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The SEC's Proposed Rules Applicable to SPACs

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Agenda

- Background on SPACs
- The Proposed Rules
  - Specialized disclosure requirements for SPAC transactions
  - Alignment of de-SPAC transactions with traditional IPOs
  - Business combinations involving shell companies generally
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  - Proposed safe harbor under the Investment Company Act of 1940

Background on SPACs

SPAC overview

- A special purpose acquisition company ("SPAC") is a shell company that completes an IPO with no business operations of its own.
- A SPAC's sole purpose is to identify a target operating company and consummate a business combination (commonly referred to as a "de-SPAC transaction"). A SPAC has a limited time period in which to complete a de-SPAC transaction.
- Upon completion of the initial business combination, the target company effectively becomes a publicly traded company.
- Because a SPAC has no operations, the disclosure in a SPAC IPO typically focuses on the prior experience of the SPAC's organizers/founders (referred to as "sponsors"), who are expected to successfully find a target company and complete the de-SPAC transaction.

Key SPAC IPO Terms

1. Sale of **Units** ordinarily priced at $10.00 per unit, comprised of one share of Class A common stock and a fraction of a redeemable warrant to purchase one share of Class A common stock with a strike price of $11.50
2. The gross proceeds from a SPAC IPO are placed in a **trust account** and may be removed only in limited circumstances (*e.g.*, the SPAC completes a business combination or it fails to complete a business combination in the allotted time and dissolves, in which case the funds in the trust account are returned to Class A stockholders).
3. Investment banks receive an **underwriting commission** (1/3 payable upon SPAC IPO closing, the balance deferred to, and payable only upon, the consummation of the business combination).
4. Class A stockholders have **redemption rights** in connection with the consummation of the business combination. Redemption price is $10.00, plus pro rata share of any interest earned in the trust account).
5. "**Sponsor promote**" consisting of founder shares (typically represent 20% of the SPAC's total outstanding common stock after IPO closing) and private placement warrants (issued simultaneously with the IPO, typically for a purchase price of $1.00 to $1.50 per warrant).

De-SPAC Transaction Features

1. Once a target company is identified, the SPAC will often raise additional capital through a private investment in public equity **("PIPE") transaction** (typically: one share of Class A common stock for a price of $10.00, but as investor interest has waned, PIPE transactions have included additional securities).
2. Announce all transactions to the market in a **press release** filed with the SEC on a Current Report on Form 8-K. The SPAC will usually also publicly release the projected financial information for the target company, which was shared with PIPE investors.
3. SPAC then uses a proxy statement (often combined with a prospectus on a Form S-4 or Form F-4 registration statement) to **solicit stockholders' approval** of the terms of the business combination and related transactions.
4. If approved by stockholders and other **closing conditions** satisfied, (1) de-SPAC closes, (2) trust account funds (net) released to the target company, and (3) any financing transactions are simultaneously consummated.

Specialized Disclosure Requirements for SPAC Transactions

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Information on SPAC Sponsors

- New Item 1603(a) of Regulation S-K would require additional disclosure about a SPAC's sponsor, its affiliates and any promoters in registration statements or schedules used in either a SPAC IPO or de-SPAC transaction, including:
  - the experience, material roles, and responsibilities of these parties, and any agreement, arrangement or understanding (1) between the sponsor and the SPAC, its 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 those with direct or indirect material interests in the sponsor;
  - organizational chart showing the relationship between the SPAC, the sponsor and the sponsor's affiliates;
  - tabular disclosure of material terms of any lock-up agreements with the sponsor and its affiliates; and
  - the nature and amounts of all compensation that has been or will be awarded to, earned by, or paid to the sponsor, its affiliates and any promoters for all services rendered in all capacities to the SPAC and its affiliates; also 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.

Conflicts of Interest

- In both SPAC IPOs and de-SPAC transaction filings, new Item 1603(b) would require disclosure of any actual or potential material conflicts of interest between (a) the sponsor or its affiliates or the SPAC's officers, directors, or promoters; and (b) unaffiliated security holders.
- Examples:
  - conflicts stemming from the contingent nature of the sponsor's compensation that result in the sponsor having an incentive to complete a de-SPAC transaction even when doing so results in lower returns to Class A stockholders when compared to a liquidation of the SPAC or an alternative transaction;
  - conflicts arising when sponsor of multiple SPACs simultaneously and manages several different SPACs at once;
  - conflicts arising when a sponsor and/or its affiliate holds financial interests in, or have contractual obligations to, other entities;
  - conflicts arising when a target is affiliated with the sponsor, the SPAC or its founders, officers or directors; and
  - conflicts arising from the fact that a SPAC's officers may not work full time for the SPAC and thus have limited ability to devote the time necessary to find and execute a de-SPAC transaction.
- A new Item 1603(c) would require disclosure regarding the fiduciary duties that each officer and director owes to other companies.

