KIRKLAND & ELLIS
Kirkland Alert

The SEC Proposes New Rules Regarding SPACs

06 April 2022

On March 30, 2022, noting that over the past two years there has been an unprecedented surge in the number of initial public offerings by SPACs, the U.S. Securities and Exchange Commission (SEC) proposed a sweeping new set of rules regarding SPAC IPOs and mergers in a 3-to-1 vote of the SEC Commissioners.

We highlight below some key aspects of the proposals and our brief commentary.

- *The de-SPAC Transaction is an Offer of Securities to Existing SPAC Investors.* The proposed rules would treat the SPAC's business combination as a sale of securities that would require the filing of a registration statement. The SEC states that deeming the de-SPAC transaction a sale for purposes of the Securities Act of 1933 as amended (the Securities Act) addresses potential disparities in the disclosure and liability protections available to SPAC shareholders and traditional IPO investors.
  - *Commentary*. This proposed rule reflects the view that the de-SPAC transaction is the "SPAC target IPO" and the SEC's rules should "treat like cases alike." Deeming the de-SPAC transaction a distribution of securities subject to the Securities Act is the gateway to imposing liability for material misstatements or omissions in de-SPAC disclosure documents on a wide range of actors involved in the transaction, whether or not their roles have traditionally carried such responsibility.

- *Underwriter Status and Liability in a de-Spac Transaction.* The proposed rules would deem underwriters of a SPAC's IPO that take steps to facilitate the de-SPAC transaction or any related financing transaction, or otherwise participate in the de-SPAC transaction, to be underwriters within the meaning of Section 2(a)(11) of the Securities Act in the de-SPAC transaction.
  - *Commentary.* Consistent with recent speeches by various SEC officials, the SEC focuses on applying "gatekeeper" liability. The proposed rule would subject the SPAC IPO underwriter to underwriter liability in the de-SPAC transaction

regardless of its actual role and, potentially, even without a formal role. The SEC indicates that the proposed rule is "clarifying the underwriter status" of the SPAC IPO underwriter in the de-SPAC transaction, which implies that investment banks have underwriter liability for completed transactions, as well. Further, the SEC indicates the proposed rule is not intended to limit the definition of underwriter under Section 2(a)(11), meaning additional de-SPAC participants, including financial advisers, PIPE investors or other advisers also may be deemed underwriters in connection with a de-SPAC transaction whether or not they acted as SPAC IPO underwriter. The scope of this proposed rule, as well as the potential consequences of expanded retrospective liability for investment banks, defines the gravamen of the SEC's proposals.

- *Target Company as Co-Registrant*. The proposed rules require that the target company be a co-registrant when a SPAC files a registration statement on Form S-4 or Form F-4 for a de-SPAC transaction. The SEC explains that this requirement is intended to improve reliability of the disclosures provided to investors in the de-SPAC transaction by ensuring the target company's directors and officers are held accountable to investors by making them liable for disclosures in the registration statement.
  - *Commentary*. We note that many de-SPAC transactions are already structured such that the target company is the registrant and the target's board and management sign the registration statement. Therefore, we do not believe this proposal would have substantial effect on the market.

- *Status of SPACs under the Investment Company Act of 1940.* The proposed rules create a safe harbor such that, if a SPAC (i) maintains assets comprising only cash items, government securities and certain money market funds; (ii) seeks to complete a de-SPAC transaction after which the surviving entity will be primarily engaged in the business of the target company; and (iii) enters into an agreement with a target company to engage in a de-SPAC transaction within 18 months after its IPO and complete its de-SPAC transaction within 24 months of such offering, it will not be an "investment company" under the Investment Company Act of 1940 (the Investment Company Act).
  - *Commentary*. The fact that a SPAC is not an investment company subject to regulation under the Investment Company Act was not in doubt among practitioners. Over 1,000 SPAC IPOs have been reviewed by the staff of the SEC over two decades and have not been deemed by the SEC staff to be subject to the Investment Company Act. Although the SEC points to the timeframe referenced in Rule 419 promulgated under the Securities Act as its reasoning for the 18/24-month timeframes, many SPACs have longer to find a prospective target company

and listing rules contemplate a maximum timeframe of 36 months. The SEC has stated that "While a SPAC would not be required to rely on the proposed rule, the proposed conditions are intended to align with the structures and practices that the Commission preliminarily believes would distinguish a SPAC that is likely to raise serious questions as to its status as an investment company from one that does not." Again, the proposed rule is a safe harbor, not a requirement. The complexity of de-SPAC transactions and the impact of market dynamics and regulators, including the SEC, on the overall transaction timeline will complicate the ability to utilize this safe harbor.

- *PSLRA Safe Harbor*. The proposed rules seek to amend the definition of "blank check company" to make the liability safe harbor in the Private Securities Litigation Reform Act of 1995 (PSLRA) for forward-looking statements, such as projections, unavailable in disclosure documents filed by SPACs. The SEC explains that "some market participants are of the view" that the availability of the PSLRA safe harbor means that SPACs do not exercise the same level of care in preparing forward-looking statements, including projections, as in traditional IPOs.
  - *Commentary*. Many de-SPAC transactions are already structured in a manner in which the registrant is not claiming the safe harbor. Where a de-SPAC disclosure document contains projections, they are not included for purposes of marketing the transaction to investors. Rather, the projections are included in the disclosure document because existing rules mandate disclosure of all information the SPAC's board of directors considered in assessing the de-SPAC transaction. The disclosures generally highlight this fact and indicate that the projections were prepared for internal purposes only and not with a view to disclosure. Removing the protections of the PSLRA may have the effect of a SPAC board choosing to not include the consideration of projections in its review of a transaction and therefore have the unintended consequence of narrowing the scope of the board's due diligence.

