed from prison on a \$100 million bond.¹ Milton is the founder, former CEO and executive chairman of Nikola Corporation, an electric vehicle startup.² He had just pleaded not guilty to two counts of securities fraud and one count of wire fraud after being indicted by a federal grand jury.³ The fraud counts alleged Milton lied about “nearly all aspects of the business” to bolster stock sales of the electric vehicle startup.⁴ It is alleged Milton “brazenly and repeatedly used social media, and appearances and interviews on television, podcasts, and in print, to make false and misleading claims about the status of Nikola’s trucks and technology.”⁵

In December 2021, just 18 months after its shares debuted on the NASDAQ, Nikola agreed to pay \$125 million to settle charges brought by the Securities and Exchange Commission (SEC), separate from the criminal fraud charges brought against Milton.⁶ Similar to the criminal suit against Milton, the SEC suit claimed Milton embarked on a public relations campaign aimed at inflating and maintaining Nikola’s stock

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¹ Michael Wayland, *Nikola founder Trevor Milton Pleads not guilty to fraud charges, released on \$100 million bail*, CNBC (July 29, 2021, 2:53 PM), <https://www.cnbc.com/2021/07/29/nikola-founder-trevor-milton-pleads-not-guilty-to-fraud-charges.html>.

² *Id.*

³ *Id.*

⁴ *Id.*

⁵ THE UNITED STATES ATTORNEY’S OFFICE SOUTHERN DISTRICT OF NEW YORK, Press Release, *Former Nikola Corporation CEO Trevor Milton Charged in Securities Fraud Scheme* (July 29, 2021), <https://www.justice.gov/usao-sdny/pr/former-nikola-corporation-ceo-trevor-milton-charged-securities-fraud-scheme>.

⁶ Sam Sutton, *SEC slaps Nikola with \$125M penalty in latest SPAC crackdown* (Dec. 21, 2021, 7:01 AM), <https://subscriber-politicopro-com.ezp.slu.edu/article/2021/12/sec-slaps-nikola-with-125m-penalty-in-latest-spac-crackdown-2100135>.

price, all before it had produced a single commercial product.⁷ More specifically, the SEC's order found that Milton "misled investors about Nikola's technological advancements, in-house production capabilities, hydrogen production, truck reservation orders, and financial outlook."⁸ The order went on to find Nikola "further misled investors by misrepresenting or omitting material facts about the refueling time of its prototype vehicles, the status of its headquarters' hydrogen station, the anticipated cost and sources of electricity for its planned hydrogen production, and the economic risks and benefits associated with its contemplated partnership with a leading auto manufacturer."⁹

Why was Milton allowed to embark on this public relations campaign with lofty projections to inflate Nikola's stock before it went public? After all, in the run-up to an initial public offering, startups typically hunker down in a quiet period, keeping their executives out of the media to avoid running afoul of regulatory requirements.¹⁰ These regulatory requirements are imposed by the SEC to prevent companies from marketing their stock to unsophisticated investors outside of the normal regimented process.¹¹ Milton was allowed to make these projections and vigorously promote Nikola stock because Nikola was going public via a special purpose acquisition company (SPAC) versus a traditional IPO.¹²

A SPAC is a shell company that has no commercial operations and is formed strictly to raise capital through an IPO for the purpose of

⁷ SEC, Press Release, *Nikola Corporation to Pay \$125 Million to Resolve Fraud Charges* (Dec. 21, 2021), <https://www.sec.gov/news/press-release/2021-267>.

⁸ *Id.*

⁹ *Id.*

¹⁰ INVESTOR.GOV, *Quiet Period*, <https://www.investor.gov/introduction-investing/investing-basics/glossary/quiet-period> (last visited Jan. 8, 2022).

