GIBSON DUNN

SEC Adopts Final Rules to Align SPACs More Closely with IPOs

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Among the meaningful changes in the Final Rules, the Commission did not adopt a safe harbor from the "investment company" definition under the Investment Company Act of 1940, as amended (the "Investment Company Act") for SPACs. On January 24, 2024, the U.S. Securities and Exchange Commission (the "Commission"), by a three-to-two vote, adopted new rules and amendments (the "Final Rules") to enhance disclosure and investor protections in initial public offerings ("IPO") by special purpose acquisition companies ("SPACs") and in subsequent business combinations between SPACs and private operating companies ("de-SPAC transaction").[1] The Final Rules are thematically aligned with the rule proposal issued by the Commission nearly two years ago in March 2020,[2] but with meaningful changes as noted below, including *not* adopting a safe harbor from the "investment company" definition under the Investment Company Act of 1940, as amended (the "Investment Company Act") for SPACs. The adopting release for the Final Rules (the "Adopting Release") provides a lengthy and comprehensive discussion that builds upon the Commission's prior statements and actions regarding SPAC IPOs and de-SPAC transactions.[3] As noted by the Commission's Chair, Gary Gensler, in the accompanying press release, the Final Rules are intended to "help ensure that the rules for SPACs are substantially aligned with those of traditional IPOs."[4] Chair Gensler further noted that the measures adopted in the Final Rules "will help protect investors by addressing information asymmetries, misleading information, and conflicts of interest in SPAC and de-SPAC transactions."[5] The Adopting Release is available here and a Fact Sheet is available here. 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 rules in the Federal Register. **I. Overview** There are four key components of the Final Rules:

- ***Disclosure and Investor Protection***. The Final Rules impose specific disclosure requirements with respect to, among other things, compensation paid to sponsors, potential conflicts of interest, shareholder dilution, and the fairness of the business combination, for both the SPAC IPOs and de?SPAC transactions;
- ***Business Combinations Involving Shell Companies***. Under the Final Rules, the Commission will deem a business combination transaction involving a reporting shell company and a private operating company as a "sale" of securities under the Securities Act of 1933, as amended (the "Securities Act"), amend the financial statement requirements applicable to transactions involving shell companies, and amend the current "blank check company" definition to make clear that SPACs cannot rely on the safe harbor provision under the Private Securities Litigation Reform Act of 1995, as amended (the "PSLRA") when marketing a de-SPAC transaction;
- ***Projections***. The Final Rules amend the Commission's guidance on the presentation of projections in any filings with the Commission (not only on de-SPAC transactions, but affecting all projections filed with the Commission) and adds new guidance only for de-SPAC transactions, in both instances to address the reliability of such projections; and
- ***Status of SPACs under the Investment Company Act of 1940***. The Proposed Rules included a safe harbor that qualifying SPACs could have used to avoid registering as investment companies under the Investment Company Act. The

Related People

Evan M. D'Amico

Gerry Spedale

James O. Springer

Rodrigo Surcan

Final Rules do not include a safe harbor, and instead, the Commission takes the position that SPACs should consider investment company status in light of the facts and circumstances and provides further guidance on what actions might cause a SPAC to fall into the investment company definition.

We provide below our key takeaways, a summary of the Final Rules and links to Commissioner statements regarding the Final Rules. **II. Key Takeaways** Below are the key takeaways from the Final Rules:

- ***Timing***. Although the Final Rules will not be in effect for about 4 months, existing SPACs and their targets should expect to receive comments from the Commission staff along the broader lines of the Final Rules. SPACs and their targets also should consider the extent to which they will want to comply voluntarily with certain of the Final Rules, especially those focused on financial statement requirements and enhanced disclosures.
- ***Conforming SPACs to Traditional IPOs***. The Final Rules go to great lengths to contrast the current SPAC regulatory regime against the one applicable to traditional IPOs and to "level" the playing field between the two. Closer alignment of the two regimes may reduce some potential benefits of a de-SPAC transaction (*g.*, availability of alternative financing sources and expedited path to becoming a public company) while also exposing the SPAC, its target and their advisors to additional liability.
- ***No PSLRA Protection***. The PSLRA safe harbor against a private right of action for forward-looking statements is not available in, among other transactions, an offering by a blank check company or a "penny stock" issuer, or in an initial public offering. Some market participants believed the PSLRA safe harbor was otherwise available in de-SPAC transactions when a SPAC is not a blank check company under Rule 419. Under the Final Rules, the Commission adopts a new definition of "blank check company" for purposes of the PSLRA making clear that SPACs may no longer rely on the safe harbor provision under the PSLRA as it relates to the use of projections and other forward-looking statements when marketing a de-SPAC The lack of the PSLRA safe harbor, especially coupled with enhanced disclosure requirements relating to projections under the Final Rules, may lead to changes in the presentation of projections and assumptions, or the abandonment of projections in a SPAC board's evaluation of a potential de-SPAC target, which will further undermine the viability of the de-SPAC transaction as an alternative to traditional IPOs for target companies that do not have a lengthy operating history.
- ***Co-Registrant Liability***. The Final Rules impose Section 11 liability on target companies and their officers and directors as co-registrants under Form S-4 and Form F-4 Liability will now extend to both SPAC and target company disclosures contained in such filings. Target companies assessing a de-SPAC transaction should now consider whether its current director and officer liability insurance is sufficient prior to the filing of an initial Form S-4 or Form F-4 for its de-SPAC transaction given the potential for increased liability related to the target's disclosures.
- ***Extension of Current Disclosure Guidance (Projections, Dilution, Sponsor, Conflicts)***. The Final Rules codify current guidance and practice by the Commission, and require additional information and specificity (in some cases, beyond current rules and guidance). Nonetheless, some of the prescriptive rulemakings around enhanced disclosures—including required financial statements, disclosure of sources of dilution, sponsor control and relationships, and potential conflicts of interest—should not be particularly novel for practitioners as many of these requirements are based on existing rules and guidance.
- ***Board Determination***. If required by the law of the jurisdiction of a SPAC's organization, a SPAC must disclose its board's determination whether the de-SPAC transaction is advisable and in the best interests of the SPAC and its shareholders and discuss the material factors considered in making the determination. The Final Rules specify that such factors must include, without limitation and to the extent considered, the valuation of the target company,

