

SEC Targets SPAC Conflicts of Interest

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On September 6, investment advisory firm Perceptive Advisors LLC (Perceptive) agreed to a cease-and-desist order with the U.S. Securities and Exchange Commission (SEC) for failing to disclose alleged conflicts of interest involving its employees' ownership of sponsors of special purpose acquisition companies (SPACs) in which the firm advised its clients to invest.

Background

Between February and August 2020, Perceptive formed three SPACs — ARYA II, ARYA III, and ARYA IV (Arya SPACs) — each with a separate sponsor whose ownership was shared by five individuals associated with Perceptive (Perceptive Personnel), as well as Perceptive Life Sciences Master Fund Ltd. (PLSM Fund), a private equity fund for which Perceptive was an advisor. In their roles at Perceptive, the Perceptive Personnel made investment decisions on behalf of the PLSM Fund, as well as other advisory clients. Due to their ownership in the ARYA SPAC sponsors, the Perceptive Personnel were entitled to compensation upon completion of a business combination by the ARYA SPACs.

At issue is the SEC's allegation that Perceptive did not disclose its SPAC-related conflicts of interest to the PLSM Fund's board until after: (1) ARYA II completed a business combination; (2) the PLSM Fund subscribed to a private investment in public equity (PIPE) for ARYA III; and (3) ARYA IV completed an IPO. In connection with the business combinations consummated by ARYA II and ARYA III, Perceptive caused the PLSM Fund to participate in PIPE transactions in the amount of \$30 million and \$55 million, respectively.

Additionally, Perceptive allegedly failed to adopt and implement written compliance policies and procedures to prevent violations of the Advisers Act (and the rules thereunder) concerning Perceptive Personnel's co-ownership of SPAC sponsors alongside Perceptive advisory clients, and investments in affiliated SPACs on behalf of Perceptive advisory clients.

Perceptive's failure to timely disclose these conflicts of interest constituted a breach of its disclosure obligations and led the SEC to determine that "Perceptive did not provide its private fund clients and investors with adequate information about the conflicted SPAC investments."^[1] In particular, the SEC found that Perceptive's conduct violated Exchange Act Section 13(d) and Rule 13d-1 thereunder, as well as Advisers Act Sections 206(2) and 206(4) and Rule 206(4)-7 and (4)-8 thereunder. Perceptive was ultimately censured and ordered to pay a civil monetary penalty in the amount of \$1.5 million to the SEC.

SPAC Landscape

The agreed order is indicative of the SEC's tightened focus on limiting SPACs, and more specifically, its push to mitigate conflicts among parties that may have differing incentives. In March 2022, the SEC [proposed](#) new rules and amendments regarding SPACs — which rules and amendments would enhance disclosure requirements and more specifically, which would require additional disclosures about the sponsor of a SPAC and potential conflicts of interest. For example, the proposal — which is still open for comment — would require, among other things, disclosure of any “conflicts of interest between (1) the sponsor or its affiliates or the SPAC’s officers, directors, or promoters.” In keeping with this theme, on August 3, the SEC released [new guidance](#), noting that it is “important that firms and their financial professionals review their business models and relationships with investors to address conflicts of interest specific to them.” The SEC’s explicit guidance and the proposed rules appear to target the exact sort of conduct that was on display by Perceptive. As C. Dabney O’Riordan — chief of the Enforcement Division’s Asset Management Unit — stated while discussing the SEC’s order in the Perceptive matter, the “action reflects the Commission’s continued effort to hold private fund advisers accountable when they fail to live up to their obligations under the Adviser’s Act.”

It should come as no surprise that SPACs find themselves with a target on their back. Though not altogether novel, SPACs have seen a surge in recent years — increasing from 248 IPOs in 2020 to 613 in 2021. Moreover, SPAC proceeds increased from \$83 billion in 2020 to more than \$160 billion in 2021. Yet, amid these increasing IPOs and accompanying revenues, SPACs are becoming a cause for concern. There have only been [76](#) SPAC IPOs in 2022, 69 of which are still searching for targets. Combined with 2020 and 2021, there are 558 SPACs still looking for targets. More concerning is the fact that SPAC IPO gross proceeds are sitting at 12,619.7mm midway through 2022, when 2021 closed out at 162,502.7mm. This sort of underperformance can be a nightmare for investors and lead to a volatile market, thereby causing the SEC to take notice. It is likely not a coincidence that the SEC proposed new rules and amendments in spring 2022, at a time when, of the 199 de-SPAC mergers that closed in 2021, only 11% were trading above their offer price, and the group was averaging a -43% [return](#).

Implications of the SPAC market notwithstanding, the SEC has been clear about its disdain for the SPAC business model, with SEC Chair Gary Gensler going so far as to [warn](#) investors against putting money into SPACs back in December 2021. Even as far back as March 2021, former Chair Allison Herren Lee [asserted](#) that the SEC had evidence that SPAC “performance for most investors doesn’t match the hype.” Accordingly, the SEC’s focus on SPACs, and specifically the issue of conflicts of interest, should not be viewed as a sudden or temporary shift, but rather as the SEC forging ahead in pursuit of its stated goals.

Takeaway

The Perceptive order is an unequivocal sign of things to come. The SEC has made clear that it will not sit idly by in hopes that the SPAC environment will rein in itself. Rather, the SEC is taking affirmative steps to corral SPACs, whether it be by rule and amendment, the issuance of new guidance, or the direct prosecution of investment firms. And high on their list of priorities is the potential for conflicts of interest. Diligent investors must ensure they are up to date on all new guidance and rule proposals by the SEC. Not only will these help to direct appropriate and compliant conduct, but they also will offer key insights into the SEC’s focus and the types of behavior being targeted. Members of the Troutman Pepper team are available to assist on any and all SEC developments.

[1] See [Perceptive Cease-and-Desist Order Press Release](#).

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