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# SEC PROPOSES RULES TO ENHANCE REPORTING AND DUE DILIGENCE IN SPAC TRANSACTIONS

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On March 30, 2022, the SEC proposed new rules that aim to increase investor protections for transactions involving special purpose acquisition companies (SPACs) and when a SPAC merges with a private company in what is commonly referred to as a de-SPAC transaction. The rules focus on three main areas: disclosure, marketing activities and liabilities for gatekeepers to SPAC deals. In theory, the rules will allow investors to enjoy similar protections afforded to investors in a traditional IPO and ensure they have access to complete information before making investing decisions. The **SEC stated** that the public comment period for the proposed rules will remain open for *"60 days following publication of the proposing release on the SEC's website or 30 days following publication of the proposing release in the Federal Register, whichever period is longer."*

## BACKGROUND

SPACs are publicly traded companies formed with the sole purpose of raising capital to acquire one or more unspecified businesses. SPACs may offer multiple benefits over the traditional IPO process. Generally, for target companies of a SPAC, the process from private entity to public registrant can be a quicker process than for companies pursuing a traditional IPO. One benefit for private companies looking to go the SPAC route is the avoidance of the customary roadshows that are more typical in a traditional IPO, a benefit that became even clearer during the height of the pandemic in 2020 and 2021. Another possible benefit for private companies choosing the SPAC path is the ability to negotiate directly with the SPAC regarding the valuation of the target company, which may result in more favorable terms for sellers. In addition, because of the nature of the transaction process and existing rules and regulations, SPACs often present future projections of future performance of the combined entity (post the de-SPAC transaction) that may differ from those of a company pursing a traditional IPO as well as lesser disclosures in their registration document than that of a traditional IPO.

## RECENT DEVELOPMENTS

The SEC has raised concerns related to SPAC transactions and the information provided to investors. In a speech for the Healthy Markets Association, SEC Chairman Gary Gensler stated, *"I believe the investing public may not be getting like protections between traditional IPOs and SPACs."* In particular, SPACs are permitted to make forward-looking projections for revenues and profits, which is not allowed in the traditional IPO process.

As part of the proposed rules, the SEC clarifies when a SPAC becomes subject to the Investment Company Act. Furthermore, in an attempt to regulate SPACs in a way that is more consistent with the traditional IPO process, the SEC has proposed guidance in **three areas**. Here we provide a brief overview of each:

### Disclosure

The disclosure-related guidance is aimed at ensuring investors have the right information to make fully informed investment decisions. The proposed rules include:

- Additional disclosure requirements, including those related to SPAC sponsors, conflicts of interest and dilution.
- Additional non-financial disclosure requirements related to the target private operating company.
- A new requirement that disclosure documents must be provided to investors at minimum 20 calendar days before shareholders vote on the transaction.
- Adjustment to financial statement requirements for SPACs so they are in sync with those required in the traditional IPO process.

### Marketing Activities

SPAC marketing activities have come under scrutiny for influencing market behavior prior to the disclosure of financial reporting requirements, which impacted the rules' proposal on disclosure timelines. Other important aspects of the proposed guidance include:

- Amendment of the definition of "blank check company" so it includes SPACs; as a result, the Private Securities Litigation Reform Act (PSLRA), which previously acted as a safe harbor for SPACs, would no longer be applicable to SPAC transactions.
- Creation of a new safe harbor for SPACs that meet certain requirements, including announcing a de-SPAC transaction within 18 months and completing said transaction within 24 months.

### Liabilities for Gatekeepers

Under current SPAC rules, very little liability is placed on certain gatekeepers of SPAC transactions, such as underwriters. The new rules seek to change that. Some of the changes include:

- Making the target company liable for de-SPAC registration statements.
- Expanding the definition of underwriter such that any SPAC underwriter that takes step to facilitate a de-SPAC transaction will be considered an underwriter to that transaction.
- Considering all transactions in which a SPAC joins with a non-shell organization as a sale to the SPAC's shareholders, thus making it subject to Securities Act liability.

