KIRKLAND & ELLIS

Kirkland Alert

The SEC Adopts New Rules Regarding SPACs, Shell Companies and Projections

30 January 2024

On January 24, 2024, the Securities and Exchange Commission (the "SEC") adopted some of the previously proposed rules as final rules in a 3-2 vote of the SEC Commissioners. The regulations will go into effect 125 days following the date of publication in the Federal Register. We highlight below some key aspects of the final rules and our brief commentary.

The SEC adopts updates to guidance on the use of projections in SEC filings and adopts rules applicable to projections used in connection with de-SPAC transactions.

The SEC adopted amendments to Item 10(b) of Regulation S-K to expand and update the SEC's views on the use and disclosure of projections in filings made with the SEC. The SEC affirmed its long-standing position encouraging the use of management's projections that have a reasonable basis and are presented in an appropriate format. In addition, the SEC adopted Item 1609 of Regulation S-K, which will require the disclosure of additional information about projections used in connection with de-SPAC transactions.

The amendments to Item 10(b) of Regulation S-K (applicable to all projections, not only those used in de-SPAC transactions) state that projections that are not based on historical results or operations should be distinguished from projections based on operational history. Proposed Item 10(b) also states that it would be misleading if a presentation of projections that are based on historical results does not give equal prominence to such historical results and that management should disclose what is the most probable specific amount or most reasonable range for each financial item projected based on selected assumptions.

New Item 1609 of Regulation S-K, which will apply to de-SPAC transactions only, requires disclosure of the purpose for which projections were prepared, the party who prepared them and all material bases and assumptions. Registrants are also required to disclose any material growth or reduction rates or discount rates used in preparing the projections and why such rates were used. Most notably, a statement must be included concerning whether projections of the SPAC or target company reflect the view of its respective management or board of directors as of the most recent practicable date prior to dissemination of the disclosure document (including an amendment to a filing that included projections as of an earlier date). If the SPAC or target company, as applicable, does not provide such affirmation, then disclosure must be included to explain the purpose for disclosing the projections and the reasons for continued reliance on such projections. Item 1609 of Regulation S-K also applies to Current Reports on Form 8-K and exhibits thereto, which means projections disclosures contained in investor presentations attached as exhibits to Current Reports on Form 8-K will need to conform with the disclosures required by Item 1609.

Commentary: Item 1609 of Regulation S-K does not impose a duty to update projections on either the SPAC or target company. The disclosure focuses on confirming whether the projections have been updated immediately prior to the dissemination of documents to shareholders and, if not, the purpose for which the projections were prepared and the reasons for continued reliance on such projections. The requirement to include information concerning the material basses, assumptions and factors affecting projections comports with best market practices.

The SEC adopted amendments to the definition of “blank check company” to make the Private Securities Litigation Reform Act of 1995 (“PSLRA”) safe harbor unavailable to SPACs, including with respect to projections of target companies.

The SEC’s stated reason for adopting this amendment is to align de-SPAC transactions with traditional IPOs. The unavailability of the PSLRA will not have retroactive effect related to forward-looking statements made before the effective date of the final rules where the safe harbor was available.

Commentary: As a result of the structure of many de-SPAC transactions, the forward-looking statements contained in the registration statements relating to such transactions historically already were outside the bounds of the PSLRA safe harbor. The SEC agreed with commentators that other long-standing protections for forward-looking statements, such as projections, afforded by existing SEC rules namely

Securities Act Rule 175 and Exchange Act Rule 3b-6 (and in common law, such as the "bespeaks caution doctrine") remain potentially available to SPACs based on facts and circumstances.

The SEC declined to adopt a safe harbor from the definition of "investment company" that would have been applicable to SPACs.

Instead, the SEC stated that whether a SPAC is an investment company would continue to be based on particular facts and circumstances, as assessed at inception and throughout a SPAC's existence.