Dilution

- A new Item 1602(c) would require all SPAC registration statements, other than those for a de-SPAC transaction, to include a description of all material potential sources of future dilution following a SPAC's IPO as well as tabular disclosure of the potential future dilution from the public offering price that will be absorbed by non-redeeming SPAC stockholders, to the extent quantifiable.
- A new Item 1602(a)(4) would require tabular dilution disclosure of pro forma net tangible book value per share under a range of potential redemption levels on the cover page of any prospectus included in SPAC registration statements on Forms S-1 or F-1, with separate rows showing effects of redemptions in both non-exercise and full exercise scenarios of overallotment or "green shoe" option, if applicable.

Dilution *(cont.)*

- For de-SPAC transactions, new Item 1604(c) would require disclosure of each material potential source of additional dilution that non-redeeming shareholders may experience at different phases of the SPAC life-cycle (*e.g.*, sponsor compensation (including the sponsor promote), underwriting fees, outstanding warrants and convertible securities, and financing transactions (including PIPE transactions).
- To the extent material, disclosures would need to explain that when a redeeming stockholder retains its warrants in a de-SPAC transaction, the non-redeeming stockholders may face additional potential dilution.
- A new Item 1604(c)(1) would also require a sensitivity analysis in a tabular format that shows the amount of potential dilution under a range of reasonably likely redemption levels and quantifies the increasing impact of dilution on non-redeeming stockholders as redemptions increase.
- SPACs would also be required to include a description of the model, methods, assumptions, estimates and parameters necessary to understand the sensitivity analysis disclosure.

Disclosure & Procedural Requirements for de-SPAC transactions

<u>Background of the de-SPAC transaction</u>

- New Item 1605 would require disclosure of de-SPAC transaction background, material terms and effects, 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;
  - 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.
- New Item 1605(d) would require disclosure of material (including non-pecuniary) interests that the sponsor and the SPAC's officers and directors have in a de-SPAC transaction or any related financing transaction.
- New Item 1605(e) would require disclosure of whether security holders are entitled to any redemption or appraisal rights, and if so, a summary of the redemption or appraisal rights.

Disclosure & Procedural Requirements for de-SPAC transactions *(cont.)*

Fairness of the de-SPAC transaction

- New Item 1606(a) would require disclosure of whether the SPAC reasonably believes that the de-SPAC transaction and any related financing transaction are fair to the SPAC's unaffiliated security holders, as well as a discussion of the basis for this statement. A statement that the SPAC "has no reasonable belief as to the fairness or unfairness of the de-SPAC transaction or any related financing transaction to unaffiliated security holders" is not considered sufficient disclosure.
- New Item 1606(b) would require disclosure of the material factors upon which this reasonable belief is based and, to the extent practicable, the weight assigned to each factor. Possible factors include:
  - the valuation of the private operating 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 stockholders.
- These requirements are substantially similar to the requirements in Item 1014 of Regulation M-A applicable to "going private" transactions under Rule 13e-3 under the Securities Exchange Act of 1934.

Disclosure & Procedural Requirements for de-SPAC transactions *(cont.)*

***Fairness of the de-SPAC transaction* (cont.)**

- Additional requirements for disclosure include whether:
  - 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;
  - any director voted against or abstained from voting on, approval of the de-SPAC transaction or any related financing transaction and the reasons for such vote or abstention;
  - 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
  - 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.

Disclosure & Procedural Requirements for de-SPAC transactions *(cont.)*

***Fairness of the de-SPAC transaction* (cont.)**

- New Item 1607(a), similar to Item 1015 of Regulation M-A: would require disclosure of any report, opinion, or appraisal obtained from an outside party relating to the consideration or the fairness of the de-SPAC transaction or any related financing transaction.
- If any outside party rendered any such report, opinion or appraisal, new Item 1607(b) requires disclosure of:
  - 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 private operating company or its security holders, or the valuation of the private operating company, or whether the outside party recommended the amount of consideration to be paid or the valuation of the private operating 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.

