The Need for Regulation of Private Equity: Evidence from De-SPAC Transactions

Sureyya Burcu Avci,[*] Cindy A. Schipani,[**] and H. Nejat Seyhun[***]

ABSTRACT: In this Article, we examine whether regulation is needed to protect investors in private equity. We do this by analyzing the performance of de-SPAC transactions that solicited private investment. These private investments in public equity are known as PIPEs. Because PIPE returns are publicly available, we are empirically able to determine whether the limited PIPE investors are getting a fair deal in these investments. We find that de-SPAC investors lose about forty-five percent of their investment within two years of the de-SPAC transactions. Furthermore, we find that almost all these losses are limited to those cases when the SPAC sponsors resort to PIPE financing, losing about fifty-five percent of their value abnormally. Hence, our evidence suggests that limited private-fund investors suffer substantial and systematic losses when they make PIPE investments in de-SPAC transactions. Our evidence at least partially justifies the SEC's new rules regarding the regulation of the private funds industry. Moreover, the need to address this matter has become more urgent in light of the August 7, 2025, executive order further opening pension funds' access to private equity markets, thus also exposing the retirement investments of retail investors to these risks.

[*] Adjunct Lecturer, Vanderbilt University.

[**] Merwin H. Waterman Collegiate Professor of Business Administration and Professor of Business Law, University of Michigan.

[***] Jerome B. & Eilene M. York Professor of Business Administration and Professor of Finance, University of Michigan.

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Introduction

Prior to August 2023, the private fund industry had been lightly regulated, and the regulations were limited to internal controls, ethics codes, and anti-money laundering practices. This was considered appropriate because small retail investors were not allowed to participate in private funds. Instead, only accredited investors, such as institutions, retirement funds, and wealthy individuals, could invest in these funds.[1] Individuals can also qualify as accredited investors by holding specific positions, such as director, executive officer, or general partner of the issuer of the securities.[2] Accredited investors are

1. 17 C.F.R. §§ 230.501(a)(5)–(6), 230.506(b)–(c) (2025); Net Worth Standard for Accredited Investors, 76 Fed. Reg. 81793 (Dec. 29, 2011) (codified at 17 C.F.R. pts. 230, 239, 270, 275) (adopting Net Worth Standard for Accredited Investors).

2. *See* 17 C.F.R. § 230.501(a)(4) (defining "accredited investor" to include "[a]ny director, executive officer, or general partner of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of that issuer"); *id.* § 230.501(a)(10) (defining "accredited investor" to include "[a]ny natural person holding in good standing one or more professional certifications or designations or credentials from an accredited educational institution that the Commission has designated as qualifying an individual for accredited investor status"). As of 2020, the qualifying professional certifications are "the General Securities Representative license (Series 7), the Private Securities Offerings Representative license (Series

presumed to be able to protect themselves without the Securities and Exchange Commission's ("SEC") oversight.[3]

In 2023, the SEC instituted new regulations governing private investments, requiring additional disclosures to prevent conflicts of interest, fraud, deception, and manipulation by private investment advisers.[4] The new rules required greater transparency regarding compensation schemes, sales practices, and potential conflicts of interest in the private funds industry.[5] In particular, the SEC required that fees and expense structures be disclosed to investors within forty-five days of the end of the fiscal quarter and allowed limited shareholder clawback of these fees in certain situations.[6] Charging for expenses on a non-pro rata basis required advance notice.[7] Any borrowings by the fund required both advance notice and client consent.[8]

The SEC's attempts to bring greater transparency were, however, thwarted in June 2024 when the Fifth Circuit Court of Appeals in *National Ass'n of Private Fund Managers v. SEC* unanimously vacated the SEC's new rules.[9] The court found that the SEC did not have the authority to promulgate these regulations in part because it had not established, with specificity, a link between the new rules and the prevention of fraud or deception.[10] This is true even though many retail investors are already exposed to private fund risks in a limited way through their investments in mutual funds and pension funds. The SEC is authorized to protect small retail investors.

The Fifth Circuit thus put the SEC squarely in a classic catch-22. Without regulation requiring disclosures, there is little data on private funds to determine whether the disclosures are complete, accurate, and timely, or whether they are insufficient and deceptive. Without data, it is nearly impossible to satisfy the court's requirements for specificity; thus, there is no regulation.

The SEC's 2023 attempts to bring greater transparency are made even more relevant in 2025 since the new SEC chair, Paul Atkins, expressed an interest in expanding the availability of private equity investments to a broader swath of investors, including small retail investors.[11] One way to

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82), and the Investment Adviser Representative license (Series 65)." Order Designating Certain Professional Licenses as Qualifying Natural Persons for Accredited Investor Status, 85 Fed. Reg. 64234, 64234 (Oct. 9, 2020) (codified at 17 C.F.R. pt. 230).

3. *See* U.S. SEC. & EXCH. COMM'N, REVIEW OF THE "ACCREDITED INVESTOR" DEFINITION UNDER THE DODD-FRANK ACT 34–35 (2023), https://www.sec.gov/files/review-definition-accredited-investor-2023.pdf [https://perma.cc/N7XZ-9TYB].

4. 17 C.F.R. § 275; *see* U.S. SEC. & EXCH. COMM'N, FACT SHEET: PRIVATE FUND ADVISER REFORMS: FINAL RULES 1 [hereinafter SEC FACT SHEET], https://www.sec.gov/files/ia-6383-fact-sheet.pdf [https://perma.cc/93SE-W3HE].

5. 17 C.F.R. § 275; *see* SEC FACT SHEET, *supra* note 4, at 1.

6. 17 C.F.R. § 275.211(h)(2)–(1)(a).

7. *Id.* § 275.211(h)(2)–(1)(a)(4)(ii); *see* SEC FACT SHEET, *supra* note 4, at 3.

8. 17 C.F.R. § 275.211(h)(2)–(1)(a); *see* SEC FACT SHEET, *supra* note 4, at 3.

9. *See generally* Nat'l Ass'n of Priv. Fund Managers v. SEC, 103 F.4th 1097, 1101 (5th Cir. 2024) (invalidating the SEC's 2023 Private Fund Advisers Rules).

10. *Id.* at 1113–14.

11. *See* Paul S. Atkins, *Prepared Remarks Before SEC Speaks*, U.S. SEC. & EXCH. COMM'N (May 19, 2025), https://www.sec.gov/newsroom/speeches-statements/atkins-prepared-remarks-sec-s

do this might be to increase the amounts mutual funds and pension funds can invest in private funds, such as private equity and hedge funds, without having to restrict their sales to accredited investors.[12] Moreover, the President signed an executive order on August 7, 2025, requiring the Department of Labor to reexamine fiduciary standards under the Employment Retirement Income Security Act of 1974 ("ERISA")[13] to make available, among other alternative assets, investments in private markets.[14] These relaxations of the current standards will make small retail investors even more exposed to private equity, thus increasing the need for closer supervision.

We address this catch-22 problem by examining the performance of private investments in public equity ("PIPEs"). Because the private investment occurs in public equity, we have publicly available information from which we can deduce whether the limited partner ("LP") investors are getting a fair deal. The evidence suggests that private LP investors suffer substantially and systematically when they make PIPE investments in special purpose acquisition companies ("SPACs") to fund a merger into a target company ("de-SPACs"). De-SPAC transactions involve a SPAC combining with a private company, thereby taking the private company public. We deduce that general partners ("GPs") of PIPEs are conflicted—they seem to invest in de-SPACs even when these investments are not in the best interest of the LP equity investors. Furthermore, GPs of private equity funds are considered investment advisers by the SEC and hence are subject to distinct fiduciary requirements.[15] Any

peaks-051925 [https://perma.cc/7PBM-QS6E]; *see also* Dylan Tokar & Matt Wirz, *SEC Chair Signals Investor Access to Private Markets Could Soon Broaden*, WALL ST. J. (May 19, 2025, 12:16 PM), https://www.wsj.com/finance/investing/sec-chair-paul-atkins-private-markets-investors-d6d37e3a (on file with the *Iowa Law Review*).

12. Miriam Gottfried, Dylan Tokar & Matt Wirz, *Trump Executive Order to Help Open Up 401(k)s to Private Markets*, WALL ST. J. (July 15, 2025, 7:10 PM), https://www.wsj.com/finance/investing/trump-executive-order-to-help-open-up-401-k-s-to-private-markets-c90c6788 (on file with the *Iowa Law Review*).

13. Employment Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (codified as amended in scattered sections of 26 and 29 U.S.C.).

14. *See* Exec. Order No. 14330, Democratizing Assets to Alternative Assets for 401(k) Investors, 90 Fed. Reg. 38921, 38921 (Aug. 12, 2025).

15. This is consistent with jurisprudence holding that GPs who manage investments and receive compensation for said management are considered investment advisers under the Investment Advisers Act.

> An investment adviser is an individual or firm that is engaged in the business of providing investment advice to others or issuing reports or analyses about securities for compensation. Investment advisers may include money managers, investment consultants, financial planners, general partners of private funds, and others who are compensated for providing advice about securities. Investment advisers are required to register with the SEC or applicable state securities regulators as a registered investment adviser unless they are exempt from applicable registration requirements (for example, as an exempt reporting adviser).

Glossary, U.S. SEC. & EXCH. COMM'N (Aug. 20, 2025), https://www.sec.gov/resources-small-businesses/cutting-through-jargon-z [https://perma.cc/D3YA-K26Q]; *see also* 15 U.S.C. § 80b-2(a)(11) (2018).

investment that benefits the GPs while hurting the LPs is likely to be considered a violation of the GP's fiduciary responsibilities.[16]

From a doctrinal standpoint, even with full, accurate, and timely disclosures, there are built-in conflicts between GPs and LPs due to the rules of private equity. These investments will benefit the GPs (i.e., the advisers) even when their outside investors or LPs lose based on typical compensation rules. These conflicts arise because GPs will be compensated simply by making a de-SPAC, thereby earning annual management fees as a percentage of initial investment or one-time deal initiation fees, regardless of performance. Conflicts can also arise when GPs receive separate private benefits on the side (i.e., monitoring fees), while the LPs' compensation depends solely on the eventual performance of the de-SPAC firm. Furthermore, economists Andrew Metrick and Ayako Yasuda empirically show that, on average, "about two-thirds of the expected revenue" for the GPs comes from fixed components that are insensitive to performance, thereby exacerbating the conflict of interest between the GPs and LPs.[17] Thus, at a minimum, a structural potential conflict of interest is typically in play, at least theoretically justifying the SEC's new rules to provide greater transparency and disclosure of conflicts of interest to investors in private equity.

This Article proceeds as follows. Part I provides an overview of the private funds industry, followed by a discussion of the SEC rules regulating private funds in Part II. Part III then analyzes cases that seem to curtail the regulatory authority of administrative agencies. Part IV assesses the structure of de-SPAC transactions and the impact on PIPE investments. Part V continues with a discussion of SEC regulations regarding special purpose acquisition companies' private equity investments in public equity. We provide an empirical analysis in Part VI, concluding that the data provide direct empirical evidence further justifying the necessity of SEC regulation to disincentivize conflicted and overzealous private fund general partners. Our policy recommendations and concluding remarks then follow.

I. PRIVATE FUNDS INDUSTRY

Most private equity funds are organized as closed-end funds where GPs manage the fund and LPs provide the capital. The funds generally have a fixed life of approximately ten years.[18] GPs typically provide one percent of the total capital, while the remainder comes from LPs and debt capital.[19]

Private funds, estimated to exceed $30 trillion in 2025, provide important equity and credit funding to small, nonpublic firms.[20] By definition, these

16. However, in Delaware, where most private investment funds are formed, the fiduciary requirements can be modified or waived by the limited partnership agreement. *See* William W. Clayton, *The Private Equity Negotiation Myth*, 37 YALE J. ON REGUL. 67, 77 (2020).

17. *See* Andrew Metrick & Ayako Yasuda, *The Economics of Private Equity Funds*, 23 REV. FIN. STUD. 2303, 2305 (2010).

18. *See id.* at 2309.

19. *Id.* at 2315; Steven N. Kaplan & Per Strömberg, *Leveraged Buyouts and Private Equity*, 23 J. ECON. PERSPS. 121, 123 (2009).

20. *See* Atkins, *supra* note 11.

investments are private, illiquid, and have high levels of business risk.[21] Private equity funds typically bar their LPs from selling their holdings for years, resulting in extreme illiquidity for the shareholders. Private investments are typically made in high-default-risk private firms in need of capital, thus presenting a high-risk profile. There is no public trading of their portfolio companies' shares, resulting in extreme opacity regarding the value of the private equity holdings. Fund managers use self-reported portfolio values to price these investments, resulting in artificially smooth pricing even when the true market value of the portfolio investments can fluctuate wildly. Because of this, estimated net asset values reported to the LPs can diverge greatly from the true market values.[22]

Private equity uses higher leverage than publicly held firms.[23] A typical buyout is "financed with 60 to 90 percent debt."[24] Hedge funds' use of leverage varies between 20% to 5.8 times their equity, with relative value and macro strategies topping the list.[25] These extremely high levels of leverage result in higher financial risk.

Finally, private funds are expensive to manage. Private fund GPs charge one-time deal fees, also known as transaction fees,[26] an annual management fee, a share of the profits of the fund called carried interest, plus annual monitoring fees to the companies they invest in.[27] Total fees that GPs charge can eat sixty percent or more of the gross returns on investors' capital.[28] Net of fees, some recent studies suggest that private equity funds underperform

21. While hedge funds are also private, they invest in liquid publicly traded securities, thereby providing transparency to their LPs. Metrick & Yasuda, *supra* note 17, at 2318 ("Our model uses a risk-neutral approach . . . Since private securities are illiquid, the reality is far from this perfect-markets ideal.").

22. *See* Wonho Wilson Choi, Andrew Metrick & Ayako Yasuda, *A Model of Private Equity Fund Compensation* 3 (Nat'l Bureau of Econ. Rsch., Working Paper No. 17568, 2011), https://www.nber.org/system/files/working_papers/w17568/w17568.pdf [https://perma.cc/D2D9-AGEM]. Valuation Research Corporation reports that secondary market prices are at ten percent to thirty percent discounts to the net asset values for LP sellers. *See* John Czapla, *Valuation Dynamics of Secondary Transactions*, VALUATION RSCH. CORP., https://www.valuationresearch.com/insights/valuation-secondary-transactions [https://perma.cc/3FGE-5CJP].

23. *See* Yang Liu & Lue Xiong, *Leverage in Private Equity: What Do We Know?*, MSCI (Sept. 9, 2024), https://www.msci.com/research-and-insights/blog-post/leverage-in-private-equity-what-do-we-know [https://perma.cc/275C-HFAQ]; Kaplan & Strömberg, *supra* note 19, at 124–25.

24. *See* Kaplan & Strömberg, *supra* note 19, at 124.

25. *See Hedge Fund Monitor: Leverage*, OFF. FIN. RSCH., https://www.financialresearch.gov/hedge-fund-monitor/categories/leverage/chart-28 [https://perma.cc/PTD5-GBD9].

26. *See* Metrick & Yasuda, *supra* note 17, at 2319.

27. *See id.* at 2314–16; *see also* Kaplan & Strömberg, *supra* note 19, at 123–24.

28. *See* Kaplan & Strömberg, *supra* note 19, at 124; *see also* Itzhak Ben-David, Justin Birru & Andrea Rossi, *The Performance of Hedge Fund Performance Fees* 1 (Ohio State Univ. Fisher Coll. of Bus., Working Paper No. 2020-03-014, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3630723 [https://perma.cc/DRP7-9SWV]; Tim Jenkinson, Hyeik Kim & Michael S. Weisbach, *Buyouts: A Primer* 22–28 (Ohio State Univ. Fisher Coll. of Bus., Working Paper No. 2021-03-018, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3964770 [https://perma.cc/9ESD-GF2E].

compared to the S&P 500 index, even though private equity carries much higher levels of financial risk, business risk, and liquidity risk.[29]

Although some accredited investors may be able to evaluate the appropriateness of a particular private investment, many are troubled with the opacity and conflicts of interest in the industry. In 2024, CalPERS, the largest pension fund in the United States, trimmed private investments over concerns regarding the lack of information on private funds' portfolio companies' labor practices.[30] Similarly, a Michigan pension fund sued Vista Equity Partners in 2024 for conflicts of interest in its approval of the take-private acquisition of a company it controlled, Cvent.[31] The pension fund claimed that "Vista received unique consideration not shared with Cvent's minority stockholders" in the sale and thereby breached its fiduciary duties as a controlling shareholder.[32] The Michigan pension fund claimed that it received $8.50 per share consideration, while Cvent was valued by Vista at $10.[33] Moreover, Vista invested its "stock into a new, bespoke, better-than-market preferred security in the newly private company."[34] Furthermore, some pension funds themselves have been sued by retirees for "risky and high-cost hedge fund and private equity investments" causing "massive losses and enormous excess fees," and charging violations of ERISA's fiduciary responsibilities.[35]

Given high levels of business and financial risks, illiquidity, opacity, and high costs, it is clear that private investments are not suitable for small retail investors or even many sophisticated, institutional, and accredited individual investors. Nevertheless, these private investments are finding their way into retail investors' portfolios through mutual funds, pension funds, 401(k) plans, and other retirement vehicles.[36] As of 2025, rules allowed mutual funds

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29. *See* Kaplan & Strömberg, *supra* note 19, at 136. The underperformance typically occurs because of high fees. Suppose that a private equity firm raised $2 billion in capital commitments from its limited partners, and ten years later, realizes $3 billion by selling its investments. The GPs would then get $400 million in total management fees (10 times $40 million per year, or 2% of $2 billion) and $200 million in carried interest (20% of the $1 billion gross returns), or a total of $600 million or 60% of the gross returns, even excluding deal fees and monitoring fees. The LPs would receive the remainder $400 million.

30. *See* Heather Gillers, *Calpers Trims Investments over Labor Practices*, WALL ST. J. (June 10, 2024, 6:23 PM), https://www.wsj.com/livecoverage/stock-market-today-dow-sp500-nasdaq-live-o6-10-2024/card/calpers-trims-investments-over-labor-practices-1ML2053ApIkleKAUQvbK (on file with the *Iowa Law Review*).

31. Verified Stockholder Class Action Complaint at 1–9, Genesee Cnty. Emps.' Ret. Sys. v. Vista Equity Partners Mgmt., No. 2024-0299 (Del. Ch. Mar. 28, 2024), 2024 WL 1484081.

32. *Id.* at 2; Palash Ghosh, *Michigan Pension Fund Sues Vista Equity Partners over Sale Price of Cvent*, PENSIONS & INVS. (Apr. 2, 2024, 1:29 PM), https://www.pionline.com/courts/michigan-pension-fund-sues-vista-equity-partners-over-sale-price-cvent [https://perma.cc/TB4V-96QB].

33. Verified Stockholder Class Action Complaint, *supra* note 31, at 4.

34. *Id.* at 1.

35. Complaint at 1, Sulyma v. Intel Corp. Inv. Pol'y Comm., No. 15-CV-04977 (N.D. Cal. Oct. 29, 2015), *rev'd and remanded*, 909 F.3d 1069, 1078 (9th Cir. 2018), *aff'd*, 589 U.S. 178, 180 (2020); Vincent Pitaro, *Class Action Lawsuit May Affect Retirement Plan Allocations to Hedge Funds*, HEDGE FUND L. REP. (Nov. 12, 2015), https://www.hflawreport.com/2550171/class-action-lawsuit-may-affect-retirement-plan-allocations-to-hedge-funds.thtml (on file with the *Iowa Law Review*).

