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SEC Proposes New SPAC Rules

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Executive Summary

On March 30, 2022, the Securities and Exchange Commission (the "SEC") proposed new rules and amendments (the "Proposal")[1] to require new disclosures designed to implement heightened investor protections in initial public offerings by special purpose acquisition companies ("SPACs") and in subsequent business combination transactions between SPACs and private operating companies ("de-SPAC transactions"). If adopted as proposed, the Proposal would require, among other things, additional disclosures about SPAC sponsors, conflicts of interest, and sources of dilution. It also would require additional disclosures regarding de-SPAC transactions, including disclosures relating to the fairness of these transactions. Further, new rules would address issues relating to projections made by SPACs and their target companies, including the Private Securities Litigation Reform Act of 1995 (the "PSLRA") safe harbor for forward-looking statements and the use of projections in SEC filings and in business combination transactions. The Proposal would also create a new safe harbor from registration under the Investment Company Act of 1940 (the "Investment Company Act") for a SPAC that meets prescribed conditions. The Proposal challenges some of the advantages de-SPAC transactions are perceived to have over traditional IPOs.

Background

There has been a dramatic surge in the number of initial public offerings by SPACs over the past two years – in 2020 and 2021, more than half of all IPOs were conducted by SPACs. Concurrently with the rise of SPACs, the SEC has raised investor protection concerns about the SPAC structure and the increasing use of de-SPAC transactions by private operating companies to become public companies. The SEC also has cited concerns that projections for SPAC targets are sometimes prepared or used without a reasonable basis in de-SPAC transactions. The SEC also has noted that there have been discussions about whether some SPACs may be investment companies that are subject to the requirements of the Investment Company Act.

Proposed Enhanced Disclosures

The Proposal includes the following:

Sponsor

Disclosure would be required on:

- the experience, material roles and responsibilities of the sponsor, its affiliates and any promoters, as well as any agreement, arrangement or understanding (1) between the sponsor and the SPAC, its executive officers, directors or affiliates, in determining whether to proceed with a de-SPAC transaction, and (2) regarding the redemption of outstanding securities;
- the controlling persons of the sponsor and any persons who have direct and indirect material interests in the sponsor, as well as an organizational chart that shows the relationship between the SPAC, the sponsor, and the sponsor's affiliates;
- in tabular form, the material terms of any lock-up agreements with the sponsor and its affiliates; and
- the nature and amounts of all compensation that has or will be paid to the sponsor, its affiliates and any promoters for all services rendered in all capacities to the SPAC and its affiliates, as well as the nature and amounts of any reimbursements to be paid to the sponsor, its affiliates and any promoters upon the completion of a de-SPAC transaction. [2]

Conflicts of Interest

Disclosure would be required on: of any actual or potential material conflict of interest between (1) the sponsor or its affiliates or the SPAC's officers, directors, or promoters, and (2) unaffiliated security holders, including any conflict of interest in determining whether to proceed with a de-SPAC transaction and any conflict of interest arising from the manner in which a SPAC compensates the sponsor or the SPAC's executive officers and directors, or the manner in which the sponsor compensates its own executive officers and directors. [3] Disclosure would also be required of the fiduciary duties each officer and director of a SPAC owes to other companies. [4]

Dilution

Additional disclosure about the potential for dilution would be required in (a) registration statements filed by SPACs, and (b) de-SPAC transactions, both to include simplified tabular dilution disclosure. [5]

Prospectus Cover Page and Prospectus Summary Requirements

In response to concerns about the complexity of disclosures in registration statements filed by SPACs for IPOs and for de-SPAC transactions, certain information would be required to be provided on the prospectus cover page and in the prospectus summary in plain English.

In registered offerings (including IPOs) by SPACs other than for de-SPAC transactions, the prospectus cover page would need to include the time frame for the SPAC to consummate a de-SPAC transaction, redemptions, sponsor compensation, dilution (including simplified tabular disclosure) and conflicts of interest. The following information would also be required:

- the process by which a potential business combination candidate will be identified and evaluated;
- whether shareholder approval is required for the de-SPAC transaction;
- the material terms of the trust or escrow account, including the amount of gross offering proceeds that will be placed in such account;
- the material terms of the securities being offered, including redemption rights;
- whether the securities being offered are the same class as those held by the sponsor and its affiliates;
- the length of the time period during which the SPAC intends to consummate a de-SPAC transaction, and its plans if it does not do so, including, whether and how the time period may be extended, the consequences to the sponsor of not completing an extension of this time period, and whether shareholders will have voting or redemption rights with respect to an extension of time to consummate a de-SPAC transaction;
- any plans to seek additional financing and how such additional financing might impact shareholders;

- tabular disclosure of sponsor compensation and the extent to which material dilution may result from such compensation; and
- material conflicts of interest.