financial projections relied upon by the board of directors, the terms of any financing materially related to the de-SPAC transaction, the dilutive impact of the transaction, and any fairness opinion. While the Proposed Rules would have required disclosure of the SPAC board's reasonable belief as to the fairness of a de-SPAC transaction and related financings to the SPAC's shareholders when approving a de-SPAC transaction, that requirement is not included in the Final Rules. Coupled with the enhanced disclosure requirements related to any projections used in a de-SPAC transaction, the Final Rules may result in SPACs not using a target company's projections to assess a transaction or for marketing purposes, and SPACs may decide against obtaining fairness opinions in connection with de-SPAC transactions.
- ***Underwriter Liability***. The Commission did not adopt its proposal of extending underwriter status (and resulting potential liability) in the de-SPAC transaction to those underwriters to SPAC IPOs involved, directly or indirectly, in the de-SPAC transaction (*g.*, advisory services, placement agent services, and other activities related to the de-SPAC transaction would all be considered direct and indirect activities). Rather, the Commission noted in the Final Rules that it will apply the terms "distribution" and "underwriter" "broadly and flexibly" in light of the facts and circumstances of a particular transaction, including a de-SPAC transaction. The introduction of proposed underwriter liability in the Proposed Rules and pivot back to statutory interpretation creates further ambiguity and uncertainty on a going-forward basis. 2022 and 2023 saw a dramatic pullback by financial advisors in their participation in the SPAC market, and we anticipate that certain financial advisors will choose not to participate in SPAC IPOs and de-SPAC transactions as a result of the ambiguity under the Final Rules.
- ***Investment Company Act Safe Harbor***. The Commission did not adopt its proposed new safe harbor for SPACs under the Investment Company Act, which would have exempted SPACs from being treated as an "investment company" if the SPAC met certain subjective criteria, related to, among other things, the nature and management of the assets held by the SPAC and the SPAC's general purpose. Similar to its approach with respect to SPAC IPO underwriter liability, the Final Rules opt to provide general guidance regarding activities that could cause a SPAC to be an "investment company." As a result, SPACs should carefully assess and monitor their activities, and consider changing their operations if necessary to bring them into compliance with the Investment Company Act.

III. Summary of Final Rules

1. New Subpart 1600 of Regulation S-K

The Final Rules create a new Subpart 1600 of Regulation S-K solely related to SPAC IPOs and de-SPAC transactions. Among other things, this new Subpart 1600 prescribes specific disclosure requirements with respect to the sponsor, potential conflicts of interest, potential shareholder dilution, and fairness to shareholders. ***Sponsor, Affiliates, and Promoters*** To provide investors with a more complete understanding of the role of SPAC sponsors, affiliates, and promoters,[6] the Commission has adopted Item 1603(a) of Regulation S-K, to require:

- ***Experience***. Description of the experience, material roles, and responsibilities of sponsors, affiliates, and promoters.
- ***Arrangements***. Discussion of any agreement, arrangement, or understanding (i) between the sponsor and the SPAC, its officers, directors, or affiliates, in determining whether to proceed with a de-SPAC transaction and (ii) regarding the redemption of outstanding securities.
- ***Sponsor Control***. Discussion of the controlling persons of the sponsor and any persons who have direct or indirect material interests in the sponsor. The Commission declined to adopt the proposed requirement that SPACs also provide an organizational chart that shows the relationship between the SPAC, the sponsor, and the sponsor's affiliates.

