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The SEC's Final Rules Applicable to SPACs, Shell Companies and Projections

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Agenda

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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 (often called a "de-SPAC transaction"). A SPAC has a limited time during which to complete a de-SPAC transaction.
- Upon completion of the initial business combination, the target operating 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"), which are expected to find a target company and complete the de-SPAC transaction.

Key SPAC IPO terms

1. Sale of **Units**, 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.
2. The gross proceeds from a SPAC IPO are placed in a **trust account** and may be accessed only in limited circumstances (*e.g.*, the SPAC completes a de-SPAC transaction; the SPAC seeks permission from its stockholders to amend its charter to extend the time it has to complete a de-SPAC transaction and offers its Class A stockholders the opportunity to redeem their shares; or it fails to complete a de-SPAC transaction in the allotted time and dissolves, in which case the funds in the trust account are returned to stockholders).
3. Investment banks receive an **underwriting commission** (typically 1/3 payable upon SPAC IPO closing, and the balance deferred, and payable only upon, consummation of the de-SPAC transaction).
4. Class A stockholders have **redemption rights** in connection with the consummation of the de-SPAC transaction. The redemption price equals the investor's original investment, plus a pro rata share of any interest earned in the trust account).
5. "**Sponsor promote**" consisting of founder shares (typically representing 20% of the SPAC's total outstanding common stock after IPO closing) and private placement warrants issued simultaneously with the SPAC IPO.

De-SPAC transaction features

1. Once a target company is identified, the SPAC will often seek to raise additional capital through a private investment in public equity ("PIPE") transaction.
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 any projected financial information for the target company, which was shared with PIPE investors.
3. The SPAC then uses a proxy statement (often combined with a prospectus on a Form S-4 or Form F-4 registration statement) to **solicit stockholder approval** of the terms of the business combination and related transactions.
4. If approved by stockholders and other **closing conditions** are satisfied, (1) the de-SPAC transaction closes and the target company becomes a publicly listed company, (2) trust account funds (net) released to the target company, and (3) any financing transactions are simultaneously consummated.

Key changes from the Proposed Rules

Key changes from the Proposed Rule

- The Final Rules, which were adopted on January 24, 2024, by a divided SEC (voting 3-2), were substantially similar to the proposed rules (“Proposed Rules”) released for comment nearly two years earlier despite significant comment and in summary:
  - Require **increased public disclosures in connection with SPAC IPOs and de-SPAC transactions**, (e.g., additional disclosures regarding SPAC sponsors, dilution, SPAC sponsor compensation, factors considered by the SPAC’s board in evaluating a proposed business combination, disclosures of any opinion received from a third party regarding the de-SPAC transaction (e.g., a fairness opinion) and additional disclosures about the target company);
  - Require **new disclosures related to projections in de-SPAC transactions** (e.g., purpose for projections and who prepared them, all material bases and assumptions underlying the projections and whether the projections continue to reflect the views of the preparer);
  - Adopt a new definition of “blank check company” for purposes of the Private Securities Litigation Reform Act of 1995 (the “PSLRA”) that **renders the PSLRA’s safe harbor for forward-looking statements unavailable for SPACs;**

Key changes from the Proposed Rule *(cont.)*

- Require the **target company in a de-SPAC transaction to be a co-registrant**, requiring the target company's directors and executive officers to sign the registration statement on Form S-4 or Form F-4 filed in connection with a de-SPAC transaction (the "de-SPAC Registration Statement");
- Require **redetermination of smaller reporting company ("SRC") status following completion of a de-SPAC transaction**;
- Require the **dissemination and public filing** of prospectuses and proxy statements **at least 20 calendar days prior to a stockholder meeting**;
- Adopt amendments to Regulation S-X intended to **align financial statement requirements between IPOs and business combinations**;
- Substitute proposed Rule 140a with a **guidance relating to statutory underwriter status** for investment banks participating in a de-SPAC transaction; and
- Substitute the proposed safe harbor Rule 3a-10 under the Investment Company Act of 1940, as amended (the "Investment Company Act") with a **guidance for assessing whether a SPAC falls within the definition of an "investment company."**

