SEC Adopts New Rules Regarding SPAC Transactions

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On Jan. 24, 2024, the Securities and Exchange Commission (SEC) adopted new rules aimed to enhance protections in initial public offerings (IPOs) made by special purpose acquisition companies (SPAC) and in subsequent business combination transactions between SPACs and private operating companies, known as de-SPAC transactions.

The new SPAC rules were adopted by a 3-2 vote of the SEC Commissioners, and follow the rules proposed in March 2022. The final rules will become effective 125 days after their publication in the Federal Register. Registrants will have 490 days following publication in the Federal Register to comply with the structured data requirements set forth in the final rules.

Key highlights of the final rules include as follows:

- Require additional disclosures about the SPAC sponsor, potential conflicts of interest, and dilution;
- Require certain disclosures on the prospectus' outside front cover page and in the prospectus summary of registration statements filed in connection with SPAC IPOs and de-SPAC transactions;
- Require additional disclosures regarding de-SPAC transactions, including (1) if the law of the jurisdiction in which the SPAC is organized requires its board of directors (or similar governing body) to determine whether the de-SPAC transaction is advisable and in the best interests of the SPAC and its shareholders, or otherwise make any comparable determination, disclosure of that determination, and (2) if the SPAC or SPAC sponsor has received any outside report, opinion, or appraisal materially relating to the de-SPAC transaction, certain disclosures concerning the report, opinion, or appraisal;
- Amend the registration statement forms and schedules filed in connection with de-SPAC transactions to require additional disclosures about the target company;
- Provide that a target company in a registered de-SPAC transaction is a co-registrant on the registration statement used for the de-SPAC transaction such that the target company will be subject to liability under Section 11 of the Securities Act of 1933;

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- Make the Private Securities Litigation Reform Act of 1995 (PSLRA) safe harbor unavailable to SPACs (including with respect to projections of target companies seeking to access the public markets through a de-SPAC transaction), by defining “blank check company” to encompass SPACs (and other companies that would be blank check companies but for the fact that they do not sell penny stock); and
- Require re-determination of smaller reporting company (SRC) status following a de-SPAC transaction.

Background

A SPAC is a type of shell company without operations that raises capital for the purpose of identifying and merging with private target operating companies. Once a SPAC identifies its private target company, it completes the de-SPAC transaction, which is the business combination that results in a combined public company. SPACs became increasingly popular in 2020 and 2021, however the volume of SPAC activity has decreased since that boom. The SEC acknowledged the decrease in volume of SPAC activity, and noted that the amount of SPAC activity could change again in the future.

The adopting release of the final rules included the following chart, which demonstrates the significant share of the U.S. IPO market in recent years.

Table 1. Number of SPAC IPOs in the U.S. Securities Market from 2012-2023

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Number of Offerings												
SPAC IPOs	9	10	12	20	13	34	46	59	248	613	86	31
IPOs (including SPAC IPOs)	147	220	258	173	111	189	225	213	459	968	118	72
Percentage from SPACs	6%	5%	5%	12%	12%	18%	20%	28%	55%	63%	73%	43%
Total Proceeds (in billions of dollars)												
SPAC IPOs	0.5	1.4	1.8	3.9	3.5	10.0	10.8	13.6	83.4	162.5	13.4	3.8
IPOs (including SPAC IPOs)	50.1	70.8	93.0	39.2	25.8	50.3	63.9	72.2	179.4	334.7	22.9	25.1
Percentage from SPACs	1%	2%	2%	10%	14%	2-%	17%	19%	46%	49%	59%	15%
Number of Completed De-SPAC Transactions	6	11	5	10	9	13	23	28	64	199	101	89

Source: Securities and Exchange Commission Special Purpose Acquisition Companies, Shell Companies, and Projections

While the SEC noted that, like overall IPO activity, the SPAC IPO market has declined recently, SPAC IPOs nonetheless constituted over half of all U.S. IPOs respectively in 2020, 2021, and 2022, and constituted 43 percent of all U.S. IPOs in 2023.