Commentary: Although the SEC referenced time periods in exemptions from the Investment Company Act for so-called "transient investment companies" (which are granted a one-year safe harbor) or blank check companies relying on Rule 419 (which SPACs do not and which limits the duration of these accounts to 18 months) and expressed a view that SPACs should reassess their status on such dates, the SEC noted that the duration of a SPAC is not the sole or principal factor in determining whether a SPAC is an investment company. The SEC set forth its view that the nature of the SPAC's assets and income, the SPAC's management activities and how the SPAC holds itself out also impact the analysis. Accordingly, a SPAC operated as SPACs typically have been in the past (marketing as a business combination vehicle, having teams actively seeking business combination opportunities, operating within certain duration limits, and holding assets in U.S. government treasuries, money market funds or cash) should not be considered an investment company under the SEC's guidance, particularly if they shifted any funds held in their trust accounts from short-term treasuries or money market funds to demand deposit accounts after certain duration periods following their IPOs as many SPACs have been doing since the proposed rules were first published in March 2022 to further support the conclusion that the SPACs are not investment companies because they do not hold any "securities," within the meaning of the Investment Company Act.[1]

The SEC declined to adopt a proposed rule that would have provided that anyone who acts as an underwriter in a SPAC IPO and participates in the de-SPAC transaction by taking steps to facilitate the transaction and the related distribution of securities, is an "underwriter" within the meaning of Section 2(a)(11) of the Securities Act.

While declining to adopt the proposed rule, the SEC affirmed its intent to continue applying the statutory terms "distribution" and "underwriter" broadly and flexibly. The

SEC also noted that its discussion of the issue is not intended to signal that the SEC believes that every de-SPAC transaction or offering of securities generally involves or needs the involvement of an underwriter, but if a distribution is present and a party is deemed to be a statutory underwriter, such party would have had to perform the necessary due diligence to obtain the benefit of the due diligence defense afforded to underwriters under the Securities Act.

Commentary: Nothing in the final rules release alters the long-standing definition of underwriter for purposes of Section 2(a)(11) of the Securities Act. We expect diligence efforts of certain parties involved in de-SPAC transactions to remain robust and in many instances, depending on specific facts and circumstances including the roles of the parties involved, comparable to the diligence conducted in connection with traditional IPOs. We note there is a pending litigation regarding whether financial institutions in de-SPAC transactions are indeed statutory "underwriters" and we expect practice will be informed by the outcome of the case.

Reporting shell company business combinations involve the sale of securities to the reporting shell company's shareholders.

The SEC adopted Rule 145a, which provides that the combined company in a de-SPAC transaction is making an offer of securities to the reporting shell company's shareholders. The new Rule 145a provides that in any de-SPAC transaction requiring a registration statement the SPAC and the target company will be subject to strict liability and the officers and directors who sign the registration statement will be subject to potential liability under Section 11 of the Securities Act for the disclosures therein. In addition, the SEC adopted amendments to the relevant forms of registration statements to require the target company of a de-SPAC transaction to be a co-signatory.

Commentary: Many de-SPAC transactions are structured such that a registration statement is required. In addition, it is not uncommon in de-SPAC transactions that the target company, or a new registrant formed by the target company, is the filer of such registration statement. Effectively, the adoption of these new rules and instructions does not dramatically shift the liability scheme to which the directors and officers of the SPAC and target company have been subject. Furthermore, it is the nature of de-SPAC transactions that the target company essentially assumes the liabilities of the SPAC at closing, thereby rendering the practical implications of whether SPACs or target companies sign a registration statement largely irrelevant.

The SEC declined to adopt a proposal to require disclosure as to whether the board of directors of the SPAC reasonably believes the de-SPAC transaction and related financing is fair or unfair to the unaffiliated shareholders of the SPAC. The SEC did, however, adopt other disclosure requirements on process.

The SEC did adopt a revised Item 1606, which requires disclosure of a board of directors' determination as to whether the de-SPAC transaction is advisable and in the best interest of shareholders, if such determination or comparable determination is required by the law of the jurisdiction in which the SPAC is organized. A registrant must also state whether the de-SPAC transaction is structured so that the approval of a majority of unaffiliated security holders of the SPAC is required and whether the de-SPAC transaction was approved by a majority of the directors of the SPAC who are not SPAC employees. A statement must also be included as to whether or not the majority of directors who are not employees of the SPAC has retained an unaffiliated representative to act solely on their behalf for purposes of negotiating the de-SPAC transaction. Finally, if any director voted against, or abstained from voting on the de-SPAC transaction, such director must be identified and the reasons for such vote disclosed.

Commentary: Many of the new requirements regarding board determinations (e.g., describing the material factors the board of directors considered when making any determination about the transaction) will not significantly change disclosure practices. We note the adopted rule creates no additional procedural requirements that are not already applicable to de-SPAC transactions. In practice, a de-SPAC transaction is usually approved by the unanimous vote of its board of directors, thus the requirement to disclose reasons for a vote against a proposed transaction is unlikely to have a meaningful effect. Although the SEC stated that the final rules do not require fairness opinions be obtained in connection with a de-SPAC transaction, we expect the trend towards obtaining a third-party fairness opinion of a business combination transaction to SPAC shareholders to continue.

