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SEC Proposes Rules to Align SPACs More Closely with IPOs

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On March 30, 2022, the U.S. Securities and Exchange Commission (the "Commission"), by a three-to-one vote, issued a press release announcing proposed new rules (the "Proposal") intended to enhance disclosure and investor protections in initial public offerings ("IPO") by special purpose acquisition companies ("SPACs") and in subsequent business combinations between SPACs and private operating companies ("de-SPAC transaction").[1]

The Proposal provides a lengthy and comprehensive discussion that builds upon the Commission's prior statements and actions regarding SPAC IPOs and de-SPAC transactions.[2] As noted by the Commission's Chair, Gary Gensler, in the press release, the Proposal is intended to "help ensure" that "disclosure[,] standards for marketing practices[,] and gatekeeper and issuer obligations," as applied in the traditional IPO context, also apply to SPACs.[3] Chair Gensler further noted that "[f]unctionally, the SPAC target IPO is being used as an alternative means to conduct an IPO."[4]

Overview

There are four key components of the Proposed Rules:

- ***Disclosure and Investor Protection***. Proposes specific disclosure requirements with respect to, among other things, compensation paid to sponsors, potential conflicts of interest, dilution, and the fairness of the business combination, for both the SPAC IPOs and de?SPAC transactions;
- ***Business Combinations Involving Shell Companies***. Deems a business combination transaction involving a reporting shell company and a private operating company as a "sale" of securities under the Securities Act of 1933, as amended (the "Securities Act"), amends the financial statement requirements applicable to transactions involving shell companies, and amends the current "blank check company" definition to make clear that SPACs cannot rely on the safe harbor provision under the Private Securities Litigation Reform Act of 1995, as amended (the "PSLRA") when marketing a de-SPAC transaction;
- ***Projections***. Expands and updates the Commission's guidance on the presentation of projections in filings with the Commission to address the reliability of such projections; and
- ***New Safe Harbor under the Investment Company Act of 1940***. Proposes a safe harbor that SPACs may rely on to avoid being subject to registration as investment companies under the Investment Company Act of 1940, as amended (the "Investment Company Act"). The safe harbor would (i) require SPACs to hold only assets comprising of cash, government securities, or certain money market funds; (ii) require the surviving entity to be engaged primarily in the business of the target company; and (iii) impose a time limit, from the SPAC IPO, of 18 months for the announcement (and 24 months for the completion) of the de-SPAC transaction.

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We provide below our key takeaways, a summary of the Proposal, links to Commissioner statements regarding the Proposal, and a note regarding the comment period and process.

Key Takeaways

Below are the key takeaways from the Proposal:

- ***Timing***. Although the proposed rules will not be in effect unless and until the Commission approves final rules after the public comment period and the Commission's review process, existing SPACs and their targets should expect to receive comments from the Commission staff along the broader lines of the Proposal. SPACs and their targets also should consider the extent to which they will want to comply voluntarily with some of the proposed rules, especially those focused on financial statement requirements and enhanced disclosures.
- ***Conforming SPACs to Traditional IPOs***. The Proposal goes to great lengths to contrast the current SPAC regulatory regime against the one applicable to traditional IPOs and to seek to "level" the playing field between the two. Closer alignment of the two regimes may reduce some potential benefits of a de-SPAC transaction (*e.g.*, availability of alternative financing sources and expedited path to becoming a public company) while also exposing the SPAC, its target and their advisors to additional liability.
- ***No PSLRA Protection***. PSLRA safe harbor against a private right of action for forward-looking statements is not available in, among others, an offering by a blank check company or a "penny stock" issuer, or in an initial public offering. Some market participants believe the PSLRA safe harbor is otherwise available in de-SPAC transactions when a SPAC is not a blank check company under Rule 419. The Commission proposes to amend the current "blank check company" definition to remove the "penny stock" condition and make clear that SPACs may no longer rely on the safe harbor provision under the PSLRA as it relates to the use of projections and other forward-looking statements when marketing a de-SPAC transaction. If the Proposal is adopted, it is unclear whether the lack of the PSLRA safe harbor, especially if coupled with proposed changes to regulations relating to projections, will lead to changes in the presentation of projections and assumptions, or the abandonment of projections. If the latter, this could effectively eliminate the de-SPAC transaction as an alternative for target companies that do not have a lengthy operating history.
- ***Co-Registrant Liability***. The Proposal would include target companies and their officers and directors as co-registrants under Form S-4 and Form F-4 filings, thus imposing Section 11 liability on such persons. Liability will extend to both SPAC and target company disclosures contained in such filings.
- ***Extension of Current Disclosure Guidance (Projections, Dilution, Sponsor, Conflicts)***. Much of the Proposal is simply an extension of current guidance and practice by the Commission. The Proposal does require additional information and specificity (in some cases, beyond current rules and guidance). Nonetheless, some of the prescriptive rulemakings around enhanced disclosures—including the required financial statements, disclosure of sources of dilution, sponsor control and relationships, and potential conflicts of interest—are based on existing rules and guidance, and should not be particularly novel for practitioners.
- ***Fairness to Shareholders***. The Proposal does not go as far as requiring a SPAC board to obtain a fairness opinion, although that seems the likely, practical outcome of the Proposal, since it requires more fulsome discussion of these matters and a determination by the board of directors of a SPAC regarding its reasonable belief as to the fairness of a de-SPAC transaction and related financings to the SPAC's shareholders when approving a de-SPAC transaction. Studies have indicated that only 15% of de-SPAC transactions disclose that they

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were supported by fairness opinions (compared to 85% of traditional mergers and acquisitions, excluding de-SPAC transactions).[5] If the Proposal is adopted, a SPAC's board of directors will need to consider obtaining a fairness opinion, and whether or not it obtains a fairness opinion, the bases for the SPAC's reasonable belief as to the fairness of the transaction.

