GUNDERSON DETTMER

Client Insight: SEC Adopts New SPAC Regulatory Regime

Insights
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Extension of Traditional IPO Investor Protections to SPAC Transactions Will Significantly Increase Costs, Complexity and Potential Liability for Market Participants Throughout the SPAC Lifecycle

KEY TAKEAWAYS

- The Securities and Exchange Commission (SEC or Commission) recently approved a wide-ranging set of reforms designed to regulate special purpose acquisition companies (commonly known as SPACs), which exploded in popularity in 2020 and 2021 as a means for private companies to go public through business combinations, before declining precipitously beginning in early 2022 amid regulatory pressure and poor performance.

- The final rules and related new interpretive guidance—summarized at a high level beginning here and in detail beginning here—extend traditional initial public offering (IPO) disclosure and liability investor protections to SPAC IPOs and to subsequent business combination transactions between SPACs and private operating companies (commonly known as de-SPAC transactions) through which such companies become public reporting companies.

- The final rules and guidance—which take effect on July 1, 2024—will significantly increase costs, complexity and potential federal securities law liability for market participants throughout the SPAC lifecycle. As a result, some private companies could consider the traditional IPO or direct listing channels a more viable alternative to accessing the U.S. public capital markets, or could choose to forgo going public at all.

- Notably, two provisions of the final rules have wider application beyond the SPAC context:
  - New Rule 145a, which deems *all business combinations of a reporting shell company involving a non-shell company* (not just de-SPAC transactions) to constitute a "sale" of securities to the reporting shell company's existing shareholders (regardless of transaction structure), thus requiring the filing of a registration statement under the Securities Act of 1933 (Securities Act).
    - Of particular significance for the life sciences sector, this could reduce the appeal of certain types of reverse merger transactions that serve as a non-IPO pathway to the public markets, which have come under increasing scrutiny. In a shift from historical practice, the Commission staff (staff) has recently begun finding that, in some circumstances, "fallen angel" public biotech companies (i.e., those with failed clinical programs) are shell companies (rather than operating companies)—a new and more aggressive interpretive position the staff has been communicating through comment letters on transaction filings.
  - Expanded and updated existing Commission guidance in Item 10(b) of Regulation S-K on the use of financial projections in SEC filings generally, which applies broadly to *all companies* (not just SPACs).
- In light of the changes in the SEC's regulatory approach to SPAC transactions—and the intensified investor and regulatory scrutiny and heightened litigation and enforcement risks they portend—parties currently involved in or planning a SPAC IPO, de-SPAC transaction or other shell company business combination transaction are encouraged to review the new rules and guidance carefully and assess with counsel their implications for pending or contemplated deals. Please engage with Gunderson Dettmer's public companies and M&A teams to discuss actions you may wish to consider taking now in preparation for the compliance date this summer.

BACKGROUND AND OVERVIEW

On January 24, 2024, nearly two years after releasing its initial suite of proposed reforms, the SEC voted 3-2 to adopt expansive new requirements and related interpretive guidance affecting SPAC IPOs, de-SPAC transactions and shell company business combinations more broadly—including enhanced investor protections around disclosures, the use of financial projections and issuer obligations and liability—intended to more closely align the regulatory treatment of SPAC transactions with that of traditional IPOs.

The changes affect all stages of the SPAC lifecycle and will significantly increase costs, complexity and potential federal securities law liability for SPAC participants. As a result, some private companies could consider the traditional IPO or direct listing channels a more viable alternative to accessing the U.S. public capital markets, or could choose to forgo going public at all.

SPACs have been in existence since the 1990s, and their prevalence has varied over time. In 2020 and 2021, the U.S. securities markets experienced an unprecedented surge in SPAC activity, aided by low interest rates and pandemic-related stimulus, with the number of SPAC IPOs soaring from 59 in 2019 (constituting 28% of all U.S. IPOs) to 613 in 2021 (constituting 63% of all U.S. IPOs), and SPAC IPO total gross proceeds multiplying more than tenfold over this period from approximately $14 billion to $163 billion. The number of completed de-SPAC transactions similarly swelled from 28 in 2019 to 199 in 2021, representing a more than sevenfold increase.

The exponential growth in the number and value of SPAC IPOs and rapidly increasing use of de-SPAC transactions as a mechanism for private operating companies to access the public markets caused the SEC and market observers to raise concerns about whether the SPAC's organizers/founders (referred to as sponsors) and target companies may be engaging in "regulatory arbitrage" by using de-SPAC transactions (rather than the conventional IPO process) as a path to the public markets to avoid the disclosure, liability and other investor safeguards afforded by Securities Act registration. The reform proposals released in March 2022 marked the Commission's first broad regulatory effort to comprehensively address these concerns.

In early 2022, SPAC activity began to recede substantially due to a variety of factors, including rising interest rates, an uncertain macroeconomic environment, poor post-merger performance, growing investor, regulatory and judicial scrutiny, and elevated private litigation and SEC enforcement activity. In sharp contrast to the height of the SPAC market boom in 2021, 2023 saw just 31 SPAC IPOs, SPAC IPO total gross proceeds of approximately $4 billion and only 89 completed de-SPAC transactions. Notwithstanding this precipitous decline, the SEC believes the greater transparency and more robust investor protections the final rules and guidance afford are necessary should SPAC activity resurge as macroeconomic and other factors change. However, the additional regulatory obstacles the new rules and guidance impose are unlikely to help deal volume return to peak levels anytime soon and more plausibly will contribute to the SPAC market remaining subdued.

