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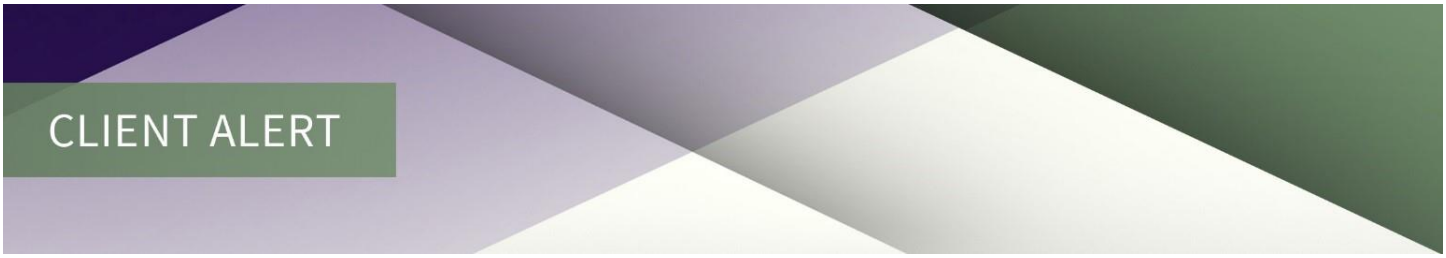

SEC Proposes SPAC Rules

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AUTHORS

David K. Boston | Michael E. Brandt | William H. Gump | Russell L. Leaf
Jesse P. Myers | Ransel N. Potter | Danielle Scalzo | Robert B. Stebbins

On March 30, 2022, the Securities and Exchange Commission (the "SEC" or the "Commission") voted 3-1 to propose new rules and amendments relating to initial public offerings ("IPOs") by special purpose acquisition companies ("SPACs") and subsequent business combination transactions between SPACs and private operating companies ("de-SPAC transactions").[1]

Background.

SPACs emerged in the 1990s as an alternative to blank check companies regulated pursuant to Rule 419 under the Securities Act of 1933 (the "Securities Act"). Between 2010 and 2019, the average number of SPAC IPOs was 22 per year, with 248 occurring in 2020 and 613 occurring in 2021.[2] SPAC IPOs raised more than $83 billion in 2020 and more than $160 billion in 2021. During the last two years, more than half of all IPOs were conducted by SPACs.[3]

Proposing Release.

In the Proposing Release, the Commission proposes (i) new Subpart 1600 of Regulation S-K setting forth certain specialized disclosure requirements in SPAC IPOs and in de-SPAC transactions, (ii) rules and amendments designed to align the disclosures and legal obligations of companies in de-SPAC transactions more closely with those in traditional

1 *See* Special Purpose Acquisition Companies, Shell Companies, and Projections (Mar. 30, 2022) (the "Proposing Release").

2 *See* SPAC Insider, SPAC IPO Transactions: Summarized by Year, available at spacinsider.com.

3 *Id.* at p. 8.

IPOs, (iii) new Securities Act Rule 145a, which would deem any business combination of a reporting shell company with an entity that is not a shell company, to involve a sale of securities to a reporting shell company's shareholders, (iv) amendments to Regulation S-K relating to disclosure of projections, and (v) a safe harbor under the Investment Company Act of 1940 (the "40 Act").[4]

Specialized Disclosure Requirements.

The Proposing Release provides for the addition of new Subpart 1600 of Regulation S-K that would set forth certain specialized disclosure requirements in SPAC IPOs and in de-SPAC transactions.[5] Subpart 1600 would require, among other things:

- additional disclosures about the sponsor of the SPAC and potential conflicts of interest in registration statements filed in connection with SPAC offerings and de-SPAC transactions. The proposed rule would require disclosure of, among other things: (i) the experience, material roles and responsibilities of the sponsor, its affiliates and any promoters of the SPAC, (ii) any agreement between the sponsor and the SPAC (including its executive officers, directors or affiliates) in determining whether to proceed with a de-SPAC transaction and any agreement regarding the redemption of outstanding securities, (iii) the controlling persons of the sponsor and any persons having a direct or indirect material interest in the sponsor, (iv) all compensation that has or will be earned by or paid to the sponsor, its affiliates and any promoters for all services rendered to the SPAC and its affiliates, as well as any reimbursements to be paid to such persons upon the completion of a de-SPAC transaction, and (v) actual or potential material conflicts of interest among the sponsor, its affiliates and the SPAC's officers, directors or promoters, on the one hand, and unaffiliated security holders, on the other hand;[6]

- additional disclosures about potential dilution, with different requirements for registration statements filed in connection with a de-SPAC transaction and in all other SPAC registration statements. The registration statement for a de-SPAC transaction would be required to include (i) a sensitivity analysis in a tabular format that shows the amount of potential dilution under a range of reasonably likely redemption levels and quantifies the impact of dilution on non-redeeming shareholders as redemptions increase, and (ii) disclosure of a description of the model, methods, assumptions, and estimates required to understand the sensitivity analysis disclosure;[7]

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4 *Id.* at pp. 18-22.