- ***Underwriter Liability***. The Commission seeks to extend underwriter status (and resulting potential liability) in the de-SPAC transaction to those underwriters to SPAC IPOs involved, directly or indirectly, in the de-SPAC transaction (*e.g.*, advisory services, placement agent services, and other activities related to the de-SPAC transaction would all be considered direct and indirect activities). Underwriters to SPAC IPOs who participate in the de-SPAC transaction will need to consider whether to make changes to the typical de-SPAC transaction process, to ensure they have the benefit of their due diligence defense.
- ***SPAC Time Limits***. In order to rely on a proposed safe harbor for SPACs under the Investment Company Act, SPACs would have a limited time period of no later than 18 months to announce a de-SPAC transaction (and no later than 24 months to complete a de-SPAC transaction) following the effective date of the SPAC's registration statement for its IPO. This would remove SPACs' flexibility to seek extensions from its shareholders to their required liquidation date without running the risk of being considered to be an investment company subject to registration and regulation under the Investment Company Act.

Proposal Summary

New Subpart 1600 of Regulation S-K

The Proposal would create a new Subpart 1600 of Regulation S-K solely related to SPAC IPOs and de-SPAC transactions. Among other things, this new Subpart 1600 would prescribe specific disclosure about the sponsor, potential conflicts of interest, and dilution.

Sponsor, Affiliates, and Promoters

To provide investors with a more complete understanding of the role of SPAC sponsors, affiliates, and promoters,[6] the Commission is proposing a new Item 1603(a) of Regulation S-K, to require:

- ***Experience***. Description of the experience, material roles, and responsibilities of sponsors, affiliates, and promoters.
- ***Arrangements***. Discussion of any agreement, arrangement, or understanding (i) between the sponsor and the SPAC, its executive officers, directors, or affiliates, in determining whether to proceed with a de-SPAC transaction and (ii) regarding the redemption of outstanding securities.
- ***Sponsor Control***. Discussion of the controlling persons of the sponsor and any persons who have direct or indirect material interests in the sponsor, as well as an organizational chart that shows the relationship between the SPAC, the sponsor, and the sponsor's affiliates.
- ***Lock-Ups***. A table describing the material terms of any lock-up agreements with the sponsor and its affiliates.
- ***Compensation***. Discussion of the nature and amounts of all compensation that has been or will be awarded to, earned by, or paid to the sponsor, its affiliates, and any promoters for all services rendered in all capacities to the SPAC and its affiliates, as well as the nature and amounts of any reimbursements to be paid to the sponsor, its affiliates, and any promoters upon the completion of a de-SPAC transaction.

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Potential Conflicts of Interest

To provide investors with a more complete understanding of the potential conflicts of interest between (i) the sponsor or its affiliates or the SPAC's officers, directors, or promoters, and (ii) unaffiliated security holders, the Commission is proposing a new Item 1603(b) of Regulation S-K. This would include a discussion of conflicts arising as a result of a determination to proceed with a de-SPAC transaction and from the manner in which a SPAC compensates the sponsor or the SPAC's executive officers and directors, or the manner in which the sponsor compensates its own executive officers and directors.

Relatedly, proposed Item 1603(c) of Regulation S-K would require disclosure of the fiduciary duties that each officer and director of a SPAC owes to other companies.

Sources of Dilution

In an effort to conform and enhance disclosure relating to dilution in SPAC IPOs and de-SPAC transactions, the Commission is proposing proposed Items 1602 and 1604 of Regulation S-K, respectively.

- ***IPO Dilution Disclosure***. In providing disclosure pursuant to Item 506, SPACs currently provide prospective investors with estimates of dilution as a function of the difference between the initial public offering price and the pro forma net tangible book value per share after the offering, often including an assumption of the maximum number of shares eligible for redemption in a de-SPAC transaction. The Proposal would require additional granularity on the prospectus cover page, requiring SPACs to present redemption scenarios in quartiles up to the maximum redemption scenario. In addition to changes to the cover page, the Proposal would supplement Item 506 disclosure by requiring a description of material potential sources of future dilution following a SPAC's initial public offering, as well as tabular disclosure of the amount of potential future dilution from the public offering price that will be absorbed by non-redeeming SPAC shareholders, to the extent quantifiable.
- ***De-SPAC Dilution Disclosure***. In addition to disclosure at the IPO stage of a SPAC's lifecycle, the Proposal would require additional disclosure regarding material potential sources of dilution as a result of the de-SPAC transaction.[7] As seen in recent comment letters by the Commission, the Commission has requested additional granularity with respect to post-closing pro forma ownership disclosure, often requiring various redemption thresholds and the effects of potential sources of dilution. The Proposal would codify this practice by requiring SPACs to affirmatively provide a sensitivity analysis in a tabular format that expresses the amount of potential dilution under a range of reasonably likely redemption levels. The Proposal does not specify what are "reasonably likely" redemption levels, but looking at the proposed SPAC IPO dilution requirements (as discussed above), quartile disclosure up to the maximum redemption scenario may be acceptable.

