

# The Proposed SPAC Rules and Their Impact on Investment Banks

April 27, 2022

The new rules relating to special purpose acquisition companies proposed by the Securities and Exchange Commission on March 30, 2022, would, if adopted, have far-reaching effects on investment banks involved in business combination transactions involving SPACs. The proposed rules aim to remove perceived disparities in disclosures and investor protections as between traditional initial public offerings and de-SPAC transactions.<sup>1</sup> In this update, we focus on how the proposed rules may impact investment banks involved in SPAC IPOs, de-SPAC transactions or financings for de-SPAC transactions.

Investment banks often play multiple roles, and have multiple interests, in connection with de-SPAC transactions. The investment banks that serve as underwriters of a SPAC's IPO generally receive only a portion of their commission at the closing of the IPO, with the balance being paid only if and when the issuer successfully completes a de-SPAC transaction. The SPAC will also hire an investment bank—which in many cases was the lead underwriter of the SPAC IPO—to identify a merger target and advise the SPAC in connection with the de-SPAC transaction. Investment banks—again, potentially including the SPAC's IPO underwriters—may act as placement agent for, or themselves invest in, a private placement of equity securities of the SPAC, commonly referred to as a "PIPE," used to finance the de-SPAC transaction. And the target company in any de-SPAC transaction will undoubtedly also have its own financial advisor who may also have been an underwriter on the SPAC IPO.

---

## Impact of Proposed Rules on Investment Banks

The new rules, if adopted, are likely to dramatically change the landscape for investment banks involved in de-SPAC transactions and may increase their risk profile in a number of ways. Several provisions specifically target investment banks; others would have an indirect effect on their protocols and liability profile.

---

<sup>1</sup> For a fuller description of the proposed rules, see our Debevoise In Depth (April 18, 2022), which can be found [here](#).

- ***The SPAC board of directors will be required to state whether it reasonably believes that the de-SPAC transaction and related financing are fair to the SPAC's unaffiliated security holders, and must provide the basis for its determination.*** To support its conclusion, the SPAC board is likely to call on its financial advisor to render a fairness opinion in connection with the de-SPAC transaction, a rarity in today's SPAC market. As in most merger proxies, the fairness opinion provider will need to disclose in detail the analyses performed and assumptions made in connection with rendering its opinion. Any financial projections used by the financial advisors for its opinion, such as in connection with a discounted cash flow analysis, would generally be expected to be summarized in the disclosure as well.
- ***Projections used in a de-SPAC registration statement would be deprived of the protection of the safe harbor provided by the Private Securities Litigation Reform Act of 1995 ("PSLRA").*** The PSLRA safe harbor protects registrants and underwriters from liability for forward-looking statements under the federal securities laws in any private action if the forward-looking statement is identified as such and is accompanied by meaningful cautionary language. SPAC sponsors have touted the benefit of the safe harbor as a comparative advantage over a traditional IPO, for which the safe harbor is not available.

While today projections are a staple in de-SPAC registration statements, the rule changes would put pressure on their continued inclusion, particularly where the target is an early-stage company with little or no operating history. Inability to rely on the safe harbor may create unwanted tension between the bank and its client: either or both may shy away from publishing projections that could provide ammunition to private plaintiffs and draw enhanced scrutiny from regulators. On the other hand, as noted above, their use in connection with the bank's fairness opinion may make it difficult to avoid such disclosure.

- ***An underwriter of the SPAC IPO would also be deemed an underwriter in a subsequent de-SPAC transaction if the underwriter takes steps to "facilitate" the de-SPAC transaction or related financing or participates directly or indirectly in the de-SPAC transaction, which could include acting as placement agent for the PIPE, acting as financial advisor to the SPAC in connection with finding, analyzing or negotiating a transaction with a target (whether or not the bank renders a fairness opinion), or potentially even serving as financial advisor to the target.***

The proposed rules, if adopted, will likely lead to significant changes to current market practice. As noted above, an underwriter of the SPAC IPO often serves in additional roles that could be caught up in the rule. De-SPAC transactions, funded with a substantial new equity placement (through a PIPE), are often larger than the original SPAC IPO, and banks would understandably like to participate in that larger

transaction. But under the new rules, participation may trigger underwriter liability for the bank with respect to the de-SPAC registration statement.