5 *Id.* at p. 18.

6 *Id.* at p. 28-34.

7 *Id.* at pp. 36-39.

- a statement by the SPAC as to whether it reasonably believes that the de-SPAC transaction and any related financing transaction are fair or unfair to investors. A SPAC would be required to discuss in reasonable detail the material factors upon which a reasonable belief regarding the fairness of a de-SPAC transaction and any related financing transaction is based and, to the extent practicable, the weight assigned to each factor. In addition, disclosure is required as to whether (i) the de-SPAC transaction or any related financing transaction is structured to require approval of a majority of unaffiliated security holders, (ii) a majority of directors who are not employees of the SPAC have retained an unaffiliated representative to represent the unaffiliated security holders for purposes of negotiating the terms of the de-SPAC transaction or any related financing, and (iii) the de-SPAC transaction or any related financing transaction was approved by a majority of the directors of the SPAC who are not employees thereof;[8]

- a statement by the SPAC as to whether it has received any outside report, opinion, or appraisal relating to the fairness of the transaction. Proposed Item 1607 would also require disclosure of, among other things, (i) the qualifications and method of selection of the outside party, (ii) any material relationship between the outside party and its affiliates, on the one hand, and the SPAC, its sponsor and/or their affiliates, on the other hand, during the past two years and any compensation received pursuant thereto, and (iii) a summary of the report, opinion or appraisal;[9]

- additional disclosure on the background and reasons for the transaction; and[10]

- certain disclosures on the cover page of the prospectus and in the prospectus summary of registration statements filed in connection with SPAC IPOs and de-SPAC transactions.[11]

Aligning de-SPAC Transactions with Traditional IPOs.

The proposed rules and amendments are intended to provide investors with disclosures and liability protections comparable to those they would receive if the operating company were to conduct a traditional firm commitment IPO.[12] The proposed rules and amendments would, among other things:

- more closely align the disclosure requirements for the operating company in a de-SPAC transaction with the requirements in a Form S-1 or Form F-1 for an IPO. The proposed additional information is already

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8 *Id.* at pp. 52-53.

9 *Id.* at pp. 55-57.

10 *Id.* at pp. 46-50.

11 *Id.* at pp. 41-44.

12 *Id.* at p. 66.

required to be included in a Form 8-K due within four business days of the completion of the de-SPAC transaction, and as a result of being instead included in the Form S-1 or Form F-1, this information would be provided to shareholders before they make voting, investment, or redemption decisions in connection with the proposed transactions, and any material misstatements or omissions contained therein would subject the issuers and other parties to potential liability under Sections 11 and 12 of the Securities Act;[13]

- require a minimum dissemination period for disclosure documents in de-SPAC transactions (generally at least 20 calendar days in advance of a shareholder meeting);[14]
- treat the target company as a co-registrant of the Form S-4 or Form F-4 for a de-SPAC transaction. This would result in the officers and directors of the operating company signing the registration statement and thus being subject to potential liability under Section 11 of the Securities Act for any material misstatements or omissions in the Form S-4 or Form F-4;[15]
- amend the definition of "blank check company" in regards to the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), such that the safe harbor for forward-looking statements would not apply to projections in filings by SPACs and certain other blank check companies; and[16]
- provide that underwriters in a SPAC IPO are deemed to be underwriters of the de-SPAC transaction under certain circumstances.[17] Proposed Rule 140a would provide that a person who has acted as an underwriter in a SPAC IPO and participates in the distribution by taking steps to facilitate the de-SPAC transaction, or any related financing transaction, or otherwise directly or indirectly participates in the de-SPAC transaction, will be deemed to be engaged in the distribution of the securities of the surviving public entity in a de-SPAC transaction. Thus, such persons would be subject to Section 11 liability for the registered de-SPAC transaction.[18]

Shell Company Business Combinations.

The Proposing Release sets forth new rules that would apply to business combination transactions involving shell companies, which include de-SPAC transactions.

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[13] *Id.* at pp. 67-69.

[14] *Id.* at pp. 70-71.

[15] *Id.* at pp. 74-77.

[16] *Id.* at pp. 67-69.

[17] *Id.* at pp. 66-67.

[18] *Id.* at p. 99.