Fairness of the De-SPAC Transaction and Related Financings

SPACs would be required to disclose whether their board of directors reasonably believes that the de-SPAC transaction and any related financing transaction are fair or unfair to the SPAC's unaffiliated security holders, as well as a discussion of the bases for this statement. Proposed Item 1606 of Regulation S-K would require a discussion, "in reasonable detail," of the material factors upon which a reasonable belief regarding the fairness of a de-SPAC transaction and any related financing transaction is based, and, to the extent practicable, the weight assigned to each factor. As noted by Commissioner Hester M. Peirce, "[w]hile this disclosure requirement technically does not require a SPAC board to hire third parties to conduct analyses and prepare a fairness opinion, the proposed rules clearly contemplate that this is the likely outcome of the new requirement.

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For example, [proposed Item 1606] would require disclosure of whether 'an unaffiliated representative' has been retained to either negotiate the de-SPAC transaction or prepare a fairness opinion and [proposed Item 1607] would elicit disclosures about 'any report, opinion, or appraisal from an outside party relating to . . . the fairness of the de-SPAC transaction.'"[8]

Relatedly, if any director voted against, or abstained from voting on, approval of the de-SPAC transaction or any related financing transaction, SPACs would be required to identify the director, and indicate, if known, after making reasonable inquiry, the reasons for the vote against the transaction or abstention.

Aligning De-SPAC Transactions with IPOs

Target Company as Co-Registrant

Under the current rules, only the SPAC and its officers and directors are required to sign the registration statement and are liable for material misstatements or omissions. The Proposal would require the target company to be treated as a co-registrant with the SPAC when a Form S?4 or Form F?4 registration statement is filed by the SPAC in connection with a de-SPAC transaction.[9] Registrant status for a target company and its officers and directors would result in such parties being liable for material misstatements or omissions pursuant to Section 11 of the Securities Act. Under the Proposal, target companies and their officers and directors would be liable with respect to their own material misstatements or omissions, as well as any material misstatements or omissions made by the SPAC or its officers and directors. As a result, the Proposal seeks to further incentivize target companies and SPACs to be diligent in monitoring each other's disclosure.

Smaller Reporting Company Status

Currently, de-SPAC companies are able to avail themselves – as almost all SPACs have done since 2016[10] – of the smaller reporting company rules for at least a year following the de-SPAC transaction (and most SPACs would still retain this status at the time of the de-SPAC transaction when the SPAC is the legal acquirer of the target company). The "smaller reporting company" status benefits the combined company after the de-SPAC transaction by availing it of scaled disclosure and other accommodations as it adjusts to being a public company.

Citing the disparate treatment between traditional IPO companies and de-SPAC companies (the former having to determine smaller reporting company status at the time it files its initial registration statement and the latter retaining the SPAC's smaller reporting company status until the next annual determination date), the Proposal would require de-SPAC companies to determine compliance with the public float threshold (*i.e.*, public float of (i) less than $250 million, or (ii) in addition to annual revenues less than $100 million, less than $700 million or no public float)[11] within four business days after the consummation of the de-SPAC transaction.

The revenue threshold would be determined by using the annual revenues of the target company as of the most recently completed fiscal year for which audited financial statements are available, and the de-SPAC company would then reflect this re-determination in its first periodic report following the closing of the de-SPAC transaction.

The Commission estimates that an average of 50 post-business combination companies following a de-SPAC transaction will no longer qualify as smaller reporting companies, when compared to current rules.[12] Studies have indicated that the average size of a de-SPAC company has consistently remained north of $1 billion in 2021.[13] Assuming this trend continues, there is an expectation that an increasing number of target companies will no longer qualify as smaller reporting companies after the de-SPAC transaction, and will need to adapt toward the enhanced public disclosure requirements. This would include faster additional board and management training to prepare the post-de-SPAC company

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for additional disclosure requirements.

PSLRA Safe Harbor

The PSLRA provides a safe harbor for forward-looking statements under the Securities Act and the Securities Exchange Act of 1934, as amended (the "Exchange Act"), under which a company is protected from liability for forward-looking statements in any private right of action under the Securities Act or Exchange Act when, among other things, the forward-looking statement is identified as such and is accompanied by meaningful cautionary statements.

The safe harbor, however, is not available when the forward looking statement is made in connection with an offering by a "blank check company," a company that is (i) a development stage company with no specific business plan or purpose or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies, or other entity or person, and (ii) is issuing "penny stock."[14]

Because of the penny stock requirement, many practitioners have considered SPACs to be excluded from the definition of blank check company for purposes of the PSLRA safe harbor. The Proposal seeks to amend the current definition of "blank check company" to remove the penny stock requirement, thus effectively removing a SPAC's ability to qualify for the PSLRA safe harbor provision for the de-SPAC transaction.

This inability to rely on the PSLRA is coupled with the Proposal's addition of new and modified projections disclosure requirements (as further discussed below). If the Proposal is adopted, it remains unclear whether that will lead to changes in projections and assumptions (especially considering the current environment where market participants, investors, and financiers have come to expect detailed projections disclosure, similar to what is used in public merger and acquisitions ("M&A") transactions), or the abandonment of projections. The latter could effectively eliminate the de-SPAC transaction as an alternative for target companies that do not have a lengthy operating history.