It is not always obvious whether a bank will be subject to backend underwriter liability. If the bank plays no role other than as underwriter in the original SPAC IPO, then we believe that the fact that a portion of its compensation is payable only if the de-SPAC transaction is consummated should not, by itself, trigger underwriter liability regarding the de-SPAC disclosure. On the other hand, if an underwriter acts as financial advisor to the *target* company, under the plain language of the proposed rules, the underwriter could be deemed to be “facilitating” the de-SPAC transaction and thus be subject to underwriter liability on the de-SPAC registration statement.

The context of the potential liability is particularly challenging. Often, underwriters obtain commitments from SPACs to act as their financial advisors or PIPE placement agent before the de-SPAC target has been identified. That mandate is generally lucrative for the underwriter, but the additional liability created by the proposed rules may make the bank reluctant to accept that engagement before the target is known. Moreover, without a significant change in market practice, none of the standard underwriter protections would apply to the de-SPAC transaction—no underwriting agreement or indemnity, no thorough due diligence process (including legal opinions and auditor “comfort” letters), no control over the timing of the closing. This last point is particularly awkward: in a traditional IPO, an underwriter unhappy with the disclosure can simply refuse to underwrite until the disclosure is cured. The de-SPAC financial advisor or PIPE placement agent currently has no analogous ability to hold up the closing of a de-SPAC transaction until it is satisfied with the related disclosure.

Banks also need to keep in mind that once they assume this potential liability, there does not seem to be an escape hatch. For instance, if an underwriter of a SPAC IPO signs on to be the SPAC’s financial advisor and assists the SPAC in finding a target, it is not clear that if the bank then withdraws and foregoes its success fee, it can escape from the back-end underwriter liability (though one hopes this is clarified in the final rules).

- ***The proposing release may suggest additional sources of underwriter liability.*** As the proposed rule is currently written, deemed back-end underwriter liability would apply only to a bank that underwrote the original IPO. However, language in the proposing release indicates that the SEC (or courts) may take the position that a party other than the original underwriter might be deemed an underwriter in the de-SPAC transaction if it is purchasing from the issuer with a view to distribution or is otherwise participating in a distribution of securities in the de-SPAC transaction. The language tracks portions of the definition of “underwriter” in the federal securities

laws and may be nothing more than a reservation of rights. We believe there are good arguments why a bank serving as a PIPE placement agent would not satisfy this criterion, because the nature of a private placement is that it does not entail a public distribution of securities. While a better argument might be made that the SPAC's financial advisor is "participating" in the distribution of the SPAC's securities, we also think there are strong reasons why this should not be so. It has never been suggested, for instance, that buyer (or target) financial advisors in stock-for-stock mergers might be deemed underwriters of the buyer's stock. In short, the risk seems relatively low that a bank that did not participate in the underwriting of the SPAC IPO would be subject to underwriter liability on the de-SPAC transaction simply for acting as placement agent or financial advisor.

- ***The new rules contain new conflict of interest disclosure provisions, although they do not specifically apply to investment banks.*** However, the perceived conflicts inherent in the multiple roles banks often play would be enhanced by the bank's deemed role as an underwriter. Banks should expect that they will be subject to expanded conflicts disclosure.

---

## What Should Investment Banks Be Thinking About?

Assuming the rules are adopted in roughly the form proposed, investment banks will need to reassess their participation in SPAC transactions, what risks they are willing to bear and how they go about mitigating those risks.

### Due Diligence

Most importantly, once an investment bank determines that it might be deemed an underwriter in the de-SPAC transaction, it should seek to perform the same level of due diligence on the target as it would in a traditional IPO with respect to the issuer—sufficient to establish its due diligence defense under the securities laws. This entails not only a deep dive into the target's business and operations, but ideally would also include receipt of standard "comfort" letters and legal opinions from auditors and counsel to both the target and the SPAC.

