ALERTS

SEC Adopts Final Rules on SPAC IPOs and De-SPACs to More Closely Align With Traditional IPO Requirements

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The adopting release also provides guidance on potential underwriter liability in De-SPACs and the applicability to SPACs of the Investment Company Act of 1940.

On Jan. 24, 2024, the Securities and Exchange Commission ("SEC") adopted long-awaited rule changes ("Final Rules") applicable to special purpose acquisition companies ("SPACs") and provided related guidance in its adopting release ("Adopting Release").[1] The Final Rules largely codify the substance of the rules proposed by the SEC on March 30, 2022 ("Proposed Rules"), which were intended to enhance investor protections in SPAC initial public offerings ("IPOs") and initial business combinations ("De-SPACs").[2] We previously summarized the Proposed Rules, available here.[3] While the SEC largely adopted the Proposed Rules in substance, this *Alert* highlights the key modifications and changes from the Proposed Rules, as well as the potential impact of guidance the SEC provided on underwriter liability and the application of the Investment Company Act of 1940, as amended ("ICA") to SPACs instead of adopting those controversial portions of the Proposed Rules.

New Specialized SPAC Disclosure Requirements:

1. *Sponsors:* The Final Rules largely codify the additional disclosures proposed regarding: (i) the experience and material roles played by, as

well as a description of any material agreements between, each party to a De-SPAC, including the sponsor; (ii) the identity of the control persons of the sponsor; and (iii) information regarding compensation paid to the sponsor and promoters of a De-SPAC. In addition, the Final Rules require disclosure of transfers of SPAC securities by SPAC sponsors, their affiliates and promoters. However, the SEC declined to adopt the proposal requiring disclosure of an organizational chart showing the relationship between the SPAC and its sponsors.[4]

2. *Dilution:* The Final Rules largely adopt the proposal relating to additional disclosure of potential dilution, with the exception of the proposed tabular sensitivity analysis.[5]

3. *Fairness of the Business Combination Transaction, Procedural Requirements and Related Disclosure*

The Final Rules largely adopt the Proposed Rules' disclosure requirements relating to the fairness of a De-SPAC to the SPAC's unaffiliated security holders, with the following modifications:

- The Final Rules require disclosure of any fairness determination of a De-SPAC only if such determination is required by the law of the jurisdiction of the SPAC's organization, (i.e., such as Delaware law requires for a merger transaction).[6] In addition, the Final Rules clarify that this disclosure need only include factors which were considered in connection with any fairness determination, including, if applicable, any related financing transaction. [7]

- Further, if the SPAC or its sponsor has received any report, opinion (other than an opinion of counsel) or appraisal from a third party, the Final Rules require disclosure of the substance of such report in connection with a De-SPAC.[8]

Aligning De-SPACs More Closely With IPOs

With the adoption of the Final Rules, the SEC aims to better align traditional IPO and De-SPAC disclosure requirements, including: (i) non-financial statement disclosure requirements; (ii) minimum dissemination time periods; and (iii) requiring that a target company be a co-registrant on certain filings. The SEC made a few minor changes to the Proposed Rules, including:

- Extending the time period for re-determining smaller reporting company status from within four business days following the consummation of a De-SPAC to within 45 days following the consummation of a De-SPAC. [9]

- The SEC declined to adopt the proposed rule codifying that named underwriters who participate in a SPAC IPO or in financings related to a De-SPAC are deemed underwriters.[10] Instead, the SEC issued guidance in the Adopting Release regarding statutory underwriter status in De-SPACs, which we discuss below.[11]

Enhanced Projections Disclosure

The SEC generally adopted the Proposed Rules regarding the disclosure of projections, with certain clarifying revisions, such as changing the requirement that a registrant in a De-SPAC provide a statement regarding whether or not any projections put forth still accurately reflects the views of the board and management "as of the date of filing."[12] Instead, the Final Rules require a registrant to provide such statement "as of the most recent practicable date prior to the date of the disclosure document required to be disseminated to security holders".[13]