In de-SPAC transactions, SPACs would be required to include on the prospectus cover page, among other things, the fairness of the de-SPAC transaction, material financing transactions, sponsor compensation and dilution, and conflicts of interest. SPACs would also be required to include, in the prospectus summary, the following information:

- the background and material terms of the de-SPAC transaction;
- the fairness of the de-SPAC transaction;
- material conflicts of interest;
- tabular disclosure on sponsor compensation and dilution;
- financing transactions in connection with de-SPAC transactions; and
- redemption rights.

De-SPAC Transactions

Specific disclosure would be required of the background, material terms and effects of the de-SPAC transaction, including:

- a summary of the background of the de-SPAC transaction, including, but not limited to, a description of any contacts, negotiations, or transactions that have occurred concerning the de-SPAC transaction;
- a brief description of any related financing transaction, including any payments from the sponsor to investors in connection with the financing transaction;
- the reasons for engaging in the particular de-SPAC transaction and for the structure and timing of the de-SPAC transaction and any related financing transaction;
- where the shares of a SPAC are being exchanged for shares of a new holding company or the target company in a de-SPAC transaction, an explanation of any material differences in the rights of security holders of the post-business combination company as a result of the de-SPAC transaction; and
- disclosure regarding the accounting treatment and the federal income tax consequences of the de-SPAC transaction, if material.

In addition, disclosure would be required of the effects of the de-SPAC transaction and any related financing transaction on the SPAC and its affiliates, the sponsor and its affiliates, the private operating company and its affiliates, and unaffiliated security holders of the SPAC. [6] Disclosure would also be required of material interests of the SPAC's sponsors, officers and directors in the de-SPAC transaction or any related financing transaction, including any fiduciary or contractual obligations to other entities and any interest in, or affiliation with, the private operating company that is the target of the de-SPAC transaction. [7]

SPACs would also be required to disclose whether or not security holders are entitled to any redemption or appraisal rights and, if so, to provide a summary of the redemption or appraisal rights. This includes, among other things, whether shareholders may redeem their shares regardless of whether they vote in favor of or against a proposed de-SPAC transaction, or abstain from voting, and whether shareholders have the right to redeem their securities at the time of any extension of the time period to complete a de-SPAC transaction. If there are no redemption or appraisal rights available for security holders who object to the de-SPAC transaction, the Proposal would require disclosure of any other rights that may be available to security holders under the law of the jurisdiction of organization. [8]

Fairness of the De-SPAC Transaction

To address the SEC's concerns regarding potential conflicts of interest and potentially misaligned incentives in connection with the decision to proceed with a de-SPAC transaction, and to assist investors in assessing the fairness of

a particular de-SPAC transaction to unaffiliated investors, the Proposal would require a statement from a SPAC as to whether it reasonably believes that the de-SPAC transaction and any related financing transaction are fair or unfair to the SPAC's unaffiliated security holders, as well as a discussion of the bases for this statement. The SPAC would be required to disclose whether any director voted against, or abstained from voting on, approval of the de-SPAC transaction or any related financing transaction and, if so, the identity of the director and, if known after making a reasonable inquiry, the reasons for the vote against the transaction or abstention. [9]

A SPAC would be required to discuss in reasonable detail the material factors upon which a reasonable belief regarding the fairness of a de-SPAC transaction and any related financing transaction is based and, to the extent practicable, the weight assigned to each factor. These factors would include but not be limited to: the valuation of the target company; the consideration of any financial projections; any report, opinion, or appraisal obtained from a third party; and the dilutive effects of the de-SPAC transaction and any related financing transaction on non-redeeming shareholders. [10]

Additional disclosure would be required on whether (a) the de-SPAC transaction or any related financing transaction is structured so that approval of at least a majority of unaffiliated security holders is required; (b) a majority of directors who are not employees of the SPAC has retained an unaffiliated representative to act solely on behalf of unaffiliated security holders for purposes of negotiating the terms of the de-SPAC transaction or any related financing transaction and/or preparing a report concerning the fairness of the de-SPAC transaction or any related financing transaction; and (c) the de-SPAC transaction or any related financing transaction was approved by a majority of the directors of the SPAC who are not employees of the SPAC. [11]

