In brief

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SEC proposes new rules related to SPAC and de-SPAC transactions

At a glance

The SEC has proposed new rules and amendments related to SPAC IPOs and de-SPAC transactions to enhance disclosures and provide additional investor protections. The proposed rules aim to align these transactions with traditional IPOs.

What happened?

On March 30, the SEC proposed new rules and amendments that would impact special purpose acquisition company (SPAC) initial public offerings (IPO) and the subsequent merger between a SPAC and private operating company (de-SPAC).

In voting for the proposal, SEC Chair Gensler noted, "Functionally, the SPAC target IPO [the de-SPAC transaction] is being used as an alternative means to conduct an IPO." The proposed rules seek to provide SPAC investors with the same level of protection that investors receive from traditional IPOs, addressing concerns over "information asymmetries, misleading information, and conflicts of interest."

Initial public offerings by SPACs

As proposed, the new rules would require additional disclosures in SPAC IPOs, including but not limited to the following:

- Identification of the SPAC sponsor (controlling persons) and its affiliates and any promoters of the SPAC
- An organizational chart of relationships and tabular disclosure of lock-up terms with the sponsor and its affiliates
- The nature and amount of compensation that has or will be awarded to the SPAC sponsor, its affiliates, and promoters for services rendered in all capacities to the SPAC and upon completion of a de-SPAC transaction
- Conflicts of interest that may arise between the SPAC sponsor, or its officers/directors or promoters, and purchasers in the offering, including those that may arise in determining whether to proceed with a de-SPAC transaction
- Additional cover page and/or prospectus summary information, including disclosure of the time frame to consummate a de-SPAC, plans for additional financing, and tabular disclosure of potential sources of dilution with ranges of redemption amounts (i.e., 25%, 50%, 75% and maximum redemption).

The proposed rules would provide a safe harbor from certain defining conditions under the Investment Company Act of 1940 if specified conditions are met. Those conditions reference the type of investments in which the SPAC may invest its assets, the type of transaction being contemplated, and the length of time to complete the de-SPAC transaction.

De-SPAC transactions

Similar to the SPAC IPO requirements, the proposal would require disclosures in filings for the de-SPAC transaction, such as those filed on Forms S-4 or F-4 or Schedule 14A, that provide additional information regarding the SPAC sponsors, tabular presentation of the sensitivity to each source of potential dilution, and conflicts of interest. The proposal would also require a statement from the SPAC about whether it reasonably believes that the de-SPAC transaction and any related financing transactions are fair or unfair to unaffiliated security holders and if any outside party prepared a report on the fairness of the transactions. The proposal also requires a minimum period of time for information to be disseminated to shareholders (generally 20 days).

The proposal would also:

- provide guidance on the use of projections to address concerns about their overall reliability (see further details below);
- deem the private operating company to be a "co-registrant" on Forms S-4 and F-4, which would subject the private operating company and any signing persons (i.e., principal executive officer, principal financial officer, controller or chief accounting officer and the majority of directors) to liability under Section 11 of the Securities Act;
- deem an underwriter in the SPAC IPO that takes steps to facilitate the de-SPAC transaction to be an underwriter with respect to the de-SPAC transaction;
- deem the de-SPAC transaction to be a sale of securities to the SPAC's shareholders for purposes of the Securities Act; and
- clarify and change certain financial statement requirements for the private operating company (see further details below).

Use of projections

In de-SPAC transactions, the proposal would require additional disclosures regarding the preparation of projections, including disclosure of the party that prepared them, the basis on which they were prepared, and all material assumptions. It would also amend the definition of "blank check company" such that the safe harbor for forward-looking information under the Private Securities LItigation Reform Act of 1995 would not be available to the SPAC, including with respect to projections of a private operating company in a de-SPAC transaction, similar to traditional IPOs.

In addition, Item 10(b) of Regulation S-K related to projected financial information would be amended to provide that:

- projections that are not based on historical financial results or operational history (e.g., a private operating company that has no operations) need to be clearly distinguished from those that are;
- projections based on historical information would generally be misleading if the historical information was not presented with equal or greater prominence within the document; and
- non-GAAP measures included in the projections include a clear definition or explanation of the measure, a description of the GAAP financial measure to which it is most closely related, and an explanation why the non-GAAP financial measure was used instead of a GAAP measure.

Financial statement impacts

The financial statement requirements of the private operating company would be more closely aligned with those required for a traditional IPO. In a change from current practice, the proposal would only require two years of audited financial statements of the private operating company if it would qualify as an EGC and the SPAC qualifies as an EGC, irrespective of whether the SPAC filed its first Form 10-K. The proposed rules also address the age of financial statements when the private operating company qualifies as a smaller reporting company (SRC), and financial statement requirements related to business acquisitions by the private operating company for periods prior to or contemplated during the de-SPAC transaction. The proposal also clarifies that once certain conditions are met,

the SPAC financial statements can be excluded from filings following the consummation of the de-SPAC transaction.

The proposal would also codify existing SEC staff guidance that the financial statements of the private operating company in a de-SPAC transaction be audited in accordance with the standards of the PCAOB.

SRC determination

Following the consummation of the de-SPAC transaction, a new requirement would accelerate the combined entity's redetermination date of its smaller reporting company status, thereby impacting the availability of the SRC scaled disclosure and other accommodations in its first periodic report (Form 10-K or 10-Q) following the consummation of the de-SPAC transaction.

Why is this important?

The proposed rules may impact stakeholders' decisions regarding participating in a SPAC transaction, and private operating companies' considerations as to how to access the public markets while providing investors with more information to make decisions. The proposal is over 350 pages and asks over 175 questions about the specific provisions. Each of the commissioners encouraged feedback and comments on the proposals. Notably, the release did not specifically address transition or compliance dates.

What's next?

Comments are due 30 days after the proposal is published in the Federal Register or May 31 (whichever is later). The SEC will consider the feedback received and could issue a final rule by the end of 2022. In the interim, companies involved in a SPAC IPO or de-SPAC transaction may want to consider providing the incremental disclosures addressed in the proposal, including the disclosures related to projections and potential conflicts of interest as they are currently common areas of SEC staff comment.

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