SEC Adopts New Rules and Amendments for SPACs, Shell Companies and Projections

On January 24, 2024, in a 3-2 vote, the U.S. Securities and Exchange Commission (the "SEC") adopted new rules and amendments (the "Final Rules") to enhance disclosures and provide additional investor protections in connection with initial public offerings ("IPOs") by special purpose acquisition companies ("SPACs")[1] and in subsequent business combination transactions between SPACs and target companies[2] (so called, de-SPAC transactions).[3] A key underpinning of the Final Rules is the SEC's view that, while structured as an M&A transaction, a de-SPAC transaction is the functional equivalent of the private target company's IPO and, but for the Final Rules, investors may not receive the same information about the target company as they would in a registration statement for a traditional IPO because filings for M&A transactions have different disclosure requirements. The Final Rules, with their additional disclosure requirements and expanded liability, will likely further reduce the already declining number of SPAC IPOs and de-SPAC transactions.

EXECUTIVE SUMMARY

The Final Rules adopted new requirements for SPAC IPOs and de-SPAC transactions, adopted new and amended previous requirements for shell company business combinations, adopted new requirements related to projections and provided guidance on other SPAC-related items. This executive summary provides an overview of these noteworthy facets of the Final Rules, and the sections following provide additional details.

The Final Rules adopted new requirements for SPAC IPOs and de-SPAC transactions through:

- Requiring additional disclosures related to:
  - The SPAC sponsor;[4]
  - Conflicts of interest; and
  - Dilution;
- Requiring disclosures related to de-SPAC transactions, including:
  - Background, material terms and effects of the transaction;
  - Any board determinations regarding the transaction;
  - The existence of any outside reports; and
  - Additional disclosures concerning the target company;
- Other new de-SPAC transaction rules such as:
  - Requiring the target company to co-sign registration statements and therefore become subject to Section 11 liability for such disclosures;

- Requiring a 20-day minimum dissemination period for prospectuses and proxy and information statements filed for de-SPAC transactions;
- Requiring a re-determination of smaller reporting company ("SRC") status following the consummation of a de-SPAC transaction; and
- Codifying the SEC staff's positions on tender offer filing obligations.

The Final Rules and the related Adopting Release also provide guidance on, among other things, topics such as:

- When SPACs may meet the definition of an investment company under the Investment Company Act of 1940 (the "Investment Company Act"); and
- Statutory underwriter status in connection with de-SPAC transactions.

Further, the Final Rules adopted new requirements related to forward-looking statements and projections by:

- Making unavailable the forward-looking statements liability safe harbor from the Private Securities Litigation Reform Act of 1995 (the "PSLRA") for de-SPAC transactions;
- Providing disclosure requirements related to projections, including requiring disclosure of all material bases of the projections and all material assumptions underlying the projections for de-SPAC transactions; and
- Updating and expanding guidance on the use of projections in all SEC filings.

The Final Rules also provide new and amended requirements for shell company business combinations.

NEW REQUIREMENTS FOR SPAC IPOS AND DE-SPAC TRANSACTIONS

The Final Rules introduce new disclosure requirements for SPAC IPOs and de-SPAC transactions. The new required disclosures relate to, among other things, the SPAC sponsor, potential conflicts of interest and dilution. Additionally, there are various new disclosures related to the de-SPAC transaction, including background on the transaction and its material terms, any board determinations regarding the transaction and the existence of any outside reports that materially relate to the de-SPAC transaction.

SPAC Sponsor Disclosures

SPACs are required to disclose detailed information relating to the SPAC sponsor,[5] including:[6]

- General character of the SPAC sponsor's business;
- Experience in organizing SPACs and involvement in other SPACs;
- Material roles and responsibilities in directing and managing the SPAC's activities;
- Any arrangements with the SPAC or its officers, directors or affiliates with respect to determining whether to proceed with a de-SPAC transaction;
- Details regarding the nature and amount of compensation for all services provided (or to be provided) to the SPAC and any reimbursements payable upon consummation of the de-SPAC transaction;
- Amount and price of securities issued (or to be issued) to the SPAC sponsor, and whether such securities were (or could be) directly or indirectly transferred or cancelled;
- Controlling persons and those with direct and indirect material interests in the SPAC sponsor, as well as the nature and amount of their interests;
- Any arrangements, including any payments, with unaffiliated security holders of the SPAC regarding the redemption of the outstanding securities of the SPAC; and
- Tabular disclosure of material arrangements regarding restrictions on whether and when the SPAC sponsor and its affiliates may sell securities of the SPAC.