36. Deloitte Center for Financial Services estimates that "retail investors' allocations to private capital will grow exponentially by 2030, from an estimated US$80 billion to US$2.4

to invest up to fifteen percent of their assets in private funds, without requiring accreditation from individual investors. On May 19, 2025, however, SEC Chairman Paul Atkins announced that the fifteen percent upper limit rule is likely to be eliminated soon, allowing retail investors to invest greater amounts directly in private funds.[37] Chairman Atkins explained that eliminating the rule "could increase investment opportunities for retail investors," who "have missed out on" private market growth as private fund assets have tripled in the past ten years.[38] Greater access to private funds by retail investors is likely to lead to highly inappropriate investments because retail investors generally lack the sophistication of accredited investors.

II. PRIVATE FUND ADVISERS RULES OVERVIEW

A private fund is a "privately offered investment vehicle[]" that aggregates capital "from one or more investors and invest[s] in securities and other instruments or investments."[39] Under 15 U.S.C. § 77d, issuer transactions that do not involve a public offering are exempted from securities law, which mandates that each purchaser is an accredited investor.[40] According to the SEC, accredited investors are "able to fend for themselves" as the offerings directed toward them are often accompanied by minimal disclosures, higher risks, or involve intricate investment strategies.[41] Some studies, however, question the ability of accredited investors to better protect themselves through negotiation.[42]

To qualify as an accredited investor, an individual typically must have a net worth exceeding $1 million or an annual income exceeding $200,000.[43] Individuals can also qualify as accredited investors by holding specific professional licenses or meeting other professional criteria.[44] Given their

trillion in the United States, and more than triple in the European Union—from €924 billion to €3.3 trillion." Eric Fox & Sean Collins, *Increasing Retail Client Exposure to Private Capital Investing*, DELOITTE CTR. FOR FIN. SERVS. (Apr. 24, 2025), https://www.deloitte.com/us/en/insights/industry/financial-services/financial-services-industry-predictions/2025/private-capital-investing.html [https://perma.cc/6YBA-CKLD].

37. Atkins, *supra* note 11.

38. *Id.*

39. Private Fund Advisers; Documentation of Registered Investment Adviser Compliance, Investment Advisors Act Release No. 6383, 88 Fed. Reg. 63206, 63207 (Sept. 14, 2023).

40. *See* 15 U.S.C. § 77d(a)(2).

41. *See* U.S. SEC. & EXCH. COMM'N, *supra* note 3, at 34.

42. INT'L MONETARY FUND, GLOBAL FINANCIAL STABILITY REPORT 73–74 (2024), https://www.imf.org/-/media/Files/Publications/GFSR/2024/April/English/text.ashx [https://perma.cc/J4SB-C2GA].

43. *See* 17 C.F.R. § 230.501(a)(5)–(6) (2024). Previously, the thresholds for those who qualified as accredited investors were lower and thus encompassed a broader category of investors. *See* Net Worth Standard for Accredited Investors, 76 Fed. Reg. 81793, 81804 (Dec. 29, 2011) (codified at 17 C.F.R. pts. 230, 239, 270, 275); *"Accredited Investor" Net Worth Standard*, U.S. SEC. & EXCH. COMM'N (Feb. 5, 2024), https://www.sec.gov/resources-small-businesses/small-business-compliance-guides/accredited-investor-net-worth-standard [https://perma.cc/FS5E-GKZF].

44. *See* 17 C.F.R. § 230.501(a)(4) (defining "accredited investor" to include "[a]ny director, executive officer, or general partner of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of that issuer"); *id.* § 230.501(a)(10)

comparatively high earnings and net worth, as well as their specialized education and experience in finance, accredited investors are considered more financially sophisticated than the average investor.[45]

The SEC's criteria for who qualifies as an accredited investor have been subject to much criticism. For example, on February 8, 2023, Jennifer J. Schulp, the Director of Financial Regulation Studies at the Cato Institute, testified in front of the House Subcommittee on Capital Markets concerning the pitfalls of the SEC's accredited investor definition.[46] In her statement, Schulp noted that wealth is not an appropriate "proxy for financial sophistication."[47] Moreover, the high threshold for income and net worth effectively prohibits anyone who is not currently wealthy from accessing the private capital market, which is larger than the public market.[48] Nonetheless, SEC rulemaking continued to reflect the view that accredited investors require fewer protections

(defining "accredited investor" to include "[a]ny natural person holding in good standing one or more professional certifications or designations or credentials from an accredited educational institution that the Commission has designated as qualifying an individual for accredited investor status"). As of 2020, the qualifying professional certifications are the General Securities Representative license (Series 7), the Private Securities Offerings Representative license (Series 82), and the Investment Adviser Representative license (Series 65). *See* Order Designating Certain Professional Licenses as Qualifying Natural Persons for Accredited Investor Status, 85 Fed. Reg. 64234, 64234 (Oct. 9, 2020) (codified at 17 C.F.R. pt. 230).

45. In addition to wealth, the SEC considers:

> [T]he ability to adequately analyze the risks and rewards, the capacity to allocate investments in such a way as to mitigate or avoid risks of unsustainable loss, or the ability to gain access to information about an issuer or about an investment opportunity—or the ability to assess and mitigate the risk of a loss [to determine whether an accredited investor is financially sophisticated].

U.S. SEC. & EXCH. COMM'N, *supra* note 3, at 35.

46. *Sophistication or Discrimination? How the "Accredited Investor" Definition Unfairly Limits Investment Access for the Non-Wealthy and the Need for Reform: Hearing Before the Subcomm. on Cap. Mkts. of the H. Comm. on Fin. Servs.*, 118th Cong. 9–10 (2023) (statement of Jennifer Schulp, Dir. of Fin. Regul. Stud., Ctr. for Monetary and Fin. Alts., Cato Inst.).

47. *Id.* Using wealth as a proxy "lumps the elderly with substantial retirement savings and lottery winners with windfall profits in with people whose earnings have depended on some financial know-how." *Id.* at 9.

48. Moses v. Carnahan, 186 S.W.3d 889, 908 (Mo. Ct. App. 2006) ("Accordingly, although this is something of an oversimplification, reduced to its essence, 15 CSR 30–54.215 essentially allows certain wealthier individual investors and large business entities to knowingly forego the benefits of the registration requirements of the securities laws."); *Sophistication or Discrimination?*, *supra* note 46, at 9–10; *see also* Mark M. Goldberg, *Haves and Have Nots: The Illusory Promise of SEC Investor Protection*, INV. NEWS (May 16, 2024), https://www.investmentnews.com/opinion/haves-and-have-nots-the-illusory-promise-of-sec-investor-protection/253444 [https://perma.cc/A6WQ-HKT2].

due to their financial sophistication until 2023.[49] Correspondingly, private funds have been historically less regulated than other financial tools.[50]

Despite its traditional approach, in 2023, the SEC adopted new rules requiring various disclosures from private funds, thus attempting to address the opacity, governance, and conflicts of interest issues.[51] In its original rule proposal, the Commission explained that despite its examination and enforcement efforts since Congress enacted the Dodd–Frank Act in 2010,[52] it had observed persistent problems.[53] In particular, the Commission noted that conflicts of interest and inadequate governance mechanisms continued to pose risks to investor protection.[54] Further amplifying the ongoing risk, the former SEC Chair, Gary Gensler, noted the interconnected nature of financial markets, stating that "[p]rivate funds and their advisers play an important role in nearly every sector of the capital markets."[55] Former Chair Gensler claimed that the proposed rules would benefit "all investors—big or small, institutional or retail, sophisticated or not."[56] The SEC also noted the near tripling of private funds over the last decade, explaining that these funds "play an increasingly important role in the lives of millions of Americans."[57] The Commission did not draw a connection to its prevailing view that accredited investors are more sophisticated and knowledgeable than average.[58] Rather, the justifications for the Private Fund Advisers Rules ("PFA Rules") focused on the interconnected nature of today's economy.

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49. The regulation explicitly states that accredited investors are deemed to have sufficient knowledge in financial matters to evaluate the risks of investments. 17 C.F.R. § 230.501(a)(10)(iii). This implies that accredited investors require fewer protections compared to non-accredited investors. *See* U.S. SEC. & EXCH. COMM'N, *supra* note 3, at 13; David Brummer, *Qualified Purchaser vs Accredited Investor: Key Differences*, OURCROWD (Apr. 2, 2024), https://www.ourcrowd.com/learn/qualified-purchaser-vs-accredited-investor [https://perma.cc/9HLC-LYK5].

50. *See* Goldstein v. SEC, 451 F.3d 873, 875–77 (D.C. Cir. 2006) (noting that the Investment Company Act of 1940 exempts private funds from many regulatory requirements because of the understanding that private investments have limited public exposure and a sophisticated investment base, and thus are historically less regulated); U.S. SEC. & EXCH. COMM'N, *supra* note 3, at 13–14; *see also* Brummer, *supra* note 49.

51. *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Enhances the Regulation of Private Fund Advisers (Aug. 23, 2023), https://www.sec.gov/newsroom/press-releases/2023-155 [https://perma.cc/VSC6-98M6].

52. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of the U.S.C.).

53. *See* Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 87 Fed. Reg. 16886, 16887–90 (proposed Mar. 24, 2022) (finding persistent problems in which investors did not have sufficient information on the private investments or potential conflicts of interest to make informed decisions); SEC FACT SHEET, *supra* note 4, at 1.

54. The SEC cited examples of recent enforcement actions to support its finding of ongoing risk, including a settled action "alleging private fund adviser misallocated more than $17 million in so-called 'broken deal' expenses to its [adviser's] flagship private equity fund" and an action where an "adviser improperly allocated approximately $2 million of compensation-related expenses to three private equity funds [the adviser] advised." Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 87 Fed. Reg. at 16888 n.10.

55. Press Release, U.S. Sec. & Exch. Comm'n, *supra* note 51.

56. *Id.*

57. *See* SEC FACT SHEET, *supra* note 4, at 1.

58. *See* U.S. SEC. & EXCH. COMM'N, *supra* note 3, at 35–36.

On August 23, 2023, the SEC adopted the PFA Rules.[59] The PFA Rules set out a series of regulations and requirements intended to regulate private fund advisers more stringently.[60] They set out requirements for all private fund advisers, regardless of registration status.[61] In addition, under the rules, registered private fund advisers were required to comply with several additional disclosure requirements, including those provided in the Quarterly Statement Rule,[62] the Private Fund Audit Rule,[63] the Adviser-Led Secondaries Rule,[64] and the Books and Records Rule Amendments.[65] The Quarterly Statement Rule required registered private funds to circulate quarterly statements to investors.[66] These statements needed to include information regarding fund performance, fees and expenses, and adviser compensation.[67] The Private Funds Audit Rule required registered private funds to undergo a financial statement audit.[68] The Adviser-Led Secondaries Rule required registered private fund advisers to obtain an independent fairness or valuation report "when offering existing fund investors the option between selling their interests in a private fund and converting or exchanging their interests in the private fund for interests in another vehicle advised by the adviser or any of its related persons."[69] Finally, the PFA Rules also included "amendments to the books and records rule under the Advisers Act for registered private fund advisers."[70]

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59. *See* Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 88 Fed. Reg. 63206 (to be codified at 17 C.F.R. pt. 275); Michael P. Calabrese et al., *SEC Adopts New Private Funds Rules: Key Takeaways for Private Fund Advisers and Investors*, FOLEY & LARDNER LLP (Aug. 28, 2023), https://www.foley.com/insights/publications/2023/08/sec-adopts-new-private-funds-rules-key-takeaways [https://perma.cc/3YRH-5NWA].

60. *See* SEC FACT SHEET, *supra* note 4, at 1.

61. *See* 17 C.F.R. pt. 275 (2025); SEC FACT SHEET, *supra* note 4, at 1.

62. 17 C.F.R. § 275.211(h)(1)-2 (2024), *repealed by* Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 89 Fed. Reg. 91252, 91253 (Nov. 19, 2024); *see* SEC FACT SHEET, *supra* note 4, at 2.

63. 17 C.F.R. § 275.206(4)-10, *repealed by* Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 89 Fed. Reg. at 91253; *see* SEC FACT SHEET, *supra* note 4, at 2.

64. 17 C.F.R. § 275.211(h)(2), *repealed by* Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 89 Fed. Reg. at 91253; *see* SEC FACT SHEET, *supra* note 4, at 2.

65. 17 C.F.R. § 275.204-2 (2025); *see* SEC FACT SHEET, *supra* note 4, at 2.

66. 17 C.F.R. § 275.211(h)(1)-2(a) (2024), *repealed by* Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 89 Fed. Reg. at 91253; *see* SEC FACT SHEET, *supra* note 4, at 2.

67. 17 C.F.R. § 275.211(h)(1)-2(b), *repealed by* Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 89 Fed. Reg. at 91253; *see* SEC FACT SHEET, *supra* note 4, at 2.

68. 17 C.F.R. § 275.206(4)-10(a), *repealed by* Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 89 Fed. Reg. at 91253; *see* SEC FACT SHEET, *supra* note 4, at 2.

69. SEC FACT SHEET, *supra* note 4, at 2; 17 C.F.R. § 275.211(h)(2)-2, *repealed by* Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 89 Fed. Reg. at 91253.

70. SEC FACT SHEET, *supra* note 4, at 2; *see also* 17 C.F.R. § 275.204-2(e)(1) (2025) (requiring registered advisers to maintain records relating to their investment advisory businesses "in an

The PFA rules required all private fund advisers to comply with the Restricted Activities[71] and Preferential Treatment Rules.[72] The Restricted Activities Rule set out certain prohibited activities for private fund advisers that are considered to introduce conflicts of interest or danger to the public interest.[73] The Preferential Treatment Rule prohibited preferential treatment that has a material negative impact on other investors and prohibited private fund advisers from providing investors with certain types of preferential terms unless they receive investor consent.[74] Finally, the PFA Rules also included amendments to the Adviser Act's compliance rule.[75] All registered advisers, even those not advising on private funds, were required to write an annual review of their compliance policies.[76]

A. *Conflicts of Interest*

Important provisions in the PFA Rules required disclosure of conflicts of interest between an investment adviser and the investor in the fund. Informed by its observations of industry practices and prior enforcement actions, conflicts of interest were one of the SEC's primary motivations in promulgating the now-vacated PFA Rules.[77] In 2020, the SEC's Office of Compliance Inspections and Examinations ("OCIE") issued a Private Fund Risk Alert ("Risk Alert") that found that private fund advisers did not adequately disclose conflicts arising from their investment allocations.[78] The OCIE identified

easily accessible place for" five years to enhance internal compliance and the SEC's ability to assess compliance).

71. 17 C.F.R. § 275.211(h)(2)-1 (2024), *repealed by* Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 89 Fed. Reg. at 91253; SEC FACT SHEET, *supra* note 4, at 2–3.

72. 17 C.F.R. § 275.211(h)(2)-3, *repealed by* Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 89 Fed. Reg. at 91253; *see* SEC FACT SHEETS, *supra* note 4, at 3.

73. 17 C.F.R. § 275.211(h)(2)-1, *repealed by* Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 89 Fed. Reg. at 91253; *see* SEC FACT SHEET, *supra* note 4, at 2–3.

74. 17 C.F.R. § 275.211(h)(2)-3, *repealed by* Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 89 Fed. Reg. at 91253; SEC FACT SHEET, *supra* note 4, at 3.

75. The amendments require all registered advisers to document "the required annual review of their compliance policies and procedures." SEC FACT SHEET, *supra* note 4, at 3.

76. 17 C.F.R. § 275.206(4)-7(b), *amended by* Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 89 Fed. Reg. at 91253; *see* Opening Brief for Petitioners at 2, Nat'l Ass'n of Priv. Fund Managers v. SEC, 103 F.4th 1097 (5th Cir. 2024) (No. 23-60471), 2023 WL 7458588, at *2 (noting that the SEC Rule "restricts-or even prohibits-the longstanding, widely used business arrangements of private funds" and per the SEC's own estimate, the Rule would have "cost billions" and required "millions of hours of employee time" (emphasis omitted)).

77. Conflicts of interest were one of the three primary factors the SEC included in the Final Rules that "contribute to investor protection risks and harms." Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 88 Fed. Reg. 63206, 63209 (Sept. 14, 2023) (to be codified at 17 C.F.R. pt. 275). The other two factors that the SEC cited are "lack of transparency" and "lack of governance mechanisms." *Id.*

78. The conflicts pertained to allocations of investments among clients, "including the adviser's largest private fund clients, private funds that invest alongside flagship funds in the same

additional sources of conflicts, including those related to multiple clients investing in the same portfolio company, financial relationships between investors and the adviser, and preferential liquidity rights.[79] In 2022, the OCIE issued another Risk Alert after observing private fund advisers' failure to act consistently with their disclosures, using misleading disclosures, due diligence failures, and "use of potentially misleading 'hedge clauses.'"[80]

In the PFA Rules, the SEC addressed five specific areas where conflicts of interest are most prevalent.[81] First, in response to the prevalence of misinformation for investors in private funds, the PFA Rules provide for additional disclosures by advisers about actual and potential conflicts of interest with the fund.[82] Second, to address conflicts of interest in adviser-led transactions, the SEC promulgated the Adviser-Led Secondaries Rule to provide a check against conflicts of interest for an adviser structuring and leading a transaction where they stand to profit at the expense of the fund's investors.[83] Conflicts of interest in adviser-led transactions stem from the private fund adviser being on both sides, having interests in the transaction potentially at odds with private fund investors. This can occur, for example, when private fund advisers exert substantial influence over a portfolio investment, such as when the advisers "own[] a sizable but non-controlling share of the investment or if the portfolio investment is otherwise dependent on the adviser to operate its business."[84]

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investments ('co-investment vehicles'), sub-advised mutual funds, collateralized loan obligation funds, and separately managed accounts." OFF. OF COMPLIANCE INSPECTIONS & EXAMINATIONS, U.S. SEC. & EXCH. COMM'N, OBSERVATIONS FROM EXAMINATIONS OF INVESTMENT ADVISERS MANAGING PRIVATE FUNDS 2 (2020), https://www.sec.gov/files/ocie-risk-alert-private-funds [https://perma.cc/59J2-UZXN].

79. In particular, the OCIE staff observed that private fund advisers entering into agreements to select side investors and establish special terms, including preferential liquidity, did not provide adequate disclosure to the rest of the fund about the side letters. The OCIE also observed conflicts of interest for private fund advisers related to recommended investments, service providers, restructuring, and cross-transactions. *Id.* at 3.

80. DIV. OF EXAMINATIONS, U.S. SEC. & EXCH. COMM'N, OBSERVATIONS FROM EXAMINATIONS OF PRIVATE FUND ADVISORS 1 (2022), https://www.sec.gov/files/private-fund-risk-alert-pt-2.pdf [https://perma.cc/98JH-KHZR].

81. The PFA Rules attempted to address these specific conflicts of interest. Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 88 Fed. Reg. at 63210.

82. *See id.* at 63222.

83. *See id.* at 63211–12.

