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Memorandum

SEC Proposes Sweeping Changes to SPAC Regulatory and Disclosure Regime

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Overview

On March 31, 2022, the U.S. Securities and Exchange Commission (SEC) proposed "rules intended to enhance investor protections in IPOs by special purpose acquisition companies (SPACs) and in subsequent business combination transactions between SPACs and private operating companies." This proposal to increase regulation of SPACs in both IPOs and in de-SPAC transactions is the culmination of significant activity by the SEC on a variety of SPAC-related topics over the past two years, which included extensive comments by the SEC Staff on SPAC SEC filings, Staff statements on accounting and disclosure matters, public speeches by SEC Staff members, and new Staff Compliance and Disclosure Interpretations (C&DIs). The SEC release reflects a concerted effort by the SEC to change a number of market practices at various phases of the SPAC lifecycle. The scope of the SEC proposal is formidable and has created significant uncertainty for participants in SPAC IPOs and de-SPAC transactions on a number of points even prior to the adoption of any final rules by the SEC.

The proposed rules, which are subject to a comment period expected to last until at least May 31, 2022,[1] are focused on the following areas:

- new specialized disclosure requirements for SPACs;
- modifying disclosure requirements and expanding legal obligations in de-SPAC transactions to more closely mirror those in traditional IPOs;
- additional guidance on the use of projections in SEC filings to address SEC concerns about their reliability;
- a new safe harbor for SPACs under the Investment Company Act of 1940 (the 1940 Act);
- the treatment of business combination transactions involving reporting shell companies under the Securities Act of 1933 (the Securities Act); and
- the amendment of various financial statement requirements relating to SPACs under Regulation S-X.

[1] The SEC deadline for comments is the later of 30 days after publication of the proposal in the Federal Register or May 31, 2022 (which is 60 days after the SEC posted the release to its website).

Set forth below is a summary of each of these key aspects of the proposal, along with considerations and potential implications for SPAC market participants.

Specialized Disclosure Requirements for SPACs

Building on themes that the Staff has highlighted in many SEC comment letters over the past year, the SEC proposed additional detailed disclosure requirements for SEC filings by SPACs related to three particular topics: information relating to the sponsor, potential conflicts of interest and shareholder dilution.

- *Sponsors*. Given the central role of the sponsor in the activities of SPACs, the proposed rules would require additional disclosure about the sponsor, its affiliates and any promotors[2] of SPACs in filings with the SEC in connection with SPAC IPOs as well as in de-SPAC transactions. Proposed Item 1603(a) of Regulation S-K under the Securities Exchange Act of 1934 (the Exchange Act) would require SPACs to disclose the experience, roles and responsibilities of the sponsor, its affiliates and promoters in SEC filings related to SPAC IPOs and de-SPAC transactions. Among other requirements, proposed Item 1603(a) would require disclosure of the nature and amounts of all compensation that has been, or will be, awarded to the sponsor, its affiliates and any promoters for services rendered to the SPAC. The proposed Item would supplement existing Items 701 and 404 of Regulation S-K, which require disclosure of the terms of private securities transactions between a SPAC and its sponsor, and disclosure of certain related-party transactions, respectively.
- *Conflicts of Interest*. The SEC highlighted that typical SPAC structures, which typically provide a sponsor with a so-called "promote" that is earned upon the closing of a business combination, can create a number of possible conflicts of interest. To address these potential conflicts of interest, the proposed rules would require incremental and standardized disclosures relating to these potential conflicts via proposed Items 1603(b)-(c) of Regulation S-K. Item 1603(b) would require disclosure of any actual or potential material conflict of interest between (1) the sponsor, its affiliates or the SPAC's officers, directors, or promoters, and (2) unaffiliated shareholders. Item 1603(c) would require the disclosure of any fiduciary duty owed by each SPAC officer and director to other companies. These proposed Items largely codify existing SEC guidance for SPACs and are not likely to pose significant challenges for most SPACs.
- *Shareholder Dilution*
  - *IPO Stage*. To address potential sources of shareholder dilution arising from the typical SPAC structure (redemptions, sponsor compensation, underwriting fees, warrants and convertible securities, PIPEs, etc.), the SEC proposed new disclosure requirements for SPAC IPOs.
    - SPACs would be required to provide a description of material potential sources of future dilution (such as forward purchase agreements), as well as tabular disclosure of the amount of potential

