

SEC Adopts Major Changes to SPAC Rules

May 15, 2024

On Jan. 24, 2024, the Securities and Exchange Commission (the “SEC”) adopted final rules to enhance disclosures and provide additional investor protections in initial public offerings (IPOs) for special purpose acquisition companies (“SPACs”). The new rules are intended for SPACs and later business combinations between SPAC IPOs and target companies (“de-SPAC transactions”). Generally, the final rules follow the proposed rules issued by the SEC four years ago in March 2020, but with some significant departures. The SEC did not adopt final rules addressing the status of potential statutory underwriters in de-SPAC transactions, nor did they adopt a safe harbor from the “investment company” definition under the Investment Company Act of 1940 for SPACs.

Our client advisory summary of the Proposed Rules is available [here](#). The Adopting Release for the final rules is available [here](#), and the Fact Sheet is available [here](#). The final rules shall become effective on July 1, 2024.

The final rules significantly affect SPACs as summarized below.

1) Enhanced Disclosure and Enhanced Investor Protection.

The SEC adopted a new Subpart 1600 to Regulation S-K to provide specialized disclosure requirements for SPACs regarding the sponsor, potential conflicts of interest, and dilution. Subpart 1600 now requires enhanced disclosure for de-SPAC transactions, including disclosure of any determination required to be made by the SPAC’s board of directors in relation to a de-SPAC transaction.

A. Sponsors. Item 1603(a) requires additional disclosure about the sponsor, its affiliates and any promoters of the SPAC, including disclosure of the following:

- Their experience, material roles, and responsibilities and any agreement, arrangement or understanding: (1) between the sponsor and the SPAC, its executive 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 any persons who have direct and indirect material interests in the sponsor;
- A table describing the material terms of any lock-up agreements with the sponsor and its affiliates;
- The nature and amount of all compensation and reimbursements that has or will be paid to the sponsor, its affiliates and any promoters for all services rendered in all capacities to the SPAC and its affiliates.

B. Conflicts of Interest. Item 1603(b) requires disclosure of any actual or potential material conflict of interest between: (1) the sponsor or its affiliates or the SPAC’s officers, directors, or promoters, and (2) unaffiliated security holders. This will include disclosure of any conflict of interest in determining whether to proceed with a de-SPAC transaction and any conflict of interest arising from the manner in which a SPAC compensates the sponsor or the SPAC’s executive officers and directors, or the manner in which the sponsor compensates its own executive

officers and directors. Additionally, Item 1603(c) requires disclosure regarding the fiduciary duties each officer and director of a SPAC owes to other companies.

C. Dilution. Items 1602 and 1604 requires additional disclosure about the potential for dilution in: (1) registration statements filed by SPACs, including those for initial public offerings, and (2) de-SPAC transactions. Sources of dilution may include sponsor compensation, underwriting fees, shareholder dilution, outstanding warrants, convertible securities and PIPE financings.

D. Background of and Reasons for the De-SPAC Transaction; Terms and Effects. Item 1605 requires disclosure of the background, material terms, and effects of the de-SPAC transaction, as well as the SPAC sponsor's, officers, and directors' material interests in the de-SPAC transaction or any related financing transaction and any redemption or appraisal rights of security holders of the SPAC.

E. Board Determination About the De-SPAC Transaction. Item 1606 (b) requires disclosure of any determination required to be made by the SPAC's board of directors as to whether the de-SPAC transaction is advisable and in the best interests of the SPAC and its shareholders. This disclosure is required only to the extent such a determination is required by the law of the jurisdiction where the SPAC is organized. Any board determination disclosure must be supplemented by a discussion of the material factors the board of directors considered in making its determination. Here, the SEC declined to adopt the stricter standard proposed, which would have required all SPACs to disclose a reasonable belief regarding the fairness of the proposed business combination and any related financing transactions to unaffiliated security holders. Item 1606(a) also requires disclosure of whether any director voted against, or abstained from voting on, approval of the de-SPAC transaction or any related financing transaction, and if so, identifying the director and, if known after making a reasonable inquiry, the reasons for the vote against the transaction or abstention. The final rules may thus result in SPACs not using a target company's projections to assess a transaction or for marketing purposes, and SPACs may decide against obtaining fairness opinions in connection with de-SPAC transactions because of this required disclosure coupled with the enhanced disclosure requirements related to any projections used in a de-SPAC transaction.

