Alert

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Final Rules on Special Purpose Acquisition Companies, Shell Companies, and Projections

Introduction

On January 24, 2024, the Securities and Exchange Commission (SEC) adopted the final rules intended to augment 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).

More specifically, the SEC adopted disclosure requirements related to:

- compensation paid to sponsors,
- conflicts of interest, dilution, and the determination, if any, of the board of directors (or similar governing body) of a SPAC regarding whether a de-SPAC transaction is advisable and in the best interests of the SPAC and its stockholders.

These new rules also clarify and provide guidance related to potential liability for these disclosures.

The SEC also adopted rules that require a minimum dissemination time-frame for the distribution of security holder communication materials in connection with de-SPAC transactions. As part of the new rules, the SEC is further requiring a re-determination of smaller reporting company (SRC) status in connection with de-SPAC transactions. The SEC also adopted new rules that focus on the scope of the safe harbor for forward-looking statements under the Private Securities Litigation Reform Act of 1995 (PSLRA). Perhaps more significantly, the rules deem any business combination transaction involving a reporting shell company, including a SPAC, to be a sale of securities to the reporting shell company's stockholders. In addition, the SEC adopted amendments to a number of financial statement requirements applicable to transactions involving shell companies.

As part of the rules release the SEC provided guidance on the status of potential underwriters in de-SPAC transactions and adopted updates to the SEC's guidance regarding the use of projections in SEC filings, as well as requiring additional disclosures regarding projections when used in connection with business combination transactions involving SPACs. The SEC also provided additional guidance for SPACs to consider when analyzing their status under the Investment Company Act of 1940 (the '40 Act).

Effective Date

These final rules will become effective 125 days after publication in the Federal Register. However, the final rules may be subject to challenge. As such, any legal challenge could impact the effective date or the final rules.

Disclosures and Additional Protections

The SEC added new Subpart 1600 to Regulation S-K. The new Subpart sets forth disclosure requirements applicable to SPACs regarding, among other things, the sponsor, potential conflicts of interest, and dilution and requires certain disclosures on the prospectus cover page and in the prospectus summary. The SEC also adopted final rules to amend a number of forms and schedules used by SPACs for IPOs and de-SPAC transactions and to require the information set forth in Subpart 1600. To the extent that the disclosure requirements in Subpart 1600 are duplicative of the existing disclosure requirements of the forms or schedules, the requirements of Subpart 1600 would control.

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Disclosures And Liability In De-SPAC Transactions

Non-Financial Disclosures in De-SPAC Disclosure Documents (aligning De-SPACs with IPOs)

As part of these rules, the SEC adopted:

a. new instructions to Form S-4,
b. new instructions to Form F-4,
c. Item 14(f)(2) of Schedule 14A,
d. new instructions to Schedule TO,
e. new instructions to Form S-1, and
f. new instructions to Form F-1.

The SEC has indicated the two main benefits to investors from these changes will be:

a. the inclusion of these disclosures in a Form S-4 or Form F-4 registration statement and will mean now that any explicitly material misstatements or omissions contained therein would subject the issuers and other parties to liability under Sections 11 and 12 of the Securities Act of 1933, as amended (the Securities Act) (which aligns with the protections afforded to investors under the Securities Act for disclosures provided in a Form S-1 or F-1 for an IPO) and
b. as a result of these new requirements, this information will 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 the earliest instance of such requirement being the requirement to set this information out in a Form 8-K due within four business days after the completion of a de-SPAC transaction (the so called Super 8-K) (which is the current rule and historical requirement). As such, such disclosures will now be required to be included in the disclosures that are filed in connection with a de-SPAC transaction (on Form S-4 or F-4, a proxy or information statement or a Schedule TO).

Minimum Dissemination Period

The SEC has also adopted certain amendments to Rule 14a-6 and Rule 14c-2 and Forms S-4 (General Instruction) and F-4 (General Instruction). The SEC indicated that, in addition to the need for enhanced disclosure in de-SPAC transactions, it continues to believe that it is important to ensure that SPAC security holders have adequate time to analyze the information presented in these transactions. The SEC indicated that although the laws of a SPAC's jurisdiction of incorporation or organization generally require the SPAC to send a notice to its security holders at least a specified number of days before the security holder meeting to approve a proposed business combination transaction, the information in such notices is in many cases limited. The SEC further noted that because these state and jurisdictional laws generally vary and are limited related to matters such as the minimum period of time for dissemination of other information about the transaction (including any proxy statements or other materials required by the Federal securities laws) that the SEC is imposing a 20- calendar day minimum dissemination period in de-SPAC transactions. The SEC believes that such a dissemination period will provide an important investor protection by establishing a minimum time period for security holders to review prospectuses and proxy and information statements in de-SPAC transactions.