84. Conflicts of interest in adviser-led transactions stem from the private fund adviser being on both sides, having interests in the transaction potentially at odds with private fund investors. This can occur, for example, when private fund advisers exert substantial influence over a portfolio investment, such as when the advisers "own[] a sizable but non-controlling share of the investment or if the portfolio investment is otherwise dependent on the adviser to operate its business." *Id.* at 63233 n.290. An adviser is subject to potential conflicts of interest with "advisory client[s]" when the adviser has a conflicting interest that may cause the adviser to render "advice which was not disinterested." *Id.*; *see also id.* at 63216 n.99 ("The adviser-led secondaries rule is designed to ensure that the private fund and investors that participate in the secondary transaction are offered a fair price, which is a critical component of preventing the type of harm that might result from the adviser's conflict of interest in leading the transaction.").

Third, the SEC identified compensation schemes that are "contrary to the public interest,"[85] noting that "such allocations create a conflict of interest because they provide an incentive for an adviser to place its own interests ahead of the private fund's interests."[86] In response, the SEC aimed for the PFA Rules "to restrict the practice of charging or allocating fees and expenses related to a portfolio investment (or potential portfolio investment) on a non-pro rata basis."[87]

Fourth, the SEC explained that when advisers borrow from private funds, a conflict arises because the interests of the funds are subject to misalignment with the adviser's interests.[88] Similarly, the SEC noted that conflicts arise when private fund advisers are in financial distress as the fund's interests may conflict with the adviser "seeking to discharge the liability or otherwise renegotiate more favorable terms for itself."[89]

Finally, the SEC sought to address conflicts of interest arising when advisers have incentives to provide preferential terms to themselves and one or more investors to the detriment of other investors.[90] Preferential treatment can occur when an adviser waives all or part of their confidentiality obligation for one investor. This waiver hurts other investors as the information may become available to third parties and negatively impact the fund's competitive advantage.[91]

In one example of SEC enforcement in response to conflicts of interest, the SEC brought action against private fund advisers for misallocating $17 million in expenses to the "adviser's flagship private equity fund and improperly allocat[ing] approximately $2 million of compensation-related expenses to three private equity funds [the] adviser managed."[92] The SEC elaborated that concerns over conflicts of interest are especially acute where private fund advisers grant preferential redemption rights or promulgate problematic compensation schemes.[93]

85. *Id.* at 63264 (finding that compensation schemes that require investors to pay for regulatory or compliance fees and expenses of the advisers are compensation schemes contrary to the public interest).

86. *Id.*

87. *Id.* at 63269.

88. *See id.* at 63272–74.

89. *See id.* at 63272.

90. *See id.* at 63278.

91. *See id.*

92. *Id.* at 63209 (footnote omitted) (first citing Kohlberg Kravis Roberts & Co., Investment Advisors Act Release No. 4131, 2015 WL 3941621 (June 29, 2015); and then citing NB Alts. Advisers LLC, Investment Advisers Act of 1940 Release No. 5079, 2018 WL 6696600 (Dec. 17, 2018)).

93. *Id.* at 63209–10. Specifically, the PFA Rules explained, "advisers have a conflict of interest with private funds (and, indirectly, investors in those funds) when they value the fund's assets and use that valuation as the basis for the calculation of the adviser's fees and fund performance," and that

> advisers have a conflict of interest with the fund (and, indirectly, its investors) when they offer existing fund investors the choice between selling and exchanging their

The SEC was not alone in its concern over conflicts of interest in private equity.[94] In its *2024 Global Financial Stability Report*, the International Monetary Fund analyzed risks posed by private equity, noting private equity's rising popularity, pension funds' increasing illiquid investments in private equity, and private equity's interconnectedness with private credit.[95] It stated that supervisors of private funds "should continue to thoroughly assess valuation governance and controls through intrusive supervision, including on-site inspection, on the valuation practices of private credit funds."[96] Also, scholars have previously observed a pattern indicating that private equity practices that may initially appear to protect investors create prominent conflicts of interest in practice.[97] The limited data available impedes assessing how the potential conflicts unfold.[98]

B. Response and Challenge to the PFA Rules

The heightened reporting, disclosure, and recordkeeping requirements under the PFA Rules also garnered significant criticism from the industry. Many argued that the SEC had exceeded its statutory rulemaking authority and that, if implemented, the PFA Rules would negatively impact capital markets.[99] Special interest groups, including the National Association of Private Fund Managers ("NAPFM"), challenged the PFA Rules in the Fifth Circuit Court of Appeals.[100]

> interests in the private fund for interests in another vehicle advised by the adviser or any of its related persons as part of an adviser-led secondary transaction.

Id. at 63210.

94. William Clayton highlighted "the private equity negotiation myth," which refers to the assertion that the idea that substantive concerns about private fund agreements are unwarranted because the agreements are negotiated is wrong. Clayton, *supra* note 16, at 69. Along the same thread, William Magnuson acknowledged that conventional views of private equity's self-governance are often flawed in practice. William Magnuson, *The Public Cost of Private Equity*, 102 MINN. L. REV. 1847, 1865 (2018). The conventional view is that private equity is governed by the structure of the firms themselves, with managers better oriented to improve fund performance because of financial incentives, close monitoring, and expertise. *Id.* at 1848–49.

95. INT'L MONETARY FUND, *supra* note 42, at 67–74.

96. *Id.* at 74.

97. *See* Clayton, *supra* note 16, at 78 ("One line of criticism argues that the compensation arrangements set forth in [limited partnership agreements], which are supposed to align managers' interests with their investors' interests, actually create serious conflicts of interest." (footnote omitted)).

98. *See* Kobi Kastiel & Yaron Nili, *The Rise of Private Equity Continuation Funds*, 172 U. PA. L. REV. 1601, 1606 (2024) (discussing a potential conflict created by continuation funds but explaining that "[a]ssessing how this conflict unfolds in practice is challenging due to data limitations").

99. *See, e.g.*, U.S. CHAMBER OF COM. CTR. FOR CAP. MKTS. COMPETITIVENESS, INVESTORS AND THE MARKETS FIRST: REFORMS TO RESTORE CONFIDENCE IN THE SEC 8–21, 25–27 (2024), https://www.uschamber.com/assets/documents/CCMC_SEC_Paper_Investors-and-the-markets-first.pdf [https://perma.cc/77FX-WGN9].

100. Nat'l Ass'n of Priv. Fund Managers v. SEC, 103 F.4th 1097, 1101 (5th Cir. 2024). The Private Fund Managers appealed directly to the Fifth Circuit. The SEC contended that the court was not the proper venue. *Id.* at 1108–09. The court disagreed, stating that under the Advisers Act, any aggrieved person or party can seek review of an SEC rule in the court of appeals where they reside or have their principal office or place of business. *Id.* at 1109 ("Any person or party

When the NAPFM judicially challenged the PFA Rules, business press organizations, professional organizations,[101] and pension funds filed an amicus brief supporting the PFA Rules and their more stringent focus on conflicts of interest.[102] In their brief, the broader business community shared the SEC's concerns with conflicts of interest, stating that "[e]veryday people are ultimately harmed when the institutions investing for their benefit are indirectly exposed to risk as a result of the imbalance of power between advisers and institutional investors and the information asymmetry around conflicts that can result."[103]

Despite this, on June 5, 2024, the Fifth Circuit vacated the PFA Rules in their entirety, including the conflicts of interest provisions.[104] The court held that the SEC lacked statutory authority to pass the PFA Rules, and consequently, private fund advisers are under no obligation to follow them.[105] The SEC issued the PFA Rules under the Investment Advisers Act of 1940 ("Advisers Act").[106] The Fifth Circuit determined that the Advisers Act did not authorize the SEC to pass these stringent regulations.[107] The court agreed with the private fund managers that the SEC had failed to demonstrate how the PFA Rules would prevent fraud, deception, or manipulation as required under section 206(4) of the Advisers Act.[108] It further noted that the SEC had only observed misconduct in 0.05% of advisers,[109] and "that the Final Rule will cost

aggrieved by an order issued by the Commission under this subchapter may obtain a review of such order in the United States court of appeals within any circuit wherein such person resides or has his principal office or place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part." (quoting 15 U.S.C. § 80b-13(a))).

101. *See, e.g.*, Brief for Amici Curiae Institutional Ltd. Partners Ass'n et al. in Support of Respondent at 1–4, *Nat'l Ass'n of Priv. Fund Managers*, 103 F.4th 1097 (No. 23-60471), 2023 WL 9021469, at *1–4.

102. Brian Croce, *ILPA, CalSTRS Among Those Backing SEC's Private Funds Rule*, PENSIONS & INVS. (Jan. 4, 2024, 1:15 PM), https://www.pionline.com/regulation/ilpa-calstrs-among-those-backing-secs-private-funds-rule (on file with the *Iowa Law Review*).

103. *See* Brief for Amici Curiae Institutional Ltd. Partners Ass'n et al. in Support of Respondent, *supra* note 101, at 11.

104. *See Nat'l Ass'n of Priv. Fund Managers*, 103 F.4th at 1114.

105. *See id.*

106. *See* 15 U.S.C. §§ 80b–1 to 80b–21; Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 88 Fed. Reg. 63206, 63206 (Sept. 14, 2023) (to be codified at 17 C.F.R. pt. 275).

107. *Nat'l Ass'n of Priv. Fund Managers*, 103 F.4th at 1114. The Supreme Court handed down its decisions in *SEC v. Jarkesy*, 603 U.S. 109, 140–41 (2024), and *Loper Bright Enterprises v. Raimondo*, 603 U.S. 369, 412–13 (2024) (overturning Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837 (1984)), discussed *infra* Part III, shortly after this decision, potentially influencing the SEC's decision to not pursue a rehearing or appeal. *See SEC Private Funds Rule – Roadblocks to Regulation*, CBIZ (Aug. 5, 2024), https://www.cbiz.com/insights/article/sec-private-funds-rule-roadblocks-to-regulation [https://perma.cc/VW6R-NT84].

108. "Section 206(4), as amended, specifically requires the Commission to 'define' an act, practice, or course of business that is 'fraudulent, deceptive, or manipulative' before the Commission can prescribe 'means reasonably designed to prevent' 'such' act, practice, or course of business." *Nat'l Ass'n of Priv. Fund Managers*, 103 F.4th at 1113 (quoting 15 U.S.C. § 80b–6(4)).

109. *Id.*

$5.4 billion and require millions of hours of employee time."[110] Yet, the so-called $5.4 billion in additional costs amounts to fewer than two basis points of assets involved, which were hardly burdensome.[111]

The timeframe within which the SEC could have requested a rehearing before the Fifth Circuit en banc or appealed to the Supreme Court has now lapsed.[112] The SEC's remaining options are to redraft the PFA Rules in compliance with the Fifth Circuit's decision or do nothing and proceed without private fund rules.[113] It is currently unclear which route, if any, the SEC has elected, especially with the beginning of a new administration. In its report on objectives for the 2025 fiscal year, the SEC's Office of the Investor Advocate noted that it had received feedback from numerous investors with varying views on the appropriate definition for accredited investors and that "to achieve an appropriate balance between investor protection and investor access," the Commission would have "the difficult task of making amendments to the accredited investor definition" which "may require more than the adjustment of the thresholds alone can accomplish."[114] Other than this acknowledgment, the SEC has not yet announced a more specific rulemaking agenda with respect to private funds.

Since the Fifth Circuit rendered its decision in *National Ass'n of Private Fund Managers v. SEC*, the case has predictably been used to clarify the duties regarding private funds and investment advisers.[115] The case has also been cited in a growing number of court challenges to SEC rules and decision-making.[116] The NAPFM initiated some of these challenges or wrote amicus

110. *Id.* at 1108.

111. The assets under management are estimated to be $30.9 trillion, hence, $5.4 billion / $30.9 trillion = 0.0001748 or 1.748 basis points. *See* Atkins, *supra* note 11.

112. *See* FED. R. APP. P. 40(d)(1); 28 U.S.C. § 2101(c); Christine Ayako Schleppegrell et al., *Fifth Circuit Vacates SEC Private Fund Adviser Rules in Full*, MORGAN LEWIS (June 7, 2024), https://www.morganlewis.com/pubs/2024/06/fifth-circuit-vacates-sec-private-fund-adviser-rules-in-full [https://perma.cc/AS2L-B2TD].

113. *See* John Hunt & Rachael Schwartz, *Are the SEC's Private Fund Advisers Rules Now Dead? No, but They Are on Life Support*, JD SUPRA (June 11, 2024), https://www.jdsupra.com/legalnews/are-the-sec-s-private-fund-advisers-8043283 [https://perma.cc/S7PF-DQM2].

114. *See* OFF. OF THE INV. ADVOC., U.S. SEC. & EXCH. COMM'N, FISCAL YEAR 2025: REPORT ON OBJECTIVES 7 (2025), https://www.sec.gov/files/fy25-oiad-sar-objectives-report.pdf [https://perma.cc/GL53-ZVU3].

115. *See, e.g.*, United States v. Watson, No. 23-CR-0082, 2024 WL 4827734, at *10 n.17 (E.D.N.Y. Nov. 19, 2024) (finding that private funds are not subject to the extensive disclosure requirements seen with mutual funds); Charitable DAF Fund v. Highland Cap. Mgmt., L.P. (*In re* Highland Cap. Mgmt., L.P.), No. 3:23-CV-1503, 2024 WL 4139647, at *4 (N.D. Tex. Sept. 10, 2024) ("Section 206 of the IAA imposes fiduciary duties upon investment advisors to act in the best interest of their investors.").

116. *See* SEC v. Auctus Fund Mgmt., LLC, No. 23-cv-11233, 2024 WL 3498593, at *3 n.1 (D. Mass. July 22, 2024) (holding that the defendants were "dealers" under the Exchange Act, rejecting defendant's argument that the court should apply the Fifth Circuit's reasoning for rejecting the SEC's interpretation of the Private Fund Rules); Crypto Freedom All. of Tex. v. SEC, No. 24-cv-00361, 2024 WL 4858590, at *5 (N.D. Tex. Nov. 21, 2024) (vacating the SEC's Dealer Rule); Nat'l Ass'n of Priv. Fund Managers v. SEC, No. 24-cv-00250, 2024 WL 4858589, at *8 (N.D. Tex. Nov. 21, 2024) (vacating the SEC's Dealer Rule); Nat'l Ass'n of Mfrs. v. SEC, 105 F.4th 802, 807, 811 (5th Cir. 2024) (holding that the SEC had acted "arbitrarily and capriciously" in

briefs in support.[117] For example, the NAPFM brought a case in the Northern District of Texas, also entitled *National Ass'n of Private Fund Managers v. SEC.*[118] Here, the NAPFM challenged the SEC Dealer Rule.[119] The SEC Dealer Rule expanded the definition of a "dealer" under the Securities Exchange Act of 1934 to include anyone with a trading activity regularly providing liquidity to the marketplace.[120] Market participants providing liquidity would have had to register with the SEC, conform to its registered broker-dealer rules, and become a self-regulatory organization.[121] NAPFM argued that the SEC had exceeded its rulemaking authority in violation of the Administrative Procedure Act ("APA") when it enacted the Dealer Rule.[122] The district court agreed, citing the Fifth Circuit's decision in *National Ass'n of Private Fund Managers* in support of the proposition that vacatur of the Dealer Rule in its entirety was appropriate.[123]

More broadly, the Fifth Circuit decision in *National Ass'n of Private Fund Managers* has also been used to support the principle that statutory terms should be interpreted in accordance with their ordinary meaning.[124] In doing so, the result has been to limit the discretion of other administrative agencies.[125]

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violation of the APA when it rescinded a 2020 rule addressing "transparency and accuracy in proxy voting advice").

117. *See generally Nat'l Ass'n of Priv. Fund Managers*, 2024 WL 4858589 (initiating the challenge themselves).

118. *Id.* at *1.

119. Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer in Connection with Certain Liquidity Providers, Exchange Act Release No. 34–99477, 89 Fed. Reg. 14938, 14938–39 (Feb. 29, 2024) (to be codified at 17 C.F.R. § 240) (adopting the Dealer Rule).

120. Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts Rules to Include Certain Significant Market Participants as "Dealers" or "Government Securities Dealers" (Feb. 6, 2024), https://www.sec.gov/newsroom/press-releases/2024-14 [https://perma.cc/QH8F-EC9V].

121. Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer in Connection with Certain Liquidity Providers, 89 Fed. Reg. at 14938–39.

122. *Nat'l Ass'n of Priv. Fund Managers*, 2024 WL 4858589, at *2; *see also* Administrative Procedure Act, 5 U.S.C. §§ 551–559.

123. *Nat'l Ass'n of Priv. Fund Managers*, 2024 WL 4858589, at *3–8.

124. *See* Barr v. SEC, 114 F.4th 441, 448–51 (5th Cir. 2024) (holding that a bankruptcy proceeding was not "a 'covered judicial or administrative action' or a 'related action'" under the Dodd–Frank Act and thus rejecting a petition by whistleblowers contending that their award should have been calculated based on what the SEC would have been awarded in bankruptcy); Consumer Fin. Prot. Bureau v. FirstCash, Inc., 756 F. Supp. 3d 299, 310 (N.D. Tex. 2024) (holding that the bona-fide-error defense under the Military Lending Act, which shields defendants from civil liability to a covered borrower, did not extend to claims brought by a federal agency).

125. *See* Teche Vermilion Sugar Cane Growers Ass'n v. Su, 749 F. Supp. 3d 697, 729, 735–36 (W.D. La. 2024) (holding that the Department of Labor had exceeded its rulemaking authority concerning a rule that set wages for certain sugarcane truck drivers); Tennessee v. Becerra, 739 F. Supp. 3d 467, 472 (S.D. Miss. 2024) (enjoining the Department of Health and Human Services from enforcing a rule which had interpreted the Affordable Care Act's provision prohibiting the "discrimination on the basis of sex to include discrimination [based on] gender identity").

III. JUDICIAL TRENDS CURTAILING ADMINISTRATIVE AUTHORITY

The Fifth Circuit's ruling in *National Ass'n of Private Fund Managers* is in line with a judicial trend curtailing some of the authority of administrative agencies regarding enforcing and promulgating regulations. This Part examines those trends, beginning with a discussion of *SEC v. Jarkesy*, where the U.S. Supreme Court affirmed a Fifth Circuit ruling that curtailed the authority of the administrative law court to rule on an enforcement action brought by the SEC.[126] Our discussion of *Jarkesy* is followed by an analysis of the U.S. Supreme Court decision in *Loper Bright Enterprises v. Raimondo*, abolishing a prior doctrine of judicial deference to the rulings of administrative agencies when interpreting statutory ambiguity.[127]

A. SEC V. JARKESY

In 2013, the SEC brought an enforcement action against George Jarkesy, Jr. and Patriot28, LLC,[128] seeking civil penalties for alleged violations of anti-fraud provisions designed to combat securities fraud.[129] Jarkesy had launched two investment funds. The SEC alleged Jarkesy misrepresented his investment strategy, lied about the funds' auditor's identity, and inflated the funds' values to collect larger management fees for himself.[130] The administrative law judge ("ALJ") found Jarkesy liable for securities fraud and ordered civil penalties.[131] Jarkesy appealed to the Fifth Circuit, arguing that the SEC had infringed on his Seventh Amendment right to a jury trial and that the SEC's use of ALJs

126. *See* SEC v. Jarkesy, 603 U.S. 109, 140–41 (2024).

127. *See* Loper Bright Enters. v. Raimondo, 603 U.S. 369, 412–13 (2024) (overturning what was commonly referred to as "Chevron deference").