Here is a brief summary of the final rules.

1. New Subpart 1600 of Regulation S-K—Special Purpose Acquisition Companies

The final rules add a new subpart 1600 of Regulation S-K titled “Special Purpose Acquisition Companies.” This new subpart, among other things, requires specialized disclosures applicable to SPACs, including disclosures regarding the SPAC sponsor, conflicts of interest, dilutions, board determinations and prospectus summaries.

Sponsors

The final rules impose additional disclosure requirements regarding the SPAC sponsor, its affiliates and any promoters of the SPAC, including, among other things:

- Their experience with organizing SPACs, their roles and responsibilities in directing the SPAC, the extent of their involvement with other SPACs;
- Any arrangement between the SPAC sponsor and the SPAC related to determinations of whether to enter into a de-SPAC transaction;
- The nature and amounts of all compensation that has been or will be awarded, earned or paid to the SPAC sponsor, its affiliates, and any promoter.

Conflicts of Interest

The final rules impose additional disclosure requirements relating to actual or potential conflicts of interest, including, among other things, any conflict of interest between (i) the SPAC sponsor, or its affiliates, the SPACs officers, SPAC directors, or SPAC affiliates or promoters, target company officers, or target company directors; and (ii) unaffiliated security holders of the SPAC.

Dilution

The final rules require disclosures of additional information about potential SPAC dilution. Sources of dilution may include compensation paid to sponsors, financing transaction occurring alongside a de-SPAC transaction, or redemptions.

Board Determinations

The final rules require disclosures regarding any determination by a board of directors of whether the de-SPAC transaction is advisable and in the best interest of the SPAC and its shareholders, if required by the applicable jurisdiction. The final rules also require disclosures of any report, opinion or

appraisal received by the SPAC or the SPAC sponsor that relates to the de-SPAC transaction.

Prospectus Cover Page and Prospectus Summary Disclosure

For registered offerings by SPACs, other than de-SPAC transactions, it is required to have certain key information on the prospectus' front cover page, such as the time frame for the SPAC to consummate a de-SPAC transaction; redemptions; sponsor compensation; dilution; and conflicts of interest. Additionally, for these registered offerings by SPACs, it is required to have a brief description in the prospectus summary about how the SPAC will identify potential business combination candidates and material terms of the trust and escrow account.

For de-SPAC transactions, it is required to have on the prospectus' front cover page information related to the fairness of the de-SPAC transaction, material financing transactions, sponsor compensation, and conflicts of interest. Additionally, it is required for de-SPAC transactions to have a brief description in the prospectus summary about the background and material terms of the de-SPAC transaction.

Background, Reasons, Terms, and Effects

The final rules require disclosures of the background, material terms, and effects of the de-SPAC transaction, including, among other things, a summary of the background of the transaction, a brief description of any related financing transactions, reasons for engaging in the particular de-SPAC transaction and disclosures regarding the accounting treatment and Federal income tax consequences.

2. Disclosures and Liability In De-SPAC Transactions

Minimum Dissemination Period

The amendments to Exchange Act Rule 14a-6 and Rule 14c-2 require that prospectuses and proxy and information statements filed in connection with a de-SPAC transaction must be distributed to security holders at least 20 calendar days in advance of a security holder meeting, or the maximum number of days permitted under applicable jurisdiction if such period is less than 20 calendar days.

Target Company as Co-Registrant

Amendments to Forms S-4 and F-4 require that target companies in a de-SPAC transaction be named as a co-registrant with respect to any registration statement filed by the SPAC. As such, the private target company and its signing persons (directors and certain executive officers) are subject to liability under Section 11 of the Securities Act of 1933, as amended, for any material misstatements or omissions in the Form S-4 or Form F-4.