- *Fairness of the de-SPAC Transaction.* The proposed rules would require disclosure regarding whether the SPAC believes that the de-SPAC transaction is fair to the SPAC's unaffiliated investors. The SEC indicated that this proposal is informed by Rule 13e-3 promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act), which applies to going-private transactions, because the "the conflicts of interests and misaligned incentives inherent in going-private transactions are similar to those often present in de-SPAC transactions."
  - *Commentary*. While this is ostensibly a disclosure requirement, in practice it would impose a new substantive requirement that the SPAC board consider whether the de-SPAC transaction and related financing is fair. As in many going-private

transactions, the SPAC board may elect to bolster its analysis by obtaining an opinion of a third party to make such statement. The proposal suggests that this statement also include a statement on any related financing.

- *Specialized Disclosure and Financial Statement Requirements.* The proposed rules would require disclosure regarding, among other things, SPAC sponsors, potential conflicts of interest and dilution in connection with the SPAC's IPO and de-SPAC transaction. In addition, the proposed rules require disclosure about the target company, the background of the transaction, material terms and effects of the proposed de-SPAC transaction. The proposed rules also address the financial statements required for the disclosure documents, including the age of financial statements, the SPAC's financials following the closing of a de-SPAC transaction and the financial statements required for businesses acquired by the target company.
  - *Commentary*. Much of the substance of the proposed disclosure and financial statement rules is already contained in the IPO prospectus and in de-SPAC disclosure documents as a result of existing SEC staff positions, the application of existing rules relating to IPOs and M&A transactions involving public companies, market demands and the SEC comment process. Of note with respect to the proposed rules on financial statements is the proposal to remove whether the SPAC has filed an annual report on Form 10-K as a factor in determining if a target company must present two years or three years of audited financial statements. This proposed rule, if implemented, would expand the circumstances in which target companies may report two years of audited financial statements and align the financial reporting with traditional IPOs.

- *Minimum Dissemination Period.* The proposed rules would require a minimum dissemination period for disclosure documents in a de-SPAC transaction. The staff's proposal of a 20-calendar-day minimum dissemination period is informed by Rule 13e-3.
  - *Commentary*. The laws of the jurisdiction of incorporation of the SPAC already mandate the minimum amount of time security holders need to consider disclosure materials. Presumably the minimum dissemination period will apply to the initial distribution of materials rather than to the distribution of additional disclosure materials, which are commonly used in many de-SPAC transactions and other solicitations and tender offers by public companies.

- *Determining Smaller Reporting Company Status.* The proposed rules require a re-determination of smaller reporting company status within four business days following the consummation of a de-SPAC transaction. The company would be

required to reflect this re-determination of smaller reporting company status in its first periodic report (Form 10-K or Form 10-Q) following the closing of the de-SPAC transaction.

  - *Commentary*. This proposal may be particularly onerous to companies that consummate a de-SPAC transaction shortly prior to the filing deadline of its first periodic report. As a result, such a company may be unable to rely on the scaled disclosure accommodations when filing a registration statement shortly following the consummation of the de-SPAC transaction as required by typical PIPE financing transactions.

Conclusion

We believe that the increase in SPAC transactions warrants SEC review — not only for potential disclosure improvements but also to better understand how to improve the other avenues for taking companies public. We anticipate that the proposed expansion of liability — limiting the availability of the forward-looking statements safe harbor and expanding the definition of statutory "underwriter" — will be subject to close scrutiny, substantial comments and potential legal challenges if the rules are adopted as proposed.

The SEC proposal is available here: Proposed rule: Special Purpose Acquisition Companies, Shell Companies, and Projections (sec.gov).

The statement from Commissioner Hester Peirce in opposition of the proposal is available here: https://www.sec.gov/news/statement/peirce-statement-spac-proposal-033022

The SEC is requesting comments of the proposals 30 days after the publication in the Federal Register or May 31, 2022, whichever is later.

Authors

Norm Champ, P.C.

Partner / New York

Tamar Donikyan

Partner / New York

Sophia Hudson, P.C.

Partner / New York

Joshua N. Korff, P.C.

Partner / New York

Christian O. Nagler

Partner / New York

Peter Seligson

Partner / New York

Stefan Atkinson, P.C.

Partner / New York

Related Services

Practices

- Capital Markets

Suggested Reading

- 24 March 2022 Kirkland Alert SEC Proposes New Climate Disclosure Requirements
- 14 March 2022 Kirkland Alert SEC Proposes New Cybersecurity Disclosure Regime for Public Companies
- 01 October 2021 Kirkland Alert The SEC's Recent and Planned Activity on Climate Change Disclosures: What Companies Can Do To Prepare

This publication is distributed with the understanding that the author, publisher and distributor of this publication and/or any linked publication are not rendering legal, accounting, or other professional advice or opinions on specific facts or matters and, accordingly, assume no liability whatsoever in connection with its use. Pursuant to applicable rules of professional conduct, portions of this publication may constitute Attorney Advertising.

© 2022 Kirkland & Ellis LLP.