[2] Rule 405 of the Securities Act defines a promoter as ". . . Any person who, acting alone or in conjunction with one or more persons, directly or indirectly takes initiative in founding and organizing the business or enterprise of an issuer . . . ."

future dilution from the public offering price that non-redeeming SPAC shareholders could experience.

- SPACs would also need to provide simplified tabular disclosure incorporating a range of potential redemption levels on the prospectus cover page for a SPAC IPO.

◦ *De-SPAC Transaction Stage*. The SEC also proposed dilution disclosure requirements for the registration statements filed in connection with de-SPAC transactions. The proposal includes tabular disclosure of public shareholder dilution at various redemption levels and additional sources of potential dilution faced by non-redeeming shareholders.

- *Fairness Disclosure*. Additionally, in connection with de-SPAC transactions, the proposed rules require detailed descriptions of the de-SPAC transaction and related financing, along with a statement from the SPAC as to its view of the fairness of the de-SPAC transaction to unaffiliated shareholders in the registration statement. Although transaction details are already required by existing regulations (albeit less explicitly than under the proposed rules), the proposed statement of fairness would be a new requirement that is unprecedented in our experience. For example, in a traditional M&A transaction, the board of the target (and, depending on the structure of the deal, the board of the acquiror too) typically recommends to shareholders that they vote to approve the transaction, but does not express an opinion as to whether or not the transaction is "fair" to any particular class of shareholders. As such, we anticipate this requirement to express an opinion as to "fairness" would lead to an increase in requests by boards of directors for fairness opinions from financial advisors. Such opinions are typically narrowly focused on the price being paid in the transaction, and do not address concepts of "relative fairness"—*i.e.*, fairness of the consideration being paid to one class of shareholders (such as the unaffiliated common shareholders) in relation to the consideration paid to another class of shareholders (such as the sponsor-affiliated shareholders). Further, to the extent a fairness opinion is obtained, the proposed rules would require disclosure of any fairness opinion received by a SPAC's board to be included in the registration statement for the de-SPAC transaction. Based on the SEC's analysis, only 15% of de-SPAC transactions in 2021 referenced receipt of a fairness opinion by the SPAC in connection with an initial business combination.

Aligning Disclosures and Legal Obligations Between De-SPAC Transactions and Traditional IPOs

UNDERWRITER LIABILITY

- *Underwriters*. The SEC release sets forth the SEC's view that underwriters form an essential link in the distribution of securities from an issuer to investors.[3] In a traditional IPO, banks serving as underwriters with a firm underwriting commitment are treated as underwriters with prospective underwriter liability under the Securities Act. After serving as an underwriter on a SPAC IPO, a bank often plays various and

[3] The SEC cites Section 2(a)(11) of the Securities Act which defines an "underwriter" as "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation of any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking."

frequently multiple additional roles in connection with a de-SPAC transaction, including serving as a placement agent for any related PIPE offering, a financial advisor to the SPAC or target company and/or a capital markets advisor. To date, most market participants have considered that banks providing any of these additional complementary services were not serving in these capacities as underwriters with potential underwriter liability under the Securities Act. In the release, the SEC proposed a much broader interpretation of the types of transaction participants that may be captured by the concept of a "statutory underwriter"[4] and would include any underwriter of a SPAC IPO that also provides services to the SPAC or target in connection with the de-SPAC transaction. This liability could even apply to banks that do not provide any services in the de-SPAC transaction if they are entitled to receive any deferred underwriting fees from the SPAC's IPO upon the closing of a successful de-SPAC transaction. The SEC bases its theory of liability, in large part, on the notion that a de-SPAC transaction is a "distribution" of the securities of the combined company (*i.e.*, SPAC and target company) and the participation by banks in that distribution means that they should be considered statutory underwriters.