Private Operating Company as Co-Registrant

The SEC also adopted the co-registration proposal from the proposed rules as substantially proposed, with some modifications. Under current rules, when a SPAC or a holding company offers and sells its securities in a registered de-SPAC transaction, the majority of the relevant disclosure in the de-SPAC transaction registration statement relates to the target company, but only the SPAC or holding company, 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 (or persons performing similar functions) are required to sign the registration statement for the SPAC transaction. These signers are subject to liability under Section 11 of the Securities Act (along with other persons who have liability under Section 11). Under the legacy rules, in these situations, the private operating company and its officers and directors may therefore not incur liability as signatories to the registration statement under Section 11 of the Securities Act, even though information about the target company is highly significant to investors and this result is unlike if the target company had conducted a traditional IPO registered on Form S-1 or Form F-1. In the SEC's view, in a de-SPAC transaction the target company is an issuer of securities under Section 2(a)(4) of the Securities Act, and, therefore, the target company along with its required officers and directors must sign a registration statement filed by a SPAC or another shell company for the de-SPAC transaction, because both in substance and by operation of new Securities Act Rule 145a, the target company is issuing or proposing to issue securities in a de-SPAC transaction, regardless of the transaction structure. In addition, the business operations of the target company will be those that are carried on by the combined company going forward. The SEC therefore believes that the co-registration requirements will enhance investor protection by aligning Federal securities law liability with the entity that is the primary source of the information disclosed about the new public operating company. Under the final rules, when a registration statement is filed for a de-SPAC transaction, a target company, its principal executive officer or officers, its principal financial officer, its comptroller or principal accounting officer, and a majority of its board of directors or persons performing similar functions will now sign the registration statement. These signatories, among others, will now be potentially liable under Section 11, for any material misstatements or omissions in the registration statement (subject to a due diligence defense for all parties other than an issuer).

Re-Determination of Smaller Reporting Company (SRC) Status

After considering the comments received, the SEC adopted the amendments regarding SRC re-determination as proposed with certain modifications. The SEC did not adopt requirements, as suggested by several commenters, to re-determine filer status, emerging growth company (EGC) status or foreign private issuer (FPI) status upon the completion of a de-SPAC transaction. Under the current rules, most SPACs qualify as SRCs, and the SEC rules permit a post-business combination company after a de-SPAC transaction to retain this status until that SPAC's next annual determination date in cases where the legal entity that was the SPAC is the legal entity that is the combined company in connection with the de-SPAC transaction. Under current rules, the absence of a re-determination of SRC status upon the completion of these de-SPAC transactions has permitted certain post-business combination companies to avail themselves of scaled disclosure and other accommodations when they otherwise would not have qualified as a SRC had they become public companies through a traditional IPO. The final rules attempt to level the playing field with a traditional IPO in this respect and reduce information asymmetries that result when a target company chooses to go public through a de-SPAC transaction. As adopted, a post-de-SPAC transaction registrant must re-determine its SRC status prior to the time it makes its first SEC filing, other than the Super Form 8-K, with the public float measured as of a date within four business days after the consummation of the de-SPAC transaction and annual revenues measured using the annual revenues of the target company as of the most recently completed fiscal year reported in such Super Form 8-K. The SEC also provided additional guidance, concerning FPI status as more fully set forth in the final rules release.

PSLRA Safe Harbor

The SEC has adopted new definitions of the term "blank check company" in Securities Act Rule 405 and Securities Exchange Act of 1934, as amended (the Exchange Act) Rule 12b-2 under the PSLRA. The new definition of "blank check company" in Rule 405 provides:

> "For purposes of Section 27A of the Securities, the term blank check company means 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."

The new definition of "blank check company" in Rule 12b-2 provides:

> "For purposes of Section 21E of the Exchange Act, the term blank check company means 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."

