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Electronic Submission

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Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Special Purpose Acquisition Companies, Shell Companies and Projections
Release Nos. 33-11048; 34-94546; IC-34549 (March 30, 2022); File No. S7-13-22

Dear Ms. Countryman:

This letter is submitted on behalf of Goodwin Procter LLP ("Goodwin" or "we"), in response to the request for public comments by the Securities and Exchange Commission (the "Commission") with respect to the above-referenced release (the "Proposed Rules") proposing new rules and certain amendments applicable to special purpose acquisition companies ("SPACs"), shell companies and their use of projections, as set forth in a release published in the Federal Register on May 13, 2022 (the "Proposing Release").

The Commission states that it has issued the Proposed Rules to enhance investor protections in initial public offerings ("IPOs") by SPACs and in subsequent business combination transactions ("De-SPAC Transactions") between SPACs and operating companies ("Targets"). The Commission, however, has a tripartite mission to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation. We wholeheartedly support the Commission's mission to protect investors in connection with SPAC IPOs and De-SPAC Transactions and agree that investors are entitled to robust disclosures from issuers and other protections in connection with their investment decisions. We generally support proposed rules that emphasize the importance of clear disclosures, including those relating to conflicts of interests, and enhanced disclosures that would provide greater clarity on many aspects of DeSPAC Transactions. However, we believe that as currently drafted, the Proposed Rules fail to strike the right balance between the three facets of the mission. We, therefore, believe that the Proposed Rules should be calibrated to take also into consideration the Commission's mission to "facilitate capital formation" because many of the Proposed Rules, which largely seek to impose liability or restrict certain activities rather than increase disclosure, if adopted as-is, would severely curtail capital formation while providing increased investor protections that are marginal at best. Moreover, some of the rules have created uncertainty, which does not advance the Commission's goal of maintaining fair, orderly and efficient markets. For example, Proposed Rule 140a purports to be retroactive, creating uncertainty as to what level of participation that has already occurred or that can be undertaken in transactions underway results in underwriter status. Because the Commission's statements in the Proposing Release are characterized as an interpretation of its current views, even though the language of proposed Rule 140a is more narrowly (but still broadly) written, the mere issuance of the Proposing Release has resulted in such uncertainty and market concern that there has been a chilling effect on legitimate capital formation transactions.

It is difficult to overstate the changes that have occurred in U.S. public capital markets over the last twenty years. An explosion in private funding, the rise of index and passive investing, technological advances in our equities markets such as electronic trading, the development of hedge funds, high frequency trading, the maturation of international exchanges, consolidation in the investment banking industry, and the impact of regulations from Sarbanes-Oxley and Dodd-Frank have all played a role in reshaping our capital markets. From a peak in 1996, the total number of publicly listed domestic companies in the U.S. has fallen by almost 50%, from 8,000+ to just over 4,300. In 2019, the number of U.S. publicly listed companies had declined to 4,266. [1] The U.S. now has about as many public companies as it did in the early 1980s. Further, the annual number of U.S.-listed IPOs dropped from a peak of 492 in 1996 to ranging between 24 and 232 annually for the period from 2001 to 2017,[2] despite the attempts of policymakers to revitalize this market through the Jumpstart Our Business Startups (JOBS) Act of 2012[3] (the "JOBS Act") and follow-on legislation. Primarily, the JOBS Act was meant to make it easier for startups to raise capital. Secondarily, it is meant to allow retail investors to invest in startups. In this regard, proponents of the legislation contended that Commission rules were preventing startups from raising the capital they needed to expand. [4] Opponents contended that SEC regulations exist to provide oversight and transparency which prevent people from defrauding investors.

Whichever side of the debate one finds oneself, even the Commission recognizes the significant decline in the number of U.S. public companies in recent years, and the increased reliance by both private companies and public companies on exempt offerings to raise capital.[5] Legislators and some policymakers have concluded that changes in market trends require

[1] Listed Domestic Companies, total – United States, THE WORLD BANK – DATA, https://data.worldbank.org/indicator/CM.MKT.LDOM.NO?end=2020&locations=US&start=1975&view=chart (last visited May 19, 2022).
[2] *Id.*
[3] The Jumpstart Our Business Startups (JOBS) Act is a piece of U.S. legislation that was signed into law by President Barack Obama on April 5, 2012, that loosens regulations instituted by the Commission on small businesses. It lowers reporting and disclosure requirements for companies with less than $1 billion in revenue and allows the advertising of securities offerings. It also allows greater access to crowdfunding and greatly expands the number of companies that can offer stock without going through SEC registration. See Jumpstart Our Business Startups (JOBS) Act Definition (investopedia.com).
[4] In the wake of the 2008 financial crisis, Congress created the Jumpstart Our Business Startups Act (JOBS Act) to encourage capital formation in order to grow businesses, create jobs and spur economic activity. Congress and the Commission continue to monitor and update the JOBS Act rules to further achieve this goal. Since its enactment in 2012, the JOBS Act has succeeded in increasing market activity by easing regulatory requirements for smaller companies going public as well as companies raising capital in the private markets. See The JOBS Act: Did It Accomplish Its Goals? (harvard.edu)
[5] See SEC.gov | Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets.

updated regulations governing capital access. Specifically, small- to medium-sized companies are said to have more difficulty accessing capital relative to larger companies. To facilitate capital formation, new capital access tools not previously part of the SEC regulatory regime, such as crowdfunding and initial coin offerings, have emerged. These new tools are especially helpful for small businesses and startups. As previously noted, the bipartisan JOBS Act scaled regulation for smaller companies and reduced regulations in general for certain types of capital formation. It established a number of new options to expand capital access through both public and private offerings, including a new provision for crowdfunding. Parts of the Fixing America's Surface Transportation Act (JOBS Act 2.0) provided additional relief. Following the JOBS Act, the public and private offering dichotomy has started to blur, and securities regulation has become increasingly tailored to suit companies of different sizes and with different needs.

Notwithstanding these efforts, concerns over capital formation have persisted, given that the number of traditional IPOs remained at far below long-term average levels post-JOBS Act and smaller businesses continue to face capital access pressure. To address these concerns, Congress has considered numerous legislative proposals to further expand the scaled approach, with some proposals building on existing JOBS Act provisions.[6] The policy debate surrounding capital formation proposals often focuses on expanding capital access and protecting investors, two of the SEC's core missions. Expanding capital access promotes capital formation and allows for greater access of investment opportunities for more investors. Investor protection is considered to be important for healthy and efficient capital markets because many investors would be more willing to provide capital, and even at a lower cost, if they could expect enforceable contracts for their investments through a transparent process. At times, expanding capital access can come at the expense of investor protection. For example, proposals that reduce the registration and disclosures that a company must make can decrease the company's compliance costs and increase the speed and efficiency of capital formation. But the reduced disclosures may expose a company's investors to additional risks if they are not receiving information that is important to making informed investment decisions.

As corporate and securities law practitioners, we have assisted private companies in accessing the capital markets through a variety of transactions, including traditional initial public offerings, De-SPAC Transactions and direct listings. Each structure has advantages and disadvantages; and, it appears that many of the Proposed Rules are based upon fundamental misperceptions of SPACs and their role in the capital markets. In this regard, we believe that SPACs often have been unfairly criticized and often provide many advantages to investors that have been insufficiently recognized by the Commission. Through a SPAC IPO, a public investor can secure an opportunity to invest, often in an earlier stage company, while preserving a

[6] The most notable of these proposals is S. 488, a capital formation package referred to as JOBS Act 3.0. Originally a relatively narrow bill, S. 488 was passed by the Senate and then was amended significantly and passed by the House in a 406-4 vote on July 17, 2018. The package includes 32 titles, many of which have previously passed the House with bipartisan support as standalone bills.

redemption right (regardless of whether they vote in favor of or against the initial business combination, or at all).

Further, we believe that the current SPAC IPO rules provide adequate protection for public investors in various ways. For example, the total proceeds raised from the public in a SPAC IPO (and oftentimes a greater amount) are held in a trust account ("Trust Account") maintained by an independent third-party trustee and invested only in short-term U.S. government securities or in money market funds invested in those securities. The funds in the Trust Account may not be released from the Trust Account until consummation of the De-SPAC Transaction ("Closing") or the redemption of public shares if the SPAC is unable to complete a business combination within the specified timeframe. SPACs generally require third-party contractors to execute "waivers against trust" ensuring that they will not assert claims against the Trust Account. The funds in the Trust Account are available to make payments to public stockholders who elect to have their shares redeemed in connection with a De-SPAC Transaction, to pay out public stockholders should the SPAC be required to liquidate or to provide capital to the Target upon Closing.

In addition, public stockholders have the right to vote on the business combination and other related transactions. Because of the need to obtain stockholder approval, the matters that would be presented to the stockholder in order to seek the vote generally include information consistent with the disclosure that would be prepared for a public company merger. Given how SPACs are structured, and in compliance with governing documents, there has never been an instance in which public stockholders who exercised their right to have their public shares redeemed in connection with a De-SPAC Transaction, and who previously purchased SPAC units (generally consisting of shares and redeemable warrants)[7] for $10.00 per unit, received less than $10.00 per share on redemption of their public shares.

Even if public investors in a SPAC elect to have their common shares redeemed before voting to approve a De-SPAC Transaction, they may retain the warrants that are part of the units purchased in the SPAC IPO, which may provide potential upside even after having had their original investment returned.[8] A traditional IPO does not have a redemption feature for the common shares. Further, although SPAC IPO registration statements do not typically limit the sectors in which the Targets will be focused, most SPACs already specify one or more sectors in which they intend to focus their Target search. These sectors often reflect those in which the SPAC sponsor ("Sponsor") has industry experience and in which it can add significant value to the Target. Usually, the depth of support offered by a sponsor exceeds that which most Targets have when they undertake traditional IPOs. Moreover, the SPAC sponsor often provides a level

[7] In addition to shares and warrants, some SPAC IPO prospectuses include rights to receive shares upon a De-SPAC Transaction, and others include "subunits" consisting of shares and warrants, which are intended to minimize redemptions.
[8] Though most SPAC warrants have an exercise price of $11.50 per share, the warrants will have a market price, and, therefore, a value, even if the price of the shares is below the exercise price. The warrants generally have a term of five years after the De-SPAC Transaction.

of industry, managerial or market expertise to the Target, which means that public stockholders have better quality companies to invest in, and companies can more readily enter public markets.

Thus, we believe it would be counterproductive to the goals of capital formation and democratizing access by the general public to a broad range of investment opportunities to impose regulations that may effectively foreclose access to a key financing alternative that would facilitate a path to the public markets by private companies. At least, prior to the release of the Proposed Rules, Targets had been considering three alternatives to access the public markets: a traditional IPO, a De-SPAC Transaction, or a direct listing. Each alternative has its place in the financing continuum as the traditional IPO is no longer the principal capital raising alternative for private companies.

We believe that, with some enhanced investor protections in the case of SPAC IPOs and De-SPAC Transactions consisting of increased disclosure requirements, investors will be in a position to make their own investment decisions and rely on disclosure as the basis of their decisions. However, certain of the Proposed Rules take the decision out of the hands of investors—the mere release of the Proposed Rules has had a chilling effect on the SPAC IPO and De-SPAC Transaction market. In no small measure this is because the Proposing Release continues to create uncertainty while propagating a number of misconceptions related to SPACs, SPAC IPOs and De-SPAC Transactions. As we note throughout our comment letter, the Proposed Rules, attempt to draw parallels between SPAC IPOs and De-SPAC Transactions and traditional IPOs, some appropriate and some erroneous. As we discuss, the absence of a traditional underwriter does not mean that there are no gatekeepers or that there are no investor protections. Combining the SPAC IPO and the De-SPAC Transaction into one continuing distribution of some hypothetical issuer's securities and seeking to identify one or more statutory underwriters and associating them with this process is inconsistent with basic securities law principles regarding underwriter status and creates a level of uncertainty regarding potential and actual liability such that it very nearly eliminates these transactions as viable capital-raising alternatives. If the Proposed Rules are adopted in substantially the form in which these have been currently proposed, SPACs and Targets would need to undertake additional measures (that entail significant new, additional costs) in order for market participants to consider pursuing a De-SPAC.

As noted above, we generally support most of the Proposed Rules that seek to increase the disclosure required in SPAC IPOs and De-SPAC Transactions. For example, we generally support the additional disclosures included in proposed Items 1601 through 1605, 1608 and 1610 of Regulation S-K, as these largely codify current market practice.[9] Therefore, in this letter, we focus primarily on the portions of the Proposed Rules that we believe would be detrimental to the capital markets and to investors, particularly disclosure requirements related to the fairness of the De-SPAC Transaction to unaffiliated stockholders, the imposition of underwriter liability on

[9] However, the disclosure requirements should be adjusted in order to account for the status of the issuer, providing appropriate accommodations, for example, for emerging growth companies ("EGCs") and foreign private issuers ("FPIs").

participants in De-SPAC Transactions, liability and other requirements related to financial projections, including the loss of protection from liability as forward-looking statements under the Private Securities Litigation Reform Act of 1995, and the proposed safe harbor from regulation under the Investment Company Act of 1940.

A. DISCUSSION

A.1. Proposed amendments we believe raise concerns

A.1.1. Determining fairness of the De-SPAC Transaction (proposed Items 1606 and 1607 of Regulation S-K).

We do not believe that proposed Items 1606 and 1607 are within the scope of the Commission's rulemaking authority. As a general matter, U.S. federal securities laws are disclosure-based and do not regulate the fairness or advisability of securities transactions. This overarching principle is a policy decision made by Congress and codified in federal statute. As a federal administrative agency, the Commission's rulemaking authority is limited to the specific grants of authority provided by Congress.[10] A useful example of this principle is the Commission's rulemaking authority pursuant to Section 10(b) of the Exchange Act. When interpreting the scope of conduct prohibited by Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, the Supreme Court has held[11] that a claim brought by a stockholder alleging simply that the stockholder has been treated "unfairly" by a fiduciary, without more, is not valid, writing that if "full and fair disclosure is made, transactions eliminating minority interests are beyond the purview of Rule 10b-5."[12]

Proposed Items 1606 and 1607 stop short of expressly requiring business combination transactions to be substantively fair and instead require *disclosure* of the issuer's reasonable belief as to a transaction's fairness or unfairness to unaffiliated securityholders. However, the practical effect of these proposed rules is to require substantive fairness. A SPAC could hardly state in the disclosure materials sent to its investors that it believes a De-SPAC Transaction is unfair to unaffiliated stockholders. Such a position would be untenable; no such transaction would be able to proceed as every stockholder would run to their state courthouse to file a complaint for breach of fiduciary duty under applicable state corporation law. Proposed Item 1606 also provides that an issuer cannot abstain from stating whether it believes the business combination is fair or unfair. Thus, proposed Items 1606 and 1607 impose such stringent disclosure requirements regarding the fairness of a business "that a fairness objective is clearly

[10] Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 472 (1977) ("The rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law. Rather, it is 'the power to adopt regulations to carry into effect the will of Congress as expressed by the statute.'" (citation omitted)).
[11] *Id.* at 473-74 ("[T]he claim of fraud and fiduciary breach in this complaint states a cause of action under any part of Rule 10b-5 only if the conduct alleged can be fairly viewed as "manipulative or deceptive" within the meaning of the statute."). The court went on to state that "[case law does] not support the proposition, adopted by the Court of Appeals below and urged by respondents here, that a breach of fiduciary duty by majority stockholders, without any deception, misrepresentation, or nondisclosure, violates the [Section 10(b) of the Exchange Act] and [Rule 10b-5]. *Id.* at 476.
[12] *Id.* at 469.

implicit in its provisions."[13] Following the reasoning of the Supreme Court in *Santa Fe Indus., Inc. v. Green,* we believe that the Commission does not have the statutory authority to impose a substantive fairness standard on business combinations.

