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SEC Proposes Sweeping Rules Applicable to SPAC IPOs and De-SPAC Transactions

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On March 30, the commissioners of the Securities and Exchange Commission approved much-anticipated proposed rules relating to special purpose acquisition companies. The proposed rule changes cover a wide range of topics, including expanding underwriter liability for regulatory filings in connection with de-SPAC transactions, exposing target companies to liability under the Securities Act of 1933 for such filings and expanding and revising disclosure requirements applicable to SPAC IPOs and de-SPAC transactions. While some of the proposed rules simply codify existing SEC staff positions and guidance or standard SPAC industry practice, the proposed rules may have substantive impacts on SPACs, SPAC sponsors, underwriters, private companies seeking to go public via a de-SPAC transaction, institutional and retail SPAC investors and others.

The proposed rules are available here and a summary SEC "Fact Sheet" on the proposed rules is available here.

The proposed rules were approved by a 3-1 vote of the SEC commissioners. While the rules may change in response to comments or further consideration by the SEC and its staff and commissioners, or theoretically the SEC could determine not to adopt some or all of the rules in response to the comments, we expect many of the proposed rules to be adopted in largely their proposed form. Companies, investors and other interested parties that want to raise concerns, make suggestions or provide information to support or flag issues with the proposed rules have until May 31 to provide written comments to the SEC.

The proposed rules cover the following topics:

- Enhancing Disclosure and Investor Protection
- Revising the Registration Requirements for De-SPAC Transactions
- Projections DisclosureStatus of SPACs under the Investment Company Act of 1940

Enhancing Disclosure and Investor Protection

The enhanced disclosure and investor protection topics covered in the proposed rules include the following items:

"A rule that deems underwriters in a SPAC initial public offering to be underwriters in a subsequent de-SPAC transaction when certain conditions are met." (Unless otherwise noted, quotes are taken from the SEC's published Fact Sheet.)

A new rule would provide that underwriters of a SPAC's IPO who take steps to facilitate the de-SPAC transaction or any related financing transaction, or otherwise participate (directly or indirectly) in the de-SPAC transaction, will be deemed to be engaged in the distribution of the securities of the combined company resulting from the de-SPAC. This would make such entities liable for material misstatements or omissions, subject to a due diligence defense, in the de-SPAC registration statement. The proposing release states "receipt of compensation in connection with the de-SPAC transaction could constitute direct or indirect participation in the de-SPAC transaction." The SEC's stated purpose for the change is to motivate SPAC IPO underwriters to exercise care to ensure the adequacy of disclosures in de-SPAC transactions. This would be a major substantive change and may have a chilling effect on the willingness of underwriters to participate in SPAC IPOs and de-SPAC transactions or, as noted by one of the SEC commissioners, may prompt institutions to reconfigure their role and compensation in de-SPAC transactions in an attempt to avoid this designation.

"A requirement that the private operating company would be a co-registrant when a SPAC files a registration statement on Form S-4 or Form F-4 for a de-SPAC transaction."

The proposed rules would deem the target company in a de-SPAC transaction to be a co-registrant, requiring the target company, certain of its officers and a majority of its board to sign the registration statement filed in connection with the de-SPAC. This will expand Exchange Act liability for material misstatements and omissions in the Form S-4 or Form F-4 to the target and its directors and officers who sign the registration statement, in addition to the currently existing potential exposure under the Exchange Act for participating in the solicitation of proxies that contain a material misstatement or omission. This may not be a substantive expansion of the practical liability that target companies and their officers and directors already have in a de-SPAC transaction. Post de-SPAC, the target company will have merged with, acquired or been acquired by the SPAC, and it will have effectively assumed any securities law liability the SPAC incurred. Moreover, in many de-SPAC transactions, the target company or its affiliate already serves as the registrant, with tax consequences driving the structure more than liability concerns. Finally, as a practical matter, the target company and its directors and officers may already have similar exposure, as they are participating in the proxy solicitation by the SPAC, as seen in recent SEC settlements involving material misstatements or omissions by target companies that are repeated by SPACs.