Underwriter Status and Liability

Historically, Section 11 and Section 12(a)(2) of the Securities Act[15] have imposed underwriter liability on underwriters of a SPAC's IPO. The Proposal takes a novel approach in arriving at the conclusion that a de-SPAC transaction would constitute a "distribution" under applicable underwriter regulations and seeks to extend such underwriter liability to a de-SPAC transaction. Proposed Rule 140a would deem a SPAC IPO underwriter to be an underwriter in the de-SPAC transaction, provided that such party is engaged in certain de-SPAC activities or compensation arrangements.

Specifically, an underwriter in a SPAC's IPO would be deemed an underwriter for purposes of a de-SPAC transaction if such person "takes steps to facilitate the de-SPAC transaction, or any related financing transaction, or otherwise participates (directly or indirectly) in the de-SPAC transaction," including if such entities are (i) serving as financial advisor, (ii) identifying potential target companies, (iii) negotiating merger terms, or (iv) serving as a placement agent in private investments in public equity ("PIPE") or other alternative financing transactions.

While Proposed Rule 140a only addresses "underwriter" status in de-SPAC transactions with respect to those serving as underwriters to the SPAC's IPO, the Commission leaves open the door for subsequent determinations for finding additional "statutory underwriters" in a de-SPAC transaction, suggesting that "financial advisors, PIPE investors, or other advisors, depending on the circumstances, may be deemed statutory underwriters in connection with a de-SPAC transaction if they are purchasing from an issuer 'with a view to' distribution, are selling 'for an issuer,' and/or are 'participating' in a distribution."[16]

In addition to the potential chilling effect that underwriter status may have on financial

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institutions' participation in a de-SPAC transaction, the Commission's statement that other "statutory underwriters" may be designated in the future, coupled with the traditional "due diligence" defenses of underwriters,[17] suggests that SPACs and target companies should expect extensive diligence requests from financial institutions, advisors, and their counsel in connection with a de-SPAC transaction and other related changes to the de-SPAC transaction process that add complexity, time, and cost.

Business Combinations Involving Shell Companies

The Commission's concern related to private companies becoming U.S. public companies via de-SPAC transactions is substantially related to the opportunity for such private companies "to avoid the disclosure, liability, and other provisions applicable to traditional registered offerings."[18]

Proposed Rule 145a

Based on the structure of certain de-SPAC transactions, the Commission expressed concern that, unlike investors in transaction structures in which the Securities Act applies (and a registration statement would be filed, absent an exemption), investors in reporting shell companies may not always receive the disclosures and other protection afforded by the Securities Act at the time the change in the nature of their investment occurs, due to the business combination involving another entity that is not a shell company.

Proposed Rule 145a intends to address the issue by deeming any direct or indirect business combination of a reporting shell company involving another entity that is not a shell company to involve "an offer, offer to sell, offer for sale, or sale within the meaning of section 2(a)(2) of the [Securities] Act."[19] By deeming such transaction to be a "sale" of securities for the purposes of the Securities Act, the Proposal is intended to address potential disparities in the disclosure and liability protections available to shareholders of reporting shell companies, depending on the transaction structure deployed.

Proposed Rule 145a defines a reporting shell company as a company (other than an asset-backed issuer as defined in Item 1101(b) of Regulation AB) that has:

1. no or nominal operations;
2. either:
    i. no or nominal assets;
    ii. assets consisting solely of cash and cash equivalents; or
    iii. assets consisting of any amount of cash and cash equivalents and nominal other assets; and
3. an obligation to file reports under Section 13 or Section 15(d) of the Exchange Act.

The Proposal notes that the sales covered by Proposed Rule 145a would not be covered by the exemption provided under Section 3(a)(9) of the Securities Act, because the exchange of securities would not be exclusively with the reporting shell company's existing security holders, but also would include the private company's existing security holders.

Financial Statement Requirements in Business Combination Transactions Involving Shell Companies

The Proposal amends the financial statements required to be provided in a business combination with an intention to bridge the gap between such financial statements and the financial statements required to be provided in an IPO. The Commission views such Proposal as simply codifying "current staff guidance for transactions involving shell companies."[20]

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Number of Years of Financial Statements

Proposed Rule 15-01(b) would require a registration statement for a de-SPAC transaction where the target business will be a predecessor to the SPAC registrant to include the same financial statements for that business as would be required in a Securities Act registration statement for an IPO of that business.

Audit Requirements of Predecessor

Proposed Rule 15-01(a) would require the examination of the financial statements of a business that will be a predecessor to a shell company to be audited by an independent accountant in accordance with the standards of the Public Company Accounting Oversight Board ("PCAOB") for the purpose of expressing an opinion, to the same extent as a registrant would be audited for an IPO, effectively codifying the staff's existing guidance.[21]

Age of Financial Statements of the Predecessor

Proposed Rule 15-01(c) would provide for the age of the financial statements of a private operating company as predecessor to be based on whether such private company would qualify as a smaller reporting company in a traditional IPO process, ultimately aligning with the financial statement requirements in a traditional IPO.