Specialized disclosure requirements

SPAC sponsor information

- New Item 1603(a) of Regulation S-K requires additional disclosures about a SPAC 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 SPAC sponsor and the SPAC, its officers, directors or affiliates with respect to determining whether to proceed with a de-SPAC transaction; and (2) regarding the redemption of outstanding securities;
  - The control persons of the SPAC sponsor and those with direct or indirect material interests in the SPAC sponsor;
  - Tabular disclosure of material terms of any lock-up agreements with the SPAC 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 SPAC sponsor, its affiliates and any promoters for all services rendered or to be rendered in all capacities to the SPAC and its affiliates; the amount of securities issued or to be issued to the same persons and the price paid or to be paid for such securities, including any circumstances or arrangements under which the ownership of these securities were or could be transferred; also the nature and amounts of any reimbursements to be paid to the SPAC 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) requires disclosure of actual or potential material conflicts of interest between (a) the SPAC sponsor or its affiliates; the SPAC's officers, directors or promoters; or the target company's officers or directors and (b) unaffiliated security holders of the SPAC.
- Examples:
  - Conflicts stemming from the contingent nature of the SPAC sponsor's compensation that result in the SPAC 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 a 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 has 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 have limited ability to devote the time necessary to find and execute a de-SPAC transaction.
- New Item 1603(c) requires disclosure of any fiduciary duties that each officer and director of the SPAC owes to other companies.

Dilution

- New Item 1602(c) requires 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 IPO as well as a tabular disclosure at quartile intervals of possible redemption scenarios of the amount of the offering price; net tangible book value per share, as adjusted; and the difference between the offering price and such net tangible book value per share, as adjusted.
- The tabular disclosure must describe:
  - The nature and amounts of each source of dilution used to determine net tangible book value per share, as adjusted;
  - The number of shares used to determine net tangible book value per share, as adjusted; and
  - Any adjustments to the number of shares used to determine the per share component of net tangible book value per share, as adjusted.

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Dilution *(cont.)*

- Item 1602(c) also requires a description of the model, methods, assumptions, estimates and parameters necessary to understand such tabular disclosure is required.
- New Item 1602(a)(4) requires disclosure in tabular format specified at quartile intervals based on percentages of the maximum redemption threshold of dilution to new investors using the most recent balance sheet and disclosing dilution in net tangible book value per share, as adjusted for the offering and assumed redemption levels and giving effect to material probable or consummated transactions (other than the de-SPAC transaction) on the cover page of any prospectus included in SPAC registration statements on Forms S-1 or F-1 (the "IPO Registration Statement").
  - If the offering includes an overallotment or "green shoe" option, the table must include separate rows showing the effects of redemptions in both non-exercise and full exercise scenarios.

Dilution *(cont.)*

- For de-SPAC transactions, new Item 1604(c) requires all de-SPAC Registration Statements to include:
  - A description of all material potential sources of future dilution that may be experienced by non-redeeming stockholders in a de-SPAC transaction;
  - A tabular disclosure, under a range of potential redemption levels, of the offering price in the SPAC IPO as of the most recent balance sheet date filed;
  - The pro forma net tangible book value per share, as adjusted; and
  - The difference between the offering price and the net tangible book value per share, as adjusted.
- Similar to new Item 1602(c)'s requirement, the tabular disclosure must also include:
  - The nature and amounts of each source of dilution used to determine net tangible book value per share, as adjusted;
  - The number of shares used to determine net tangible book value per share, as adjusted; and
  - Any adjustments to the number of shares used to determine the per share component of net tangible book value per share, as adjusted.

Dilution *(cont.)*

- With respect to each redemption level, new Item 1604(c)(1) requires disclosure of the company valuation at or above which the potential dilution results in the amount of the non-redeeming stockholders' interest per share being at least the initial public offering price per share of common stock.
- SPACs will also be required to include a description of the model, methods, assumptions, estimates and parameters necessary to understand such tabular disclosure.

