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SEC Adopts Long-Awaited SPAC Rules

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Summary

On January 24, 2024, nearly two years after the SEC initially proposed industry-chilling rules overhauling the treatment of special purpose acquisition companies ("SPACs") in their IPOs and de-SPAC transactions, the SEC adopted final rules. The adopting release is quite extensive, clocking in at 581 pages. The rules add new Subpart 1600 to Regulation S-K, which relates to the disclosure requirements for SPAC IPOs and de-SPAC transactions, and new Article 15 to Regulation S-X, which "more closely aligns" the financial reporting requirements for de-SPACs with those of traditional IPOs. The final rules will be effective 125 days following their publication in the Federal Register. A brief overview of the new requirements included in the final rules is set forth below.

Disclosure Requirements:

- **Sponsors**: Under the requirements of the final rules, registrants will be required to provide detailed disclosure regarding the SPAC sponsor, its affiliates and promoters, including, among other things:
  - their respective experience with "organizing" SPACs and the extent of their involvement with other SPACs;
  - their business overall;
  - their material roles and responsibilities in directing and managing the SPAC;
  - any arrangements between the SPAC sponsor and the SPAC or its directors, officers, and affiliates related to determinations of whether to enter into a de-SPAC transaction;
  - details regarding the nature and amount of their compensation for any and all services provided to the SPAC and any reimbursements paid to them upon consummation of the de-SPAC transaction;
  - the price and number of securities issued or to be issued to them and details regarding when their ownership in SPAC securities were or could be directly or indirectly transferred, surrendered, or cancelled;
  - the identity of the controlling persons of the SPAC sponsor and details regarding the persons who have direct or indirect material interests in the SPAC sponsor;

  - arrangements between the SPAC sponsor and unaffiliated SPAC shareholders related to the redemption of SPAC securities; and
  - detailed tabular disclosure of material arrangements regarding restrictions on the sale of SPAC securities by the sponsor and its affiliates.

- **Conflicts of Interest**: The final rules call for disclosure related to conflicts of interest among SPACs, SPACs' affiliates, and investors.
- **Dilution**: The final rules include required disclosures related to circumstances that may cause dilution to an investor, including, for example, dilution caused by compensation paid to the SPAC sponsor or its affiliates, incurred as a result of financing transactions occurring alongside a de-SPAC transaction or suffered due to redemptions.
- **Board Opinion Regarding Advisability of de-SPAC**: The final rules require disclosure regarding a board's evaluation of a de-SPAC transaction, including whether the body determines the combination to be advisable and in the best interest of the SPAC and its shareholders. The rules call for disclosure related to a non-exhaustive list of factors considered in connection with the decision to pursue a de-SPAC transaction, including any third-party reports, opinions, or appraisals materially related to the transaction, the target company's valuation, projections, financing terms, and dilution.
- **New Cover Page Disclosure**: Pursuant to the final rules, registrants will be required to include certain key disclosures (e.g., related to sponsor compensation, dilution, conflicts of interest, redemptions and related limitations, runway to complete a de-SPAC transaction, fairness of the de-SPAC transaction, related financings transactions, etc.), in a standardized format, on the cover page and in the prospectus summary of registration statements filed in connection with SPAC IPOs and de-SPAC transactions.
- **Target Company**: The new rules will require significantly expanded disclosure related to the target company in a de-SPAC transaction, including, among other things:
  - Item 101 of Regulation S-K or the Description of Business section;
  - Item 102 of Regulation S-K of the Description of Property section;
  - Item 103 of Regulation S-K or the Legal Proceedings section;
  - Item 304 of Regulation S-K or the Changes in and Disagreements With Accountants on Accounting and Financial Disclosure section;
  - Item 403 of Regulation S-K or the Security Ownership of Certain Beneficial Owners and Management section; and
  - Item 701 of Regulation S-K or the Recent Sales of Unregistered Securities section.
- **De-SPAC Background**: The new rules include detailed disclosure requirements related to the background, reasons, terms, and effects of a contemplated de-SPAC transaction and any related financing arrangements.

Liability:

- **Target Company as Co-Registrant**: Pursuant to the final rules, the target company in a de-SPAC transaction will be considered an issuer and its principal financial officer, controller, or principal accounting officer, and a majority of its board of directors will be required to sign any Securities Act registration statement filed in connection with a de-SPAC transaction, thereby subjecting such new individuals to Section 11 liability for material misstatements or omissions under the Securities Act.

- **Underwriter Status**: The SEC declined to adopt its proposed rule pursuant to which parties acting as an underwriter in a SPAC IPO also participating in a distribution of securities (e.g., PIPE offering) in the de-SPAC transaction would be deemed an underwriter with respect to the de-SPAC transaction. Rather, the SEC guides that "the statutory definition of underwriter, itself, encompasses any person who sells for the issuer or participates in a distribution associated with a de-SPAC transaction" and that it will interpret the terms "distribution" and "underwriter" "broadly and flexibly" in light of the facts and circumstances of a particular transaction, including a de-SPAC transaction.

- **Projections**: The final rules include enhanced disclosure requirements related to the provision of projections in de-SPAC transactions, including information regarding the material bases of and material assumptions underlying the projections.

- **Forward-looking Statements**: The final rules include new definitions of "blank check company" in Rule 405 of the Securities Act and Rule 12b-2 of the Exchange Act, rendering the Private Securities Litigation Reform Act of 1995's safe harbor for forward-looking statements unavailable to SPACs.

Other Technical Changes:

- **Minimum Dissemination Period for Shareholder Communications**: The final rules necessitate a minimum dissemination period of 20 calendar days for prospectuses, proxy or information statements filed in connection with a de-SPAC transaction, to the extent allowable by governing law.

- **Evaluation of Smaller Reporting Company (SRC) Status**: Pursuant to the final rules, the combined company will be required to reevaluate its SRC status following closing of a de-SPAC transaction and to reflect any re-determination in filings made 45 or more days following closing.

- **De-SPAC Deemed Sale of Securities to SPAC Shareholders**: The new rules provide that "any direct or indirect business combination of a reporting shell company (that is not a business combination related shell company) involving another entity that is not a shell company" is considered to be a sale of securities for purposes of Section 2(a)(3) of the Securities Act.

- **Enhanced Financial Statement Requirements**: New Article 15 of Regulation S-X is geared at making the financial statement requirements applicable in a de-SPAC transaction more similar to those applicable in the context of a traditional IPO.

- **Structured Data Requirements**: Like all recent SEC rules, the final rules include certain structured data requirements.

Investment Company Status

The SEC decided not to adopt a safe harbor from the "investment company" definition under the Investment Company Act for SPACs that complied with the safe harbor's conditions regarding the SPAC's asset classes, activities, primary engagement, and duration (including that in order to rely on the safe harbor, the SPAC would need to enter into a definitive business combination agreement within 18 months after its IPO and close the transaction within 24 months). Rather, the SEC guides that the investment company determination must be considered in light of the facts and circumstances and provides further guidance regarding what actions might push a SPAC toward investment company status.

Effective Date and Compliance

The rules will be effective 125 days following their publication in the Federal Register, which the SEC believes to be ample time for pending or planned transactions to make their initial public filings, though any filings made following the effective date of the new rules need to comply with such rules. In addition, registrants will have 490 days following publication in the Federal Register to comply with the structured data requirements set forth in the rules.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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