Reports, Opinions and Appraisals

Disclosure would be required about whether or not the SPAC or its sponsor has received any report, opinion, or appraisal obtained from an outside party relating to the consideration or the fairness of the consideration to be offered to security holders or the fairness of the de-SPAC transaction or any related financing transaction to the SPAC, the sponsor or security holders who are not affiliates. [12] If such materials are received, the SPAC would be required to disclose:

- the identity, qualifications, and method of selection of the outside party and/or unaffiliated representative;
- any material relationship between (1) the outside party, its affiliates, and/or unaffiliated representative, and (2) the SPAC, its sponsor and/or their affiliates, that existed during the past two years or is mutually understood to be contemplated and any compensation received or to be received as a result of the relationship;
- whether the SPAC or the sponsor determined the amount of consideration to be paid to the target company or its security holders, or the valuation of the target company, or whether the outside party recommended the amount of consideration to be paid or the valuation of the target company; and
- a summary concerning the negotiation, report, opinion or appraisal, which would be required to include a description of the procedures followed; the findings and recommendations; the bases for and methods of arriving at such findings and recommendations; instructions received from the SPAC or its sponsor; and any limitation imposed by the SPAC or its sponsor on the scope of the investigation. [13]

All such reports, opinions or appraisals would be filed as exhibits to the SEC filing for the de-SPAC transaction. [14]

Extending Traditional IPO Protections to SPACs

As private operating companies have increasingly used de-SPAC transactions to access public securities markets and become public reporting companies, investors may receive disclosures about the future public company that differ from, or are not presented in the same manner as, those received in connection with a traditional IPO. Some of the investor protections available in a traditional IPO are either not available or pared down in a de-SPAC transaction. The Proposal would provide investors with disclosures and liability protections comparable to those in a traditional firm commitment IPO.

Aligning Non-Financial Disclosures in De-SPAC Disclosure Documents

If the target company in a de-SPAC transaction is not subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act, disclosure with respect to the target company would be required pursuant to certain items in Regulation S-K or would be required in the registration statement or schedule filed in connection with the de-SPAC transaction. [15] If the target company is a foreign private issuer, disclosure may be provided in accordance with certain items of Form 20-F [16], consistent with disclosure that could be provided by the issuer in an IPO. The proposed additional information would be available to investors prior to the inception of trading of the post-business combination company's securities on a national securities exchange, rather than being required in a "Super 8-K" or "Super 20-F" due within four business days of the completion of the de-SPAC transaction.

Minimum Dissemination Period

The Proposal also includes new rules [17] to require that prospectuses and proxy and information statements filed for de-SPAC transactions be distributed to shareholders at least 20 calendar days in advance of a shareholder meeting or the earliest date of action by consent, or the maximum period for disseminating such disclosure documents permitted under the applicable laws of the SPAC's jurisdiction of incorporation or organization if such period is less than 20 calendar days.

Target Company as Co-Registrant to Form S-4 or F-4

Currently, when a SPAC offers and sells its own securities in a registered de-SPAC transaction, only the SPAC, its principal executive officer or officers, its principal financial officer, its controller or principal accounting officer, and at least a majority of its board of directors are required to sign the registration statement for the transaction. Accordingly, none of the target company and its officers and directors sign the registration statement, which contains disclosure about the target company's business and financial results. This may allow avoidance of signatory liability under Section 11 of the Securities Act, which liability would attach if the target company had conducted a traditional IPO. The Proposal would amend Form S-4 and Form F-4 to require that the SPAC and the target company be treated as co-registrants when these registration statements are filed by the SPAC in connection with a de-SPAC transaction. [18] Signature instructions to these forms would be amended to make the additional signatories, including the principal executive officer, principal financial officer, controller/principal accounting officer, and a majority of the board of directors or persons performing similar functions of the target company, liable (subject to a due diligence defense for all parties other than the SPAC and the target company) for any material misstatements or omissions in the Form S-4 or Form F-4. The SEC believes that this change would (a) mitigate the risk that the target company's directors and management would not be held accountable to investors for the accuracy of the disclosures in the registration statement due to the absence of Section 11 liability, and (b) improve the reliability of the disclosure provided to investors in connection with de-SPAC transactions by creating strong incentives for such additional signing persons to review more closely the disclosure about the target company and to conduct more searching due diligence in connection with de-SPAC transactions and related registration statements.

