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Legal Update

SEC Proposes a "Sea Change" Set of New Rules Applicable to SPACs and Other Market Participants

On March 30, 2022, the Securities and Exchange Commission (the "SEC") proposed new rules and amendments to existing rules and forms (the "Proposed Rules") addressing the treatment of special purpose acquisition companies ("SPACs") in connection with their initial public offerings ("IPOs") and subsequent de-SPAC transactions. Comments on the Proposed Rules are due 30 days after publication in the Federal Register or May 31, 2022 (60 days after issuance), whichever is later.[1]

The Proposed Rules, if adopted, would represent a sea change in the treatment of SPACs by the SEC. A wide variety of market participants would do well to take heed of the Proposed Rules and to consider commenting on the Proposed Rules. If the Proposed Rules were to be adopted as written, they reflect a number of fundamental changes to basic principles of securities law liability that extend in their application beyond SPACs and de-SPAC transactions.

This Legal Update (i) provides background on SPACs generally; (ii) summarizes the Proposed Rules; and (iii) provides key takeaways and practical considerations.

Background on SPACs

A SPAC is a shell company that completes an IPO with no business operations of its own. Instead, a SPAC's sole purpose is to identify, and consummate a business combination (also commonly referred to as a "de-SPAC transaction") with, a target operating company; a process that the SPAC has a limited time to complete. Upon completion of the business combination, the target effectively becomes a publicly traded company. Because a SPAC has no operations, the disclosure in a SPAC IPO typically focuses on the prior experience of the SPAC's organizers/founders (referred to as "sponsors"), who are expected to successfully find a target company and complete the de-SPAC transaction.

Although terms vary from offering to offering, a SPAC's IPO typically consists of the sale of units, typically priced at $10.00 per unit, comprised of one share of Class A common stock and a fraction of a redeemable warrant to purchase one share of Class A common stock with a strike price of $11.50. The gross proceeds from a SPAC's IPO are placed in a trust account and are generally unavailable to the SPAC prior to consummation of the business combination. Funds in the trust account may be removed only in limited circumstances, primarily if either: (i) the SPAC completes a business combination; or (ii) the SPAC fails to complete a business combination in the allotted time and dissolves, in which case the funds in the trust account are returned to Class A stockholders.

Investment banks that underwrite a SPAC's IPO typically receive one-third of their underwriting compensation upon the closing of the SPAC IPO, with the remaining portion payable when, and only if, the SPAC completes the business combination.

The terms of a SPAC's charter typically include a requirement that the SPAC must offer to redeem its Class A shares (though not its warrants) in connection with the consummation of the business combination. The redemption price equals the investor's original $10.00 investment plus the investor's pro rata share of any interest earned on the funds while held in the trust account.

A SPAC's sponsors typically receive a "sponsor promote" consisting of shares of Class B common stock (sometimes referred to as "founder shares") issued prior to the IPO for a nominal amount (typically $25,000) and warrants purchased in a private placement consummated simultaneously with the IPO (typically for a purchase price of $1.00 to $1.50 per warrant). These "private placement" warrants typically allow their holders to purchase one share of Class A common stock for a strike price of $11.50. The founder shares typically represent 20% of the SPAC's total outstanding common stock after closing of the IPO. The number of private placement warrants varies based on the size of the IPO and the price per warrant paid. The proceeds from the sale of the private placement warrants fund the SPAC's IPO expenses and working capital while the SPAC searches for a target company.

Once a SPAC identifies a target company with which to combine, the SPAC will often raise additional capital through a private investment in public equity ("PIPE") transaction in order to provide additional cash for the post-business combination company and to mitigate the risk that a significant number of SPAC stockholders will tender their Class A shares for redemption. Typically, a SPAC will market the PIPE to institutional investors as it nears execution of a business combination agreement with the target company. The marketing materials provided to potential PIPE investors typically include projected financial information for the target company. The terms of a SPAC's PIPE transaction vary more widely than the terms of a SPAC's IPO. A typical PIPE transaction will include one share of Class A common stock for a price of $10.00. However, as investor interest in PIPE transactions has waned over the past year, some SPACs have had to modify the terms of these transactions to include warrant coverage, rights or even a share of the sponsor promote all for the same $10.00 price. Typically, a SPAC will simultaneously sign the business combination agreement with the target company and subscription agreements for a PIPE transaction with investors, and then announce all transactions to the market in a press release filed with the SEC on a Current Report on Form 8-K. The SPAC will usually also publicly release the projected financial information for the target company, which was shared with PIPE investors.

Prior to consummating a de-SPAC transaction, a SPAC will typically seek approval for the transaction from its stockholders using a proxy statement to solicit proxies to be voted at a special stockholder meeting. The proxy statement will describe, among other things, the terms of the business combination as well as the target company, including the target company's business, results of operations, financial condition, prospects and risks. In many cases, SPACs combine the proxy statement with a prospectus registering securities to be in issued to the target company sellers in the business combination on a Form S-4 or Form F-4 registration statement.

If the business combination is approved by the stockholders and the other conditions precedent to the business combination agreement have been satisfied, the SPAC will consummate its de-SPAC transaction shortly after the stockholder meeting. The funds from the trust account are released to the target company (net of any amounts returned to investors who tender their Class A shares for redemption and payment of the deferred IPO underwriting fee to the underwriters of the SPAC's IPO) and any financing transactions are simultaneously consummated.

The Proposed Rules

As mentioned, the Proposed Rules would represent a significant change in the treatment of SPACs under the U.S. securities laws and would impact (i) the disclosure required in SPAC IPOs and de-SPAC transactions; (ii) the potential liability of various transaction participants in a de-SPAC transaction; (iii) the use and content of forward-looking statements, including projections, in de-SPAC transactions; and (iv) a SPAC's status under the Investment Company Act of 1940 (the "Investment Company Act").

SPECIALIZED DISCLOSURE REQUIREMENTS FOR SPAC TRANSACTIONS

The Proposed Rules would introduce a new Subpart 1600 to Regulation S-K that would set forth specialized disclosure requirements in connection with SPAC IPOs and de-SPAC transactions.[2]

Information on SPAC Sponsors

New Item 1603(a) would require additional disclosure about a SPAC's sponsor,[3] its affiliates and any promoters in registration statements or schedules used in either a SPAC IPO or de-SPAC transaction, including:

- the experience, material roles, and responsibilities of these parties, as well as any agreement, arrangement or understanding (1) between the sponsor and the SPAC, its executive officers, directors or affiliates, in determining whether to proceed with a de-SPAC transaction; and (2) regarding the redemption of outstanding securities;
- the controlling persons of the sponsor and any persons who have direct or indirect material interests in the sponsor, as well as an organizational chart that shows the relationship between the SPAC, the sponsor, and the sponsor's affiliates;
- tabular disclosure of the material terms of any lock-up agreements with the sponsor and its affiliates; and
- the nature and amounts of all compensation 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 transaction.