First, new Securities Act Rule 145a would deem such business combination transactions to involve a sale of securities to a reporting shell company's shareholders.[19] The proposed rule is intended to address disparities in the disclosure and liability protections available to reporting shell company shareholders depending on the transaction. Registration would result in potential liability for the additional signatories to any registration statement and potential underwriter liability as described above.[20] The Proposing Release makes clear that Rule 145a would not apply to shell companies formed solely to change an entity's domicile or to effect a business combination transaction, or to a combination of two shell companies.[21]

Second, the SEC is proposing a new Article 15 of Regulation S-X and related amendments to more closely align the financial statement reporting requirements in business combinations involving a shell company and a private operating company with those in traditional IPOs.[22] The financial statements that would be required under the proposed amendments are based in large part on current SEC staff guidance for transactions involving shell companies.[23]

Disclosure of Projections.

The Proposing Release provides that Item 10(b) of Regulation S-K would be amended to update the Commission's views on the use and presentation of projections. These amendments would provide, among other things, that the guidance in this Item is also applicable to projections of future economic performance of persons other than the registrant (including the target company in a business combination) that are included in the registrant's SEC filings.[24]

In addition, the Commission is proposing new Item 1609 of Regulation S-K, which Item would set forth certain additional disclosure requirements for financial projections used in de-SPAC transactions, including the purpose for which they were prepared, all material bases of the projections, all material assumptions underlying the projections, any factor that may materially impact the assumptions, and whether the projections still reflect the view of the board or management of the SPAC or target company, as applicable, as of the date of the filing.[25]

40 Act Safe Harbor.

One area of controversy as to SPACs has been whether such entities implicate the 40 Act. In August 2021, former SEC Commissioner Robert Jackson and John Morley, a professor at Yale Law School, filed shareholder derivative lawsuits

[19] *Id.* at pp. 105-106.

[20] *Id.* at p. 107.

[21] *Id.* at pp. 108-109.

[22] *Id.* at p. 112.

[23] *Id.*

[24] *Id.* at pp. 129-130.

[25] *Id.* at pp. 132-134.

against three SPACs, claiming in each instance that the SPAC was an unregistered investment company by virtue of its only activity since the IPO being investing its money in investment securities. Within a few days thereafter, a statement was released by approximately 60 law firms (including Willkie Farr & Gallagher LLP) arguing that the legal theory advanced in the lawsuits was incorrect; the statement argued that consistent with longstanding interpretations of the 40 Act, any company that temporarily holds short-term treasuries and qualifying money market funds while engaging in its primary business of seeking a business combination is not an investment company.[26]

The Proposing Release would provide a safe harbor under the "subjective test" for investment company status under the 40 Act.[27] The following conditions would need to be met to fall within the safe harbor: (a) the SPAC's assets consist solely of government securities, government money market funds and cash items prior to the completion of the de-SPAC transaction, (b) the SPAC seeks to complete a single de-SPAC transaction that results in a combined company that is primarily engaged in the business of the target company (which must not be that of an investment company),[28] and (c) the SPAC files a Form 8-K within 18 months of the effective date of its IPO registration statement announcing that it has entered into a de-SPAC agreement and completes such transaction within 24 months after the effective date of its IPO registration statement.[29] A SPAC that fails to meet either such deadline would be required to distribute its assets in cash to investors as soon as reasonably practicable thereafter.[30]

Miscellaneous.

Inline XBRL. The Proposing Release would require registrants to tag SPAC specialized disclosures made pursuant to new Subpart 1600 of Regulation S-K (as described above) in a structured, machine-readable data language.

Comments. Comments on the proposed rules and amendments must be received by the later of May 21, 2022 or 30 days after the Proposing Release is published in the Federal Register.

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[26] Statement of Willkie Farr & Gallagher LLP, "Willkie Joins More Than 55 Leading Law Firms in Statement About Recent Investment Company Act Lawsuits Targeting the SPAC Industry," Aug. 30, 2021.

[27] Section 3(a)(1)(C) of the 40 Act also provides an alternate "objective test" that generally defines an "investment company" as an entity that is engaged in the business of investing, owning or trading securities having a value in excess of 40% of the value of the Company's total assets. *Id.* at pp. 139.

[28] The transaction may involve the combination of multiple target companies so long as the SPAC treats them for all purposes as part of a single de-SPAC transaction. *Id.* at p. 145.

[29] *Id.* at pp. 142-152.

[30] *Id.* at pp. 152-153.

Dissenting Statement.