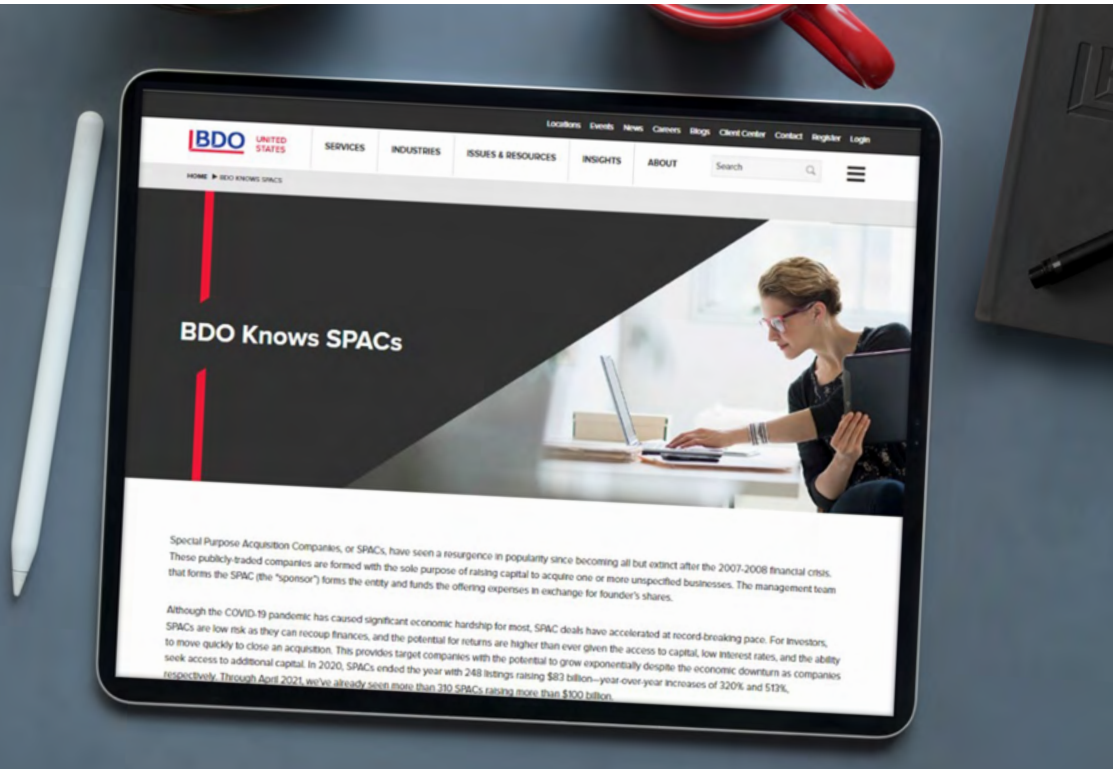
## BDO INSIGHT

While some may see the proposed SEC rules as more burdensome, they may in fact offer advantages for SPAC sponsors, investors, and companies alike. At their core, the rules promote greater clarity and information to investors and likely promote a greater degree of due diligence prior to pursuing a transaction. As a result, we expect to see a greater emphasis on diligence and quality of the targets identified for merging with a SPAC, which could result in greater market success post de-SPAC. The rules will also afford investors greater protection, similar to those afforded investors in the traditional IPO process.

At the present time, it's too early to tell how the SPAC market will be disrupted by these proposed rules. SPACs still offer a variety of advantages to capitalize on, including largely maintaining the streamlined process to go public and the ability of a target company of the SPAC to negotiate its valuation directly with the SPAC and its Sponsors. While some SPAC sponsors who have historically been successful in the market may choose to sit on the sidelines for a period of time, or exit the SPAC market all together, others may continue to view SPACs as a valuable vehicle.

While the recent proposals by the SEC could be seen as the last step on the regulatory front, it always remains possible that further regulatory changes are on the horizon that could impact SPACs. Entities that are interested in pursuing a SPAC should consider their options with this revised guidance in mind, and with the knowledge that the regulatory environment could continue to evolve further in the future.

**Want more information on SPACs?**
**Visit our resource center: BDO Knows SPACs.**

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