The Final Rules exclude forward-looking statements made in SPAC IPO and De-SPAC filings from the safe harbor provided by the Private Securities Litigation Reform Act of 1995 ("PSLRA"). The change is intended to more closely align the disclosure regime with a traditional IPO, because a De-SPAC serves a similar role for the private target company as a traditional IPO, and there is similar information asymmetry between issuers and public investors.[14] This change may raise particular issues in De-SPACs that include fairness disclosure, as discussed above, because often one basis for any such fairness determination is based on projections, which have generally been disclosed in De-SPACs with the benefit of the PSLRA safe harbor. However, it is unclear whether the unavailability of the PSLRA safe harbor will materially change market practice, as projections are already commonly included in many sectors of the traditional IPO market, such as master limited partnerships, yieldcos and REITs. Courts have often reviewed such forward-looking information under the "bespeaks caution" standard of review, requiring sufficient cautionary language to accompany forward looking statements, a path that may provide a similar framework for review and inclusion in the SPAC context.

Underwriter Liability Guidance

A focus of the SEC's SPAC rulemaking has been to clarify the gatekeeper role provided by investment banks involved in bringing a target company public by De-SPAC as compared to the role of investment banks acting as underwriters in a traditional IPO and the related liabilities attached to each role. Instead of codifying the Proposed Rules related to statutory underwriters in a De-SPAC, the SEC instead provided guidance in the Adopting Release reaffirming its view that statutory terms such as "distribution" and "underwriter" apply broadly and flexibly, according to the facts and circumstances of the applicable transaction.[15] The statutory definition of "underwriter" is not limited to traditional underwriters in firm commitment IPOs, and encompasses anyone who is selling on behalf of the issuer or participating in the distribution of securities in the combined company to the SPAC's investors and broader public.[16] In the context of a De-SPAC, the guidance states that a distribution occurs when the SPAC's investors receive an interest in the combined operating company.[17] Thus, depending on the facts and circumstances of the transaction, a participating investment bank might be deemed a "statutory underwriter" even if the entity is not named as an underwriter in any offering or may not be engaged in any activities that are typical of a named underwriter in a traditional capital raising.[18] In these cases, Section 11 of the Securities Act of 1933[19] would apply as it would to anyone acting as an underwriter with respect to a De-SPAC, and any such person would be liable for any material misstatement or omission in the registration statement.[20]

Status of SPACs under the Investment Company Act of 1940

In August 2021, two law professors, one a former SEC commissioner, filed a series of lawsuits claiming that SPACs were subject to the ICA, despite market practice to the contrary. Within days, most major private law firms active in the market joined together to issue a joint statement rebutting the claim, including Schulte.[21] Perhaps in response to this controversy, the Proposed Rules included a safe harbor from the ICA, largely based on executing documentation with respect to a De-SPAC within 18 months of the IPO and completing the De-SPAC within 24 months of the IPO. However, the SEC declined to adopt the safe harbor in the Final Rules because of the "fact-based, individualized nature" of whether a SPAC meets the definition of an "investment company" under the ICA. Noting that "a SPAC could be an investment company at any stage of its operation," the SEC concluded that a specific duration limitation safe harbor would not be appropriate.[22]

Instead, the SEC provided guidance to assist SPACs in analyzing their potential status as an "investment company" under Sections 3(a)(1)(A) [23] and 3(a)(1)(C)[24] of the ICA ("ICA Guidance"). Specifically, the ICA Guidance, the SEC noted, will assist SPACs in applying the five-factor test that the SEC and its Staff has historically used in determining whether an issuer is an investment company under Section 3(a)(1)(A), which are known as the *Tonopah* factors. [25] Typically, a SPAC is organized for the purpose of completing a De-SPAC with one or more operating companies, providing its shareholders with the opportunity to invest in a public entity that will be, or will control, an operating company. Nevertheless, the SEC highlighted certain activities a SPAC could engage in that raise "serious questions" about its status as an investment company under the ICA.