Assuming for the sake of discussion, but without necessarily admitting, that the Commission has the statutory authority to adopt proposed Item 1606, we believe that:

- *The scope of the fairness determination should cover the De-SPAC Transaction and any related financing transaction as a whole*. We do not believe that separate determinations regarding any aspect of the De-SPAC Transaction as proposed are appropriate. For example, it is unclear how the board of directors of a SPAC (or a financial advisor providing a fairness opinion to support the board's determination) would evaluate the fairness of any financing transaction itself. De-SPAC Transactions involve multiple complex and, often, mutually dependent steps and should be viewed on a combined basis. Furthermore, from the standpoint of the SPAC's continuing stockholders, they will continue to own shares of the combined company after Closing ("Combined Company") that reflect all of these transactions. As part of analyzing the fairness of the De-SPAC Transaction, we would expect the SPAC's board of directors to take into account all of these transactions and look at the Combined Company, including its pro forma capitalization as a result of related financing transactions. We propose that the Commission clarify that a fairness assessment should apply to the De-SPAC Transaction and all of its components taken as a whole.

- *The fairness determination should be as to the SPAC's securityholders as a whole, rather than solely to the SPAC's unaffiliated securityholders*. A fairness determination should be made as to a SPAC's securityholders as a whole. For most SPACs, this would include both holders of the publicly registered and traded shares of Class A common stock and the holders of privately held shares of Class B common stock awarded to a sponsor as part of the Sponsor promote. A fairness evaluation is a complex analytical process and the methodology used to determine the enterprise value of a particular Target will vary depending on the circumstances. However, at its core, fairness involves determining whether the *enterprise value* of the Target that is implied by the terms of the definitive documentation for a De-SPAC Transaction is higher or lower than the implied consideration being paid. Financial advisors that undertake this analysis in relation to a SPAC's enterprise value have sometimes used a discounted cash flow analysis, a precedent transactions analysis or a comparable companies analysis, among others, to estimate a range for a SPAC's enterprise value and then evaluate whether a particular value implied by a subject transaction's terms is fair or unfair. However, taking the analysis a step further and attempting to determine whether a De-SPAC Transaction is fair to a subset of a SPAC's securityholders would necessarily require a SPAC (or financial advisor) to opine on whether the *allocation of the rights to a Target's enterprise*

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[13] *See* Randal J. Brotherhood, *Rule 13e3 and the Going Private Dilemma: The SEC's Quest for a Substantive Fairness Doctrine*, 58 WASH. U. L. REV. 883, 908-09 (1980) (discussing the practical effect of Items 1014 and 1015 of Regulation M-A).

value as between the Class A and Class B stockholders is fair or unfair. Whether any allocation of value as between classes of stockholders is fair or unfair has less to do with the imperfect science of enterprise valuation traditionally undertaken by financial advisors and more to do with the business deal that Class A and Class B stockholders have struck as part of a SPAC IPO.

- *The factors enumerated in proposed Item 1606(b) in determining fairness should be discussed to the extent they were actually used by the SPAC in making its fairness determination*. Proposed Item 1606(b) would require a SPAC to discuss in reasonable detail the material factors upon which it bases its belief on the fairness of a De-SPAC Transaction and any related financing transaction to unaffiliated securityholders of the SPAC. Proposed Item 1606(b) then states that "such factors *shall* include… the consideration of any financial projections…" Since proposed Item 1606(b) would require a SPAC to discuss and, thus, disclose its Target's financial projections as part of the description of the basis of its fairness determination, the Proposed Rules should provide that the PSLRA's safe harbor for forward-looking statements applies to financial projections disclosed by a SPAC in response to this proposed item. It is patently unfair, on the one hand, to heighten the potential liability for forward-looking information and then require SPACs to include this inherently uncertain information in its public filings, on the other. What if a Target, having established attractive historical results, would like to opt not to present its forward-looking projections to mitigate its liability and given its concern that the future is, by definition, uncertain? This tension is further exacerbated by proposed Rule 145a, which effectively requires virtually all De-SPAC Transactions to be conducted pursuant to a registration statement, which would render projections presented in response to this proposed item subject to the liability provisions of the Securities Act.

  In a related vein, proposed Item 1606(b)'s list of factors that "shall" be included in a discussion of a fairness determination is at odds with the Commission's history of implementing a principles-based disclosure regime. The factors relevant to making a fairness determination will vary from company to company and different fairness assessors may take different views on which factors are appropriate for the same company. Instruction 2 to Item 1014 states: "[t]he factors that are important in determining the fairness of a transaction to unaffiliated securityholders and the weight, if any, that should be given to them in a particular context will vary." By prescribing which factors "shall" be discussed, the Commission may force the SPAC to disclose information not actually considered by the SPAC in making its fairness determination. We propose that the Commission modify proposed Item 1606(b) to provide that the factors should be discussed "to the extent" they were actually considered by the SPAC in making its determination.

- *The costs to comply with the disclosures required by proposed Item 1606(a) will discourage De-SPAC Transactions*. We believe proposed Item 1606(a) will dramatically reduce the number of De-SPAC Transactions that will be undertaken. First, we believe transaction costs will increase materially as a result of the additional work that will need to be done to reach the fairness determination, including the cost of obtaining a fairness opinion from a financial advisor and the expected increase in premiums for D&O liability insurance given the increased potential liability. Separately, requiring a fairness determination may halt some De-SPAC Transactions even when it would be a reasonable business decision to proceed because of the difficulties in reaching a fairness determination or in obtaining a fairness opinion. Moreover, because of the potential liability attendant to delivering a fairness opinion, we believe that some transactions may be financially attractive and yet will not be "opinion-able" by a financial advisor. This will have the undesired result of some De-SPAC Transactions not proceeding as no fairness opinion will be able to be given and the SPAC board of directors will not proceed without a fairness opinion for fear of liability. In short, investors may miss out on otherwise attractive transactions because of the difficulty or liability associated with declaring them "fair."

- *Registrants should not be required to assign a weight to each material factor underlying the fairness determination*. A fairness determination is a complex analytical process. Ultimately, some professional judgment based on experience and/or business acumen will be required in each case. It is neither practical nor workable to assign a weight to various factors and could result in investors placing too much or not enough emphasis on the factors described by the SPAC.

Assuming for the sake of discussion, but without necessarily admitting, that the Commission has the authority to adopt proposed Item 1607, we believe it is inappropriate to require the filing of board books and other written materials presented to the board in connection with the reports, opinions or appraisals, as is the case with going-private transactions. Free flow of information is critical to a board's deliberative process and necessary for it to discharge its fiduciary duties. Requiring filing of board materials will inevitably result in a reduction of information presented to, and considered by, a SPAC's board of directors. Board materials are typically not prepared with a view that they will be included public filings and subject to Securities Act and Exchange Act liability. If filing these materials was required, it would require board materials to be drafted to withstand scrutiny under the Securities Act and the Exchange Act's liability provisions. This is impractical and unworkable. Most professionals preparing these materials are not trained to prepare these documents in a manner that would be appropriate for public disclosure. Some materials may reflect management's preliminary analysis or some draft documents that will later be refined after new information comes to light as a result of the due diligence process. Some other materials may be prepared by a third party that will not consent to their use in a public filing. Some information may be immaterial, speculative or ultimately determined to be unreliable. As a result of these and other unforeseeable factors, the inevitable result of required public filing of materials presented to a board of directors will be a reduction in the information presented.

A.1.2. <u>Imposing underwriting liability in De-SPAC Transactions</u>.

Although, as discussed in this letter, Goodwin supports the Commission's efforts to improve the quality of disclosure in connection with SPAC IPOs and De-SPAC Transactions and to encourage participants in these transactions to undertake thorough diligence, we believe that the SPAC IPO should be viewed as distinct from the De-SPAC Transaction for purposes of determining underwriter status because, among other reasons, after the underwritten SPAC IPO, the securities would have "come to rest" in the hands of the investors without any subsequent transaction being on the table. The Commission has at different times said that "holding securities for six months is a reasonable indication that an investor has assumed the economic risk of investment in those securities."[14] Therefore, the period between the SPAC IPO and the De-SPAC Transaction should not be construed as one long, continuous offering. Rather, these are two separate and distinct transactions. In the case of a SPAC IPO, there are named "underwriters" who take on a traditional underwriter role; in the case of a De-SPAC Transaction, just like other M&A transactions, there may be no one who by virtue of their role in the transaction, and based upon longstanding practice and understanding, fits being designated as an "underwriter" under statute. We understand the Commission's desire to identify additional "gatekeepers" in connection with a De-SPAC Transaction, but that does not justify going beyond what the statute permits. In fact, the context of an M&A transaction provides heightened responsibility for participants to perform a gatekeeper role, just not as an "underwriter" with underwriter liability. For example, as a negotiated transaction, the parties are already performing diligence that is reflected in a merger or business combination agreement with representations and warranties and disclosure schedules. The SPAC's board of directors has a fiduciary duty and disclosure obligations as a matter of state law, which compel conducting a thorough diligence review, including in connection with any fairness determination and with respect to projections, and in insuring high quality disclosure.[15] Moreover, as we discuss throughout this letter, there already are various parties with securities law liability, which, as a result, have an incentive to undertake a rigorous diligence inquiry and insure full and fair disclosure in connection with a De-SPAC Transaction.

In its effort to justify its proposal, the Commission advances an overly expansive view of the activities and connections that give rise to statutory underwriting liability. We believe the Proposing Release's description of the types of persons that may be viewed as statutory underwriters in the context of a De-SPAC Transaction is conceptually flawed, is at odds with interpretations of existing law and disregards longstanding market practice. Because the Commission's statements in the Proposing Release are characterized as an interpretation of its current views, even though the language of proposed Rule 140a is more narrowly (but still broadly) written, the mere issuance of the Proposing Release has resulted in such uncertainty and market concern that legitimate capital formation transactions have been brought to a halt. As a result, regardless of whether and in what form Rule 140a is ultimately adopted, we respectfully

[14] Revisions to Rule 144 and Rule 145 to Shorten Holding Period for Affiliates and Non-Affiliates, 72 Fed. Reg. 36,822, 36,825 (proposed Jul. 5, 2007).
[15] *See* In re Multiplan Corp. Stockholder Litigation, C.A. No. 2021-0300-LWW (Del. Ch. Jan. 3, 2022).

request that the Commission clarify the overly broad statements included in the Proposing Release that are at odds with current law. We set out below our views regarding the ways in which we believe this to be the case.

A.1.2.1. The interpretive position and proposed Rule 140a inappropriately stretch the concept of "distribution" in the definition of "underwriter"

Section 2(a)(11) of the Securities Act defines an "underwriter" as "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the *distribution* of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking." [emphasis added] As the Commission notes in the Proposing Release, the definition of underwriter is indeed expansive and does not simply cover persons or entities engaged in the business of underwriting. This term has always been understood to require a functional analysis—premised on assessing the nature of the transaction and the actual role undertaken by the person in connection with the transaction, and extends to anyone who acts for an issuer in connection with the distribution of securities, or that functions as a "link in the chain of distribution." It further extends to affiliates of the issuer whether they are acting on behalf of the issuer or on their own behalf,[16] which is a "difficult factual [question], not merely a question of who receives the proceeds."[17] Underwriter status is based on the individual's relationship with the issuer and the nature and extent of the individual's involvement in the proposed offering.[18] Historically, the Commission has taken the position that the individual or entity in question is in the best position to determine whether it is an "underwriter."[19] The Commission has routinely refused to make specific factual determinations as to who is an "underwriter" through requests for no-action relief.[20] It is not clear what the justification is for the Commission to depart from past practice and to now take a prescriptive approach rather than to acknowledge

[16] SEC v. Kern, 425 F.3d 143, 153 (2d Cir. 2005) ("Underwriter" includes any person who is engaged in steps necessary to the distribution of securities.); Ackerberg v. Johnson, 892 F.2d 1328, 1335 (8th Cir. 1989) (Congress intended "to cover all persons who might operate as conduits for the transfer of securities to the public.").

[17] SEC Staff Compliance and Disclosure Interpretations, Questions and Answers of General Applicability, question no. 612.09 (Jan. 26, 2009) acknowledges that the analysis of whether an offering is a primary or secondary offering is "a difficult factual one," rather than the position expressed in the Proposing Release. "Consideration should be given to how long the selling shareholders have held the shares, the circumstances under which they received them, their relationship to the issuer, the amount of shares involved, whether the sellers are in the business of underwriting securities, and finally, whether under all the circumstances it appears that the seller is acting as a conduit for the issuer." Even where the facts suggest a primary offering, the Staff has permitted exceptions, *see Id.* question 139.11 (Nov. 26, 2008) (where an issuer privately placed convertible securities in reliance on the exemption provided by Section 4(2) of the Securities Act and has not yet issued some or all of the convertible securities, filing a registration for resale of the common stock underlying the unissued convertible security would not be viewed as a valid secondary offering but instead treated as an indirect offering by the issuer, and thus a primary offering, with the investor being identified in the registration statement as an "underwriter"); *Id.* question 139.13 (Nov. 13, 2020) (private equity line financings (not PIPEs) considered as indirect primary offerings, even though the "resale" form of registration is sought in these financings).

[18] Nelson v. Quimby Island Reclamation Dist. Facilities Corp., 491 F. Supp. 1364, 1371 (N.D. Cal. 1980) (holding that the definition of underwriter includes "any person who performs one of the specified functions in relation to the offering . . . even though he is not a broker or dealer.") (citation omitted).

[19] *Id.*

[20] Butler Manufacturing Co., SEC No-Action Letter, 1989 WL 246101 (Jul. 19, 1989); Shopsmith, Inc., SEC No-Action Letter, 1978 WL 12233 (Dec. 6, 1978); Ward Foods Inc., SEC No-Action Letter, 1977 WL 15051 (Sept. 20, 1977).

that who is a statutory underwriter is a factual determination to be made based upon the particular circumstances as they relate to the statutory definition.

Through its interpretation and proposed Rule 140a, the Commission's view is that various parties involved in a De-SPAC Transaction may nonetheless be deemed underwriters because of their "direct or indirect participation" in the distribution of securities of the issuer. We disagree.