Re-Determination of Smaller Reporting Company Status

Smaller reporting companies are registrants that are eligible for scaled disclosure requirements in Regulation S-K and Regulation S-X and in various forms under the Securities Act and the Exchange Act. [19] Smaller reporting company status is determined at the time of filing an initial registration statement under the Securities Act or Exchange Act for shares of common equity and is re-determined on an annual basis. Currently, most SPACs qualify as smaller reporting companies, and a post-business combination company after a de-SPAC transaction is permitted to retain this status until the next annual determination date when a SPAC is the legal acquirer of the private operating company in a de-SPAC transaction. The absence of a re-determination of smaller reporting company status upon the completion of these de-SPAC transactions permits certain post-business combination companies to avail themselves of scaled disclosure and other accommodations when they otherwise would not have qualified as a smaller reporting company

had they become public companies through a traditional IPO. Under the Proposal, smaller reporting company status would be re-determined following the consummation of a de-SPAC transaction and before the post-business combination company files its first Form 10-Q or Form 10-K, with the public float measured as of a date within four business days after the consummation of the de-SPAC transaction and the revenue threshold determined by using the annual revenues of the de-SPAC target as of the most recently completed fiscal year for which audited financial statements are available.

Loss of PSLRA Safe Harbor

The PSLRA provides a safe harbor for forward-looking statements, protecting a company from liability for forward-looking statements in any private action under the Securities Act or Exchange Act when, among other things, the forward-looking statements are identified as such and are accompanied by meaningful cautionary statements. The safe harbor is not available, however, when a forward-looking statement is made in connection with an offering by a "blank check company" (as currently defined) or an initial public offering. The current definition of "blank check company" for purposes of and in Rule 419 is a development stage company that is issuing "penny stock," as defined in Exchange Act Rule 3a51-1, and that has no specific business plan or purpose, or has indicated that its business plan is to merge with or acquire an unidentified company or companies or persons. SPACs that raise more than $5 million in a firm commitment underwritten IPO are excluded from this definition of "blank check company" because they are not selling "penny stock."

Projections of the target company's performance are typically prepared and disclosed in the run-up to a de-SPAC transaction. To address concerns about the dissemination of forward-looking statements, including projections, in anticipation of de-SPAC transactions, and pursuant to the statutory authority under the PSLRA to define "blank check company" by rule or regulation, the Proposal would amend the definition of "blank check company" for purposes of the PSLRA to remove the "penny stock" condition and to define the term as "a company that has no specific business plan or purpose or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies, or other entity or person." As a result, forward-looking statements made in connection with de-SPAC transactions would be treated in the same manner as those made in traditional IPOs.

Underwriter Status and Liabilities

Under proposed new Rule 140a, a person who has acted as an underwriter in a SPAC initial public offering ("SPAC IPO underwriter") and participates in the distribution by taking 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 to be engaged in the distribution of the securities of the surviving public entity in a de-SPAC transaction within the meaning of Section 2(a)(11) of the Securities Act. The deemed underwriter status of SPAC IPO underwriters of de-SPAC transactions is intended to motivate them to exercise the care necessary to help ensure the accuracy of the disclosures in these transactions by affirming that they are subject to Section 11 liability for registered de-SPAC transactions. Under this proposed new rule, the liability protections in de-SPAC transactions involving registered offerings have the same effect as those in underwritten IPOs.

Business Combinations Involving Shell Companies

In response to the SEC's concerns over the use of shell companies to access public securities markets, the Proposal would deem that a business combination transaction involving a reporting shell company and another entity that is not a shell company constitutes a sale of securities to the reporting shell company's shareholders for purposes of the Securities Act. In addition, the Proposal would more closely align the required financial statements of private operating companies in transactions involving shell companies with those required in registration statements for IPOs.