- ***Lock-Ups***. A table describing the material terms of any lock-up agreements with the sponsor and its affiliates.
- ***Compensation***. Discussion of the nature and amounts of all compensation (including securities issued by the SPAC) that has been or will be awarded to, earned by, or paid to the sponsor, its affiliates, and any promoters for all services rendered in all capacities to the SPAC and its affiliates, as well as the nature and amounts of any reimbursements to be paid to the sponsor, its affiliates, and any promoters upon the completion of a de-SPAC

Potential Conflicts of Interest To provide investors with a more complete understanding of the potential conflicts of interest between (i) any SPAC sponsor or affiliate, target company officers and directors, or the SPAC's officers, directors, or promoters, and (ii) unaffiliated security holders of the SPAC, the Commission adopted a new Item 1603(b) of Regulation S-K. This new Item includes a discussion of conflicts arising as a result of a determination to proceed with a de-SPAC transaction and from the manner in which a SPAC compensates the sponsor or the SPAC's executive officers and directors, or the manner in which the sponsor compensates its own executive officers and directors. Relatedly, Item 1603(c) of Regulation S-K will require disclosure of the fiduciary duties that each officer and director of a SPAC owes to other companies. ***Sources of Dilution*** In an effort to conform and enhance disclosure relating to dilution in SPAC IPOs and de-SPAC transactions, the Commission has adopted Items 1602 and 1604 of Regulation S-K, respectively.

- ***IPO Dilution Disclosure***. In providing disclosure pursuant to Item 506, SPAC disclosure previously estimated dilution as a function of the difference between the initial public offering price and the pro forma net tangible book value per share after the offering, often including an assumption of the maximum number of shares eligible for redemption in a de-SPAC transaction. The Final Rules will now require additional granularity on the prospectus cover page, requiring SPACs to present redemption scenarios in quartiles up to the maximum redemption scenario. In addition to changes to the cover page, the Final Rules also supplement Item 506 disclosure by requiring a description of material potential sources of future dilution following a SPAC's initial public offering, as well as tabular disclosure of the amount of potential future dilution from the public offering price that will be absorbed by non-redeeming SPAC shareholders, to the extent quantifiable.
- ***De-SPAC Dilution Disclosure***. In addition to disclosure at the IPO stage of a SPAC's lifecycle, the Final Rules require additional disclosure regarding material potential sources of dilution as a result of the de-SPAC As seen in comment letters issued by the Commission following the release of the Proposed Rules, the Commission has requested additional granularity with respect to post-closing pro forma ownership disclosure, often requiring the disclosure of various redemption thresholds and the effects of potential sources of dilution. The Final Rules now codify this practice by requiring disclosure in a tabular format that includes intervals representing selected potential redemption levels that may occur across a reasonably likely range of outcomes. The Final Rules do not prescribe specific redemption levels for which dilution information must be provided, but looking at the SPAC IPO dilution requirements (as discussed above), quartile disclosure up to the maximum redemption scenario may be acceptable.

Board Determination Regarding De-SPAC Transaction Under Item 1606, if the law of the jurisdiction of the SPAC's organization requires the SPAC's board of directors to determine whether the de-SPAC transaction is advisable and in the best interests of the SPAC and its shareholders, then the SPAC will be required to disclose that determination. Item 1606 of Regulation S-K will also require a discussion, of the material factors considered in making that determination. This is one of the few areas of the Final Rule where the Commission declined to adopt a more stringent standard, with the initial proposed rule creating a potential "backdoor" opinion requirement by asking that a board of directors affirmatively state whether it reasonably believes a de-SPAC transaction, including any related financing, was fair to the unaffiliated securityholders of the SPAC.

Relatedly, if any director voted against, or abstained from voting on, approval of the de-SPAC transaction or any related financing transaction, SPACs would be required to identify the director, and indicate, if known, after making reasonable inquiry, the reasons for the vote against the transaction or abstention.