- *The SPAC IPO and De-SPAC Transaction are two separate transactions and should not be conflated*. Proposed Rule 140a purports to use Section 2(a)(11) and case law on "statutory underwriter" status to extend underwriting liability to various parties in the SPAC IPO and the De-SPAC Transaction process. In so doing, it fails to recognize the nature of a De-SPAC Transaction and conflates two separate transactions. Although the Commission may want to equate a De-SPAC Transaction to a traditional IPO of the Target, a De-SPAC Transaction is in reality a hybrid transaction and not the same as a traditional IPO of the Target. In a traditional IPO, the identity of the underwriters is seldom in doubt—an investment bank purchases securities from the issuer for immediate resale to the purchasers in the registered offering. The underwriter purchases securities from the issuer, makes the purchase with a view to a distribution, offers and sells the securities for the issuer and makes offers and sales in connection with the distribution (the public offering). While a SPAC IPO has all of these elements and the investment banks engaged by the SPAC clearly serve as underwriters, there are no parties performing similar functions in a De-SPAC Transaction. A De-SPAC Transaction is largely a typical M&A transaction and should be regulated as such. The Commission's proposal, if it were to be applied coherently, would suggest that every M&A transaction involving a registered offering would involve a statutory underwriter. We know that is not the case.

- *Not every De-SPAC Transaction is a "distribution" of securities*. Proposed Rule 140a is not clear as to which "securities" are being distributed, who is the "seller" of such securities, when the "distribution" is occurring and to whom the distribution is being made. If the securities are the SPAC common shares, proposed Rule 140a fails to recognize the ability of SPAC investors to elect to have their shares redeemed, resulting in not all SPAC stockholders becoming stockholders of the [Combined Company]. Moreover, as discussed in Section 2.3.1 of this letter, particularly in relation to statutory underwriters who are persons who have purchased with a view to distribution of a security, not all De-SPAC Transactions are "distributions." Neither every M&A transaction with stock as consideration, nor every M&A transaction that is registered on a registration statement on Form S-4/F-4 ("Merger Registration Statement"), is a "distribution" that involves a statutory underwriter. Is the "distribution" that the Commission references a distribution of the SPAC stock that constitutes the merger consideration since those are the only "new" securities introduced into the market? How should this be distinguished from the merger consideration in any other M&A transaction? And how is a financial intermediary that acted as a buy side or a sell side advisor a statutory underwriter in this context? Target is not "selling" or "distributing" any securities in the transaction (at least in most De-SPAC Transactions), so is the Commission focused only on the status of the advisor to the SPAC?

A.1.2.2. Proposed Rule 140a imposes underwriting liability on a number of De-SPAC Transaction financial intermediaries without sufficient participation in the "distribution" of securities

There are two types of underwriters: (i) a *traditional underwriter* which includes investment banks engaged to render a firm commitment underwriting on behalf of an issuer[21] and (ii) a *statutory underwriter* as described in Section 2(a)(11) of the Securities Act which includes any party that participates in a distribution of securities. We believe Proposed Rule 140a, as well as the Commission's interpretive statements in the Proposing Release, goes beyond what is authorized by the Securities Act by inappropriately expanding the concept of a statutory underwriter in order to find a traditional underwriter in a De-SPAC Transaction where there is none.

- *Rule 140a mischaracterizes basic securities law principles to find a gatekeeper, when there already are numerous parties with rigorous responsibilities in connection with the SPAC IPO and the De-SPAC Transaction.* Proposed Rule 140a suggests that there needs to be a party characterized as an underwriter taking Section 11 liability in connection with the De-SPAC Transaction in order to provide investor protections. While that might be a salutary policy objective, there are many securities transactions in which no underwriter is involved. There are a number of parties involved in the SPAC IPO and in the De-SPAC Transaction process that are already subject to securities law liability and that must discharge fiduciary and other obligations, thereby requiring them to act as gatekeepers. Moreover, the acquisition process itself involves a discipline not present in a traditional IPO. In a De-SPAC Transaction, a diligence review is undertaken not only by the SPAC and its counsel, but also by the Target and its counsel and also often by the PIPE placement agent and its counsel. The registrant has strict Section 11 liability without a due diligence defense.

- *The required level of "participation" to be a statutory underwriter in a De-SPAC Transaction*.[22] Based on the definition provided in Section 2(a)(11) of the Securities Act,[23] there are three types of statutory underwriters: (1) a person who purchases from an issuer "with a view to" the distribution of a security, (2) a person who offers or sells for an issuer "in connection with" the distribution of a security and (3) a person who "participates" in any distribution of a security. The first type does not apply to a De-SPAC Transaction because, depending on its structure, the existing SPAC stockholders

[21] See LOUIS LOSS, JOEL SELIGMAN, AND TROY PAREDES, 1 FUNDAMENTALS OF SECURITIES REGULATION 97–126 (6th ed. 2011).
[22] In this sub-section, we adopt the case summaries provided in Benjamin J. Nickerson, Comment, *The Underlying Underwriter: An Analysis of the Spotify Direct Listing*, 86 U. CHI. L. REV. 985, 1008-1014 (2019).
[23] 15 U.S.C. §77b(a)(11).

may continue to hold shares of the SPAC following Closing. The second type also does not apply to a De-SPAC Transaction because there is no "sale" in a De-SPAC Transaction. The third type is most relevant in analyzing proposed Rule 140a.

Participation alone does not make one a statutory underwriter unless it is participation in the distribution. Finding underwriter status of the third type depends on the interpretation of "participates" and "any such undertaking."[24] Courts have taken several approaches to defining these terms. More broadly, some courts ask whether the party's actions were simply distribution-related. Some courts look to whether the public relies on a party's expertise when purchasing the securities. Others consider whether the party's actions were necessary to the distribution, similar to the analysis undertaken in *SEC v. Chinese Consolidated Benevolent Association,*[25] in which the Second Circuit considered whether a charitable association that promoted the sale of Chinese government war bonds should be characterized as an underwriter when it offered to sell the Chinese securities to American investors. In particular, the association marketed the securities to members of Chinese communities in New York, New Jersey and Connecticut through meetings and newspaper advertisements. The association then exchanged funds that it collected for the securities and distributed them to its members. The court determined that the association should be considered an underwriter because the language of the statute should be read "as covering continual solicitations . . . which normally would result in a distribution of [securities]."[26] The court continued to state that the definition includes any person who "engaged in steps necessary to the distribution of securit[ies]."[27]

We address each interpretation in turn:

- First, if the public relies on the party's expertise in evaluating the registration statement, then that party may be considered to have participated in a distribution and would be considered an underwriter. This interpretation does not apply to a De-SPAC Transaction. In *McFarland v. Memorex Corp*,[28] the court concluded that institutional investors that exercised registration rights in a securities offering were not underwriters because they did not have control over the registration statement and the public did not rely on their expertise when making investment decisions.[29] The court observed that "underwriters are subjected to liability because they hold themselves out as professionals who are able to evaluate the financial condition of the issuer."[30] Although this case demonstrates the

[24] 15 U.S.C. §77b(a)(11). For a full discussion of "participation in an underwriting" and a collection of relevant case law, see Loss, Seligman, and Paredes at 471–74.
[25] 120 F.2d 738 (2d Cir. 1941).
[26] *Id*. at 741.
[27] *Id*.
[28] 493 F. Supp. 631 (N.D. Cal. 1980), modified on other grounds, 581 F. Supp. 878 (N.D. Cal. 1984).
[29] *Id*. at 646.
[30] *Id*. See also *In re Activision Securities Litigation*, 621 F. Supp. 415, 424 (N.D. Cal. 1985) ("[U]nderwriters who participate in the preparation of the registration statement are liable [under § 11]."). For further discussion of *McFarland* and *Activision*, see

importance of considering the role the SPAC IPO investment banks had in drafting the registration statement when analyzing underwriter status, its doctrine does not apply to a De-SPAC Transaction because unlike in a SPAC IPO, the SPAC IPO underwriters do not have any role in drafting the Merger Registration Statement.

- Second—an expansion of the Chinese Consolidated approach, if the person's role was "necessary to the distribution,"[31] that party may be considered an underwriter but only if its activities are "related to the *actual* distribution of securities." In *Harden v. Raffensperger, Hughes & Co*,[32] the Seventh Circuit considered whether a qualified independent underwriter was subject to Section 11 liability as a statutory underwriter.[33] Firstmark Corporation, a financial services company, issued debt securities through a subsidiary and was required to retain a "qualified independent underwriter" in connection with the offering.[34] The court rejected the defendant's argument that it was not an underwriter solely because it did not purchase the issuer's securities. Instead, the court held that the third party Firstmark retained "participated" in the distribution—and was therefore a statutory underwriter—because its actions were "necessary to the distribution."[35] In contrast to other circuits, the Second Circuit takes a narrower approach and looks at whether the party engaged in distribution-related activities. In *In re Lehman Brothers Mortgage-Backed Securities Litigation*,[36] the Second Circuit concluded that credit rating agencies involved in structuring mortgage-backed securities did not "participate" in a distribution because their activities were not "distribution-related." The plaintiffs asserted that the rating agencies qualified as underwriters because their actions were a "necessary predicate to the securities' distribution."[37] The court, in rejecting the plaintiffs' argument, distinguished between entities "who provide services that facilitate a securities offering" and

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Jennifer O'Hare, *Institutional Investors, Registration Rights, and the Specter of Liability under Section 11 of the Securities Act of 1933*, 1996 WIS. L. REV. 217, 239–45.

[31] See, for example, *SEC v. Kern*, 425 F.3d 143, 152–53 (2d Cir. 2005) (holding a corporation who "engaged in steps necessary to the distribution" to be a statutory underwriter (quoting SEC v. Chinese Consolidated Benevolent Assoc., 120 F.2d 738, 741 (2d Cir. 1941)). *See* also, e.g., SEC. v. Universal Major Industries Corp., 546 F.2d 1044, 1046–47 (2d Cir. 1976) (holding that an attorney who wrote letters in connection with transfers of unregistered stock that expressed his opinion that such transfers were legal violated Section 5 of the Securities Act). *But see* SEC. v. North American Research and Development Corp., 424 F.2d 63, 71–72 (2d Cir. 1970) (observing that "joining in the common effort" to sell unregistered shares subjects one to "the injunctive and other powers of the SEC and the federal courts").

[32] 65 F.3d 1392 (7th Cir. 1995).

[33] *Id*. at 1394.

[34] *Id*. at 1394–95. A minimum yield on a bond offering is similar to a minimum price on an equity offering.

[35] *Id.* at 1400–01 (quoting SEC v. Holschuh, 694 F.2d 130, 139 n.13 (7th Cir. 1982)). The Ninth Circuit takes a similarly broad approach. See generally SEC v. Platform Wireless Int. Corp., 617 F.3d 1072, 1086 (9th Cir. 2010) (interpreting the underwriter definition to include "[a]ny intermediary between the issuer and the investor that is an essential cog in the distribution process" (citation omitted)).

[36] 650 F.3d 167 (2d Cir. 2011).

[37] *Id.* at 175. In addition to passively evaluating the credit risk of each pool of mortgage-backed securities, the rating agencies allegedly aided in the structuring and securitization process. Id at 172–73.

those who "participate in the statutorily specified distribution-related activities."[38] The court interpreted Section 2(a)(11) to mean that the underwriter definition encompasses only activities that are "related to the actual distribution of securities."[39] The rating agencies merely facilitated the participation of others in the offering; they did not participate in the offering themselves and were therefore not statutory underwriters. The *In re Lehman Brothers Mortgage-Backed Securities Litigation*[40] doctrine has been historically followed and correctly applies in analyzing underwriter status in a De-SPAC Transaction.

- *Proposed Rule 140a imposes underwriting liability on any number of financial intermediaries without justification and without providing sufficient legal certainty*. Proposed Rule 140a wrongly assumes that underwriter liability attaches in a broad set of circumstances. As discussed in Section 2.4.3.1 of this letter, the Commission reads into the case law much more than the case law actually holds. The case law turns on participation in distribution-*related* activity; however, the Commission would include as statutory underwriters entities that are not selling securities to the public, that are not in privity of contract with the issuer of the securities that are the subject of the purported distribution, that are performing advisory services only, and that have no direct nexus to the purported distribution.[41] We consider below the various parties in the process and their roles.

  - SPAC IPO underwriters. Proposed Rule 140a would deem a SPAC IPO underwriter who "takes steps to facilitate the De-SPAC Transaction, or any related financing transaction, or otherwise participates (directly or indirectly) in the De-SPAC Transaction" to be engaged in the *distribution* of the securities of the Combined Company within the meaning of Section 2(a)(11) of the Securities Act, and thereby subject to underwriting liability. However, there is no necessary nexus between the SPAC IPO, a completed transaction, involving a distribution of securities, and the subsequent De-SPAC Transaction. The two transactions may be separated by a period of a year or more. A general reference to "steps to

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[38] *Id*. at 176.

[39] *Id.* In reaching its conclusion, the court looked to *In re Refco, Inc. Securities Litigation*, 2008 WL 3843343, *4 (S.D.N.Y 2008) ("While the definition of 'underwriter' is indeed broad and is to be interpreted broadly, it must be read in relation to the underwriting function that the definition is intended to capture.").

[40] *Id.*

[41] All the cases the Commission relies on found that an actor was an underwriter when it played a *necessary* or *crucial* role in the distribution: SEC v. Chinese Consolidated Benevolent Association, 120 F.2d 738, 740-741 (2d Cir. 1941) addressed a defendant who engaged in the solicitation and sales of bonds. The defendant actively engaged in the sale of bonds, and its only argument for exemption was that its solicitation was not authorized by the Chinese government, which was the issuer; SEC v. Kern, 425 F.3d 143 (2d Cir. 2005) only discusses sellers of securities; Harden v. Raffensperger, Hughes & Co., 65 F.3d 1392, 1401 (7th Cir. 1995) found that underwriter liability attaches only because the actor's actions were "necessary to the distribution of … [the] securities" in question; Geiger v. SEC, 363 F.3d 481, 487 (D.C. Cir. 2004) addressed the actor's role (finding the buyer, negotiating the terms, facilitating the resale) as "crucial;" SEC v. Allison, No. C-81-19 RPA, 1982 WL 1322 (N.D. Cal. 1982) (the court holds that defendants who "arranged for public trading to commerce through market makers, brokers, and transfer agents; they stimulated demand through advertisements, research reports, and television promotions; and, through these efforts, they were able to sell a substantial amount of stock in SNG and Olympic to the public" are underwriters through the participation prong of section 11, regardless of their intent).

facilitate" the De-SPAC Transaction is overly broad and imprecise by not identifying actual steps, if any, that would qualify as participation in a distribution as to make a SPAC IPO underwriter an underwriter in the De-SPAC Transaction. For example, the Commission references the receipt of deferred compensation, but that alone cannot be a basis for participation in a distribution sufficient to trigger statutory underwriter status.

- <u>PIPE placement agent</u>. While a PIPE placement agent may appear to perform some functions that one might associate with those of a statutory underwriter (identifying potential purchasers for securities, and assisting in the introduction of such securities into the market), all those functions relate to an investment by institutional accredited investors in the PIPE transaction, which itself, as an exempt transaction, does not involve a distribution. The PIPE placement agent's activities are completed when subscription agreements are executed, which typically is concurrently with the public announcement of the De-SPAC Transaction and well before the preparation of the Merger Registration Statement. There also is no necessary nexus between the services provided by the PIPE placement agent (solely in that role) and the SPAC stockholder vote on the De-SPAC Transaction, or the De-SPAC Transaction itself.

