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SEC Proposes Broad Changes for SPACs and De-SPACs

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On March 30, 2022, in a 3-1 vote, the SEC proposed broad new rules regarding special purpose acquisition companies (SPACs) that would impose additional disclosure and other requirements on initial public offerings (IPOs) by SPACs, and additional disclosures and potential liability for SPACs, SPAC sponsors, target companies, financial advisors and other market participants in business combination transactions involving SPACs (de-SPACs). Though described as an effort to more closely align the procedural and disclosure requirements for de-SPACs with traditional IPOs, the new regulations, if adopted largely "as is," could significantly alter how SPACs acquire targets or conduct IPOs and will likely increase the cost, risk and complexity of compliance for SPACs and their targets. Many of these changes are likely to have follow-on impacts in current market practices that are beyond the scope of this alert, such as timing and amount of D&O insurance coverage, investment bank engagement letter and underwriting terms, business combination agreement terms and identification of potential SPAC business combination targets.

Highlights

Enhanced Projections Disclosure and Exclusion from PSLRA Safe Harbor Protections

The SEC has proposed to update and expand guidance applicable to both non-SPAC and de-SPAC transactions regarding the general use of projections included in SEC filings. Proposed amendments to Item 10(b) of Regulation S-K would, among other things, reiterate the SEC's view that projections must have a reasonable basis. Additionally, the proposed rules would require that projections based on historical financial results or operating history be clearly distinguished from those that are not and would also require projections based on historical financial results or operating history to be presented with equal or greater prominence as compared to those that are not.

The proposed rules would also provide additional disclosure requirements specifically applicable to financial projections used in connection with de-SPAC transactions. A proposed new Item 1609 of Regulation S-K would require a registrant in a de-SPAC transaction to disclose:

- the purpose for which the projections were prepared and the party that prepared them;
- the material bases of the disclosed projections and all material assumptions underlying the projections, including any factors that may materially impact such assumptions; and
- whether the disclosed projections continue to reflect the view of the board or management of the SPAC or target company as of the date of filing.

The proposal would also amend the definition of "blank check company" to specifically include SPACs, which would have the effect of making the Private Securities Litigation Reform Act (PSLRA) forward-looking statements safe harbor unavailable for disclosure in de-SPAC registration statements, including in relation to the aforementioned enhanced projections disclosures.

What to do now:

The availability of the PSLRA safe harbor in connection with de-SPAC transactions has not been considered settled law, and its availability would be subject to a number of conditions and/or challenges. However, the express *unavailability* of the safe harbor, when coupled with the proposed additional disclosures regarding projections, represents a significant departure from the treatment of projections in non-SPAC related mergers and acquisitions and could increase the potential liability associated with their use. One immediate practical effect could be the elimination of the de-SPAC transaction as an alternative for target companies that do not have lengthy operating histories. Although the unavailability of the PSLRA safe harbor does not preclude reliance on the "bespeaks caution" doctrine, SPACs and target companies should carefully consider what information is included in de-SPAC-related projections, when to prepare, ask for or provide such projections and closely analyze the bases and assumptions underlying those projections.

Additionally, although projections disclosure is not *per se* required by the federal securities laws, they are commonly produced and disclosed for a number of reasons, including: (i) state fiduciary duty laws that govern the basis for a board's decision to approve a business combination; (ii) the basis underlying the financial analysis of a financial advisor in connection with the provision of a fairness opinion; (iii) raising PIPE capital; and (iv) for marketing de-SPAC transactions (particularly for pre-revenue target companies with little historical operations). For these reasons, the proposed enhanced projections disclosure will likely not curb the use of projections. However, with the potential increased liability surrounding their use (see *Underwriter Status and Liability* below) and the related disclosure obligations noted above, parties and advisors to de-SPAC transactions in process now should consider whether any additional disclosures regarding projections in de-SPAC and related PIPE transactions are advisable and should expect an enhanced level of scrutiny on an ongoing basis from all potentially liable parties to ensure justifiable bases for their use and underlying assumptions and closely review the target's performance against those projections during the course of the de-SPAC transaction. SPACs, target companies and their advisors may also need to adapt procedures to ensure any projections that are used have been subject to consistent diligence throughout the process and reviewed and updated at each filing.