Disclosure & Procedural Requirements for de-SPAC transactions *(cont.)*

Fairness of the de-SPAC transaction **(cont.)**

- Any such report, opinion or appraisal would be required to be included as an exhibit to a registration statement on Form S-4 or F-4 or a Schedule TO for a de-SPAC transaction and included directly in any proxy or information statement for a de-SPAC transaction.
- Rationale: to "address concerns regarding potential conflicts of interest and 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 transaction to unaffiliated investors; and
  - the basis of a SPAC's reasonable believe that a de-SPAC transaction and related financing transactions are fair to unaffiliated investors.
- Following on the recent Delaware Court of Chancery decision in *In re MultiPlan Corp. Stockholders Litigation* applying the "entire fairness" standard to a breach of fiduciary duty claim in a de-SPAC transaction, the SEC seems to be codifying a judicial determination that de-SPAC transactions and related financings are inherently "conflicted transactions" in need of special procedures to ensure that they are entirely fair to unaffiliated stockholders. The proposing release states that disclosures required in going-private transactions "provide an appropriate model" for de-SPAC transactions "in that the conflicts of interests and misaligned incentives inherent in going-private transactions are similar to those often present in de-SPAC transactions."

Alignment of de-SPAC transactions with traditional IPOs

Non-Financial Statement Disclosure Requirements

- In a de-SPAC transaction involving a target company not already subject to Section 13(a) or 15(d) of the Exchange Act's reporting requirements, to include the following items from Regulation S-K in the registration statement or proxy or information statement filed with the SEC:
  - 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 completion of the de-SPAC transaction and related financing transactions); and
  - Item 701 (recent sales of unregistered securities).

Non-Financial Statement Disclosure Requirements *(cont.)*

- If target company is a foreign private issuer, it would have the option to provide disclosure based on the following Form 20-F items:
  - Item 3.C (Key Information; Reasons for the Offer and Use of Proceeds);
  - Item 4 (Information on the Company, including history, business overview; organizational structure and property plants and equipment);
  - Item 6.E (Directors, Senior Management and Employees; Share Ownership);
  - Item 7.A (Major Shareholders);
  - Item 8.A.7 (Legal and Arbitration Proceedings); and
  - Item 9.E (Dilution).
- Already required in "Super 8-K" filed after de-SPAC closing, but Proposed Rules would require this information earlier in the de-SPAC process.

Minimum Dissemination Period for de-SPAC Transaction Docs

- Proxy statements and information statements filed in connection with a de-SPAC transaction would be required to be distributed to stockholders at least 20 calendar days in advance of a stockholder meeting or date of action by consent.

- If the maximum period for disseminating such documents permitted under the laws of a SPAC's jurisdiction of incorporation or organization is shorter than 20 calendar days, the Proposed Rules would permit that shorter period to govern.

Target Company as Co-Registrant

- When a SPAC proposes to register the issuance of shares in connection with a de-SPAC transaction on a registration statement on Form S-4 or F-4, the Proposed Rules would require the target company be deemed a co-registrant.
- In addition to subjecting the target company to potential liability under Section 11 of the Securities Act, each of a target company's (i) principal executive officer; (ii) principal financial officer; and (iii) controller/principal accounting officer, as well as at least a majority of the target company's board of directors, would be required to sign the registration statement. By signing the registration statement, each of these individuals will be subject to Securities Act liability.
- Since no securities of the target company are being sold, and since the target company is not a "promoter" or a "control person," this is an unusual extension of the co-registrant theory and raises many novel securities law issues, creating a potential slippery slope in other merger contexts, as well as giving rise to a number of practical issues.

Re-Determination of Smaller Reporting Company Status

- In a traditional IPO, smaller reporting company ("SRC") status is determined at the time the private company files its initial registration statement with the SEC. SRCs are eligible for certain disclosure accommodations in various forms under the Securities Act and Exchange Act.
- Currently, a re-determination of continued eligibility is required only once a year, as of the last business day of an issuer's second fiscal quarter.
- The Proposed Rules would require a newly combined company to re-determine whether it qualifies as a SRC following consummation of a de-SPAC transaction.
- Public float would be measured as of a date within four business days after the consummation of the de-SPAC transaction and revenue would be measured using the annual revenues of the target company as of the most recently completed fiscal year for which audited financial statements are available.
- If a post-business combination company does not qualify as a SRC, its next periodic report (Form 10-Q or Form 10-K) would need to reflect this fact by including any necessary incremental disclosure.

