Articles + Publications | January 30, 2024

SEC Adopts Final Rules Enhancing Disclosures and Providing Additional Investor Protections Related to SPACs

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Introduction

Nearly two years after first proposing new rules related to special purpose acquisition companies (SPACs), the U.S. Securities and Exchange Commission (SEC) has adopted final rules aimed at enhancing investor protections in initial public offerings by SPACs and in subsequent de-SPAC transactions. The final rules require new enhanced disclosure requirements related to SPACs, and include new procedural protections in de-SPAC transactions. The SEC also provided guidance regarding underwriter status in de-SPAC transactions and analysis of a SPAC's potential status as an investment company under the Investment Company Act. The final rules' text can be found here, and the SEC's fact sheet can be found here.

The final rules become effective 125 days after their publication in the *Federal Register* and compliance with the structured data requirements requiring the tagging of information in Inline XBRL will be required 490 days after publication of the final rules in the *Federal Register*.

Enhanced Disclosure Requirements for SPACs

New subpart 1600 of Regulation S-K codifies and standardizes some of the disclosures that SPACs may or may not have always provided in their registration statements and prospectuses. A brief summary of some of these new disclosure requirements is set forth below:

- *SPAC sponsors, affiliates, and promoters*: SPACs will be required to provide enhanced disclosures regarding SPAC sponsors, affiliates, and promoters, including, among other things, the general character of the SPAC sponsor's business and a description of the experience and material roles and responsibilities of the SPAC sponsor.

- *Conflicts of interest:* SPACs will be required to provide certain disclosures regarding conflicts of interest between the SPAC, SPAC affiliates, the target company, and unaffiliated security holders.

- *Dilution*: Disclosures related to instances that may cause dilution to investors will be required, including, whether compensation paid to, and securities received by the SPAC sponsor, its affiliates and promoters in connection with a de-SPAC transaction, or any related financing transaction, may result in material dilution to non-redeeming shareholders.

- *Board of directors' determination about the de-SPAC transactions*: The final rules require disclosure of, among other things, the determination by the SPAC's board of directors as to whether the de-SPAC transaction is advisable and in the best interest of the SPAC and its security holders, if required by the SPAC's governing law.

- *Reports, opinions, appraisals, and negotiations*: The final rules require disclosure regarding any reports, opinions, or appraisals from an outside party that are materially related to certain determinations by the SPAC's board of directors, including for, among other items, whether the de-SPAC transaction is advisable and in the best interest of the SPAC and its security holders, or the consideration or fairness of the consideration to security holders in the de-SPAC transaction.

Additional Procedural Protections and Securities Act Liability

Private Target Operating Companies Deemed Co-Registrants: The final rules amended the signature requirements under Forms S-4 and F-4 to require that the term "registrant" in a SPAC registration statement for a de-SPAC transaction also includes the target company, requiring the target company, a majority of its board of directors, and certain officers to sign the registration statement. As a result, the private target company would be deemed a co-registrant for the registration statement and subject to liability under the Securities Act for statements made in such registration statement.

Re-Determination of Smaller Reporting Company Status: The final rules amend the definition of smaller reporting company (SRC) to require a re-determination of SRC status following the consummation of a de-SPAC transaction.

Underwriter Status and Liability in Securities Transactions: The SEC confirmed that a de-SPAC transaction is a distribution of securities under the Securities Act. Therefore, depending on the facts and circumstances, an underwriter in a de-SPAC transaction could be deemed a "statutory underwriter," subjecting it to underwriter liability under the Securities Act, even though it may not have been named as an underwriter in the offering or engaged in traditional named underwriter activities.

New Rules Regarding Business Combinations Involving Shell Companies

New Rules for Shell Company Business Combinations: The SEC adopted rules that deem business combinations involving a reporting shell company and another entity that is not a shell company to be a sale of securities to the reporting shell company's shareholders that implicates the registration requirements of the Securities Act. They further clarified that there are no additional registration requirements under the Securities Act when a shell

company business combination transaction is already registered under the Securities Act, as is the case in many de-SPAC transactions.