Projections Disclosure

The Proposal would amend Item 10(b) of Regulation S-K to expand and update the SEC's guidance on the presentation of projections of future economic performance in filings to allow investors to better assess the reliability of the projections and whether they have a reasonable basis. As amended, Item 10(b) would state that:

- any projected measures that are not based on historical financial results or operational history should be clearly distinguished from projected measures that are based on historical financial results or operational history;
- it generally would be misleading to present projections that are based on historical financial results or operational history without presenting such historical measure or operational history with equal or greater prominence;
- the 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 why the non-GAAP financial measure was used instead of a GAAP measure; and
- the guidance therein applies to any projections of future economic performance of persons other than the registrant, such as the target company in a business combination transaction, that are included in the registrant's SEC filings.

The Proposal also would require disclosure to allow investors to better assess the basis of projections when they are used in de-SPAC transactions. New Item 1609 of Regulation S-K would apply only to de-SPAC transactions and would require a registrant to provide:

- with respect to any projections disclosed by the registrant, the purpose for which the projections were prepared and the party that prepared the projections;
- all material bases of the disclosed projections and all material assumptions underlying the projections, and any factors that may materially impact such assumptions (including a discussion of any factors that may cause the assumptions to be no longer reasonable, material growth rates or discount multiples used in preparing the projections, and the reasons for selecting such growth rates or discount multiples); and
- whether the disclosed projections still reflect view of the board or management of the SPAC or target company, as applicable, as of the date of the filing; if not, then discussion of the purpose of disclosing the projections and the reasons for any continued reliance by the management or board on the projections.

Proposed Safe Harbor Under the Investment Company Act

Under proposed new Rule 3a-10 in the Proposal, a SPAC that fully complies with the rule's conditions would not need to register as an investment company under the Investment Company Act, including the conditions that the SPAC (a) maintain assets comprising only cash items, government securities, and certain money market funds; (b) seek to complete a de-SPAC transaction after which the surviving entity will be primarily engaged in the business of the target company; and (c) enter into an agreement with a target company to engage in a de-SPAC transaction within 18 months after the effective date of the SPAC's registration statement for its initial public offering and complete its de-SPAC transaction within 24 months of such effective date. The conditions are intended to align with the structures and practices that the SEC suggests would distinguish a SPAC that is likely to raise serious questions as to its status as an investment company from one that does not.

Public Comment Period

The public comment period for the proposed rules will remain open for 60 days following publication of the proposing release on the SEC's website or 30 days following publication of the proposing release in the Federal Register, whichever period is longer. The SEC will consider the public's input before finalizing the rules. The commissioners of the SEC will vote on the rules before they become final.

References Back To Top

1 The Proposal can be found **here**.

2 Proposed Item 1603(a) of Regulation S-K.

3 Proposed Item 1603(b) of Regulation S-K.

4 Proposed Item 1603(c) of Regulation S-K.

5 Proposed Items 1602(a)(4), 1602(c) and 1604(c) of Regulation S-K.

6 Proposed Item 1605(c) of Regulation S-K.

7 Proposed Item 1605(d) of Regulation S-K.

8 Proposed Item 1605(e) of Regulation S-K.

9 Proposed Item 1606(a) of Regulation S-K.

10 Proposed Item 1606(b) of Regulation S-K.

11 Proposed Items 1606(c), (d) and (e) of Regulation S-K.

12 Proposed Item 1607(a) of Regulation S-K.

13 Proposed Item 1607(b) of Regulation S-K.

14 Proposed Item 1607(c) of Regulation S-K.

15 These items are: (1) Item 101 (description of business); (2) Item 102 (description of property); (3) Item 103 (legal proceedings); (4) Item 304 (changes in and disagreements with accountants on accounting and financial disclosure); (5) Item 403 (security ownership of certain beneficial owners and management, assuming the completion of the de-SPAC transaction and any related financing transaction); and (6) Item 701 (recent sales of unregistered securities).

16 These items are Items 3.C, 4, 6.E, 7.A, 8.A.7, and 9.E of Form 20-F.

17 To impose this requirement, the SEC would amend Exchange Act Rules 14a-6 and 14c-2 and add Proposed General Instruction L.3. to Form S-4 and Proposed General Instruction I.3. to Form F-4.

18 Proposed General Instruction L.4. to Form S-4; Proposed General Instruction I.4. to Form F-4.

19 In general, a smaller reporting company is a company that is not an investment company, an asset-backed issuer or a majority-owned subsidiary of a parent that is not a smaller reporting company, and had (1) a public float of less than $250 million, or (2) had annual revenues of less than $100 million during the most recently completed fiscal year for which audited financial statements are available and either had no public float or a public float of less than $700 million.

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