1. *Nature of Assets and Income* – In general, a SPAC would likely not be considered an investment company if it limits its holdings prior to a De-SPAC to cash and the types of securities held by SPACs today, such as US government securities and money market funds and if its primary business is to complete a traditional initial business combination as a De-SPAC.[26]In contrast, a SPAC that invests in corporate bonds or proposes or forms an intent to acquire a minority interest in a target company as a passive investor would affect the SPAC's status under the ICA. Specifically, absent an exclusion, a SPAC that "owns or proposes to acquire 40% or more of its total assets in investment securities" might trigger ICA registration.[27]

2. *Management Activities* – The SEC also guided SPACs to evaluate the actions of its "officers, directors and employees." For example, if the management team of a SPAC was spending a considerable amount of time actively managing the SPAC's portfolio of securities (for these purposes including US government securities or money market funds) or was otherwise not actively seeking a De-SPAC transaction, this would weigh more heavily in favor of the SPAC's primary purpose being the business of investing, reinvesting or trading in securities. Relatedly, triggering ICA registration, could cause SPAC sponsors to come within the definition of 'investment adviser' ...in the Investment Advisers Act of 1940.

3. *Duration* – The SEC's guidance also focused on the duration of the SPAC, noting that "a SPAC's activities may become more difficult to

distinguish from those of an investment company the longer the SPAC takes to achieve its stated business purpose." In evaluating a SPAC's duration within the framework of the ICA, the SEC pointed to the 12-month duration permitted for so-called "transient investment companies" under the ICA[28] and the 18-month duration permitted for blank check companies[29]. Specifically, the SEC noted that "a SPAC should reassess its status and analyze whether it has become an investment company if it has . . . failed to enter into an agreement with a target company beyond such timelines." This durational requirement has the potential to significantly shorten the potential life of a SPAC, which had generally been three to three-and-a-half years under the listing rules of the NYSE and NASDAQ, subject to providing public shareholders with earlier redemption opportunities agreed during the IPO process. The combination of the durational guidance and the guidance related to assets held in trust may cause SPACs to err on the side of holding amounts in cash or demand deposit accounts, particularly the longer the SPAC takes to complete a De-SPAC.

4. *Holding Out* – In response to concerns that SPACs had, in some instances, been viewed primarily as fixed-income investment opportunities (i.e., means to gain exposure to a portfolio of securities), the SEC cautioned SPACs from holding themselves out as such an investment alternative. In other words, the SPAC's investment in securities, if any, should be merely a vehicle to hold the amounts in trust while the SPAC seeks out a suitable De-SPAC opportunity, not the focus of the SPAC.[30]

5. *Merging with an Investment Company* – Lastly, a SPAC that engages in, or proposes to engage in, a De-SPAC with an investment company would itself likely be considered an investment company requiring registration even prior to completion of the De-SPAC. This is because once it settles on an investment company as a potential target, the SPAC's primary purpose likely shifts to the business of being an investment company (as compared to a "typical" SPAC that is engaged in the business of merging with an operating company).

In summary, although the Final Rules do not codify a safe harbor or contradict the existing ICA regime that applies to SPACs, it does provide a framework for SPACs to analyze their status under the ICA. Depending upon the facts and circumstances, a SPAC may meet the definition of investment company under the ICA at any time in the lifecycle of a SPAC.

Issuers that meet the definition of investment company but fail to comply with the ICA could, among other things, be subject to enforcement action by the SEC or to private litigation. To the extent that a SPAC's activities may cause it to fall within one or more of these definitions, a SPAC should consider options that would bring it into compliance with the ICA such as moving its assets to demand deposits, changing its operations, winding down its operations or registering as an investment company under the ICA.

What This Might Mean

Because the Final Rules largely adopt the Proposed Rules or the Adopting Release provides guidance consistent with the substance of the Proposed Rules, market practice has largely adjusted to these rules. While this may be a significant deviation from the historical practices related to SPACs the Final Rules are unlikely to have a significant effect on a market that has cooled significantly since the initial proposal in 2022.

Implementation Timeline

The Final Rules will become effective 125 days after publication in the Federal Register, with the additional requirement to comply with structured data requirements a year later.[31]

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[1] *See* Securities and Exchange Commission, Final Rules, Special Purpose Acquisition Companies, Shell Companies, and Projections, Release No. 33-11265 (Jan. 24, 2024), available here ("Final Rules").

[2] *See* Securities and Exchange Commission, Proposed Rules, Special Purpose Acquisition Companies, Shell Companies, and Projections, Release No. 33-11048 (March 30, 2022), available here.