- <u>PIPE investors</u>. PIPE investors are sophisticated investors, usually institutional accredited investors, who have an opportunity to evaluate an investment in the securities offered by the SPAC in connection with a De-SPAC Transaction. The PIPE investors may conduct their own diligence, are given an opportunity to meet with SPAC and Target representatives and have their questions answered, and may also rely on representations and warranties contained in the subscription agreement negotiated in connection with the transaction. Consistent with the doctrine in *American Council of Life Insurance,*[42] there would seem to be no reason to suggest, as the Proposing Release does, that a PIPE investor, investing without a view to a distribution, may be a statutory underwriter.[43]

- <u>Financial advisor to SPAC or Target</u>. Each of the SPAC and the Target typically engages one or more investment banks to provide financial advisory services, which may include identifying potential counterparties, assisting with determining valuation and preparing materials about the company, assisting with structuring a potential transaction, and assisting with negotiating the terms of the De-SPAC Transaction. The financial advisor or another service provider also might provide a fairness opinion. These advisors may or may not have been the SPAC IPO underwriters. In the case of Target's advisor, the advisory services are provided for Target's benefit, which has an incentive to maximize its valuation for the

[42] American Council of Life Insurance, SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2542 (May 10, 1983).
[43] *See* Special Purpose Acquisition Companies, Shell Companies, and Projections, 87 Fed. Reg. 29,458, 29,486 (proposed May 13, 2022).

benefit of its stakeholders. Its interests are not aligned with the interests of the SPAC public stockholders. Target's advisor clearly has no nexus to the SPAC public stockholders. It is not clear how a financial advisor to Target functions in the role of a statutory underwriter—it is not acting on behalf of the SPAC, it has no privity of contract with the SPAC, it is not distributing SPAC securities, nor is it distributing Target securities. The SPAC advisor, while it may assist the SPAC to identify Target, structure the transaction, and negotiate the transaction is still performing an advisory function, not an underwriter function—it is not buying SPAC securities to resell, nor is it participating in a chain of sale of securities to the public market, or otherwise participating in a distribution in any way beyond what similar advisors have always done in connection with like transactions. The SPAC advisor is rendering services to the SPAC's board of directors, which has certain duties, as we have discussed elsewhere, and is not recommending the purchase of securities to any investor.

It is inconsistent with longstanding principles regarding statutory underwriter status to find parties that are acting merely in an advisory capacity—not offering securities of the SPAC or the Target, not acting as principal and buying and reselling securities, not providing any financing to facilitate the consummation of the De-SPAC Transaction, and not recommending the purchase of securities, but rather solely identifying potential Targets, or providing tax, corporate, restructuring or other financial advisory advice—to be statutory underwriters. A financial advisor is not distributing securities, participating in a chain of sales of securities to the public, or introducing investors to an investment in securities. The overbroad language of the Proposing Release creates uncertainty in this regard that, as we indicated, the Commission needs to clarify. In this connection, financial advisors play an important role in transactions that serve to protect the interests of investors and maximize value. It would be counterproductive for the Commission to discourage performance of such roles by seeking to impose unjustified liability impediments.

In a traditional M&A transaction, there is no "gatekeeper" in the form of a statutory underwriter and there is no compelling reason to distinguish the business combination that is part of the De-SPAC Transaction from a traditional M&A transaction. There are other protections for the stockholders, as discussed elsewhere in this letter.

- <u>Fairness opinion provider</u>. The financial advisor engaged by the SPAC's board of directors to provide a fairness opinion is typically unrelated to the SPAC IPO underwriters in order to ensure the independence of the advisor. Nevertheless, regardless of whether such financial advisor has a prior relationship to the SPAC, it provides its services solely for the purpose of delivering an opinion to the board of directors in connection with the board's fulfilling its duties. The fairness opinion giver may be viewed as an "expert" under the Securities Act in connection with its opinion if it is contained in the Merger Registration Statement, but that does not make it an underwriter. The adopting release of any Final Rules ("Adopting Release") should clarify that a fairness opinion giver (on that basis alone) will not be viewed as a statutory underwriter. Again, such role protects the interest of SPAC investors and should not be discouraged by the Commission.

A.1.2.3. Proposed Rule 140a is inconsistent with market practice and replete with practical challenges

Proposed Rule 140a is inconsistent with market practice because the Commission's rationale in relying on underwriters as "gatekeepers" is not justified *after* the SPAC IPO. The Commission cites *WorldCom, Inc. Sec. Litig,* 346 F. Supp 2d 628, 684 (S.D.N.Y) for the proposition that "[u]nderwriters … have special access to information about an issuer at a critical time in the issuer's corporate life, at a time it is seeking to raise capital. The public relies on the underwriter to obtain and verify relevant information and then make sure that essential facts are disclosed." Yet in the De-SPAC Transaction, there is no underwriter *intermediating*. The public can obtain information about the publicly traded SPAC, without the need for the SPAC IPO underwriter to play any special role. The Commission's opinions about underwriters' due diligence obligations refer only to the "representations made in the prospectus and other sales literature,"[44] and to the event of "undertaking a distribution."[45] In the De-SPAC Transaction context, these rationales are not relevant.

If proposed Rule 140a is adopted, a third-party advisor would be subject to potential liability as an underwriter and would need to establish a due diligence defense, which it may not be in a position to undertake or may be able to do so only with difficulty and additional costs. This poses a number of significant issues. The disclosure in the Merger Registration Statement is prepared following announcement of the signing of a merger agreement. As a result, the advisor will need to remain involved in the transaction following the completion of the performance of the services for which it was engaged. The advisor will need to perform extensive due diligence with respect to the Target and the information contained in the Merger Registration Statement following the announcement of the merger agreement. While an advisor may be able to perform due diligence and may negotiate in the terms of its engagement as an advisor for the right to conduct due diligence, including participation in the preparation of the Merger Registration Statement and access to information, differences in the process of completing a De-SPAC Transaction from a traditional IPO create practical challenges. For example, in a traditional IPO, the underwriters are not bound to purchase securities in the transaction until the underwriting agreement is executed, which coincides with the Commission's declaration of effectiveness of the IPO registration statement. This occurs at the end of the process, and the underwriters are engaged through pricing and review and sign off on any changes to the registration statement. However, in the context of a De-SPAC Transaction, the third-party advisors may have completed their engagements prior to

[44] In the Matter of Charles E. Bailey & Co., Exchange Act Release No. 34-4,806, 35 S.E.C. 33, 41 (Mar. 25, 1953).
[45] In the Matter of Brown, Barton & Engel, Exchange Act Release No. 34-6,821, 41 S.E.C. 59, 64 (Jun. 8, 1962).

the preparation and finalization of the Merger Registration Statement. The third-party advisors may have little influence over the contents of the Merger Registration Statement. Similarly, the underwriting agreement in a traditional IPO contains closing conditions to the underwriters' obligations to complete an IPO, including receipt of a comfort letter from the independent auditors and legal opinions and negative assurance letters from counsel to the issuer and counsel to the underwriters. While these requirements could be incorporated in an engagement letter between the third-party advisor and the SPAC or Target, the lack of leverage as of Closing to address non-performance would remain an issue. In addition, unlike in a traditional IPO, the number of advisors in a De-SPAC Transaction would be expanded to include independent auditors and counsel for both the SPAC and the Target, as well as counsel for the advisor. Moreover, unlike in a traditional IPO in which the closing occurs a few days after the effectiveness of the registration statement, in a De-SPAC Transaction, approximately a month typically elapses between the effectiveness of the Merger Registration Statement and the Closing, raising the likelihood that disclosures will require updating. All of this activity will result in significant increased costs in the transaction, indeed making some transactions uneconomic or reducing value received by the investors. This is compounded when there are multiple advisors or other parties who may be deemed to be statutory underwriters, all of whom would seek to engage in diligence and obtain third-party comfort. We have indeed seen this phenomenon occur just as a result of the Commission's overly broad statements in the Proposing Release as to who might be considered a statutory underwriter.

As discussed elsewhere in this letter, unlike a traditional IPO, a De-SPAC Transaction includes the preparation of financial projections, necessitated by the structure of the transaction as an M&A transaction. Projections are inherently forward-looking and should be protected under the safe harbor for forward-looking information contained in the PSLRA. However, the Proposed Rules would eliminate the availability of the safe harbor. Given that projections are forward-looking and cannot be objectively verified, the ability of the underwriters to perform due diligence is limited. While the underwriters may obtain representations and warranties from the Target with respect to such projections and ask questions to ascertain the reasonable basis for the projections, due diligence efforts cannot eliminate the risk that the projections ultimately do not come to fruition, limiting the utility of this exercise to investors, especially when compared to the anticipated costs of defending against litigation.

Finally, proposed Rule 140a purports to be retroactive, creating uncertainty as to what level of participation that has already occurred or that can be undertaken in transactions underway results in underwriter status. In fact, the Commission's views stated in the Proposing Release to justify proposed Rule 140a and characterizing it as a clarification already has been read to have retroactive application and to expose SPAC IPO underwriters and others to liabilities in De-SPAC Transactions. The result, in a curious way, makes proposed Rule 140a unnecessary to achieve the Commission's basic goals. However, for the reasons explained above, we do not believe that proposed Rule 140a should be adopted and, therefore, consider it important for the Commission to clarify its overly broad and unsupported interpretation of who may be considered a statutory underwriter.

A.1.2.4. Proposed Rule 140a, if adopted as proposed, requires additional clarification

If proposed Rule 140a nonetheless were to be adopted as proposed, the Commission should provide additional clarification or guidance regarding what it views as the "distribution" (what "securities" are being distributed, to whom is the distribution made, and who is the "seller" of such securities, especially in light of the Co-Registrant Amendment), and clarify the obvious—that the SPAC IPO and the De-SPAC Transaction are two separate and distinct transactions. Once the Commission has identified what "securities" of which "issuer" or "seller" are being "distributed," it would be helpful to market participants to understand (i) how the Commission would view underwriting liability in the absence of an underwriting syndicate, (ii) how "time of sale" would be viewed where there is no "sale," (iii) to whom a "sale" would be deemed made since the SPAC stockholders are simply voting for or against a transaction and not making an investment decision other than whether to exercise a redemption right, (iv) how a "loss" arising from an underwriting liability would be assessed, and (v) how "traceability" would work since there has been no "issuance" of securities other than the issuance of the SPAC shares to Target and Target stockholders. Therefore, if the proposition being advanced by the Commission based on the case law cited in the Proposing Release is correct (which we believe is wrong) , the expanded underwriting liability provision should only apply to a PIPE placement agent and a SPAC IPO underwriter who also "takes steps to facilitate the De-SPAC Transaction, or any related financing transaction, or otherwise participates (directly or indirectly) in the De-SPAC Transaction." Finally, the Commission should also provide clarification or guidance on how a De-SPAC Transaction differs from an M&A transaction involving stock consideration in that the former involves a "distribution" but the latter does not and, in its analysis, the Commission should consider why, in the case of the former, the Merger Registration Statement disclosure requirements, with the additional disclosures that the Proposed Rules would incorporate from a traditional IPO, are not sufficient to protect investors such that the Commission must preempt the traditional role of courts and not consider the facts and circumstances but rather make a prescriptive finding of statutory underwriter status.

A.1.3. <u>Enhancing projection disclosures</u>.

A.1.3.1. Proposed amendments to Item 10(b) of Regulation S-K

We generally support the proposed amendments to Item 10(b) of Regulation S-K and believe that these amendments should apply to all filings in order to level the playing field for all disclosures related to projections. We believe that these proposed amendments will assist all registrants with their presentation of projections, as applicable, which in turn should facilitate investors' evaluation of the projections, assessment of the reasonableness of the bases for these projections (particularly when compared to historical performance and results), and determinations about the appropriate reliance to place on the projections when making an investment or voting decision. However, the resulting transparency and clarity in disclosures should not be limited to De-SPAC Transactions. Hence, we respectfully request that the

Commission confirm the continued applicability of existing Staff guidance that the general requirements of Item 10(e) and Regulation G for non-GAAP financial measures are not applicable if (i) the non-GAAP financial measures in the projections were provided to the financial advisor for purposes of rendering a fairness opinion or were provided to bidders in the transaction, and/or (ii) the non-GAAP financial measures in the projections are being disclosed to comply with state or foreign law (including case law) or to avoid anti-fraud liability under the federal securities laws.[46]

Federal securities laws and state corporate law directly or indirectly, as applicable, require the disclosure of projections. Often, these disclosures are required in the "Background of the Merger" and "Fairness Opinion" sections of the Merger Registration Statement. To this end, most registrants already organize the disclosure of projections through the use of headings in the merger proposal section under the "Background of the Merger" section and under a separate sub-caption, usually titled "Projected Financial Information." Therefore, we believe that requiring registrants to present some or all financial projections in a separately captioned section of a Commission filing would be consistent with current practice and unlikely to lead to significant changes in information disclosed to investors or undue burdens on registrants.

Our comments and recommendations to specific proposed changes to Item 10(b) are as follows:

- *As to the preamble on projections of future economic performance of persons other than the registrant*. The first proposed change to Item 10(b) is to add a clarification to the preamble that the guidelines set forth in Item 10(b) apply to projections of future economic performance of persons other than the registrant, such as the Target in a De-SPAC Transaction, and are included in the registrant's Commission filings. Historically, companies engaging in business combinations have been compelled to disclose to stockholders the projections that their boards relied upon in deciding to pursue the transaction. This stems from a combination of formal Commission disclosure rules, informal Commission requests when the Staff reviews and approves the disclosure documents that must be filed in connection with these transactions, and the effect of state corporate law.

  The Staff has a relatively straightforward approach to the issue by typically calling for disclosure of projections that the Target provided to the acquirer and other bidders. For example, the Staff has historically asked for disclosure of projections exchanged between an acquirer and Target if the projections are material to stockholders in assessing the value of the consideration offered in the merger. Additionally, while not expressly stated that projections are required, Item 4(a)(2) of Form S-4 and Item 14(b)(4) of Schedule 14A each require the registrant to include disclosure of the reasons for engaging in the transaction. Item 4(b) of Form S-4 and Item 14(b)(6) each refers to Item 1015(b) of

[46] *See* SEC Staff Compliance and Disclosure Interpretations, Non-GAAP Financial Measures, question no. 101.01 (Oct. 17, 2017); *id.* question no.101.03 (Apr. 4, 2018).

Regulation M-A, which requires disclosure regarding certain reports obtained from a third-party advisor, including a fairness opinion. Item 1015(b)(6) of Regulation M-A requires disclosure of "the bases for and methods of arriving at" the findings and recommendations contained in an investment bank's fairness opinion; thus, resulting in a frequent comment from Staff reviewers for disclosure of projections furnished to the bank in connection with the preparation of its opinion.[47] Further, the background of the transaction discussion provides disclosures material to an understanding of the retention of advisors in the search for a Target, the search itself, any negotiation with the Target and with any potential additional investors, and the actions taken by the Sponsor. Items 5(a) and 14(b)(7) of Schedule 14A, Item 6 of the Merger Registration Statements and general principles of materiality as set forth in Section 10(b), Rule 10b-5 and Rule 12b-20 of the Exchange Act, have been cited as sources of authority to support a request by the Staff for material information on the background of the transaction, including the disclosure of projections. The Staff's position in interpreting the above rules virtually ensures that disclosure documents in connection with public company M&As will include some projections. Specifically, the Staff's position has generally been that projections provided by the target to the acquirer are likely material and should be disclosed to the target's stockholders.[48]

In addition, state law and related case law often require extensive disclosures of the transaction's background, with a particular focus on demonstrating that the boards fulfilled their fiduciary duties. In particular, Delaware law requires the board of directors to disclose fully and fairly all material information when seeking stockholder action, and information is generally considered material if "from the perspective of a reasonable stockholder, there is a substantial likelihood that it 'significantly alter[s] the 'total mix' of information made available.'"[49] Accordingly, if the board of directors relies on projections when approving a transaction, which is often the case, then those projections are typically considered at least potentially "material" and, thus, disclosed to stockholders (though the decision to disclose them does not itself establish their materiality).

