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# SEC Proposes Major Rule Changes for SPACs

April 18, 2022

## The Proposed Rules Would Significantly Alter the Liability and Disclosure Regimes Applicable to SPACs and de-SPAC Transactions

The SEC recently announced proposed rules and amendments aimed at enhancing disclosure and investor protection in initial public offerings by special purpose acquisition companies ("SPACs") and in SPAC business combination transactions with private operating companies ("de-SPAC transactions").[1]

If adopted, the SEC's proposed rules and amendments would significantly alter the SPAC landscape by imposing new and extensive disclosure requirements for SPACs and expanding potential liability under the federal securities laws for SPACs and participants in SPAC IPOs and de-SPAC transactions. The proposed rules are an outgrowth of the SEC's previously stated goal of more closely aligning investor protections in de-SPAC transactions with those of traditional IPOs. The proposed rules also would assist SPACs in assessing their status as investment companies under the Investment Company Act of 1940 (the "1940 Act").

The SEC's proposed rules would:

### Mandate Fairness Disclosures for de-SPAC Transactions

Subpart 1600 of Regulation S-K would impose a new disclosure requirement for de-SPAC transactions by mandating a fairness determination with regard to the de-SPAC transaction. The rule would require the SPAC to disclose whether it reasonably believes that the de-SPAC transaction and any related financing transactions are fair or unfair to the SPAC's unaffiliated security holders and the basis for such determination. A statement that the SPAC has no basis to evaluate the fairness of the transaction would not satisfy the requirement.

[1] Special Purpose Acquisition Companies, Shell Companies, and Projections, Proposed Rules, IC-34549 (March 30, 2022).

Further, Item 1607(a) would require disclosure about whether or not the SPAC or its sponsor has received any report, opinion or appraisal from an outside party relating to the consideration to be offered to the SPAC's security holders or the fairness of the de-SPAC transaction or any related financing transactions. This requirement would provide additional transparency about whether a SPAC's board of directors and its sponsor have access to information underlying a fairness determination with respect to the de-SPAC transaction.

We anticipate that the proposed fairness determination would lead to SPAC boards seeking fairness opinions from financial advisors ahead of approving a de-SPAC transaction, a practice that has been historically uncommon in de-SPAC transactions.

## Enhance Disclosure Requirements Relating to SPAC Sponsors, Potential Conflicts of Interest and Dilution of Shareholders Interests

### SPAC Sponsors

Proposed Item 1603 would require additional disclosure about the SPAC's sponsor, its affiliates and any promoters of the SPAC in registration statements filed in connection with IPOs and de-SPAC transactions, including:

- the experience, material roles, and responsibilities of these parties;
- the controlling persons of the sponsor and any persons who have direct and indirect material interests in the sponsor;
- tabular disclosure of the material terms of any lock-up agreements with the sponsor and its affiliates; and
- the nature and amounts of all compensation that has been or will be awarded to, earned by, or paid to the sponsor, its affiliates and any promoters for all services rendered in all capacities to the SPAC and its affiliates, as well as the nature and amounts of any reimbursements to be paid to the sponsor, its affiliates and any promoters upon the completion of a de-SPAC transaction.

### Potential Conflicts of Interest

Proposed Item 1603 would require that a SPAC specifically disclose any actual or potential material conflict of interest between (1) the sponsor or its affiliates or the SPAC's officers, directors or promoters and (2) unaffiliated security holders. While Item 1603 is consistent with current practice, the proposed rules would require more specific and extensive disclosure with regard to conflicts of interest.

This new requirement would mandate disclosures about conflicts of interest in determining whether to proceed with a de-SPAC transaction and conflicts of interest stemming from the manner in which a SPAC compensates the sponsor or the SPAC's executive officers and directors, as well as the manner in which the sponsor compensates its own executive officers and directors. Additionally, the rules would mandate disclosure regarding any companies to whom each of the SPAC's officers and directors owe fiduciary duties, in addition to the SPAC.