As noted by the SEC, some of this information is already provided by SPACs in their SEC filings and the proposed rules would codify and amplify these existing disclosure practices to ensure that SPACs provide consistent information.

Conflicts of Interest

In both SPAC IPOs and de-SPAC transaction filings, new Item 1603(b) would require disclosure of any actual or potential material conflicts of interest between (a) the sponsor or its affiliates or the SPAC's officers, directors, or promoters; and (b) unaffiliated security holders. The release states that Item 1603(b) would require a description of any material conflict of interest in determining whether to proceed with a de-SPAC transaction and any material conflict of interest arising 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. The proposing release includes several examples of potential conflicts of interest, including the following:

- conflicts stemming from the contingent nature of the sponsor's compensation that result in the sponsor having an incentive to complete a de-SPAC transaction even when doing so results in lower returns to Class A stockholders when compared to a liquidation of the SPAC or an alternative transaction;[4]

- conflicts arising when a sponsor is the sponsor of multiple SPACs simultaneously and manages several different SPACs at once;
- conflicts arising when a sponsor and/or its affiliate holds financial interests in, or have contractual obligations to, other entities;
- conflicts arising when a SPAC's target is affiliated with the sponsor, the SPAC or its founders, officers or directors; and
- conflicts arising from the fact that a SPAC's officers may not work full time for the SPAC and thus have limited ability to devote the time necessary to find and execute a de-SPAC transaction.

The proposing release notes that these potential conflicts of interest could become more acute as the SPAC nears the end of the period it has to complete a de-SPAC transaction.

Additionally, new Item 1603(c) would require disclosure regarding the fiduciary duties that each officer and director owes to other companies.

Dilution

The proposing release observes that there are many sources of potential significant dilution in a SPAC's life-cycle. In light of this, new Item 1602(c) would require all SPAC registration statements, other than those for a de-SPAC transaction, to include a description of all material potential sources of future dilution following a SPAC's IPO 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 stockholders, to the extent quantifiable.

In addition, new Item 1602(a)(4) would require tabular dilution disclosure of pro forma net tangible book value per share under a range of potential redemption levels on the cover page of any prospectus included in SPAC registration statements on Forms S-1 or F-1. If the offering includes an overallotment or "green shoe" option, the table would need to include separate rows showing effects of redemptions in both non-exercise and full exercise scenarios.

For de-SPAC transactions, new Item 1604(c) would require disclosure of each material potential source of additional dilution that non-redeeming shareholders may experience at different phases of the SPAC life-cycle. The proposing release gives the following examples of "material potential sources" of dilution:

- sponsor compensation (including the sponsor promote);
- underwriting fees;
- outstanding warrants and convertible securities; and
- financing transactions (including PIPE transactions).

To the extent material, disclosures would need to explain that when a redeeming stockholder retains its warrants in a de-SPAC transaction, the non-redeeming stockholders may face additional potential dilution.

Finally, new Item 1604(c)(1) would also require 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 increasing impact of dilution on non-redeeming stockholders as redemptions increase. SPACs would also be required to include a description of the model, methods, assumptions, estimates, and parameters necessary to understand the sensitivity analysis disclosure.

Prospectus Cover Page and Prospectus Summary Disclosure

SPAC IPOs and other registered offerings other than a de-SPAC transaction

For registered offerings by SPACs other than de-SPAC transactions, new Item 1602(a) would require the prospectus cover page to include, in plain English:[5]

- the time frame for the SPAC to consummate a de-SPAC transaction and whether this time frame may be extended;
- whether security holders will have the opportunity to redeem the securities offered and whether the redemptions will be subject to any limitations; and
- the amount of compensation received or to be received by the SPAC sponsor and its affiliates, and whether this compensation may result in material dilution of the purchasers' equity interests.

New Item 1602(b) would require the following information be included in the prospectus summary section, in plain English:

- the process by which a potential business combination candidate will be identified and evaluated;
- whether shareholder approval is required for the de-SPAC transaction;
- the material terms of the trust or escrow account, including the amount of gross offering proceeds that will be placed in the trust;
- the material terms of the securities being offered, including redemption rights;
- whether the securities being offered are of the same class as those held by the sponsor and its affiliates;
- the length of the time period during which the SPAC intends to consummate a de-SPAC transaction, and its plans if it does not do so, including, whether and how the time period may be extended, the consequences to the sponsor of not extending this time period, and whether stockholders will have voting or redemption rights with respect to an extension to consummate a de-SPAC transaction;
- any plans to seek additional financing and how such additional financing might impact stockholders;
- tabular disclosure of sponsor compensation and the extent to which material dilution may result from such compensation; and
- material conflicts of interest.

De-SPAC Transactions

In de-SPAC transactions, new Item 1604(a) would require that SPACs include the following on the cover page of the prospectus or proxy statement, in plain English:

- whether the SPAC reasonably believes that the de-SPAC transaction is fair or unfair to unaffiliated security holders, and whether the SPAC or the sponsor has received a report, opinion or appraisal from an outside party regarding the fairness of the transaction;
- a brief description of any material financing transactions that have occurred since the SPAC's IPO or will occur in connection with consummation of the de-SPAC transaction;
- the amount of compensation received or to be received by the sponsor, its affiliates and promoters in connection with the de-SPAC transaction or any related financing transaction, and whether this compensation may result in material dilution of the equity interests of non-redeeming stockholders who hold the securities until the consummation of the de-SPAC transaction; and

- whether there may be material actual or potential conflicts of interest between the SPAC sponsor or its affiliates or promoters and unaffiliated security holders in connection with the de-SPAC transaction.