- *De-SPAC liability for IPO underwriters*. Under the Securities Act, Section 11 imposes potential liability on underwriters (and other parties) for any material misstatements or omissions by an issuer in a registration statement. Section 12(a)(2) of the Securities Act separately imposes potential liability on underwriters if they offer or sell a security by means of a prospectus or oral statement, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading, to any purchaser of a security. Consistent with the statutory underwriter theory noted above, the SEC's proposed Rule 140a provides for underwriter liability on the de-SPAC registration statement for any person that has acted as an underwriter in the SPAC IPO and participates in the de-SPAC transaction, or any related financing transaction, or otherwise facilitates (directly or indirectly) the de-SPAC transaction, as such party will be deemed to be engaged in the distribution of securities of the surviving public company resulting from the de-SPAC transaction.
- *Underwriter due diligence*. During the SEC open meeting at which the proposal was approved by the SEC, Chairman Gensler highlighted his view that banks should play a much greater "gatekeeper" role in de-SPAC transactions. The SEC release observes that underwriters in an IPO typically take various actions to ensure that the prospectus and registration statement do not include any material misstatements and omissions in connection with establishing their due diligence defense. These procedures include, for example, due diligence calls with company management and the issuer's independent auditors, negotiating a comfort letter with the issuer's independent auditors, obtaining a CFO certificate that covers certain financial

[4] The release clarified: ". . . the Commission's longstanding view is that, depending on facts and circumstances, any person, including an individual investor who is not a professional in the securities business, can be an 'underwriter' within the meaning of the Securities Act if that person acts as a link in a chain of transactions through which securities are distributed from an issuer or its control persons to the public." It separately noted that "Federal courts and the Commission may find that other parties involved in securities distributions, including other parties that perform activities necessary to the successful completion of de-SPAC transactions, are 'statutory underwriters' within the definition of underwriter in Section 2(a)(11). For example, financial advisors, PIPE investors, or other advisors, depending on the circumstances, may be deemed statutory underwriters in connection with a de-SPAC transaction if they are purchasing from an issuer 'with a view to' distribution, are selling 'for an issuer,' and/or are 'participating' in a distribution."

metrics, as well as requesting negative assurance letters from both company counsel and underwriter's counsel, which requires those law firms to conduct their own due diligence procedures. To date, banks have taken various approaches on due diligence in connection with de-SPAC transactions, often on the belief that they are not statutory underwriters when serving as financial advisors, PIPE placement agents or capital markets advisors.

- *Impact on SPAC IPO underwriters*. The proposed changes to the regulatory regime for SPACs could have a significant impact on banks participating in SPAC IPOs, de-SPAC transactions or both. As noted by Commissioner Peirce in her dissent to the proposal, the SEC's proposed rules potentially impact the operations, economics, and timeline of SPAC-related transactions. This observation is equally true for banks involved in de-SPAC transactions. The SEC envisions that banks will continue to provide similar services to SPACs and target companies in connection with de-SPAC transactions but will conduct additional due diligence procedures necessary to establish a due diligence defense. While that is one possible way that banks and other parties with potential statutory underwriter liability might respond to the proposed rules, it is also possible that some banks will find that the new regulatory regime dramatically alters the balance between the risks and rewards of being involved with de-SPAC transactions. We expect that banks will respond to the SEC's proposal by objecting to the SEC's characterization of SPAC IPO underwriters which advise on a de-SPAC transaction as being participants in a distribution of securities with potential underwriter liability. The additional costs and time necessary for banks to implement a thorough due diligence investigation in connection with advising parties engaged in de-SPAC transactions could make advising on de-SPAC transactions less attractive to banks—even before factoring in potential underwriter liability. The changing risk profile of de-SPAC transactions could affect the willingness of SPAC IPO underwriters to defer as large a portion of their underwriting commission as under current practice, or the prices they charge for services at the time of a de-SPAC transaction. Another possibility is that some banks will specialize in underwriting SPAC IPOs (and perhaps require greater upfront fees at the time of the IPO), but will not agree to have any deferred underwriting fees at risk and will not have any involvement in de-SPAC transactions to avoid potential underwriter liability.
- *Due diligence procedures*. The SEC release creates a difficult position for banks which were IPO underwriters and are currently serving as financial advisors, PIPE placement agents or capital markets advisors to active de-SPAC transactions. While the new rules will not be effective until final rules are adopted by the Commission, we anticipate that participants in de-SPAC transactions will likely seek to augment their scope of work with certain due diligence procedures, such as conducting due diligence calls with the SPAC and target company, requesting additional representations and indemnities in their engagement documentation and requiring deliverables that are customarily requested in IPOs, such as negative assurance letters and comfort letters; receipt of such assurances will likely require additional time, expense and certain representations to be made by requesting banks. It is unclear whether or when audit firms will be prepared to deliver comfort letters or whether law firms will be prepared to deliver negative assurance letters in connection with de-SPAC transactions in the manner that the SEC seems to envision in