128. Patriot28 was the capital management group Jarkesy managed. *See* H. Gregory Baker & Alvin Li, *Supreme Court Decision in* SEC v. Jarkesy *Limits the SEC's Ability to Seek Civil Penalties*, PATTERSON BELKNAP (July 10, 2024), https://www.pbwt.com/securities-enforcement-litigation-insider/supreme-court-decision-in-sec-v-jarkesy-limits-the-secs-ability-to-seek-civil-penalties [https://perma.cc/9FKC-GYHR].

129. The three statutes that were relevant for *Jarkesy* were: (1) Securities Act of 1933 (Securities Act), Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a–77mm); (2) Securities Exchange Act of 1934 (Securities Exchange Act), Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78qq); and (3) Investment Advisers Act of 1940, Pub. L. No. 76-768, 54 Stat. 789 (codified as amended at 15 U.S.C. § 80b-1–80b-21). *See also Jarkesy*, 603 U.S. at 109.

130. John Thomas Cap. Mgmt. Grp. LLC, S.E.C. Release No. 693, 2014 WL 5304908 (ALJ Oct. 17, 2014); *Jarkesy*, 603 U.S. at 117–19.

131. The SEC opted to bring the claims in an in-house administrative proceeding before an administrative law judge ("ALJ"). In 2010, Congress passed the Dodd–Frank Wall Street Reform and Consumer Protection Act ("Dodd–Frank Act"), Pub. L. No. 111-203, 124 Stat. 1376 (codified as amended in scattered sections of the U.S.C.). The Act gave the SEC the authority to seek the same penalties in administrative proceedings as it would in federal court. Before the Dodd–Frank Act, the SEC could only obtain civil penalties in federal court. After the Dodd–Frank Act, the SEC had the power to impose civil penalties in its own in-house proceedings. The ALJ's final order in the SEC in-house proceeding levied a $300,000 civil penalty against Jarkesy and Patriot28. *See Jarkesy*, 603 U.S. at 119.

exceeded its authority.[132] The Fifth Circuit agreed, and the Supreme Court affirmed.[133]

With respect to the Seventh Amendment claim, the Court held that the right to a jury trial extended to statutory claims legal in nature.[134] According to the Court, the civil penalty imposed against Jarkesy demonstrated that the claim was legal in nature and thus implicated the Seventh Amendment.[135] Additionally, the Court held that the public rights exception under the Seventh Amendment, which would permit the use of an administrative forum, did not apply.[136] Conceding that courts have not necessarily articulated the contours of public rights precisely, the Court nonetheless emphasized the limited nature of the exception.[137] The Court found that the substance of the suit, as opposed to its statutory nature, was of the utmost importance when determining whether the public rights exception applied.[138] Looking at the similarities between federal securities fraud and common law fraud, the Court concluded that the federal anti-fraud provisions replicated common law fraud. Thus, the substance of the SEC's claim was a matter of private, not public right, precluding adjudication by an ALJ.[139]

The impact of *Jarkesy* remains uncertain. Commentators note that because the SEC was already bringing many enforcement actions in federal court, *Jarkesy* may have less of an immediate impact on the SEC than other administrative agencies.[140] Still, the SEC may feel the weight of additional scrutiny on its use of ALJs or pressure to forgo civil penalty remedies in active

132. *See* Brief for Petitioners at 6–7, 33, Jarkesy v. SEC, 51 F.4th 644 (5th Cir. 2022) (No. 20-61007), 2021 WL 1044807, at *6–7, *33.

133. *See Jarkesy*, 603 U.S. at 140–41.

134. According to the Court, monetary remedies are "legal in nature" when intended to punish the wrongdoer instead of restoring the status quo. *Id.* at 111 (quoting Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 53 (1989)).

135. The Court outlined three reasons the penalty was legal in nature: (1) the SEC tied the availability of civil penalties to the need to punish the defendant; (2) the criteria conditioning the size of the available remedy on the culpability of the defendant and need for deterrence demonstrated the penalty was punitive; and (3) the SEC was not obliged to return any money to the victims. *Id.* at 123–25.

136. The public rights exception allows Congress to assign a matter to an agency without a jury, consistent with the Seventh Amendment. *Id.* at 127–28.

137. *Id.* at 131, 136–41 ("The public rights exception is, after all, an *exception.* It has no textual basis in the Constitution and must therefore derive instead from background legal principles.").

138. *Id.* at 134–36 (citing *Granfinanciera*, 492 U.S. at 56).

139. *Id.* at 134. The Court noted both target the same basic conduct—misrepresenting or concealing material facts—and observed that Congress incorporated aspects from common law fraud into federal securities law. *Id.* at 125.

140. *See, e.g.*, Roger E. Barton & James E. Heavey, *SEC and FINRA Face New Limits on Enforcement Powers in Post-*Chevron *Landscape*, REUTERS (July 26, 2024), https://www.reuters.com/legal/legalindustry/sec-finra-face-new-limits-enforcement-powers-post-chevron-landscape-2024-07-25 [https://perma.cc/MKG3-S86X] (discussing the impacts of *Jarkesy* on the SEC, noting that "the SEC had already largely shifted away from administrative proceedings beginning in 2018, when there were other legal challenges aimed towards its ALJs").

matters.[141] The potential impact extends to other federal agencies relying on in-house administrative proceedings to obtain civil penalties.[142]

B. LOPER BRIGHT ENTERPRISES V. RAIMONDO

In addition, the Supreme Court recently abolished a forty-year-old doctrine of judicial deference afforded to administrative agencies. In 1984, the Court decided *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, a case involving a challenge to Environmental Protection Agency regulations under the Clean Air Act.[143] In resolving the statutory ambiguities, the Court articulated a doctrine that has informed the administrative state since it was decided.[144] The *Chevron* Court held that absent a discernable congressional intent, reviewing courts faced with either silence or ambiguity in a statute must defer to the authorizing agency's permissible construction.[145] This broad grant of regulatory discretion allowed administrative agencies, including the SEC, to prevail against challenges to their authority.[146]

On June 28, 2024, a 6-3 Supreme Court majority in *Loper Bright Enterprises v. Raimondo* overruled *Chevron.*[147] The *Loper Bright* Court rejected the notion that a reviewing court must defer to an agency's interpretation "simply because a statute is ambiguous."[148] Rather, the Court held that, under the APA, reviewing courts are required to exercise independent judgment to determine if the agency had acted within its statutory authority.[149]

Although *Loper Bright* does not entirely reject an agency's interpretation or expertise, courts are no longer bound to defer to the agency.[150] There is an exception, however, when a court finds that the statute "delegates discretionary authority to an agency," at which point the court must respect Congress's will "subject to constitutional limits."[151]

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141. *See* Elizabeth Profaci, SEC v. Jarkesy*: Possible Implications for the SEC's FCPA Enforcement*, SQUIRE PATTON BOGGS (Aug. 7, 2024), https://www.globalinvestigations.blog/u-s-securities-and-exchange-commission/sec-v-jarkesy-possible-implications-for-the-secs-fcpa-enforcement [https://perma.cc/Y7LV-FVSW].

142. *See* Baker & Li, *supra* note 128.

143. *See* Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837, 842–45 (1984), *overruled by* Loper Bright Enters. v. Raimondo, 603 U.S. 369 (2024).

144. *See Loper Bright*, 603 U.S. at 396–98; Nowell D. Bamberger, Carmine D. Boccuzzi, Jr., William E. Baldwin & Angela L. Dunning, *After* Chevron*: What the Supreme Court's* Loper Bright *Decision Changed, and What It Didn't*, CLEARY GOTTLIEB (July 11, 2024), https://www.clearygottlieb.com/news-and-insights/publication-listing/after-chevron-what-the-supreme-courts-loper-bright-decision-changed-and-what-it-didnt [https://perma.cc/WG8F-CBK8].

145. *See Chevron*, 467 U.S. at 842–45.

146. *See* Stephen T. Gannon, Thomas P. DeFranco, Robert P. Howard Jr. & James K. Goldfarb, *The Administrative State After* Jarkesy*,* Loper Bright*, and* Corner Post *– Context and Consequences*, DAVIS WRIGHT TREMAINE LLP (July 15, 2024), https://www.dwt.com/blogs/financial-services-law-advisor/2024/07/how-scotus-rulings-will-change-administrative-law [https://perma.cc/TB25-TKLT].

147. *See Loper Bright*, 603 U.S. at 412–13.

148. *See id.* at 413.

149. *See id.* at 393–94.

150. *See* Bamberger et al., *supra* note 144.

151. *Loper Bright*, 603 U.S. at 395.

The *Loper Bright* decision changed how courts will review agency decisions. It is unclear, however, if the decision will cause the SEC to change its approach to rulemaking.[152] On one hand, in terms of its enforcement strategy, both *Jarkesy* and *Loper Bright*—decided only a day apart—may incentivize the SEC to be more selective in its enforcement approach.[153] Yet, fewer legal proceedings and settlements against only the most serious offenders may ultimately curtail the development of securities law, thus creating challenges for both the SEC and the entities subject to its regulations.[154] Even if the SEC's approach remains relatively unchanged, the *Loper Bright* decision is likely to strengthen and increase challenges to SEC rulemaking.[155]

Two areas where SEC rulemaking may be especially important are in SPACs and PIPEs. As will be discussed *infra*, we find that these investments may involve significant conflicts of interest, whereby the investment adviser reaps benefits to the detriment of the limited investors. The now-dismantled PFA Rules would have been an important step forward in addressing these issues. The next Part analyzes SPACs, PIPEs, and SEC disclosures for redemption rights.

IV. SPECIAL PURPOSE ACQUISITION COMPANIES

Special purpose acquisition companies ("SPACs") emerged in the 1990s as an efficient alternative for private companies to raise public funds without the formalities of an initial public offering ("IPO").[156] Under the direction of a sponsor, the SPAC raises money through an IPO. The SPAC is a shell

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152. At least one source suggests that reduced deference post-*Chevron* will limit the SEC's ability to carry out efficiency assessments for proposed rulemaking. *See* James Tierney, *How* Loper Bright *and the End to the* Chevron *Doctrine Impact the SEC*, PROMARKET (Sept. 9, 2024), https://www.promarket.org/2024/09/09/how-loper-bright-and-the-end-to-the-chevron-doctrine-impact-the-sec [https://perma.cc/NNL6-RD5M].

153. *See* Jerry W. Markham, *U.S. Securities and Exchange Commission and the "Deep Administrative State": A Case Study of Its ESG Rules*, 14 AM. U. BUS. L. REV. 151, 262–65 (2024); Frederick L. Block, Lindsay B. Jackson, Christine Ayako Schleppegrell & Steven W. Stone, *Financial Regulation in a Post-*Chevron *World: What's Next?*, MORGAN LEWIS (Aug. 1, 2024), https://www.morganlewis.com/pubs/2024/08/financial-regulation-in-a-post-chevron-world-whats-next [https://perma.cc/B4LN-LHUL].

154. *See* Tierney, *supra* note 152 ("[*Jarkesy*] is also likely to have a demand-side effect on settlements across a range of programs. Together with *Loper Bright*, these cases are likely to manifest in fewer proceedings and settlements in the adjudication forum, fewer lawsuits in court overall, and less production of 'securities law.'").

155. *See* Block et al., *supra* note 153.

156. *See* Garrard R. Beeney, Brian T. Frawley, William B. Monahan & Jacob M. Croke, *Derivative Actions by Stockholders*, *in* 3 BUSINESS AND COMMERCIAL LITIGATION IN FEDERAL COURTS § 26:35.50 (Robert L. Haig ed., 5th ed. 2024); Delman v. GigAcquisitions3, LLC, 288 A.3d 692, 700–01 (Del. Ch. 2023) (describing a SPAC as "a shell corporation, most commonly incorporated in Delaware, that lacks operations and takes a private company public through a form of reverse merger"); ROBERT J. HAFT, ARTHUR F. HAFT & MICHELE HAFT HUDSON, ANALYSIS OF KEY SEC NO-ACTION LETTERS § 11:12 (2024–2025 ed.) ("As compared to operating company IPOs . . . SPAC IPOs are faster. SPAC financial statements in the IPO registration statement are short, not complex and can be prepared in weeks (compared to months for an operating business)."); *see, e.g.*, Neal F. Newman & Lawrence J. Trautman, *Special Purpose Acquisition Companies (SPACS) and the SEC*, 24 U. PA. J. BUS. L. 639, 642 (2022).

corporation without any commercial operation and is sometimes referred to as a "blank check compan[y]."[157] The sponsor typically has eighteen to twenty-four months to complete a business combination, which entails locating a target private company and negotiating an acquisition agreement.[158] The merger is effectuated through a "de-SPAC" transaction, whereby the acquisition is announced, and the target company becomes public by virtue of the merger.[159] Between 2020 and 2021, SPACs offered enticing return-on-investment promises and the chance for shareholders to redeem their investments at cost if the SPAC failed to find a target.[160] Private companies were going public at unprecedented rates via de-SPAC transactions.[161] Since 2021, however, several factors have caused SPACs to decline in popularity.[162] Although this decline is partly due to many SPACs being bad investments, the fall is also the result of controversy surrounding SPACs' limited disclosures concerning shareholder redemption rights, and that "something is amiss in the SPAC regulatory and governance space."[163] SPACs' technical features have historically evaded standard stock distribution disclosure requirements and anti-fraud provisions, allowing sponsors to mislead and shoehorn shareholders into bad investments.[164]

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157. *See* Beeney et al., *supra* note 156; *Delman*, 288 A.3d at 700–01.

158. The sponsor "may be associated with a private equity or hedge fund, or it may simply be an individual or group of individuals." Michael Klausner, Michael Ohlrogge & Emily Ruan, *A Sober Look at SPACs*, 39 YALE J. ON REGUL. 228, 230 (2022); 1 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 3:58 (8th ed. 2023).

159. *See Delman*, 288 A.3d at 700–01.

160. "In 2021, there were 362 SPAC [IPOs]," as compared to only 68 in the first half of 2022. HAZEN, *supra* note 158, at 572. In 2021, both "[e]xperienced investors and celebrities alike sponsored SPACs with the promise of huge returns." *In re* Hennessy Cap. Acquisition Corp. IV S'holder Litig., 318 A.3d 306, 310 (Del. Ch. 2024).

161. *See In re Hennessy Cap. Acquisition Corp. IV S'holder Litig.*, 318 A.3d at 310.

162. *See* Max Brzozowski, *The Death of SPACs*, MICH. J. ECON. (Apr. 2, 2024), https://sites.lsa.umich.edu/mje/2024/04/02/the-death-of-spacs [https://perma.cc/LL3T-8ST8] ("The strengths of the SPAC . . . quickly grew into its weaknesses. . . . [G]oing public via SPAC afforded companies latitude in projections . . . . [which] quickly [grew] into latitude for fraud in many cases for bullish SPACs."); Christopher Barlow et al., *De-SPAC Transaction Trends in 2023*, *in* LEXISNEXIS PRACTICAL GUIDANCE (2023), https://www.skadden.com//media/files/publications/2023/06/de_spac_transaction_trends_in_2023.pdf [https://perma.cc/32H4-SLVW].

163. Connor J. Haaland, Note, *SPACs: A Post-Mortem and a Path Forward*, 61 HARV. J. ON LEGIS. 181, 190 (2024) (noting that over a three-year time period, SPACs were "cumulatively *down nearly seventy-five percent*" while the S&P 500 had "a roughly sixteen percent *increase*" (emphases added)); *see also* Klausner et al., *supra* note 158, at 298 (analyzing SPACs merged between January 2019 and June 2020 and concluding "that, on average, post-merger companies' share prices decline . . . [leaving] nonredeeming SPAC shareholders bearing much of the cost"); Michael Klausner & Michael Ohlrogge, *Was the SPAC Crash Predictable?*, 40 YALE J. ON REGUL. BULL. 101, 102 (2023) (confirming prior analysis of SPACs' "poor performance" with more data). Redemption rights arise out of stock exchange listing rules and offer shareholders the opportunity to redeem their shares just prior to the de-SPAC transaction. *See In re Hennessy Cap. Acquisition Corp. IV S'holder Litig.*, 318 A.3d at 310; HAZEN, *supra* note 158; *see also* Klausner et al., *supra* note 158, at 287–88 (arguing that the costs embedded within SPACs are greater than anticipated and can result in great losses for shareholders post-merger, thus necessitating regulation mandating more robust disclosure). Redemption rights are further discussed in Part V.

164. *See* Haaland, *supra* note 163, at 188–90. Before the SEC adopted SPAC rules in 2024, SPACs received safe-harbor protection for forward-looking statements, so lofty assurances of reliability would not incur liability, but lacked statutory underwriters and the corresponding

In 2024, the SEC issued rules regulating SPACs ("SPAC Rules").[165] Under the SPAC Rules, certain management activities could cause a sponsor to fall under the definition of an investment adviser under section 202(a)(11) of the Advisers Act.[166] If qualifying as investment advisers, these sponsors would have also been subject to the now-vacated PFA Rules.

A. *SPACS AND PRIVATE INVESTMENTS IN PUBLIC EQUITY*

SPACs typically offer their shareholders a chance to exercise their conversion or redemption rights.[167] These redemption rights allow shareholders to redeem their shares before the de-SPAC transaction.[168] If too many SPAC shareholders choose to exercise these rights, the SPAC may be left vying for enough funds to acquire its target.[169] For many SPACs, shareholder redemptions "are foreseeable and, in many cases, expected."[170] But, the SPAC faces a fork in the road—either find a way to secure the de-SPAC transaction

liability and trustworthiness. De-SPAC transactions were considered mergers and not distributions of stock, and therefore not subject to the extensive disclosure requirements that a traditional IPO or distribution would require. *See id.*

165. *See* Special Purpose Acquisition Companies, Shell Companies, and Projections, 89 Fed. Reg. 14158, 14158 (Feb. 26, 2024) (codified at 17 C.F.R pts. 210, 229, 230, 232, 239, 240, 249).

166. *See id.* at 14260 ("The definition generally includes three elements for determining whether a person is an investment adviser: (i) the person provides advice, or issues analyses or reports, concerning securities; (ii) the person is in the business of providing such services; and (iii) the person provides such services for compensation. Each element must be met in order for a person to be deemed an investment adviser."); *see* 15 U.S.C. § 80b-2(a)(11) (defining "investment adviser").