Inapplicability of PSLRA

- Upon satisfaction of specified conditions, the Private Securities Litigation Reform Act of 1995 (the "PSLRA") provides a safe harbor, which protects a company from liability in any private right of action brought under the Securities Act or Exchange Act based on material misstatements or omissions in forward-looking statements.
- The PSLRA safe harbor is not available in an IPO.
- The PSLRA safe harbor is also not available for offerings made by a "blank check company," which is defined as a development stage company that has no specific business plan or purpose or that has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies, and that is issuing "penny stock" (as defined in Exchange Act Rule 3a51-1). By raising greater than $5 million in their IPOs, SPACs avoid being deemed "blank check companies" thus enabling them to rely on the PSLRA safe harbor in connection with disclosing projected financial information as part of the de-SPAC transaction.
- The Proposed Rules would amend the definition of "blank check company" by removing the element that a company issue "penny stock" thereby making the PSLRA's safe harbor not available for forward-looking statements, including projections.

Underwriting Liability in de-SPAC Transactions

- Under new proposed Securities Act Rule 140a, a person who has acted as an underwriter in a SPAC's IPO and who "takes steps to facilitate the de-SPAC transaction, 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 proposing release states that this "clarification" of underwriter status in de-SPAC transactions should "motivate" SPAC IPO underwriters to exercise the care necessary to help ensure the accuracy of the disclosures in de-SPAC transactions by affirming that they are subject to Section 11 liability for registered de-SPAC transactions.
- Even if a SPAC IPO underwriter is not formally retained to act as an underwriter in a de-SPAC transaction, the release describes ways in which a SPAC IPO underwriter may be deemed to be "participating" in activities that are necessary for the de-SPAC transaction's distribution of the combined company's securities:
  - acting as a financial advisor to the SPAC;
  - assisting in identifying potential target companies or negotiating merger terms;
  - finding investors for, and negotiating, PIPE instruments; or
  - receiving compensation in connection with the de-SPAC transaction (including any deferred underwriting compensation that is delivered upon completion of the de-SPAC transaction).

Underwriting Liability in de-SPAC Transactions *(cont.)*

- The proposing release notes that the summarized discussion is not an exhaustive assessment of underwriter status in the SPAC context and is in no way intended to limit the definition of "underwriter" under the Securities Act.
- Even without acting as a SPAC IPO underwriter, "financial advisors, PIPE investors or other advisors" could be deemed to be statutory underwriters in a de-SPAC transaction, depending on the circumstances.
- This aspect of the Proposed Rules has very significant consequences.

Business Combinations Involving Shell Companies, Generally

Business Combinations with a Shell Company as Sales to the Shell Company's Stockholders

- Under new Rule 145a, any business combination of a reporting shell company involving another entity that is not a shell company would be deemed to involve a "sale" of securities to the reporting shell company's stockholders.
- Since a SPAC would be a reporting shell company **proposed Rule 145a would effectively require any de-SPAC transaction to either be registered or qualify for an applicable exemption**. The rationale: "the substantive reality of [such a transaction] is that the reporting shell company investors have effectively exchanged their security representing an interest in the reporting shell company for a new security representing an interest in the combined operating company."
- **Section 3(a)(9),** which exempts any securities exchange by an issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange, **would likely not be available for transactions covered by proposed Rule 145a**.
  - Proposing Release: Deemed exchange by the reporting shell company's existing shareholders for the combined company's securities should be viewed as part of the same offering as the exchange of the private company's securities for their interests in the combined company and as a result the exchange is not "exclusively with the reporting shell company's existing security holders."
  - Any shell companies that hire and compensate a proxy solicitor to solicit approval of the reporting company's stockholders for the business combination would create an independent reason for the inapplicability of Section 3(a)(9).

Business Combinations with a Shell Company as Sales to the Shell Company's Stockholders *(cont.)*

- The release also notes that even if an exemption applies, by deeming these transactions to include a "sale" under the Securities Act, investors would have the protections of the anti-fraud provisions in Section 17(a) of the Securities Act and Section 10(b) of, and Rule 10b-5 under, the Exchange Act.