- *As to proposed changes to Item 10(b)(1)*. The proposed changes to Item 10(b)(1) would not change the required basis for the projections, including (i) management's reasonable basis for the projections, (ii) permissibility of disclosure of projections without any prior history of operations or experience in projecting and (iii) a requirement that, if a third-party report that reviews such projections is included in the Merger Registration Statement, then the reviewer's qualifications and relationship to the registrant must be disclosed and the reviewer will be considered an expert if the report is included in a Securities Act filing.

[47] See Nick Grabar, Ethan Klingsberg, Sandra Flow, Meredith Kotler, and Neil Markel, *Setting the Record Straight: Regulation G Doesn't Apply to M&A Forecasts,* 11 DEAL LAWYERS1, 2 (Nov.-Dec.2017).
[48] Thomas Cole, *Projections in Public Company M&A,* 9 DEAL LAWYERS 1, 3 (Nov.-Dec. 2015).
[49] In re Solera Holdings, Inc. Stockholder Litig., 2017 WL 57839, at *9 (Del. Ch. Jan. 5, 2017) (quoting Arnold v. Soc'y for Sav. Bancorp, 650 A.2d 1270, 1277 (Del. 1994)).

- *As to proposed changes to Item 10(b)(2)*. Proposed Item 10(b)(2)(ii) and (iii) would require the disclosure of historical information that should be readily available. These changes would increase transparency of disclosure to investors without creating undue disclosure burdens on parties to De-SPAC Transactions and other participants in public company M&As, as these proposed changes are not limited to De-SPAC Transactions.

  Proposed Item 10(b)(2)(iv) would add required disclosures relating to the use of forward-looking non-GAAP financial measures. We believe these requirements would enhance the disclosure provided to investors without creating undue disclosure burdens on parties to De-SPAC Transactions or other participants in public company M&As, as long as the Commission clarifies that the guidance provided in Questions 101.01, 101.02 and 101.03 of the Staff's Compliance and Disclosure Interpretations relating to Non-GAAP Financial Measures (last updated April 4, 2018) will continue to apply, exempting non-GAAP financial measures included in Merger Registration Statements as part of the disclosure of projections related to the background of the transaction, the SPAC board's reasons for the approval of the transaction and the bases for the third-party advisor's fairness opinion from Item 10(e) of Regulation S-K and Regulation G, notwithstanding adoption of proposed Item 10(b)(2)(iv).

A.1.3.2. Projections under Item 1609 of Regulation S-K

Similar to our earlier comment on Item 10(b) of Regulation S-K, we believe that proposed Item 1609 of Regulation S-K should also apply to all companies that disclose financial projections in Commission filings (and not just to De-SPAC Transactions as proposed), specifically in connection with any business combination where (a) the Target is at an early stage and has a limited financial track record, which may result in more speculative forecasts and (b) the transaction may involve more significant dilution, which may undermine the reliability or relevance of forecasts to investors where they are presented on an unadjusted income or cash flow basis, especially if those forecasts are not presented alongside dilution forecasts. We also believe that the Commission should not prohibit the disclosure of any specific financial measures or metrics. Projections often include or consist of forecasts of the Target's revenue, earnings and cash flow (operating profit or earnings before interest and taxes). Since these projections are prepared for the use of the board and third-party advisor providing a fairness opinion, we believe that the parties to the transaction should have the flexibility to determine which metrics are most useful.

We generally support proposed Item 1609 of Regulation S-K, subject to the following comments:

- *As to proposed Item 1609(b)*. Proposed Item 1609(b) states that "[t]he disclosure referred to in this section should include a discussion of any material growth rates or discount multiples used in preparing the projections, and the reasons for selecting such growth rates or discount multiples." This requirement is unduly prescriptive, as the inputs and assumptions used in preparing projections vary widely by transaction. Although the requirement is qualified by materiality, we are concerned that registrants will tend towards a conservative approach of disclosing growth rates and/or discount multiples in order to protect against future claims that such inputs were material. This may lead to the over-inclusion of inputs and assumptions that are not material to an investor's understanding of the projections, diluting the quality of disclosure provided. Accordingly, we recommend that the Commission remove these detailed requirements and consider including examples of where it might require additional disclosure related to "material growth rates" or "discount multiples" in these contexts. For example:

  - Where projections that may be driven by simple assumptions about growth rates are included for new or pre-revenue businesses beyond three years, the Commission may ask companies to provide an explanation for the basis of the projections beyond year three and if the forecasts reflect more than simple growth rate assumptions. We understand that significant growth rates are difficult to sustain over long periods of time, and companies assuming such growth rates should be able to explain why they think they are reasonable.

  - Where projections are not in line with historic operating trends, the Commission may ask that the disclosure address why the change in trends is appropriate or assumptions are reasonable. If a Target has no historic operations but projects highly optimistic revenue growth rates in the near future, the disclosure should clearly describe the basis for projecting this revenue growth and the factors or contingencies that would affect such growth ultimately materializing.

  - If the assumptions or the projections do not seem reasonable, the Commission may seek disclosures of the process undertaken to formulate the projections and assumptions, the parties who participated in the preparation of the projections and how they participated.

  - A company may have multiple "sets" of projections, with some sets reflecting optimistic assumptions and others reflecting more conservative assumptions. If multiple sets of projections were prepared in connection with the De-SPAC Transaction, the Commission may ask to include a disclosure that discusses whether alternative "cases" or "sets" of projections exist, what these projections are and why they were prepared, in order to present the projections in the disclosure document as materially complete.

- *As to proposed Item 1609(c)*. Proposed Item 1609(c) relates to the timing of the preparation of projections and the views of the parties to the De-SPAC Transaction with respect thereto. We believe that it is appropriate to require clear disclosure as to the identity of the preparer of the projections, including where the Target has prepared the projections and whether the Target's management or board has reviewed and affirmed such projections. To require the

SPAC or the Target's board or management to reaffirm or update its view of the projections as of the date of the definitive proxy statement is unduly burdensome and inconsistent with the purpose of the preparation of the projections to assist the SPAC board and its advisors in assessing the terms of the transaction. If the SPAC or the Target is required to express a view of the projections as of the date of the definitive proxy statement, it may be required to prepare an updated set of projections, which will be expensive and time-consuming, solely to include such projections in the Merger Registration Statement. Such an approach would be inconsistent with the Commission's concern that investors excessively rely upon projections by placing greater emphasis on them. Conversely, we propose that the Merger Registration Statement be required to disclose (i) the date as of which the projections were prepared and (ii) the views of the preparer of the projections as of such date of preparation and, if different, the date upon which the SPAC board approved the transaction, but be permitted to disclaim any duty to update the projections as of a later date except to the extent there is a material lapse in time and change in circumstances, the Commission may seek disclosure confirming whether the projections still reflect management's views on future performance and/or describing what consideration the board gave to obtaining updated projections or a lack of reliance upon the projections.

A.1.3.3. Impact on use of projections under Item 1609

If forward-looking information (including projections) is neither protected nor mandated, companies will typically not publicly release it, at least where there is significant litigation risk. Not surprisingly, as a matter of practice, IPO issuers discuss (but do not disclose in the registration statements) projections, and instead limit their forward-looking disclosures to the small number of items required to be included in their registration statements. IPO issuers are able to avoid disclosure because, unlike registrants in De-SPAC Transactions, IPO issuers are not subject to the provisions of Regulation M-A, Form S-4, Schedule 14A or state corporate law requiring disclosure of projections. Similarly, proposed Item 1609(b) would discourage the use of financial projections in De-SPAC Transactions but registrants in De-SPAC Transactions would still be unable to avoid such disclosure because they are compelled to disclose to stockholders the projections that their boards and third-party advisors relied upon in deciding to pursue the transactions. As noted above, this stems from a combination of formal Commission disclosure rules, informal Commission requests when the Staff reviews and approves the required disclosure documents,[50] and the effect of state corporate law.[51] These proposed rules

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[50] *See, e.g.*, John Jenkins, *Disclosure of Projections: Will Delaware's Approach Still Rule the Roost?*, 13 DEAL LAWYERS 7, 8 (Sept.-Oct. 2019) (explaining that the Staff "virtually ensures that public company M&A disclosure documents will include some financial projections"); BRANDON VAN DYKE, EILEEN T. NUGENT, AND LOU R. KLING, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS § 5.03(2)(b) (1992) (explaining that, although the Commission has not made by rulemaking the disclosure of projections in proxy statements or prospectuses mandatory, "in any given case the SEC, through its review and comment process, might insist upon their disclosure," and noting that "[d]isclosure of third[-]party appraisals materially related to a going[-]private transaction is required").

[51] *See*, *e.g.*, George Casey, Adam Hakki, and Roger Morscheiser, *SEC Considering Heightened Scrutiny of Projections in De-SPAC Transactions*, HARV. L. SCHOOL FORUM ON CORP. GOVERNANCE (May 17, 2021), https://corpgov.law.harvard.edu/2021/05/17/sec-considering-heightened-scrutiny-of-projections-in-de-spac-transactions/ (explaining that "Delaware law requires the board of directors to disclose fully and fairly all material information when seeking

are unlikely to significantly impact the willingness of parties to De-SPAC Transactions to continue preparing and disclosing projections since it is compelled as we discuss.

Moreover, if a projection turns out to be incorrect, issuers fear that investors could bring a securities fraud action against the issuer and various collateral participants. Some cases hold issuers liable for incorrect projections on the theory that an uninformed projection or one that was made without a reasonable basis is false. Furthermore, as discussed elsewhere in this letter, the proposed imposition of underwriter liability pursuant to proposed Rule 140a would result in potential liability for the investment banks and other transaction participants for disclosure in the Merger Registration Statement, which, if the PSLRA safe harbor is rendered unavailable in De-SPAC Transactions, would include inaccuracies in the projections even if such transaction participants have little or no role in their preparation.

In light of the inherently forward-looking nature of projections and the impossibility of obtaining objective verification despite extensive due diligence, we believe that it is unreasonable to impose liability on underwriters for any misstatements contained in projections. While the description of the fairness opinion and the bases thereof may be "expertized," eliminating the underwriters' exposure under Section 11 with respect thereto, the portion of the disclosure that is "expertized" is limited to the description of the fairness opinion, not including the projections. Accordingly, we strongly urge the Commission to expressly provide that the projections are excluded from any potential liability of underwriters pursuant to proposed Rule 140a, if adopted.

A.1.3.4. Impact of enhanced projection disclosures on investors

We believe that reasonable investors are just as interested in projections in De-SPAC Transactions as they are in any other business combinations; and they are just as capable of discounting that information for bias. For example, reasonable investors are likely to be as interested in management's predictions and the assumptions that underlie these when they invest in a new issue as when they invest in a seasoned one—probably more so in the case of a new issue because there will be fewer alternative information sources about the company. This is borne out in market practice: underwriters regularly ask for financial projections from IPO issuers, as do PIPE investors.[52] IPO investors who tend to be sophisticated institutions also privately seek access to projections.[53]

shareholder action," so "if the board of directors relies on projections when approving a transaction, which is often the case, then those projections are typically considered at least potentially 'material' and thus disclosed to shareholders"); Michael B. Tumas and Michael K. Reilly, *The Disclosure of Projections Under Delaware Law*, POTTER, ANDERSON & CORROON LLP (Apr. 2008) https://www.potteranderson.com/media/publication/155_TheDisclosureofProjectionsUnderDelawareLaw.pdf (discussing recent case law on point).

[52] *See* LATHAM & WATKINS LLP, U.S. IPO GUIDE 23-24 (2021 ed.), https://www.lw.com/thoughtLeadership/lw-us-ipo-guide, at 23-24 (explaining that, '[g]iven that the IPO process can take many months, an IPO issuer may want, or need, to pursue a private offering that is not registered with the Commission on the same schedule as the IPO," and that "private investors may expect information that is not typically part of the IPO disclosure package, *particularly projections*" (emphasis added)).

[53] While neither the company or underwriters will provide projections to these investors directly (due to liability risk), the company will provide projections to analysts who work them into their models and then verbally discuss them with these

An alleged benefit to this mandated projection disclosure is the elimination of a "black market" in projected information which is provided privately in certain transactions. Proponents of this view suggest that analysts and other institutional investors regularly attempt to gain access to nonpublic management projections. In a traditional IPO, the issuer is not yet subject to Regulation FD and there is no active trading market. Accordingly, the issuer may provide projections to analysts without violating selective disclosure requirements. These analysts then use the information to prepare their research reports. By contrast, in a De-SPAC Transaction, existing disclosure requirements discussed above typically result in the disclosure of the material projections, as well as disclosure of the assumptions underlying those projections. Currently, investors in De-SPAC Transactions have greater access to information than investors in other types of transactions. The imposition of additional requirements with respect to projections, particularly exposure to liability, is likely to result in the disclosure of less information to investors. Reduction of information is contrary to the goal of promoting transparency and the Commission's aim to democratize opportunities for retail investors. Indeed, if the Commission is seeking to create a "level playing field" between De-SPAC Transactions and traditional IPOs, it should consider how to encourage and facilitate disclosure of projections in traditional IPOs rather than discouraging disclosure of projections in De-SPAC Transactions.

A.1.3.5. Impact on the ability to comply with state or foreign law obligations relating to projection disclosure obligations

As further discussed below, we do not believe that proposed Item 1609 of Regulation S-K may impact registrants' ability to comply with state or foreign law obligations insofar as the requirements call for projections that are already being disclosed pursuant to federal securities laws or state corporate law, or projections that are newly required that do not appear to conflict with state law requirements based on the state we reviewed: Delaware, the dominant jurisdiction for public companies, including public M&A litigation jurisprudence.[54]

The nature and extent of a company's obligation to disclose financial projections when soliciting stockholder approval of a business combination transaction is a particularly complex area. Despite generally requiring their disclosure, the Commission and federal courts have not addressed the issues surrounding which financial projections may be material and the extent of the required disclosure. That burden has largely fallen on Delaware's shoulders. As a result, Delaware remains dominant in litigation contesting the terms and disclosure relating to M&A

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investors. *See id*. at 9. It is also common for venture capital firms to demand projections when deciding whether to invest in a start-up. *See* Martin Zwilling, *5 Rules of Thumb for Startup Financial Projections*, ALLEYWATCH.COM (May 2013), https://www.alleywatch.com/2013/05/5-rules-of-thumb-for-startup-financial-projections/ ("making no projections, or non-credible projections will get your startup marked as unfundable").