167. *See* Nasdaq Rule IM-5101-2, NASDAQ LISTING CTR. (June 24, 2017), https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/Nasdaq%205100%20Series [https://perma.cc/D8G9-AAN4]; Order Approving Proposed Rule Change to Amend IM-5101-2, 75 Fed. Reg. 82420, 82420–24 (Dec. 30, 2010); NYSE LISTED COMPANY MANUAL § 102.06 (2017), https://nyseguide.srorules.com/listed-company-manual/09013e2c85545f2a [https://perma.cc/66KM-TVND]; Order Granting Accelerated Approval, 82 Fed. Reg. 32022, 32022 (July 11, 2017) (collectively requiring SPACs listed on the exchanges to offer redemption rights to shareholders voting against the de-SPAC transaction); *see also* 17 C.F.R. § 229.1602(a)(2) (2024) (requiring SPAC disclosure of redemption rights and restrictions in the registration statement and prospectus); Special Purpose Acquisition Companies, Shell Companies, and Projections, 89 Fed. Reg. at 14160–61 ("Prior to the closing of the de-SPAC transaction, the shareholders of the SPAC typically have the opportunity to either: (1) require the SPAC to redeem their shares . . . or (2) remain a shareholder of the surviving company . . . ." (footnote omitted)); Holger Spamann & Hao Guo, *The SPAC Trap: How SPACs Disable Indirect Investor Protection*, 40 YALE J. ON REGUL. BULL. 75, 76 (2022) ("SPACs . . . offer[] two alternative payoffs for the same security: the post-merger share, or a cash redemption."); Michael Klausner & Michael Ohlrogge, *SPAC Governance: In Need of Judicial Review* 7 (John M. Olin Program in L. & Econ., Stan. L. Sch., Working Paper No. 564; N.Y.U. L. & Econ. Rsch. Paper Series, Working Paper No. 22-07, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3967693 [https://perma.cc/Y74C-87XW] ("The redemption right is provided for in the SPAC's charter and the terms of the trust."); *see also* Delman v. GigAcquisitions3, LLC, 288 A.3d 692, 701 (Del. Ch. 2023) ("SPAC structures have become largely standardized. . . . The IPO proceeds are held in trust for the benefit of the SPAC's public stockholders, who have a right to redeem their shares after a merger target is identified.").

168. *See* Newman & Trautman, *supra* note 156, at 659.

169. *See id.* at 663.

170. *See id.*

or liquidate the SPAC's trust and return all the proceeds to the shareholders.[171] Facing a forced abandonment of the merger agreement as a result of the capital lost to redemptions, SPACs often turn to PIPEs, an efficient capital-raising mechanism.[172]

In PIPEs, accredited investors (through their advisers and GPs) enter into agreements to purchase securities, the most common of which are common or preferred stock.[173] PIPEs are often structured to avoid stockholder approval and do not require registration with the SEC or a prospectus, speeding up the funding process.[174] Private equity funds are commonly structured as limited partnerships.[175] The fund partners are GPs tasked with raising capital contributions from LPs who are only liable for their specific investment.[176]

While the SPAC negotiates its merger, a PIPE issuer can quickly sell stock to institutional investors at a discounted price.[177] Furthermore, PIPE investors must commit to purchasing the shares, contingent upon a successful business combination.[178] Thus, even if shareholders in SPACs exercise their redemption rights, the SPAC will have acquired sufficient capital to proceed from PIPE investors.

The pressure to secure adequate funding quickly may compel SPAC directors to enter the PIPE transaction that favors the private investors over

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171. *See id.* at 667.

172. Public companies usually sell privately issued equity or equity-linked securities to accredited investors in a hybrid transaction. Issuers range from "over-the-counter . . . bulletin board companies to large-cap, NYSE-traded companies." Marc I. Steinberg & Emmanuel U. Obi, *Examining the Pipeline: A Contemporary Assessment of Private Investments in Public Equity ("PIPEs")*, 11 U. PA. J. BUS. L. 1, 3–5 (2008); *see also* HAZEN, *supra* note 158, § 3:60; Newman & Trautman, *supra* note 156, at 663.

173. ALAN J. BERKELEY, PIPES HEDGING UNDER SCRUTINY 753–54 (Am. L. Inst. Continuing Legal Educ., SS031 ALI-ABA 751, 2011); *see* William K. Sjostrom, Jr., *PIPEs*, 2 ENTREPRENEURIAL BUS. L.J. 381, 383 (2007). Governance rights are more common for holders of preferred stock and can include, for example, the right to nominate directors and veto rights. *See* Paul Tiger, Omar Pringle, Andrea Basham & Vinita Sithapathy, *A Primer on Private Investments in Public Equity (PIPEs) in the US*, LEXOLOGY (Apr. 2, 2020), https://www.lexology.com/library/detail.aspx?g=88b2a5ca-753b-4881-9bde-7eeb1954a2e9 [https://perma.cc/4PXR-EBRM].

174. *See* Steinberg & Obi, *supra* note 172, at 1. As an efficient funding source, PIPEs are more commonly used when a company faces financial trouble or can be used by an "IPO compan[y] to issue common shares to an 'anchor' investor alongside the public offering."

> Companies typically structure PIPEs to avoid requiring stockholder approval either by issuing securities that fall below the 20% threshold altogether or by issuing the excess securities that would otherwise trip the 20% threshold in the form of non-voting convertible securities or warrants that require stockholder approval prior to conversion or exercise into common stock or other voting securities.

Tiger et al., *supra* note 173.

175. *See* Jennifer J. Johnson, *Private Placements: A Regulatory Black Hole*, 35 DEL. J. CORP. L. 151, 177 (2010); James Garrett Baldwin, *What Is the Structure of a Private Equity Fund?*, INVESTOPEDIA (June 13, 2025), https://www.investopedia.com/articles/investing/093015/understanding-private-equity-funds-structure.asp [https://perma.cc/DAM6-NNFA].

176. *See* Steinberg & Obi, *supra* note 172, at 21.

177. *See* Anna Pinedo & Brian Hirshberg, *Staying Nimble in the SPAC PIPE Market*, BLOOMBERG L. (Jan. 2022), https://www.bloomberglaw.com/external/document/X82Q9BOK000000/capital-markets-professional-perspective-staying-nimble-in-the-s [https://perma.cc/EE2X-EPJB].

178. *See id.*

the current shareholders.[179] A sponsor might solicit PIPEs by offering shares below market price.[180] This type of preferential treatment can result in dilution for the remaining shareholders after the de-SPAC transaction.[181] If, however, the de-SPAC loses a substantial portion of its value later on, a little concession at the beginning will be a drop in the bucket.

Another issue concerning the SEC is the potential conflicts of interest between the GPs and LPs in a private investment.[182] Although the PIPE may require concessions to participate in de-SPAC transactions, it is not obvious who gets the concessions—that is, whether the concessions benefit all partners or only GPs.[183] If the LPs are not given the same privileges as the GPs, the LPs may need protection from the GPs who want to participate in a de-SPAC PIPE investment. This is one of the problems that the SEC's PFA Rules addressed before the Fifth Circuit overturned them.[184]

In addition, and even before the SPAC boom in 2021, PIPEs already drew suspicion from courts and the SEC, who saw them as potentially creating opportunities for insider trading before the private offering.[185] The SPAC boom reinforced the suspicion, generating enormous profits for the companies'

179. *See* Newman & Trautman, *supra* note 156, at 663.

180. *See* Frank Fagan & Saul Levmore, *SPACs, PIPEs, and Common Investors*, 25 U. PA. J. BUS. L. 103, 110–11 (2023) (explaining that the relative advantage of PIPEs to obtain favorable terms from SPACs is amplified by the fact that there is a high demand for SPAC financing but a low supply of PIPEs).

181. *See* Newman & Trautman, *supra* note 156, at 663; Fagan & Levmore, *supra* note 180, at 108–10.

182. Potential conflicts of interest between general partners and limited partners in the private fund environment arise in various ways. For example, GPs typically have significant control over the partnership's operations and decisions affecting the fund. *See, e.g.*, 31 C.F.R. § 800.208(e)(7) (2024). This may give rise to conflicts of interest when the GP's decisions favor their own interest over those of the LPs. Furthermore, the presence of fiduciary duties, contractual provisions, and safe harbors are evidence of the private fund legal sphere's awareness of the potential for conflicts of interest and the need for a "check" on the power of GPs. *See, e.g.*, SEC v. Criterion Wealth Mgmt. Servs., Inc., 599 F. Supp. 3d 932, 951–56 (C.D. Cal. 2022) (discussing the breach of fiduciary duty that arose when Criterion failed to disclose conflicts of interest); Allen v. El Paso Pipeline GP Co., 113 A.3d 167, 181 (Del. Ch. 2014) (explaining that the LP agreement conferred "contractual discretion on the Conflicts Committee to balance the competing interests of the Partnership's various entity constituencies when determining whether a conflict-of-interest transaction is in the best interests of the Partnership").

183. The material terms of a de-SPAC transaction, including any PIPE financing, must be disclosed. 17 C.F.R. § 229.1604 (2024). However, the typical PIPE transaction is controlled by a placement agent, where "PIPE purchasers generally do not negotiate for themselves." ANNA T. PINEDO & JAMES R. TANENBAUM, FREQUENTLY ASKED QUESTIONS ABOUT PIPES 3, https://www.sec.gov/info/smallbus/gbfor25_2006/pinedo_tanenbaum_pipefaq.pdf [https://perma.cc/N94E-EZ75].

184. One of the ways the PFA Rules addressed this concern was via the Restricted Activities Rule, prohibiting private fund advisers from engaging in various activities contrary to investor protection. 17 C.F.R. § 275.211(h)(2)-1; *see* SEC FACT SHEET, *supra* note 4, at 2–3.

185. *See, e.g.*, Burnett v. Rowzee, 561 F. Supp. 2d 1120, 1128 (C.D. Cal. 2008); CompuDyne Corp. v. Shane, 453 F. Supp. 2d 807, 816, 826–28 (S.D.N.Y. 2006); HealthExtras, Inc. v. SG Cowen Sec. Corp., No. 02 Civ. 9613, 2004 WL 97699, at *2 (S.D.N.Y. Jan. 20, 2004); *see also* Steinberg & Obi, *supra* note 172, at 35 n.148; HAZEN, *supra* note 158, § 3:60.

insiders who went public while costing investors billions.[186] This included SPAC sponsors who typically pay only nominal amounts during the IPO for twenty to twenty-five percent of the shares (referred to as founder or sponsor shares), and the executives of the target companies who are often compensated with various stock options.[187]

The use of PIPEs heightens this risk of insider trading. SPAC sponsors seeking funding through PIPEs may divulge specific details about the upcoming business combination.[188] In the course of a SPAC transaction, information that the SPAC is pursuing a business combination with a specific target is likely material non-public information ("MNPI").[189] Trading on MNPI is illegal insider trading.[190]

B. Redemption Rights as Arising Out of Stock Exchange Listing Rules

Redemption rights are the principal protection for SPAC shareholders.[191] After the SPAC has found a target and publicly announces the de-SPAC transaction, it goes through a mandatory shareholder vote or tender offer process, offering "shareholder[s] the right to redeem [their] SPAC shares up until a point just prior to a pending business combination."[192] Redemption rights "essentially guarantee public IPO investors a fixed return," enticing shareholders to invest in the SPAC at the outset.[193]

Although exchanges in the United States generally only mandate redemption rights for shareholders that vote against the de-SPAC transaction,

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186. *See* Tom McGinty, Shane Shifflett & Amrith Ramkumar, *Company Insiders Made Billions Before SPAC Bust*, WALL ST. J. (May 30, 2023, 12:01 AM), https://www.wsj.com/articles/company-insiders-made-billions-before-spac-bust-4607a869 (on file with the *Iowa Law Review*) (noting that "[c]ompanies that went public this way have lost more than $100 billion in market value. At least 12 have filed for bankruptcy and more than 100 are running low on cash, battered by higher interest rates and rising costs," and of the 460 de-SPAC entities analyzed, 232 had company insiders who traded significant amounts of their de-SPAC entity stock).

187. *See* Newman & Trautman, *supra* note 156, at 653. Executive compensation tends to come with lockup provisions that prevent executives from trading for a set period. However, once this period is over, executives can generally trade in the now-public entity's shares. *See also* Landon W. Mignardi, *SEC Enforcement Continues SPAC Crackdown as Founder Trading Profits Generate Scrutiny*, HOLLAND & KNIGHT (June 15, 2023), https://www.hklaw.com/en/insights/publications/2023/06/sec-enforcement-continues-spac-crackdown-as-founder-trading [https://perma.cc/3EAB-U6Y7].

188. *See* Newman & Trautman, *supra* note 156, at 652–54; Alex Wyman, Colleen Smith & Kristin Murphy, *SPAC-Related Enforcement and Litigation: What to Expect in 2022*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 13, 2022), https://www.lw.com/admin/upload/SiteAttachments/2022-04-13-spac-related-enforcement-and-litigation-what-to-expect-in-2022.pdf [https://perma.cc/4NQD-263P].

189. *See* Wyman et al., *supra* note 188.

190. *See id.*

191. Delman v. GigAcquisitions3, LLC, 288 A.3d 692, 709 (Del. Ch. 2023) ("Because of a SPAC's distinctive structure and the absence of a meaningful vote on the merger, the redemption right is the central form of stockholder protection . . . ." (footnote omitted)). Redemption rights are a feature that is unique to SPACs. *See* Newman & Trautman, *supra* note 156, at 659.

192. Newman & Trautman, *supra* note 156, at 665–66.

193. *Delman*, 288 A.3d at 701.

most SPAC sponsors grant them to all shareholders.[194] Additionally, many SPAC sponsors agree to waive their redemption rights for their founder shares.[195] The two most popular exchanges for SPACs are the Nasdaq Stock Market ("Nasdaq") and the New York Stock Exchange ("NYSE").[196] Because Nasdaq and the NYSE typically disallow the initial or continued listing of shell corporations created to merge with other companies, both exchanges require the SPAC to follow discrete requirements to be listed, including providing shareholders with redemption rights.[197] Nasdaq's SPAC rule IM-5101-2(d) addresses redemption rights, stating:

> If a shareholder vote on the business combination is held, public Shareholders voting against a business combination must have the right to convert their shares of common stock into a pro rata share of the aggregate amount then in the deposit account (net of taxes payable and amounts distributed to management for working capital purposes) if the business combination is approved and consummated.[198]

Furthermore, Nasdaq Rule IM-5101-2(d) provides that the SPAC may set a limit, no lower than ten percent of the shares sold in the IPO, as the maximum number of shares to which any shareholder may exercise their conversion rights.[199] Alternatively, suppose a shareholder vote is not held for failure to find an acquisition target to complete a de-SPAC transaction. In that case, the SPAC must allow shareholders to redeem their shares for a percentage of cash in the deposit account (net of taxes payable and amounts

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194. For a helpful table summarizing the relevant Nasdaq, NYSE, and SGX rules on de-SPAC transactions, redemption rights, and SPAC liquidation, see CLIFFORD CHANCE, GUIDE TO SPECIAL PURPOSE ACQUISITION COMPANIES 11–19 (2021), https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2021/09/guide-to-special-purpose-acquisition-companies.pdf [https://perma.cc/2Q3Z-TL28].

195. *See id.* at 15.

196. *See id.*

197. Nasdaq Rule IM-5101-2, *supra* note 167 ("Generally, Nasdaq will not permit the initial or continued listing of a Company that has no specific business plan or that has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies."); NYSE LISTED COMPANY MANUAL, *supra* note 167, § 102.06 ("The Exchange will consider on a case-by-case basis the appropriateness for listing of companies ('acquisition companies' or 'ACs') with no prior operating history that conduct an initial public offering of which at least 90% of the proceeds, together with the proceeds of any other concurrent sales of the AC's equity securities, will be held in a trust account controlled by an independent custodian until consummation of a business combination in the form of a merger . . . ."); *see supra* note 167 and accompanying text.

198. Nasdaq Rule IM-5101-2, *supra* note 167; Order Approving Proposed Rule Change to Amend IM-5101-2, 75 Fed. Reg. 82420, 82421 (Dec. 30, 2010).

199. Nasdaq Rule IM-5101-2, *supra* note 167 ("For purposes of this [rule] . . . Shareholder excludes [the SPAC's] officers[,] . . . directors[, and] sponsor[s] . . . ."); Order Approving Proposed Rule Change to Amend IM-5101-2, 75 Fed. Reg. at 82421. In practice, SPACs tend to impose redemption limitations of fifteen to twenty percent. The limits are rarely below fifteen percent. *See* CLIFFORD CHANCE, *supra* note 194, at 15.

distributed to management for working capital purposes).[200] With these guidelines, Nasdaq is the most common exchange for SPACs.[201]

The NYSE advances similar listing rules for SPACs.[202] Under NYSE Rule section 102.06(b):

> [I]f a shareholder vote on a Business Combination is held, each public shareholder voting against the Business Combination will have the right . . . to convert its shares of common stock into a pro rata share of the aggregate amount then on deposit in the trust account (net of taxes payable, and amounts disbursed to management for working capital purposes), provided that the Business Combination is approved and consummated.[203]

When a shareholder vote is not held, the SPAC "must provide all shareholders with the opportunity to redeem all their shares for cash equal to their pro rata share of the aggregate amount then in the deposit account."[204] The NYSE, however, limits the maximum number of shares for which a shareholder may exercise their redemption rights.[205] Distinct from Nasdaq, the NYSE requires that the SPAC's founding shareholders "waive their rights to participate in any liquidation distribution with respect to all shares of common stock owned by each of them prior to the IPO or purchased in any private placement occurring in conjunction with the IPO."[206]

The main exchanges effectively require SPAC IPOs[207] to provide minimum shareholder redemption protections: Shareholders voting against the transaction must be able to redeem a certain number of shares, and sponsors must place ninety percent of IPO proceeds in trust while searching

200. Nasdaq Rule IM-5101-2, *supra* note 167; Order Approving Proposed Rule Change to Amend IM-5101-2, 75 Fed. Reg. at 82421–22.

201. *See What Is a SPAC?*, NASDAQ, https://www.nasdaq.com/solutions/listings/markets/americas/ways-to-list/spac [https://perma.cc/34MP-TRUT].

202. *See* NYSE LISTED COMPANY MANUAL, *supra* note 167, § 102.06; Order Granting Accelerated Approval, 82 Fed. Reg. 32022, 32022–24 (July 11, 2017).

203. NYSE LISTED COMPANY MANUAL, *supra* note 167, § 102.06(b); Order Granting Accelerated Approval, 82 Fed. Reg. at 32023. However, to encourage investment, most U.S. SPACs offer redemption rights to all shareholders "regardless of how they vote[d] on a proposed merger." *See* J. Clayton Burnheimer, Comment, *SPACS: Sponsor Compensation, Redemption Rights, and Congressional Oversight*, 2023 MICH. ST. L. REV. 529, 540.

204. NYSE LISTED COMPANY MANUAL, *supra* note 167, § 102.06(c); Order Granting Accelerated Approval, 82 Fed. Reg. at 32023 n.16.

205. For both the NYSE and Nasdaq, SPACs may set a limit of no lower than ten percent of any shares sold in the IPO, and the maximum is generally limited to between fifteen to twenty percent of the outstanding SPAC shares. *See* CLIFFORD CHANCE, *supra* note 194, at 15.

206. NYSE LISTED COMPANY MANUAL, *supra* note 167, § 102.06(f); Order Granting Accelerated Approval, 82 Fed. Reg. at 32022–24.

207. NASDAQ, NASDAQ WELCOMES 66 IPOS IN THE FIRST HALF OF 2024 (2024), https://ir.nasdaq.com/node/107736/pdf [https://perma.cc/4N4P-BBWJ] (explaining "81% of all eligible SPAC IPOs" in the first half of 2024 were listed on Nasdaq).

for a target acquisition.[208] In practice, most SPACs offer redemption rights to all shareholders and place all IPO proceeds in trust to assure redeeming shareholders will receive the full IPO price paid.[209] In light of the prevailing practices, the SEC has declined to require SPACs to offer redemption rights but does require extensive disclosure regarding redemption rights.[210]

V. SEC'S DISCLOSURE RULES REGARDING REDEMPTION RIGHTS

The SEC requires disclosures about the shareholders' redemption rights at each stage in a SPAC's lifespan to keep the public informed.[211] Item 1602(a)(2) requires SPACs to "[s]tate whether security holders will have the opportunity to redeem the securities offered and whether the redemptions will be subject to any limitations."[212] Accordingly, under Item 1604(b), the SPAC is required to briefly summarize security holders' redemption rights as well as "the potential dilutive impact of redemptions on non-redeeming shareholders" for the protection of shareholders as the SPAC nears a business combination.[213]

Finally, the SEC also requires redemption right disclosures at the final de-SPAC transaction stage.[214] If a security holder objects to the transaction and no redemption or appraisal rights are available, Item 1605 requires SPACs

208. Nasdaq Rule IM-5101-2, *supra* note 167; Order Approving Proposed Rule Change to Amend IM-5101-2, 75 Fed. Reg. 82420, 82421 (Dec. 30, 2010); NYSE LISTED COMPANY MANUAL, *supra* note 167, § 102.06; Order Granting Accelerated Approval, 82 Fed. Reg. at 32023 n.12.

