January 29, 2024

# The SEC Adopts New Rules for SPACs

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On January 24, 2024, the U.S. Securities and Exchange Commission ("SEC") adopted new rules governing initial public offerings ("IPOs") of special purpose acquisition companies ("SPACs") and subsequent combinations between SPACs and target operating companies ("de-SPAC transactions"). The SEC's original proposals in March 2022 generated substantial public comment. The final rules, reflected in a 581-page release, were narrowly approved on a 3-2 vote of the Commissioners and will take effect 125 days after publication in the Federal Register.[1]

SPACs are publicly-held shell companies organized and managed by a sponsor for the purpose of identifying and merging with one or more usually private operating companies in a de-SPAC transaction. While terms may vary, investors in the initial SPAC IPO typically receive a unit, priced at $10.00 per share, consisting of one share of stock and a fraction of a warrant to purchase additional stock at a strike price of $11.50. The IPO proceeds are placed in a trust account that is typically not available to the SPAC until the completion of a business combination. The SPAC sponsor generally acquires, for a nominal amount, shares in the SPAC representing 20% of the total capitalization.

The de-SPAC transaction is a hybrid transaction that contains elements of both an IPO and a merger. Although the de-SPAC transaction generally is structured as a merger, the SEC explained that it represents the functional equivalent of an initial public offering of the target company. The SPAC shareholders go from owning shares in a shell company to owning shares in a combined company that conducts the business of the target company. SPAC investors customarily have the right to redeem all or a portion of their shares for cash immediately prior to the consummation of the de-SPAC transaction. If a de-SPAC transaction does not occur within a set period of time (often two years), the funds in the trust account are returned to SPAC investors.

The new rules are intended to more closely align the required disclosures and legal liabilities associated with de-SPAC transactions with those in traditional IPOs. Among the most significant new provisions:

- *Disclosure of conflicts of interests.* The new rules are designed to require disclosure of the ways in which the interests of SPAC sponsors and their affiliates differ from and potentially conflict with the interests of SPAC investors, particularly in the context of a potential de-SPAC transaction. SPAC sponsors may have financial incentives to complete a de-SPAC transaction even in the absence of an attractive target and beneficial terms. SPAC sponsors and their affiliates also may sponsor multiple SPACs, which may lead to allocations of time,

[1] U.S. Securities and Exchange Comm'n, Release Nos. 33-11265; 34-99418; IC-35096; File No. S7-13-22, available at https://www.sec.gov/files/rules/final/2024/33-11265.pdf.

attention and acquisition opportunities among the affiliated SPACs. Similarly, SPAC sponsors may have employment, contractual or fiduciary duties to entities other than the SPAC, which may affect the sponsors' consideration of target companies and de-SPAC transaction terms. In addition, the directors and officers of the target company may have conflicts of interests, which would be subject to disclosure in a traditional IPO. The new rules will require disclosure of all such potential and actual conflicts.

- *Dilution.* The new rules mandate disclosure in the SPAC IPO of the impact of dilution on the interests of SPAC investors, including tabular disclosure on the front cover of the registration statement and in the prospectus summary. The de-SPAC registration statement must include additional disclosure concerning compensation received or to be received by the SPAC sponsor, its affiliates and any promoters in connection with the de-SPAC transaction and any related financing transaction.

- *Fairness determination and disclosure of any appraisals or reports on the merits of a de-SPAC transaction obtained by the SPAC sponsor.* If the corporation law of the SPAC's jurisdiction of incorporation requires the SPAC board to determine whether the de-SPAC transaction is advisable and in the best interests of shareholders, the new rules require the SPAC to disclose that determination and the factors considered in making such determination. The new rules also require disclosure of any report, appraisal or opinion (other than an opinion of counsel) received from a third-party materially relating to the approval of the de-SPAC transaction, the consideration to be offered to shareholders of the target company, or the fairness of the transaction to the SPAC and its shareholders. The rules do not require the SPAC sponsor to obtain a report or opinion, only to disclose any that are obtained.

- *Exclusion of de-SPAC transactions from the PSLRA safe harbor for forward-looking statements.* Projections are often critical in evaluating growth company targets, particularly in some industries, and may be used by the SPAC in its own evaluation of the target as well as in discussions with investors. Projections may also be used by the target board in evaluating the transaction. Projections and other forward-looking statements in de-SPAC transactions have been protected under the safe harbor in the Private Securities Litigation Reform Act ("PSLRA"). Under the PSLRA, a company is protected from liability for forward-looking statements in any private right of action under the Securities Act or Securities Exchange Act when, among other conditions, the forward-looking statement is identified as such and is accompanied by meaningful cautionary statements.[2] The PSLRA safe harbor is not available for forward-looking statements in connection with, among other things, an offering by a blank check company, an offering by an issuer of penny stock, or an IPO. The new rules amend the definition of a "blank check company" to exclude forward-looking statements in a de-SPAC transaction from the PSLRA safe harbor.

- *The target company as a co-registrant on the de-SPAC registration statement.* When a registration statement is filed in a de-SPAC transaction, the target company will be deemed a co-registrant. The principal officers of the target and at least a majority of the

[2] 15 U.S. Code § 78u–5.

target board must therefore sign the registration statement and will be subject to liability under Section 11 of the Securities Act.

- *The de-SPAC transaction as a sale of securities subject to Section 5 of the Securities Act*. Under new Rule 145a, a business combination of an operating company with a shell corporation will be deemed to be a sale of securities of the operating company to the shell company shareholders, whether or not any shares actually change hands. As a result, the transaction will be subject to all relevant disclosure and other requirements for a sale of securities under the Securities Act.

- *Guidance on the status of potential underwriters in de-SPAC transactions.* The SEC's original proposed rules would have deemed a SPAC IPO underwriter that facilitates or participates in a subsequent de-SPAC transaction to be a statutory underwriter of de-SPAC transaction within the meaning of Section 2(a)(11) of the Securities Act. The SEC declined to adopt the proposed rule, finding that the statutory definition of underwriter encompasses any person who sells for the issuer or participates in a distribution associated with a de-SPAC transaction. The final rules, however, include guidance on the status of potential underwriters, including the conclusion that a de-SPAC transaction constitutes a distribution of securities under Section 2(a)(11) of the Securities Act, and that a person who sells securities for the issuer or otherwise participates in the distribution of securities in the combined company to the SPAC's investors and the broader public may be deemed a statutory underwriter.

- *Investment Company Act issues.* The proposed rules contained a safe harbor for SPACs to avoid falling within the definition of an "investment company" subject to registration under the Investment Company Act of 1940, as amended. This proposal garnered significant criticism, as few within the SPAC community believed that SPACs were likely to fit within the definition. The SEC withdrew the proposed safe harbor, but the adopting release includes a discussion of the facts and circumstances that the SEC believes are relevant to whether a SPAC meets the definition of an investment company.

The final rules, while expected, will have a significant impact on SPACs going forward. Some of the newly mandated disclosures are already made in practice by SPAC issuers, while others will need thoughtful implementation or may encourage changes in the way transactions are structured. The new rules will increase compliance costs for de-SPAC transactions, as well as increase the risk of litigation and scope of potential liability. Nonetheless, we believe that SPAC transactions will remain a viable method of bringing companies to public markets.

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