Acquisitions of Businesses by a Shell Company Registrant or Its Predecessor That Are Not or Will Not Be the Predecessor

The Commission is proposing a series of rules intended to clarify when companies should disclose financial statements of businesses acquired by SPAC targets or where such business are probable of being acquired by SPAC targets. Proposed Rule 15-01(d) would address situations where financial statements of other businesses (other than the predecessor) that have been acquired or are probable to be acquired should be included in a registration statement or proxy/information statement for a de-SPAC transaction. The Proposal would require application of Rule 3-05, Rule 8-04 or Rule 3-14 (with respect to real estate operation) of Regulation S-X to acquisitions by the private target in the context of a de-SPAC transaction, which the staff views as codifying its existing guidance.

Proposed amendments to the significance tests in Rule 1-02(w) of Regulation S-X will require the significance of the acquisition target of the private target in a de-SPAC transaction to be calculated using the SPAC's target's financial information, rather than the SPAC's financial information.

In addition, Proposed Rule 15-01(d)(2) would require the de-SPAC company to file the financial statements of a recently acquired business, that is not or will not be its predecessor pursuant to Rule 3-05(b)(4)(i) in an Item 2.01(f) of Form 8-K filed in connection with the closing of the de-SPAC transaction where such financial statements were omitted from the registration statement for the de-SPAC transaction, to the extent the significance of the acquisition is greater than 20% but less than 50%.

Financial Statements of a Shell Company Registrant after the Combination with Predecessor

Proposed Rule 15-01(e) allows a registrant to exclude the financial statements of a SPAC for the period prior to the de-SPAC transaction if (i) all financial statements of the SPAC have been filed for all required periods through the de-SPAC transaction, and (ii) the financial statements of the registrant include the period on which the de-SPAC transaction was consummated. The Proposal eliminates any distinction between a de-SPAC structured as a forward acquisition or a reverse recapitalization.

Other Amendments

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In addition, the Proposal is also addressing the following related amendments:

- amendment of Rule 11-01(d) of Regulation S-X to expressly state that a SPAC is a business for purposes of the rule, effectively requiring an issuer that is not a SPAC to file financial statements of the SPAC in a resale registration statement on Form S-1;
- amendment of Item 2.01(f) of Form 8-K to refer to "acquired business," rather than "registrant," to clarify that the information required to be provided "relates to the acquired business and for periods prior to consummation of the acquisition";[22] and
- amendment of Rules 3-01, 8-02, and 10-01(a)(1) of Regulation S-X to expressly refer to the balance sheet of the predecessors, consistent with the provision regarding income statements.

Enhanced Projections Disclosure

Disclosure of financial projections is not expressly required by the U.S. federal securities laws; however, it has been common practice for SPACs to use projections of the target company and post-de-SPAC company in its assessment of a proposed de-SPAC transaction, its investor presentations, and soliciting material once a definitive agreement is executed. The Proposal seeks to amend existing regulations regarding the use of projections as well as add new, supplemental disclosure requirements.

Amended Item 10(b) of Regulation S-K

Under Item 10(b) of Regulation S-K, management may present projections regarding a registrant's future performance, provided that (i) there is a reasonable and good faith basis for such projections, and (ii) they include disclosure of the assumptions underlying the projections and the limitations of such projections, and the presentation and format of such projections. Citing concerns of instances where target companies have disclosed projections that lack a reasonable basis,[23] the Proposal seeks to amend Item 10(b) of Regulation S-K as follows:

- ***Clarification of Applicability to Target Company***. Item 10(b) of Regulation S-K currently refers to projections regarding the "registrant." Proposed amendments would modify the language to clarify that the guidance therein applies to any projections of "future economic performance of persons other than the registrant, such as the target company in a business combination transaction, that are included in the registrant's Commission filings." Application of the term "persons other than the registrant" suggests that it is likely that the proposed amended guidance also would apply to the use of projections in non-SPAC transactions.
- ***Historical Results***. Disclosure of projected measures that are not based on historical financial results or operational history should be clearly distinguished from projected measures that are based on historical financial results or operational history.
- ***Prominence of Historical Results***. Similar to non-GAAP presentation, the Commission would consider it misleading to present projections that are based on historical financial results or operational history without presenting such historical measure or operational history with equal or greater prominence.
- ***Non-GAAP Measures***. Presentation of projections that include a non-GAAP financial measure should include a clear definition or explanation of the measure, a description of the GAAP financial measure to which it is most closely related, and an explanation why the non-GAAP financial measure was used instead of a GAAP measure. The Proposal notes that the reference to the nearest GAAP measure called for by amended Item 10(b) would not require a reconciliation to that GAAP measure; however, the need to provide a GAAP reconciliation for any non-GAAP

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financial measures would continue to be governed by Regulation G and Item 10(e) of Regulation S-K.

Proposed Item 1609 of Regulation S-K

In light of the traditional SPAC sponsor compensation structure (*i.e.*, compensation in the form of post-closing equity) and the potential incentives and overall dynamics of a de-SPAC transaction, the Commission has proposed a new rule specific to SPACs that would supplement the proposed amendments to Item 10(b) of Regulation S-K (as discussed above). Specifically, the Commission is proposing a new Item 1609 of Regulation S-K that would require SPACs to provide the accompanying disclosures to financial projections:

- ***Purpose of Projections***. Any projection disclosed by the registrant must include disclosure regarding (i) the purpose for which the projection was prepared, and (ii) the party that prepared the projection.
- ***Bases and Assumptions***. Disclosure would include all material bases of the disclosed projections and all material assumptions underlying the projections, and any factors that may materially impact such assumptions. This would include a discussion of any factors that may cause the assumptions to be no longer reasonable, material growth rates or discount multiples used in preparing the projections, and the reasons for selecting such growth rates or discount multiples.
- ***Views of Management and the Board***. Disclosure must discuss whether the projections disclosed continue to reflect the views of the board and/or management of the SPAC or target company, as applicable, as of the date of the filing. If the projections do not continue to reflect the views of the board and/or management, the SPAC should include a discussion of the purpose of disclosing the projections and the reasons for any continued reliance by the management or board on the projections.