209. *See* CLIFFORD CHANCE, *supra* note 194, at 17.

210. Special Purpose Acquisition Companies, Shell Companies, and Projections, 89 Fed. Reg. 14158, 14166–67 (Feb. 26, 2024) (codified at 17 C.F.R pts. 210, 229, 230, 232, 239, 240, 249) ("We continue to believe . . . that the definition should not include certain criteria, including the issuance of redeemable securities, that could result in an overly narrow definition by including transactional terms that have not applied to every SPAC offering in the past or that could change as the SPAC market continues to evolve."); 17 C.F.R. § 229.1602(a)(2) (2024) (requiring SPAC disclosure of redemption rights and restrictions in the registration statement and prospectus).

211. 17 C.F.R. §§ 229.1602, 229.1605.

212. *Id.* § 229.1602(a)(2).

213. *Id.* § 229.1604(b)(6). Disclosures include:

> [T]he offering price disclosed pursuant to § 229.1602(a)(4) (Item 1602(a)(4)) in the initial registered offering by the SPAC; as of the most recent balance sheet date filed, the net tangible book value per share, as adjusted, as if the selected redemption levels have occurred, and to give effect to, while excluding the de-SPAC transaction itself, material probable or consummated transactions and other material effects on the SPAC's net tangible book value per share from the de-SPAC transaction; and the difference between such offering price and such net tangible book value per share, as adjusted.

Id. § 229.1604(c); *id.* § 229.1604(c)(1) ("With respect to each redemption level, state the company valuation at or above which the potential dilution results in the amount of the non-redeeming shareholders' interest per share being at least the initial public offering price per share of common stock.").

214. *Id.* § 229.1602(a)(2) (requiring the prospectus at the final de-SPAC transaction stage to "state whether securit[ies] holders will have the opportunity to redeem the securities offered and . . . any limitations" that may apply). Furthermore, the SEC requires the disclosure to state whether or not securities holders are entitled to redemption rights. *Id.* § 229.1605(e).

to identify "any other rights that may be available to security holders."[215] This Part discusses how litigation has been used as a means of enforcing redemption rights, as well as new rules adopted by the SEC in 2024 to regulate SPACs with the goal of investor protection.

A. *Litigation as a Means of Enforcing Redemption Rights*

If a SPAC fails to adhere to stock exchange listing rules, it is not permitted to list its IPO.[216] If the SPAC is already listed, it gets delisted. If the SPAC does not comply with redemption rights protected under state corporate law, shareholders have generally brought claims alleging breach of fiduciary duty.[217]

Delaware, where most SPACs in the United States are incorporated, has faced increased SPAC challenges alleging a breach of fiduciary duty.[218] Generally, when "assessing [a] claim[] for breach of fiduciary duty, Delaware courts apply one of three standards of review": the business judgment rule, entire fairness, or enhanced scrutiny.[219] Enhanced scrutiny is typically applied in the case of a takeover defense or change in control rather than in the SPAC context.[220] The business judgment rule presumes that directors and officers have acted on an informed basis when making decisions on behalf of a corporation.[221] A plaintiff can rebut the presumption by demonstrating a breach of fiduciary duties.[222] If the plaintiff rebuts the presumption, the entire fairness test applies. Under the entire fairness test, the highest level of scrutiny, the fiduciary bears the burden to show the challenged transaction was entirely fair *both* in terms of (1) price and (2) the process of dealing.[223] The fiduciary duty of care requires that officers and directors act with

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215. *Id.* § 229.1605(e).

216. An exchange may not be listed as a national securities exchange unless the SEC determines "[t]he rules of the exchange prohibit the listing of any security . . . in a limited partnership rollup transaction" unless the transaction follows the procedures protecting LPs' rights. This implies that adherence to rules is a prerequisite for listing. *See* 15 U.S.C. § 78f(9)(A); *see also* Atlas Tack Corp. v. N.Y. Stock Exch., 246 F.2d 311, 319 (1st Cir. 1957) (indicating that compliance with listing rules is essential for a security to be listed).

217. *E.g.*, Delman v. GigAcquisitions3, LLC, 288 A.3d 692, 708 (Del. Ch. 2023); *In re* MultiPlan Corp. S'holders Litig., 268 A.3d 784, 798–800 (Del. Ch. 2022); *In re* Hennessy Cap. Acquisition Corp. IV S'holder Litig., 318 A.3d 306, 318 (Del. Ch. 2024), *aff'd*, No. 245, 2024, 2024 WL 5114140, at *1 (Del. Dec. 16, 2024).

218. Manola Aillaud, *Fiduciary Duty Claims in the Context of SPACs: A "Quintessential Delaware Concern*,*"* COLUM. BUS. L. REV. ONLINE (Nov. 28, 2022), https://journals.library.columbia.edu/index.php/CBLR/announcement/view/575 [https://perma.cc/R3C2-NY34]; *e.g.*, *MultiPlan*, 268 A.3d at 798–800; *Delman*, 288 A.3d at 708.

219. Richard I. Werder, Jr., Rachel E. Epstein, Marlo A. Pecora & Michael A. Barlow, *Comparison with Business and Commercial Litigation in Delaware Courts*, *in* BUSINESS AND COMMERCIAL LITIGATION IN FEDERAL COURTS § 13:79 (Robert L. Haig ed., 5th ed. Supp. 2024).

220. *See In re* Match Grp., Inc. Derivative Litig., 315 A.3d 446, 459–60 (Del. 2024).

221. *See* Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1162–63 (Del. 1995); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (holding that before the business judgment rule presumption can be applied, directors must demonstrate reasonableness in decision-making in light of the circumstances), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

222. *See Cinerama, Inc.*, 663 A.2d at 1162–63.

223. Werder et al., *supra* note 219, § 13:79.

reasonable care and consider reasonably available information when making business decisions.[224] The fiduciary duty of loyalty mandates that company decision-makers act in the corporation's and its shareholders' best interest.[225] It should be noted, however, that fiduciary responsibilities of the GPs can be modified or waived by the limited partnership agreement in Delaware.[226]

With regard to SPACs, Delaware courts have held that failure to respect redemption rights may be a breach of these fiduciary duties.[227] A duty of loyalty concern arises in the case of a conflicted transaction in which directors are either self-interested or lack independence from the interested party.[228] In this case, Delaware courts have held that the more demanding standard of entire fairness is the appropriate standard.[229] To defeat a motion to dismiss, the plaintiff must rebut the business judgment rule presumption by providing enough to create a reasonable inference of a conflict.[230] Then, the burden shifts to the defendant to demonstrate the entire fairness of the transaction.[231]

The first case in which the Delaware Chancery Court denied a motion to dismiss in a SPAC case was *In re MultiPlan Corp. Stockholders Litigation*, which occurred in 2022.[232] Stockholders of a SPAC brought a putative class action alleging that the SPAC's directors breached their fiduciary duties by, among other things, issuing allegedly "false and misleading proxy [statements] that impaired . . . stockholders' informed exercise of their redemption rights."[233] The Delaware court agreed, holding that the stockholders stated viable claims for breach of fiduciary duties by the directors.[234] Additionally, the court held that the entire fairness standard of review was applicable due to the conflicting nature of the de-SPAC transaction and because the SPAC directors "failed, disloyally, to disclose information necessary for the plaintiffs to knowledgeably exercise their redemption rights."[235] The court's holding in *MultiPlan* protected redemption rights within a SPAC director's fiduciary duties, setting the stage for further clarification on their enforceability.

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224. Duty of care claims are protected by the business judgment rule presumption and are generally subject to exculpation under Delaware corporate law. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2006 & Supp. 2025); Werder et al., *supra* note 219, § 13:78.

225. Werder et al., *supra* note 219, § 13:77.

226. *See* Clayton, *supra* note 16, at 77.

227. *E.g.*, *In re* MultiPlan Corp. S'holders Litig., 268 A.3d 784, 815–17 (Del. Ch. 2022); Delman v. GigAcquisitions3, LLC, 288 A.3d 692, 712–13 (Del. Ch. 2023).

228. *See MultiPlan*, 268 A.3d at 800; *Delman*, 288 A.3d at 712–14.

229. Entire fairness is "Delaware's 'most onerous standard of review.'" *MultiPlan*, 268 A.3d at 809 (quoting Frederick Hsu Living Tr. v. ODN Holding Corp., No. 12108, 2017 WL 1437308, at *26 (Del. Ch. Apr. 14, 2017)). "Delaware courts place conflicted controller transactions implicating entire fairness into one of two categories: where the controller stands on both sides and where the controller competes with the common stockholders for consideration." *Id.* (internal quotation marks omitted).

230. *See id.* at 812–17.

231. This requires a showing of fair dealing and fair price. *Id.* at 815–16.

232. *See id.* at 792.

233. *See id.* at 799.

234. *See id.* at 802–03.

235. *See id.* at 816.

Like the shareholders in *MultiPlan*, the public shareholders in *Delman v. GigAcquisitions3, LLC* filed a putative class action against the directors of the SPAC (GigAcquisitions3, LLC) for breach of fiduciary duties.[236] The suit resulted from the SPAC's aggressive forecasts, followed by the stock value rapidly dropping after the de-SPAC transaction.[237] The SPAC shareholders claimed the directors breached their fiduciary duties by prioritizing their own finances, "depriving [the] stockholders of information necessary to decide whether to redeem or to invest in the combined company."[238] Denying the SPAC's motion to dismiss, the *Delman* court reaffirmed *MultiPlan* and, after finding that the plaintiffs stated "reasonably conceivable claims," applied the entire fairness standard of review.[239] Furthering redemption right jurisprudence, the *Delman* court stated that the fiduciary duties of care and loyalty "give rise to a duty of disclosure" and those "duties owed by the fiduciaries of a SPAC organized as a Delaware corporation are no different" than other corporations.[240] The court also noted that individual proof of shareholder reliance on the SPAC's proxy was unnecessary because "[t]he redemption right, though individual in nature, created a 'collective action problem.'"[241]

Together, *MultiPlan* and *Delman* create important protections for redemption rights. Under both cases, if the SPAC fails to properly disclose information regarding the de-SPAC transaction or misleads the shareholders on how to utilize their redemption rights, the shareholders likely have a claim for breach of fiduciary duty under state law.[242]

B. *THE SEC'S 2024 RULES REGARDING SPACS*

According to the SEC, although the number of SPAC IPOs has declined since its boom in 2021, SPACs still play an increasing role in U.S. securities markets.[243] Thus, the concerns over investment protection remain. To address these concerns, the SEC adopted the SPAC Rules in February 2024.[244] Effective July 2024, the SPAC Rules reflect the SEC's continued goal of protecting investors by addressing information imbalances, misleading content, and conflicts of interest in SPACs and de-SPAC transactions.[245] In passing the

236. The *Delman* plaintiffs also sued for unjust enrichment, along with breach of fiduciary duty. *See* Delman v. GigAcquisitions3, LLC, 288 A.3d 692, 707–09 (Del. Ch. 2023).

237. GigAcquisitions3's stock fell more than ninety-five percent in the months following its de-SPAC transaction. *Id.* at 707.

238. *Id.* at 708.

239. *Id.* at 729.

240. *Id.* at 712.

241. *Id.* at 711.

242. *See In re* MultiPlan Corp. S'holders Litig., 268 A.3d 784, 815–17 (Del. Ch. 2022); *Delman*, 288 A.3d at 711–13.

243. *See* Special Purpose Acquisition Companies, Shell Companies, and Projections, 89 Fed. Reg. 14158, 14162 (Feb. 26, 2024) (codified at 17 C.F.R pts. 210, 229, 230, 232, 239, 240, 249).

244. *Id.*

245. The rules took effect July 1, 2024, and were not invalidated by the Fifth Circuit ruling in *National Ass'n of Private Fund Managers v. SEC*, 103 F.4th 1097, 1114 (5th Cir. 2024). 17 C.F.R.

SPAC Rules, the SEC considered many SPAC-related concerns, such as SPAC sponsor compensation, dilution, and potential conflicts of interest.[246] The most prominent changes in the SPAC Rules included: (1) underwriter status and liability in de-SPAC transactions; (2) the elimination of the Private Securities Litigation Reform Act ("PSLRA") safe harbor; (3) the status of SPACs under the Investment Company Act; and (4) enhanced projections and de-SPAC transaction disclosure requirements.

First, regarding the status of underwriters, rather than adopting a rule, the SEC issued guidance on how to apply the statutory definition of underwriter to de-SPAC transactions.[247] The Securities Act defines an underwriter as "any person who has purchased [shares] from an issuer with a view to . . . the distribution of any security, or participates" in the distribution of securities.[248] Underwriters are one of the parties subject to anti-fraud liability in the required disclosure documents accompanying distributions of stock, subject to a due diligence defense. As routine players and gatekeepers in the industry, underwriters "occup[y] a unique position" and are subject to higher standards in asserting a due diligence defense.[249] Traditionally, de-SPAC transactions have not involved underwriters or corresponding liability because they involve a merger and not a distribution.[250] The SEC adopted a rule deeming any SPAC transaction to be a sale of securities (i.e., a distribution) subject to disclosure requirements and anti-fraud provisions.[251]

The SEC initially proposed a rule that would have automatically extended underwriter liability to SPAC IPO underwriters partaking in the de-SPAC transaction.[252] Market feedback, however, indicated that this would have a "chilling effect on the use of projections that investors find useful."[253] Instead, the SEC's SPAC Rules adopted guidance to assist participants in determining whether they qualified as underwriters.[254] There is concern, however, that the guidance does not sufficiently explain what qualifies as a statutory underwriter in the de-SPAC transaction.[255] Simultaneously, the guidance instructs institutions

§§ 229.1602–229.1605 (2024); 1 BRENT A. OLSON, PUBLICLY TRADED CORPORATIONS HANDBOOK § 5:78 (2d ed. Supp. 2025).

246. *See* 1 OLSON, *supra* note 245, § 5:78(g).

247. *See* Special Purpose Acquisition Companies, Shell Companies, and Projections, 89 Fed. Reg. at 14236.

248. 15 U.S.C. § 77b(a)(11).

249. *In re* WorldCom, Inc. Sec. Litig., 346 F. Supp. 2d 628, 662 (S.D.N.Y. 2004) (quoting The Regulation of Securities Offerings, Securities Act Release No. 7606A, 63 Fed. Reg. 67174, 67230 (proposed Dec. 4, 1998) (to be codified at 17 C.F.R. pts. 200, 202, 210, 228, 229, 230, 232, 239, 240, 249)).

250. Haaland, *supra* note 163, at 201.

251. 17 C.F.R. § 230.145a (2024).

252. *See* Special Purpose Acquisition Companies, Shell Companies, and Projections, 89 Fed. Reg. at 14235.

253. *Id.* at 14226–27 ("One of the commenters said that 'we believe the removal of the PSLRA safe harbor would have a significant chilling effect on De-SPAC Transactions' and that this 'chilling effect is also demonstrated by the fact that IPO issuers rarely publicly include projections in the registration statement.'").

254. *Id.* at 14235–38.

255. *Id.* at 14237–38.

"to perform the necessary due diligence" in SPAC transactions "or face full exposure to liability without the benefit of the due diligence defense under the Securities Act of 1933."[256] Accordingly, institutions may not know what level of due diligence to provide.

Next, the SEC rules effectively prevent SPACs from taking advantage of the PSLRA's rule that provides a safe harbor for forward-looking statements.[257] The SEC did this by expanding the definition of "blank check company" under the PSLRA to include SPACs.[258] This change could have a chilling effect on a director's use of projections for de-SPAC transactions.[259] Furthermore, the SEC chose not to add a safe harbor for SPACs under the Investment Company Act.[260] The SEC noted that SPACs may meet the definition of investment company at any stage, "depending on the facts and circumstances."[261] Thus, the rules restricted SPACs from using safe harbors and left open the possibility that SPACs could be classified as investment companies.

Finally, the SPAC Rules also added new disclosure requirements.[262] Specifically, the SEC now requires enhanced projections disclosures, mandating SPACs to issue statements regarding whether projections have been made based on historical financial results or operational history.[263] For de-SPAC transactions, the SPAC Rules require disclosure of: (1) "the purpose for which the projections were prepared"; (2) "the party that prepared the projections"; (3) "all material bases of . . . [and] assumptions underlying the projections"; and (4) "factors that may affect such assumptions. . . . [and a] state[ment] whether or not the projections reflect the view of the . . . board."[264]

The rules also require the SPAC's governing body to disclose determinations about "whether the de-SPAC transaction is advisable and in the best interests of the SPAC and its shareholders."[265] The rules mandate disclosure

256. *Id.* at 14238.

257. *See* 17 C.F.R. §§ 229.1602–229.1605 (2024). The PSLRA's safe harbor provides immunization for forward-looking statements that meet the requirements of 15 U.S.C. § 78u-5(c)(1). *See* 1 OLSON, *supra* note 245, § 12:125.

258. Special Purpose Acquisition Companies, Shell Companies, and Projections, 89 Fed. Reg. 14158, 14160 n.1 (Feb. 26, 2024) ("The regulation at 17 [C.F.R.] 230.419(a)(2) defines the term 'blank check company' as a development stage company that has no specific business plan or purpose or that has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies and that is issuing 'penny stock,' as defined in 17 [C.F.R.] 240.3a51-1 ('Rule 3a51-1' under the Securities Exchange Act of 1934).").

259. *Id.* at 14222–27.

260. *Id.* at 14164, 14258–59; *SEC Approves Final SPAC Rules*, VINSON & ELKINS (Jan. 25, 2024), https://www.velaw.com/insights/sec-approves-final-spac-rules [https://perma.cc/RF8H-QBAY].

261. Special Purpose Acquisition Companies, Shell Companies, and Projections, 89 Fed. Reg. at 14164.

262. *See id.* at 14163.

263. *See* 17 C.F.R. § 229.1609 (2024); *SEC Approves Final SPAC Rules*, *supra* note 260 (explaining that the final rules also mandate a disclosure "defining and explaining non-GAAP financial measures in projections").

264. 17 C.F.R. § 229.1609; *see* Special Purpose Acquisition Companies, Shell Companies, and Projections, 89 Fed. Reg. at 14254; *SEC Approves Final SPAC Rules*, *supra* note 260.