2. **Aligning De-SPAC Transactions with IPOs**

Target Company as Co-Registrant Under the current rules, only the SPAC and its officers and directors are required to sign the registration statement and are liable for material misstatements or omissions. The Final Rules require the target company to be treated as a co-registrant with the SPAC when a Form S-4 or Form F-4 registration statement is filed by the SPAC in connection with a de-SPAC transaction.[7] Registrant status for a target company and its officers and directors will result in such parties being liable for material misstatements or omissions pursuant to Section 11 of the Securities Act. Under the Final Rules, target companies and their officers and directors will be liable with respect to their own material misstatements or omissions, as well as any material misstatements or omissions made by the SPAC or its officers and directors. As a result, the Final Rules seeks to further incentivize target companies and SPACs to be diligent in monitoring each other's disclosure. ***Smaller Reporting Company Status*** Currently, de-SPAC companies are able to avail themselves – as almost all SPACs have done since 2016[8] – of the smaller reporting company rules for at least one year following the de-SPAC transaction (and most SPACs would still retain this status at the time of the de-SPAC transaction when the SPAC is the legal acquirer of the target company). The "smaller reporting company" status benefits the combined company after the de-SPAC transaction by availing it of scaled disclosure and other accommodations as it adjusts to being a public company. Citing the disparate treatment between traditional IPO companies and de-SPAC companies (the former having to determine smaller reporting company status at the time it files its initial registration statement and the latter retaining the SPAC's smaller reporting company status until the next annual determination date), the Final Rules require de-SPAC companies to determine compliance with the public float threshold (*i.e.*, public float of (i) less than $250 million, or (ii) in addition to annual revenues less than $100 million, less than $700 million or no public float)[9] prior to the time it makes its first filing with the Commission (other than the Form 8-K filed with Form 10 information). The public float must be measured as of a date within four business days after the consummation of the de-SPAC transaction. The revenue threshold must be determined by using the annual revenues of the target company as of the most recently completed fiscal year for which audited financial statements are available. The de-SPAC company must reflect its re-determination in its first periodic report due after a 45-day period following the consummation of the de-SPAC transaction. Target companies will need to consider the burdens of additional reporting requirements in light of the potential of not being able to qualify as a smaller reporting company following their de-SPAC transactions. ***PSLRA Safe Harbor*** The PSLRA provides a safe harbor for forward-looking statements under the Securities Act and the Securities Exchange Act of 1934, as amended (the "Exchange Act"), under which a company is protected from liability for forward-looking statements in any private right of action under the Securities Act or Exchange Act when, among other things, the forward-looking statement is identified as such and is accompanied by meaningful cautionary statements. The safe harbor, however, is not available when the forward looking statement is made in connection with an offering by a "blank check company," a company that is (i) a development stage company with no specific business plan or purpose or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies, or other entity or person, and (ii) is issuing "penny stock."[10] Because of the penny stock requirement, many practitioners have considered SPACs to be afforded protection under the PSLRA safe harbor as it does not otherwise meet the second prong of the definition of blank check company for purposes of the PSLRA safe harbor. The Final Rules will adopt a new definition of "blank check company" for purposes of the PSLRA to remove the penny stock requirement, thus effectively removing a SPAC's ability to qualify for the PSLRA safe harbor provision for the de-SPAC transaction. This inability to rely on the PSLRA is coupled with the Final Rules' addition of new and modified projections disclosure requirements (as further discussed below). It remains unclear whether the application of the Final Rules will lead to changes in the use of projections and assumptions (especially considering the current environment where market participants, investors, and financiers have come to expect detailed projections disclosure, similar to what is used in public merger and acquisitions ("M&A") transactions), or the abandonment of projections in assessing and marketing a de-SPAC transaction. ***Underwriter Status and Liability*** Historically, Section 11 and Section 12(a)(2) of the Securities Act[11] have imposed underwriter liability on underwriters of a SPAC's IPO. The Commission declined to adopt its proposal to establish that a de-SPAC transaction would constitute a "distribution" under applicable underwriter regulations, which would have automatically extended underwriter liability to the SPAC IPO underwriter if it engaged in certain de-SPAC activities or compensation arrangements. Instead, the Final Rules provide general guidance regarding statutory underwriter status, following its "longstanding practice of applying the statutory terms "distribution" and "underwriter" broadly and flexibly, as the facts and circumstances of any transaction may warrant."[12] The Commission may find a "statutory underwriter" 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, even though it may not be named as an underwriter in any given offering or may not be engaged in activities typical of a named underwriter in traditional capital raising.[13] The Commission's extensive broad interpretation of the concept of "statutory underwriter," coupled with the traditional "due diligence" defenses of underwriters,[14] suggests that SPACs and target companies should expect extensive diligence requests from financial institutions, advisors, and their counsel in connection with a de-SPAC transaction, requests from investment banks that advisors to a SPAC and its target provide negative assurance and comfort letters in connection with the de-SPAC transaction, and other related changes to the de-SPAC transaction process that add complexity, time, and cost.

3. Business Combinations Involving Shell Companies

The Commission's concern related to private companies becoming U.S. public companies via de-SPAC transactions is substantially related to the perceived opportunity for such private companies to avoid "Securities Act registration and the related disclosures which are intended to protect investors."[15] ***Rule 145a*** Based on the structure of certain de-SPAC transactions, the Commission expressed concern that, unlike investors in transaction structures in which the Securities Act applies (and a registration statement would be filed, absent an exemption), investors in reporting shell companies may not always receive the disclosures and other protection afforded by the Securities Act at the time the change in the nature of their investment occurs, due to the business combination involving another entity that is not a shell company. Rule 145a intends to address the issue by deeming any direct or indirect business combination of a reporting shell company (other than a business combination related shell company) involving another entity that is not a shell company constitutes "a sale of securities to the reporting shell company's shareholders."[16] By deeming such transaction to be a "sale" of securities for the purposes of the Securities Act, the Final Rule is intended to address potential disparities in the disclosure and liability protections available to shareholders of reporting shell companies, depending on the transaction structure deployed. Rule 145a defines a reporting shell company as a company (other than an asset-backed issuer as defined in Item 1101(b) of Regulation AB) that has:

1. no or nominal operations;
2. either:
    - no or nominal assets;
    - assets consisting solely of cash and cash equivalents; or
    - assets consisting of any amount of cash and cash equivalents and nominal other assets; and
3. an obligation to file reports under Section 13 or Section 15(d) of the Exchange Act.