- Proposed Rule 145a would not apply to:
  - business combinations between two bona fide non-shell entities;
  - transactions involving reporting shell companies that are business combination related shell companies; and
  - business combinations of one shell company into another shell company.

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Financial Statement Requirements

- ***Number of Years of Financial Statements***
  - Currently, one exception applicable to business combination related offerings permits two years of financial statements of a target company to be presented (instead of three) when the target company: (1) would be an emerging growth company (an “EGC”) if it were conducting an IPO of common equity securities; and (2) the registrant is an EGC that has not yet filed or been required to file its first annual report.
  - The Proposed Rules would remove whether the shell company has filed its first annual report as a factor in determining the number of years of financial statements required.

- ***Audit Requirements of Target Company***
  - When a target company will be deemed the predecessor to a shell company in a registration statement or proxy statement, the Proposed Rules would require audits of a target company’s financial statements to be conducted by an independent accountant in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB).

Financial Statement Requirements *(cont.)*

- ***Age of Financial Statements***
  - Proposed Rule 15-01(c): the age of financial statements for a target company that would be the predecessor to a shell company in a registration statement or proxy statement **depends on whether the target company would qualify as a smaller reporting company** if it were filing its own initial registration statement.
  - A target company that qualifies as a smaller reporting company would apply Rule 8-08 for the age of its financial statements, which permits registration statements and proxy statements with an effective or mailing date, respectively:
    - within 45 days after the end of the fiscal year, to include financial statements only as current as of the end of third fiscal quarter; and
    - after 45 days but within 90 days of the end of the fiscal year, to omit audited financial statements for such fiscal year if (A) all reports due have otherwise been filed (if the target is already a reporting company); (B) for the most recent fiscal year for which audited financial statements are not yet available, the smaller reporting company reasonably and in good faith expects to report income from continuing operations attributable to the registrant before taxes; and (C) for at least one of the two fiscal years immediately preceding the most recent fiscal year, the smaller reporting company reported income from continuing operations attributable to the registrant before taxes.
  - Target companies not meeting the definition of smaller reporting company would not benefit from the second bullet above and would need to include a new audit for the most recent fiscal year when the effective date or mailing date is 46 days or more after the end of such fiscal year.

Financial Statement Requirements *(cont.)*

Recent or Probable Acquisitions of Businesses by the Target Company

- When a target company in a business combination transaction has itself acquired, or it is probable that it will acquire, another business (an "Other Acquisition"), historical financial statements of that Other Acquisition may be required in the business combination registration statement or proxy statement. Currently, such financial statements are required only when omission of those financial statements would render the target company's financial statements substantially incomplete or misleading.
- The Proposed Rules would require application of the Regulation S-X provisions related to financial statements of an acquired business (*i.e.*, Rules 3-05 or 8-04, depending on the facts and circumstances) to such situations.
- The Proposed Rules would also provide that the significance tests set forth in Rule 1-02(w) of Regulation S-X, which determine when an acquired business' financial statements are required, would be calculated using the target company's financial information for the denominator instead of the shelf company registrant's financial information.
- If, after application of Rule 3-05, the financial statements of an Other Acquisition are omitted because the significance of the Other Acquisition is greater than 20% but less than 50%, the current rules would require those financials to be filed on a Form 8-K within 75 days after the consummation of the acquisition.
- However, it is possible that this 75-day period would expire before a target company has completed a de-SPAC transaction. In such a case, it is unclear how that target company would file a Form 8-K. The Proposed Rules provide that the omitted financial statements in such a case would be required to be filed as an exhibit to the "Super 8-K" following completion of the de-SPAC transaction.

Financial Statements of a Shell Company After a Business Combination

- The Proposed Rules would provide that a registrant may exclude the financial statements of a shell company, including a SPAC, for periods prior to the acquisition once the following conditions have been met: (1) the financial statements of the shell company have been filed for all required periods through the acquisition date, and (2) the financial statements of the registrant include the period in which the acquisition was consummated.