Conflicts of Interest Disclosures

The Final Rules require disclosure about material potential or actual conflicts that SPAC sponsors,

SPAC directors or officers and target company directors or officers may have with the interests of unaffiliated security holders of the SPAC. The Adopting Release for the Final Rules provides a number of examples of potential conflicts of interest, such as a SPAC sponsor's compensation structure or security ownership that incentivizes the pursuit or completion of a de-SPAC transaction on unfavorable terms and situations where SPAC sponsors owe employment, contractual or fiduciary duties to companies other than the SPAC. The Final Rules require disclosure of material potential or actual conflicts for both SPAC IPOs and de-SPAC transactions on the outside front cover of the prospectus, in the prospectus summary and in the prospectus body. Notably, these conflict of interest disclosures extend to all "officers" and not just "executive officers" of the SPAC or target company.

Dilution Disclosures

The Adopting Release for the Final Rules provides a number of examples of potential sources of dilution in common SPAC structures, including through shareholder redemptions, SPAC sponsor compensation, underwriting fees, warrants, convertible securities and PIPE financings. The Final Rules require disclosure of potential sources of dilution for both SPAC IPOs and de-SPAC transactions on the outside front cover of the prospectus, in the prospectus summary and in the prospectus body.

Background, Material Terms and Effects of the De-SPAC Transaction

The Final Rules require disclosure of the background of the de-SPAC transaction, material terms of the de-SPAC transaction, and the effects of the de-SPAC transaction and any related financing transactions. The disclosure must include any material interests in the de-SPAC transaction (or any related financing) held by the SPAC sponsor, the SPAC's officers or directors or the target company's officers or directors.

Board Determination and Reports

If the laws of the jurisdiction in which the SPAC is organized require its board (or similar body) to determine whether the de-SPAC transaction is advisable and in the best interests of the SPAC and its security holders, or otherwise make any comparable determination, the Final Rules require that such determination be disclosed. If the board (or similar body) was required to and did make such a determination, the Final Rules also require disclosure of the material factors that it considered in making such determination, including the target company's valuation, financial projections relied upon by the board (or similar body), financing terms, any report, opinion or appraisal that was received and any dilution. Additionally, if any director (or member of a similar governing body) voted against or abstained from voting on the approval of the de-SPAC transaction, disclosure is required of such persons and the reasons for voting against or abstaining.[7]

Disclosure is also required if the SPAC or SPAC sponsor received any report, opinion (other than by counsel) or appraisal from an outside party or unaffiliated representative materially relating to (i) a board determination described in the preceding paragraph, (ii) the approval of the de-SPAC transaction, (iii) the consideration or fairness of the consideration offered to security holders of the target company in the de-SPAC transaction or (iv) the fairness of the de-SPAC transaction to the SPAC, its security holders or SPAC sponsor.[8] If such a report, opinion or appraisal from an outside party or unaffiliated representative was not received, then no disclosure is required.

Target Company Disclosure

The Final Rules require de-SPAC transactions to include, among other things, the following Regulation S-K disclosures concerning the target company (if it is not an SEC registrant):

- Item 101 (Description of Business);
- Item 102 (Description of Property);
- Item 103 (Legal Proceedings);
- Item 304 (Changes in and Disagreements With Accountants on Accounting and Financial Disclosure);

- Item 403 (Security Ownership of Certain Beneficial Owners and Management, assuming the completion of the de-SPAC transaction and any related financing transaction); and
- Item 701 (Recent Sales of Unregistered Securities).

If the private company is a foreign private issuer, similar disclosure is generally required, but with reference to the corresponding items in Form 20-F.

The Final Rules also amend certain financial statement requirements applicable to transactions involving shell companies (including SPACs) to more closely align with the requirements for an IPO on Form S-1 or F-1.

Other New De-SPAC Transaction Rules

Under the Securities Act of 1933 (the "Securities Act"), each "issuer" must sign a registration statement. Under the Final Rules, when a registration statement is filed for a de-SPAC transaction, the registration statement must now be signed by the target company (even though it is not technically the "issuer"), as well as its principal executive officer(s), principal financial officer, comptroller or principal accounting officer and a majority of its board (or similar body). By signing the registration statement, these persons will be subject to liability under Section 11 for any material misstatements or omissions in the registration statement.