Prospectus cover page

- Item 1602 requires basic disclosures in plain English on the cover page for a SPAC IPO:
  - Time period during which the SPAC must consummate the de-SPAC transaction
  - Redemptions
  - Sponsor compensation
  - Dilution disclosure
  - Conflicts of interest
- Item 1604 requires that a de-SPAC transaction cover page include on the cover page
  - Any board determination on the de-SPAC transaction
  - Whether a fairness opinion was received
  - A description of any material financing transaction
  - Sponsor compensation
  - Dilution
  - Conflicts of interest

Disclosure & procedural requirements for de-SPAC transactions

De-SPAC transaction background

- New Item 1605 requires disclosure of de-SPAC transaction background, material terms and effects, including:
  - A summary of the background of the de-SPAC transaction, including a description of any contacts, negotiations or transactions relating to the de-SPAC transaction;
  - A brief description of any related financing transaction, including any payments from the SPAC sponsor to investors in connection with the financing transaction;
  - The reasons for the SPAC and target to engage in the de-SPAC transaction and reasons of the SPAC 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 SPAC and target company security holders as compared to those of the security holders of the post-business combination company; and
  - Disclosure regarding the accounting treatment and the federal income tax consequences of the de-SPAC transaction to the SPAC, the target company and their respective security holders.

Disclosure & procedural requirements for de-SPAC transactions *(cont.)*

De-SPAC transaction background (cont.)

- Item 1605(c) requires "a reasonably detailed discussion of both the benefits and detriments" (which must be quantified to the extent practicable) of the de-SPAC transaction and any related financing transaction on the SPAC and its affiliates, the SPAC sponsor and its affiliates, the target company and its affiliates, and unaffiliated security holders of the SPAC.
- Item 1605(d) requires disclosure of material interests that the SPAC sponsor or the SPAC's officers or directors have in a de-SPAC transaction or any related financing transaction, including fiduciary or contractual obligations owed to other entities, as well as any interest in, or affiliation with, the target company, or held by the target company's officers or directors that consist of any interest in, or affiliation with, the SPAC sponsor or the SPAC.
- New Item 1605(e) requires disclosure of whether security holders are entitled to any redemption or appraisal rights and, if so, a summary of such rights.

Disclosure & procedural requirements for de-SPAC transactions *(cont.)*

SPAC's board consideration and evaluation of the de-SPAC transaction

- If the law of the domicile in which a SPAC is organized requires its board of directors (or similar governing body) to determine (or otherwise make a comparable determination) whether a de-SPAC transaction is advisable and in the best interests of the SPAC and the SPAC's security holders, new Item 1606(a) requires that the SPAC disclose that determination.
- New Item 1606(b) requires the SPAC to discuss the material factors considered in making any such determination. To the extent considered by the board, such factors must include:
  - The valuation of the target company;
  - The financial projections relied on by the board of directors;
  - The terms of financing materially related to the de-SPAC transaction;
  - Any report, opinion, or appraisal relating thereto; and
  - The material potential sources of future dilution described in new Item 1604(c).
- 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.)*

<u>SPAC's board consideration and evaluation of the de-SPAC transaction</u> (cont.)

- Additional disclosure requirements include whether:
  - The de-SPAC transaction is structured so that approval of at least a majority of unaffiliated security holders of the SPAC is required;
  - Any of the SPAC's directors voted against, or abstained from voting on, approval of the de-SPAC transaction (if so, such persons must be identified and there must be disclosure of their reasons for voting against or abstaining from voting on the transaction);
  - 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 and/or preparing a report concerning the approval of the de-SPAC transaction; and
  - The de-SPAC 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.)*

***<u>SPAC's board consideration and evaluation of the de-SPAC transaction</u>* (cont.)**

- Item 1607(a), similar to Item 1015 of Regulation M-A, requires disclosure about whether the SPAC or the sponsor received any report, opinion or appraisal from an outside party or an unaffiliated representative materially relating to:
  - The determination, if any, of the board of directors of the SPAC has made as to whether the de-SPAC transaction is advisable and in the best interests of the SPAC and its security holders;
  - The approval of the de-SPAC transaction;
  - The consideration or the fairness of the consideration to be offered to security holders; or
  - The fairness of the de-SPAC transaction to the SPAC, its security holders or the SPAC sponsor.

