SEC Adopts Final Rules Relating to SPACs and de-SPAC Transactions

February 1, 2024

On January 24, 2024, the Securities and Exchange Commission adopted the final rules relating to special purpose acquisition companies (“SPACs”) and SPAC business combination transactions with private operating companies (“de-SPAC transactions”). The final rules create significant new disclosure obligations for SPACs and expand potential liability under the federal securities laws for SPACs and participants in SPAC IPOs and de-SPAC transactions.

The final rules are substantially similar to those proposed by the SEC in March 2022, with two notable exceptions. First, the SEC did not adopt proposed Rule 140a, which would have deemed SPAC IPO underwriters participating in de-SPAC transactions to be liable as statutory “underwriters” under the Securities Act of 1933 (the “Securities Act”), instead providing guidance meant to assist participants in SPAC IPOs and de-SPAC transactions in determining when they may have underwriter liability in connection with de-SPAC transactions. The SEC also did not adopt the proposed safe harbor for SPACs under the Investment Company Act of 1940 (the “1940 Act”), again opting instead to provide guidance on when SPACs are likely to meet the definition of an “investment company” under the 1940 Act.

The proposed rules had a significant chilling effect on the SPAC market when proposed, in large part due to the risk of underwriter liability that de-SPAC transaction participants feared they could become subject to from proposed Rule 140a. Despite declining to adopt Rule 140a in the final rules and opting instead to provide guidance on analyzing the “facts and circumstances” of when a transaction participant may be an “underwriter,” it seems unlikely that this will provide much of a thaw to the SPAC market as investment banks continue to wrestle with what measures they need to take in order to protect themselves in the absence of clear rules from the SEC.

Overview of the Final Rules

Underwriter Status and Liability for Participants

- In a departure from the proposed rules, the SEC did not adopt proposed Rule 140a, which would have provided that any underwriter in a SPAC IPO would be deemed an underwriter in a subsequent de-SPAC transaction if the underwriter took steps to facilitate the de-SPAC transaction or any related financing transaction or otherwise participated, directly or indirectly, in the de-SPAC transaction.

- Despite not adopting proposed Rule 140a, the SEC provided guidance on when a participant may have statutory underwriter status in de-SPAC transactions. The SEC noted that "it is insufficient to conclude that a person is not an underwriter solely because he did not purchase securities from an issuer with a view to their distribution." In coming to this conclusion, the SEC again stated that it views a de-SPAC transaction as a distribution of securities in that the purpose of a de-SPAC transaction "is to provide the target company with capital and access to the public markets" and that the distribution is the "process by which the SPAC's investors, and therefore the public, receive interests in the combined operating company." The SEC acknowledged that in a de-SPAC transaction, "there is generally no single party accepting securities from the issuer with a view to resell such securities to the public in a distribution in the same manner as a traditional underwriter in traditional capital raising" but that "there would be an underwriter present where someone is selling for the issuer or participating in the distribution of securities in the combined company to the SPAC's investors and the broader public."

- Unfortunately, the SEC's guidance is unlikely to clarify for the market who is and is not "participating" in the "distribution" that is the de-SPAC transaction and who may have underwriter liability. As such, going forward, we may see financial institutions participating in de-SPAC transactions take a conservative approach and treat de-SPAC transactions more akin to a traditional IPO than a public M&A transaction to manage liability until market practice settles in this area or further guidance is provided by the SEC or courts.

Enhanced Disclosure Obligations

- **Fairness Disclosures for De-SPAC Transactions.** Under the final rules, if a SPAC's board of directors is required by state law to determine whether the de-SPAC transaction is advisable and in the best interests of the SPAC and its shareholders, the SPAC is required to disclose the determination, along with a discussion of the material factors the board considered in making that determination. Further, if the board of directors receives an outside report, opinion or appraisal that materially relates to the fairness of the de-SPAC transaction, the SPAC is required to disclose certain information about that report, opinion or appraisal and file it as an exhibit. This is largely in line with existing market practice. This is a slight departure from the proposed rules, which would have required a statement from the SPAC as to whether it reasonably believed that the de-SPAC transaction and any related financing was fair (or unfair) to unaffiliated security holders, which some commenters noted created a thinly veiled obligation on the SPAC to obtain a fairness opinion.

