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April 1, 2022

Ropes & Gray Update on Proposed Rules and Amendments Regarding SPAC Transactions

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On March 30, 2022, the Securities and Exchange Commission ("SEC") proposed new rules and amendments regarding initial public offerings by special purchase acquisition companies ("SPACs") and business combination transactions involving shell companies (such as SPACs) and private operating companies.

SPACs are shell entities that raise money through traditional initial public offerings ("IPOs") in order to ultimately combine with a private operating company (the "Target") so as to take the Target public. While the SPAC engages in its search for a Target, the funds raised in the IPO are held in trust and invested in short-term treasuries and qualifying money market funds. After the SPAC announces that it has entered a business combination agreement with a Target (the "de-SPAC"), the public shareholders have an opportunity to redeem their shares for their pro rata share of the amount held in the trust and generally to vote on the proposed de-SPAC transaction. If a SPAC is unable to complete a de-SPAC transaction within a certain defined amount of time (typically 18-24 months), the SPAC liquidates the trust and returns the funds to its shareholders on a pro rata basis. The prevalence of SPAC IPOs and business combinations has exploded in recent years, with SPACs raising more than $83 billion in IPOs in 2020 and more than $160 billion in 2021 IPOs.

In proposing the rules, SEC Chair Gary Gensler noted that "investors deserve the protections they receive from traditional IPOs, with respect to information asymmetries, fraud, and conflicts, and when it comes to disclosure, marketing practices, gatekeepers and issuers." Commissioner Hester Peirce – the one commissioner to dissent to the proposed rules – stated that the "proposal . . . seems designed to stop SPACs in their tracks" by "mak[ing] a lot of sweeping interpretations of the law." Commissioner Peirce went on to say that "[the] proposal . . . imposes a set of substantive burdens that seems designed to damn, diminish, and discourage SPACs because [the SEC does] not like them, rather than elucidate them so that investors can decide whether they like them."

As evidenced by the statements of both the proponents and opponents of the proposed rules, if adopted, the proposed new rules will have a significant impact on SPACs throughout their life cycle, with particular focus on both the IPO and de-SPAC phases.

For SPAC IPOs, the proposed rules would:

- Require that the front cover page of the prospectus include information, in plain English, about the time frame for the SPAC to consummate a de-SPAC transaction, redemptions, sponsor compensation, dilution (including simplified tabular disclosure), and conflicts of interest and require additional disclosures on these topics throughout the registration statement.

For de-SPAC transactions, the proposed rules would:

- Require additional disclosures regarding the de-SPAC transaction, including a requirement that the SPAC state (1) whether the SPAC reasonably believes that the de-SPAC transaction and any related financing transaction are fair or unfair to investors, and (2) whether the SPAC has received any outside report, opinion or appraisal relating to the fairness of the transaction;
- Deem the Target to be a co-registrant of any registration statement filed on Form S-4 or F-4 filed by the SPAC in connection with a de-SPAC transaction, such that the Target and its signing persons would be subject to liability under Section 11 of the Securities Act of 1933 (the "Securities Act") as signatories to the registration statement;

- Amend the definition of "blank check company" in such a way that would not allow SPACs and certain other blank check companies to avail themselves of the safe harbor for forward-looking statements under the Private Securities Litigation Reform Act of 1995 ("PSLRA"), including with respect to projections of Target companies seeking to access the public markets through a de-SPAC transaction;
- Provide that any person who has acted as an underwriter of the securities of a SPAC and takes steps to facilitate the de-SPAC transaction, or any related financing transaction, or otherwise participates (directly or indirectly) 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 within the meaning of Section 2(a)(11) of the Securities Act subject to Section 11 liability for registered de-SPAC transactions;
- Require that disclosure documents in de-SPAC transactions be disseminated to investors at least 20 calendar days in advance of a shareholder meeting or the earliest date of action by consent, or the maximum period for disseminating such disclosure documents permitted under the laws of the jurisdiction of incorporation or organization if such period is less than 20 calendar days;
- Amend the definition of "smaller reporting company" to require a redetermination of smaller reporting company status following the consummation of a de-SPAC transaction;
- Add new Article 15 of Regulation S-X 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 initial public offerings;
- Add new Rule 145a that 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.

The proposed rules also address the issue of whether SPACs should be considered "investment companies" under the Investment Company Act of 1940 (the "Investment Company Act"). In particular, the SEC is proposing a new safe harbor under the Investment Company Act that would apply to SPACs that satisfy the following conditions:

- The SPAC's assets must consist solely of government securities, government money market funds and cash items prior to the completion of the de-SPAC transaction;
- The SPAC must seek to complete a de-SPAC transaction as a result of which the surviving public entity, either directly or through a primarily controlled company, will be primarily engaged in the business of the Target company or companies, which is not an investment company;
- The SPAC must enter into an agreement with the target company to engage in a de-SPAC transaction no later than 18 months after the effective date of the SPAC's registration statement for its IPO and must then complete the de-SPAC transaction no later than 24 months after the effective date of its registration statement for its IPO.

The proposed rules are now subject to public comment. Comments on the proposed rules need to be received by the later of May 31, 2022 or 30 days after the date of publication of the proposed rules in the Federal Register.