F. Reports, Opinions and Appraisals. Item 1607(a) requires disclosure about whether or not the SPAC or its sponsor has received any report, opinion, or appraisal obtained from an outside party relating to the consideration or the fairness of the consideration to be offered to security holders or the fairness of the de-SPAC transaction or any related financing transaction to the SPAC, the sponsor or security holders who are not affiliates. Item 1607(c) requires all such reports, opinions or appraisals to be filed as exhibits to the applicable SEC forms for the de-SPAC transaction. Therefore, any such report, opinion or appraisal must be filed as an exhibit to the Form S-4, Form F-4 and Schedule TO for the de-SPAC transaction or included in the Schedule 14A or 14C for the transaction, as applicable.

G. Re-Determining Smaller Reporting Company Status After Consummating the De-Spac Transaction. The final rules require a smaller reporting company ("SRC") to redetermine its status as a smaller reporting company within 4 business days following the consummation of the de-SPAC transaction. The post-de-SPAC company must reflect the redetermined status in its filings beginning 45 days after consummating the de-SPAC transaction. This re-determination of smaller reporting company status would occur before the post-business combination company makes its first SEC filing but, after the filing of its Super Form 8-K (i.e., the Form 8-K with Form 10 information), with the public float threshold measured and the revenue threshold determined by using the annual revenues of the private operating company as of the most recently completed fiscal year for which audited financial statements are available. Generally, this would require SPACs that initially qualified as SRCs to provide more comprehensive disclosures (such as three years of financial statements and quantitative and qualitative information about market risk) earlier following a de-SPAC transaction than under existing rules (subject to potential EGC disclosure accommodations).

2) Aligning De-SPAC Transactions With SPAC IPOs.

SEC Chairman, Gary Gensler stated that, the final rules are intended to "help ensure that the rules for SPACs are substantially aligned with those of traditional IPOs." The final rules also amend the current "blank check company" definition to clarify that SPACs cannot rely on the safe harbor provision under the Private Securities Litigation Reform Act of 1995, as amended (the "PSLRA") when marketing a de-SPAC transaction.

A. Target Company as Co-Registrant. The final rules require that the SPAC and the target company be treated as co-registrants on Form S-4 and Form F-4 registration statements filed by the SPAC for a de-SPAC transaction. Accordingly, this would make the target company a signatory to the registration statement, as well as its principal executive officer, principal financial officer, controller or principal accounting officer, and a majority of the board of directors or persons performing similar functions of the target company. As a result, these parties may be held liable under Section 11 of the Securities Act of 1933, as amended (the “Securities Act”), for any material false statements or misleading omissions in the Form S-4 or Form F-4, subject to a due diligence defense for all parties other than the SPAC and the target company. Therefore, target companies assessing a de-SPAC transaction should consider whether its current director and officer liability insurance is sufficient before the filing of an initial Form S-4 or Form F-4 for its de-SPAC transaction given the potential for increased liability related to the target’s disclosures.

B. Minimum Dissemination Period. The final rules require a minimum dissemination period of 20 calendar days (or the maximum period allowable by the SPAC’s jurisdiction, if that period is less than 20 calendar days) for prospectuses and proxy or information statements filed in a de-SPAC transaction.

C. Protection for Projections Eliminated. The Private Securities Litigation Reform Act of 1995 (the “PSLRA”) provides a safe harbor for forward-looking statements under the Securities Act and the Securities Exchange Act of 1934, as amended (the “Exchange Act”). However, the safe harbor is not available when a forward-looking statement is made in an IPO or an offering by a blank check company. Under the final rules, the SEC adopted a new definition of “blank check company” for purposes of the PSLRA, to clarify that the statutory safe harbor is not available for forward-looking statements, such as projections, made in de-SPAC transactions. The unavailability extends to statements about the projections of target private operating companies in these transactions. The lack of the PSLRA safe harbor, especially coupled with enhanced disclosure requirements relating to projections under the final rules, may lead to changes in the presentation of projections and assumptions, or the abandonment of projections in a SPAC board’s evaluation of a potential de-SPAC target. That would further undermine the viability of the de-SPAC transaction as an alternative to traditional IPOs for target companies that do not have a lengthy operating history. However, the judicially-created “bespeaks caution” doctrine, recognized in numerous federal circuits, might provide protections for defendants, depending on the specific facts and circumstances.

3) Business Combinations Involving Shell Companies.

The final rules deem a business combination involving a reporting shell company and a private operating company as a “sale” of securities under the Securities Act, and amend the financial statement requirements for transactions involving shell companies.

