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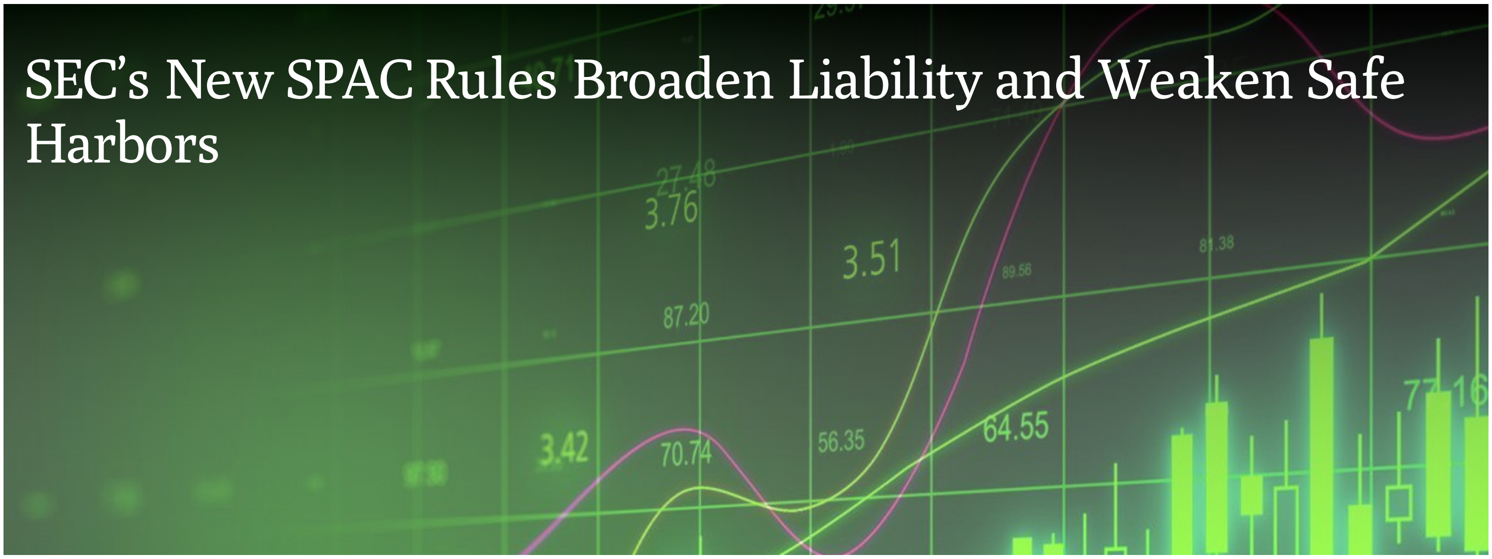
SEC's New SPAC Rules Broaden Liability and Weaken Safe Harbors



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The Securities and Exchange Commission's final rules governing special-purpose acquisition companies contain a number of provisions targeting SPAC-related liability and litigation. The practical effect of this guidance is that a broader pool of market participants may face Securities Act liability.

As a result of these rules, both SPACs and target companies, as well as their executives, should ensure their filings contain robust disclosures, including specific and tailored cautionary language with respect to any forward-looking statements, such as financial projections.

Additionally, financial advisers and similar participants in SPAC transactions should understand that participating in the distribution of securities in such a transaction may result in underwriter due diligence obligations and potential liability under Section 11 of the Securities Act for false or misleading statements.

The new rules amend the definition of a blank check company under the Private Securities Litigation Reform Act to remove safe harbor protection for forward-looking statements in SPAC transactions. While SPACs will no longer enjoy safe harbor statutory protection, forward-looking statements may still get common law protection under the bespeaks caution doctrine.

The doctrine provides a defense when forward-looking statements contain enough cautionary language or risk disclosure about the subject matter of the statement to nullify any misleading effect.

While the PSLRA safe harbor and bespeaks caution doctrine protections overlap, the safeguards aren't identical. Most federal courts applying the bespeaks caution doctrine require a forward-looking statement to have been made in good faith (without knowledge of its falsity). But the safe harbor's first prong doesn't require it: The inquiry ends, and the defendant's state of mind is irrelevant, once the court determines that a forward-looking statement was couched in sufficiently meaningful cautionary language.

Under the bespeaks caution doctrine, not every risk disclosure will be sufficient to immunize statements relating to the disclosure. The doctrine's cautionary language must be tailored to expressly warn of the loss at issue, while the safe harbor merely requires identifying “important factors” that could cause actual results to differ materially from the forward-looking statement.

The SEC’s new rules also require a target company in a SPAC transaction to be an issuer of securities under Section 2(a)(4) of the Securities Act and be a co-registrant on the statement used for the transaction. This makes the target company subject to liability under Section 11 of the Securities Act.

The new rule further requires that the target’s principal executive officers and a majority of its board sign the registration statement, bringing each signatory within reach of Section 11 liability for material misstatements or omissions in the registration statement.

Officers and directors still may be able to invoke common defenses to Section 11, such as the due diligence defense. And plaintiffs will still have to deal with Section 11’s strict procedural requirements, including establishing that they purchased shares traceable to the allegedly defective registration statement. Even with these new SPAC rules, there may be shares issued under multiple registration statements, making tracing difficult.

The SEC issued additional guidance suggesting that, in certain situations, financial participants in a SPAC transaction may function as underwriters subject to Section 11 liability. A SPAC transaction is considered a “distribution” of securities because it’s “the process by which the SPAC’s investors, and therefore the public, receive interests in the combined operating company.”

The guidance suggests that the text of Section 2(a)(11) of the Securities Act, which defines “underwriter,” is to be interpreted “broadly” and “flexibly,” and doesn’t require that one purchase securities from an issuer with a view to their distribution to be deemed an “underwriter.” Rather, in a SPAC transaction “there would be an underwriter present where someone is … participating in the distribution of securities in the combined company to the SPAC’s investors and the broader public.”

In this situation, the SEC cautions that “the party acting as underwriter will need to perform the necessary due diligence of the disclosures” made in the offering or “face full exposure.”

For instance, agents for private investments in public equity who solicit votes or bring parties into the transaction may face greater exposure. The SEC noted, the guidance is just guidance. It remains to be seen whether courts will accept the SEC’s interpretations.

The new rules also require substantial disclosures from SPACs regarding sponsor compensation, conflicts of interest, and the effects of stock dilution—all of which must be prominently displayed either early on, or on the cover of the registration statement, including in tabular form.

Assuming the disclosure requirements are complied with, they may upend a recent wave of cases filed in Delaware alleging that SPACs failed to adequately disclose the “net cash per share” investors receive in a de-SPAC transaction.

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