- **SPAC Sponsors, Their Affiliates and Promotors.** The final rules require disclosure about the SPAC's sponsor, its affiliates and any promotors, including: (i) the experience, material roles and responsibilities of these parties; (ii) the controlling persons of the sponsor and any persons who have direct and indirect material interests in the sponsor; (iii) the circumstances or arrangements under which the sponsor, its affiliates and promotors have or could transfer ownership of the SPAC's securities; (iv) tabular disclosure of the material terms of any lock-up agreements with the sponsor and its affiliates; and (v) 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 promotors, as well as the nature and amounts of any reimbursements to be paid to the sponsor, its affiliates and any promotors upon the completion of a de-SPAC transaction. The final rule in this area was adopted largely as proposed.

- **Potential Conflicts of Interest.** The final rules also mandate that SPACs specifically disclose any actual or potential material conflict of interest between: (1) the sponsor or its affiliates and the SPAC's officers, directors or promotors or the target company's officers and directors; and (2) unaffiliated security holders of the SPAC. This is substantially similar to the proposed rule.

- **Dilution of Shareholder Interests.** SPACs will also be required to provide detailed disclosure regarding material potential sources of dilution, with sensitivity analyses at varying redemption levels, including on the front cover of the prospectus. The final rule differs from the proposal by including clarified guidance on how to calculate dilution information and requires additional disclosure on the nature and amounts of each source of dilution to prevent misinterpretation.

Guidance on the Use of Projections in SEC Filings

- **Item 10(b) of Regulation S-K.** The final rules adopt amendments to Regulation S-K Item 10(b), which sets forth the SEC's guidance regarding the use of any projections in SEC filings and is not limited to those used in de-SPAC transactions. The SEC's amendments require that: (i) projections that are not based on historical results be clearly distinguished from projections that are based on historical results; and (ii) projections that include non-GAAP financial measures include a clear definition of those measures, a description of the GAAP measure that is most directly comparable and an explanation as to why the non-GAAP financial measure is used instead of the GAAP financial measure. Further, the SEC stated in the release that it would be generally misleading to present projections based on historical results without also presenting the historical results with equal or greater prominence.

- **Item 1609.** Item 1609, which will only apply to de-SPAC transactions, requires 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 any material growth or reduction rates used in preparing such projections. In addition, the final rules require a statement as to whether or not the projections reflect the view of the board or management of either the SPAC or the target company as of the most recent practicable date prior to the date of the disclosure document required to be disseminated to security holders.

Expansion of Liability

- **Deemed Sale of Securities.** The final rules add new Rule 145a under the Securities Act, which will provide that any business combination transaction involving a SPAC is a sale of securities to the SPAC's shareholders. New Rule 145a, which was adopted as proposed, requires SPACs to file a registration statement under the Securities Act in connection with all de-SPAC transactions. 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 expands the Securities Act registration requirements (and potential liability) to cover the distribution to the SPAC's shareholders as well.

- **The Target Company as Co-Registrant and Issuer.** The final rules 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 will make the private operating company in a de-SPAC transaction both a co-registrant and an "issuer" under the Securities Act, exposing the target company, its executive officers that sign the registration statement and its board of directors to potential liability under the Securities Act, including under Sections 11 and 12.

- **Exclusion of De-SPAC Transactions from the PSLRA Safe Harbor Protections.** The final rules amend the definition of "blank check company," which has the effect of explicitly making unavailable the Private Securities Litigation Reform Act of 1995 ("PSLRA") safe harbor for forward-looking statements in SEC filings by SPACs. 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. As a result, SPACs will lose the ability to claim the protections of the PSLRA safe harbor, including with respect to financial projections of the target company in de-SPAC transactions. Despite the unavailability of the PSLRA, we expect most de-SPAC registration statements to continue to disclose target company projections when such projections have been considered by the SPAC board in approving the proposed transaction. However, we do expect increased scrutiny on such projections from de-SPAC transaction participants with enhanced cautionary disclosures around such projections, which became market practice following the release of the proposed rules.