the release. In the context of 144A offerings and some liability management transactions, banks have developed a practice of obtaining comfort letters, opinions and other certifications to bolster their due diligence defense. If there is resistance to delivery of such documents, banks may explore alternative solutions such as certificates and memos that document the diligence conducted while acknowledging their distinct roles in the SPAC context.

- *Impacts on other banks and advisors*. While the proposed rulemaking is limited to potential underwriter liability for underwriters of SPAC IPOs that participate in the de-SPAC transaction, the release leaves open the question of whether other participants such as banks serving only as financial advisors, PIPE placement agents or other advisors (such as law firms or accounting firms) should also be deemed to be statutory underwriters and subject to similar potential liability. We anticipate that such parties may also consider whether to similarly expand their due diligence procedures in light of this additional prospective liability. Conceivably, if all PIPE investors, banks, law firms, accounting firms and other advisors face prospective liability as a statutory underwriter in connection with de-SPAC transactions, they might simply cease participating in de-SPAC transactions.

CO-REGISTRANT LIABILITY

- *Target companies as co-registrants*. The SEC proposed that target companies, their boards of directors and certain executive officers sign the registration statement and thereby take on potential liability under Section 11 of the Securities Act. The Commission views a de-SPAC transaction as a method of introducing a private company to the investing public and believes that having the target company take potential liability as a co-registrant with the SPAC provides protection to investors consistent with IPO protection. Section 11 of the Securities Act imposes liability on the issuer and any person which has signed the registration statement for any material misstatements or omissions in the registration statement, subject to a due diligence defense for all parties other than the issuer.

- *Impacts on target company directors and officers*. The possibility of Securities Act liability will require target company directors and officers who sign the registration statement to demonstrate that they have made a reasonable inquiry into statements in the registration statement in order to establish their due diligence defense, including potentially requesting to be named as additional addressees for comfort letters and/or legal opinions/negative assurance letters being delivered to underwriters. In addition, target companies will need to consider whether their existing D&O insurance and indemnification policies are adequate for the types of additional exposures that the target company, as well as its directors and officers, could face in the event of a material misstatement or omission in the registration statement.

LIABILITY TO SPAC AND TARGET SHAREHOLDERS

- *Expansion of potential liability*. In proposing its theory that as part of a de-SPAC transaction, a SPAC is offering its securities, not only to target shareholders but also its own shareholders, the SEC has dramatically expanded the number of investors to whom the SPAC is making an offer and who could potentially claim that there has been a material omission or misstatement under Section 11 of the

Securities Act. In a traditional IPO, underwriters have potential underwriter liability on the securities sold in the IPO. In the SEC's proposed de-SPAC liability regime, SPACs and target companies and their respective officers and directors, as well as banks, would have potential liability to all target and SPAC shareholders, which increases the potential exposure to all parties. If the rules are adopted as proposed, this expansion of potential liability will likely be welcomed by plaintiffs and their counsel seeking to bring Securities Act cases where the stock price of the combined company declines after the closing of a de-SPAC transaction.

