BDO BULLETIN

SEC ADOPTS RULES ON SPACS, SHELL COMPANIES, AND PROJECTIONS

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SUMMARY

The SEC adopted final rules on special purpose acquisition companies (SPACs), shell companies, and projections that significantly enhance and expand disclosure requirements related to SPAC initial public offerings (IPOs) and de-SPAC transactions.

These final rules:

- Expand the liability for parties involved in a SPAC transaction by requiring private operating company targets ("targets") to be co-registrants and remove the safe harbor for forward-looking statements in SPAC filings
- Require incremental SPAC disclosures and align the financial statement requirements in a de-SPAC transaction with those applicable to traditional IPOs
- Require the combined company to redetermine smaller reporting company (SRC) status and reflect a change in status in filings made 45 days following the de-SPAC transaction

BACKGROUND

SPACs are companies with no commercial operations that are formed to raise capital through an IPO for the sole purpose of acquiring one or more target businesses (when completed, referred to as the "de-SPAC transaction"). Although SPACs first emerged in the 1990s, their popularity increased substantially in 2020, particularly as a mechanism for private companies to go public. The surge led to increased regulatory scrutiny and concerns about various aspects of the SPAC structure and investor protection matters. Following the SEC's proposed rules in March 2022, SPAC IPOs and de-SPAC transactions drastically decreased. The SEC did not finalize some of the more controversial proposed amendments that would:

- Deem certain underwriters in a SPAC's IPO underwriters in the de-SPAC transaction
- Provide certain SPACs with a safe harbor from the definition of an investment company

However, the adopting release includes Commission guidance on both topics that reflect the SEC's views on the facts and circumstances relevant to assessing underwriter status in a de-SPAC transaction and a SPAC's investment company status. The guidance, along with the final rules' enhanced liability and disclosure requirements may create additional uncertainty about the future use of SPACs for private companies to go public

NEW DISCLOSURE REQUIREMENTS

The new disclosure requirements applicable to SPACs in new Subpart 1600 of Regulation S-K largely codify existing practice. These disclosures, required in connection with SPAC IPOs and de-SPAC transactions, include information about:

- SPAC sponsors, affiliates, and promoters
  - Background on the experience, roles, and responsibilities, including the nature and amounts of compensation earned, awarded, or paid
- Conflicts of interest
  - Actual and potential material conflicts of interest between the SPAC sponsor or its affiliates, the SPAC's officers, directors, or promoters, or the target's officers and directors and the SPAC's unaffiliated security holders
- Dilution
  - Presented in tabular format showing the nature and amount of each source of dilution
  - A description of potential sources of future dilution
- The board's consideration of the de-SPAC transaction
  - Whether the de-SPAC is advisable and in the best interest of the shareholders if such determination is otherwise required by law
  - A summary of any reports, opinions, or appraisals received that materially relate to the fairness of the de-SPAC.
  - The name of any SPAC director that voted against or abstained from voting on the de-SPAC, and the reason for doing so (if known)

Additionally, the final rules align other non-financial statement disclosure requirements (such as the description of the business and property, legal proceedings, and changes in and disagreements with accountants) for the target with those required in an IPO registration statement. Such disclosures were not previously required until the combined company filed the Form 8-K due within four business days of the completion of the de-SPAC transaction (the "Super 8-K").

FINANCIAL STATEMENT REQUIREMENTS

The final rules add Article 15 of Regulation S-X to align certain financial statement disclosure requirements for de-SPAC transactions with traditional IPOs (most of which are largely consistent with existing staff views and guidance), including:

- Audit standards
  - The financial statements of the target must be audited in accordance with PCAOB standards. If there are multiple targets, only those deemed to be the predecessor must be audited in accordance with PCAOB standards; others may be audited in accordance with U.S. GAAS
- Target financial statement requirements
  - Only two years of the target's audited annual financial statements are required if the target would qualify as an SRC **or** emerging growth company (EGC)
  - The age of the target's financial statements must comply with the requirements in Rule 3-12 of Regulation S-X (S-X) (or Rule 8-08 of S-X if the target would qualify as an SRC)
- The target's acquisition of a business or real estate operation
  - The target must apply Rule 3-05 of S-X (or Rule 8-04 of S-X if the target would qualify as an SRC) to businesses or real estate operations acquired or to be acquired
- SPAC financial statement requirements following the de-SPAC transaction
  - The combined company may exclude the SPAC's financial statements from its filings if:
    - The predecessor's financial statements prior to the de-SPAC transaction have been filed for all required periods
    - The combined company has filed financial statements that include the period in which the de-SPAC transaction was completed