Clarification and Codification of Certain Procedural Aspects of De-SPAC Transactions

- **Minimum Dissemination Period.** The final rules require a minimum dissemination period of 20 calendar days ahead of the shareholder meeting for prospectuses and proxy or information statements filed in connection with de-SPAC transactions.

- **Re-Determination of Smaller Reporting Company Status.** Following the completion of a de-SPAC transaction, a smaller reporting company ("SRC") must retest its SRC status. If the registrant determines that it no longer qualifies as an SRC, then it must reflect this redetermination in its filings made with the SEC within 45 days of the consummation of the de-SPAC transaction. The 45-day transition period is longer than the SEC initially proposed under the proposed rules, where a registrant would have needed to reflect non-SRC status as soon as four days after the consummation of the de-SPAC transaction.

Investment Company Act

- **Proposed Safe Harbor.** The SEC declined to adopt the proposed safe harbor that would have provided an exemption from the definition of "investment company" under the Investment Company Act of 1940 (the "1940 Act") for SPACs meeting certain conditions. Instead, the SEC provided its views on the considerations it believes are relevant to determine whether a SPAC is an investment company. Considering that the inclusion of a safe harbor exemption in the proposed rule signaled the SEC's presumption that SPACs are investment companies, this change is relatively positive.

- **Guidance.** The SEC issued guidance on certain facts and circumstances that it considers to be relevant as to whether a SPAC meets the definition of an investment company under the 1940 Act, which largely follows existing judicial and SEC guidance on the five factors an issuer must consider in determining its status under Section 3(a)(1)(A) of the 1940 Act: (1) the nature of the issuer's assets; (2) the sources of its income; (3) the activities of its directors, officers and employees; (4) its public statements concerning the nature of its business; and (5) its historical development. The SEC and its staff traditionally view the asset and income factors as most indicative of an issuer's status, but the SEC noted specifically in the adopting release the duration from a SPAC's inception to its entering into an agreement to purchase one or more operating businesses, and in particular a period greater than 18 months, as being indicative of a SPAC's investment company status.

- **SPAC Activities.** A SPAC may hold assets, or propose to hold assets, that would suggest that it is an investment company. For example, a SPAC that owns 40% or more of its total assets in investment securities (such as corporate bonds) will likely be considered an investment company. In addition, a SPAC whose income is substantially derived from such assets would further suggest that the SPAC is an investment company.

- **Management Activities.** A SPAC may be considered an investment company if it held investors' money in securities, but its management did not actively seek a de-SPAC transaction or spent significant time actively managing the SPAC's portfolio for the primary purpose of achieving investment returns. Further, certain management activities could cause SPAC sponsors to fall within the definition of "investment adviser" under the 1940 Act.

- **Duration.** As noted above, although there is no bright-line test, after a certain period of time, a SPAC's historical development and director, officer and employee activities, together with its asset composition and sources of income may suggest that the SPAC is an investment company. The SEC noted in particular that a SPAC's activities may become more difficult to distinguish from those of an investment company the longer the SPAC takes to achieve its stated business purpose.

- **Holding out.** A SPAC that holds itself out in a manner that suggests that investors should invest in its securities primarily to gain exposure to its portfolio of securities prior to the de-SPAC transaction will likely be considered an investment company.

- **Merging with an Investment Company.** A SPAC will likely satisfy the definition of an investment company if it proposes to engage in a de-SPAC transaction with a target company that is itself an investment company, such as a registered closed-end fund or business development company.

Compliance Dates

The final rules will become effective 125 days after their publication in the Federal Register. Registrants will be required to comply with XBRL tagging requirements 490 days after publication of the final rules in the Federal Register.

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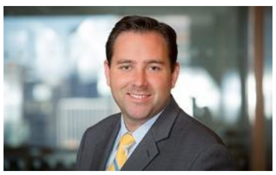
Please do not hesitate to contact us with any questions.



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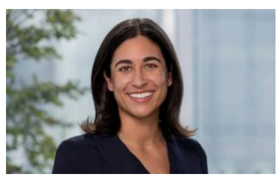

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