New Item 1604(b) would require the following information in the summary section of the prospectus or proxy statement, in plain English:

- the background and material terms of the de-SPAC transaction;
- whether the SPAC reasonably believes that the de-SPAC transaction is fair or unfair to unaffiliated security holders, the bases for such belief, and whether the SPAC or the sponsor has received any report, opinion or appraisal from an outside party concerning the fairness of the de-SPAC transaction;
- any material actual or potential conflicts of interest between the sponsor or its affiliates or promoters and unaffiliated security holders in connection with the de-SPAC transaction;
- in a tabular format, the terms and amount of the compensation received or to be received by the SPAC sponsor and its affiliates in connection with the de-SPAC transaction or any related financing transaction, and whether that compensation has resulted or may result in a material dilution of the equity interests of unaffiliated security holders of the SPAC;
- the material terms of any financing transactions that have occurred or will occur in connection with the consummation of the de-SPAC transaction, the anticipated use of proceeds from these financing transactions and the dilutive impact, if any, of these financing transactions on unaffiliated security holders; and
- the rights of security holders to redeem the outstanding securities of the SPAC and the potential impact of redemptions on the value of the securities owned by non-redeeming stockholders.

Many of the proposed disclosure requirements relating to conflicts of interest and dilution are unsurprising as they are consistent with recommendations to the SEC made by the SEC's Investor Advisory Committee in September 2021,[6] as well as consistent with the requirements that were set forth proposed in legislation introduced in Congress.[7]

Disclosure and Procedural Requirements for de-SPAC Transactions

Background of the de-SPAC transaction

New Item 1605 would require disclosure of the background, material terms and effects of the de-SPAC transaction, including:

- a summary of the background of the de-SPAC transaction, including, but not limited to, a description of any contacts, negotiations, or transactions that have occurred concerning the de-SPAC transaction;
- a brief description of any related financing transaction, including any payments from the sponsor to investors in connection with the financing transaction;
- the reasons for engaging in the particular de-SPAC transaction and for the structure and timing of the de-SPAC transaction and any related financing transaction;
- an explanation of any material differences in the rights of security holders of the post-business combination company as a result of the de-SPAC transaction; and
- disclosure regarding the accounting treatment and the federal income tax consequences of the de-SPAC transaction, if material.

New Item 1605(d) would require disclosure of material interests (including non-pecuniary interests) that the sponsor and the SPAC's officers and directors have in a de-SPAC transaction or any related financing transaction, including fiduciary or contractual obligations to other entities as well as any interest in, or affiliation with, the target company. New Item 1605(e) would require disclosure of whether security holders are entitled to any redemption or appraisal rights, and if so, a summary of the redemption or appraisal rights.

Fairness of the de-SPAC transaction

New Item 1606(a) would require a statement from a SPAC as to whether it reasonably believes that the de-SPAC transaction and any related financing transaction are fair or unfair to the SPAC's unaffiliated security holders, as well as a discussion of the bases for this statement. An Instruction to Item 1606(a) states that "[a] statement that the special purpose acquisition company has no reasonable belief as to the fairness or unfairness of the de-SPAC transaction or any related financing transaction to unaffiliated security holders will not be considered sufficient disclosure in response to paragraph (a) of this section."

New Item 1606(b) would require a SPAC to discuss 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. Proposed Rule 1606(b) lists a number of such possible factors, including: the valuation of the private operating company; the consideration of any financial projections; any report, opinion, or appraisal obtained from a third party; and the dilutive effects of the de-SPAC transaction and any related financing transaction on non-redeeming stockholders.

These requirements are substantially similar to the requirements in Item 1014 of Regulation M-A applicable to "going private" transactions under Rule 13e-3 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), of course, now being applied in a very different context—a "going public" context.

Additional requirements for disclosure include whether:

- the de-SPAC transaction or any related financing transaction is structured so that approval of at least a majority of unaffiliated security holders is required;
- any director voted against or abstained from voting on, approval of the de-SPAC transaction or any related financing transaction and the reasons for such vote or abstention;
- a majority of directors who are not employees of the SPAC has retained an unaffiliated representative to act solely on behalf of unaffiliated security holders for purposes of negotiating the terms of the de-SPAC transaction or any related financing transaction and/or preparing a report concerning the fairness of the de-SPAC transaction or any related financing transaction; and
- the de-SPAC transaction or any related financing transaction was approved by a majority of the directors of the SPAC who are not employees of the SPAC.

New Item 1607(a), similar to Item 1015 of Regulation M-A, would require disclosure about whether the SPAC or its sponsor has received any report, opinion, or appraisal obtained from an outside party relating to the consideration or the fairness of the consideration to be offered to security holders or the fairness of the de-SPAC transaction or any related financing transaction to the SPAC, the sponsor or security holders who are not affiliates. If any outside party rendered any such report, opinion or appraisal, new Item 1607(b) would require disclosure of:

- the identity, qualifications, and method of selection of the outside party and/or unaffiliated representative;

- any material relationship between (1) the outside party, its affiliates, and/or unaffiliated representative; and (2) the SPAC, its sponsor and/or their affiliates, that existed during the past two years or is mutually understood to be contemplated and any compensation received or to be received as a result of the relationship;
- whether the SPAC or the sponsor determined the amount of consideration to be paid to the private operating company or its security holders, or the valuation of the private operating company, or whether the outside party recommended the amount of consideration to be paid or the valuation of the private operating company; and
- a summary concerning the negotiation, report, opinion or appraisal, which would be required to include a description of the procedures followed; the findings and recommendations; the bases for and methods of arriving at such findings and recommendations; instructions received from the SPAC or its sponsor; and any limitation imposed by the SPAC or its sponsor on the scope of the investigation.

Any such report, opinion or appraisal would be required to be included as an exhibit to a registration statement on Form S-4 or F-4 or a Schedule TO for a de-SPAC transaction and included directly in any proxy or information statement for a de-SPAC transaction.

The proposing release states that the rationale for these proposed rules is to: "address concerns regarding potential conflicts of interest and misaligned incentives in connection with the decision to proceed with a de-SPAC transaction" and to assist investors in assessing the (i) fairness of a particular transaction to unaffiliated investors; and (ii) the basis of a SPAC's reasonable believe that a de-SPAC transaction and related financing transactions are fair to unaffiliated investors. Following on the recent Delaware Court of Chancery decision in *In re MultiPlan Corp. Stockholders Litigation* applying the "entire fairness" standard to a breach of fiduciary duty claim in a de-SPAC transaction,[8] the SEC seems to be codifying a judicial determination that de-SPAC transactions and related financings are inherently "conflicted transactions" in need of special procedures to ensure that they are entirely fair to unaffiliated stockholders. The proposing release states that disclosures required in going-private transactions "provide an appropriate model" for de-SPAC transactions "in that the conflicts of interests and misaligned incentives inherent in going-private transactions are similar to those often present in de-SPAC transactions."