Disclosure & procedural requirements for de-SPAC transactions *(cont.)*

***SPAC's board consideration and evaluation of the de-SPAC transaction* (cont.)**

- If any outside party rendered any such report, opinion, appraisal or negotiation, 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, the SPAC 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;
  - If the report, opinion or appraisal relates to the fairness of the consideration to be offered to security holders of the target company, whether the SPAC or the SPAC 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 and/or unaffiliated representative 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 the SPAC sponsor; and any limitation imposed by the SPAC or the SPAC sponsor on the scope of the investigation.

Disclosure & procedural requirements for de-SPAC transactions *(cont.)*

<u>SPAC's board consideration and evaluation of the de-SPAC transaction</u> (cont.)

- Any such report, opinion or appraisal would be required to be included as an exhibit to a de-SPAC Registration Statement or a Schedule TO for a de-SPAC transaction and included directly in any proxy or information statement for a de-SPAC transaction.

Alignment of disclosures in de-SPAC transactions with those in traditional IPOs

Non-financial statement disclosure requirements

- In a de-SPAC transaction involving a target company not already subject to Exchange Act Section 13(a) or 15(d) reporting requirements, disclosure complying with the following items from Regulation S-K must be included with respect to the target company 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 any related financing transaction); and
  - Item 701 (recent sales of unregistered securities).

Non-financial statement disclosure requirements *(cont.)*

- If the target company is a foreign private issuer ("FPI"), it would have the option to provide disclosure based on the following Form 20-F items:
  - 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 16F (Change in Registrant's Certifying Accountant).
- Although already required in the "Super 8-K" (or "Super 20-F" for FPIs) filed after a de-SPAC transaction closing, the Final Rules require this information earlier in the de-SPAC process and prior to when the voting, tender or redemption decision is to be made by investors.

Required dissemination period for de-SPAC transaction docs

- Prospectuses, proxy statements and information statements filed in connection with a de-SPAC transaction are required to be distributed to stockholders at least 20 calendar days in advance of a stockholder meeting or the earliest 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 Final Rules permit that shorter period to govern.

Redetermination of smaller reporting company status

- SRCs are eligible for certain disclosure accommodations in various forms under the Securities Act and Exchange Act.
- In general, a redetermination of continued eligibility is required only once a year, as of the last business day of an issuer's second fiscal quarter.
- In a traditional IPO, SRC status is determined at the time the registrant files its IPO Registration Statement with the SEC.
- The Final Rules require a newly combined company to redetermine whether it qualifies as an SRC prior to the time it makes its first SEC filing (other than the Super 8-K) with public float measured as of a date within four business days after the de-SPAC transaction is consummated and revenue measured using the target company's most recent financial statements.
- If a post-business combination company does not qualify as an SRC, its filings would need to reflect this fact by including any necessary incremental disclosure beginning 45 days after consummation of the de-SPAC transaction.

Inapplicability of PSLRA

- Upon satisfaction of specified conditions, the PSLRA provides a safe harbor that generally serves to mitigate a company's liability in connection with a private right of action brought under the Securities Act and 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, prior to the final rules was 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 traditionally avoided being deemed "blank check companies" under this definition 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 Final Rules amend the definition of "blank check company" for purposes of the PSLRA 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.
- The bespeaks caution doctrine may provide protection (depending on the facts and circumstances) if forward-looking statements were used.

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 regardless of how the transaction is structured.
- Since a SPAC would be a reporting shell company, **new Rule 145a effectively requires any de-SPAC transaction to either be registered or to qualify for an applicable exemption**. The rationale: "[a] change in a reporting shell company's status via a business combination with an operating company results in the reporting shell company investors effectively exchanging their security representing an interest in the reporting shell company […] for a new security representing an interest in a combined operating company."
- Section 3(a)(9), which exempts any 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 new Rule 145a.