The Final Rules also require a minimum dissemination period of at least 20 calendar days in advance of a security holder meeting (or the earliest date of action by consent) for registration statements, proxy statements and information statements filed in connection with de-SPAC transactions. As a very limited accommodation to foreign parties to the de-SPAC transaction, if applicable laws of the jurisdiction of organization impose a maximum number of days for dissemination, then the required period is the lesser of 20 calendar days and such maximum period permitted under applicable laws.

Generally, SRC status is re-determined on an annual basis at the end of the issuer's second fiscal quarter. Under the Final Rules, following a de-SPAC transaction, the newly combined company must re-determine its SRC status prior to its first post-closing SEC filing (other than the "Super 8-K" filed with Form 10 information shortly following closing) and reflect this re-determination in its filings beginning 45 days after consummation of the de-SPAC transaction. To re-determine SRC status, public float is measured as of a date within four business days after the consummation of the de-SPAC transaction and annual revenues are measured using the annual revenues of the target company as of the most recently completed fiscal year reported in the Super 8-K.

Tender Offer Filing Obligations

For a de-SPAC transaction that neither requires a proxy statement for a shareholder vote nor a registration statement for the offer or sale of securities, the SPAC will generally file a Schedule TO in connection with the redemption offer to its security holders. The Final Rules codify an SEC staff position that a Schedule TO filed in connection with a de-SPAC transaction should contain substantially the same information about a target private operating company that is required under the proxy rules and that a SPAC must comply with the procedural requirements of the tender offer rules when conducting the transaction for which the Schedule TO is filed, such as the redemption offer.

INVESTMENT COMPANY ACT CONSIDERATIONS

In the Final Rules, the SEC decided not to adopt proposed Rule 3a-10 under the Investment Company Act, which would have provided a safe harbor from the definition of "investment company" for SPACs meeting the criteria therein, including entering into an agreement with a target company within 18 months. Instead, the SEC stated that whether a SPAC is an investment company as defined in the Investment Company Act is a facts and circumstances determination, and the SEC opted to provide guidance for SPACs to consider when analyzing their status under the Investment Company Act.

While no specific duration period (18 months or otherwise) is itself determinative, the Adopting Release provides that duration is a relevant factor in determining whether a SPAC is an investment company. The SEC also noted that a SPAC should consider its historical development when analyzing whether it is an investment company. The nature of a SPAC's assets and income is also relevant, and the SEC acknowledged that a SPAC that holds only the sort of securities typically held by SPACs today, such as U.S. Treasury bills (and that does not propose to acquire investment securities), would be more likely *not* to be considered an investment company. Other relevant considerations include management activities, how the SPAC holds itself out and whether the SPAC intends to combine with a company that meets the definition of an investment company.

STATUTORY UNDERWRITER CONSIDERATIONS

In a change from the proposed rules, the SEC declined to adopt a rule stating that anyone who acts as an underwriter in a SPAC IPO and participates in the distribution associated with a de-SPAC transaction is an "underwriter" within the meaning of Section 2(a)(11) of the Securities Act. Instead, the SEC provided general guidance regarding statutory underwriter status and stated that it intends to follow its longstanding practice of applying the statutory terms "distribution" and "underwriter" broadly and flexibly, as the facts and circumstances of any transaction may warrant.

In the context of a de-SPAC transaction, the SEC stated its positions that the "distribution" is the process by which the SPAC's investors, and therefore the public, receive interests in the combined operating company, and that there *would be* an underwriter present where someone is selling for the issuer or participating in the distribution of securities of the combined company to the SPAC's investors and the broader public. The SEC expressly acknowledged that not every de-SPAC transaction involves, or needs to involve, an underwriter. Where an underwriter is present, that underwriter will need to perform appropriate diligence in order to be able to establish a due diligence defense.

NEW REQUIREMENTS RELATED TO FORWARD-LOOKING STATEMENTS AND PROJECTIONS

Forward-Looking Statements

The PSLRA provides a safe harbor from private rights of action under the U.S. securities laws when forward-looking statements are accompanied by meaningful cautionary language and the other conditions of the PSLRA are satisfied. However, the safe harbor is not available when a forward-looking statement is made in connection with, among other things, an offering by a blank check company or an IPO. In the Final Rules, the SEC adopted a new definition of "blank check company" that has the effect of eliminating the safe harbor protections of the PSLRA in de-SPAC transactions.