ALLIGNMENT OF DE-SPAC TRANSACTIONS WITH A TRADITIONAL IPO

In the proposing release, the SEC expresses its view that a private operating company's method of becoming a public company (i.e., via a de-SPAC transaction vs. a traditional IPO) should not negatively impact investor protection. As a consequence, the proposing release states that the Proposed Rules contain various provisions designed, according to the proposing release, to provide investors with disclosures and liability protections comparable to those that would be present if a private company undertaking a de-SPAC transaction were instead conducting a traditional IPO.

Non-Financial Statement Disclosure Requirements

In de-SPAC transactions involving a target company not already subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act, disclosure in the registration statement or proxy or information statement filed with the SEC would be required to include the following items from Regulation S-K:

- Item 101 (description of business);
- Item 102 (description of property);
- Item 103 (legal proceedings);

- Item 304 (changes in and disagreements with accountants on accounting and financial disclosure);
- Item 403 (security ownership of certain beneficial owners and management, assuming completion of the de-SPAC transaction and related financing transactions); and
- Item 701 (recent sales of unregistered securities).

If the target company is a foreign private issuer,[9] the Proposed Rules would include the option to provide disclosure in accordance with the following items of Form 20-F:

- Item 3.C (Key Information; Reasons for the Offer and Use of Proceeds);
- Item 4 (Information on the Company, including history, business overview; organizational structure and property plants and equipment);
- Item 6.E (Directors, Senior Management and Employees; Share Ownership);
- Item 7.A (Major Shareholders);
- Item 8.A.7 (Legal and Arbitration Proceedings); and
- Item 9.E (Dilution).

The proposing release notes that the proposed information to be included is already required in what has become known as the "Super 8-K,"[10] which is filed after completion of the de-SPAC transaction and thus this new requirement should not add a substantial burden. The Proposed Rules would require disclosure of this information earlier in the de-SPAC process and prior to when the voting, tender or redemption decision is to be made by investors. Furthermore, the information would also be available to investors prior to the inception of trading of the post-business combination company's securities on a national securities exchange, rather than being required to be included in the "Super 8-K" due within four business days of the completion of the de-SPAC transaction. The release also notes that if this information is included in a registration statement (as opposed to a proxy or information statement), investors would be further protected against material misstatements or omissions by subjecting various transaction participants to potential liability under Sections 11 or 12 of the Securities Act of 1933, as amended (the "Securities Act").

Minimum Dissemination Period for de-SPAC Transaction Documents

Under the Proposed Rules, prospectuses, proxy statements and information statements filed in connection with a de-SPAC transaction would be required to be distributed to stockholders at least 20 calendar days in advance of a stockholder meeting or date of action by consent. If the maximum period for disseminating such documents permitted under the laws of a SPAC's jurisdiction of incorporation or organization is shorter than 20 calendar days, the Proposed Rules would permit that shorter period to govern.

Target Company as Co-Registrant

When a SPAC proposes to register the issuance of shares in connection with a de-SPAC transaction on a registration statement on Form S-4 or F-4, the Proposed Rules would require the target company be deemed a co-registrant. In addition to subjecting the target company to potential liability under Section 11 of the Securities Act, each of a target company's (i) principal executive officer; (ii) principal financial officer; and (iii) controller/principal accounting officer, as well as at least a majority of the target company's board of directors, would be required to sign the registration statement. By signing the registration statement, each of these individuals will be subject to Securities Act liability.

Re-Determination of Smaller Reporting Company Status

In a traditional IPO, a private company would determine whether it qualifies as a smaller reporting company[11] at the time of filing its initial registration statement on Form S-1 or F-1. This determination is important because smaller reporting companies are eligible for certain disclosure accommodations in various forms under the Securities Act and Exchange Act. Most SPACs qualify as smaller reporting companies at the time of their IPO. Once a company determines it is a smaller reporting company, it is required to make a re-determination of its continued eligibility only once a year, as of the last business day of its second fiscal quarter.

The proposing release notes that without a requirement for a re-determination upon completion of a de-SPAC transaction, the rules permit certain post-business combination companies to avail themselves of scaled disclosure requirements and other accommodations when they otherwise would not have qualified as a smaller reporting company had they become public companies through a traditional IPO.

The Proposed Rules would require a newly combined company to re-determine whether it qualifies as a smaller reporting company following consummation of a de-SPAC transaction. This re-determination would be required to occur prior to the time the newly combined combination company makes its first filing with the SEC (excluding the "Super 8-K") with public float measured as of a date within four business days after the consummation of the de-SPAC transaction and revenue determined using the annual revenues of the target company as of the most recently completed fiscal year for which audited financial statements are available. If a post-business combination company does not qualify as a smaller reporting company, its next periodic report (Form 10-Q or Form 10-K) would need to reflect this fact by including any necessary incremental disclosure.

Inapplicability of PSLRA

Upon satisfaction of specified conditions, the Private Securities Litigation Reform Act of 1995 (the "PSLRA") provides a safe harbor under which a company is protected from liability in any private right of action brought under the Securities Act or Exchange Act based on material misstatements or omissions in forward-looking statements. Importantly, the PSLRA safe harbor is not available in an IPO.

The PSLRA safe harbor is also not available for offerings made by "blank check companies." In short, a "blank check company" is a development stage company that has no specific business plan or purpose or that has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies, and that is issuing "penny stock" (as defined in Exchange Act Rule 3a51-1). By raising more than $5 million in their IPOs, SPACs avoid being deemed "blank check companies" thus enabling them to rely on the PSLRA safe harbor in connection with disclosing projected financial information as part of the de-SPAC transaction. The Proposed Rules would amend the definition of "blank check company" for purposes of the PSLRA by removing the requirement that a company issue "penny stock" in order to be considered a "blank check company." The release states that amending this definition would clarify that the PSLRA's safe harbor is not available for forward-looking statements, including projections, made by a SPAC in connection with a de-SPAC transaction. The release also notes that the safe harbor is already not available to target companies in a de-SPAC transaction as the target company is not then subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act.