Projections

ADDITIONAL DISCLOSURES

- *Universal and SPAC-specific new requirements.* The proposal would increase disclosure obligations if projections are included in an SEC filing (*even in transactions not involving SPACs*, such as public company mergers) and require additional disclosure regarding projections when used in connection with business combination transactions involving SPACs. Currently, Item 10(b) of Regulation S-K provides management with the option to present in SEC filings its good faith assessment of a registrant's future performance, so long as management has a reasonable basis for such an assessment. Item 10(b) also includes certain formatting considerations for projections. Among other things, the proposed amendments would address the presentation of projections by companies with no history of operations and provide that the guidance in the Item also applies to projections of future economic performance of persons other than the registrant, such as the target company in a business combination. In addition, a new Item 1609 of Regulation S-K would apply to financial projections used in de-SPAC transactions and other transactions, and would set forth additional disclosure requirements relating to financial projections.

  Specifically, these proposed changes to Item 10(b) would require all registrants to provide:

  - a clear distinction of any projected measures not based on historical financial results or operational history;
  - equal prominence of actual historical results (or the absence of any operations) with projections; and
  - a clear definition or explanation of any non-GAAP financial measure included in the presentation of projections, accompanied by the corresponding GAAP measure and an explanation of why the non-GAAP financial measure was used instead of a GAAP measure.

  For projections prepared in connection with a de-SPAC transaction, the proposed Item 1609 would also require a registrant to provide the following disclosures:

  - the purpose for which the projections included in the registration statement 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 impact 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 each filing of the registration statement.

- *Implications*. The rule's dichotomy between SPACs and all issuers reaffirms the SEC's heightened concern about merger transactions in the SPAC context, but non-SPAC issuers might miss this proposed development given the provision's location in a voluminous SPAC proposal. Plausibly, the SPAC-specific provisions could apply to the use of projections in non-SPAC contexts. The enumerated required disclosures for both of the above categories impose some guardrails on the use of projections but are unlikely to be particularly onerous. Many deals with robust projections probably already satisfy the proposed criteria, except the provision related to a change in management's view may be less commonly employed. Nevertheless, as a practical matter, boards of directors already wrestle with this question (and whether disclosure is appropriate), especially for de-SPAC transactions with a protracted timeline. An affirmative disclosure requirement will provide investors with updates on a target's business prospects in connection with their evaluation of the business combination.

- Furthermore, it is not entirely clear how these new disclosure requirements relate to existing obligations under the federal securities laws to disclose the financial analyses underlying a fairness opinion, such as Item 1015(b) of Regulation MA. It is also not entirely clear how these new disclosure requirements relate to existing obligations under state law to disclose projections where shareholders are being asked to vote on a matter.[5]

ELIMINATION OF PSLRA SAFE HARBOR

- *Modified "blank check company" definition*. While the proposed changes to the use of projections would not likely quash usage of projections in isolation, the coupling of this change with the modifications to the Private Securities Litigation Reform Act (PSLRA) complicates the analysis for market participants. The PSLRA safe harbor is inextricably intertwined with the use of projections, as the PSLRA provides a safe harbor for forward-looking statements under the Securities Act and the Exchange Act, pursuant to which a company is protected from liability in any private right of action for forward-looking statements when, among other things, the forward-looking statement is identified as such and is accompanied by meaningful cautionary language. Although the safe harbor is not available to IPO issuers or to "blank check companies," until now, many SPACs have taken the view that they were permitted to rely on the safe harbor since the current definition of "blank check companies" does not necessarily capture SPACs, which are normally not formed pursuant to Rule 419 under the Securities Act. The SEC proposal would

[5] *See, e.g.*, *In re Pure Resources, Inc., Shareholders Litigation*, 808 A.2d 421 (Del. Ch. 2002).

amend the definition of "blank check company" (to remove the "penny stock" condition) to encompass SPACs, and would have the effect of making the safe harbor unavailable for disclosure in de-SPAC registration statements. The absence of the safe harbor protection could increase the rigor around the preparation of projections in de-SPAC deals because the safe harbor has given SPACs some reassurance about usage of projections, but we would not expect de-SPAC transactions to forego including projections in their proxy statements and registration statements given that this information will likely continue to be provided by the target to the board of the SPAC in evaluation of a potential acquisition transaction and, depending on the structure of the transaction, may even be required to be included by Regulation MA or state law concerns.