Business combinations with a shell company as sales to the shell company's stockholders *(cont.)*

  - <u>Adopting Release</u>: Deemed exchange by the reporting shell company's existing stockholders 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 company that hires and compensates a proxy solicitor to solicit approval of the reporting company's stockholders for the business combination would create an independent reason to render Section 3(a)(9) unavailable.
- Even if an exemption were applicable, by deeming these transactions to include a "sale" under the Securities Act, investors will 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.
- New Rule 145a does 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.

Business combinations with a shell company as sales to the shell company's stockholders *(cont.)*

- Interestingly, the SEC staff has been finding that many reverse mergers with life sciences companies (ostensibly operating companies with failed clinical programs) involve "shell companies."

Financial statement requirements

- ***Number of years of financial statements***
  - 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.
  - Final Rule 15-01(b) removes 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, final Rule 15-01(a) requires a target company’s financial statements to be audited by an independent accountant in accordance with the Public Company Accounting Oversight Board (PCAOB) standards.

Financial statement requirements *(cont.)*

- ***Age of financial statements***
  - Final Rule 15-01(c): the age of financial statements for a business that will be acquired by a shell company in a registration statement or proxy statement will be based on the age requirements in Rule 3-12 or Rule 8-08 of Regulation S-X, rather than the target company provisions in Item 17 of Form S-4.
  - A target company that qualifies as an SRC 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 SRC 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 SRC reported income from continuing operations attributable to the registrant before taxes.
  - Target companies not meeting the definition of SRC would apply Rule 3-12 and 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. Prior to the Final Rules, such financial statements are required only when omission of those financial statements would render the target company's financial statements substantially incomplete or misleading.
- Final Rule 15-01(d) requires 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.
- Final Rule 15-01(d)(1) provides 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 predecessor's financial information for the denominator instead of the shelf company registrant's financial information.
- If, after application of Rule 3-05 or 8-04, 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. Final Rule 15-01(d)(2) provides 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 or 75 days after consummation of the acquisition, whichever is later.

Financial statement requirements *(cont.)*

Financial statements of a shell company after a business combination

- Final Rule 15-01(e) provides that a registrant post-combination may exclude the financial statements of a shell company, including a SPAC, for periods prior to the business combination that results in the combined entity no longer being a shell company once the following conditions have been met: (1) the financial statements of the predecessor have been filed for all required periods through the acquisition date and (2) the financial statements of the combined entity registrant include the period in which the acquisition was consummated.

Enhanced projections disclosure

General presentation

- Prior to the Final Rules, Item 10(b) of Regulation S-K stated that management had the option to present in SEC filings its good faith assessment of a registrant's future performance, but it also stated that management must have a reasonable basis for that assessment.
- The Final Rules 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 financial results 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 directly comparable, and an explanation as to why the non-GAAP financial measure was used instead of a GAAP measure.
- The Final Rules also clarify that the guidance in Item 10(b), including as modified per the above, applies 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 applies to disclosures of projections in connection with de-SPAC transactions.
- Under new Item 1609, a SPAC is required to provide the following disclosures:
  - With respect to any projections disclosed by the registrant in the filing (or any exhibit thereto), the purpose for which they were prepared and the party that prepared the projections;
  - All material bases of the projections and all material assumptions underlying the projections, and any material factors that may affect such assumptions (including a discussion of material growth or reduction rates or discount rates used in preparing the projections, and the reasons for selecting such growth or reduction rates or discount rates); and
  - Whether the disclosed projections still reflect the view of the board (or similar governing body) or management of the SPAC or target company, as applicable, as of the most recent practicable date prior to the date of the disclosure document required to be disseminated to security holders; if not, then discussion of the purpose of disclosing the projections and the reasons for any continued reliance by the management or board (or similar governing body) on the projections.

SEC guidance on statutory underwriter status in de-SPAC transactions

Who is a statutory underwriter?