[54] As of May 10, 2022, the state of Delaware accounted for 56% of all public companies incorporated in the United States. Data sourced from Capital IQ, Company Screening Report. Additionally, in FY 2020, 67.6% of all Fortune 500 companies were incorporated in Delaware. See Delaware Division of Corporations' 2020 Annual Report Statistics, https://corpfiles.delaware.gov/Annual-Reports/Division-of-Corporations-2020-Annual-Report.pdf (last visited May 20, 2022).

transactions notwithstanding some migration toward the federal courts.[55] Hence, this letter focuses on Delaware's approach to the materiality of projections and suggests some reasons why that approach does not in conflict with proposed Item 1609.

Delaware courts have generally endorsed the view that financial projections prepared by management and shared with the Target's financial advisor must, as a matter of Delaware fiduciary law, be disclosed to stockholders.[56] How extensive that disclosure needs to be in connection with a merger is more uncertain. It is settled Delaware law that directors have a duty to disclose to stockholders all material information in their possession when seeking stockholder approval of a merger transaction.[57] Information is material "if there is a substantial likelihood that a reasonable stockholder would consider it important in deciding how to vote."[58] Further projections cases tend to involve a handful of recurring issues: disclosure of multiple sets of projections, disclosure of free cash flow and the impact of the transaction structure on the disclosure obligation:

- *Multiple sets of projections*. It is fairly common to see multiple sets of projections generated during the course of a business combination transaction. Often, the projections initially shared with potential buyers are fairly aggressive "puff pieces." In other settings, projections may be updated to reflect changes in the business during the course of the transactions, or the board may be provided with "best case," "base case" and "bank case" projections reflecting different potential performance ranges. Delaware courts recognize that these multiple sets of projections are not per se material, and instead tend to focus on their reliability and whether the board or its financial advisors actually relied upon them.[59] In doing so, they often provide wide latitude to boards and their advisors in determining which projections were appropriate to rely upon and to disclose to stockholders.[60] In some instances, Delaware courts have decided that projections were insufficiently reliable to require their disclosure—even in cases where they had been

[55] *See*, *e.g.*, In re Trulia Shareholders Litig., 129 A.3d 884 (Del. Ch. 2016). According to Cornerstone Research, only 13% of merger objection litigation for Delaware corporations was filed in the Chancery Court in 2018. Cornerstone Research, *Shareholder Litigation Involving Acquisitions of Public Companies* 5 (2019) at 5, available at https://www.cornerstone.com/wp-content/uploads/2021/12/Shareholder-Litigation-Involving-Acquisitions-of-Public-Companies-2018.pdf (last accessed Jun. 1, 2022). Notwithstanding, there is reason to believe that Delaware's approach to the materiality of projections and various issues surrounding the extent to which they need to be disclosed as a matter of directors' fiduciary duty may remain influential for federal courts that will be called upon most frequently to interpret the requirements of the federal securities laws in the context of merger objection litigation.
[56] Thomas Cole, *Projections in Public Company M&A,* 9 DEAL LAWYERS 1, 3 (Nov.-Dec. 2015).
[57] *See* Arnold v. Society for Sav. Bancorp. Inc., 650 A.2d 1270, 1277 (Del. 1994).
[58] Loudon v. Archer-Daniels-Midland Co., 700 A.2d 135, 143 (Del. 1997).
[59] *See*, *e.g.*, Frank v. Elgamal, 2014 WL 957550, *34 (Del. Ch. 2014) ("American Surgical only disclosed the updated midpoint case projections, but these projections were the only ones relied upon by HFBE when it delivered its second and then final fairness opinion presentations in December 2010.").
[60] *See*, *e.g.*, In re Orchid Cellmark Inc. Shareholder Litig., 2011 WL 1938253, *6 (Del. Ch. 2011) ("[i]n evaluating the fairness and advisability of this tender offer, the Special Committee and its financial advisor [were] not precluded from considering various sets of financial projections before determining that one set reflect[ed] the best estimate of future performance.").

presented to the target's board of directors.[61] In other cases, Delaware courts have been less deferential to decisions not to disclose multiple sets of projections. For example, a recent Chancery Court decision held that disclosure of projections that reflected a downward adjustment to prior projections made after the board approved the final deal price was insufficient, and that the company should have disclosed both the more optimistic prior version of the projections and the reasons for the downward adjustment.[62] This is consistent with the requirements of proposed Item 1609.

- *Free cash flow projections*. Another recurring issue relating to projections is the need to disclose assumptions about free cash flow made in connection with fairness opinions. These are often targeted by plaintiffs, because those assumptions form the foundation for any discounted cash flow analysis, and changes in them can result in dramatically different valuations. Delaware case law on this issue has been characterized as standing for the proposition that if a discounted cash flow analysis is used as part of the financial advisor's fairness opinion, disclosure of the free cash flow assumptions "will often, but not always, be required."[63]

  The identity of the party preparing the free cash flow projections is often a critical factor. Some Delaware courts have treated management's free cash flow projections as per se material.[64] Other courts have held that free cash flow projections prepared by the company's financial advisor were not material and need not be disclosed.[65] While some Chancery decisions indicate the free cash flow projections are per se material, other decisions indicate that disclosure of free cash flow projections may not be required under some circumstances. In his bench ruling in *Cox v. Guzy*, then-Vice Chancellor Strine held that if other forecasts were disclosed, the target had negligible debt and the free-cash flow proxy EBITDA could be calculated based on the publicly disclosed forecasts, as further disclosure regarding projected free cash flow was unnecessary.[66]

- *Impact of different transaction structures*. Delaware case law also suggests that in evaluating the materiality of projections, the structure of the deal is also an important consideration. The materiality of projections is heightened in cash-out merger transactions, where the stockholders are asked to evaluate whether to accept the merger

[61] Transcript of Oral Argument on Plaintiffs' Motion for Preliminary Injunction at 100, In re BEA Systems, Inc. Shareholder Litig., 2009 WL 1931641 (Del. Ch. 2009) (No. C.A. 3298) ("the fact that something is included in materials that are presented to a board of directors does not, ipso facto, make that something material.").
[62] Chester County Employees' Retirement Fund v. KCG Holdings, Inc., 2019 WL 2564093, *14 (Del. Ch. 2019).
[63] Krishna Veeraraghavan and Scott B. Crofton, *Financial Projection Disclosure Requirements in M&A Deals: Preparing, Using and Disclosing Projections* 26 (Jul. 20, 2016), http://media.straffordpub.com/products/financial-projection-disclosure-requirements-in-manda-deals-preparing-using-and-disclosing-projections-2016-07-20/presentation.pdf.
[64] Maric Capital Master fund, Ltd. v. Plato Learning, Inc., 11 A.3d 1175, 1178 (Del. Ch. 2010) ("[I]n my view, management's best estimate of the future cash flow of a corporation that is proposed to be sold in a cash merger is clearly material information.").
[65] *See*, *e.g.*, In re BioClinica, Inc. Shareholder Litig., 2013 WL 5631233 (Del. Ch. 2013); Nguyen v. Barrett, 2015 WL 5882709 at *4 (Del. Ch. 2015).
[66] Veeraraghavan & Crofton, *supra* note [63], at 28 (citing Transcript of Status Conference at 9, Cox v. Guzy, No. C.A.7529 (Del. Ch. Jun. 8, 2012)).

consideration or to continue as stockholders of the corporation. The materiality of projections is heightened uniquely in going-private transactions, and particularly where "key managers seek to remain as executives and will receive options in the company once it goes private."[67] While most Delaware litigation has focused on issues surrounding the seller's projections, that is not always the case. In certain stock-for-stock transactions, Delaware courts have also held that the buyer's projections may be material to the seller's stockholders and should be disclosed.

The salient points from Delaware case law are as follows:[68]

- *"Fair summary" requirement*. A "fair summary" of the substantive work performed by a financial advisor must be disclosed, including (i) the basic valuation exercises, (ii) the key assumptions and (iii) the range of values generated. Whether the "fair summary" requirement has been satisfied in a particular situation is decided on a case-by-case basis. Proposed Item 1609 would not conflict with this "fair summary" requirement.

- *Materiality remains the touchstone*. Only projections that are material, not those that are merely helpful, must be disclosed. Proposed Item 1609(c) may conflict with this standard if the impact results in disclosure that is not material. However, if our recommendations are adopted, we believe that may mitigate against the inclusion of information that would not be material.

- *Reliability*. As demonstrated in the Delaware precedents, projections that are unreliable or misleading need not be disclosed.[69] If projections are reliable, however, the materiality of those projections is significantly heightened at least in the context of cash-out or going-private merger transactions. We believe proposed Item 1609 seeks to elicit reliable disclosure and would therefore not conflict with Delaware law.

- *The transaction structure*.[70] Because of dilution and conflicts of interest issues, as well as the nature of the target operating companies, which are often early stage and pre-revenue, the materiality of projections is heightened and proposed Item 1609 would not conflict with Delaware law.

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[67] Michael Tumas and Michael Reilly, *The Disclosure of Projections Under Delaware Law*, POTTER ANDERSON & CORROON LLP CLIENT MEMO (Apr. 2008), http://www.potteranderson.com/media/publication/155_TheDisclosureofProjectionsUnderDelawareLaw.pdf.
[68] Id.
[69] In re Netsmart Technologies, Inc. Shareholders Litig., 924 A.2d 171, 201 (Del. Ch. 2007); In re CheckFree Corp. Shareholders Litig., 2007 WL 3262188, at *3 (Del. Ch. 2007); Globis Partners, L.P., v. Plumtree Software, Inc., 2007 WL 4292024, at *11 (Del. Ch. 2007).
[70] The materiality of projections is heightened in cash-out merger transactions, where the stockholders are asked to evaluate whether to accept the merger consideration or to continue as stockholders of the corporation. The materiality of projections is heightened uniquely in going-private transactions. Although not addressed in the recent cases, it follows that the materiality of a buyer's projections is heightened in stock-for-stock merger transactions, in which the target corporation's stockholders must evaluate the "price" to be paid in the form of the buyer's shares. See Michael Tumas and Michael Reilly, *The Disclosure of Projections Under Delaware Law*, POTTER ANDERSON & CORROON LLP CLIENT MEMO (Apr. 2008).

- *Utility of projections*. If projections are reliable, disclosure may not be required if the projections are of questionable utility to stockholders. This approach is consistent with proposed Item 1609.

- *Target's unique circumstances*. Any unique circumstances should be considered when determining whether projections are material. This approach is consistent with proposed Item 1609.

- *Reliance by the financial advisor and board; sharing with bidders*. Projections relied upon by Target's financial advisor and board, as well as those shared with bidders, are more likely to be material and, thus, to require disclosure.[71] Those facts standing alone do not necessitate disclosure, however, as the projections must still be reliable and otherwise material in the particular circumstances.[72] This is not consistent with federal securities laws and the Proposed Rule that would require disclosure in such instances.

- *Partial or incomplete disclosure*. The partial disclosure of financial projections that fail to offer the best estimate of a corporation's future financial performance triggers a broader fiduciary obligation to supplement the proxy with materially complete information.[73] Once a board "opens the door" to partial disclosure, more complete information may be necessary. This approach is consistent with proposed Item 1609.

The Delaware courts have not articulated a rote legal standard or checklist providing clear guidance whether projections must be disclosed in a particular situation. Rather, a context-specific analysis is required to determine whether projections must be disclosed. As such, we do not believe that proposed Item 1609 would conflict with Delaware law.

A.1.4. Rendering the PSLRA safe harbor inapplicable.

The Commission has proposed a definition for "blank check company" that would encompass SPACs and certain other blank check companies for PSLRA purposes, such that the safe harbor for forward-looking statements under the PSLRA would not be available to SPACs. For purposes of the PSLRA, the Commission stated that, among other things, it sees no reason to treat forward-looking statements made in connection with a De-SPAC Transaction differently than forward-looking statements made in a traditional IPO.

We do not support this proposed amendment. We believe there are important distinctions between a De-SPAC Transaction and a traditional IPO that justify maintaining the PSLRA safe

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[71] In re Pure Resources, Inc., Shareholders Litig., 808 A.2d 421, 450 (Del. Ch. 2002); In re JCC Holding Co., Inc., 843 A.2d 713, 720 (Del. Ch. 2003).
[72] Transcript of Oral Argument on Plaintiffs' Motion for Preliminary Injunction at 100, In re BEA Systems, Inc. Shareholder Litig., 2009 WL 1931641 (Del. Ch. 2009) (No. C.A. 3298).
[73] *Netsmart*, 924 A.2d at 199-200; *Pure Resources*, 808 A.2d at 448.

harbor in the form enacted by Congress. In particular, when coupled with other proposed amendments that would require disclosure of a fairness determination (effectively mandating the provision of projections) as well as impose underwriter liability in a De-SPAC Transaction, we believe removal of the PSLRA safe harbor protections would have a chilling effect on De-SPAC Transactions and significantly disadvantage a De-SPAC Transaction compared to a traditional IPO. We also believe there is substantial doubt as to the Commission's authority to narrow the scope of the safe harbor as currently proposed.

A.1.4.1. Rationale and perspective shift on PSLRA safe harbor

As Amanda Rose observed, in an earlier era, the Commission was willing to let liability risk operate to discourage the corporate release of forward-looking information, including projections, by prohibiting inclusion of forward-looking information in Commission filings.[74] The Commission's position was based on a concern that unsophisticated investors would place undue reliance on even non-fraudulent forward-looking information, leading them to make poor investment decisions. Reasonable investors rallied against the Commission's paternalistic position, emphasizing the importance of forward-looking information to their investment decisions and their ability to discount management forecasts for bias. In the 1970s, the Commission began to address these concerns, and seemingly changed its position. Instead of prioritizing the interests of investors who might overreact to management forecasts, it began to take steps to encourage companies to share their forecasts. To this end, the Commission adopted two safe harbors from liability for forward-looking statements. After these safe harbors proved ineffective in encouraging disclosure, Congress adopted the more robust PSLRA safe harbor.[75]

The PSLRA safe harbor, however, does not cover all forward-looking statements. It contains a number of exclusions. Some can easily be justified as advancing goals independent to those that motivated the safe harbor's adoption. In this category are a variety of "bad boy" disqualifiers that apply to companies that have violated certain provisions of the securities laws in the past three years. A second category of exclusions cover situations—like tender offers, roll-up and going-private transactions—where companies are compelled by law to share projections with investors. In such situations, there is less risk that liability will chill disclosure and the safe harbor exclusion can be understood as an effort to increase the accuracy of disclosures. Projections disclosed in De-SPAC Transactions fall under this second category. The remaining exclusions (third category) cover situations where a company is not compelled to share projections with investors. Projections disclosed in traditional IPOs fall in this category, as well as exclusions for communications by investment companies and communications by blank check companies and penny stock issuers in connection with an offering, among others.[76]

[74] See Amanda M. Rose, SPAC Mergers, IPOs, and the PSLRA's Safe Harbor: Unpacking Claims of Regulatory Arbitrage (May 19, 2021). Available at https://ssrn.com/abstract=3945975 or http://dx.doi.org/10.2139/ssrn.3945975
[75] Id.
[76] Id.

