

The SEC Amends Policy on Economic Projections, and Issues Final Rules and Additional Guidance for SPACs and Shell Companies

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On Wednesday, January 24, 2024, the SEC adopted final rules:

- updating Item 10(b) of Regulation S-K, which sets forth for domestic and most foreign reporting companies the SEC's policy on how to make economic projections in SEC filings;
- adopting final rules relating to the special purpose acquisition company (SPAC) and shell company proposals they had issued in March 2022, which significantly change the requirements applicable to SPAC IPOs and de-SPAC transactions by SPACs and similar SEC reporting shell companies; and
- setting out additional guidance on related topics, including underwriter liability for de-SPAC transactions and when a SPAC may be deemed to be an investment company.

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Changes to SEC Policy on Projections – Applicable to Most SEC Reporting Companies

Item 10(b) of Regulation S-K represents the SEC's views on important factors to be considered in formulating and disclosing economic projections in SEC filings. The final rules amend Item 10(b) to:

- Clarify that the SEC's policies apply not only to projections made by the reporting company, but also projections made by other companies (such as target companies in a proposed acquisition) that the reporting issuer includes in its SEC filings.
- State that projected measures that are not based on historical financial results or operational history should be clearly distinguished from projected measures that are based on historical financial results or operational history.
- State that it would generally be misleading to present projections that are based on historical financial results or operational history without presenting such historical financial results or operational history with equal or greater prominence.

Practice Note: This treats projections in a similar manner to non-GAAP financial

measures. Looking forward, this may mean that if a reporting company wants to disclose a measure such as projected revenue for 2024, the SEC will expect the company to first state what revenue was for 2023, and avoid using any management quotation, superlative, bold text, highlighting, heading or other feature that might imply the 2024 projection is more important than the 2023 results.

- State that the presentation of projections that include non-GAAP financial measures should include a clear definition or explanation of those financial measures, a description of the Generally Accepted Accounting Principles (GAAP) financial measure to which it is most directly comparable, and an explanation why the non-GAAP measure was selected instead of a GAAP measure.

Rule Changes for SPACs and Shell Companies

Who Do the Rules Apply to?

The rules create a new defined term for a SPAC. The rules define a SPAC as a company that has either represented that it will pursue a special purpose acquisition strategy, or otherwise has a plan to conduct a primary offering of securities that is not subject to Rule 419 under the Securities Act (such as a IPO that results in listing on Nasdaq or the NYSE), complete a business combination or similar transaction, and return proceeds to its security holders if it fails to do so within a specified time frame.

Shell companies that do not fall within the definition of a SPAC are subject to only some of the new rules.

Consistent with the original proposals, the final rules apply only to companies that register or file reports with the SEC. Other companies, such as private or foreign companies that do not register or file reports with the SEC, are not covered.

How do the Rules Apply?

Practice Note: The amendments seem intended in part to reduce any inadvertent benefits to an operating company of going public through a de-SPAC transaction instead of a traditional IPO, and in part to help ensure that adequate information is provided to the security holders of the operating company in connection with the de-SPAC transaction, and to the security holders of the SPAC in connection with both the IPO and the de-SPAC transaction.

1. Enhancing Investor Protections in SPAC IPOs and De-SPAC Transactions

The SEC adopted new Subpart 1600 of Regulation S-K which applies to SPAC IPOs and de-SPAC transactions. The final rules enhance SPAC-related disclosures and provide additional protections by:

- More closely aligning the required disclosures and the legal liabilities that may be incurred in de-SPAC transactions with those in traditional IPOs, including by deeming

the target company an issuer that must sign a Securities Act registration statement filed by a SPAC (or other shell company) in connection with a de-SPAC transaction;

Practice Note: While the target already effectively inherited the SPAC's liability following the de-SPAC transaction, the target's directors and officers previously had no such responsibility. This change makes the target's board and signing officers directly responsible and will presumably increase their focus on the quality of the disclosures. It also means the target company becomes a reporting company in its own right after the registration statement becomes effective, and the target will now need to begin filing SEC reports and otherwise comply with the obligations of a Section 15(d) reporting company prior to closing of the de-SPAC transaction and continue doing so until it is able to suspend reporting under the SEC rules. Staff Legal Bulletin No. 18 generally permits suspension of reporting if the de-SPAC transaction is closed or abandoned.

- Requiring additional disclosures regarding, among other things, SPAC sponsors, SPAC sponsor compensation, conflicts of interest, dilution, and the target company;
- Requiring additional disclosures in de-SPAC transactions regarding any determination by a board of directors or similar body as to whether the de-SPAC transaction is advisable and in the best interests of the SPAC and its shareholders, if required by law, and any outside report, opinion, or appraisal received that materially relates to the de-SPAC transaction;
- Requiring a 20-calendar-day minimum dissemination period for prospectuses and proxy and information statements filed for de-SPAC transactions where consistent with local law; and
- Requiring a re-determination of smaller reporting company status following the consummation of a de-SPAC transaction and requiring such re-determination to be reflected in filings beginning 45 days after the de-SPAC transaction's consummation.