#### Dilution

Item 1602(c) would require tabular dilution and other dilution disclosures, including on the prospectus cover page, with sensitivity analyses at varying redemption levels.

### Provide Additional Guidance on the Use of Projections in SEC Filings to Address Concerns About the Reliability of Projections

Noting concerns about misleading and misstated projections disclosure in connection with de-SPAC transactions, the SEC's proposal updates SEC guidance regarding the use of projections in SEC filings and creates additional disclosure requirements with respect to the preparation and use of projections when used in connection with de-SPAC transactions.

The proposed amendment to Item 10(b) of Regulation S-K would require that any projected measures not based on either historical financial results or operational history be clearly distinguished from those that are based on historical financial results and operational history. Additionally, projections that are based on historical measures and operating history would generally be misleading unless accompanied by the actual historical measures and operating history, presented in the filing with equal or greater prominence.

Further, Item 1609, which would only apply to de-SPAC transactions, would require SPACs to disclose the purpose for which financial projections were prepared and the party that prepared the projections, together with any material assumptions underlying the projections, including the material growth rates used in preparing such projections. In addition, disclosure would be required as to whether or not the projections still reflect the view of the board or management of either the SPAC or the target company as of the filing date.

Together with the removal of the PSLRA safe harbor and other enhanced liability risks (discussed below), the SEC's proposed rules will put significant pressure on the use of projections in de-SPAC transactions. SPACs will need to weigh these concerns against the usefulness of projections in making their required fairness determination with

respect to the transaction, in addition to their disclosure obligations and fiduciary duties under state law.

## Further Align Disclosures in de-SPAC Transactions With Traditional IPOs

### Financial Statement Requirements

The SEC's proposed rules would more closely align the required financial statements of de-SPAC transactions with those required in registration statements for IPOs. These requirements would include three years of audited financial statements for the private operating company target or two years if the private operating company qualified as an emerging growth company, or for such shorter time as the company has been operating.

### Move up Timing of Required "Super 8-K" Disclosures

The proposed rules would move up the timing of a number of additional disclosures with respect to the target private operating company. Currently, a post-closing Form 8-K must be filed within four days of the de-SPAC transaction closing date. Pursuant to Item 2.01(f) of Form 8-K, this "Super 8-K" is required to include all information that would be required under a Form 10 registration under the Exchange Act. However, the proposed rules would significantly accelerate the timing of such disclosure, requiring such information to be made available in the registration statement for the de-SPAC transaction.

Market practice in the SPAC ecosystem has been evolving toward following these financial statement and disclosure guidelines in de-SPAC transaction filings.

## Expand the Liability Regime Applicable to de-SPAC Transactions

### All de-SPAC Transactions Will Be Considered Securities Offerings

The SEC's proposal includes a new Rule 145a which would provide that any business combination transaction involving a SPAC is a sale of securities to the SPAC's shareholders. This would require, in connection with all de-SPAC transactions, the SPAC to file a registration statement under the Securities Act of 1933. Although historically the majority of de-SPAC transactions include a Form S-4 or Form F-4 registration statement with respect to the shares issued to the target company shareholders, this new requirement would expand the Securities Act registration requirements (and potential liability) to cover the SPAC's shareholders as well.

### The Target as Co-Registrant on de-SPAC Registration Statement

The SEC has proposed to amend Form S-4 and Form F-4 to require that SPACs and target companies be treated as co-registrants on registration statements filed by the SPACs in connection with de-SPAC transactions. This would make the private operating company in a de-SPAC transaction both a co-registrant and an "issuer" under the Securities Act.

This requirement will expose the target company, its executive officers that sign the registration statement and its board of directors to potential liability under the Securities Act, including Sections 11 and 12.

**Underwriter Status and Liability for Financial Advisors, Placement Agents and other Participants**

In a major change, the SEC's proposed Rule 140a would provide that any underwriter in a SPAC IPO be deemed an underwriter in a subsequent de-SPAC transaction if the underwriter takes steps to facilitate the de-SPAC transaction or any related financing transaction or otherwise participates, directly or indirectly, in the de-SPAC transaction. These "steps to facilitate" would include acting as financial advisor or placement agent with respect to private investment in public equity ("PIPE") financing in connection with the de-SPAC transaction, a role commonly undertaken by SPAC IPO underwriters. This change would subject SPAC IPO underwriters to potential liability under Securities Act Sections 11 and 12 with respect to any de-SPAC transaction registration statement.