¹¹ *Id.*

¹² REUTERS, *Nikola Corp to go public at over \$3.3 billion valuation* (Mar. 3, 2020, 6:23 AM), <https://www.reuters.com/article/us-nikola-corp-vectoiq/nikola-corp-to-go-public-at-over-3-3-billion-valuation-idUSKBN20Q1J5>.

acquiring or merging with an existing company.¹³ SPACs are commonly referred to as blank check companies because they do not have an established business plan.¹⁴ A SPAC conducts an IPO to raise capital from a mix of institutional and retail investors.¹⁵ Typically, 100% of the cash raised in the IPO is placed in a trust account and not released until the SPAC completes a business combination or upon a specified outside date if the SPAC fails to complete a business combination by such time.¹⁶ A SPAC generally has two years to complete a deal or face liquidation.¹⁷ In order to compensate investors for agreeing to have their capital held in the trust account for such period, a SPAC generally offers units in its IPO, each comprised of one share of common stock and a warrant to purchase common stock.¹⁸ A warrant is a right, but not an obligation, to acquire securities from the issuer at a set price during a specified period.¹⁹ The warrant portion of the unit is intended to provide investors with this extra compensation.²⁰

A key difference between SPACs and traditional IPOs concerns differences in disclosure-based liability exposure.²¹ One prominent 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).²² The PSLRA is a provision that makes it harder for investors to win a lawsuit

¹³ Julie Young, *Special purpose Acquisition Company (SPAC)*, INVESTOPEDIA (Oct. 16, 2021), <https://www.investopedia.com/terms/s/spac.asp>.

¹⁴ Gordon Scott, *Blank Check Company*, INVESTOPEDIA (Sept. 29, 2021), <https://www.investopedia.com/terms/b/blankcheckcompany.asp>.

¹⁵ Special Purpose Acquisition Company, Practical Law Glossary Item w-028-3768.

¹⁶ *Id.*

¹⁷ See Young, *supra* note 13.

¹⁸ Special Purpose Acquisition Company, Practical Law Glossary Item w-028-3768.

¹⁹ Warrant, Practical Law Glossary Item 5-382-3907.

²⁰ Special Purpose Acquisition Company, Practical Law Glossary Item w-028-3768.

²¹ Amanda M. Rose, SPAC MERGERS, IPOS, AND THE PSLRA'S SAFE HARBOR: UNPACKING CLAIMS OF REGULATORY ARBITRAGE. *Available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3945975.

²² *Id.*

alleging that forward-looking statements were misleading.²³ A SPAC is protected by the PSLRA's safe harbor provision when it shares its target's growth projections with investors, a traditional IPO is not.²⁴ This allows for regulatory arbitrage, which is the practice whereby firms capitalize on loopholes in regulatory systems in order to circumvent unfavorable regulations.²⁵ Lawmakers and the SEC have recently called for reform that would remove SPACs from the protection of the PSLRA's safe harbor and force them to follow the same rules traditional IPOs must conform to as it relates to forward-looking statements.²⁶

But are these proposed regulations that would strip SPACs of the PSLRA's safe harbor necessary? If forward-looking statements were eliminated to shield unreasonable investors, it would come at the expense of reasonable investors.²⁷ Reasonable investors want forward-looking information to make informed investment decisions.²⁸ An issue regulators are trying to address is retail investors have on average paid inflated prices for SPAC shares after the announcement of a business combination.²⁹ But is this a result of overreliance on forward-looking statements or is it lack of comprehension regarding other elements of a typical SPAC? Traditional IPO issuers do not provide any forecasts to the market, and yet there are still large runups in IPO share prices when aftermarket trading commences.³⁰ If unreasonable investors trading in inefficient markets misvalue stocks when exposed to management forecasts, they will also misvalue stocks for a myriad of other reasons, including lack of financial acumen.³¹

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*, Adam Hayes, *Regulatory Arbitrage*, INVESTOPEDIA (June 29, 2021), <https://www.investopedia.com/terms/r/regulatory-arbitrage.asp>.

²⁶ *Rose, supra* note 27.

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

With so many unknowns as to the motivations of unreasonable investors, it is not clear that eliminating safe harbor protections of SPACs will have the intended effects regulators are currently setting out to effectuate. Therefore, Congress and the SEC should first explore these motivations before passing legislation or rules addressing SPACs and the PSLRA. But regulators must act swiftly in this effort because as the SPAC boom continues, it is only a matter of time before the next Nikola emerges.

Edited by Alex Beezley