The Final Rule notes that the sales covered by Rule 145a will not be covered by the exemption provided under Section 3(a)(9) of the Securities Act, because the exchange of securities would not be exclusively with the reporting shell company's existing security holders, but also would include the target company's existing security holders. We would also note that this provision has broader market implications as it would apply to all reporting shell companies (other than a "business combination related shell company," as defined in Rule 405 under the Securities Act and Rule 12b-2 under the Exchange Act), and not just SPAC transactions. ***Financial Statement Requirements in Business Combination Transactions Involving Shell Companies*** The Final Rule amends the financial statements required to be provided in a business combination with an intention to bridge the gap between such financial statements and the financial statements required to be provided in an IPO. The Commission views such Final Rule as simply codifying "current staff guidance for transactions involving shell companies."[17] While the below information is presented in the context of a de-SPAC transaction, we would note that these requirements will apply to all shell companies (other than a "business combination related shell company," as defined in Rule 405 under the Securities Act and Rule 12b-2 under the Exchange Act), and not just SPAC transactions. ***Number of Years of Financial Statements*** Rule 15-01(b) will require a registration statement for a de-SPAC transaction where a business is combining with a shell company registrant to include the same financial statements for that business as would be required in a Securities Act registration statement for an IPO of that business. ***Audit Requirements*** Rule 15-01(a) will require the examination of the financial statements of a business that is or will be a predecessor to a shell company to be audited by an independent accountant in accordance with the standards of the Public Company Accounting Oversight Board ("PCAOB") for the purpose of expressing an opinion, to the same extent as a registrant would be audited for an IPO, effectively codifying the staff's existing guidance.[18] ***Age of Financial Statements*** Rule 15-01(c) will provide for the age of the financial statements of a business involved in a business combination with a shell company to be based on whether such private company would qualify as a smaller reporting company in a traditional IPO process, ultimately aligning with the financial statement requirements in a traditional IPO. ***Acquisitions of a Business or Real Estate Operation by a Predecessor*** The Commission is implementing a series of rules intended to clarify when companies should disclose financial statements of businesses acquired by SPAC targets or where such business are probable of being acquired by SPAC targets. Rule 15-01(d) will address situations where financial statements of other businesses (other than the predecessor) that have been acquired or are probable to be acquired should be included in a registration statement or proxy/information statement for a de-SPAC transaction. The Final Rule will require application of Rule 3-05 and Rule 8-04 (or Rule 3-14 and Rule 8-06 with respect to real estate operation) of Regulation S-X to acquisitions by a predecessor to the shell company, which the staff views as codifying its existing guidance. Amendments to the significance tests in Rule 1-02(w) of Regulation S-X will require the significance of the acquisition target of the private target in a de-SPAC transaction to be calculated using the SPAC's target's financial information, rather than the SPAC's financial information. In addition, Rule 15-01(d)(2) will require the de-SPAC company to file the financial statements of a recently acquired business, that is not or will not be its predecessor pursuant to Rule 3-05(b)(4)(i) in an Item 2.01(f) of Form 8-K filed in connection with the closing of the de-SPAC transaction where such financial statements were omitted from the registration statement for the de-SPAC transaction, to the extent the significance of the acquisition is greater than 20% but less than 50%. ***Financial Statements of a Shell Company Registrant after the Combination with Predecessor*** Rule 15-01(e) allows a registrant to exclude the financial statements of a SPAC for the period prior to the de-SPAC transaction if (i) all financial statements of the SPAC have been filed for all required periods through the de-SPAC transaction, and (ii) the financial statements of the registrant include the period on which the de-SPAC transaction was consummated. The Final Rule eliminates any distinction between a de-SPAC structured as a forward acquisition or a reverse recapitalization. **Other Amendments** In addition, the Final Rules are also addressing the following related amendments:

- amendment of Item 2.01(f) of Form 8-K to (i) refer to "predecessor," rather than "registrant," to clarify that the information required to be provided "relates to the acquired business and for periods prior to consummation of the acquisition"[19] and (ii) establish that registrant need not present audited financial statements for predecessor for any period prior to the earliest audited period if, at the time of filing, the predecessor meets the conditions of an “emerging growth company”; and

- amendment of Rules 3-01, 8-02, and 10-01(a)(1) of Regulation S-X to expressly refer to the balance sheet of the predecessors, consistent with the provision regarding income statements.

4. Enhanced Projections Disclosure

Disclosure of financial projections is not expressly required by the U.S. federal securities laws; however, it has been common practice for SPACs to use projections of the target company and post-de-SPAC company in its assessment of a proposed de-SPAC transaction, its investor presentations, and soliciting material once a definitive agreement is executed. The Final Rules amend existing Commission guidance under Item 10(b) of Regulation S-K with respect to the use of any projections of future economic performance for any registrant and persons other than the registrant for any filings subject to Regulation S-K, as well as to add new, supplemental disclosure requirements applying only to de-SPAC transactions, under the new Item 1609 of Regulation S?K. ***Amended Item 10(b) of Regulation S-K*** Under Item 10(b) of Regulation S-K, management may present projections regarding a registrant’s future performance, provided that (i) there is a reasonable and good faith basis for such projections, and (ii) they include disclosure of the assumptions underlying the projections and the limitations of such projections, and the presentation and format of such projections. Citing concerns of instances where target companies have disclosed projections that lack a reasonable basis,[20] the Final Rules amend Item 10(b) of Regulation S-K as follows:[21]

- ***Clarification of Applicability to Target Company***. Item 10(b) of Regulation S-K currently refers to projections regarding the “registrant.” The Final Rule will modify the language to clarify that the guidance therein applies to any projections of future economic performance of both the registrant and persons other than the registrant (which would include a target company in a de-SPAC transaction), that are included in the registrant’s Commission filings.
- ***Historical Results***. Disclosure of 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.
- ***Prominence of Historical Results***. Similar to non-GAAP presentation, the Commission will consider it misleading to present projections that are based on historical financial results or operational history without presenting such historical measure or operational history with equal or greater prominence.
- ***Non-GAAP Measures***. Presentation of projections that include a non-GAAP financial measure should include a clear definition or explanation of the measure, a description of the GAAP financial measure to which it is most closely related, and an explanation why the non-GAAP financial measure was used instead of a GAAP measure. The Final Rule notes that the reference to the nearest GAAP measure called for by amended Item 10(b) will not require a reconciliation to that GAAP measure; however, the need to provide a GAAP reconciliation for any non-GAAP financial measures will continue to be governed by Regulation G and Item 10(e) of Regulation S-K.