"Additional disclosures on de-SPAC transactions, including with respect to the fairness of the transactions to the SPAC investors."

The proposed rule would require disclosure with respect to fairness of the de-SPAC transaction and any related financing. This would be a new requirement and appears to be similar to the requirement of fairness disclosure in connection with tender offers and going private transaction subject to Rule 13e-3. In light of the fiduciary duties applicable to SPACs and their directors, simply making a statement regarding fairness would likely not be significant. However, robust disclosure regarding the basis for the fairness determination, together with a requirement to file reports, opinions and appraisals received by the board, would impose substantial administrative requirements and could limit the willingness of certain advisors to provide such reports, opinions or other written advice.

"Enhanced disclosures regarding, among other things, SPAC sponsors, conflicts of interest, and dilution."

The SEC has proposed to add a number of new mandatory disclosures in connection with SPAC IPOs and de-SPAC transactions. Many of these are expected to codify existing disclosure practices of the last several years, including disclosure added in response to recent SEC comments. New tabular disclosure on the potential for dilution to SPAC investors would be required in both SPAC IPO registration statements and registration statements filed in connection with a de-SPAC transaction and incremental disclosure regarding the SPAC sponsor, and its officers and directors and their compensation, may be required.

"A re-determination of smaller reporting company status within four days following the consummation of a de-SPAC transaction."

A smaller reporting company is defined as a public company that has (1) a public float of less than $250 million or (2) less than $100 million in annual revenues and either no public float or a public float of less than $700 million. SRC status allows companies to avail themselves of reduced disclosure obligations, notably with respect to financial statements and SRCs typically have six to 12 months to transition to standard reporting requirements after losing SRC status. Given their structure, most SPACs qualify for SRC status. Where the target company also qualifies as an SRC, the reduced disclosure obligations apply to the target as well. The proposed rules would require a redetermination of SRC status of the surviving company based on public float promptly after the closing of the de-SPAC transaction. Where the public float is greater than $700 million, the entity would lose SRC status as of the next periodic report. In our view, the proposed change could be potentially problematic for companies that may be close to the SRC thresholds depending on stock price post-closing, as it could provide uncertainty about disclosure that may be required promptly after the de-SPAC transaction and not provide sufficient time to plan for and prepare that disclosure.

"An amended definition of "blank check company" to make the liability safe harbor in the Private Securities Litigation Reform Act of 1995 for forward-looking statements, such as projections, unavailable in filings by SPACs and certain other blank check companies."

The Private Securities Litigation Reform Act of 1995 provides a safe harbor from liability for forward-looking statements. The safe harbor does not apply to statements made in IPOs, to statements made by certain types of registrants, such as limited partnerships or penny-stock issuers, or to statements made in connection with certain types of transactions, such as tender offers. The proposed rule would deem de-SPAC transactions to be IPOs and thus outside of the safe harbor. We view this as unlikely to alone impact the decision of whether or not to disclose projections in de-SPAC transactions. However, when combined with the proposed expansion of underwriter liability described above, this may have a chilling effect on the use of projections in connection with de-SPAC transactions.

Revising Registration Requirements for De-SPAC Transactions

With respect to a de-SPAC transaction, the proposed rules would:

"Deem by rule that a business combination transaction involving a reporting shell company and another entity that is not a shell company constitutes a sale of securities to the reporting shell company's shareholders for purposes of the Securities Act."

This would require a Form S-4 or Form F-4 for most de-SPAC transactions. Under current rules, depending on the structure of the de-SPAC and other considerations, a de-SPAC transaction can be accomplished using only a proxy statement. While introducing certain technical differences in applicable liability regimes, this will not be a substantive change. Structuring considerations other than securities laws often require that the target company or one of its newly formed subsidiaries serve as the resulting company, which requires a registration statement for the offering of securities to the SPAC's existing public stockholders. Moreover, the SPAC has substantively identical obligations for misstatements or omissions in a proxy statement as in a registration statement.

"Better align the required financial statements of private operating companies in transactions involving shell companies with those required in registration statements for initial public offerings."