- *Practical implications*. Although IPO registration statements omit projections, projections still play a role in the IPO process, principally in engagement with analysts in modeling which informs pricing; thus, the absence of the protections of the PSLRA for IPO issuers does not entirely eliminate projections from traditional IPOs. In the case of de-SPAC deals, projections can be a critical factor in supporting the board's evaluation of a transaction, deriving a valuation for the business combination, marketing the deal, and providing the basis for a fairness opinion and recommendation to shareholders that they approve the transaction; this process of preparing projections for a de-SPAC transaction has some similarities to the preparation of a financial model for an IPO, but also has aspects that are unique to the M&A context which would support the continued use of projections notwithstanding elimination of the safe harbor. Although projections are not universally featured in all de-SPAC transactions (*e.g.*, some pre-revenue companies exclude them), they are widely embraced and market participants have touted the ability to use projections as an advantage to de-SPAC transactions. If the PSLRA becomes unavailable for de-SPAC transactions, the judicial "bespeaks caution" doctrine would also support inclusion of tailored and meaningful cautionary language to reduce or negate the reasonableness of reliance on the forward-looking statements and the materiality of those statements. The differentiation between these contexts would also support the differential availability (to de-SPAC transactions as compared to IPOs) under the current framework. We would also anticipate increased scrutiny of projections included in de-SPAC registration statements by banks with potential statutory underwriter liability as noted above.

Proposed Safe Harbor Under the 1940 Act

- *Existing practice*. SPACs with conventional structures have historically taken the position that they are not investment companies subject to the 1940 Act for a number of reasons, including the fact that their primary purpose is to consummate a business combination with a target company. There have been a few cases where market participants sought to come up with structural innovations to SPACs, which the Staff thought raised potential concerns under the 1940 Act.
- *New safe harbor for SPACs*. To guide SPACs in ascertaining when the SEC might view SPACs to be subject to the 1940 Act, the SEC proposed Rule 3a-10 under the 1940 Act, which would provide a safe harbor from the definition of "investment company" under Section 3(a)(1)(A) of the 1940 Act. The safe

harbor's conditions require SPACs to restrict their activities to their stated business purpose: acquiring assets to fund a de-SPAC transaction with an operating business within a specified timeframe. The proposed safe harbor has a few key components:[6]

- Prior to their business combination, SPACs may invest only in U.S. government securities, government money market funds and cash items, with a view towards preserving principal and liquidity of SPAC assets.
- SPACs must engage in a single de-SPAC transaction that will result in SPAC shareholders owning publicly-traded interests in an operating company (*i.e.*, not an investment company).
- After the de-SPAC transaction, the surviving company should have at least one class of securities listed for trading on a national stock exchange. The SEC proposed this requirement to ensure SPAC investors would benefit from the protections of stock exchange listing standards.
- SPACs must announce their de-SPAC transactions within 18 months and close within 24 months of the SPAC IPO, respectively.[7]
- To qualify for the proposed safe harbor, a SPAC would either need to announce its business combination or close it prior to the 18th or 24th month anniversary of its IPO, respectively; failure to satisfy such timing parameters would require unwinding and redemption of all public shares as soon as reasonably practicable. The proposed rule does not account for any extensions approved by SPAC shareholders.
- Additionally, the SEC proposed that the SPAC's board of directors would also need to adopt and memorialize an appropriate resolution evidencing that the company is primarily engaged in the business of seeking to complete a de-SPAC transaction.