This proposed rule could have far-reaching impact on the SPAC marketplace because investment banks working on de-SPAC transactions will likely require diligence procedures akin to traditional IPOs, including obtaining "comfort" letters and legal opinions from the auditors and legal advisors to both SPAC and target in connection with the de-SPAC transaction, for liability risk management reasons.

In addition to the proposed rule, the proposing release indicates that it is not intended to be an exhaustive assessment of underwriter liability in de-SPAC transactions and that other parties involved in a de-SPAC transaction, including financial advisors, PIPE investors or other advisors could be determined to be "underwriters" if they are purchasing from an issuer with "a view to" distribution or otherwise "participating" in a distribution of securities in the de-SPAC transaction, regardless of whether they also acted as underwriter in connection with the SPAC IPO.

**Limit the Availability of the PSLRA Safe Harbor for Forward-Looking Statements**

In another move designed to expand the liability regime of the federal securities laws to SPACs and de-SPAC transactions, the proposed rules would amend the definition of "blank check company" to remove the Private Securities Litigation Reform Act of 1995 ("PSLRA") safe harbor for forward-looking statements in SEC filings by SPACs.

This important change would result in SPACs losing the PSLRA liability safe harbor, including with respect to financial projections of the target company in de-SPAC transactions. The PSLRA safe harbor protects companies from liability for forward-looking statements in any private right of action under the Securities Act or Exchange Act of 1934 if the forward-looking statement is identified as such and is accompanied by meaningful cautionary language. SPAC market participants have historically looked to

the availability of the PSLRA safe harbor as a key differentiator from traditional IPOs because of the protections it provides for publishing projected financial information to investors and the market.

SPACs, target companies, underwriters and other SPAC market participants will need to evaluate the increased potential for liability, and the protections that may need to be undertaken to protect against such potential liability, when considering the presentation of projections for SPAC target companies. The loss of the PSLRA safe harbor will likely have the effect of chilling the SPAC market and adding additional costs and time to de-SPAC transactions.

## Clarify and Codify Certain Procedural Aspects of de-SPAC Transactions

### Minimum Dissemination Period

The proposal would amend Exchange Act Rules 14a-6 and 14c-2, as well as add instructions to Forms S-4 and F-4, to require that disclosure documents in de-SPAC transactions (such as prospectuses and proxy statements filed in connection with de-SPAC transactions) be distributed to the SPAC's shareholders at least 20 calendar days in advance of a shareholder meeting.

### Re-Determine Smaller Reporting Company Status

The proposed rules would require a re-determination of smaller reporting company status within four days following the consummation of a de-SPAC transaction, rather than annually as is currently the case. This re-determination of smaller reporting company status would utilize the public float threshold measured as of a date within four business days after the consummation of the de-SPAC transaction and the annual revenues of the private operating company as of the most recently completed fiscal year for which audited financial statements are available.

## Assist SPACs in Assessing When They May Be Subject to Regulation Under the 1940 Act With Proposed Safe Harbor

Proposed Rule 3a-10 under the 1940 Act would provide a safe harbor exemption from the definition of "investment company" under the 1940 Act for SPACs that meet specified conditions, including the following:

- Nature and Management of SPAC Assets.
    - Prior to the completion of the de-SPAC transaction, a SPAC's assets consist solely of (i) "Government securities," (ii) "Government money market funds" and (iii) "cash items," each as defined in the 1940 Act, the rules thereunder or as interpreted by the SEC staff. The SPAC could not at any time acquire or dispose of such assets for the primary purpose of recognizing gains or decreasing losses.