265. *SEC Approves Final SPAC Rules*, *supra* note 260; *see* Special Purpose Acquisition Companies, Shell Companies, and Projections, 89 Fed. Reg. at 14254.

of the factors the SPAC board considered in making its decision and information about the approvals for de-SPAC transactions and related financing transactions.[266] Additionally, the SPAC Rules mandate disclosure of potential or actual material conflicts of interest between: "(1) [t]he SPAC sponsor or its affiliates; the [SPAC's] officers, directors, or promoters; . . . and (2) [u]naffiliated security holders" in de-SPAC transactions and SPAC IPOs.[267] The SPAC Rules also ensure that disclosure requirements for conflicts of interest cover the target company's officers and directors.[268] In sum, the SPAC Rules impose stricter disclosure requirements, requiring information on the rationale behind de-SPAC transactions as well as the factors considered in making the decisions and the approvals obtained for the transaction.

Overall, the SPAC Rules reflect the SEC's goal of aligning SPAC rules with those of traditional IPOs.[269] There is concern, however, that the SPAC Rules fail to address the "discrepancies in the treatment of companies that go public via de-SPAC transaction and those that go public through the traditional IPO process."[270] For example, the restrictions imposed "on former SPACs have materially impacted many investors' ability to sell their securities."[271] At the same time, the impact of the SPAC Rules may be overstated. Because the 2024 rules were an outgrowth of rules proposed by the SEC in 2022, many SPACs already follow many of the finalized regulations. For example, many SPACs already disclose in their proxy and registration statements regarding the director's reasons for de-SPAC determinations, and enhanced projection disclosures are already industry standard.[272] Thus, the rules may not have a substantial impact on current practice.

266. *SEC Approves Final SPAC Rules*, *supra* note 260; *see* Special Purpose Acquisition Companies, Shell Companies, and Projections, 89 Fed. Reg. at 14175–78.

267. 17 C.F.R. § 229.1603(b).

268. *Id.*

269. *See* Gary Gensler, *Statement on Final Rules Regarding Special Purpose Acquisition Companies (SPACs), Shell Companies, and Projections*, U.S. SEC. & EXCH. COMM'N (Jan. 24, 2024), https://www.sec.gov/newsroom/speeches-statements/gensler-statement-final-rule-012424 [https://perma.cc/5RSZ-86B6] ("I am pleased to support these final rules because they will better align the protections investors receive when investing in SPACs with those provided to them when investing in traditional IPOs."); *cf.* Hester M. Peirce, *For the Birds: Statement on Adoption of Rule Regarding Special Purpose Acquisition Companies, Shell Companies, and Projections*, U.S. SEC. & EXCH. COMM'N (Jan. 24, 2024), https://www.sec.gov/newsroom/speeches-statements/peirce-statement-final-rule-012424 [https://perma.cc/KZX2-ZUU7] ("I cannot support this rule. The Commission has failed to identify a problem in need of a regulatory solution. . . . [T]he traditional IPO is not the right process for every company to enter the public markets."); Mark T. Uyeda, *Dissenting Statement on Final Rule on Special Purpose Acquisition Companies, Shell Companies, and Projections: The Commission Embraces Merit Regulation*, U.S. SEC & EXCH. COMM'N (Jan. 24, 2024), https://www.sec.gov/newsroom/speeches-statements/uyeda-statement-final-rule-012424 [https://perma.cc/VBA4-ZZGK] (collectively discussing the regulatory overreach and characterizing the Rules as an attempt to discourage SPACs altogether).

270. *SEC Approves Final SPAC Rules*, *supra* note 260.

271. *Id.*

272. *See id.*

VI. Empirical Analysis

This Article now turns to the data. How do the limited partners in a PIPE investment perform in a de-SPAC transaction? This Part presents evidence and analysis consistent with demonstrating substantial and systematic losses suffered by the private investors in de-SPAC transactions, justifying the SEC's efforts to regulate the private funds sector. Section VI.A describes our data and empirical methodology, and Section VI.B shares the results.

A. Data

The SPAC data includes IPO proceeds, IPO date, de-SPAC trading symbol, PIPE status and amount of PIPE financing, de-SPAC date, dollar amount and percentage of shares redeemed around the de-SPAC dates, and sponsor shares and forfeitures of sponsor shares from SPACInsider, which is a subscription-only data vendor.[273] Our sample includes all U.S. SPACs that have successfully completed the de-SPAC transaction. The time period is from December 2010 to August 2023. We stopped the de-SPAC dates on August 31, 2023, to allow a minimum four-month performance measurement window since our return data extends to the end of 2023. All stock price and return data come from the Center for Research in Security Prices ("CRSP")— a University of Chicago affiliate that provides subscription-based, high-quality data used in financial research.[274] Ticker symbols and unique numbers assigned to each public firm by the Committee on Uniform Security Identification Procedures were used to match the SPAC data from the SPACInsider dataset to price and return information from the CRSP dataset.

We include only completed de-SPAC transactions because our study focuses on the valuations around the de-SPAC dates. Hence, we exclude all SPACs filed, searched, announced, withdrawn, or abandoned.

1. Sample Characteristics

Table 1 shows the dataset's sample characteristics. The final sample contains 408 firms with sufficient data on CRSP to compute abnormal returns. We define large and small firms based on the size of the IPO proceeds. Firms with greater than $250 million in proceeds are defined as large IPOs. This threshold approximately divides our sample into two equal-sized groups.

The average PIPE ownership at the de-SPAC date is about nine percent. The average IPO proceeds are about $250 million and vary from $150 million for small IPOs to $441 million for large IPOs. Approximately half of the original IPO shareholders redeem their shares at the de-SPAC date, creating the need for new funding for the de-SPAC transaction.

273. See *Pricing*, SPACInsider, https://www.spacinsider.com/pricing [https://perma.cc/9GJU-RY3A], for subscription information.

274. The CRSP database is also a subscription-only database that comes with a subscription to the Wharton Research Database. *See Center for Research in Security Prices, LLC (CRSP)*, Wharton Rsch. Data Servs., https://wrds-www.wharton.upenn.edu/pages/about/data-vendors/center-for-research-in-security-prices-crsp [https://perma.cc/W2FB-UPWN].

Table 1. Sample Characteristics of De-SPAC Transactions, 2010 to 2023

	Small Firms	**Large Firms**	**All Firms**
Number of Firms	209	199	408
Number of Firms with PIPE Financing at De-SPAC Date	124	167	291
Average PIPE Ownership (%) at De-SPAC Date	7.81	10.29	9.02
% Redeemed at De-SPAC Date	58.60	46.10	52.50
Average Total Public Proceeds at IPO ($)	152.0M	441.3M	293.1M

2. Measurement of Abnormal Returns

Next, we turn our attention to the information content of de-SPAC transactions.[275] We take the expected return as the market return on small firms. Hence, we compute abnormal returns by subtracting the return to the equally weighted index of NYSE, American Stock Exchange ("AMEX"), and Nasdaq stocks from the returns for the stocks in the de-SPAC sample.[276] This approach assumes a beta of one for each firm and controls for market movements. Given that the sample contains over four hundred firms, this assumption is satisfied. Hence, the abnormal return AR_{it} for stock *i* and day *t* is computed as $AR_{it} = (R_{it} - R_{mt})$ for each firm *i* and day *t*. R_{it} is the simple daily return on the stock *i* disposed of by insiders on day *t*. R_{mt} is the daily return to the equally weighted index of NYSE, AMEX, and Nasdaq stocks on day *t*. For each event date *t*, these returns are first averaged across all de-SPAC firms *i* to compute average abnormal returns:

$$AAR_t = \frac{1}{n_t}\sum_{i=1}^{n_t} AR_{it}$$

The average abnormal returns are then cumulated across the event dates as:

275. We take our methodology from Sureyya Burcu Avci, Cindy A. Schipani, H. Nejat Seyhun & Andrew Verstein, *Insider Trading by Other Means*, 15 HARV. BUS. L. REV. 217, 257–62 (2025).

276. Our approach here is the same as in S. Burcu Avci, Cindy A. Schipani & H. Nejat Seyhun, *Manipulative Games of Gifts by Corporate Executives*, 18 U. PA. J. BUS. L. 1131, 1152–53 (2016). Using the total return to the value-weighted market portfolio as the benchmark instead of the total return to the equally weighted market portfolio gives similar results. We prefer the equally weighted returns because most of the firms in our sample are small firms, and the equally weighted index of NYSE, AMEX, and Nasdaq firms is a better match for small firms.

$$CAR_T = \sum_{t=1}^{T} AAR_t$$

Positive values of cumulative abnormal profits would show that the de-SPAC investors benefited from the merger transaction, while negative values of the cumulative abnormal profits would show that the de-SPAC investors were hurt by the merger transaction. These cumulative abnormal returns are then graphed to examine the behavior of abnormal returns around the de-SPAC dates.

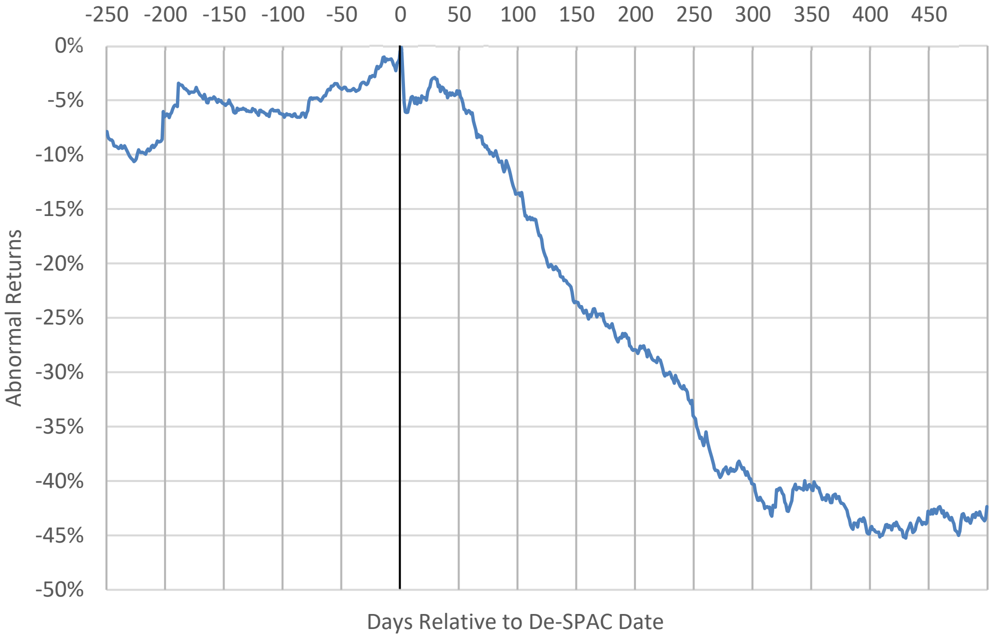
B. Empirical Findings

We now examine the evidence regarding the performance of SPACs as well as de-SPAC transactions with and without PIPE financing. Our results are highly statistically significant given the large economic magnitudes and reasonably large sample sizes. As an example, the difference between PIPE financing and no PIPE financing is statistically significant at better than the 0.001 level. Hence, we can easily reject the interpretation that our results are due to random noise. For expositional purposes, we do not show these regression results.

In Figure 1, we show the cumulative abnormal returns for the overall de-SPAC sample. Prior to the de-SPAC date, cumulative abnormal returns stay near zero, indicating that there is not much news about these IPO firms prior to the de-SPAC date. Following the de-SPAC merger date, however, the stock price begins to drop, starting approximately one month after the de-SPAC date. A year later, stock prices of de-SPAC firms have dropped about forty to forty-five percent. These stock price drops are highly statistically significant. Abnormal performance remains flat after one year.

The fact that cumulative abnormal returns are significantly negative after the de-SPAC date indicates that, on average, SPAC sponsors are paying too high a price for the target firms. As the market recognizes these overvaluations over time, target firms' stock prices drop abnormally, and the cumulative abnormal returns turn negative. This evidence is consistent with the interpretation that the typical SPAC transaction does not benefit the de-SPAC shareholders.

Figure 1. Cumulative Abnormal Returns for All SPACs Around the De-SPAC Date

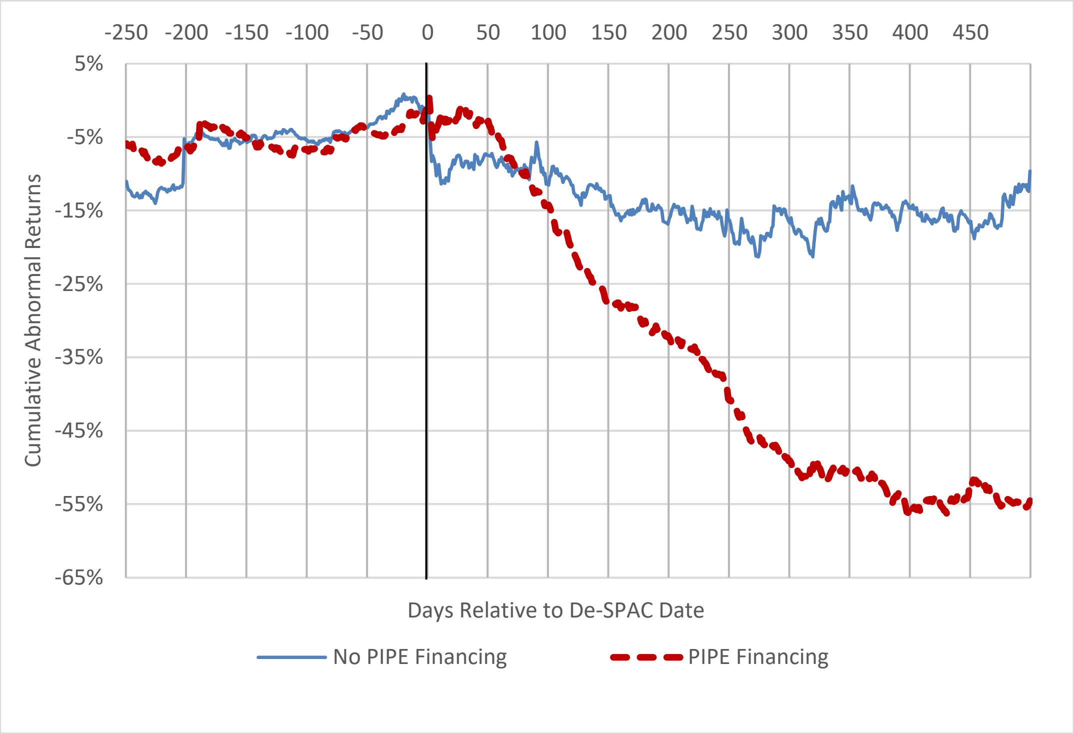


Next, we focus on the presence of PIPE financing at the de-SPAC dates. Our sample contains 291 firms with PIPE financing and 117 firms without PIPE financing.[277] PIPE financing represents a dilution of the original SPAC investors' claims. If the de-SPAC transaction were to be successful, this dilution would hurt the interests of the IPO shareholders. If the de-SPAC transaction were to be a failure, then this dilution would actually benefit the interests of the IPO shareholders.

Our results are shown below in Figure 2. If the de-SPAC transaction did not utilize any PIPE financing, abnormal returns remain close to zero. This finding indicates that the no-PIPE-financing firms basically experienced similar returns as all the other firms in the market. In contrast, firms that utilized PIPE financing experienced immediate and large negative abnormal returns. A little over one year following the de-SPAC transaction, abnormal returns reached over fifty-five percent. Our finding indicates that almost all of the negative performance experienced by the de-SPAC firms was limited to those with PIPE financing.

277. *See supra* Table 1.

Figure 2. Cumulative Abnormal Returns for All SPACs Around the De-SPAC Date, Grouped by PIPE Financing



Our evidence, shown in Figure 2, is consistent with the presence of conflicts of interest, which was one of the issues that the SEC's PFA Rules were designed to address.[278] The sponsors of the SPAC transactions receive a large windfall in the form of promoter shares if the de-SPAC transaction is completed, regardless of the future performance of these firms. Thus, the sponsors are incentivized to complete the de-SPAC transaction. On the other hand, the shareholders and the PIPE investors only benefit if the de-SPAC transaction does well in the marketplace. This divergence and the potential conflicts of interest can result in sponsors pushing even potentially unprofitable de-SPAC transactions to completion.

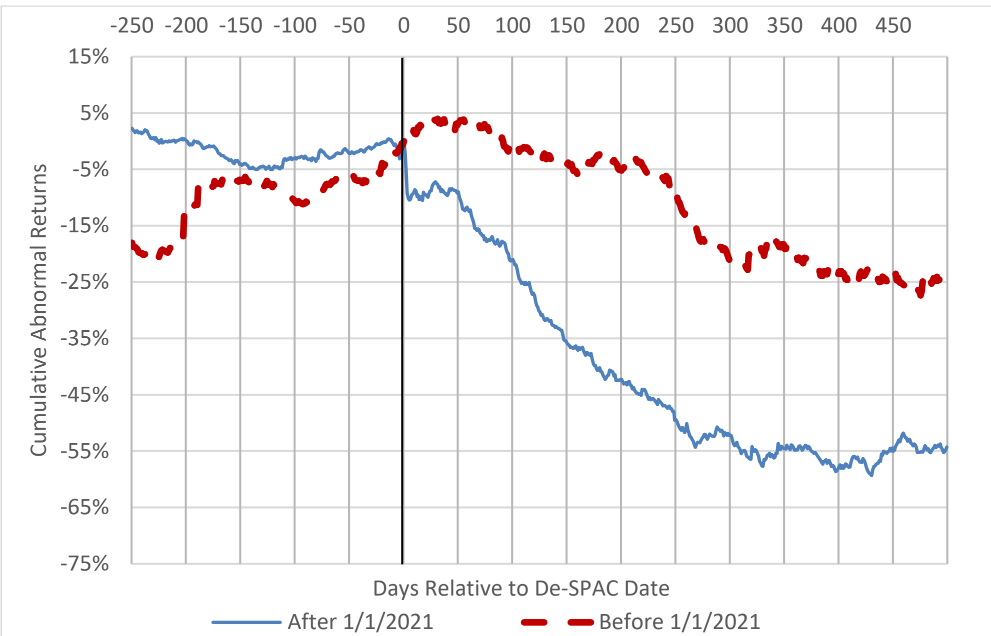
Consequently, sponsors will want to complete the de-SPAC transaction regardless of the price the target firm demands. Overpaying for the target firm will, however, require additional funding sources, including PIPE financing. Therefore, PIPE financing is likely to be associated with overvalued targets. As the market eventually recognizes the overvaluation, the de-SPAC target stock price falls, resulting in negative abnormal performance. The negative cumulative abnormal returns to the de-SPAC, restricted only to the PIPE financing sample,

278. *See supra* Part II.

are thus consistent with the conflicts of interest hypothesis. Negative cumulative abnormal returns mean that LPs whose only source of compensation comes from the performance of de-SPAC firms must lose systematically. Yet, GPs, who receive the bulk of their compensation from one-time fixed deal fees, annual fixed monitoring fees, and annual management fees, can still come out ahead. After all, GPs had access to all of this information, and they still decided to initiate the investment.

Next, we examine the timing of the de-SPAC transactions and break up our sample into groups that completed the de-SPAC transactions before and after January 1, 2021. Our sample contains 156 transactions that occurred before January 1, 2021, and 252 transactions after January 1, 2021. The performance of these firms is shown in Figure 3.