What ties the situations covered in this third category together? Perhaps they involve a heightened risk of fraud due to greater information asymmetries. At least in situations where liability risk is meaningful (and hence the safe harbor's applicability of significance), denying voluntary management forecasts the protection of the safe harbor does not merely deter dishonest forecasts, it silences all forecasts. If given the choice, reasonable investors may rather risk an occasional fraud by a bad actor than be denied access to valuable forward-looking information. Instead, these exclusions are only justified in cases where the potential defendant's securities are unlikely to trade in an efficient market. As Holger Spamann has observed, efficient markets provide a critical "indirect investor protection" to unreasonable investors.[77]

Investors may overweigh management projections in connection with a seasoned offering, just as with a traditional IPO. In a seasoned offering, there is additional available information and the efficient markets will set the trading price, minimizing the risk that the projections have a material impact. In a traditional IPO, by contrast, unreasonable investors' undue reliance on management forecasts may cause real harm. In addition, the Commission has consistently encouraged seasoned public companies to provide investors with forward-looking information in order to regularly provide current information to investors in an active trading market. The reporting history of such companies may provide investors with useful context for this information. When understood in this light, these exclusions reveal that the safe harbor's seeming prioritization of the informational needs of investors who may be better able to evaluate the information and make their own judgments as to its reliability over protection of less sophisticated investors is in fact very circumscribed: the safe harbor operates to encourage the release of forward-looking statements for the benefit of investors only when investors are unlikely to be harmed. In situations where they may be harmed, the safe harbor continues to prioritize investor protection at the expense of investors who are capable of performing their own evaluation of such information by using the cudgel of liability risk to silence corporate forecasts. It has succeeded brilliantly in the case of IPOs. IPO issuers almost never issue projections publicly. This more nuanced account of the IPO exclusion sharpens the analysis that is required to assess whether a similar exclusion should be created for De-SPAC Transactions.[78]

To assess whether the economic realities of De-SPAC Transactions present the same regulatory concern that animates the traditional IPO exclusion, the Commission should assess the efficiency of the market for SPAC shares around the time of a De-SPAC Transaction. Since that market is likely to be inefficient, there may be greater risk of harm resulting from forward-looking statements than for a seasoned company just like in the aftermarket following a traditional IPO.[79] However, unlike companies undertaking a traditional IPO, SPACs are compelled by a combination of federal securities regulation and state corporate law to share Target projections with stockholders. Excluding De-SPAC Transactions from the safe harbor

[77] Holger Spamann, *Indirect Investor Protection: The Investment Ecosystem and Its Legal Underpinnings*, 14 J. L. ANALYSIS (forthcoming 2022), https://ssrn.com/abstract=3707249 (arguing that although "the vast majority of retail investors lack the financial expertise to value a security or to vote sensibly," these investors are nevertheless protected when they trade in efficient markets that, due to the trading behavior of more sophisticated investors, produce informed and unbiased prices).

[78] See Amanda M. Rose, *supra note 74*.

[79] Id.

would not operate to silence projections the way the traditional IPO exclusion does, although it might operate to discourage De-SPAC Transactions. To truly place De-SPAC Transactions on a "level playing field" with traditional IPOs in connection with forward-looking statements, the Commission would have to change its disclosure requirements in connection with De-SPAC Transactions and somehow override the state fiduciary obligations that compel disclosure of projections. We also do not believe that creating a new safe harbor exclusion for communications in connection with De-SPAC Transactions will solve the problem of "regulatory arbitrage" or protecting investors, at least not without further regulatory reform making the release of projections in connection with De-SPAC Transactions voluntary.

A.1.4.2. Fundamental differences between De-SPAC Transactions and traditional IPOs

Putting De-SPAC Transactions on parity with traditional IPOs for this purpose fails to take into account significant differences between these transactions. For example, while it is clear that the PSLRA safe harbor by its terms does not apply to IPOs, there has customarily been no practice or requirement in IPOs to include projections in the registration statement and thereby impose underwriter liability for those projections. That is not to say, however, that projections are not provided in IPOs. Instead, an IPO issuer will typically prepare under the guidance of underwriters a model containing projections that the issuer shares with analysts associated with the underwriting syndicate.

The Commission's statement that, for purposes of the PSLRA, it sees no reason to treat forward-looking statements made in connection with De-SPAC Transactions differently than forward-looking statements made in traditional IPOs is based on the view that "both instances involve private issuers entering the public U.S. securities markets for the first time and similar informational asymmetries that exist between these issuers (and their insiders and early investors) and public investors."[80] However, contrary to this supposition, the common practice in IPOs of disseminating projections significantly reduces the informational asymmetry between issuers and public investors, enhancing a price discovery process that is most certainly influenced by the issuer's projections. We believe this transmission of the issuer's projections to the market is an important feature of IPOs and beneficial to efficient capital markets. At the same time, we believe this practice survives because underwriters have found it to fall within an acceptable liability profile: outside of Section 11 of the Securities Act and where the absence of a PSLRA safe harbor is moot.

In contrast, in the case of a De-SPAC Transaction, there are several reasons why projections are provided in the public disclosure document as discussed above. We believe these reasons will continue to encourage, if not effectively require, public disclosure of projections.

For these reasons, we believe that although the Commission's proposed enhanced projections disclosures alone would not likely curb the use of projections, they may provide

[80] Special Purpose Acquisition Companies, Shell Companies, and Projections, 87 Fed. Reg. 29,458, 29,482 (proposed May 13, 2022).

useful benefits to investors. However, we believe the removal of the PSLRA safe harbor would have a significant chilling effect on De-SPAC Transactions (as demonstrated by the market reaction we have witnessed as a result of the mere proposal of the Proposed Rules).

We note that certain De-SPAC Transactions, as structured with a new issuer, may constitute an "initial public offering" and therefore fall outside of the PSLRA safe harbor. An issuer's ability to rely on the judicial "bespeaks caution" doctrine may mitigate to some extent liability concerns associated with providing projections. However, we believe the express unavailability of the safe harbor, particularly when coupled with the proposed amendments regarding underwriter liability, represents a significant departure from the treatment of projections in M&A deals other than a De-SPAC Transaction. One immediate practical effect could be the elimination of the De-SPAC Transaction as a capital raising option for Targets that do not have lengthy operating histories. At best, we believe removal of safe harbor will add significant additional costs for De-SPAC Transactions as transaction participants seek compensation for any real or perceived increase in liability exposure.

Considering that IPO issuers can (and almost uniformly do) avoid liability exposure for management projections through silence (i.e., non-disclosure of projections in the registration statements) whereas companies going public via a De-SPAC Transaction would not be able to remain silent, creating a new safe harbor exclusion for De-SPAC Transactions—as the Proposed Rules do—would not place them on a "level playing field" with traditional IPOs. Instead, it disadvantages De-SPAC Transactions. Market participants in traditional IPOs have a mechanism to transmit projections while limiting exposure to liability, while those in De-SPAC Transactions are either unlikely to avoid publicly disclosing projections or they will continue to do so at significantly increased cost, which may be prohibitive. For these reasons, we entreat the Commission to retain the PSLRA safe harbor as it currently applies to De-SPAC Transactions.

A.1.4.3. Commission's lack of authority to amend legislation

While the Commission has assumed Congress gave it authority to narrow the statutory safe harbor through changing the definitions of key terms that inform the scope of the safe harbor, we believe there is substantial doubt as to the Commission's authority to narrow the safe harbor as currently proposed, particularly when it is clear that Congress' intent was to protect and thereby encourage the provision of forward-looking information. As the Commission noted, the current definition of "blank check company" predates the enactment of the PSLRA in 1995 and evidences a clear intent to exclude from that definition SPACs that raise more than $5 million in a firm commitment underwritten IPO for not selling "penny stock." So while the Commission sees "no reason to treat blank check companies differently for purposes of the PSLRA safe harbor depending on whether they raise more than $5 million in a firm commitment underwritten initial public offering and thus are not selling penny stock," there is no doubt that the statute Congress enacted did in fact make that distinction.

The PSLRA states that "the terms 'blank check company,' 'rollup transaction,' 'partnership,' 'limited liability company,' 'executive officer of an entity' and 'direct participation investment program' have the meanings given those terms by rule or regulation of the Commission." The Commission appears to read "meanings *given* those terms" to mean "meanings *given* those terms and that *may be given those terms from time to time in the future*." To read that language as authorizing the Commission to narrow the scope of "blank check company" and thereby narrow the scope of the PSLRA, when the meaning "given" the term "blank check company" by rule or regulation then in effect was well-established, seems inconsistent with Congressional intent and legislates a loss of protection that Congress provided at the time. This also appears inconsistent with the exemptive authority found in Section 27A(g) and (h), which makes clear the Commission's ability to extend the scope of the safe harbor protections rather than narrow them. These sections emphasize the Commission's authority to "provide exemptions from or under any provision of this title, including with respect to liability that is based on a statement or that is based on projections or other forward-looking information" and to "adopt similar rules and regulations with respect to forward-looking statements." We believe these expressions of Commission authority are designed to promote the Congressional intent of encouraging disclosure of forward-looking information, rather than narrowing it by supplanting Congress' intent with the Commission's own policy initiatives.

A.1.5. <u>Proposing a safe harbor under the Investment Company Act</u>

SPACs are not investment companies and, therefore, not subject to registration under the Investment Company Act. Assuming, but without admitting, otherwise, we still believe that there is no apparent need or basis for this "safe harbor" which, in reality, operates as part of a rule.

Proposed Rule 3a-10 provides a safe harbor from the definition of "investment company" under Section 3(a)(1)(A) of the Investment Company Act for SPACs that meet the conditions of the safe harbor. To justify the need for this safe harbor, the Commission avers four concerns, namely: (i) "some SPACs have sought to operate in novel ways that suggest that SPACs and their sponsors should increase their focus on evaluating when a SPAC could be an investment company;"[81] (ii) "[the Commission is] concerned that SPACs may fail to recognize when their activities raise the investor protection concerns addressed by the Investment Company Act;"[82] (iii) SPACs may engage in "regulatory arbitrage, which may be used by some SPACs in an attempt to operate like an investment company without investment company registration"[83] and (iv) "[the Commission is] concerned that, the longer the SPAC operates with its assets invested in securities and its income derived from securities, the more likely investors will come to view

[81] *Id.* at 29,497.
[82] *Id.*
[83] *Id.* at 29,540.

the SPAC as a fund-like investment and the more likely the SPAC will appear to be deviating from its stated business purpose."[84]

We believe that the Commission's concerns are unjustified and it fails to provide any real-world or even hypothetical examples supporting its concerns. The transaction that seems to have prompted this proposed rule was the ill-fated, and highly unusual, proposed acquisition by Pershing Square Tontine Holdings, Ltd. ("PSTH"), a SPAC, of a ten percent stake in the common stock of Universal Music Group B.V. ("UMG"). As soon as this transaction was announced, SPAC market participants (and the Staff in its review of the transaction[85]) questioned how PTSH proposed to complete this acquisition of a non-control, minority interest in UMG without registration under the Investment Company Act. As a result, even before PSTH ultimately abandoned the transaction entirely, PTSH restructured the transaction in an attempt to avoid Investment Company Act registration. We believe that this one abandoned transaction, out of the hundreds of prior and subsequent successful De-SPAC Transactions, does not signal a trend of SPACs seeking to operate in a manner that would raise investor protection concerns under the Investment Company Act, nor that SPACs generally fail to recognize when their activities raise investor protection concerns under the Investment Company Act. In addition, we do not believe there is evidence that SPACs seek to engage in "regulatory arbitrage" to operate like an investment company, particularly because sponsors would have nothing to gain from engaging in such a strategy, as they are not paid any management or performance fees based on the amount of assets in the SPAC or income gained on those assets. A SPAC Sponsor may benefit only if the SPAC successfully completes a business combination transaction. Thus, we do not believe the first three concerns justify the need to promulgate a safe harbor.

The fourth concern was raised by the Commission in its analysis of whether SPACs fall within the definition of an investment company under Section 3(a)(1)(A) of the Investment Company Act. As further discussed below, we do not believe this concern has a reasonable basis. SPACs simply are not investment companies under Section 3(a)(1)(A) because they are not, and do not hold themselves out as, being engaged primarily, or propose to engage primarily, in the business of investing, reinvesting or trading in securities. Most of the Rule 3a-10 requirements would codify longstanding SPAC practices that support the conclusion that SPACs are not investment companies. We believe, however, that the hard-and-fast duration limitations that would require a SPAC to announce a De-SPAC Transaction within 18 months and close the transaction within 24 months are not necessary for the SPAC to avoid classification as an investment company because such limitations do not bear on whether a company is engaged primarily in the business of investing, reinvesting or trading in securities. Further, imposing such limitations would chill the SPAC market and harm investors by significantly impairing the ability of De-SPAC Transactions to Close in an orderly manner.

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[84] *Id.* at 29,498.
[85]See Pershing Square Tontine Holdings LTD, SEC Staff Comment (Jul. 16, 2021), https://www.sec.gov/Archives/edgar/data/1811882/000000000021008861/filename1.pdf.

We note that the proposed rule is styled as a safe harbor, and in theory a SPAC could operate outside it without violating the Investment Company Act. In the Proposing Release, however, the Commission stresses "that the inability of a SPAC to identify a target and complete a De-SPAC Transaction within the proposed timeframe would raise serious questions concerning the applicability of the Investment Company Act to that SPAC."[86] In addition, William Birdthistle, Director of the Division of Investment Management, has publicly warned that "certainly for those SPACs that also fall outside the safe harbor, [he] would expect that the Staff would also be taking a look at them."[87] To this end, we believe that because the SEC staff would have "serious questions" with respect to such transactions, the adoption of the safe harbor would increase the reluctance of law firms to give clean Investment Company Act opinions for transactions that fall outside the safe harbor. Accordingly, it appears that while the proposed duration limitations are styled as a safe harbor, in effect they would operate as part of a firm rule.

A.1.5.1. Analysis of SPACs under Investment Company Act Section 3(a)(1)(A)

According to Section 3(a)(1) of the Investment Company Act, an "investment company" for purposes of the federal securities laws, is a company that (a) is or holds itself out as being engaged *primarily*, or proposes to engage primarily, in the business of investing, reinvesting or trading in securities (sometimes called the "subjective test") or (b) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis (sometimes called the "objective test").

As noted in the Proposing Release, the safe harbor only addresses investment company status under the subjective test for SPACs because if a SPAC owns or proposes to acquire 40 percent or more of investment securities (which in any case is prohibited by SPAC charter documents), it would likely need to register and be regulated as an investment company under the Investment Company Act under the objective test.