This proposal is sure to generate comment letters from a wide variety of market participants. As foreshadowed by Commissioner Peirce's dissenting statement to the proposal,[12] this proposal may also lead to legal challenges in the federal courts as there is reason to conclude that Congress was looking to the then established definition of a "blank check company" contained in Rule 419, which required the issuance of "penny stock," when it enacted the PSLRA and Section 27A(i)(7) of the PSLRA states that the term "blank check company" has the meaning given to the term by rule or regulation of the SEC.[13]

Underwriting Liability in de-SPAC Transactions

Under new proposed Securities Act Rule 140a, a person who has acted as an underwriter in a SPAC's IPO and who "participates in the distribution by taking 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.

The release states that this "clarification" of underwriter status in de-SPAC transactions should "motivate" SPAC IPO underwriters to exercise the care necessary to help ensure the accuracy of the disclosures in de-SPAC transactions by affirming that they are subject to Section 11 liability for registered de-SPAC transactions.

Even if a SPAC IPO underwriter is not formally retained to act as an underwriter in a de-SPAC transaction, the release describes ways that a SPAC IPO underwriter may be deemed to be "participating" in activities that are necessary for the de-SPAC transaction's distribution of the combined company's securities:

- acting as a financial advisor to the SPAC, and assisting in identifying potential target companies or negotiating merger terms;
- finding investors for, and negotiating, PIPE instruments; or
- receiving compensation in connection with the de-SPAC transaction (including any deferred underwriting compensation that is delivered upon completion of the de-SPAC transaction).

The release notes that the above summarized discussion is not an exhaustive assessment of underwriter status in the SPAC context and is in no way intended to limit the definition of "underwriter" under the Securities Act. The release also indicates that even without acting as a SPAC IPO underwriter, "financial advisors, PIPE investors or other advisors" could be deemed to be statutory underwriters in a de-SPAC transaction, depending on the circumstances.

This aspect of the Proposed Rules represents a significant departure of what has been understood to constitute an underwriter in a de-SPAC transaction; and the beginning of a slippery slope as to what level of activity or involvement triggers, or gives rise to a finding of, "underwriter" status in other contexts under the securities laws.

BUSINESS COMBINATIONS INVOLVING SHELL COMPANIES GENERALLY

The following proposals would apply to business combination transactions involving a shell company generally, whether that shell company is a SPAC or not.

Business Combinations with a Shell Company as Sales to the Shell Company's Stockholders

Under new Rule 145a, any business combination of a reporting shell company[14] involving another entity that is not a shell company would be deemed to involve a "sale" of securities to the reporting shell company's stockholders. Since a SPAC would be a reporting shell company and under Section 5 of the Securities Act, all sales of securities must either be registered under the Securities Act or exempt from registration, the proposed Rule 145a would effectively require any de-SPAC transaction to either be registered or qualify for an applicable exemption. The release expresses the rationale for this rule by stating that: "the substantive reality of [such a transaction] is that the reporting shell company investors have effectively exchanged their security representing an interest in the reporting shell company for a new security representing an interest in the combined operating company."

The release describes the SEC's "current view" that Section 3(a)(9), which exempts any securities exchange by an issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange, would likely not be available for transactions covered by proposed Rule 145a. The primary reason for this view, according to the release, is that the deemed exchange by the reporting shell company's existing shareholders for the combined company's securities should be viewed as part of the same offering as the exchange of the private company's securities for their interests in the combined company and as a result the exchange is not "exclusively with the reporting shell company's existing security holders." The release also notes that shell companies often hire and compensate a proxy solicitor to solicit approval of the reporting company's stockholders for the business combination, a practice that would be an independent reason for the inapplicability of Section 3(a)(9).

The release also notes that even if an exemption applies, by deeming these transactions to include a "sale" under the Securities Act, investors would have the protections of the anti-fraud provisions in Section 17(a) of the Securities Act and Section 10(b) of, and Rule 10b-5 under, the Exchange Act.

Proposed Rule 145a would not apply to:

- business combinations between two bona fide non-shell entities;
- transactions involving reporting shell companies that are business combination related shell companies;[15] and
- business combinations of one shell company into another shell company.

Financial Statement Requirements

The Proposed Rules include a number of amendments designed to more closely align the financial statement reporting requirements in business combinations involving a shell company and a private operating company with those applicable to a traditional IPO.

Number of Years of Financial Statements

Currently, one exception applicable to business combinations permits two years of financial statements of a target company to be presented (instead of three) when the target company: (1) would be an emerging growth company (an "EGC") if it were conducting an IPO of common equity securities; and (2) the registrant is an EGC that has not yet filed or been required to file its first annual report. The Proposed Rules would remove whether or not the shell company has filed its first annual report as a factor in determining the number of years required.

Audit Requirements of Target Company

When a target company will be deemed the predecessor to a shell company in a registration statement or proxy statement, the Proposed Rules would require audits of a target company's financial statements to be conducted by an independent accountant in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB) for the purpose of expressing an opinion thereon.

Age of Financial Statements

Proposed Rule 15-01(c) would provide that the age of financial statements for a target company that would be the predecessor to a shell company in a registration statement or proxy statement would be based on whether the target company would qualify as a smaller reporting company if filing its own initial registration statement. A target company that qualifies as a smaller reporting company would apply Rule 8-08 for the age of its financial statements, which permits registration statements and proxy statements with an effective or mailing date, respectively:

- within 45 days after the end of the fiscal year, to include financial statements only as current as of the end of third fiscal quarter; and

- after 45 days but within 90 days of the end of the fiscal year, to omit audited financial statements for such fiscal year if:
    - all reports due have otherwise been filed (if the target is already a reporting company);
    - for the most recent fiscal year for which audited financial statements are not yet available, the smaller reporting company reasonably and in good faith expects to report income from continuing operations attributable to the registrant before taxes; and
    - for at least one of the two fiscal years immediately preceding the most recent fiscal year, the smaller reporting company reported income from continuing operations attributable to the registrant before taxes.

Target companies not meeting the definition of smaller reporting company would not benefit from the second bullet above and need to include a new audit for the most recent fiscal year when the effective date or mailing date is 46 days or more after the end of such fiscal year.

Recent or Probable Acquisitions of Businesses by the Target Company

When a target company in a business combination transaction has itself acquired, or it is probable that it will acquire, another business (an "Other Acquisition"), historical financial statements of that Other Acquisition may be required in the business combination registration statement or proxy statement. Currently, such financial statements are required only when omission of those financial statements would render the target company's financial statements substantially incomplete or misleading.