Important to note that the guidance in the amended Item 10(b) applies to all projections of future economic performance of any registrant and persons other than the registrant that are included in the registrant’s filings with the Commission (not only to de-SPAC transactions). **Proposed Item 1609 of Regulation S-K** In light of the traditional SPAC sponsor compensation structure (*i.e.*, compensation in the form of post-closing equity) and the potential incentives and overall dynamics of a de-SPAC transaction, the Commission has adopted a new rule specific to de-SPAC transactions that will supplement the amendments to Item 10(b) of Regulation S-K (as discussed above). Specifically, the new

Item 1609 of Regulation S-K that will require SPACs to provide the accompanying disclosures to financial projections:

- ***Purpose of Projections***. Any projection disclosed by the registrant in the filing (or any exhibit thereto) must include disclosure regarding (i) the purpose for which the projection was prepared, and (ii) the party that prepared the projection.
- ***Bases and Assumptions***. Disclosure will include all material bases of the disclosed projections and all material assumptions underlying the projections, and any material factors that may materially affect such assumptions. This would include a discussion of any factors that may cause the assumptions to be no longer reasonable, material growth or reduction rates or discount rates used in preparing the projections, and the reasons for selecting such growth or reduction rates or discount rates[22].
- ***Views of Management and the Board***. Disclosure must discuss whether or not the projections disclosed continue to reflect the views of the board of directors (or similar governing body) and/or management of the SPAC or target company, as applicable, as of the most recent practicable date prior to the date of the disclosure document required to be disseminated to security holders. If the projections do not continue to reflect the views of the board of directors (or similar governing body) and/or management, the SPAC should include a discussion of the purpose of disclosing the projections and the reasons for any continued reliance by the management or board on the projections.

Similar to the amendments to Item 10(b), the first two requirements summarized above should not come as a particular surprise to existing SPACs and their counsel as projections disclosure has been a significant area of scrutiny by the Commission in the registration statement and proxy statement review process. We note, however, that the requirement under Item 1609 to add disclosure as to management's and/or the board's current views likely will require additional disclosure beyond what has been typical market practice. In particular, projections disclosure in a registration statement or proxy statement is often made in the context of a historical lookback to the projections in place at the time the board of directors of the SPAC assessed whether to enter into a de-SPAC transaction with the target company. These projections typically are not updated with newer data during the pendency of the transaction since the purpose of such disclosure is to inform investors of the board's rationale for approving the transaction. Item 1609 does not explicitly require the updating of projections, but it does require the parties to disclose whether the included projections reflect the view of the SPAC and the target company as of the date of filing. Moreover, the potential to provide revised projections, coupled with obligations to disclose management's and board's continuing views, may prove challenging disclosure to be made between the signing of a business combination agreement and the filing of a registration statement or proxy statement and during the review period for such registration statement or proxy statement.

5. Status of SPACs under the Investment Company Act of 1940

Because pre-transaction SPACs are not engaged in any meaningful business other than investing their IPO proceeds, there has been uncertainty regarding whether they are "investment companies" under the Investment Company Act of 1940.[23] The Proposed Rules included a safe harbor that would have excluded certain SPACs from being defined as investment companies; however, the Commission instead set forth in the Final Rules facts and circumstances guidance relevant to investment-company classification using the five *Tonopah* factors employed in the standard analysis.[24]

- ***Nature of SPAC Assets and Income****.* If a SPAC were to invest in investment securities like corporate bonds—especially if those investments exceeded 40% of the SPAC's assets—it would likely be an investment company. (Assets commonly held by SPACs today, such as U.S. government securities, money market funds, and cash, likely would not count heavily toward investment-company status.) Similarly, if a SPAC were to derive most of its income from investment securities, it would likely be an investment company.

- ***Management Activities***. If a SPAC were to hold investment securities while its managers did not actively seek a de-SPAC transaction, or while its managers actively managed those securities to achieve investment returns, the SPAC would more likely be an investment company. Relatedly, SPAC sponsors should be aware that they may be classified as "investment advisors" under the Investment Advisors Act of 1940.[25]
- ***Duration***. The longer a SPAC takes to achieve a de-SPAC transaction, the more likely its investment-company-like characteristics qualify it as an investment company. The Commission identifies two timelines as relevant for this analysis. Rule 3a-2 under the Investment Company Act provides a one-year safe harbor for "transient investment companies." And blank-check companies under Investment Company Act Rule 419 are not investment companies because their duration is limited to 18 months. Because these timelines reflect the Commission's thinking in similar circumstances, though outside of the SPAC context, SPACs operating beyond 12 or 18 months should assess whether they otherwise qualify as investment companies.
- ***Holding Out***. A SPAC that markets itself like an investment company is likely to be considered to be an investment company. For example, a SPAC that advertises itself an alternative to mutual funds is holding itself out as an investment company.
- ***Merging with an Investment Company***. A SPAC that proposes to engage in a de-SPAC transaction with an investment company is likely to itself be an investment company.