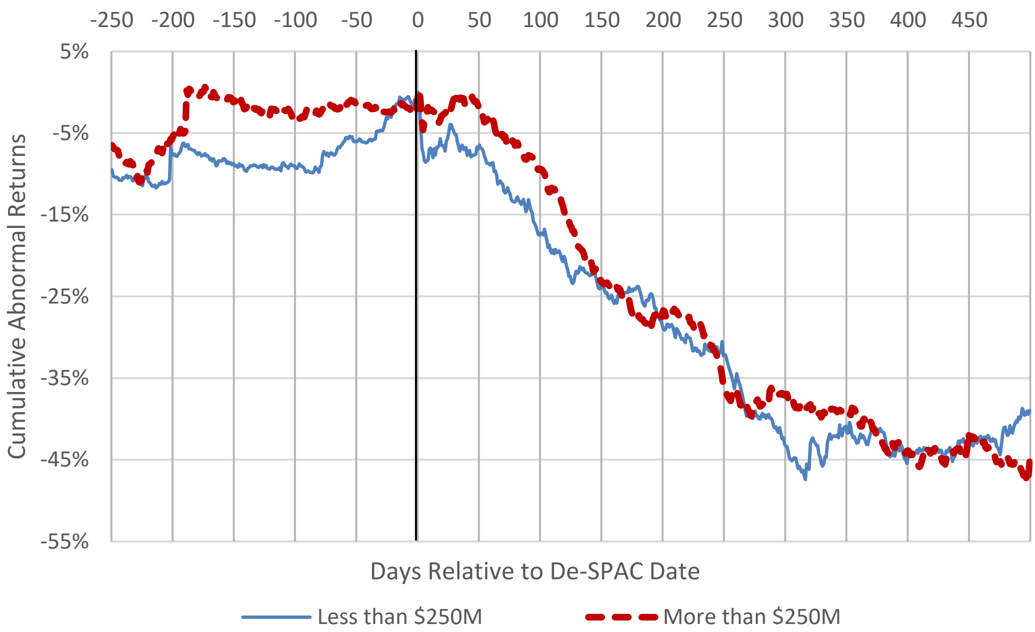
Figure 3. Cumulative Abnormal Returns for All SPACs Around the De-SPAC Date, Grouped by Timing



Our evidence in Figure 3 shows that overvaluation of SPAC targets has been a greater problem more recently. Prior to 2021, de-SPAC targets have lost around twenty-three percent of their value abnormally within two years after the merger date. Since 2021, de-SPAC targets have lost around fifty-five percent of their cumulative value abnormally within two years after the merger date. The fact that these problems appear to be getting worse over time suggests that immediate reforms by the SEC would be well-received in this area.

Next, we investigate whether the subsequent negative performance of the de-SPAC transactions can be attributed to the lack of sufficient funds raised at the IPO stage. To test this hypothesis, we break up our IPO sample into two groups: small IPOs with less than $250 million raised and large IPOs with more than $250 million raised.

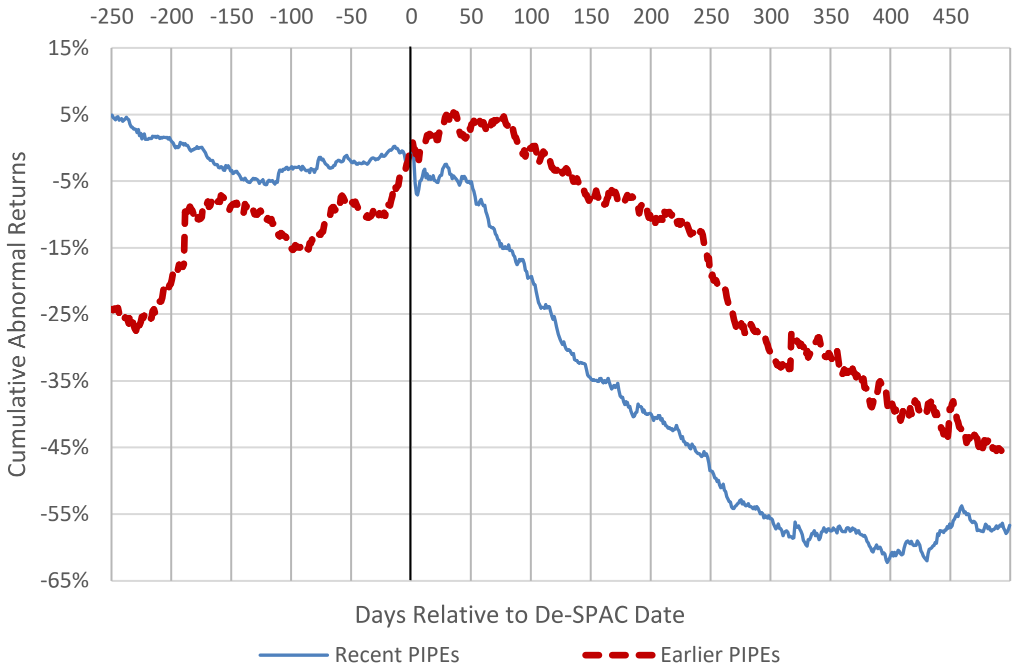
Figure 4. Cumulative Abnormal Returns for All SPACs Around the De-SPAC Date, Grouped by IPO Size



Our evidence is shown in Figure 4. As can be seen in Figure 4, there is hardly any difference in abnormal returns between small and large IPOs. In fact, the difference between the small IPO and large IPO groups is statistically indistinguishable from zero. Furthermore, smaller IPOs do slightly better by falling abnormally only thirty-nine percent, while the large IPOs fall abnormally about forty-five percent during the two years following the de-SPAC transactions. Based on our evidence in Figure 4, we conclude that the amount of funds raised during the IPO stage does not explain the post-de-SPAC performance of the IPO firms.

Finally, we compare the performance of de-SPAC transactions using PIPE financing before and after January 1, 2021. These results are shown in Figure 5. As can be seen, the problems with PIPE-financed de-SPAC transactions seem to be getting worse over time, once again confirming that reforms in this area would be well-received.

Figure 5. Cumulative Abnormal Returns for All SPACs Around the De-SPAC Date, Recent PIPEs



Our evidence so far shows that LPs in PIPE investments in de-SPAC firms lose more than half (about fifty-five percent) of their investment. Hence, there are substantial problems in this area. These problems with de-SPAC investments are mostly confined to those with PIPE investments. Non-PIPE de-SPACs lose less than ten percent. This finding suggests that the problems are not associated with de-SPACs per se, but with the PIPE investments in de-SPACs. Finally, our evidence shows that these conflicts of interest between the PIPE GPs and LPs and systematic losses by LPs are not going away by themselves over time. Instead, regulatory reforms by the SEC are needed to inform and educate the LPs and reduce these conflicts of interest.

VII. Policy Implications

Based on our empirical analysis showing that investors in PIPEs in de-SPAC transactions seem to fare poorly, it is logical to conclude that the GPs of PIPEs are entering these investments without full and fair disclosure to the LPs of the potential conflicts of interest in play. These potential conflicts are likely to be between PIPE GPs and PIPE LPs. It is surprising to find that PIPE

GPs approve de-SPAC investments that the average SPAC investor rejects in some cases by overwhelming proportions, exceeding ninety-five percent.[279]

The fact that PIPE investments take place suggests either that PIPE GPs are naive or that they are conflicted. We can summarily reject the possibility that GPs are naive since they typically have excellent educational backgrounds and have spent years in the investment banking area.[280] The idea that PIPE GPs approve investments that the typical de-SPAC investor rejects points to important conflicts of interest. Perhaps the most logical explanation is that GPs get compensated simply by doing a deal through the one-time deal fees, annual management fees, and monitoring fees, regardless of the expected performance of the de-SPAC investments. It is easy to demonstrate that GPs will be interested in funding a de-SPAC deal even if they expect somewhat unsatisfactory performance for their LPs, since they receive two-thirds of their compensation from fixed fees, regardless of the performance.[281] In contrast, LPs are similar to SPAC investors: LPs get compensated only if the de-SPAC investments are successful. This evidence shows that SEC regulations are urgently needed for the protection of PIPE LPs.

The SEC has not appealed the ruling overturning the PFA Rules. Going forward, we recommend that the SEC use tools provided under the Investment Advisers Act to address problematic conduct previously covered by the now-invalidated PFA Rules, particularly through the enforcement of fiduciary duties.[282] The Investment Advisers Act subjects private advisers to limited reporting and recordkeeping requirements and to a fiduciary duty to the fund.[283] Advisers must act in the best interest of the fund and disclose potential conflicts of interest and material facts.[284] According to the *National Ass'n of Private Fund Managers* court, in the private fund context, the client that the adviser owes this fiduciary duty to is the fund itself, rather than

279. About fifteen percent of our sample has a redemption rate of ninety-five percent or higher.

280. Kaplan & Strömberg, *supra* note 19, at 123.

281. *See* Metrick & Yasuda, *supra* note 17, at 2305–09.

282. *See* Nat'l Ass'n of Priv. Fund Managers v. SEC, 103 F.4th 1097, 1103–05 (5th Cir. 2024) (indicating that the Investment Advisers Act grants the SEC the power to facilitate clear disclosures to investors and to promulgate rules prohibiting or restriction certain sales practices, conflicts of interest, and compensation schemes that hurt the protection of investors); SEC v. Cap. Gains Rsch. Bureau, Inc., 375 U.S. 180, 186 (1963) (noting that the Investment Advisers Act was "last in a series of Acts designed to eliminate certain abuses in the securities industry"); SEC v. Nutmeg Grp., LLC, 162 F. Supp. 3d 754, 777 (N.D. Ill. 2016) ("The purpose of the Advisers Act and its rules is to protect investors, not investment advisers.").

283. 15 U.S.C. §§ 80b-4, 80b-6.

284. *See* Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 Fed. Reg. 33669, 33671 (July 12, 2019); *Nat'l Ass'n of Priv. Fund Managers*, 103 F.4th at 1103–05 (recognizing that the Investment Advisors Act imposes a fiduciary duty between an investment adviser and their client, which, in the context of private funds, is the fund itself); SEC v. Westport Cap. Mkts. LLC, 408 F. Supp. 3d 93, 103 (D. Conn. 2019) ("[A]n investment adviser may violate section 206(1) [of the Investment Advisers Act] by failing to disclose material information about the adviser's conflict of interest even if the adviser had no intent to injure his clients."); 17 C.F.R. § 275.206(3)-2 (2025). *See generally* VACATED PRIVATE FUND ADVISER RULES UNDER THE INVESTMENT ADVISERS ACT OF 1940, PRACTICAL L. CORP. & SEC. (2025).

individual investors.[285] GPs of PIPEs are investment advisers to the fund, thus owing fiduciary duties to the fund, which should then protect the LPs.

When initially proposing the PFA Rules, the SEC discussed the role of fiduciary duties. In its original notice, the SEC proposed a rule that included a prohibition on seeking "reimbursement, indemnification, exculpation, or limitation of its liability by the private fund or its investors for a breach of fiduciary duty."[286] The SEC did not adopt this rule, however, stating that it was redundant because the investment adviser's preexisting fiduciary duties under the Advisers Act independently require this prohibition.[287] Thus, the SEC acknowledged that some of the underlying purposes of the PFA Rules may also be addressed, or even enforced, through the focus on fiduciary duties.

Therefore, the SEC could potentially accomplish some of the same goals the original PFA Rules attempted through the emphasis on fiduciary duties and enforcement thereof.[288] Given the *National Ass'n of Private Fund Managers* decision, the challenge remains regarding how the SEC could further define the form of these fiduciary duties or clarify how the duties manifest where the private fund adviser owes them to the fund and not the investors. But fiduciary duties and principles are still present and remain a potential weapon for SEC enforcement opportunities moving forward, at least with respect to the protection of the private equity funds.[289] By examining whether advisers' disclosures match actual practices, the SEC may screen for fraud.[290] By assessing whether registered advisers meet fiduciary obligations in times of market volatility and exposure to interest rate fluctuations, the SEC may find that some investment practices by poorly performing private funds expose the fund to undue risk, thereby protecting illiquid and passive LPs.[291] Building a body of precedent through adjudication may provide an avenue to proscribe fund adviser practices that both violate fiduciary duties to the fund and harm LPs.

As was the case in 2024, the SEC Division of Examinations has stated that private fund advisers will remain a top priority. Specifically, the Division of Examinations will be reviewing, among others, whether disclosures align with actual practices, whether advisers have met their fiduciary obligations, and whether conflicts of interest are adequately disclosed.[292] We encourage full

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285. *Nat'l Ass'n of Priv. Fund Managers*, 103 F.4th at 1103.

286. Jason M. Daniel & James A. Deeken, *The Direction of the SEC in the Wake of* National Ass'n of Private Fund Managers v. SEC, 52 SEC. REGUL. L.J. 239, 243 (2024).

287. *Id.*; Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 89 Fed. Reg. 91252, 91252 (Nov. 19, 2024).

288. Daniel & Deeken, *supra* note 286, at 242 ("[T]he SEC may supplement its enforcement with its independent view separate from PFAR that fund managers have an unalterable fiduciary duty to their clients, . . . which [the] SEC believes should be defined as broadly as possible.").

289. *Id.* at 243.

290. *See* DIV. OF EXAMINATIONS, U.S. SEC. & EXCH. COMM'N, FISCAL YEAR 2025 EXAMINATION PRIORITIES 7 (2025), https://www.sec.gov/files/2025-exam-priorities.pdf [https://perma.cc/7HJX-864W].

291. *Id.*

292. *See id.* Among other things, the division stated that it will review "whether disclosures are consistent with actual practices," the adequacy of disclosures regarding the fund's fees and expenses, and disclosures of conflicts of interest. *Id.*

enforcement of these obligations to protect PIPE LPs in de-SPAC transactions against potential exploitation by GPs.

Although the Fifth Circuit in *National Ass'n of Private Fund Managers* found that the SEC had exceeded its rulemaking authority under section 206(4) of the Investment Advisers Act, essentially for lacking specificity between the PFA Rules and prevention of fraud,[293] we note that the SEC has broad authority to mandate disclosure of conflicts of interest to prevent fraud, deception, or manipulation. For example, in *United States v. O'Hagan*, the Supreme Court interpreted section 14(e) of the Securities Exchange Act to allow the SEC to adopt prophylactic rules to prevent fraud.[294] In the case of proxy solicitations, 15 U.S.C. § 78n mandates disclosure of conflicts of interest and empowers the SEC to adopt rules reasonably designed to prevent fraud, deception, or manipulation.[295] Likewise, § 78o-6 enables the SEC to require securities analysts and brokers to disclose conflicts of interest in public appearances and research reports.[296] We thus recommend that the SEC utilize data, such as that provided in this Article, to support another round of rulemaking to impose disclosures on private fund advisers, such as those it attempted in the PFA Rules. The Fifth Circuit in *National Ass'n of Private Fund Managers* did not see enough specificity linking fraud or deception to the need for the PFA rules. Our study, along with other studies the SEC might conduct, may help provide the needed specificity.

Finally, we urge Congress to specifically empower the SEC to regulate private funds and their advisers.[297] Simply because these investors have the financial wherewithal to take more risk and sustain more loss than the small retail investor does not negate the need for full and fair disclosures. At a bare minimum, the SEC should be authorized to reinstate the disclosure rules envisioned by the PFA rules. Our empirical analysis shows that these investors need the disclosures to avoid being duped into poor investments.

CONCLUSION

Generally, only accredited investors are allowed to invest in private investments because, by meeting investor sophistication or minimum wealth requirements, accredited investors are presumed to be able to protect themselves without the SEC's oversight. In 2023, however, the SEC took the position that

293. Nat'l Ass'n of Priv. Fund Managers v. SEC, 103 F.4th 1097, 1112–15 (5th Cir. 2024).

294. *See* United States v. O'Hagan, 521 U.S. 642, 665–667 (1997) (upholding the misappropriation theory of insider trading liability).

295. *See* 15 U.S.C. § 78n(h)(1).

296. *See id.* § 78o-6(b).

297. The House has recently twice introduced a bill proposing to amend the Investment Company Act of 1940 to explicitly *prohibit* the SEC from certain private fund regulation, including limiting closed-end companies' investments in private funds. Increasing Investor Opportunities Act, H.R. 2627, 118th Cong. (2023); Increasing Investor Opportunities Act, H.R. 3383, 119th Cong. (2025). In June 2025, the House passed the Access to Small Business Investor Capital Act, which would *reduce* SEC oversight of private fund advisors by raising the threshold for registration. Access to Small Business Investor Capital Act, H.R. 2225, 119th Cong. (as passed by the House, June 23, 2025).

so-called sophisticated investors also needed the SEC's protective rules. In August 2023, the SEC instituted new rules focusing on greater transparency, designed to prevent fraud, deception, and manipulation by private investment advisers, by requiring additional disclosures.[298] The new rules covered investment advisers' compensation schemes, sales practices, and attempted to regulate potential conflicts of interest in the private funds industry.

The SEC's attempts to bring greater transparency to the private funds industry were thwarted, however, in June 2024 when the Fifth Circuit Court of Appeals in *National Ass'n of Private Fund Managers* unanimously vacated the SEC's new rules.[299] The Fifth Circuit held that the SEC needed to state with specificity the fraud or deception that the rules are intended to address. The court found that the SEC did not have authority to promulgate these regulations in part because it had not established, with specificity, a link between the new rules and the prevention of fraud or deception. This put the SEC in a catch-22. Without regulation requiring disclosures, there is little data on private funds to determine whether the disclosures are deceptive. Without the data, it is nearly impossible to satisfy the court's requirements for specificity. Thus, there is no regulation.

In this Article, we examined the performance of de-SPAC transactions using private funds. Because the PIPE occurs in public companies, investment performance information is publicly available. Thus, we are in fact empirically able to determine whether the limited private-fund investors are getting a fair deal in these investments. We find that de-SPAC investors lose about forty-five percent of their investment within two years of the de-SPAC transactions. Furthermore, we find that almost all these losses are limited to those cases when the sponsors resort to PIPE financing, losing about fifty-five percent of their value abnormally. Hence, our evidence suggests that limited private-fund investors suffer substantial and systematic losses when they make PIPE investments in SPACs.

Furthermore, we demonstrate that the performance of PIPE-financed de-SPAC transactions is getting worse over time, consistent with the conflicts of interest hypothesis. Thus, our evidence at least partially justifies the SEC's new rules. We propose a number of policy changes to address these issues. These include urging the SEC to utilize its authority under the Investment Advisers Act to pursue fiduciary duty breaches of investment advisers to private equity funds, which includes the general partners of those funds as investment advisers to the funds, encouraging the SEC to make another attempt at PFA rulemaking citing studies, such as this one, to demonstrate that disclosure rules are directly linked to the prevention of fraud and deception, and we urge Congress to grant the SEC explicit authority to regulate private fund advisors, for the protection of private investors. As this Article shows, accredited investors can be easily deceived without full and fair disclosures. The need to

298. *See* 17 C.F.R. § 275 (2024); Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 88 Fed. Reg. 63206, 63206 (Sept. 14, 2023) (to be codified at 17 C.F.R. pt. 275).

299. *See* Nat'l Ass'n of Priv. Fund Managers v. SEC, 103 F.4th 1097, 1113–14 (5th Cir. 2024).

address this matter has become more urgent than ever in light of the August 7, 2025, executive order further opening pension funds' access to private equity markets, thus also exposing the retirement investments of retail investors to these risks.[300]

300. *See* Democratizing Access to Alternative Assets for 401(k) Investors, Exec. Order No. 14330, 90 Fed Reg. 38921, 38921 (Aug. 12, 2025).