PROJECTIONS

In de-SPAC-related registration statements and proxies, the target's projections of future financial performance are often disclosed for various reasons. The amendments to Regulation S-K require incremental disclosures related to such projections by:

- Adding new Item 1609 of Regulation S-K that requires disclosure of:
  - Why the projections were prepared and who prepared them
  - All material bases for the projections, including their assumptions (for example, the growth and discount rates and why such rates were used)
  - Whether the projections still reflect the views of the target's board or management as of the filing date, and if not, the purpose of disclosing projections and the reasons for any continued reliance on them by management or the board (the same disclosures are required by a SPAC that discloses its financial projections)
- Amending the guidelines in Item 10(b) of Regulation S-K to explicitly address the basis and format of projections of targets in de-SPAC transactions and require disclosure:
  - To distinguish projections that are not based on historical financial results from those that are (in general, if projections that are based on historical financial results or operational history are presented, the underlying historical measure or operational history should be presented with equal or greater prominence)
  - To address why projections with a non-GAAP financial measure are presented (if applicable), including a definition or explanation of the non-GAAP measure and the comparable GAAP financial measure

SMALLER REPORTING COMPANY STATUS

The amendments require the combined company to redetermine its SRC status following a de-SPAC transaction based on its public float and annual revenues as follows:

- Public float – measure within four business days following consummation of the de-SPAC
- Annual revenues – determine as of the most recently completed fiscal year reported in the Super 8-K

The change in SRC status, if any, must be reflected in all filings beginning 45 days after consummation of the de-SPAC (the "minimum transition period"). Accordingly, the combined company is not required to apply a change in status in the Super 8-K that is due within four business days of the de-SPAC. However, any change in status must be reflected in filings made after the minimum transition period, including any amendments to the Super 8-K (that is, historical financial statement periods of the target that predate those presented in the registration statement or proxy may not be omitted if they are otherwise required following the loss of SRC status). If the combined company retains EGC status following the de-SPAC, it is not required to present financial statements for a period prior to those included in the registration statement.

Prior to the amendments, the combined company retained the SRC status of the SPAC until the next annual determination date.

ENHANCED LIABILITY PROVISIONS AND OTHER REQUIREMENTS

The final rules expand the liability of certain parties associated with SPAC and de-SPAC transactions by:

- Treating the target as a co-registrant in a registered de-SPAC transaction and adding new Rule 145a, which considers the de-SPAC transaction to be a sale of securities from the combined company to the SPAC's existing shareholders. As such, the Securities Act of 1933 liability provisions for untrue material statements or material omissions apply to the target and its signing persons (for example, principal executive and financial officers).
- Amending the definition of a "blank check company" to encompass SPACs, meaning that SPACs cannot rely on the safe harbor for forward-looking statements under the Private Securities Litigation Reform Act of 1995 (PSLRA).

The final rule also requires a minimum dissemination period, generally requiring the distribution of the proxy statement, information statement, or prospectus filed in connection with the de-SPAC to investors at least 20 days in advance of a shareholder meeting.

SPAC STATUS: THE INVESTMENT COMPANY ACT OF 1940

In lieu of amending its rules, the SEC shared its views on facts and circumstances to consider when a SPAC determines its status as an investment company under the Investment Company Act of 1940. The views, provided in the context of the five-factor test typically applied in making such determination, relate to:

- The nature of the SPAC’s assets and income, and whether the SPAC’s primary business is to earn returns on investments held
- Whether the activities of the SPAC’s officers, directors, and employees are spent seeking a target (and ultimately the de-SPAC), or managing the investments to achieve returns
- Whether the SPAC’s timeline to de-SPAC exceeds the one-year safe harbor under the Investment Company Act of 1940, or the 18-month limitation applicable to certain blank check companies
- Whether the SPAC’s marketing suggests it primarily engages in investing, reinvesting, or trading in securities
- Whether the SPAC’s target is an investment company

EFFECTIVE DATE

The final rules are effective 125 days after publication in the Federal Register, except for the Inline XBRL tagging requirements, which are effective one year thereafter.

There is no transition period for in-process SPAC IPOs or de-SPAC transactions. All SPAC- and de-SPAC-related filings made after the effective date must comply with the new rules.

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Link to **Final Rule**

Link to **Fact Sheet**

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