Investment banks must recognize, however, that one of the perceived advantages of the de-SPAC structure is speed. If the due diligence exercise will slow the pace of the transaction, the banks may face pressure from the parties to limit the scope of the due diligence exercise and ask whether they really need "comfort" letters and the like. Banks will then need to balance the enhanced risk of underwriter liability with commercial realities and their client relationships.

Moreover, banks may confront challenges in obtaining comfort letters and legal opinions. Historically, many legal advisors and auditors have been unwilling to provide these letters or opinions unless the bank admits that it has securities law liability and seeks to bolster its due diligence defense. Banks may be reluctant to admit potential liability, particularly where the lesser significance of their roles may raise questions as to whether they are subject to the new rules.

### **Upfront Agreements**

Unlike regular-way IPOs, there is no actual “underwriting” in connection with the de-SPAC transaction. Currently, no underwriting agreement with standard indemnities would be entered into in connection with such a transaction. More importantly, the investment bank has limited leverage to force changes to disclosure it believes are necessary to ensure there are no material misstatements or omissions, because it cannot hold up the deal in the way it can simply refuse to underwrite a public offering. And once the bank is deemed an underwriter for these purposes, it may not have the ability to withdraw and escape potential liability.

These consequences suggest that investment banks that serve as underwriters of the SPAC IPO may prefer not to commit to serve in another role in connection with the de-SPAC transaction. Instead, if their engagement letters are not already structured in this way, they may seek the right, but not the obligation, to be involved in a particular role—so that they may exercise the right only if they are comfortable with the target and the ability to perform due diligence (though this would not arm banks against underwriter liability where the bank had already taken part in the search for a target).

SPAC IPO underwriters may also want to negotiate up front a modified “underwriting” agreement with the SPAC with respect to the de-SPAC transaction. Among other things, such agreement might include a standard indemnity provision, a clear right to perform due diligence and a right to consent to the filing and use of the SPAC registration statement, such consent not to be unreasonably withheld. The bank may also wish to establish in advance whether the parties plan to include projections in the de-SPAC registration statement.

### **Target’s Financial Advisor**

As noted above, the language of the rule is arguably broad enough to cover the *target’s* financial advisor, if the financial advisor also underwrote the SPAC IPO. This is particularly awkward for the bank, because it likely has no idea that it is representing a target that eventually will merge with a SPAC whose IPO it also underwrote. Financial advisors who also underwrite SPAC IPOs may consider including language in their engagement letters providing for protections similar to those described above in the event their client is acquired by a SPAC whose IPO it underwrote.

---

## What Should Banks Be Doing Now?

While the rules are not final, banks would do well to act as if they were. The SEC has put the SPAC universe on notice, and it is quite possible that the SEC will take the position that the rules, when adopted, simply codify the correct interpretation of the securities laws. That means banks should think ahead before agreeing to underwrite a SPAC IPO, and should consider setting internal policies now as to what the bank can and cannot do and what protections it needs based on the proposed rules. Those banks that have underwritten a SPAC IPO and are involved in a de-SPAC transaction or the search for one should do whatever they can to establish their due diligence defense with regard to the target.

---

## Conclusion

The proposed rules remain subject to public comments through at least May 31, 2022, and there will undoubtedly be numerous comments from practitioners and others. There seems to be enough momentum driving some variation of the proposed rules to be adopted, though time will tell. In the meantime, investment banks should reassess the risk/reward balance in underwriting SPAC IPOs and defining or refining protocols for protecting against or mitigating the risks. Banks should not wait to see whether the rules will be adopted before acting; even in their pending form, the proposed rules raise new risks and unknowns that banks should not ignore.

\* \* \*

Please do not hesitate to contact us with any questions.

**NEW YORK**



Christopher Anthony  
canthony@debevoise.com



Andrew L. Bab  
albab@debevoise.com



Gregory V. Gooding  
ggooding@debevoise.com



Morgan J. Hayes  
mjhayes@debevoise.com



Peter J. Loughran  
pjloughran@debevoise.com



William D. Regner  
wregner@debevoise.com



Steven J. Slutzky  
sjslutzky@debevoise.com