The final version of the rules largely mirrors the SEC's original proposal (to which SPAC market practices have already adjusted in many respects, especially as regards enhanced disclosures), though certain of the more controversial aspects of the proposed rules were withdrawn in response to critical public feedback. The final rules and related new interpretive guidance are designed to extend traditional IPO disclosure and liability protections to investors in SPAC transactions and, in doing so, impose significant new burdens on market participants throughout the SPAC lifecycle, including by:

- ***Specialized Disclosures***. Requiring extensive specialized disclosures in connection with SPAC IPOs and de-SPAC transactions, including enhanced disclosures about SPAC sponsors, sponsor compensation, conflicts of interest and shareholder dilution, as well as certain disclosures on the prospectus cover page and in the prospectus summary section of registration statements (including resale registration statements);

- ***Board Determination***. Mandating additional disclosures with respect to de-SPAC transactions, including about the background, material terms and effects of such transactions, and, if required by the law of the SPAC's jurisdiction of organization (such as in Delaware and the Cayman Islands), a determination by its board of directors whether the de-SPAC transaction is advisable and in the best interests of the SPAC and its security holders, the material factors the board considered in making any such determination (including any financial projections relied on by the board) and any related third-party report, opinion or appraisal (a fairness opinion, however, is not required);

- ***Target Co-Registrant Liability***. Deeming a target company to be a co-registrant when a SPAC files a registration statement in connection with a de-SPAC transaction, such that the target company and its control persons will be subject to liability under Section 11 of the Securities Act (Section 11 liability) as signatories to the registration statement for any material misstatements or omissions therein (subject to a due diligence defense for all parties other than the SPAC and the target company);

- ***No PSLRA Liability Protection***. Creating a new definition of "blank check company" solely for purposes of the Private Securities Litigation Reform Act of 1995 (PSLRA), such that the PSLRA safe harbor protections from liability for forward-looking information will not apply to financial projections of target companies and other forward-looking statements disclosed by SPACs in connection with de-SPAC transactions, which will increase the potential liability and litigation risk associated with their use;

- ***Re-Determination of SRC Status***. Requiring a post-business combination company to re-determine its smaller reporting company (SRC) status before its first SEC filing after the filing of the Form 8-K with Form 10 information (Super 8-K), with any loss of SRC status required to be reflected in filings made beginning 45 days following the completion of the de-SPAC transaction, which will result in more such companies losing their SRC status (and thus having to provide more expansive disclosures) sooner following a de-SPAC transaction than under existing rules;

- ***20-Day Minimum Dissemination Period***. Mandating that disclosure documents in de-SPAC transactions generally be disseminated to investors at least 20 calendar days in advance of the SPAC shareholder meeting or the earliest date of action by consent;

- ***Target Non-Financial Disclosures***. Prescribing additional non-financial statement disclosures about the target company in disclosure documents for de-SPAC transactions to align more closely with those required in a traditional IPO;

- ***Underwriter Liability***. Providing interpretive guidance regarding when a transaction participant would be considered a statutory underwriter in connection with a de-SPAC transaction and thereby subject to Section 11 liability for any material misstatements or omissions in the de-SPAC registration statement (subject to a due diligence defense);

- ***Reporting Shell Company Business Combinations***. Deeming a business combination of a reporting shell company involving a non-shell company (including de-SPAC transactions and, based on recent staff comment letters, a number of so-called "fallen angel" reverse mergers) to constitute a "sale" of securities within the meaning of the Securities Act to the reporting shell company's existing shareholders (regardless of transaction structure), thus requiring the filing of a registration statement and triggering potential Section 11 liability for signatories, underwriters, auditors and other experts for any material misstatements or omissions therein (subject to a due diligence defense for all parties other than the shell company and the target company);

- ***Financial Statement Requirements***. Harmonizing the required financial statements of private operating companies that enter the public markets through a de-SPAC transaction or other reporting shell company business combination transaction with the analogous requirements in traditional IPOs (largely codifying existing staff guidance and financial reporting practices);

- ***Enhanced Projections Disclosure***. Expanding and updating existing Commission guidance on the use of financial projections in SEC filings generally, broadening the scope of covered projections and adding detail on the formatting of disclosed projections, and imposing additional disclosure requirements specifically applicable to financial projections used in de-SPAC transactions, including disclosure of all material bases and assumptions underlying the projections; and

- ***Investment Company Status***. Providing interpretive guidance intended to assist SPACs in analyzing their status under the Investment Company Act of 1940 (ICA), including considerations related to the nature of their assets and income, management activities and duration, potentially posing risks for SPACs that operate beyond 12 or 18 months and creating pressure to accelerate SPAC timelines.

EFFECTIVE DATE

The final rules will take effect on **July 1, 2024**. An additional year is permitted to comply with the Inline XBRL tagging obligations, which take effect on June 30, 2025.

The SEC notes that this approximately four-month period before the final rules are effective will provide sufficient time for an initial public filing to be made under the existing rules for any transactions that are currently pending or planned. Any filings made on or after the July 1 effective date must comply with the final rules.

RELATED MATERIALS

- Final Rules and Guidance

- Fact Sheet

Please click here to read Gunderson's detailed summary of the final rules and guidance.

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