The Proposed Rules would require application of the Regulation S-X provisions related to financial statements of an acquired business (*i.e.*, Rules 3-05 or 8-04, depending on the facts and circumstances) to such situations. The Proposed Rules would also provide that the significance tests set forth in Rule 1-02(w) of Regulation S-X, which determine when an acquired business' financial statements are required, would be calculated using the target company's financial information for the denominator instead of the shelf company registrant's financial information.

If, after application of Rule 3-05, the financial statements of an Other Acquisition are omitted because the significance of the Other Acquisition is greater than 20% but less than 50%, the current rules would require those financials to be filed on a Form 8-K within 75 days after the consummation of the acquisition. However, it is possible that this 75-day period would expire before a target company has completed a de-SPAC transaction. In such a case, it is unclear how that target company would file a Form 8-K. The Proposed Rules provide that the omitted financial statements in such a case would be required to be filed as an exhibit to the "Super 8-K" following completion of the de-SPAC transaction.

Financial Statements of a Shell Company After a Business Combination

The Proposed Rules would provide that a registrant may exclude the financial statements of a shell company, including a SPAC, for periods prior to the acquisition once the following conditions have been met: (1) the financial statements of the shell company have been filed for all required periods through the acquisition date, and (2) the financial statements of the registrant include the period in which the acquisition was consummated.

ENHANCED PROJECTIONS DISCLOSURE

Generally

Item 10(b) of Regulation S-K states that management has the option to present in SEC filings its good faith assessment of a registrant's future performance, but it also states that management must have a reasonable basis for such an assessment.

The Proposed Rules would amend Item 10(b) to state that:

- any projected measures not based on historical financial results or operational history should be clearly distinguished from projected measures based on historical financial results or operational history;
- it generally would be misleading to present projections based on historical financial results or operational history without presenting such historical measure or operational history with equal or greater prominence; and
- the 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 as to why the non-GAAP financial measure was used instead of a GAAP measure.

The Proposed Rules would also make clear that the guidance in Item 10(b), including as modified per the above, would apply to projections relating to the registrant and to persons other than the registrant, including a target company in a business combination transaction.

Specific Rules for de-SPAC Transactions

The SEC also proposed a new Item 1609 of Regulation S-K that would apply to disclosures of projected financial information in connection with de-SPAC transactions. Under Item 1609, a SPAC would be required to provide the following disclosures:

- with respect to any projections disclosed by the registrant, the purpose for which the projections were prepared and the party that prepared the projections;
- all material bases of the disclosed projections and all material assumptions underlying the projections, and any factors that may materially impact such assumptions (including a discussion of any factors that may cause the assumptions to be no longer reasonable, material growth rates or discount multiples used in preparing the projections, and the reasons for selecting such growth rates or discount multiples); and
- whether the disclosed 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; if not, then discussion of the purpose of disclosing the projections and the reasons for any continued reliance by the management or board on the projections.

The principles behind these proposals are similar to those underlying Regulation G, applicable to the use of non-GAAP financial measures.

PROPOSED SAFE HARBOR UNDER THE INVESTMENT COMPANY ACT OF 1940

Out of a concern that “SPACs may fail to recognize when their activities raise the investor protection concerns addressed by the Investment Company Act,” the SEC is proposing a new rule, Rule 3a-10, which would provide a non-exclusive safe harbor from the definition of “investment company” under Investment Company Act Section 3(a)(1)(A) for SPACs, subject to a number of conditions. This proposal is the first time that the SEC has formally addressed the status of SPACs as investment companies.

As proposed, under Rule 3a-10, a SPAC will not be deemed to be an “investment company” under Section 3(a)(1)(A), if the following conditions are met:

Composition and Purpose of the SPAC’s Assets: The SPAC’s assets must consist solely of “government securities” as defined in the Investment Company Act, securities issued by government money market funds as defined in

Rule 2a-7(a)(14), and cash items prior to completion of the de-SPAC transaction. In addition, these assets may not at any time be acquired or disposed of for the primary purpose of recognizing gains or decreasing losses resulting from market value changes (echoing certain aspects of Rule 3a-7).

Nature and Timing of de-SPAC Transaction: The SPAC must seek to complete a *single* de-SPAC transaction as a result of which:

- the surviving company, either directly or through a primarily controlled company, will be "primarily engaged" in the business of the target company or companies, which business is not that of an investment company, and
- the surviving company will have at least one class of securities listed for trading on a national securities exchange.

In addition, the SPAC must file a Form 8-K with the SEC no later than 18 months after the effective date of its initial registration statement, disclosing an agreement to engage in the de-SPAC transaction with at least one target company.

Lastly, the SPAC must complete the de-SPAC transaction no later than 24 months after the effective date of its initial registration statement.[16]

Distribution/Use of SPAC Assets: If any assets of the SPAC are not used in connection with the de-SPAC transaction or if the SPAC fails to file a Form 8-K or complete a de-SPAC transaction within the time frames set forth above, the SPAC must distribute those assets, in cash, to investors as soon as reasonably practicable thereafter.

Business Purpose of the SPAC: The SPAC must be "primarily engaged" in the business of seeking to complete a single de-SPAC transaction, as described in Nature and Timing of de-SPAC Transaction above, and as evidenced by:

- the activities of its officers, directors and employees;
- its public representations of policies;
- its historical development; and
- an appropriate resolution of its board of directors, which resolution or action has been recorded contemporaneously in its minute books or comparable documents.

No "Holding Out" as an Investment Company: The SPAC cannot hold itself out as being primarily engaged in the business of investing, reinvesting or trading in securities.

The proposed rule follows the contours of the "five factor" analysis that the SEC and courts have employed historically to evaluate the business in which a company is primary engaged for purposes of Section 3(a)(1)(A) and related thereto, Section 3(b). It also echoes certain themes in Investment Company Act Rule 3a-2 (known as the "transient" investment company rule), as well as SEC guidance provided in connection with Rule 419.[17] However, unlike Rule 3a-2, which provides conditional relief from both Investment Company Act Section 3(a)(1)(A) and Section 3(a)(1)(C), as proposed, Rule 3a-10 provides relief only from Section 3(a)(1)(A).[18] The SEC posed a number of questions for comment by the industry, many of which signaled a possible willingness on the regulator's part to provide for more flexibility than that being proposed.