- *Implications*. Though the SEC specifically stated in the release that SPACs would not be required to rely on the safe harbor, the SEC also indicated that the boundaries of the safe harbor delineate structures and practices that could begin to raise investment company regulation questions. Most SPACs with conventional structures already invest in assets permitted under the proposed safe harbor (such as treasury securities), intend to consummate a single business combination and intend to have a class of shares of the combined company listed on a stock exchange upon the closing of the de-SPAC transaction, so these elements of the safe harbor pose few issues for most SPACs. The element of the safe harbor that could pose a challenge to many SPACs is the requirement to announce a business combination within 18 months and to close the business combination within 24 months, or else to unwind promptly if either deadline is not met, regardless of whether shareholders have approved an extension. If adopted as

[6] The requirements are designed to track the five "Tonopah factors," used by the Staff and courts in analysis under Section 3(a)(1)(A) of the 1940 Act: (1) the issuer's historic development; (2) the issuer's public representation of policy; (3) the activities of the issuer's officers and directors; (4) the source of the issuer's present income; and (5) the nature of the issuer's present assets.

[7] The SEC noted that (1) as SPACs operate for longer periods of time, investors may begin to see their investment as a fund-like investment; and (2) Stock Exchange listing rules contemplating SPAC lifespans longer than the proposed safe harbor were not enacted for the same regulatory purposes as the 1940 Act.

proposed, a number of SPACs will likely not have satisfied one or both of these requirements by the time the final rules are adopted. The proposed deadlines for this safe harbor may result in the unintended and undesirable effect of increasing pressure on some SPACs to announce and close their business combinations more quickly than required by their charters. However, because the SEC stated that non-compliance with the safe harbor is not dispositive, a careful review of the facts and circumstances would be necessary to determine whether the application of the 1940 Act is warranted and if it is necessary to promptly unwind to comply with the proposed safe harbor. Finally, it is not clear whether any existing SPAC could retroactively make the necessary commitments to bring itself into the safe harbor in a post hoc manner.

- *Interplay with proposed underwriter liability*. As underwriters grapple with the prospect of underwriter liability in de-SPAC transactions, we would anticipate that in addition to negative assurance letters, they may request legal opinions from counsel to SPACs, targets or placement agents on a range of topics that are typically covered in legal opinions delivered for IPOs. One of these opinions is that an issuer is not an investment company under the 1940 Act. Law firms would need to consider whether such opinions will be possible for de-SPAC transactions if the SPAC has not complied with all of the elements of the proposed 3a-10 safe harbor.

Business Combinations Involving Shell Companies

- *Shell company business combinations*. In addition to business combinations involving SPACs and private target companies, the SEC noted that business combinations involving reporting shell companies, including penny stock companies, and private companies have occurred for many years and have raised some investor protection concerns for the Commission. To discourage the use of non-reporting shell companies in business combinations with private companies, the SEC has previously imposed a variety of restrictions on such shell companies and successors to shell companies. These restrictions can also apply to companies resulting from a de-SPAC transaction since successors to SPACs often fall within the definition of successors to reporting shell companies.
- *Registration of de-SPAC transactions under the Securities Act*. In cases where a closely-held target company merges with a SPAC, it is not uncommon for the SPAC to file only a proxy statement to seek shareholder approval for the proposed transaction. Traditionally, some SPACs have not filed a registration statement under the Securities Act on the grounds that they were not offering or selling any securities to their shareholders who would continue to hold shares in the same entity upon the consummation of the business combination. In the release, the SEC has stated that it is of the view that investors in a de-SPAC transaction should receive the protections they would receive in a traditional IPO. A new proposed Rule 145a would deem 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 dramatically broadens the number of shareholders to whom the SPAC and target would be deemed to be making an offer of the combined company's securities. If adopted, this change would largely eliminate the

ability of SPACs to seek shareholder approval using only a proxy statement and would require SPACs and targets to file a registration statement on Form S-4 or Form F-4 and thereby subject both companies, their boards of directors, certain officers and any related SPAC IPO underwriters (or other potential statutory underwriters) to potential liability under Section 11 of the Securities Act as described elsewhere in this memo. This development would also likely increase the time and expense required to obtain SEC approval before the SPAC shareholder meeting could be held to vote on the transaction.

