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The SPAC Report: Mark Wood, National Capital Markets Practice Co-Head, Speaks With *Bloomberg Tax* on Proactive Disclosures as SEC Continues to Scrutinize SPACs; Chairman Gensler's Latest Comments on SPAC Regulation (In Capital Markets Compass Issue 2 (December 2021)

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Recent SEC Comment Letters

Recent Securities and Exchange Commission (SEC) comment letters reveal the SEC's close examination of special purpose acquisition companies (SPACs) and their proposed business combinations show no signs of letting up. SPACs have recently received comment letters on topics ranging from conflicts of interest disclosure (including notably whether such SPAC "may be incentivized to complete an acquisition of a less favorable target company or on terms less favorable to shareholders rather than liquidate"), to target company valuation methodologies and the process by which SPACs are reviewing and narrowing down potential acquisition candidates.

With respect to SPACs that have already found an acquisition target, a majority of recent comment letters have requested that registrants provide additional detail about specific risks associated with the target business. For example, the SEC has requested more explicit disclosure be provided regarding net loss histories, material regulatory hurdles and the anticipated additional research and development expense necessary before a target company becomes profitable.

Mark Wood, co-head of Katten's national Capital Markets practice, spoke with *Bloomberg Tax* recently about ways that clients can proactively improve their disclosure to ensure a smooth registration process and reduce the risk a potential business combination is held up by regulators: "We're always thinking about are there ways we could improve our disclosure to make sure we're providing best information, and also to head off SEC comments." The full article is available here.

Latest Remarks From Chairman Gensler on SPACs Renew Calls for Robust Disclosure

Continuing themes highlighted in the previous edition of the *Katten Capital Markets Compass*, in prepared remarks delivered to the Healthy Markets Association on December 9, SEC Chairman Gary Gensler again signaled that implementing new rules for SPACs remains a key objective of his administration and that market participants should expect proposals for new regulations in the coming year. Despite increased regulatory scrutiny and periods of widespread pricing pressure, more than 580 blank-check companies reached the market in 2021, raising more than $155 billion — roughly the same amount raised by traditional operating companies undertaking initial public offerings (IPOs) over the same period. Indeed, in a record year for new listings, SPACs accounted for over three-fifths of all US IPOs.[1]

Consistent with previous public statements, Chairman Gensler's latest remarks focused on increasing investor protections and minimizing perceived potentials for abuse of the SPAC structure, both at the time of the initial SPAC IPO and during the proposed business combination, or de-SPAC, which Chairman Gensler has referred to as the "SPAC Target IPO." Gensler asked the audience:

Are SPAC investors — both at the time of the initial SPAC blank-check IPO and during the SPAC target IPO — benefiting from the protections they would get in traditional IPOs, with respect to disclosure, marketing practices, and gatekeepers? In other words, are like cases being treated alike? Currently, I believe the investing public may not be getting like protections between traditional IPOs and SPACs. Further, are we mitigating the information asymmetries, fraud, and conflicts as best we can? Due to the various moving parts and SPACs' two-step structure, I believe these vehicles may have additional conflicts inherent to their structure. There are conflicts between the investors who vote then cash out, and those who stay through the deal — what might be called "redeemers" and "remainers." Thus, to reduce the potential for such information asymmetries, conflicts, and fraud, I've asked staff for proposals for the Commission's consideration around how to better align the legal treatment of SPACs and their participants with the investor protections provided in other IPOs, with respect to disclosure, marketing practices, and gatekeeper obligations.

Focus on PIPEs

Chairman Gensler's recent remarks also notably discussed a less publicized (but often critical) component of the business combination process – the supplemental committed financing provided by PIPE investors ("PIPE" referring to a private investment in public equity). The availability of supplemental PIPE financing can be crucial to ensuring that there is sufficient cash to pay the merger consideration and that the on-going business is appropriately capitalized. The PIPE also provides a critical backstop against the possibility of significant shareholder redemptions (as such redemptions reduce the cash available in the SPAC's trust, which may be applied to the merger consideration

and/or fund operations and growth after the transaction) – providing certainty to the target company that the transaction will be able to close. Although shareholder redemption rates have generally fallen in recent months amid improving market conditions, studies have shown that historically SPACs could expect over half of shareholders to choose to redeem their shares rather than continue on as shareholders of the combined company. Indeed, a third of all SPACs over the last six years experienced a greater than 90 percent redemption rate – resulting in the supplemental financing from PIPE investors becoming an indispensable part of the business combination process by providing funding certainty.

The participation of PIPE investors in the business combination process also serves the important function of signaling to the market that a proposed transaction has been vetted by institutional investors that are willing to take on risk alongside public shareholders. In his remarks, Chairman Gensler cited concerns that a "PIPE investor may gain access to information the public hasn't seen yet, at different times, and can [therefore] buy discounted shares based upon that information." Significantly, however, Chairman Gensler did not announce any specific proposals in this regard, beyond voicing continued support for transparent and robust disclosure. The SEC's Investment Advisory Committee had previously cited: (1) the acceptable range of terms under which any additional financings such as PIPEs might be sought at the time of an acquisition; (2) the identity and relationship of PIPE investors to the sponsor, target management and other interested parties; and (3) whether any side payments are to be made to certain shareholders as an inducement not to redeem their stock in the de-SPAC transaction as significant disclosure items which SPACs may wish to consider when preparing their offering documentation.

Concerns Regarding Dilution and Merger Announcements

In his remarks, Chairman Gensler also made clear he remains concerned that retail investors may not appreciate the various dilution events associated with SPAC structuring, whether from PIPE investors selling down their positions or via the award of sponsor "promote" shares, stating "[R]etail investors may not be getting adequate information about how their shares can be diluted throughout the various stages of a SPAC. For instance, SPAC sponsors generally get to pocket 20 percent of the equity — but only if they actually complete a deal later." A lack of complete and/or fulsome disclosures in connection with the announcements of proposed business combinations also was cited by the Chair as a continued area of focus: "SPAC target IPOs often are announced with a slide deck, a press release, and even celebrity endorsements. The value of SPAC shares can move dramatically based on incomplete information, long before a full disclosure document or proxy is filed. Thus, SPAC sponsors may be priming the market without providing robust disclosures to the public to back up their claims. Investors may be making decisions based on incomplete information or just plain old hype."

Proposals Expected in April 2022

Although Chairman Gensler did not outline specific proposals in his latest remarks, SPAC market participants have been advised that, consistent with previous public comments, the focus of any new regulations will likely center around ensuring the provision of complete and transparent disclosure to the investing public — the SEC's latest publicly released agenda pencils in an April 2022 target date for proposing SPAC-related rule amendments. Until that time, as with any disclosure made by a public company, participants in the SPAC market are advised that the provision of accurate and complete disclosure to investors, free of material omissions, remains best practice.

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1 Data provided by SPAC Research.

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