The proposed rules codify existing SEC practice with respect to the audit standards for target company financial statements, as well as the SEC's view as to the number of years of target company financials required. A revision would clarify that a target company that would qualify as an emerging growth company if it were undertaking an IPO would only be required to provide two years of audited financial statements, regardless of whether the SPAC had filed its first 10-K.

Projections Disclosure

The SEC is proposing to ***"expand and update the Commission's guidance on the presentation of projections of future economic performance in Commission filings to allow investors to better assess the reliability of the projections and whether they have a reasonable basis."***

These changes would largely require additional disclosures about whether or not projections were based on historical financial results or operational history, presentation of historical results or operational history with greater prominence, and defining and explaining non-GAAP financial measures in projections (but with no requirement for reconciliation, subject to any separate requirement under Regulation G). The changes described above would apply to projections generally, not just projections in connection with de-SPAC transactions. With respect to de-SPAC transactions specifically, the proposed rules would additionally require, among other things, disclosure of the purpose for which the projections were prepared and the party that prepared the projections, the material bases of and assumptions underlying the projections, and factors that may impact such assumptions, as well as a statement of whether the projections reflect the view of the board or management at the date of filing. Much of the required disclosure is already made based on industry practice or in response to SEC comments, such that the proposed rules should not substantively change the way SPACs use projections.

Status of SPACs under the Investment Company Act of 1940

Recent civil lawsuits and academic articles have suggested that SPACs are unregistered investment companies by virtue of investing in short term-U.S. government securities while they hunt for a target company. The SEC is proposing a new Rule 3a-10 under the Investment Company Act of 1940 that would establish a safe harbor from investment company act status for SPACs so long as certain conditions are met. Those conditions include:

- ***"Maintain assets comprising only cash items, government securities, and certain money market funds."*** SPACs already operate in this manner, although the condition would also prohibit acquiring or disposing of assets for the primary purpose of recognizing gains or decreasing losses resulting from market value changes.

- ***"Seek to complete a de-SPAC transaction after which the surviving entity will be primarily engaged in the business of the target company."*** This is effectively what almost every SPAC already does. However, the proposed rules would also require that the SPAC would need to seek to complete a de-SPAC transaction in which the surviving company was listed on a national securities exchange.

- ***"Enter into an agreement with a target company to engage in a de-SPAC transaction within 18 months after its initial public***

offering and complete its de-SPAC transaction within 24 months of such offering." This would shorten the investment horizon of certain SPACs with 24 month signing targets and limit the ability of SPACs to seek extensions of their outside dates. In addition, the proposed rule does not provide any certainty for the roughly 700 currently traded SPACs that may not be in technical compliance with the proposed conditions. In our view this should be eliminated or lengthened to the 36 month time horizon specified in national securities exchange rules for listed SPACs.

What Happens Next?

The SEC will accept written comments from members of the public through May 31. These comments will form part of the "administrative record" that serves as the basis for the SEC's decision to issue any final rule. Filing comments is an important way to raise specific concerns with the proposal or to provide support for aspects of the proposal. The SEC is required to review and consider these comments before finalizing a rule, and comments can result in changes to a proposal. Even when the comments don't result in changes to a rule, they are important because of the role they play in legal challenges to any final rule. Comment letters are part of the body of evidence (i.e., the "administrative record") that a court will consider when evaluating the SEC's decision, and courts generally will not allow an argument to be raised in court unless it was already raised in a public comment. Providing information that supports or critiques the SEC's proposal can therefore play an important role in whether a court ultimately upholds the SEC's rule.

We anticipate that the SEC will receive a substantial number of comments, such that adopting final rules may be delayed as the SEC processes such comments in a final rule release. It is also possible the SEC may bifurcate rule-making between hotly contested and relatively benign proposals.

We expect to see final rules adopted this year. Any final rule will include an "effective date" that will trigger the rule's requirements. Court challenges on particularly controversial proposals may be filed as soon as the SEC issues any final rule and may impact the effective date of the rule because courts have the power to "stay" or pause a rule's effective date during the case or once the case is completed.

Mary Busse *also contributed to this report.*