Governance & Securities Alert

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From the Public Company Advisory Group of Weil, Gotshal & Manges LLP

February 16, 2024

SEC Finalizes Tougher Rules for SPACs

The new rules also update and expand guidance on the use of projections in all SEC filings

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On January 24, 2024, the U.S. Securities and Exchange Commission ("SEC") approved final rules to overhaul regulations covering special purpose acquisition companies ("SPACs"). With a few notable exceptions, the final rules are in line with the rules proposed in 2022 (see our prior alert here for a discussion of the 2022 proposed rules). In this Alert, we provide a summary of the rules, as adopted, and highlight certain deviations from the proposed rules.

Effective Date. The new SPAC rules will be effective 125 days following their publication in the Federal Register. However, registrants will have 490 days following publication in the Federal Register to comply with the new Inline XBRL tagging requirements.

Underwriter Status. The SEC did not adopt the proposed Rule 140(a), pursuant to which parties acting as an underwriter in a SPAC IPO and/or also participating in a distribution of securities in the de-SPAC transaction (*i.e.*, a PIPE) would have automatically been deemed an underwriter with respect to the business combination ("de-SPAC") transaction. Instead, the SEC provided guidance that the statutory definition of underwriter is already broad enough to cover, depending on the facts and circumstances, any person or entity that participates in a distribution in connection with a de-SPAC transaction. This approach is similar to the recent updates to the SEC rules governing beneficial ownership reporting, where the SEC elected to provide guidance regarding "group" formation rather than adopting new rules or amending existing rules governing the same.

Consequently, the risk remains that an entity could be deemed a statutory underwriter in a de-SPAC transaction where such entity is selling for the issuer or participating in the distribution of the securities of the combined company to the SPAC's investors and the broader public, even though it may not be named as an underwriter in any given offering.

Projections.

Generally. The new SPAC rules amend Item 10(b) of Regulation S-K to clarify that the item applies to projections in all SEC filings. The new rules also add the requirement to, among other things, (i) distinguish between projections based on historical results and those that are not, (ii) disclose with equal or greater prominence the historical financial results or operational history underlying projections based on the same, and (iii) for any projections based on a non-GAAP measure, include a clear definition or explanation of the non-GAAP measure, a description of the most closely related GAAP measure and an explanation of why the non-GAAP projected financial measures were used instead of their GAAP counterparts, if applicable. The guidance also applies to projections of future economic performance of persons or entities other than the registrant that are included in the registrant's SEC filings.

For De-SPAC Transactions. The new SPAC rules require new disclosures for projections used in connection with de-SPAC transactions, including: (i) the purpose for which the projections were prepared and who prepared such projections; (ii) all material bases and assumptions underlying the projections, and any material factors that may affect such assumptions; and (iii) whether the projections still reflect the view of the board or management of the SPAC or target company, as applicable, as of the most recent practicable date prior to the date of the document being disseminated to shareholders (and if not, then a discussion of the purpose of including the projections in the filing).

Investment Company Status. The SEC did not adopt the proposed non-exclusive safe harbor (Rule 3a-10) from the "investment company" definition under the Investment Company Act of 1940 for SPACs that complied with the safe harbor's conditions. Instead, the SEC provided guidance regarding what actions might push a SPAC towards investment company status, including a specific discussion of *Tonopah* and other factors such as the SPAC's assets and income, the activities of the SPAC's management and directors, the SPAC's duration of existence, the manner in which the SPAC holds itself out to investors, and de-SPAC mergers with entities that may meet the definition of investment company.

Target Company as Registration Statement Co-Registrant: The new SPAC rules provide that the target company in a de-SPAC transaction will now be considered an issuer and its officers and directors will be required to sign any registration statement filed under the Securities Act of 1933, as amended (the "Securities Act") in connection with a de-SPAC transaction. These individuals will therefore now be subject to liability under Section 11 of the Securities Act for material misstatements or omissions.

Forward-Looking Statements Safe Harbor Unavailable. The safe harbor for forward-looking statements (including, for example, projections) provided under the Private Securities Litigation Reform Act of 1995 will now be definitively unavailable for SPACs and de-SPAC targets.

New Disclosure Requirements.

Sponsors. The SEC new SPAC rules require additional disclosure of:

- the SPAC sponsor's business.
- the experience these parties have in organizing SPACs and what other SPACs they are involved in.
- the material roles and responsibilities of these parties in directing and managing the SPAC's activities.
- any agreement, arrangement, or understanding between the SPAC sponsor and the SPAC, its officers, directors or affiliates with respect to determining whether to proceed with a de-SPAC transaction.
- the nature and amount of compensation that has been or will be awarded, earned or paid to these parties for all services provided or to be provided in all capacities to the SPAC and its affiliates and any reimbursements paid to them upon consummation of the de-SPAC transaction.
- any circumstances or arrangements under which these parties, directly or indirectly, have transferred or could transfer ownership of securities of the SPAC, or that have resulted or could result in the surrender or cancellation of such securities.

- 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.
- any agreement, arrangement, or understanding, including any payments, between the SPAC sponsor and unaffiliated security holders of the SPAC regarding the redemption of outstanding securities of the SPAC.
- in tabular format, the material agreements, arrangements or understandings regarding restrictions on the sale of SPAC securities by the sponsor and its affiliates.