SEC Commissioner Hester Peirce issued a statement in dissent, stating that the proposed rules and amendments present a set of requirements that go beyond "enhanc[ing] investor understanding" and impose "a set of substantive burdens that seems designed to damn, diminish, and discourage SPACs." Commissioner Peirce further noted that compliance with the proposed rules would require SPACs to undertake "significant changes to [their] operations economics, and timeline." Commissioner Peirce cites as examples of the proposed rules' overly burdensome requirements (a) the requirement that a SPAC state in its de-SPAC registration statement whether it believes the proposed de-SPAC transaction and any related financing are fair or unfair to unaffiliated security holders of the SPAC, (b) deeming target companies to be co-registrants of a de-SPAC registration statement, (c) eliminating the availability of the PSLRA safe harbor for forward-looking statements in de-SPACs registration statements, and (d) imposing underwriter liability on SPAC IPO underwriters for the contents of the related de-SPAC registration statement.[31]

As noted above, one area of controversy as to SPACs has been whether such entities implicate the 40 Act. In her dissent, Commissioner Peirce questioned the need for the SEC to provide in the Proposing Release for establishment of a non-exclusive safe harbor for SPACs under the 40 Act, asking if "any investor in a SPAC thinks she is buying an investment company?" and noting that the safe harbor seemed more designed to protect the SEC's ability to enforce the 40 Act than to protect investors.[32]

Commissioner Peirce also noted that in the proposed rules and amendments the Commission goes beyond its typical role of ensuring the adequacy of disclosure and these proposals instead reflect a policing by the Commission of an investment's viability, which should be left to the individual investor.[33]

Finally, Commissioner Peirce noted the potential cooling effect the proposed rules would have on the SPAC market, which has otherwise led a revival of going-public transactions, and that the Commission should instead use the recent SPAC boom, and the lessons learned during the past two years, to reflect on how the traditional IPO process can be improved to incentivize its use as a means for companies to enter the public markets.[34]

Takeaways.

SEC Chairman Gary Gensler and certain senior members of the Commission Staff have been outspoken critics of SPACs. If the proposed rules and amendments are enacted as provided in the Proposing Release, such rules and

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31 *See* Damning and Deeming: Dissenting Statement on Shell Companies, Projections, and SPACs Proposal, Commissioner Hester M. Peirce (Mar. 30, 2022).

32 *Id.* at p. 2.

33 *Id.* at p. 2.

34 *Id.* at p. 2.

amendments are likely to lead to a significant reduction in the number of SPAC IPOs. Based on recent market developments, such reduction may have already begun. Given that SPAC IPOs have comprised a majority of the IPOs in recent years and given the other recently proposed SEC rules that would increase the regulatory burden on public companies, a slowdown in the number of IPOs should be expected.

The Commission is attempting to drive behavior through disclosure requirements. For example, by requiring disclosure of whether a SPAC obtained a fairness opinion in connection with a de-SPAC transaction, each SPAC involved in a de-SPAC transaction may now feel obligated to obtain such an opinion. Other examples include the required disclosures as to whether (i) the de-SPAC transaction or any related financing transaction is structured to require approval of a majority of unaffiliated security holders, (ii) a majority of directors who are not employees of the SPAC have retained an unaffiliated representative to represent the unaffiliated security holders for purposes of negotiating the terms of the de-SPAC transaction or any related financing, and (iii) the de-SPAC transaction or any related financing was approved by a majority of the directors of the SPAC who are not employees thereof. Other disclosures, such as those related to the sponsor, potential conflicts of interest and dilution in both the SPAC IPO and the de-SPAC transaction, should prove less onerous as the substance of much of these is already contained in SEC filings due to existing Staff positions and the rules governing IPO and M&A disclosure.

The Proposing Release sets forth a 40 Act safe harbor; as noted above, when the issue of whether SPACs implicate the 40 Act was first raised in court filings in 2021, approximately 60 firms (including Willkie Farr & Gallagher LLP) argued that the 40 Act was not implicated by the typical SPAC transaction structure. Going forward, to the extent a SPAC does not comply with the safe harbor, any attempt by the Commission to bring enforcement proceedings against the SPAC for being an unregistered investment company would involve a great deal of litigation risk for the Commission. The relevance of the safe harbor will depend in large part on how the case law develops as to this issue in shareholder litigation filed against SPACs.

The Commission goes to great lengths in the Proposing Release to present legal justifications for its new interpretations of “underwriter” and “issuer,” each of which is a defined term under the Securities Act. Given that these new interpretations involve increased liability for SPAC IPO underwriters or operating company officers and directors, as applicable, the defenses raised by such parties in a court of law will likely include that the applicable new SEC interpretation was improper for various reasons. Thus, the validity of such interpretations will likely be addressed by one or more Federal courts in the next few years.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

David K. Boston
212 728 8625
dboston@willkie.com

Michael E. Brandt
650 887 9315
mbrandt@willkie.com

William H. Gump
212 728 8285
wgump@willkie.com

Russell L. Leaf
212 728 8593
rleaf@willkie.com

Jesse P. Myers
713 510 1709
jmyers@willkie.com

Ransel N. Potter
212 728 8751
rpotter@willkie.com

Danielle Scalzo
212 728 8620
dscalzo@willkie.com

Robert B. Stebbins
212 728 8736
rstebbins@willkie.com