SPACs should carefully assess all the facts and circumstances to determine whether they must register as investment companies. In particular, they should pay attention to the 12- and 18-month thresholds and whether investment securities account for most of their assets, income, or efforts. **IV. Conclusions** These Final Rules come as no surprise to SPAC market participants. Indeed, a comparison of existing de-SPAC transaction disclosure practices with many of the Final Rules merely evidences a codification of what the market has already adopted and anticipated over the nearly twenty-two month period since the Proposed Rules were first released. While the market appears to have already anticipated some of these changes, it remains to be seen whether the Final Rules will have any meaningful effect on current market conditions, as evidenced by the substantial retraction in the SPAC market over the last year, or if the SPAC market itself has naturally run its course in light of broader macro-economic trends. Although we may view many of the Final Rules as reiterating the status quo, the Commission's efforts here are noteworthy in that the Final Rules also touch upon broader market considerations. For example, the Final Rules' facts and circumstances guidance with respect to the applicability of "underwriter" or "investment company" status, and the changes to Item 10(b) related to projections disclosure, are not limited solely to SPACs and should be considered relevant to other public market participants and advisors in similar and adjacent circumstances. As a result, we encourage our clients and public market participants to reach out to us to see how this rulemaking may affect their going-forward operations and business plans. **V. Commissioner Statements** For the published statements of the Commissioners, please see the following links: Commissioner Jaime Lizárraga Commissioner Caroline A. Crenshaw Commissioner Mark T. Uyeda (Dissenting) Commissioner Hester M. Peirce (Dissenting) [1] U.S. Securities and Exchange Commission, *Special Purpose Acquisition Companies, Shell Companies, and Projections*, Exchange Act Release No. 99418 (January 24, 2024) ("Final Rules"), *available at https://www.sec.gov/files/rules/final/2024/33-11265.pdf*. [2] For our discussion of the proposed rules, see Gibson, Dunn & Crutcher LLP, *SEC Proposes Rules to Align SPACs More Closely with IPOs* (April 6, 2022), *available at https://gdstaging.com/sec-proposes-rules-to-align-spacs-more-closely-with-ipos/*. [3] *See* Gibson, Dunn & Crutcher LLP, *SEC Staff Issues Cautionary Guidance Related to Business Combinations with SPACs* (April 6, 2021), *link here* (addressing certain accounting, financial reporting and governance issues related to SPACs and the combined company following a SPAC business combination), *see also* Gibson, Dunn & Crutcher LLP, *SEC Division of Corporation Finance Issues Interpretations Addressed to SPACs'*

