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SEC Director of Corporation Finance Discusses Increased Liability Inherent in De-SPAC Transactions in a Trend of Heightened Regulatory Scrutiny Amid SPAC-tacular Boom

John Coates, acting director of the SEC's Division of Corporation Finance, released a public statement discussing the heightened securities laws liability attached to de-SPAC transactions, signaling the advent of increased regulatory scrutiny amid an unprecedented SPAC boom.[1] SPACs, or special purpose acquisition companies, are blank check companies formed for the purpose of entering into business combinations with private operating businesses. SPACs usually have two distinct phases: an initial public offering, or IPO, of redeemable securities the proceeds from which are placed in a trust and a business combination with a private company using the IPO proceeds as consideration for the merger with the private target surviving as the new public company. They have recently garnered great media attention as their popularity has skyrocketed with celebrities to finance moguls all SPACing up. And the SEC is taking notice.

The statement raises the issue that there is a somewhat misguided belief among some that a SPAC business combination, or de-SPAC transaction, is exempt from certain federal securities laws liabilities when, in fact, liability for de-SPAC transactions is arguably heightened due to the inherent conflicts in these transactions. More specifically, Coates states, any material misstatement in or omission from an effective registration statement as part of a de-SPAC business combination is subject to Section 11 under the Securities Act of 1933. Additionally, any material misstatement or omission in connection with a proxy solicitation is subject to liability under Section 14(a) and Rule 14a-9 and in the context of a tender offer under Section 14(e) of the Securities Exchange Act of 1934. De-SPAC transactions also may give rise to liability under state law. Coates adds that Delaware corporate law, in particular, conventionally applies both a duty of candor and fiduciary duties more strictly in conflict of interest settings, absent special procedural steps, which themselves may be a source of liability risk. **A de-SPAC transaction is not a free pass for material misstatements or omissions.**

Some argue that de-SPAC transactions are protected by the Private Securities Litigation Reform Act, or PSLRA, which allows a reprieve from certain securities laws liability with respect to the use of forward-looking statements and projections. The PSLRA was enacted to protect against frivolous lawsuits and intended for use by seasoned issuers that are well known to the market rather than as a loophole for decreased liability and disclosure in the context

1. The full statement is available at sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws.

of new issuers. It specifically carves out offerings by blank check companies, those made by penny stock issuers and those made in connection with an initial public offering. Coates explains that there is no clear definition of "initial public offering" under the PSLRA. De-SPAC transactions are one of several new ways for an issuer to list its securities for trading, which were not originally contemplated when the PSLRA was first enacted. Coates further states that de-SPAC transactions could be viewed as initial public offerings by the private target business merging with the SPAC. The economic essence of an initial public offering, he states, is the introduction of a new company to the public. As such, one could take the approach that the appropriate disclosure and securities laws liability relevant for de-SPAC transactions should be the same as traditional IPOs since the de-SPAC transaction is the first time that the target business is offering its stock to the public. Economically and practically, the target company is different from the SPAC and the de-SPAC transaction is the first time that the public is introduced to this new issuer. However, without a clear definition of "initial public offering" under the PSLRA, the safe harbor might in some instances be deemed to apply to de-SPAC transactions, but this is far from a forgone conclusion.

Coates is not looking to do away with forward-looking statements as he argues that projections are woven into the fabric of business combinations. They help "sell" the deal and can also be a key component for boards and other participants in negotiating and understanding the economics of the transaction. However, he cautions that the PSLRA safe harbor is not a "get out of jail card" for misleading and false information. He states that the safe harbor only applies in private litigation, and does not prevent the SEC from taking appropriate action to enforce the federal securities laws. An issuer in possession of multiple sets of projections that are based on reasonable assumptions, reflecting different scenarios of how the company's future may unfold, would be on shaky ground if it only disclosed favorable projections and omitted disclosure of equally reliable but unfavorable projections, regardless of the liability framework later used by courts to assess the disclosures. Further, he elaborates, the safe harbor is also not available if the statements in question are not forward-looking. Statements about current valuation or operations can be viewed as outside the safe harbor, even if they are derived from or linked to forward-looking projections or statements. Nor is the safe harbor available unless forward-looking statements are accompanied by "meaningful cautionary statements" identifying important factors that could cause actual results to differ materially from those in the forward-looking statements.

Coates concludes his public statement with a call to action by the SEC and other regulatory bodies to issue further guidance for de-SPAC transactions and with three general conclusions:

1. Information should be cost-effective and reliable, and not materially misleading, in every securities transaction and investors should have access to all relevant information.

2. If there are risks to the use of cost-effective, complete, and reliable forward-looking information in any setting, those risks should be carefully evaluated in light of the goals of the federal securities laws and the risks of misuse of such information should be given equal weight.

3. If the de-SPAC transaction is not treated akin to an IPO, attention may be focused on the wrong place, and potentially problematic forward-looking information may be disseminated without appropriate safeguards.

The public statement comes amid recent disclosure guidance issued by the SEC for SPAC transactions and heralds more scrutiny and potential regulatory action coming down the road from the SEC for SPACs. Going forward, more attention should be paid on how forward-looking information and projections are presented in de-SPAC transactions.

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