Fairness of De-SPAC Transaction and Reports, Opinions and Appraisals

The proposed rules would require a SPAC to provide a statement in any Form S-4 and F-4 or Schedules 14A, 14C and TO filed in connection with a de-SPAC transaction as to whether it reasonably believes that the de-SPAC transaction (including any related financing transaction, such as a PIPE or a backstop facility) is fair or unfair to the SPAC's unaffiliated security holders, as well as a discussion of the bases for this statement. This is a substantial departure from existing SPAC M&A practice—both with respect to the requirement to disclose the SPACs views as to "fairness," as well as requiring the additional analysis of any related financing transaction as part of that determination. The proposal would further require the SPAC's statement to include a reasonably-detailed discussion of the material factors upon which its reasonable belief is based and, to the extent practicable, the weight assigned to each factor. Enumerated factors include but were not be limited to:

- the valuation of the private operating company;
- the consideration of any financial projections; and
- any report, opinion, or appraisal obtained from a third party.

The proposed rules would also require Rule 13e-3-style disclosure about whether the SPAC or its sponsor has received any outside report, opinion or appraisal, including preliminary analyses, relating to the fairness of the transaction. All such reports, opinions or appraisals would have to be filed as exhibits to the applicable filing.

What to do now:

Although the proposed rules would not *require* a SPAC to obtain a fairness opinion from a financial advisor in connection with a de-SPAC transaction, a SPAC's board of directors will likely need to seek a fairness opinion to substantiate its reasonable belief as to the fairness of the de-SPAC and the related financings. The proposal also certainly suggests that the SEC will likely ask for any such reports during the related proxy and registration review and comment process when examining the basis of the SPACs fairness determination. Consideration should be given as to what information, including target projections, should be included in SPAC board presentations in light of the potential for all such information to be publicly filed (as is done for Rule 13e-3 take-private transactions). Moreover, consideration should be given to taking a more expansive view of the materials that may be deemed to be a disclosable report, opinion or appraisal. We have observed in both de-SPAC transactions and in other M&A transactions increased focus by the SEC staff during the comment process as to whether due diligence reports, for example, constitute reports, opinions or appraisals.

Tender Offer Disclosure and Procedural Requirements Applicable to Redemptions and Extensions

The SEC has long held the belief that redemption offers made in connection with a de-SPAC transaction or an extension of the timeframe to complete a de-SPAC transaction generally have *indicia* of being a tender offer. However, the SEC has not objected if a SPAC does not comply with the tender offer rules when the SPAC files a Schedule 14A or 14C in connection with a de-SPAC transaction or an extension, as the federal proxy rules would generally mandate substantially similar disclosures and applicable procedural protections as required by the tender offer rules.

If adopted, proposed new Item 1608 of Regulation S-K would not affect the availability of this prior SEC position for those SPACs that file Schedule 14A or 14C for their de-SPAC transactions or extensions. However, the new rule would codify the SEC's view that SPACs that are unable to avail themselves of this position would have to file a Schedule TO for the required redemption process and comply with the procedural requirements of the tender offer rules – *e.g.*, the requirement to keep the redemption period open for at least 20 business days.

The SEC also recently issued a C&DI in March 2022 which provides that, to the extent that a SPAC redemption offer constitutes a tender offer, the Rule 14e-5 prohibition of purchases outside of a tender offer would apply to the purchases of SPAC securities by the SPAC sponsor or its affiliates outside of the redemption offer. However, for policy reasons, the C&DI indicates that the staff would not object to purchases by the SPAC sponsor or its affiliates outside of the redemption offer as long as conditions specified in the C&DI are satisfied, including (i) the registration statement or proxy statement filed for the de-SPAC transaction discloses the possibility of the sponsor or its affiliates purchasing the SPAC securities outside the redemption process, along with the purpose of such purchases; (ii) the sponsor or its affiliates purchasing the SPAC securities at a price no higher than the price offered through the SPAC redemption process; (iii) the registration statement or proxy statement filed for the de-SPAC transaction including a representation that any SPAC securities purchased by the sponsor or its affiliates would not be voted in favor of approving the business combination transaction; (iv) the sponsor and its affiliates not possessing any redemption rights with respect to the SPAC securities or, if they possess redemption rights, they waive such rights; and (v) the SPAC disclosing in a Form 8-K, prior to the security holder meeting to approve the de-SPAC transaction, certain information about any purchases by sponsors and their affiliates.

What to do now:

If adopted, this proposed rule could have a significant impact on redemption offers by foreign private issuer (FPI) SPACs in connection with de-SPAC transactions, as FPIs are not subject to the federal proxy rules and therefore ineligible to file a Schedule 14A or 14C. Note that, although the federal tender offer rules contain an exemption for exempt transactions, some members of the SEC staff have held that this exemption is available only to the issuer of the redeemed securities and, therefore, would not be available for sponsor's purchase of redeemed SPAC securities. We are hopeful that in the final rules the SEC will clarify that FPIs can file Schedule 14A or 14C-type disclosure on Form 6-K and not be bound by the tender offer rules in connection with any redemptions implicated by the de-SPAC transaction or extension requests.