Removal from PSLRA Safe Harbor

The PSLRA provides a safe harbor for forward-looking statements under the Securities Act and the Exchange Act, under which a company is protected

from liability for forward-looking statements in any private right of action under the Securities Act or Exchange Act when, among other conditions, the forward-looking statement is identified as such and is accompanied by meaningful cautionary statements. Under the PSLRA, the safe harbor is not available when the forward-looking statement is made in connection with an offering by a blank check company, an offering by an issuer of penny stock, or an IPO.

The final rules amend the definition of a "blank check company" for the purposes of PSLRA to include SPACs. As such, SPACs will no longer be allowed to use the safe harbors provided under the PSLRA, aligning the regulatory treatment of blank check companies with traditional IPOs.

Redetermination of Smaller Reporting Company Status

The final rules require a post-de-SPAC company to re-determine its status as a smaller reporting company within four days following the consummation of the de-SPAC transaction, and require such re-determination to be reflected in its filing status beginning 45 days following the consummation of the de-SPAC transaction.

SEC Declined to Adopt Proposed Rule 140a

In the final rules, SEC declined to adopt Rule 140a, which was the controversial provision in the proposed rules that would have effectively deemed anyone who acted as an underwriter of SPAC IPO securities or aided and assisted in de-SPAC transaction or any related financing transaction or otherwise participated in the de-SPAC transaction as being engaged in the distribution of the SPAC's securities, and as such subject to Section 2(a)(11) of the Securities Act as an underwriter.

Instead, the SEC's adopting release provided guidance regarding underwriter status in de-SPAC transactions, and stated that it will continue to follow its practice of applying the terms "distribution" and "underwriter" broadly and flexibly, as warranted by the facts and circumstances of the transaction.

3. Business Combinations Involving Shell Companies (New Rule 145a)

The final rules include new Securities Act Rule 145a, which specifies that, for Securities Act purposes, a sale occurs to the SPAC's existing shareholders when the SPAC enters into a business combination transaction involving another entity that is not a shell company, regardless of whether or not the existing SPAC shareholders receive new securities. In these situations, Rule 145a deems there to be a share exchange implicating Section 5 of the Securities Act's requirements and protections because the interests the former SPAC shareholders owned have been exchanged for something entirely different: interests in an operating company in the course of a transaction whereby the former SPAC provides the operating company with access to the public markets. The sale identified by the rule occurs regardless of whether securities are changing hands in the business combination transaction, and thus the transaction will need to be registered in accordance with the Securities Act unless an exemption from registration is available.

4. Enhanced Projections Disclosure

Financial Projections

The SEC amended Item 10(b) of Regulation S-K to provide SEC guidance that any projected measures that are not based on historical financial results or operational history must be clearly distinguished from projected measures that are based on historical financial results or operational history. Further, the amended Item 10(b) guidance requires clear definitions and explanations of non-GAAP financial measures used in projections, and an explanation of why such non-GAAP financial measures were used compared to a GAAP measure.

Additionally, to address its concerns regarding potential risks of projections specifically in de-SPAC transactions, the SEC adopted Item 1609 of Regulation S-K. This imposes new disclosure requirements related to such projections in de-SPAC transactions, including, among others:

- The purpose of the projection and the party that prepared them;
- All material bases of the projections and all material assumptions underlying the projections; and
- All material growth or reduction rates or discount rates used in preparing the projection, and the reasons for selecting such rates.

5. The Status of SPACs Under The Investment Company Act

The SEC declined to adopt a proposed rule that would have provided a safe harbor for SPACs from the definition of “investment company” under Section 3(a)(1)(A) of the Investment Company Act. Instead, the SEC provided guidance as to what facts and circumstances are relevant to whether a SPAC meets the definition of an “investment company.” These factors include the nature of SPAC assets and income, management activities, the SPAC’s duration, its description (or holding out), and the target entity of the de-SPAC transaction. The final rules state that this determination is fact-based and individualized in nature.