Adoption of Other Disclosure-Related Requirements.

The SEC adopted various additional items in Regulation S-K that mandate disclosures concerning de-SPAC transactions. In large part, these mandates reflect current disclosure practice. We highlight the following additional disclosure requirements of note:

- Item 1603 of Regulation S-K requires expanded disclosure regarding SPAC sponsors, their compensation, potential dilution of purchaser's equity interests and agreements in place with the SPAC. Registrants must disclose the controlling persons of a sponsor and any persons who have a direct or indirect material interest in the sponsor vehicle. All compensation paid to, earned by or awarded to the sponsor, its affiliates and promoters must be disclosed. Any non-redemption agreements between the sponsor and the SPAC and any agreement regarding restrictions on whether the sponsor may sell or transfer the SPAC securities must be described in detail. Actual and potential conflicts of interest between the sponsor and the SPAC, the sponsor and the unaffiliated securityholders of the SPAC and any fiduciary duties held by the SPAC officers and directors must be fully described.
- The rules require a 20-calendar-day minimum dissemination period for disclosure documents filed for de-SPAC transactions where consistent with local law.
- A re-determination of smaller reporting company filer status following the completion of a de-SPAC transaction is now required. The re-determination is to be reflected in filings beginning 45 days after the de-SPAC transaction is completed.
- All SPAC IPO prospectuses and disclosure documents filed in connection with de-SPAC transactions must be disclosed in Inline XBRL. This is the only new regulation that will go into effect one year after the rules are adopted.

Commentary: These new Regulation S-K items are largely consistent with market practice and will create incremental additional burden on the disclosure process. Registrants should note that XBRL "tagging" does have a lead time that should be built into transaction timelines.

Application to non-SPAC shell companies.

The SEC also indicated that Rule 145a will apply to "any company" that sells or disposes of legacy assets or operations in connection with or as part of a plan to combine with a non-shell private company. The SEC further said this is true regardless of whether such assets and operations are disposed of prior to or after the business combination is consummated.

Commentary: The SEC indicated that it will apply Rule 145a to transactions that substantively convert a private company into a public company. Together with SEC comments in its review of recent non-SPAC reverse merger transactions, there is a continuing trend of the SEC taking an aggressive view of the shell status of the combined company. If the transaction is deemed to involve a shell company, the post-combination company would be an "ineligible issuer" for three years and would have limited use of the broad communication rules, and its investors would be unable to rely on Rule 144 unless the company complied with Rule 144(i)(2).

Conclusion

Since the release of the proposed rules in March 2022, participants in de-SPAC transactions have largely been operating as if many of the proposed rules had been adopted and final. Therefore, many of the newly mandated requirements are already reflected in current market practice regarding the structure, disclosure and procedures of SPAC IPOs and de-SPAC transactions. The new rules, while expansive, should not be a prohibitive burden on participants in SPAC transactions generally.

The final rules can be found here: Final Rules: Special Purpose Acquisition Companies, Shell Companies, and Projections

---

1. We note that this is generally consistent with past positions taken in the industry on the matter, including the joint statement in 2021 by more than 60 of the nation's leading law firms, including Kirkland & Ellis LLP, that underscored that a SPAC is not an investment company under the Investment Company Act if it (i) follows its stated business plan of seeking to identify and engage in a business combination with one or more operating companies within a specified period of time and (ii) holds short-term treasuries and qualifying money market funds in its trust account pending completion of its initial business combination. ↩

Authors

Christian O. Nagler, P.C.

Partner / New York

Peter Seligson, P.C.

Partner / New York

Allison Bell

Partner / New York

Tamar Donikyan

Partner / New York

Mathieu Kohmann

Partner / New York

Related Services

Practices

- Capital Markets

Suggested Reading

- 06 April 2022 Kirkland Alert The SEC Proposes New Rules Regarding SPACs
- 02 September 2021 Kirkland Alert Over 60 of the Nation’s Leading Law Firms Respond to Investment Company Act Lawsuits Targeting the SPAC Industry
- 15 April 2021 Kirkland Alert A SPAC Curveball