Underwriter Status and Liability

The proposed rules provide that a SPAC IPO underwriter that "takes steps to facilitate the de-SPAC transaction, or any related financing transaction, or otherwise participates (directly or indirectly) in the de-SPAC transaction" will be deemed a statutory "underwriter" within the meaning of Section 2(a)(11) of the Securities Act of 1933 (Securities Act) and subject to Sections 11 and 12 liability thereunder. Notably, the SEC stated that this proposal "clarifies" the SEC's position regarding underwriter liability. The proposing release flags certain conduct by SPAC IPO underwriters that the SEC believes likely rises to the level of participation in the de-SPAC transaction warranting underwriting liability, including acting as a financial advisor, capital markets advisor and/or PIPE placement agent. The proposing release is, however, unclear as to whether a financial interest in the outcome of the de-SPAC transaction alone (*i.e.*, the deferred IPO underwriter fee that has become standard in SPAC IPOs) may be sufficient to deem the IPO underwriter a statutory "underwriter" in the de-SPAC transaction. It is also unclear from the release if the clarification of the definition of statutory "underwriter" will apply retroactively to SPAC IPOs and de-SPAC transactions that have already closed or are currently in process. The proposing release also stated that "[f]ederal courts and the [SEC] may find that other parties [*e.g.*, financial advisors, PIPE investors, or other advisors], involved in securities distributions, including other parties that perform activities necessary to the successful completion of de-SPAC transactions, are 'statutory underwriters' within the definition of underwriter in Section 2(a)(11)."

What to do now:

Expansion of statutory underwriter liability in de-SPAC transactions may lead to significant changes in the role and practices of investment banks advising on, and other parties involved with, SPAC IPOs and/or de-SPAC transactions. SPAC IPO underwriters need to consider their potential exposure for de-SPAC transactions, which will now potentially make them subject to Sections 11 and 12 liability to a broad set of plaintiffs for any material misstatement or omission of fact in the registration statement filed in connection with the de-SPAC transaction. Imposing underwriter liability on SPAC IPO underwriters will likely have a chilling effect on their participation in SPAC IPOs unless the investment banks can (i) include due diligence and indemnification provisions in their underwriting agreements or engagement letters and/or (ii) receive the entire SPAC IPO fee at the closing of the SPAC IPO (which SPACs may be unwilling to pay upfront) or have the ability to unilaterally waive any deferred fee.

Likewise, investment banks have traditionally been reluctant to include projections in conventional IPO disclosures (and the SEC has not required that such projections be disclosed in that context). Because the inclusion of projections and fairness opinions in registration statements for de-SPAC transactions may be effectively required for nearly all de-SPAC transactions (as noted above), there is a risk that investment banks will consequently not participate in de-SPAC transactions or SPAC IPOs in order to avoid being deemed statutory "underwriters" subject to Sections 11 and 12 liability. To that end, it was recently reported that one large underwriter of SPAC transactions will stop underwriting SPACs until these potential liability issues are resolved.

Investment Company Act Safe Harbor

The SEC has proposed the adoption of a safe harbor for SPACs that would deem the SPAC vehicle to not be an investment company under the Investment Company Act of 1940, as amended, if the following conditions are met:

- The SPAC's assets must generally consist solely of government securities, securities issued by government money market funds and cash items prior to completion of the de-SPAC.
- The SPAC's activities must be limited to seeking to complete a single de-SPAC transaction following which the surviving public entity will be primarily engaged in the business of the target company and will have a class of securities registered on a national securities exchange.
- The SPAC's officers, directors and employees must be primarily focused on activities related to seeking a target company.
- The SPAC must announce a business combination within 18 months of the SPAC IPO and complete a business combination within 24 months of the SPAC IPO.