The new definitions of "blank check company" under the PSLRA in Securities Act Rule 405 and Exchange Act Rule 12b-2 are meant to clarify that such definitions are solely for purposes of the PSLRA and not for purposes of any other rules (including rules the SEC adopted pursuant to mandates under the Penny Stock Reform Act, such as Securities Act Rule 419). As such the net result under the final rules, is that the new definition of "blank check company" for purposes of the PSLRA makes it clear that SPACs may *no* longer rely on the safe harbor provision under the PSLRA as it relates to the use of projections and other forward-looking statements when marketing a de-SPAC.

Underwriter Status And Liability In Securities Transactions

Under the proposed rules new Rule 140a would have clarified that any party who acts as an underwriter in a SPAC initial offering and/or participates in a distribution associated with a de-SPAC transaction in the way of facilitating that transaction, or otherwise directly or indirectly participates in the de-SPAC would be engaging in a distribution of securities and therefore is an underwriter under the Securities Act. This propose rule was *not* adopted but rather the SEC, provided guidance to explain that a de-SPAC involves a process by which there is a distribution to the SPAC's investors, and therefor the public (those investors receive interests in the post-de-SPAC company). The SEC indicated that it recognizes "that in a [de-SPAC], there is generally no single party accepting securities from the issuer with a view to resell such securities." With that said, the SEC indicated that an underwriter would be present in a de-SPAC "where a party is selling for the issuer or participating in the distributions of securities in the combined company to the SPAC's investors and the broader public" and that such entity may be a statutory underwriter. The SEC indicated that this was a facts and circumstances determination. The SEC also further indicated that it was "not intend[ing] to signal that [it] believe[s] that every [de-SPAC] or offering of securities generally involves or needs the involvement of an underwriter." The SEC also noted, that "where a distribution and an underwriter are present, the party acting as underwriter will need to perform the necessary due diligence of the disclosures made in connection with the registered offering of securities or face full exposure to liability without the benefit of the due diligence defense under the Securities Act."

Business Combinations Involving Shell Companies

The SEC adopted new Rule 145a. Under the current rules investors in reporting shell companies may not always receive the disclosures and other protections afforded by the Securities Act at the time when there is a fundamental change in the nature of their investment due to the business combination involving another entity that is not a shell company. To address this, Rule 145a specifies that a sale occurs from the post-transaction company to the existing stockholders of a reporting shell company in situations where a reporting shell company that is not a business combination related shell company enters into a business combination transaction involving another entity that is not a shell company. In these situations, Rule 145a deems there to be a share exchange implicating the requirements and protections of Section 5 of the Securities Act because the interests the former reporting shell company stockholders owned have been exchanged for something entirely different—interests in an operating company in the course of a transaction whereby the former reporting shell company provides the operating company with access to the public markets. The sale identified by the rule occurs regardless of whether securities are changing hands in the business combination transaction, and thus the transaction will need to be registered in accordance with the Securities Act unless an exemption from registration is available. The final rule also applies regardless of transaction structure or the form of business combination (*e.g.*, statutory merger, share exchange, stock purchase, asset purchase, etc.). Additionally, the final rule will not have any impact on traditional business combination transactions between operating businesses, including transactions structured as traditional reverse mergers and traditional business combination transactions that make use of only business combination related shells.

Financial Statement Requirements in Business Combination Transactions Involving Shell Companies

The final rules augment the financial statements required to be provided in a de-SPAC business combination. The view of these changes is to further align de-SPAC financial statements with those required and filed in a traditional IPO. The SEC noted that the final rule was documenting "current staff guidance for transactions involving shell companies."

Investment Company Act Guidance

Based on a factual determination, a SPAC may be an inadvertent investment company under Section 3(a)(1)(A) or Section 3(a)(1)(C) (or both sections) of the '40 Act. The SEC elaborated on the facts and circumstances that are significant to whether a SPAC would meet the definitions of an investment company under the '40 Act. In doing so, the SEC indicated that, depending on the facts, a SPAC could become as an investment company during any period of its life cycle. The SEC noted in particular that some of the factors important in this analysis were:

- an examination of the nature of the SPAC's assets and income and its management's activities,
- the length of the SPAC's existence before it enters into a de-SPAC transaction and length of time incurred from creation to the closing under that arrangement,
- to the extent to which the SPAC markets its investment in the SPAC's securities in a way to indicate an investor should make the investment primarily to gain exposure to the SPAC's portfolio of securities prior to the de-SPAC transaction, and
- the extent to which the SPAC entity merges or combines with a statutory investment company.