- Instead of adopting proposed Rule 140a, the SEC provides guidance regarding statutory underwriter status.
- The guidance raises many of the same concerns raised by proposed Rule 140a.
- The adopting release:
  - States that the guidance does not implement proposed Rule 140a;
  - Cautions that the statutory terms "distribution" and "underwriter" will be applied broadly and flexibly as warranted by the facts and circumstances; and
  - Identifies various transactions or elements or components of transactions that may involve a "distribution" in a de-SPAC transaction
- For example, the adopting release notes that "in the context of a de-SPAC transaction, interests in the typically private target company are distributed to the public through a business combination with a SPAC.

Who is a statutory underwriter? *(cont.)*

- The distribution is therefore the process by which the SPAC's investors, and therefore the public, receive interests in the combined operating company." So, based on this view, the business combination is the "distribution."
- The Final Rules adopt Rule 145a and, regardless of facts, that rule deems there to be a "sale" from the combined company to the SPAC's existing stockholders in a de-SPAC transaction—even one in which the target company is not offering or selling its securities in the market.
- The SEC clarifies that the guidance is not intended to affect traditional M&A business combination transactions.

Due diligence defense

- In light of the guidance (and the text of the proposing release), should anything change insofar as market practice?
- Market practice has evolved to include:
  - More robust diligence relating to the sponsor, the target company, its directors and officers, its business and operations, etc.;
  - Legal and regulatory due diligence;
  - Comfort letters;
  - Legal opinions; and
  - Negative assurance letters

SEC guidance on status of SPACs under the Investment Company Act of 1940

Substituting proposed Rule 3a-10 with guidance

- The SEC had proposed a new Rule 3a-10, which would have provided 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 SEC did not adopt the proposed new rule and instead it provided guidance to be used in assessing whether a SPAC may be characterized as an investment company.
- The SEC guidance does not raise novel aspects of an investment company status analysis, it is nevertheless helpful in that the SEC addresses activities specific to SPACs.

Rationale

- The SEC cautioned that, like any other issuer, depending on the facts and circumstances, a SPAC, at any point in its lifetime, may meet the definition of an investment company under Investment Company Act Sections 3(a)(1)(A) or 3(a)(1)(C) or both. Although the latter section includes an objective 40% asset test, the analysis under the former section and in other contexts historically has been based on five primary factors (often referred to as the *Tonopah* factors):
  - The company's historical development,
  - Its public representations of policy,
  - The activities of its officers and directors (as well as of the company's employees),
  - The nature of its present assets; and
  - The sources of its present income.
- An analysis of a company's investment company status is based on all relevant facts and circumstances and quite individualized. Further, it is not a stagnant analysis – a SPAC or other issuer could be an investment company at any stage of its operation.

Guidance in evaluating investment company status

<u>As to the nature of a SPAC's assets and income</u>**.**

The SEC believes that a SPAC may hold, or propose to hold, assets (whether held directly or in a trust or escrow account) that would weigh heavily in favor of it being an investment company:

- Investing in corporate bonds;
- Not engaging in a de-SPAC transaction but instead acquiring a minority interest in a company with the intention of being a passive investor.
- Owning 40% more of its total assets in "investment securities" (unless an exception applies).
- Income that is substantially derived from such assets.

A SPAC can avoid Section 3(a)(1)(C) when the SPAC's assets 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.

However, a SPAC can avoid Section 3(a)(1)(C) but still trigger Section 3(a)(1)(A).

The SEC noted that a SPAC that does not hold any securities would generally not implicate the Investment Company Act, unless it *proposes* to engage in the business of being an investment company.

Guidance in evaluating investment company status *(cont.)*

As to management activities.

- Officers, directors or employees did not actively seek a de-SPAC transaction and instead spent large amounts of time managing the SPAC's portfolio for the primary purpose of achieving investment returns.
- Depending on the facts and circumstances, the management of a SPAC also could cause SPAC sponsors to come within the definition of "investment adviser" in Section 202(a)(11) of the Investment Advisers Act.

As to duration. While not the "sole determinant" the SEC warned that a SPAC's activities may become more difficult to distinguish from those of an investment company the longer the SPAC takes to complete the de-SPAC transaction. When evaluating duration, the SEC suggested that SPACs consider related time periods in the Investment Company Act and SEC positions (e.g., Investment Company Act Rule 3a-2 (12-month period), Securities Act Rule 419 (18-month period)).