Business Combinations (March 24, 2022), *link* [here](#) (discussing new Compliance and Disclosure Interpretations that addressed certain issues related to the business combination process of de-SPAC transactions), and Gibson, Dunn & Crutcher LLP, *SEC Publishes C&DIs Addressing Tender Offer Issues* (March 17, 2023), *link* [here](#) (discussing new Compliance and Disclosure Interpretations that addressed various tender offer issues in connection with de-SPAC transactions). [4] U.S. Securities and Exchange Commission, Press Release (2024-8), *SEC Adopts Rules to Enhance Investor Protections Relating to SPACs, Shell Companies, and Projections* (January 24, 2024), *available at https://www.sec.gov/news/press-release/2024-8*. [5] *Id.* [6] The term "promoter" is defined in Securities Act Rule 405 and Exchange Act Rule 12b-2. [7] Under Section 6(a) of the Securities Act, each "issuer" must sign a Securities Act registration statement. The Securities Act broadly defines the term "issuer" to include every person who issues or proposes to issue any securities. [8] Final Rules, p. 220. [9] 17 CFR 229.10(f)(1). [10] The term "penny stock" is defined in 17 CFR 240.3a51-1. [11] Section 11 of the Securities Act imposes on underwriters, among other parties identified in Section 11(a), civil liability for any part of the registration statement, at effectiveness, which contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, to any person acquiring such security. Further, Section 12(a)(2) imposes liability upon anyone, including underwriters, who offers or sells a security, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading, to any person purchasing such security from them. [12] Final Rules, p. 284 [13] *Id*., p. 285 [14] Although the Securities Act does not expressly require an underwriter to conduct a due diligence investigation, the Final Rules reiterates the Commission's long-standing view that underwriters nonetheless have an affirmative obligation to conduct reasonable due diligence. Final Rules, p. 288. This was also mentioned by the Commission in fn. 184 of the Proposed Rule (citing In re Charles E. Bailey & Co., 35 S.E.C. 33, at 41 (Mar. 25, 1953) ("[An underwriter] owe[s] a duty to the investing public to exercise a degree of care reasonable under the circumstances of th[e] offering to assure the substantial accuracy of representations made in the prospectus and other sales literature."); In re Brown, Barton & Engel, 41 SEC 59, at 64 (June 8, 1962) ("[I]n undertaking a distribution . . . [the underwriter] had a responsibility to make a reasonable investigation to assure [itself] that there was a basis for the representations they made and that a fair picture, including adverse as well as favorable factors, was presented to investors."); In the Matter of the Richmond Corp., infra note 185 ("It is a well-established practice, and a standard of the business, for underwriters to exercise diligence and care in examining into an issuer's business and the accuracy and adequacy of the information contained in the registration statement . . . The underwriter who does not make a reasonable investigation is derelict in his responsibilities to deal fairly with the investing public.")). [15] Final Rules, p. 290. [16] *Id*., p. 290-91. [17] *Id*., p. 112 (citing the staff guidance under the Division of Corporation Finance's Financial Reporting Manual). [18] *Id.*, p. 112 (citing the staff guidance under the Division of Corporation Finance's Financial Reporting Manual at Section 4110.5). [19] *Id*., p. 339. [20] For example, the Commission cites to recent enforcement actions against SPACs, alleging the use of baseless or unsupported projections about future revenues and the use of materially misleading underlying financial projections. *See*, *e.g.*, *In the Matter of Momentus, Inc.*, et al., Exch. Act Rel. No. 34-92391 (July 13, 2021); *SEC vs. Hurgin, et al.*, Case No. 1:19-cv05705 (S.D.N.Y., filed June 18, 2019); *In the Matter of Benjamin H. Gordon*, Exch. Act Rel. No. 34-86164 (June 20, 2019); and *SEC vs. Milton*, Case No. 1:21-cv-6445 (S.D.N.Y., filed July 29, 2021). [21] The Final Rules made three technical revisions to item 10(b). The first two changes are to enhance clarity and avoid potential ambiguity. The third revision is to create consistency with the terms used in existing Item 10(e)(1)(i)(A) of Regulation S-K. In Item 10(b)(2)(i), they replaced the term "foregoing measures of income" with the term "foregoing measurers of income (loss)." In Item 10(b)(2)(iii), they replaced the term "historical financial measure" with the term "historical financial results." In Item 10(b)(2)(iv), they revised the item to require a description of the GAAP financial measure "most directly comparable" to the non-GAAP measure, rather than "mostly closely related." [22] Two examples of "discount rates" are:

(1) the weighted average cost of capital used to discount to present value the future cash flows over the period of years projected in a discounted cash flow analysis and (2) the rate applied to the terminal value in a discounted cash flow analysis to calculate its present value. [23] See 15 U.S.C. §§ 80a-3(a)(1)(A), (a)(1)(C). [24] See *In the Matter of Tonopah Mining Co.*, 26 S.E.C. 426 (July 21, 1947). [25] See 15 U.S.C. § 80b-2(a)(11).

The following Gibson Dunn attorneys assisted in preparing this update: Evan D'Amico, Gerry Spedale, James Springer, and Rodrigo Surcan.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. For further information, please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Capital Markets, Mergers and Acquisitions, Securities Enforcement, or Securities Regulation and Corporate Governance practice groups, or the following practice leaders and authors: Evan M. D'Amico – Washington, D.C. (+1 202.887.3613, edamico@gibsondunn.com) Gerry Spedale – Houston (+1 346.718.6888, gspedale@gibsondunn.com) James O. Springer – Washington, D.C. (+1 202.887.3516, jspringer@gibsondunn.com) Rodrigo Surcan – New York (+1 212.351.5329, rsurcan@gibsondunn.com) **Mergers and Acquisitions**: Robert B. Little – Dallas (+1 214.698.3260, rlittle@gibsondunn.com) Saee Muzumdar – New York (+1 212.351.3966, smuzumdar@gibsondunn.com) **Capital Markets**: Andrew L. Fabens – New York (+1 212.351.4034, afabens@gibsondunn.com) Hillary H. Holmes – Houston (+1 346.718.6602, hholmes@gibsondunn.com) Stewart L. McDowell – San Francisco (+1 415.393.8322, smcdowell@gibsondunn.com) Peter W. Wardle – Los Angeles (+1 213.229.7242, pwardle@gibsondunn.com) **Securities Regulation and Corporate Governance**: Elizabeth Ising – Washington, D.C. (+1 202.955.8287, eising@gibsondunn.com) James J. Moloney – Orange County (+1 949.451.4343, jmoloney@gibsondunn.com) Lori Zyskowski – New York (+1 212.351.2309, lzyskowski@gibsondunn.com) Brian J. Lane – Washington, D.C. (+1 202.887.3646, blane@gibsondunn.com) Ronald O. Mueller – Washington, D.C. (+1 202.955.8671, rmueller@gibsondunn.com) Thomas J. Kim – Washington, D.C. (+1 202.887.3550, tkim@gibsondunn.com) Mike Titera – Orange County (+1 949.451.4365, mtitera@gibsondunn.com) Aaron Briggs – San Francisco (+1 415.393.8297, abriggs@gibsondunn.com) Julia Lapitskaya – New York (+1 212.351.2354, jlapitskaya@gibsondunn.com)

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