The Proposing Release also mentions that in determining whether an issuer is "primarily engaged" in a non-investment company business, the Commission and courts look to the following factors, which are commonly referred to as the "*Tonopah* factors:" (a) the company's historical development, (b) its public representations of policy, (c) the activities of its officers and directors, (d) the nature of its present assets, and (e) the sources of its present income.[88]

The Commission acknowledges in the Proposing Release that SPACs are formed to identify, acquire and operate a Target through a business combination, and not with a stated purpose of being an investment company, and that SPACs typically view their public

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[86] *Special Purpose Acquisition Companies, Shell Companies, and Projections*, 87 Fed. Reg. at 29,502.
[87] Commission Open Commission Meeting, YOUTUBE (Mar. 31, 2022), https://www.youtube.com/watch?v=t6qX8FGiI_8 (discussion at 43:25-44:45).
[88] The *Tonopah* factors were set forth by the Commission in In the Matter of the Tonopah Mining Co. of Nevada, Investment Company Act Release No. 812-241, 26 S.E.C. 426 (Jul. 21, 1947).

representations, historical development and efforts of officers and directors as consistent with those of issuers that are not investment companies.[89] It appears, therefore, that the Commission believes that the first three *Tonopah* factors generally are satisfied. However, as to the last two *Tonopah* factors, the Commission notes:

> [M]ost SPACs ordinarily invest substantially all their assets in securities, often for a period of a year or more, meaning that investors hold interests for an extended period in a pool of securities. Moreover, whatever income a SPAC generates during this period is generally attributable to its securities holdings. The asset composition and sources of income for most SPACs may therefore raise questions about their status as investment companies under Section 3(a)(1)(A) of the Investment Company Act and, in assessing this status, these factors would need to be weighed together with the other *Tonopah* factors.[90]

When first articulating the *Tonopah* factors, the Commission stated that the purpose of considering the assets and income of a company as part of the *Tonopah* factors is to determine whether the nature of the assets and income would "lead investors to believe that the principal activity of the company was trading and investing in securities."[91] "In other words, the Commission thought in *Tonopah* that what principally matters are the beliefs the company is likely to induce in investors. Will its portfolio and activities lead investors to treat a firm as an investment vehicle or as an operating enterprise? The Commission has never issued an opinion or rule taking a different view."[92] In the Proposing Release, the Commission states that a duration limitation is necessary under the proposed safe harbor because it is concerned that the longer a SPAC operates without having identified a Target, the more likely investors will come to view it as a fund-like investment and the more likely the SPAC will appear to be deviating from its stated business purpose.

However, SPAC IPO prospectuses make clear that SPACs are required to deposit all of the gross proceeds from their IPOs into a Trust Account, which may only be invested in U.S. "government securities" within the meaning of Section 2(a)(16) of the Investment Company Act or in money market funds meeting certain conditions under Rule 2a-7 promulgated under the Investment Company Act, which invest only in direct U.S. Treasury obligations. Pursuant to the trust agreement entered into at the time of the IPO, the trustee is not permitted to invest in other securities or assets. Government securities are not considered "investment securities" under Section 3(a)(2) of the Investment Company Act.[93] The SEC staff has also provided no-action

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[89] *Special Purpose Acquisition Companies, Shell Companies, and Projections*, 87 Fed. Reg. at 29,497.
[90] *Id.*
[91] *In the Matter of the Tonopah Mining Co. of Nevada*, 26 S.E.C. at 430.
[92] S.E.C. v. Nat'l Presto Indus., Inc., 486 F.3d 305, 315 (7th Cir. 2007).
[93] Willkie, Farr & Gallagher, SEC Staff No-action letter (Oct. 23, 2000, available https://www.sec.gov/divisions/investment/noaction/2000/willkiefarrgallagher102300.pdf. The staff, however, cautioned issuers and their counsel, that "an issuer's 'primary engagement' remains a benchmark for determining whether the issuer is an investment company for purposes of [S]ection 3(a)(1)A). For example, an issuer with a very large percentage of its total assets in money market fund shares may now be able to satisfy the 40 percent test in [S]ection 3(a)(1)(C) . . . as a result of the position we set forth here. The issuer nevertheless may be an investment company under [Section] 3(a)(1(A) of the Investment Company Act

relief that permits an issuer to treat money market funds as "cash items" (and not "investment securities") for purposes of Section 3(a)(1)(C) of the Investment Company Act.[94] In addition, SPAC IPO prospectuses state that the Trust Account is intended to hold funds pending the earliest to occur of either the Closing or the SPAC's liquidation upon its failure to complete a business combination within the specified time period.

A SPAC is not a substitute vehicle to invest in government securities and no reasonable investor would choose a SPAC as a means to invest in government securities.[95] The SPAC invests its IPO proceeds in government securities because these are perceived as "safe investments" that will preserve their value and this will ensure that funds are available to a SPAC's redeeming stockholders. The offering documents further state that the offering is not intended for persons who are seeking a return on investments in government securities or investment securities. Investors seeking exposure to the limited investments permitted to be made by SPACs would be better served by investing directly in the government securities or in any investment company whose primary investment strategy is to invest in government securities (a "government fund"). An investment in a SPAC is materially different than an investment in a government fund for a wide range of reasons, including, for example, (i) SPAC investors should expect to ultimately hold shares of the issuer resulting from the business combination and not an entity holding government securities, (ii) the officers, directors and employees of the SPAC are not primarily engaged in evaluating investments in government securities but rather in evaluating prospects for a potential business combination, (iii) SPACs often experience periods when some or all of their assets are held in cash as they move between investments or after government securities mature; (iv) SPACs are permitted to withdraw interest to pay income and franchise taxes and, upon liquidation, pay certain liquidation costs, dragging down overall returns; and (v) SPACs do not have the typical structure of a government fund, including with respect to fees and expenses and liquidity. Accordingly, we do not believe that any reasonable investor would ever view SPACs as a viable substitute for a government fund.

A.1.5.2. Analysis of Proposed Rule 3a-10

Proposed Rule 3a-10 includes several conditions, each of which must be met in order for a SPAC to rely on the safe harbor, relating to: (i) the nature and management of SPAC assets, (ii) SPAC activities and (iii) duration.

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if its primary business is investing, reinvesting, or trading in shares of money market funds (or in shares of money market funds or and other securities), or if it holds itself out as being primarily engaged in such a business."

[94] Willkie, Farr & Gallagher, SEC Staff No-action letter (Oct. 23, 2000). The staff, however, cautioned issuers and their counsel, that "an issuer's 'primary engagement' remains a benchmark for determining whether the issuer is an investment company for purposes of [S]ection 3(a)(1)A). For example, an issuer with a very large percentage of its total assets in money market fund shares may now be able to satisfy the 40 percent test in [S]ection 3(a)(1)(C) . . . as a result of the position we set forth here. The issuer nevertheless may be an investment company under [Section] 3(a)(1(A) of the Investment Company Act if its primary business is investing, reinvesting, or trading in shares of money market funds (or in shares of money market funds or and other securities), or if it holds itself out as being primarily engaged in such a business."

[95] For example, it was noted in S.E.C. v. Nat'l Presto Indus., Inc., 486 F.3d 305, 315 (7th Cir. 2007), that "Reasonable investors would treat Presto as an operating company rather than a competitor with a closed-end mutual fund. The SEC has not tried to demonstrate anything different about investors' perceptions or behavior. It follows that Presto is not an investment company."

The first two categories generally are codifications of longstanding SPAC practices that support the conclusion that SPACs are not investment companies, and thereby simply ensure that a company seeking to rely on these conditions indeed is a SPAC. The third category of the proposed safe harbor requires a SPAC to (i) announce that it has entered into a business combination agreement with a Target no later than 18 months after the effective date of the SPAC IPO's registration statement and (ii) consummate the business combination no later than 24 months after such effective date. If the SPAC fails to meet either aforementioned deadline, it would be required to distribute its assets in cash to investors as soon as reasonably practicable thereafter in order to rely on the safe harbor.

Based on the foregoing, we do not believe that a duration limitation is necessary for a SPAC to avoid classification as an investment company because we believe that a SPAC is engaged primarily in a business other than investing in government securities and government money market funds for purposes of Section 3(a)(1)(A). Its investment in these assets is temporary and merely incidental to its principal business of combining with an operating company. Moreover, as discussed above, no one will mistake a SPAC as a substitute for investing in government securities or government money market funds.[96] In addition, there are practical and market reasons why the proposed duration limits would chill the market, but that discussion is beyond the scope of this letter. As the Commission acknowledges, many SPACs have not announced De-SPAC Transactions within 18 months or Closing within 24 months. Imposing duration limitations also runs contrary to the stated intent of many of the other Proposed Rules, and would put pressure on SPACs to prioritize speed over diligence and quality, to the detriment of stockholders and contrary to a board's fiduciary obligations. The Commission, in fact, acknowledges this concern in the Proposing Release by saying:

> SPACs that are seeking to meet the proposed safe harbor conditions may in some cases compromise on the quality of the type of targets pursued to speed up their search, or offer to pay more for the target to complete a De-SPAC Transaction sooner, compared to under the baseline. In some circumstances, the duration conditions may give sponsors of SPACs seeking to avail themselves of the proposed safe harbor increased incentives to complete a De-SPAC Transaction even if liquidation would be the better choice for investors. That is, the duration conditions may increase the agency costs of the sponsors' managerial control.[97]

While the Commission claims that such agency costs would be mitigated by other provisions of the proposal, the extent of such mitigation, if any, is questionable. We also note that a SPAC's management has no incentive to deviate from its purpose of identifying a Target and Closing. Members of a SPAC's management do not receive any management or performance fees based on the amount of assets held by the SPAC or the income earned on such assets. Their only ability to profit is from a successful Closing.

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[96] *Nat'l Presto*, 486 F.3d at 315.
[97] Special Purpose Acquisition Companies, Shell Companies, and Projections, 87 Fed. Reg. 29,458, 29,541 (proposed May 13, 2022).

As the Commission notes in the Proposing Release, the New York Stock Exchange and The Nasdaq Stock Market each require listed SPACs to complete their business combinations within 36 months. Recognizing that most SPACs are listed on one of these exchanges, the Commission further notes that "[f]or such SPACs the proposed safe harbor duration condition would have reduced benefits since the exchange rules already provide a limit on the duration of the SPAC, albeit 12 months longer that the proposed limit."[98] Although the Commission states that the stock exchange duration limitations were adopted for a different regulatory purpose,[99] it is our understanding that they were, in fact, adopted, after consultation with market participants as to the appropriate length of time, for just this reason: to ensure that the SPAC remains focused on consummating a business combination, not operating indefinitely as a "cash box."

We acknowledge that after some period of time without Closing, a SPAC would appear not to be focused on consummating a De-SPAC Transaction. We submit, however, that a duration limitation in a safe harbor is unnecessary given that exchange-listed SPACs are already subject to a 36-month limitation and all SPACs have duration limitations in their organizational documents that are the product of investor requirements,[100] and that this duration limitation imposed by the stock exchanges was with the previous approval of the Commission.

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[98] *Id.* at 29,540.
[99] *Id.* at 29,501.
[100] Investors always require a duration limitation and are not be willing to lock up their money indefinitely.

B. Conclusion

The Commission has a tripartite mission to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation. We believe that, with some enhanced investor protections in the case of SPAC IPOs and De-SPAC Transactions consisting of increased disclosure requirements, investors will be in a position to make their own investment decisions and rely on disclosure as the basis of their decisions. However, certain of the Proposed Rules take the decision out of the hands of investors—the mere release of the Proposed Rules has had a chilling effect on the SPAC IPO and De-SPAC Transaction market. As we note throughout our comment letter, the Proposed Rules, attempt to draw parallels between SPAC IPOs and De-SPAC Transactions and traditional IPOs, some appropriate and some erroneous. According to Chairman Gensler, such Proposed Rules are intended to "Treat like cases alike," but, if the Proposed Rules are adopted in substantially the form in which these have been currently proposed, SPACs and Targets would need to undertake additional measures (that entail significant new, additional costs) in order for market participants to consider pursuing a De-SPAC that would place De-SPAC Transactions at a disadvantage compared to traditional IPOs, which disadvantages are in addition to the burdens described below to which De-SPAC Transactions are already subject.

We also note that certain regulations applicable to Targets in De-SPAC Transactions are more burdensome than those that apply to issuers in traditional IPOs. If the Commission is truly seeking to create a level playing field between companies that become public through De-SPAC Transactions and those that become public through traditional IPOs, then the following such burdens should be revised:

- The application of Rule 145(c) and (d) resale limitations to any party to the De-SPAC Transaction.

- As is applicable to other public company M&A transactions, financial statements for the acquired business must be filed within four business days of the completion of the business combination pursuant to Item 9.01(c) of Form 8-K. However, in a De-SPAC Transaction, the registrant is not entitled to the 71-day extension of that item available to other publicly-traded acquirers.

- The Combined Company will not be eligible to incorporate Exchange Act reports, or proxy or information statements filed pursuant to Section 14 of the Exchange Act, by reference on Form S-1 until three years after the completion of the business combination.

- The Combined Company will not be eligible to use Form S-8 for the registration of compensatory securities offerings until at least 60 calendar days after the Combined

Company has filed current Form 10 information on a Current Report on Form 8-K (the "Super 8-K").

- The Combined Company will be an "ineligible issuer" under Securities Act Rule 405 for three years following the completion of the business combination, which has consequences during that period that include that the Combined Company:
    - cannot qualify as a well-known seasoned issuer;
    - may not use a free writing prospectus;
    - may not use a term sheet free writing prospectus available to other ineligible issuers;
    - may not conduct a roadshow that constitutes a free writing prospectus, including an electronic roadshow; and
    - may not rely on the safe harbor of Rule 163A from Securities Act Section 5(c) for pre-filing communications.

- The inability of stockholders of the Combined Company to rely upon Rule 144 for resales of securities until after the first anniversary of the filing of the Super 8-K.

- If the Combined Company would be considered an EGC, and the SPAC has filed its initial annual report on Form 10-K before Closing, the SPAC is required to include in the Merger Registration Statement the Target's audited financial statements for three fiscal years. If the Target were undertaking a traditional IPO, it would be required to provide audited financial statements for only two fiscal years.

- If the SPAC has already filed its initial annual report on Form 10-K before Closing, and either the SPAC or the Combined Company had a market float of at least $700 million as of the end of the second quarter, the Combined Company could have the obligations of a large accelerated filer with respect to the first annual report on Form 10-K filed by the Combined Company.

- A Target is not permitted to file a registration statement on Form S-8 until 60 days after the Super 8-K has been filed with the Commission (within four business days after the Closing). This delay does not apply to traditional IPOs.

- A Target that is an FPI which reports its financial statements in accordance with the International Financial Reporting Standards ("IFRS") promulgated by the International Accounting Standards Board ("IASB") may be required, depending on the transaction, to report initially under U.S. generally accepted accounting principles ("GAAP") until the Target's next FPI determination date (*i.e.*, the end of the second fiscal quarter following Closing), when it can elect to report as an FPI. This requirement has considerable cost implications on the Target in a De-SPAC Transaction. If the Target were conducting a traditional IPO, it would not be required to report using GAAP and could use its IFRS financial statements.[101]

We believe that many of the Proposed Rules will significantly harm the ability for companies to seek access to capital and create jobs in industries that are critical to our country's future growth and economic development. We urge the Commission to continue to engage with industry participants before the publication of the final proposed rules. We acknowledge the Commission's desire to safeguard retail investors, but caution that the Proposed Rules, particularly with respect to Rule 140a, go above and beyond the statutory authority of the Commission and would inflict damage to capital markets well in excess of any investor protection benefits arising therefrom.

We appreciate the opportunity to participate in the comment process and respectfully request that the Commission consider our comments and recommendations. We are available to meet and discuss these comments or any questions the Commission and the Staff may have, which may be directed to the individuals listed below.

Very truly yours,

goodwin

Goodwin Procter LLP

Cc:
Jocelyn M. Arel, Co-Chair, SPAC Practice
Jeffrey A. Letalien, Partner
Gregory Larkin, Partner
Folake K. Ayoola, Counsel

[101] *See*, *e.g.*, Union Acquisition Corp. II, Registration Statement (Form S-1) F-9 (Sep. 27, 2019).