- SPAC Activities.
  - A SPAC could seek to complete only a single de-SPAC transaction as a result of which the surviving public entity (i) will be primarily engaged, either directly or through a primarily controlled company, in the business of the target company or companies (which itself is not an investment company) and (ii) would have at least one class of securities listed for trading on a national securities exchange.
  - A SPAC would be prohibited from engaging in more than one de-SPAC transaction.
- Duration Limitations: 18-Month and 24-Month Deadlines.
  - A SPAC must file a Form 8-K with the SEC no later than 18 months after the effective date of its IPO registration statement announcing that it has entered into an agreement with a target company or companies to engage in a de-SPAC transaction.
  - A SPAC must complete the de-SPAC transaction no later than 24 months after the effective date of its IPO registration statement.
  - If a SPAC does not meet either deadline, the SPAC must distribute its assets in cash to investors as soon as reasonably practicable.
  - If a SPAC completes the de-SPAC transaction, then "any assets that are not used in connection with the de-SPAC transaction would need to be distributed in cash to investors as soon as reasonably practicable thereafter."[2]

While SPACs have been operating for more than 20 years as non-investment companies (during which time the SEC and its staff reviewed hundreds of SPAC filings), the SEC's primary justification for proposing the safe harbor appears to be based on the August 2021 private shareholder lawsuit brought against the Pershing Square Tontine Holdings SPAC claiming that such SPAC is an investment company. While most SPACs will find the safe harbor helpful and its conditions reasonable,[3] a safe harbor is seemingly unnecessary given the current approach to avoiding investment company status that

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2 Special Purpose Acquisition Companies, Shell Companies, and Projections, Proposed Rules, IC-34549 (March 30, 2022), pg. 152-153 (we note that there is no specific guidance as to whether this means the remaining cash in the trust account or another type of asset).

3 We note that certain SPACs have durations longer than 18 months due to the specific terms of their governing documents or as a result of having amended their governing documents to extend the time required to complete a de-SPAC transaction. These SPACs would be required to assess their status as investment companies under the existing regulatory framework.

the SPAC industry has used for decades without issue. This suggests that the SEC itself may be questioning the very nature of SPACs as investment companies regardless of SPACs' history.

Perhaps more troubling is a statement by Commissioner Allison Herren Lee during the meeting at which the safe harbor was proposed. Commissioner Lee remarked that she had "some concerns regarding whether we've taken the right approach here. It's not clear to me whether SPACs that meet the conditions of the proposed safe harbor should nevertheless be exempted from the investor protections of the Investment Company Act."[4] Given this potential skepticism, we encourage members in the industry who would benefit from the proposed safe harbor to consider participating in the comment process ahead of the final rule, and to consider relying on the safe harbor if adopted.

## Conclusion

The SEC notes frequently in the proposed rules and amendments that they are intended to improve the relevance and clarity of information provided to investors to allow investors to make better informed decisions with respect to SPAC IPOs, secondary trading of SPAC securities, and in voting, investment and redemption decisions in connection with de-SPAC transactions.

The SEC acknowledges that many market participants will be directly affected by the proposed rules, including existing SPACs and potential SPAC sponsors and prospective investors in SPAC IPOs, PIPEs and other financing transactions in connection with de-SPAC transactions, as well as underwriters, financial advisors and placement agents advising and assisting SPACs and their target companies.

Potentially affected parties ought to review the SEC's proposed rules and their implications with regard to pending and future transactions. Potentially affected parties ought to consider accessing fairness opinions, implementing IPO-like disclosure in registration statements and filings, and ensuring that potential underwriters are conducting appropriate due diligence. In addition, in the SEC's Division of Examinations recent 2022 Examination Priorities, the Examination Division highlighted certain topics related to SPACs, which is discussed in greater detail in the article linked here.

The public comment period will remain open until May 31, 2022 or 30 days following publication of the proposing release in the Federal Register, whichever period is longer.

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[4] *See* Commissioner Allison Herren Lee, Statement on the Proposal to Enhance Investor Protections in SPACs (Mar. 30, 2022), https://www.sec.gov/news/speech/lee-statement-spac-proposal-033022.

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