Guidance in evaluating investment company status *(cont.)*

As to holding out. A SPAC that holds itself out in a manner that suggests that investors should invest in its securities primarily to gain exposure to its portfolio of securities prior to the de-SPAC transaction would likely be an investment company under the definition in Section 3(a)(1)(A).

- For example, if a SPAC were to market itself primarily as a fixed-income investment, as an alternative to an investment in a mutual fund, or as an opportunity to invest in U.S. Treasury securities or money market funds, it would likely be holding itself out as being primarily engaged in an investment company business and thus would likely be an investment company.

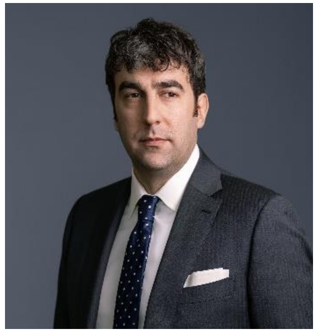
As to merging with an investment company. If a SPAC were to engage in a de-SPAC transaction with a target company that meets the definition of investment company, such as a closed-end fund or a business development company, the SPAC is likely to be an investment company under Section 3(a)(1)(A) because it would be proposing to be engaged in the business of investing, reinvesting and trading in securities. A SPAC that seeks to engage in a de-SPAC transaction with an investment company would, at some point prior to the de-SPAC transaction, be proposing to engage in the business of being an investment company.

Co-registrant status

Target company as co-registrant to de-SPAC registration statement

- When a SPAC proposes to register the issuance of shares in connection with a de-SPAC transaction on a de-SPAC Registration Statement, the Final Rules require the target company be deemed a co-registrant.
- The target company, its CEO, CFO, CAO and a majority of its board of directors will be required to sign the de-SPAC registration statement.
- The target company and its directors and executive officers who sign the de-SPAC Registration Statement will be subject to Securities Act liability.

Speakers



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- John has extensive experience advising both corporate and financial institutions in a broad range of capital markets transactions, including: investment grade and high yield debt offerings; initial public offerings and follow-on equity offerings; de SPAC transactions; preferred equity offerings; and liability management transactions.

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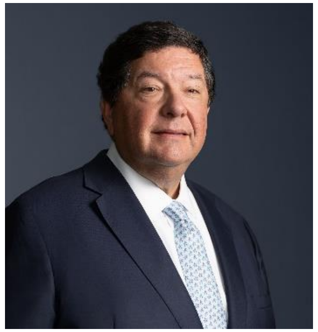

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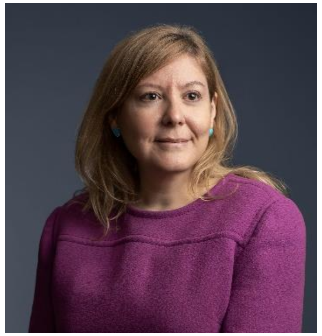
- Edward is co-leader of the firm's Capital Markets practice. His experience includes:

- Capital Markets. Representing issuers and underwriters in connection with public and Rule 144A offerings of debt, equity, convertible and hybrid securities in the US and Europe; continuously offered debt and equity programs; liability management transactions, including equity and debt self-tenders, exchange offers, and consent solicitations; particular emphasis on offerings by financial institutions, including banks, insurance companies, brokers and specialty finance companies, and cross-border offerings.

- Mergers and Acquisitions. Counseling buyers, sellers, and financial intermediaries in connection with public and private acquisitions, joint ventures, divestitures, mergers, tender offers, and proxy contests.



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- Anna represents issuers, investment banks/financial intermediaries and investors in financing transactions, including IPOs and other public offerings and private placements of equity and debt securities.

- She works closely with financial institutions to create and structure innovative financing techniques, including new securities distribution methodologies and financial products. She has particular financing experience in certain industries, including tech, telecommunications, healthcare, financial institutions, REITs and consumer and specialty finance.

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Additional resources

Read more:

- SEC Adopts Final Rules Relating to SPACs, Shell Companies and Projections
- 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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