[3] Charles J. Clark, Eleazer Klein, Gayle R. Klein, Shaina L. Maldonado and David M. Rothenberg, SEC Proposes Rules to Increase SPAC Disclosure Requirements to More Closely Align with Traditional IPO Requirements, Schulte, Roth & Zabel LLP (May 18,

2022), https://www.srz.com/resources/sec-proposes-rules-to-increase-spac-disclosure-requirements-to.html?bcrFallback=bcrFallback%23_ftnref17.

[4] Final Rules, *supra* note 1,. at 53.

[5] *See id.* at 95.

[6] *See id.* at 137.

[7] *See id.* at 143-4.

[8] *See id.* at 149.

[9] *See id.* at 223.

[10] *See id.* at 282.

[11] *See id.* at 283.

[12] *See id.* at 356.

[13] *See id.* at 356-7.

[14] *See id.* at 374 and 462.

[15] *See id.* at 283.

[16] *See id.* at 287.

[17] *See id.* at 285.

[18] *See id.* at 287-8.

[19] Section 11 of the Securities Act of 1933 provides investors with a way to hold issuers, officers, underwriters and others liable for damages caused by untrue statements of fact or material omissions of fact within registration statements at the time they become effective.

[20] *See id.* at 288.

[21] https://www.srz.com/images/content/1/9/191016.pdf

[22] The SEC stated that “ depending on the facts and circumstances, a SPAC may meet the definition of investment company under Sections 3(a)(1)(A) or 3(a)(1)(C) or both” and should be evaluated by the SPAC “both at its inception and throughout its existence.”

[23] Section 3(a)(1)(A) of the ICA defines an "investment company" as any issuer that is or holds itself out as being engaged primarily, or proposes to be engaged primarily, in the business of investing, reinvesting, or trading in securities.

[24] Section 3(a)(1)(C) of the ICA defines an "investment company" as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and that owns or proposes to acquire investment securities having a value exceeding 40% of the value of the company's total assets (exclusive of Government securities and cash items) on an unconsolidated basis. Section 3(a)(2) of the ICA generally defines "investment securities" to include all securities except Government securities, securities issued by employees' securities companies, and securities issued by majority-owned subsidiaries of the owner which are not investment companies or certain private investment companies.

[25] To assess an issuer's primary engagement under Section 3(a)(1)(A), and in other contexts under the ICA, the SEC, its Staff and the courts historically have looked at (1) the company's historical development; (2) its public representations of policy; (3) the activities of its officers and directors; (4) the nature of its present assets; and (5) the sources of its present income (known as the "*Tonopah* factors"). See In the Matter of Tonopah Mining Co., 26 S.E.C. 426 (July 21, 1947).

[26] The SEC highlights that "[w]hile U.S. Government securities and money market funds are securities for purposes of Section 3(a)(1)(A), asset composition is only one of the factors that should be considered in analyzing a SPAC's status under the [ICA]. For example, an issuer that holds these assets, but whose primary business is to achieve investment returns on such assets would still be an investment company under Section 3(a)(1)(A)."

[27] The SEC notes that "such activities would also weigh in favor of a SPAC being considered to be primarily engaged in the business of investing, reinvesting, and trading in securities under Section 3(a)(1)(A)."

[28] Rule 3a-2 of the ICA provides a one-year safe harbor to so-called "transient investment companies" which are issuers that, as a result of an unusual business occurrence may be considered an investment company under the statutory definitions but intend to be engaged in a non-investment company business.

[29] Rule 419 of the ICA.

[30] For example, the SEC highlighted, "if a SPAC were to market itself primarily as a fixed-income investment, as an alternative to an investment in a mutual fund, or as an opportunity to invest in Treasury securities or money market funds, it would likely be holding itself out as being primarily engaged in the business of investing, reinvesting or trading in securities... [and] would likely be an investment company under Section 3(a)(1)(A)."

[31] Final Rules, *supra* note 1, at 2.

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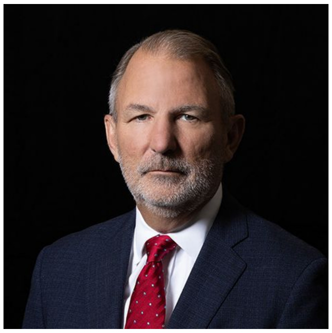

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