Enhanced Projections Disclosure

General Presentation

- Currently, Item 10(b) of Regulation S-K states that management has the option to present in SEC filings its good faith assessment of a registrant's future performance, but it also states that management must have a reasonable basis for such an assessment.
- The Proposed Rules would amend Item 10(b) to state that:
  - any projected measures not based on historical financial results or operational history should be clearly distinguished from projected measures based on historical financial results or operational history;
  - 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
  - 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 as to why the non-GAAP financial measure was used instead of a GAAP measure.
- The Proposed Rules would also make clear that the guidance in Item 10(b), including as modified per the above, would apply to projections relating to the registrant and to persons other than the registrant, including a target company in a business combination transaction.

Specific Rules for de-SPAC Transactions

- New Item 1609 of Regulation S-K would apply to disclosures of projected financial information in connection with de-SPAC transactions. Under Item 1609, a SPAC would be required to provide the following disclosures:
  - 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 the 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.
- The principles behind these proposals are similar to those underlying Regulation G, applicable to the use of non-GAAP financial measures.

Proposed Safe Harbor Under the Investment Company Act of 1940

Proposed Rule 3a-10 under the Investment Company Act of 1940

- Proposed new rule, Rule 3a-10 would provide a non-exclusive safe harbor from the definition of "investment company" under Investment Company Act Section 3(a)(1)(A) for SPACs, subject to a number of conditions.
- The proposed rule follows the contours of the "five factor" analysis that the SEC and courts have employed historically to evaluate the business in which a company is primary engaged for purposes of Section 3(a)(1)(A) and related thereto, Section 3(b). It also echoes certain themes in Investment Company Act Rule 3a-2 (known as the "transient" investment company rule), as well as SEC guidance provided in connection with Rule 419.
- However, unlike Rule 3a-2, which provides conditional relief from both Investment Company Act Section 3(a)(1)(A) and Section 3(a)(1)(C), as proposed, Rule 3a-10 provides relief only from Section 3(a)(1)(A).

Proposed Rule 3a-10 under the Investment Company Act of 1940 *(cont.)*

- As proposed, under Rule 3a-10, a SPAC will not be deemed to be an "investment company" under Section 3(a)(1)(A), if the following conditions are met:

  1. *Composition and Purpose of the SPAC's Assets*: The SPAC's assets must consist solely of "government securities" as defined in the Investment Company Act, securities issued by government money market funds as defined in Rule 2a-7(a)(14), and cash items prior to completion of the de-SPAC transaction. In addition, these assets may not at any time be acquired or disposed of for the primary purpose of recognizing gains or decreasing losses resulting from market value changes (echoing certain aspects of Rule 3a-7).

  2. *Nature and Timing of de-SPAC Transaction:*

     - The SPAC must seek to complete a *single* de-SPAC transaction as a result of which:
       - the surviving company, either directly or through a primarily controlled company, will be "primarily engaged" in the business of the target company or companies, which business is not that of an investment company, and
       - the surviving company will have at least one class of securities listed for trading on a national securities exchange.
     - The SPAC must file a Form 8-K with the SEC no later than 18 months after the effective date of its IPO registration statement, disclosing an agreement to engage in the de-SPAC transaction with at least one target company.
     - The SPAC must complete the de-SPAC transaction no later than 24 months after the effective date of its initial registration statement.

Proposed Rule 3a-10 under the Investment Company Act of 1940 *(cont.)*

3. *Distribution/Use of SPAC Assets:* If any assets of the SPAC are not used in connection with the de-SPAC transaction or if the SPAC fails to file a Form 8-K or complete a de-SPAC transaction within the time frames set forth above, the SPAC must distribute those assets, in cash, to investors as soon as reasonably practicable thereafter.

4. *Business Purpose of the SPAC:* The SPAC must be "primarily engaged" in the business of seeking to complete a single de-SPAC transaction, as evidenced by (i) the activities of its officers, directors and employees; (ii) its public representations of policies; (iii) its historical development; and (iv) an appropriate resolution of its board of directors, which resolution or action has been recorded contemporaneously in its minute books or comparable documents.

5. *No "Holding Out" as an Investment Company:* The SPAC cannot hold itself out as being primarily engaged in the business of investing, reinvesting or trading in securities.

Additional Resources

Read more:

- [SEC Proposes a “Sea Change” Set of New Rules Applicable to SPACs and Other Market Participants]
- [Delaware Court of Chancery Allows deSPAC Litigation to Proceed Applying “Entire Fairness” Standard]
- [*What’s the Deal?* - SPACS]

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