Key Takeaways & Practical Considerations

The Proposed Rules, if adopted, would significantly affect a wide variety of required disclosures and market practices associated with SPACs, SPAC IPOs and de-SPAC transactions. Many of the Proposed Rules have as their stated purpose to reduce or eliminate differences in the regulatory treatment of de-SPAC transactions as compared to traditional IPOs.

The following are some key takeaways and practical considerations:

- ***Underwriter Liability in de-SPAC Transactions.*** If enacted, Rule 140a would represent a significant expansion of the concept of an "underwriter" under the Securities Act both in de-SPAC transactions and perhaps beyond. This expansion becomes even more significant if a Securities Act registration statement would need to be filed in connection with a de-SPAC transaction as a result of proposed Rule 145a. Financial institutions that underwrite a SPAC's IPO should carefully consider the engagements they will undertake in connection with a subsequent de-SPAC transaction. If adopted as written, under the proposing release's broad interpretation, many engagements in de-SPAC transactions, such as financial advisor, PIPE placement agent and capital markets advisor, could result in a finding of underwriter liability. The proposing release indicates that even the mere acceptance of deferred underwriting compensation upon completion of a de-SPAC transaction, without more, may be enough to deem a financial institution to be a statutory underwriter. This may lead to a change in market practice whereby SPAC IPO underwriters will receive all of their underwriting compensation at the closing of the IPO. If a financial institution concludes that its activities might result in it being deemed an underwriter in the de-SPAC transaction, it should consider the additional due diligence procedures that it might undertake to supplement existing diligence. The standard for establishing a "due diligence defense" under Section 11 remains unchanged and financial institutions should consider drawing from procedures that have become customary in traditional IPOs. SPAC IPO underwriters should also consider obtaining covenants from the SPAC, at the time of the IPO, in order to facilitate a robust due diligence investigation of a target company once identified. These covenants might include a covenant not to file a de-SPAC transaction registration statement until the financial advisor has completed its due diligence, a requirement that the SPAC cause the senior management and auditors of the target company to be available for diligence sessions with the SPAC IPO underwriter as well as a requirement for delivery of comfort letters and "negative assurance" letters to the SPAC IPO underwriter in connection with the de-SPAC transaction.
- ***Fairness Opinions.*** The Proposed Rules will contribute to the use of third party fairness opinions in de-SPAC transactions. The Proposed Rules would require a SPAC to opine on whether it reasonably believes that the de-SPAC transaction and related financing transactions are fair or unfair to its unaffiliated security holders. A SPAC would then be required to disclose the basis for its fairness determination and the material factors that underpin that determination, as well as whether the SPAC or the sponsor has received a report, opinion or appraisal from an outside party regarding the fairness of the transaction. While the Proposed Rules stop short of requiring a fairness opinion in a de-SPAC transaction, Commissioner Peirce commented that the SEC seems to expect SPACs to obtain one. These proposed changes, when combined with the recent *MultiPlan* decision that made clear that fiduciary duty claims in most de-SPAC transactions will be reviewed under the enhanced "entire fairness" standard under Delaware law, provide a board of directors with strong reasons to favor obtaining a fairness opinion in a de-SPAC transaction. At the same time, the proposed Rule 140a providing increased potential for financial advisors to be deemed statutory underwriters in the de-SPAC transaction may make investment banks less willing to accept fairness opinion engagements or at the

least increase the costs associated with obtaining one, especially if the protections of the PSLRA on any financial projections included in a fairness opinion are no longer available to SPACs.

- ***Use of Projections in de-SPAC Transactions.*** The Proposed Rules would have the seemingly counter-intuitive effect of simultaneously: (i) requiring financial projections to be considered and disclosed (almost certainly in a registration statement, thanks to proposed Rule 145a) as part of a SPAC's basis for determining it has a reasonable belief that a de-SPAC transaction and related financing transactions are fair to unaffiliated stockholders; (ii) removing the PSLRA's safe harbor as applied to such projections; and (iii) attaching underwriting liability both to financial advisors that use such projections to express a fairness opinion and to any SPAC IPO underwriter that collects any deferred underwriting compensation upon consummation of the de-SPAC transaction. It is far from clear whether all of these proposed rules will be adopted as written and if adopted whether they will survive legal challenge. What is clear is that all de-SPAC market participants should expect to take great care in preparing and presenting projections in de-SPAC transactions, especially for target companies with limited or no operating history.
- ***De-SPAC Transactions as "Sales" to the SPAC's Stockholders.*** Because a SPAC's initial business combination will now be deemed to involve a "sale" of securities to the SPAC's stockholders, it would follow that the "sale" will likely need to be registered on a Form S-4 or Form F-4 (especially since the SEC has opined that it views the exemption provided by Section 3(a)(9) as inapplicable). While the practical differences between filing a proxy statement and filing a combined proxy statement/Form S-4 are not significant, there are a number of significant substantive/legal differences. Chief among these is that a Securities Act registration statement is subject to the statutory liability provisions of the Securities Act (which seems to be the goal of Rule 145a).
- ***Sources of Dilution.*** In their remarks regarding the Proposed Rules, several Commissioners expressed the concern that SPACs are "complex" vehicles that investors may not fully understand given the current disclosure requirements. The Proposed Rules purport to address this concern by proposing significant new disclosure requirements, including disclosures regarding actual and potential sources of dilution to public stockholders of a SPAC, especially to public stockholders who choose not to redeem their shares in connection with a business combination. SPACs and sponsors will need to ensure they have considered all of the ways in which the interests of public stockholders are subject to dilution, both as a disclosure matter and in their negotiations with potential acquisition targets.
- ***Investment Company Act Status.*** Although only in proposed form, Investment Company Act Rule 3a-10 and the SEC's commentary serve as important reminders for SPACs to tread carefully when it comes to their investment company status. It would be prudent for SPACs to follow the guideposts in the proposed rule pending the potential adoption of the rule.
- ***Implementation.*** The final rules, when issued, will provide an effective date. The final rules may be subject to court challenges that could impact when (or if) they become effective.

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ENDNOTES

[1] While the release says that "[w]e welcome feedback and encourage interested parties to submit comments on any or all aspects of the proposed new rules and amendments," the imposition of a very short comment period, which overlaps with the comment periods of other significant SEC rulemakings, leaves the impression that the SEC is not, in fact, really interested in feedback or comments. Recent use by the SEC of "short" comment periods in rulemakings has drawn Congressional attention. See the Jan. 10, 2022 letter to Chair Gensler from Representative McHenry and Senator Toomey at https://republicans-financialservices.house.gov/uploadedfiles/2022-01-10_pmc_toomey_letter-gensler_sec_comment_period.pdf.