Additional Conflicts of Interest. The new SPAC rules will also require conflicts of interest disclosure (actual or potential) between (a) unaffiliated security holders of the SPAC, on the one hand, and (b)(i) the SPAC sponsor or its affiliates; (ii) the SPAC's officers, directors or promoters; or (iii) the target company's officers or directors, on the other hand.

Dilution: The new SPAC rules will require tabular dilution disclosures for both SPAC IPOs and de-SPAC transactions. Sources of dilution may include sponsor compensation, underwriting fees, shareholder dilution, outstanding warrants, convertible securities and PIPE financings. The new SPAC rules will also require tabular dilution disclosure on the prospectus cover page in SPAC IPOs, showing dilution at quartile intervals of redemption levels.

Board Opinion. The new SPAC rules will require the disclosure of the SPAC board's conclusion on the advisability of a de-SPAC transaction for the SPAC and its shareholders (if the laws of the jurisdiction of the SPAC's incorporation require the SPAC board to make such determination). The new rules also call for disclosure of a non-exhaustive list of factors considered by the SPAC board 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 (and the filing of the same as exhibits).

New Cover Page, Prospectus Summary Disclosures. The new SPAC rules will require certain key disclosures on the cover page and in the prospectus summary of registration statements and Schedule TOs filed in connection with SPAC IPOs and/or de-SPAC transactions, as applicable, including relating to (i) the SPAC's shelf life (and potential for extensions), (ii) redemptions (or any limitations thereon), (iii) sponsor, promotors and their affiliates compensation, (iv) dilution, (v) conflicts of interest, (vi) fairness of the de-SPAC transaction, (vii) related financing transactions (or plans to seek the same), (viii) how the SPAC will identify and evaluate potential business combinations, and (ix) material terms of the trust account.

Financial Statement Requirements. The new SPAC rules aim to make financial statement requirements applicable in a de-SPAC transaction more similar to those applicable in the context of a traditional IPO (in terms of the number of years, audit requirements, age of financials, acquisition financials and post-acquisition shell company financials). For example, the amendments permit a SPAC to include in its registration statement/proxy statement two years of financial information for the target for all transactions involving a SPAC that qualifies as an emerging growth company ("EGC") and a target that would qualify as an EGC without regard to whether the SPAC has filed or was already required to file its Annual Report on Form 10-K. Additionally, SPACS that are "foreign issuers" and that acquire a foreign private issuer target will be able to use Form F-4 and present the target financial statements in accordance with international financial reporting standards (IFRS).

Target Company. The new SPAC rules require significantly expanded disclosure related to the target company in a de-SPAC transaction, including, among other things, Regulation S-K Item 101 (Description of Business), Item 102 (Description of Property), Item 103 (Legal Proceedings), Item 304 (Changes in and Disagreements With Accountants on Accounting and Financial Disclosure), Item 403 (Security Ownership of Certain Beneficial Owners and Management), and Item 701 (Recent Sales of Unregistered Securities). If the target is a foreign private issuer, similar disclosure will be required under Items 4, 6.E, 7.A, 8.A.7 and 16F of Form 20-F.

De-SPAC Background. The new SPAC rules will require detailed disclosure of the background, reasons, terms, and effects of a contemplated de-SPAC transaction and any related financing arrangements.

Structured Data Requirement. The new SPAC rules require information disclosed as part of the new Subpart 1600 of Regulation S-K to be tagged in Inline XBRL format (unlike traditional IPOs, which do not have this requirement).

Smaller Reporting Company, Foreign Private Issuer and EGC Status. The new SPAC rules require the post de-SPAC company to re-evaluate its smaller reporting company ("SRC") status prior to the time the newly combined company makes its first filing (excluding the "Super 8-K") with the SEC. The public float will be measured as of a date within four business days after the consummation of the de-SPAC transaction, with revenue determined using the annual revenues of the target company as of the most recently completed fiscal year for which audited financial statements are available. If a post-business combination de-SPAC company does not qualify as a SRC, its filings would need to reflect this fact by including any necessary incremental disclosure beginning 45 days after consummation of the de-SPAC transaction. The SEC, however, declined to require foreign private issuers and EGCs to reassess their status post de-SPAC transaction.

20-Calendar Day Dissemination Period. The new SPAC rules require 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 permitted by governing law.

Deemed Sale of Securities. The new SPAC rules adopt new Rule 145a, which deems the sale of securities in a de-SPAC transaction to be a sale of securities for purposes of Section 2(a)(3) of the Securities Act, even if the target company is not offering or selling any securities in the market. However, the adopting release notes Rule 145a will not have any impact on traditional business combination transactions between operating businesses, including traditional reverse mergers and business combination transactions that make use of only business combination related shell companies.

No breaks on Existing Shell Company Provisions. Importantly, the new SPAC rules did not eliminate existing onerous shell company provisions, including the evergreen provision of Rule 144(i), the 60 days waiting period for filing Form S-8s post de-SPAC, and the ineligible issuer provisions of Rule 405. The SEC indicated that further consideration of the potential application of these rules and limitations is warranted.

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