Like the proposed amendments to Item 10(b), the first two requirements summarized above should not come as a particular surprise to existing SPACs and their counsel as projections disclosure has been a significant area of scrutiny by the Commission in the registration statement and proxy statement review process.

We note, however, that the requirement under Item 1609 to add disclosure as to management's and/or the board's current views may obligate additional disclosure beyond what has been typical market practice. In particular, projections disclosure in a registration statement or proxy statement is often made in the context of a historical lookback to the projections in place at the time the board of directors of the SPAC assessed whether to enter into a de-SPAC transaction with the target company. These projections typically are not updated with newer data during the pendency of the transaction since the purpose of such disclosure is to inform investors of the board's rationale for approving the transaction. Proposed Item 1609 does not explicitly require the updating of projections, but it does require the parties to disclose whether the included projections reflect the view of the SPAC and the target company as of the date of filing. Moreover, the potential to provide revised projections, coupled with obligations to disclose management's and board's continuing views, may prove challenging disclosure to be made between the signing of a business combination agreement and the filing of a registration statement or proxy statement and during the review period for such registration statement or proxy statement.

Status of SPACs under the Investment Company Act of 1940

Section 3(a)(1)(A) of the Investment Company Act defines an "investment company" as any issuer that is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities. Given that SPACs, prior to a de-SPAC transaction, are not engaged in any meaningful business other than investing its IPO proceeds held in trust, there is a potential for SPACs to be treated

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as an “investment company.”

In recognition of the fact that SPACs are generally formed to identify, acquire, and operate a target company through a business combination and not with a stated purpose of being an investment company, the Proposal seeks to clarify SPAC status by providing a safe harbor under Section 3(a)(1)(A) of the Investment Company Act (the “Subjective Test Safe Harbor”).[24] To qualify under the Subjective Test Safe Harbor:

- ***SPAC Assets***. The assets held by a SPAC must consist solely of government securities, government money market funds, and cash items prior to the completion of the de-SPAC transaction. The Proposal further notes that (i) all proceeds obtained by the SPAC, including those from any SPAC offering, cash infusion from the sponsor, or any interest, dividend, distribution, or other such return derived from the SPAC’s underlying assets, would need to be held in these asset classes, and (ii) SPACs may not acquire interests in an operating company prior to a de-SPAC transaction.
- ***SPAC Asset Management***. Assets listed above may not at any time be acquired or disposed of for the primary purpose of recognizing gains or decreasing losses resulting from market value changes. The Proposal notes that this is not intended to prohibit SPACs the flexibility to hold their assets consistent with cash management practices.
- ***De-SPAC Transaction***. The SPAC must seek to complete a single de-SPAC transaction[25] where the surviving public company, either directly or through a primarily controlled company,[26] will be primarily engaged in the business of the target company or companies, which is not that of an investment company.
- ***Board Action***. The board of directors of the SPAC would need to adopt a resolution evidencing that the company is primarily engaged in the business of seeking to complete a single de-SPAC transaction.
- ***Primary Engagement***. Activities of the SPAC’s officers, directors, and employees, its public representations of policies, and its historical development must evidence that the SPAC is primarily engaged in completing a de-SPAC transaction. Other than a requirement that the board of directors of the SPAC adopt a resolution, the Proposal does not provide examples of other definitive actions as to how SPACs may properly evidence compliance, instead noting that a SPAC may not hold itself out as being primarily engaged in the business of investing, reinvesting, or trading in securities.
- ***Exchange Listing***. The SPAC must have at least one class of securities listed for trading on a national securities exchange “by meeting initial listing standards just as any company seeking an exchange listing would have to do.”
- ***De-SPAC Transaction Time Limits***. The SPAC would have 18 months from its IPO to enter into a de-SPAC transaction and no more than 24 months from its IPO to complete its de-SPAC transaction.

While most SPACs should not have an issue with qualifying for the Subjective Test Safe Harbor, the proposed time limits may prove problematic for existing SPACs seeking amendments to their governing documents to extend the time necessary to complete a de-SPAC transaction. Typically, these amendments are either sought when (i) a SPAC has a definitive transaction agreement entered into and needs some time to consummate the transaction, and/or (ii) a sponsor is willing to compensate existing securities holders by contributing additional amounts into a trust that is disbursable to shareholders upon lapse of the extension. Moreover, stock exchange rules require a SPAC to complete a de-SPAC transaction within 36 months from its IPO, and with its truncated time periods, the Proposal would significantly constrain some of this timing flexibility for SPACs that would like to comply with the Subjective Test Safe Harbor.