A. Rule 145(a). New Rule 145(a) deems any business combination of a reporting shell company involving another entity that is not a shell company to involve a sale of securities to the reporting shell company’s shareholders. This will treat the reporting shell company investors as having exchanged their security representing an interest in the reporting shell company for a new security representing an interest in the combined operating company. By deeming such transactions to be a “sale” within the meaning of Section 2(a)(3) of the Securities Act, Rule 145(a) will impose Securities Act disclosure and liability provisions on business combinations involving reporting shell companies. Rule 145(a) will apply to all reporting shell companies (other than a “business combination related shell company,” as defined in Rule 405 under the Securities Act and Rule 12b-2 under the Exchange Act), and not just SPAC transactions. It will also apply even when the shell company’s shareholders are making no voting or other investment decision for the transaction.

B. Financial Statement Requirements in Business Combinations Involving Shell Companies. The SEC adopted updates to Regulation S-X and related amendments intended to align the financial statement reporting requirements more closely in business combinations involving a shell company and a private operating company with those in traditional initial public offerings.

- **Number of Years of Financial Statements.** If the SPAC is an EGC and the target company is an EGC, the target would be permitted to report two years of financial statements, without regard as to whether or not the shell company has filed its first annual report. Three years of financial statements would still be required for the private operating company when it exceeds both the smaller reporting company and EGC revenue thresholds;
- **Audit Requirements of Predecessor.** Rule 15-01(a) requires a target private operating company to have its financial statements examined by an independent accountant in accordance with PCAOB standards;
- **Age of Financial Statements of the Predecessor.** Rule 15-01(c) provides that the age of financial statements for a private operating company that will be the predecessor to a shell company in a registration statement or proxy statement will be based on whether the private operating company would qualify as smaller reporting company if it were filing its own initial registration statement;
- **Acquisitions of Businesses by a Shell Company Registrant or Its Predecessor That Are Not or Will Not Be the Predecessor.** The financial statements of a target private operating company that is or will be the predecessor to a shell company registrant are required in registration statements or proxy statements related to the business combination. The financial statements of any other businesses, besides the predecessor, that have been, or are probable to be, acquired may also be required.
 - Rule 15-01(d) of Regulation S-X applies Rules 3-05 and 8-04 (and Rule 3-14 for a real estate operation), which are the current provisions for the requirements relating to the financial statements of businesses acquired or to be acquired, to acquisitions of businesses by a shell company registrant, or its predecessor, that are not or will not be the predecessor to the registrant. This new rule will be consistent with the current market practice of applying Rule 3-05 (or Rule 8-04) to acquisitions by the target private operating company in a de-SPAC transaction.
 - Currently, Rule 1-02(w) requires the financial information of the registrant, which may be a shell company, to be used as the denominator to determine significance. Because a shell company has nominal activity, applying this test results in limited to no sliding scale for business acquisitions, including those made by the private operating company that will be the predecessor to the shell company, because every acquisition would be significant and thus require financial statements. An amendment to Rule 1-02(w) of Regulation S-X will now require that significance of the acquired business be calculated using the private operating company's financial information as the denominator instead of that of the shell company registrant.
 - Rule 15-01(d)(2) specifies that the financial statements of the acquired business omitted from the previously-filed registration, proxy, or information statement (i.e., financial statements of a probable of being acquired or recently acquired business omitted from a registration, proxy, or information statement because its significance is measured at 50% or less (or Rule 3-14(b)(3)(ii) for a real estate operation)) will be required in an Item 2.01(f) Form 8-K filed with Form 10 information within 75 days after closing the acquisition.
- **Financial Statements of a Shell Company Registrant After the Combination with Predecessor.** Rule 15-01(e) allows a registrant to exclude the financial statements of a shell company, including a SPAC, for periods before 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 that were filed with the SEC include the period in which the acquisition was consummated. The financial statements of the SPAC will be required in all filings (including registration statements and the Form 8-K with Form 10 information filed following the de-SPAC transaction) before the filing of the first periodic report that includes those post-business combination financial statements.

4) Enhanced Projections Disclosures.

The final rules amend the SEC's guidance on the presentation of projections in any filings with the SEC (not only on de-SPAC transactions, but for all projections filed with the SEC) and adds new guidance only for de-SPAC transactions, in both instances to address the reliability of those projections.

A. Item 10(b) of Regulation S-K. The SEC amended Item 10(b) to support the SEC's view that projected financial information included in filings subject to Item 10(b) must have a reasonable basis. Item 10(b) states that:

- Any projected measures that are not based on historical financial results or operational history should be clearly distinguished from projected measures that are based on historical financial results or operational history;
- Projections that are based on historical financial results or operational history must be presented with such historical measure or operational history having 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 why the non- GAAP financial measure was used instead of a GAAP measure;
- Item 10(b) has also been amended to state that its guidance applies to any projections of future economic performance of the registrant and other persons, such as the target company in a business combination, that are included in the registrant's SEC filings.