[2] In proposed Item 1601(a) of Regulation S-K, the SEC proposes to define "de-SPAC transaction" as a business combination such as a merger, consolidation, exchange of securities, acquisition of assets, or similar transaction involving a special purpose acquisition company and one or more target companies (contemporaneously, in the case of more than one target company). Proposed Item 1601(b) would define "special purpose acquisition company" to mean a company that has indicated that its business plan is to (1) register a primary offering of securities that is not subject to the requirements of Rule 419; (2) complete a de-SPAC transaction within a specified time frame; and (3) return all remaining proceeds from the registered offering and any concurrent offerings to its shareholders if the company does not complete a de-SPAC transaction within the specified time frame.

[3] In proposed Item 1601(c) of Regulation S-K, the SEC proposes to define "SPAC sponsor" as the entity and/or person(s) primarily responsible for organizing, directing or managing the business and affairs of a SPAC, other than in their capacities as directors or officers of the SPAC as applicable. The SEC proposes to exclude from the scope of the definition of "SPAC sponsor" the activities performed by natural persons in their capacities as directors and/or officers of the SPAC to avoid overlap with existing disclosure requirements relating to directors and officers.

[4] It is unclear how far "alternative transactions" would go in this context and whether and to what extent disclosure on any such alternative transactions would be required.

[5] Rule 421(d) is the SEC's current rule requiring use of plain English in certain filings. The Rule requires registrants to write the prospectus cover page, prospectus summary, and risk factors sections of prospectuses using plain English principles, including the use of short sentences; definite, concrete, everyday language; active voice; tabular presentation of complex information whenever possible; no legal or business jargon; and no multiple negatives.

[6] *See* Recommendations of the Investor Advisory Committee Regarding Special Purpose Acquisition Companies (Sept. 9, 2021), *available at*: https://www.sec.gov/spotlight/investor-advisory-committee-2012/20210909-spac-recommendation.pdf.

[7] *See e.g.,* "The Sponsor Promote and Compensation Act," *available at* https://www.kennedy.senate.gov/public/_cache/files/8/c/8c5a665c-b7e8-48ce-a2bf-6cd1dbc504c3/A1E8BB9BDA5EB64CB106B92056D91B57.the-sponsor-promote-and-compensation-act-spac-act-.pdf

[8] *See* John R. Ablan, Edward S. Best, Philip O. Brandes, Brian J. Massengill and Anna T. Pinedo, *Chancery Court Allows deSPAC Litigation to Proceed*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (Jan. 30, 2022), *available at* https://corpgov.law.harvard.edu/2022/01/30/chancery-court-allows-despac-litigation-to-proceed/. Note: Harvard's rules permitted only three authors to be included on the website version of this article. However the article was written by each of the five above-named authors.

[9] "Foreign private issuer" is defined in Securities Act Rule 405 and Exchange Act Rule 3b-4(c). A foreign private issuer is any foreign issuer other than a foreign government, except for an issuer that (1) has more than 50% of its outstanding voting securities held of record by U.S. residents and (2) any of the following: (i) a majority of its officers and directors are citizens or residents of the United States, (ii) more than 50 percent of its assets are located in the United States or (iii) its business is principally administered in the United States.

[10] A "Super 8-K" refers to a Current Report on Form 8-K with Form 10 information that is filed pursuant to Items 2.01(f), 5.01(a)(8), and/or 9.01(c) of the form.

[11] In general, a smaller reporting company is a company that is not an investment company, an asset-backed issuer or a majority-owned subsidiary of a parent that is not a smaller reporting company, and had (1) a public float of less than $250 million; or (2) had annual revenues of less than $100 million during the most recently completed fiscal year for which audited financial statements are available and either had no public float or a public float of less than $700 million. *See* Rule 12b-2 under the Exchange Act and Item 10(f) of Regulation S-K.

[12] Commissioner Peirce's dissenting statement includes the following passage: "the proposal would change the existing definition of "blank check company" for purposes of the PSLRA—the definition Congress looked to when it wrote the PSLRA—to include SPACs by removing the "penny stock" condition. Look over there, Congress, while we rewrite the statute!"

[13] *See* John Coates, *SPACs, IPOs and Liability Risk under the Securities Laws* (Apr. 8, 2021), *available at* https://www.sec.gov/news/publicstatement/spacs-ipos-liability-risk-under-securities-laws (noting that Rule 419, defining a "blank check company" to require the issuance of "penny stock," predated the passage of the PSLRA).

[14] Proposed Rule 145a defines "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: (i) no or nominal assets; (ii) assets consisting solely of cash and cash equivalents; or (iii) 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.

[15] The term "business combination related shell company" is defined in Securities Act Rule 405 and Exchange Act Rule 12b-2 as a shell company that is: "(1) Formed by an entity that is not a shell company solely for the purpose of changing the corporate domicile of that entity solely within the United States; or (2) Formed by an entity that is not a shell company solely for the purpose of completing a business combination transaction (as defined in 17 CFR 230.165(f)) among one or more entities other than the shell company, none of which is a shell company."

[16] The proposing release stresses that the inability of a SPAC to identify a target and complete a de-SPAC transaction within the proposed timeframes would raise serious questions concerning the applicability of the Investment Company Act to such SPAC.

[17] The SEC addressed the status of escrow/trust accounts established by "blank check" companies that comply with Rule 419 under the Securities Act ("Rule 419 Accounts"). In these circumstances, the SEC stated that: "although a Rule 419 Account may be an investment company under the Investment Company Act of 1940, in light of the purposes served by the regulatory requirement to establish such an account, the limited nature of the investments, and the limited duration of the account, such an account will neither be required to register as an investment company nor regulated as an investment company as long as it meets the requirements of Rule 419." The SEC was quick to note in the proposal that SPACs have evolved since the SEC adopted Rule 419 and more importantly SPACs are not subject to the requirements of Rule 419.

[18] Section 3(a)(1)(C) defines an "investment company" as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and that owns or proposes to acquire investment securities, having a value exceeding 40% of the value of the company's total assets (exclusive of government securities and cash items) on an unconsolidated basis. In this regard, the SEC states that if "a SPAC owns or proposes to acquire 40% or more of investment securities, it would likely need to register and be regulated as an investment company under the Investment Company Act."