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Admittedly, a SPAC does not need to comply with the Subjective Test Safe Harbor, but the alternative would be to make an assessment that the SPAC does not qualify as an investment company, notwithstanding its non-compliance with the time limits in the Subjective Test Safe Harbor, or to register as an "investment company," and with it, comply with the regulatory regime of the Investment Company Act on top of seeking the consummation of a de-SPAC transaction.

Conclusions

As noted by Chair Gensler, much of the Proposal seeks to impose traditional IPO concepts and regulations on the SPAC IPO and de-SPAC transaction process, as well as codify existing Commission guidance and practice.

That said, there are some notable deviations and provisions in the Proposal that, if implemented, could significantly impact the SPAC marketplace. We note that certain provisions in the Proposal may have consequences for the future of SPACs as an alternative vehicle to traditional IPOs.

In particular, proposals regarding underwriter liability in the de-SPAC transaction context, unavailability of the PSLRA, and liquidation timeframes contemplated by the proposed new Investment Company Act safe harbor, all would curtail SPAC flexibility and/or increase the complexity and cost of completing a de-SPAC transaction.

We continue to monitor further developments and will keep you apprised of the latest news regarding this Proposal.

Commissioner Statements

For the published statements of the Commissioners, please see the following links:

Chair Gary Gensler

Commissioner Allison Herren Lee

Commissioner Caroline A. Crenshaw

Commissioner Hester M. Peirce (Dissent)

Comment Period

The comment period ends on the later of 30 days after publication in the Federal Register or May 31, 2022 (which is 60 days from the date of the Proposal). Comments may be submitted:
(1) using the Commission's comment form a
t https://www.sec.gov/rules/submitcomments.htm;
(2) via e-mail to rule-comments@sec.gov (with "File Number S7?13?22" on the subject line); or (3) via mail to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090. All submissions should refer to File Number S7?13?22.

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[1] U.S. Securities and Exchange Commission, Proposed Rule (RIN 3235-AM90), *Special Purpose Acquisition Companies, Shell Companies, and Projections* (March 30, 2022), *available at https://www.sec.gov/rules/proposed/2022/33-11048.pdf* (hereinafter, the "Proposed Rule").

[2] *See* Gibson, Dunn & Crutcher LLP, *SEC Staff Issues Cautionary Guidance Related to Business Combinations with SPACs* (April 7, 2021), *available at*

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https://www.gibsondunn.com/sec-staff-issues-cautionary-guidance-related-to-business-combinations-with-spacs/ (addressing the statement of the staff of the Commission's Division of Corporation Finance about certain accounting, financial reporting, and governance issues related to SPACs and the combined company following a de-SPAC transaction (*see* Division of Corporation Finance, *Announcement: Staff Statement on Select Issues Pertaining to Special Purpose Acquisition Companies* (March 31, 2021), *available at* https://www.sec.gov/corpfin/announcement/staff-statement-spac-2021-03-31), *see also* Gibson, Dunn & Crutcher LLP, *Back to the Future: SEC Chair Announces Spring 2021 Reg Flex Agenda* (June 21, 2021), *available at* https://www.gibsondunn.com/back-to-the-future-sec-chair-announces-spring-2021-reg-flex-agenda/ (discussing the inclusion of SPACs in Chair Gensler's Spring 2021 Unified Agenda of Regulatory and Deregulatory Actions announced on June 11, 2021 (*see* U.S. Securities and Exchange Commission, Press Release (2021-99), *SEC Announces Annual Regulatory Agenda* (June 11, 2021), *available at* https://www.sec.gov/news/press-release/2021-99), and Gibson, Dunn & Crutcher LLP, *SEC Fires Shot Across the Bow of SPACs* (July 14, 2021), *available at* https://www.gibsondunn.com/sec-fires-shot-across-the-bow-of-spacs/ (discussing a partially settled Commission enforcement action against a SPAC related to purported misstatements on the registration statement concerning the target's technology and business risks).

[3] U.S. Securities and Exchange Commission, Press Release (2022-56), *SEC Proposes Rules to Enhance Disclosure and Investor Protection Relating to Special Purpose Acquisition Companies, Shell Companies, and Projections* (March 30, 2022), *available at* https://www.sec.gov/news/press-release/2022-56.

[4] *Id.*

[5] Proposed Rule, p. 195 (citing on fn. 432 Michael Levitt, Valerie Jacob, Sebastian Fain, Pamela Marcogliese, Paul Tiger, & Andrea Basham, *2021 De-SPAC Debrief, FRESHFIELDS* (Jan. 24, 2022), *available at* https://blog.freshfields.us/post/102hgzy/2021-de-spacdebrief, and on fn. 433 Tingting Liu, *The Wealth Effects of Fairness Opinions in Takeovers*, 53 FIN. REV. 533 (2018)).

[6] The term "promoter" is defined in Securities Act Rule 405 and Exchange Act Rule 12b-2.

[7] Proposed Item 1604(c)(1) suggests the following potential sources: "the amount of compensation paid or to be paid to the SPAC sponsor, the terms of outstanding warrants and convertible securities, and underwriting and other fees." Proposed Rule, p. 336.

[8] Commission Hester M. Peirce, *Statement: Damning and Deeming: Dissenting Statement on Shell Companies, Projections, and SPACs Proposal* (March 30, 2022), *available at* https://www.sec.gov/news/statement/peirce-statement-spac-proposal-033022.