B. Item 1609 of Regulation S-K. The SEC adopted Item 1609 of Regulation S-K which applies only to de-SPAC transactions, and requires a registrant to provide the following disclosures:

- For 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 affect 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 a discussion of the purpose of disclosing the projections and the reasons for any continued reliance by the management or board on the projections.

5) Status of SPACs under the Investment Company Act of 1940.

Under proposed Rule 3a-10, a safe harbor would have been provided from the definition of "investment company" under Section 3(a)(1)(A) of the Investment Company Act for SPACs, which would have excluded certain SPACs from being defined and regulated as investment companies. However, the SEC declined to adopt proposed Rule 3(a)-10 and instead provided guidance as to which facts and circumstances are relevant to investment-company classification using the five *Tonopah* factors employed in the standard analysis. As a result, SPACs should carefully assess and monitor their activities, and consider changing their operations if necessary to bring them into compliance with the exclusion from the Investment Company Act.

A. Nature of SPAC Assets. A SPAC will less likely be considered an investment company if the SPAC's assets are limited to Government securities, Government money market funds and cash items before the completion of the de-SPAC transaction and those 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.

B. Management Activities. A SPAC will more likely be an investment company if the SPAC's officers, directors and employees fail to actively seek a de-SPAC transaction or spend a considerable amount of time actively managing the SPAC's portfolio for the primary purpose of achieving investment returns, which would be indicative of investment company status.

C. Duration Limitations. The SEC's guidance discusses how the longer a SPAC takes to complete a de-SPAC transaction the more likely it could qualify as an investment company. Rule 3a-2 under the Investment Company Act provides a one-year safe harbor for "transient investment companies." And blank-check companies under Investment Company Act Rule 419 are not investment companies because their duration is limited to 18 months. Based on these timelines, SPACs operating beyond 12 or 18 months should assess whether they otherwise might qualify as investment companies.

D. Holding Out. A SPAC that markets itself like an investment company is likely to be considered to be an investment company. Additionally, if a SPAC markets itself as an alternative to an investment in a mutual fund or an opportunity to invest in Treasury securities or money market funds, then it will likely be considered to be an investment company.

E. Merging with an Investment Company. A SPAC that engages or proposes to engage in a de-SPAC transaction with an investment company, such as a business development company or a closed-end fund, will "likely" be considered an investment company under Section 3(a)(1)(A).

6) Underwriter Status and Liability at De-SPAC Transaction.

Proposed Rule 140(a) provided that a person who has acted as an underwriter in a SPAC initial public offering ("SPAC IPO underwriter") and takes steps to facilitate the de-SPAC transaction, or any related financing transaction, or otherwise participates (directly or indirectly) in the de-SPAC transaction, will be deemed to be an "underwriter" engaged in the distribution of the securities of the surviving public entity in a de-SPAC transaction under Section 2(a)(11) of the Securities Act. This proposed rule would have imposed liability on SPAC IPO underwriters under Section 11 and 12(a)(2) of the Securities Act, subject to a due diligence defense, for material false statements and misleading omissions in the de-SPAC registration statement. However, the SEC declined to adopt proposed Rule 140a, because it believes the term "underwriter" does not have "unlimited applicability".

The SEC reiterated that it intends to follow "longstanding" practices of applying the relevant statutory terms "distribution" and "underwriter" broadly and flexibly, as warranted by the applicable facts and circumstances. Accordingly, the SEC stated that it may find a "statutory underwriter" where "someone is selling for the issuer or participating in the distribution of securities in the combined company to the SPAC's investors and the broader public, even though it may not be named as an underwriter in any given offering or may not be engaged in activities typical of a named underwriter in traditional capital raising." As a result of the Rule 140(a) proposal and the possible liability described above, SPACs and target companies should continue to expect extensive diligence requests from financial institutions, advisors, and their counsel in connection with a de-SPAC transaction. This typically includes requests from investment banks that advisors to a SPAC and its target provide negative assurance and comfort letters in connection with the de-SPAC transaction, and other related changes to the de-SPAC transaction process that add complexity, time, and cost.

Carter Ledyard & Milburn LLP uses Client Advisories to inform clients and other interested parties of noteworthy issues, decisions and legislation which may affect them or their businesses. A Client Advisory does not constitute legal advice or an opinion. This document was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein. © 2024 Carter Ledyard & Milburn LLP.

related professionals

Guy P. Lander / Partner

D 212-238-8619

lander@clm.com

Louie A. Ayash / Associate

D 212-238-8606

ayash@clm.com

Guy Ben-Ami / Partner

D 212-238-8658

benami@clm.com

Paul J. Brown III / Associate

D 212-238-8723

pbrown@clm.com