Article 15 of Regulation S-X and Related Amendments: The SEC also adopted Article 15 of Regulation S-X to require that, among other things, an actual or would be predecessor entity in a business combination with a shell company provide the same financial statements as if the filing were a registration statement of its own initial public offering, including providing audited financial statements. The SEC adopted related amendments to require the financial statements of a recently acquired shell company be filed as if the shell company were the registrant for the filing, subject to certain exceptions. In the specific context of a de-SPAC transaction, the new rules will require financial statements of the SPAC to be included in any registration statements filed after the de-SPAC transaction and until the transaction is fully reflected in the financial statements filed by the registrant.

Enhanced Projections Disclosure in De-SPAC Transactions, Revised Definition of Blank Check Company, and the PSLRA

The SEC adopted amendments to the rules related to management's projections of future performance disclosed in SEC filings in connection with de-SPAC transactions. The amended rules clarify certain disclosure requirements regarding the presentation of projected measures disclosed by the SPAC and a target company in a de-SPAC transaction. The SEC also adopted new rules requiring registrants to provide certain enhanced disclosures when projections are provided in the context of a de-SPAC transaction, including, for example, whether the projections reflect the view of the board of directors or management of the SPAC or target company.

Moreover, to the extent SPACs provide future projections in their de-SPAC filings with the SEC, such projections will no longer be shielded from liability by the forward-looking statements safe harbor under the Private Securities Litigation Reform Act of 1995 (PSLRA). The final rules amended the definition of "blank check company" in the Securities Act and Exchange Act to effectively remove the liability protections under the PSLRA for forward-looking statements made by blank check companies in connection with de-SPAC transactions.

Status of SPACs Under the Investment Company Act

The SEC set forth guidance regarding the facts and circumstances relevant to a determination of whether a SPAC meets the definition of investment company under the Investment Company Act (investment company). The SEC highlighted the following activities that may raise concerns about a SPAC's status as an investment:

- *The nature of SPAC assets and income:* A SPAC that does not hold, or propose to hold, any securities assets would not be an investment company, unless it proposes to engage in the business of being an investment company. The SEC noted that a SPAC that owns or proposes to acquire 40% or more of its total assets in investment securities would likely need to register under the Investment Company Act unless an exclusion applies.

- *Management activities*: Actions by a SPAC's officers, directors, and employees suggesting that the SPAC is primarily engaged in investing, reinvesting, or trading in securities instead of seeking a de-SPAC transaction are factors that would weigh in favor of the SPAC being an investment company.

- *Duration:* The longer a SPAC takes to complete a de-SPAC transaction when the SPAC's assets and income are substantially from securities, is a factor weighing in favor of being an investment company. The SEC, in the adopting release, suggested that a SPAC operating beyond a period of one year to 18 months raises concerns that a SPAC may be an investment company.

- *How the SPAC holds itself out:* A SPAC holding itself out in a way that suggests investors should invest primarily to gain exposure to the SPAC's portfolio of securities before a de-SPAC transaction would likely weigh in favor of investment company status.

- *Whether the business combination is with an investment company:* If a SPAC were to engage or seek to engage in a de-SPAC transaction with an investment company (*e.g.*, closed-end fund or a business development company), the SPAC is likely to be an investment company.

In the event that a SPAC was determined to be subject to the Investment Company Act based on the above factors, substantive regulation under the Investment Company Act may significantly limit the SPAC to engage in certain transactions and impose other restrictions on capital structure and governance.

Conclusion

The SPAC market cooled significantly in 2022 as a result of market forces, as well as the then looming SPAC rules from the SEC. Several prominent investment banks exited the SPAC market altogether, deal volume dropped dramatically, and a number of SPACs dissolved and returned capital back to their shareholders. The new rules are likely to further chill the market for SPACs, including the willingness of sponsors and investment banks to participate in SPAC transactions; however there are many SPACs that are still seeking targets and a de-SPAC transaction may still be a viable route to going public for some companies.

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