What to do now:

Though described as a safe harbor only intended to provide for circumstances in which a SPAC will not be deemed to be an investment company, certain statements made in the proposing rule release – *e.g.*, that the parameters were designed to "distinguish a SPAC that is likely to raise serious questions as to its status as an investment company from one that would not" and that "the inability of a SPAC to identify a target and complete a de-SPAC transaction within the proposed timeframe would raise serious questions concerning the applicability of the Investment Company Act to that SPAC" – create significant uncertainty for a SPAC that falls outside the safe harbor to argue as to why it should nevertheless not be considered an investment company. Essentially, such statements call into question whether the proposed safe harbor is actually non-exclusive. Additionally, creating a safe harbor, where none previously existed, as proposed, raises questions as to whether existing SPACs that do not meet the safe harbor conditions would be considered unregistered investment companies by the SEC, particularly given the significant ill-effects of being deemed an unregistered investment company under the Investment Company Act (the magnitude of which are beyond the scope of this alert). The SEC has requested comments on the safe harbor, and we would hope that the rules as ultimately adopted, or at a minimum definitive commentary from the SEC in the final adopting release, will clarify that the SEC will not question the investment company status of SPACs formed before the safe harbor takes effect. In the meantime, current SPACs which do not satisfy the requirements for the proposed safe harbor will need to assess with their advisors whether that SPAC (or former SPAC) otherwise constitutes an investment company under the SEC's existing rules.

Smaller Reporting Company Re-Determination

The SEC has proposed that a post de-SPAC entity will need to re-determine its "smaller reporting company" (SRC) status before its first periodic report (Form 10-K or 10-Q) filed after the filing of a Super Form 8-K, with its public float measured as of a date within four business days following the consummation of a de-SPAC transaction and the revenue threshold determined by using the annual revenues of the private operating company as of the most recently completed fiscal year for which audited financial statements are available.

What to do now:

De-SPAC SRC target companies will need to be ready to prepare more comprehensive disclosures following a de-SPAC transaction earlier than was previously required (or would be included in a registration statement filed in connection with a de-SPAC transaction). Specifically, there may be a need to provide an additional (third) year of financial statements and an accompanying audit, quantitative and qualitative information about market risk, and more fulsome CD&A and executive compensation disclosure. For example, if the timing of the de-SPAC transaction is such that the closing occurs just prior to the deadline to file a Form 10-Q, and the post de-SPAC company no longer qualifies as a SRC, the company would need to provide full CD&A and executive compensation disclosure in the subsequent re-sale shelf registration statement on Form S-1 (where it would not have been required to provide such disclosure previously).

Target and Potentially Sponsor as Co-Registrant on SPAC's Registration Statement

The proposed rules would require that a registration statement (and not a Schedule 14A, which is permitted under existing rules where securities of the SPAC are not being registered) be filed in connection with the de-SPAC transaction, and that such registration statement register not just the offering of securities to the target company's shareholders, but also register an offering to the existing non-affiliated SPAC shareholders. Thus, both the target entity and the SPAC will be co-registrants under the de-SPAC registration statement, resulting in both the SPAC and the target entity being subject to Section 11 and Section 12 liability. The SEC indicated that it also is considering whether the sponsor of a SPAC should be considered a co-registrant.

What to do now:

SPACs, their targets and potentially SPAC sponsors will need to consider in current business combination negotiations the potential universe of information that will be included in registration statements, including projections, because assuming this rule is adopted as is, several additional entities and individuals will sign the registration statement (thereby making them liable under Section 11 of the Securities Act). This requirement also expands the potential liability for SPAC IPO underwriters.

Other Enhanced Disclosures:

The SEC proposal includes the following additional technical changes to disclosure requirements for SPAC IPOs and de-SPAC transactions and technical reporting requirements for post-de-SPAC companies:

- Require disclosure of the sponsor's experience, any arrangements between the individuals that control the sponsor, and all compensation that has or will be awarded to the sponsor or any affiliates or promoters.
- Require a description of conflicts of interest between the unaffiliated security holders of the SPAC and the sponsor, its affiliates or the SPAC's officers, directors or promoters.
- Require detailed dilution that shareholders may experience in both the SPAC IPO and in the de-SPAC transaction (to appear on the cover of the prospectus).
- Require technical changes to the reporting requirements in de-SPAC transactions to harmonize the financial statement requirements with the analogous requirements for a traditional IPO.

What to do now:

The SEC's proposals for enhanced disclosures and financial statement requirements are largely consistent with current market practice for disclosures in SPAC IPOs and de-SPAC transactions. The SEC Staff has also been seeking such disclosures via the comment letter process during recent SPAC IPO and de-SPAC registration statement reviews. These disclosures do not appear unduly onerous, and market participants should consider including these disclosures prophylactically.

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Comment Period and Expected Timing of the Final Rules

The proposed rules will be open for public comment until the later of May 31, 2022 or the date that is 30 days after their official publication in the Federal Register. Following the public comment period, the SEC staff will consider appropriate revisions to the proposed rules before proposing final rules that will be subject to a subsequent vote by the SEC Commissioners.