Financial Statement Requirements Involving De-SPAC Transactions

- *Financial statement requirements*. As part of its initiative to harmonize the regulatory regime for de-SPAC transactions and traditional IPOs, the SEC proposed a number of technical changes to financial statement requirements. The release seeks to codify a number of changes that had been communicated to market participants through the SEC comment letter process, statements in the Division of Corporation Finance's Financial Reporting Manual and other informal channels. Some of these changes are of a technical nature, but will bring greater consistency to the application of existing SEC rules to de-SPAC transactions.
- *Required periods*. The proposed rules will permit target companies that qualify as emerging growth companies to include two years (rather than three years) of PCAOB audited financial statements in the Form S-4 or Form F-4 registration statement required for a de-SPAC transaction. This proposal will be a welcome development for SPAC market participants, as there are certain cases where target companies can be required to provide three years of PCAOB audited financial statements under existing SEC guidance.
- *Audit requirements of predecessor*. The SEC proposed to align the level of audit assurance required for the target private operating company in a de-SPAC transaction with the audit requirements for an IPO.
- *Acquired business financials*. In cases where a target company party to a de-SPAC transaction has recently acquired or will acquire another business, the proposed rules would apply Rule 3-05 of Article S-X in a manner consistent with what the Staff would require to be included in a registration statement for an IPO.
- *SPAC financial statements after de-SPAC transaction*. The release would permit combined companies to omit stand-alone financial statements of a SPAC for periods prior to the business combination if (i) the financial statements of the SPAC have been filed for all required periods through the acquisition date, and (ii) the financial statements of the registrant include the fiscal period in which the acquisition was consummated.

Next Steps for SPACs and SPAC Transaction Participants

The SEC's proposed rules seek to place private companies merging with SPACs in an analogous position to IPO issuers in many respects, which would result in a number of changes to existing market practices. To further harmonize the rules for SPACs and SPAC successors with IPO issuers, however, we believe that the SEC should revisit a number of restrictions that currently apply to SPACs and many successors to SPACs but not to IPO issuers, such as ineligible issuer status (which proscribes free writing prospectuses), the unavailability of Rule 144 for approximately 12 months following a de-SPAC transaction and the inability to file a registration statement on Form S-8 upon closing on a de-SPAC merger.

We expect that many SPAC market participants will comment on the SEC's proposal, which may bring to light and potentially reduce some of the unintended consequences of the SEC's proposal even if they do not dramatically change the SEC's primary objectives. Until further definitive rules are promulgated, we anticipate that many SPACs, targets, banks, law firms and accounting firms will adjust some of their existing approaches in light of the proposed rules while seeking to advance their de-SPAC transactions expeditiously toward closing. Until the final rules are adopted, some market participants may elect to reduce their involvement with SPAC-related transactions due to the uncertain regulatory environment created by the proposed rules. Moreover, we expect that many de-SPAC transaction participants will implement additional due diligence requirements for transactions where they are already deeply involved; comfort letters, legal opinions and more extensive due diligence procedures may become standard processes and start to resemble IPO market due diligence practices. For de-SPAC transactions that have substantially progressed toward closing, parties will likely focus on deliverables deemed critical to bolstering their due diligence record. For new SPAC-related transactions, parties will likely seek to address a number of the concepts in the SEC release through the negotiation of transaction documentation, closing deliverables and closing conditions.

If the SEC adopts the rules substantially as proposed, a significant number of SPAC market practices will need to evolve, which could dampen activity levels in the SPAC market in the near to medium term. It is not yet clear whether the potential regulatory burdens contemplated by the proposed rules and the prospect of additional liability will deter SPAC sponsors, banks and investors from supporting new SPAC IPOs and de-SPAC transactions in the future. It is also uncertain whether the proposed rules will enable the SEC to achieve its stated objective of enhancing disclosure practices and increasing investor confidence in SPACs and de-SPAC transactions, as well as supporting capital formation related to SPACs.

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