Projections

The Final Rules create new disclosure requirements for projections in de-SPAC transactions, including to require disclosure of:[9]

- The purpose of the projections and who prepared them;
- All material bases, assumptions and factors of the disclosed projections, including material growth, reduction or discount rates used and reasons for selecting such rates;
- If the projections relate to SPAC performance, then whether they reflect the view of the SPAC's management or board (or similar body) about its future performance as of the most recent practicable date prior to the date of the disclosure document;
- If the projections relate to the target company, then whether the target company has affirmed to the SPAC that its projections reflect the view of the target company's management or board (or similar body) about its future performance as of the most recent practicable date prior to the date of the disclosure document; and

- If the projections no longer reflect the views of the SPAC's or target company's board (or similar body), then the purpose of disclosing the projections and reasons for the continued reliance on such projections.

In addition to the above disclosure requirements that only apply to de-SPAC transactions, the Final Rules updated the SEC's general guidance on formulating and disclosing projections in any SEC filing, including that:[10]

- Any projection not based on historical financial results or operational history should be clearly distinguished from those that are;
- It generally would be misleading to present projections based on historical financial results or operational history without presenting such historical measure or operational history with equal or greater prominence; and
- A presentation of projections that include a non-GAAP financial measure should include a clear definition or explanation of the measure, a description of the GAAP financial measure to which it is most closely related and an explanation of why the non-GAAP financial measure was used instead of a GAAP measure.

These rules apply to projections of both the registrant and persons other than the registrant (which would include the target company in a de-SPAC transaction) when they are included in the registrant's SEC filings.

NEW AND AMENDED REQUIREMENTS FOR SHELL COMPANY BUSINESS COMBINATIONS

Under new Rule 145a, a business combination transaction involving most reporting shell companies, including a SPAC, will be deemed to be a "sale" of securities to the reporting shell company's shareholders. The SEC stated that even though there may be no traditional investment decision or vote, the effective exchange of securities in a shell company for securities of an operating company is a transaction "for value" and therefore a "sale." As a result of new Rule 145a, a de-SPAC transaction (and any other business combination with an applicable reporting shell company) must either be registered under the Securities Act or qualify for an exemption thereunder.

COMPLIANCE DATES

The Final Rules will go into effect 125 days after publication in the Federal Register. Compliance with the structured data requirements, which require XBRL data tagging, will be required 490 days after publication in the Federal Register (or, one year after the Final Rules go into effect).

TAKEAWAYS

The Adopting Release for the Final Rules includes a table indicating the number of SPAC IPOs in the U.S. securities market from 2012-2023 and notes that such table shows that "the SPAC IPO market has declined recently." Some argue that this decline is due to "regulators and courts question[ing] the model and financial markets sober[ing] up amid higher interest rates," as well as "warning statements from the SEC and uncertainty about the timing of [the Final Rules] because few sponsors wanted to raise money from investors and then face restrictions on how they could use it."[11] The increased disclosure requirements and expanded liability imposed by the Final Rules will likely further decrease, though not eliminate, SPAC activity. Companies that are considering or have SPAC or de-SPAC transactions pending must keep in mind the effective dates of the Final Rules.

1 The Final Rules define a SPAC as a company that has (1) indicated that its business plan is to (i) conduct a primary offering of securities that is not subject to the requirements of Rule 419 under the Securities Act; (ii) complete a business combination with one or more target companies within a specified time frame; and (iii) return proceeds from the offering and any concurrent offering (if such offering or concurrent offering intends to raise proceeds) to its security holders if the company does not complete a business combination with one or more target companies within the specified time frame; or (2) represented that it pursues or will pursue a SPAC strategy.
2 The Final Rules define a target company as an operating company, business or assets.
3 The Final Rules define a de-SPAC transaction as a business combination involving a SPAC and one or more target companies.
4 The Final Rules define a SPAC sponsor as any entity and/or person primarily responsible for organizing, directing or managing the business and affairs of a SPAC, excluding, if an entity is a SPAC sponsor, officers and directors of the SPAC who are not affiliates of any such entity that is a SPAC sponsor.
5 For brevity purposes, this memo discusses concepts as they relate to a "SPAC sponsor," but the Final Rules often include additional related persons, including a "SPAC sponsor, its affiliates and promoters."
6 Item 1603(a) of Regulation S-K.
7 Item 1606 of Regulation S-K.
8 Item 1607 of Regulation S-K.
9 Item 1609 of Regulation S-K.
10 Item 10(b) of Regulation S-K.
11 https://www.wsj.com/finance/regulation/sec-wants-to-make-sure-spac-investors-know-what-theyre-getting-into-510aca30.

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