2. Enhancing Investor Protections in Shell Company Business Combinations

To help ensure that investors receive Securities Act protections in business combinations involving shell companies (including de-SPAC transactions), the SEC adopted:

- Rule 145a, which provides 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 deemed to involve an offer, offer to sell, offer for sale, or sale within the meaning of Section 2(a)(3) of the Securities Act of securities, to the reporting shell company's shareholders; and

Practice Note: This will mean that the de-SPAC transaction is treated as a new offer and sale of securities to the public SPAC security holders as well as to the operating company security holders, and will likely require most de-SPAC transactions to be subject to the disclosure, procedural and liability requirements of a registration statement (with prospectus liability to both sets of shareholders), even where the operating company could otherwise have been acquired on a private placement basis. The SEC also expressed the view that the Section 3(a)(9) exemption would not be available because, among other reasons, the SPAC effectively becomes a different issuer upon completion of the de-SPAC transaction. Because the rule is limited to SEC reporting shell companies, a foreign shell company that does not file reports with the SEC will be treated differently and may still be able to complete its acquisition of an operating company on a private placement basis.

- New Article 15 of Regulation S-X so financial statement requirements applicable to

transactions involving shell companies and private operating companies will be better aligned with those in traditional IPOs.

3. Enhancing Projections Disclosure

To better align the regulatory treatment of projections in business combinations involving certain blank check companies with that in traditional IPOs, the rules adopt a definition of “blank check company” under the Private Securities Litigation Reform Act (PSLRA) that make the safe harbor for forward-looking statements under the PSLRA unavailable for such blank check companies, including SPACs.

In connection with de-SPAC transactions, the final rules also include disclosure requirements related to projections, including disclosure of all material bases of the projections and all material assumptions underlying the projections.

4. Effective Date and Implementation

The final rules will become effective 125 days after publication in the Federal Register. Compliance with the structured data requirements (which require tagging of information disclosed pursuant to new subpart 1600 of Regulation S-K in Inline XBRL) will be required 490 days after publication of the final rules in the Federal Register.

Guidance on Underwriter Status in de-SPAC Transactions

The SEC decided not to adopt the rule that they had proposed in 2022 to codify underwriter liability for de-SPAC transactions. As proposed, the underwriters for the SPAC IPO could have been deemed underwriters for the de-SPAC transaction. Instead, the final rules include non-rule guidance presenting the SEC’s views about when a person would be an underwriter under Section 2(a)(11) for a de-SPAC transaction. The SEC’s expresses the views that:

- A de-SPAC transaction involves a distribution of securities;
- In a de-SPAC distribution, there would be an “underwriter” present where someone is selling for the issuer or participating in the distribution of securities in the combined company to the SPAC’s investors and the broader public; and
- In that situation, that underwriter would be subject to underwriter liability for the de-SPAC transaction.

Investment Company Act Guidance for SPACs

When adopting the final rules, the SEC also decided not to adopt the rule they had proposed in 2022, which would have provided a “safe harbor” that, if followed, would protect a SPAC from being deemed an investment company. Instead, the final rules include SEC guidance on the types of activities that would likely raise serious questions

about whether a SPAC is an investment company under the Investment Company Act. While this guidance is directed at SPACs, it is also instructive for blank check companies and other types of shell companies.

Practice Note: The Investment Company Act is a regulatory regime that imposes registration, reporting and corporate governance obligations on publicly held investment vehicles, such as mutual funds. Companies that do not intend to register as investment companies must ensure they are not investment companies, or are eligible for an exemption from registration, to avoid the draconian penalties for violations of the Act, which can include a prohibition on engaging in business in the United States, unenforceability of contracts in the United States, enforced dissolution and criminal penalties for enablers.

To avoid investment company status, SPACs, blank check companies, and similar shell companies should review the SEC's new guidance^[1] and structure their assets and operations accordingly. Assuming that the company has the intention to become an operating company as soon as possible through an acquisition of an operating company whose business would become the company's primary business, it would be prudent for the company to:

- Describe itself and its intentions in a manner consistent with this purpose.
- Ensure that the company's directors, officers and employees are actively engaged and focused on seeking and completing the transaction that would result in the company being an operating company.
- Complete its acquisition as quickly as possible. In its new guidance, the SEC stated that "while the duration of a SPAC is not the sole determinant of its status under the Investment Company Act, a SPAC's activities may become more difficult to distinguish from those of an investment company the longer the SPAC takes to achieve its stated business purpose." The SEC noted that an exemption under the Act for a transient investment company can be available for up to 12 months, and that escrow accounts of certain blank check companies with a term limited to 18 months were not regulated under the Act, before saying that a "SPAC that operates beyond these timelines raises concerns that the SPAC may be an investment company, and these concerns increase as the departure from these timelines lengthen." The SEC acknowledged that exchange listing rules contemplate potentially longer SPAC lifespans but said that those rules were adopted for a different regulatory purpose and do not address investment company status concerns.
- Pending the completion of its acquisition, avoid holding or investing in any assets that would be deemed "investment securities" under the Investment Company Act. This term is quite broad, and includes equity and debt securities, most government bonds, and several common types of term deposits. For this reason, shell companies should pay very close attention to the types of accounts they create with their banks, and the types of investments they hold pending their transformative acquisition. Cash and U.S. federal government securities are not "investment securities".
- Pending the completion of the acquisition, minimize the amount of time spend on managing investments, and do not emphasize to investors the quality or return on such investments.
- Ensure that its acquisition target is not an investment company, and that it will be an operating company and not an investment company upon completion of the acquisition.

The analysis of whether a company is an investment company can be quite complex. The above is only an overview of factors that could be relevant for determining whether a SPAC or similar shell company is an investment company. Companies should seek legal advice to determine their own status.

[1] The SEC's new guidance regarding Investment Company Act status begins on page 360 of the SEC release for the final rules.