[9] Under Section 6(a) of the Securities Act, each "issuer" must sign a Securities Act registration statement. The Securities Act broadly defines the term "issuer" to include every person who issues or proposes to issue any securities.

[10] Proposed Rule, p. 195.

[11] 17 CFR 229.10(f)(1).

[12] Proposed Rule, p. 302 and fn. 575 (explaining that the "estimate is based, in part, on [the Commission's] estimate of the number of de-SPAC transactions in which the SPAC is the legal acquirer").

[13] *See* Jamie Payne, *Market Trends: De-SPAC Transactions*, LexisNexis

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(March 5, 2022),
available at https://www.lexisnexis.com/community/insights/legal/practical-guidance-journal/b/pa/posts/market-trends-de-spac-transactions ("The average size of de-SPAC transactions remained consistent between $2.2 billion and $2.8 billion in 2021 until a significant decline to $1.4 billion in the fourth quarter. The largest SPAC merger announced and closed in 2021, between Altimeter Growth Corp. and Grab Holdings Inc., was valued at $39.6 billion.").

[14] The term "penny stock" is defined in 17 CFR 240.3a51-1.

[15] Section 11 of the Securities Act imposes on underwriters, among other parties identified in Section 11(a), civil liability for any part of the registration statement, at effectiveness, which contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, to any person acquiring such security. Further, Section 12(a)(2) imposes liability upon anyone, including underwriters, who offers or sells a security, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading, to any person purchasing such security from them.

[16] The Proposal further notes that "Federal courts and the Commission may find that other parties involved in securities distributions, including other parties that perform activities necessary to the successful completion of de-SPAC transactions, are 'statutory underwriters' within the definition of underwriter in Section 2(a)(11)." Proposed Rule, p. 98.

[17] Although the Securities Act does not expressly require an underwriter to conduct a due diligence investigation, the Proposal reiterates the Commission's long-standing view that underwriters nonetheless have an affirmative obligation to conduct reasonable due diligence. Proposed Rule, fn. 184 (citing In re Charles E. Bailey & Co., 35 S.E.C. 33, at 41 (Mar. 25, 1953) ("[An underwriter] owe[s] a duty to the investing public to exercise a degree of care reasonable under the circumstances of th[e] offering to assure the substantial accuracy of representations made in the prospectus and other sales literature."); In re Brown, Barton & Engel, 41 SEC 59, at 64 (June 8, 1962) ("[I]n undertaking a distribution . . . [the underwriter] had a responsibility to make a reasonable investigation to assure [itself] that there was a basis for the representations they made and that a fair picture, including adverse as well as favorable factors, was presented to investors."); In the Matter of the Richmond Corp., infra note 185 ("It is a well-established practice, and a standard of the business, for underwriters to exercise diligence and care in examining into an issuer's business and the accuracy and adequacy of the information contained in the registration statement . . . The underwriter who does not make a reasonable investigation is derelict in his responsibilities to deal fairly with the investing public.")).

[18] Proposed Rule, p. 104, citing SEC v. M & A W., Inc., 538 F.3d 1043, 1053 (9th Cir. 2008) ("[W]e are informed by the purpose of registration, which is 'to protect investors by promoting full disclosure of information thought necessary to informed investment decisions.' The express purpose of the reverse mergers at issue in this case was to transform a private corporation into a corporation selling stock shares to the public, without making the extensive public disclosures required in an initial offering. Thus, the investing public had relatively little information about the former private corporation. In such transactions, the investor protections provided by registration requirements are especially important.").

[19] *Id.*, p. 343.

[20] *Id.*, p. 112 (citing the staff guidance under the Division of Corporation Finance's Financial Reporting Manual).

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[21] *Id.*, p. 112 (citing the staff guidance under the Division of Corporation Finance's Financial Reporting Manual at Section 4110.5).

[22] *Id.*, p. 124.

[23] For example, the Commission cites to recent enforcement actions against SPACs, alleging the use of baseless or unsupported projections about future revenues and the use of materially misleading underlying financial projections. *See*, *e.g.*, In the Matter of Momentus, Inc., et al., Exch. Act Rel. No. 34-92391 (July 13, 2021); SEC vs. Hurgin, et al., Case No. 1:19-cv05705 (S.D.N.Y., filed June 18, 2019); In the Matter of Benjamin H. Gordon, Exch. Act Rel. No. 34-86164 (June 20, 2019); and SEC vs. Milton, Case No. 1:21-cv-6445 (S.D.N.Y., filed July 29, 2021).

[24] Proposed Rule 3a-10. The Proposal does not provide a safe harbor under Section 3(a)(1)(C) of the Investment Company Act, with respect to issuers engaged or proposing to engage in certain securities activities.

[25] The de-SPAC transaction may involve the combination of multiple target companies, so long as intentions of the SPAC are disclosed and so long as closing with respect to all target companies occurs contemporaneously and within the required time limits (as described below). Proposed Rule, p. 145.

[26] "Primary Control Company" means an issuer that (i) "[i]s controlled within the meaning of Section 2(a)(9) of the Investment Company Act by the surviving company following a de-SPAC transaction with a degree of control that is greater than that of any other person" and (ii) "is not an investment company." Proposed Rule 3a-10(b)(2).

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. For further information, please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Capital Markets, Mergers and Acquisitions, Securities Enforcement, or Securities Regulation and Corporate Governance practice groups, or the following authors:

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