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SEC Enforcement Action Demonstrates Importance of Robust Conflicts-of-Interest Practices in SPAC Transactions

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Special purpose acquisition companies (SPACs) and those associated with SPAC transactions have increasingly become targets for enforcement action by the U.S. Securities and Exchange Commission (SEC). Most recently, the SEC continued that trend by pursuing a New York-based investment adviser, Perceptive Advisors LLC, for failing to disclose conflicts of interest regarding certain SPAC transactions. Perceptive resolved the case by consenting to pay a $1.5 million fine.

A SPAC is a publicly traded corporation that is promoted by “sponsors” that invest risk capital to cover expenses associated with consummation of an initial public offering and operating expenses as a public company (e.g., fees for bankers or lawyers). The SPAC raises public equity, hoping to combine with a privately held corporation during the SPAC’s lifespan, which is typically between one and two years. If no combination happens during its lifespan, a SPAC will be forced to liquidate and return the proceeds of the offering to public shareholders, and the sponsors will lose the risk capital. If there is a combination, the sponsors will be able to sell their shares after the expiration of their lock-up period, which often represent 20 percent of the equity interest of a SPAC prior to a combination.

According to the SEC, Perceptive advised many clients to invest in certain SPACs, but failed to disclose that the SPAC sponsors were owned by Perceptive personnel and by a private fund that Perceptive also advised. The SEC was concerned that investors did not know that Perceptive personnel “were entitled to a portion of the compensation the SPAC sponsors received upon completion of the SPACs’ business combinations.” [1]

The SEC’s order, which was entered into by agreement, found that Perceptive repeatedly invested assets of a private fund it advised in certain transactions that helped complete the SPAC’s business combinations, but that the firm failed to timely disclose these conflicts in violation of various provisions of Section 206 of the Investment Advisers Act of 1940. Those provisions make it unlawful to engage in any transaction that operates as a “fraud or deceit” on a client (Section 206(2)) or to engage in any act that is “fraudulent deceptive, or manipulative” (Section 206(4)). The SEC’s order also found that Perspective failed to timely file a required report on Schedule 13D about its beneficial ownership of stock in a public company.

It should be noted that the SEC’s Division of Corporate Finance has issued guidance on disclosures about the economic interests of SPAC sponsors, directors and officers. Among other things, Corporate

Finance has provided guidance on disclosure considerations for de-SPAC transactions, including the process for evaluating the target company, material factors leading to approval of the transaction, conflicts of interest, and other additional financing necessary to complete a de-SPAC transaction.
The SEC's decision to make an example of Perceptive is a reminder that SPACs and those involved in SPAC transactions would benefit from careful scrutiny of potential conflicts of interest. To that end, it may be worthwhile to consider developing, with the guidance of experienced legal counsel, written policies and procedures related to conflicts of interest, and conducting related training for staff to facilitate their understanding and the actual day-to-day application of those rules.

For more information, contact any of the authors listed above.

FOOTNOTES

[1] SEC Press Release, https://www.sec.gov/news/press-release/2022-155

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