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The SEC Issues Guidance Regarding SPACs

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Special Purpose Acquisition Companies (“**SPACs**”) experienced an increase in popularity in 2020 and have proceeded on a record filing pace into 2021. This popularity has been in both the initial public offering (“**IPO**”) context and the acquisition context. The Securities and Exchange Commission (the “**SEC**”) has recently issued a string of guidance regarding (i) certain issues relating to SPACs and (ii) accounting and reporting considerations for warrants issued by SPACs, which guidance should be taken into consideration by both the initial SPAC registrant and private operating companies considering a transaction with a SPAC.

Accounting, Financial Reporting and Governance Issues

On March 31, 2021, the SEC issued a staff statement addressing certain accounting, financial reporting and governance issues for private operating companies contemplating a business combination with an existing SPAC (available [here](#)). This guidance largely reminds issuers and acquisition targets of securities law limitations imposed upon companies that were formerly a shell company.

Shell Company Restrictions. SPACs are shell companies and are subject to certain limitations as a result thereof as follows:

- Upon the completion of a business combination, the combined company must file a Form 8-K within four business days of the combination and include the required financial statements of the acquired business (the usual 71-day extension for the financial statements is not available for SPACs);
- The combined company may not incorporate by reference into a registration statement on Form S-1 any reports or proxy or information statements filed under Securities Exchange Act of 1934, as amended (the “**Exchange Act**”) until three years after the completion of the business combination;
- The combined company cannot file a Form S-8 until 60 days after the combined company has filed current Form 10 information; and
- The combined company will be an “ineligible issuer” as defined under Securities Act of 1933, as amended (the “**Securities Act**”), for three years after the business combination is completed such that during that three-year period, the combined company may not do the following:
 - Be a well-known seasoned issuer;
 - Use a free writing prospectus;
 - Use a term sheet free writing prospectus;
 - Conduct a roadshow that constitutes a free writing prospectus, including an electronic

roadshow; or

- Rely on the Rule 163A safe harbor for pre-filing “testing the waters” communications.

Books and Records and Internal Controls Requirements. The SPAC and, upon the completion of a business combination, the combined company are subject to the Exchange Act “books and records” provision which requires registrants to maintain books, records and accounts in reasonable detail that accurately and fairly reflect the registrant’s transactions and dispositions of its assets. Oftentimes, private operating companies have not been subject to books and records provisions and may need to implement certain procedures regarding books and records prior to a business combination with a SPAC.

The SPAC and then the combined company are subject to the Exchange Act “internal controls” provision which requires that each registrant devise and maintain a system of internal accounting controls to provide reasonable assurances about management’s control, authority, and responsibility over such registrant’s assets. This includes management’s responsibility to establish and maintain adequate internal control over financial reporting and disclosure controls and procedures. Once again, the private operating company may not have been subject to such requirements prior the business combination with a SPAC and may need to implement such procedures in advance of such business combination.

National Securities Exchanges’ Listing Standards. Many SPACs are listed on the New York Stock Exchange or the NASDAQ Stock Market. However, after a business combination, the combined company must satisfy the quantitative and qualitative initial listing standards of such markets, including corporate governance requirements regarding the number of independent directors, an independent audit committee, independent director control of both executive compensation and the director nominating process, and a code of conduct. In addition, certain quantitative requirements must be met, including maintaining a sufficient public float, investor base and trading interest. The SPAC and the private operating company should make sure that the combined company will be in position to meet these initial listing standards upon completion of the business combination.

Accounting and Reporting Considerations for SPAC Warrants

The SEC continued its staff statements on SPACs on April 12, 2021 when it issued a statement regarding accounting and reporting considerations for warrants issued by SPACs (available [here](#)). In this statement, the Office of the Chief Accountant (the “**OCA**”) identified two warrants issued by SPACs that should have been accounted for as a liability and not equity.

Indexation. The OCA noted that under U.S. Generally Accepted Accounting Principles (“**GAAP**”), warrants are classified as equity or a liability based on the terms of the warrant and on the registrant’s specific facts and circumstances. To be classified as equity, equity-linked financial instruments such as warrants must be indexed to a registrant’s own equity. Although warrants with variables that could affect the settlement amount may cause a warrant to be classified as a liability, that is not the case if the variables would be inputs to the fair value for a fixed-for-fixed forward or option on equity. GAAP provides a list of such inputs as follows:

- Strike price of the warrant;
- Term of the instrument;

- Expected dividends or other dilutive activities;
- Stock borrow cost;
- Interest rates;
- Stock price volatility;
- Entity's credit spread; and
- Ability to maintain a standard hedge position in the underlying shares.

The first warrant provided for changes in the settlement amount which depended on the characteristics of the warrant holder. Because the warrant holder is not an input into the pricing of a fixed-for-fixed option on equity shares, the OCA stated that the warrant should have been classified as a liability measured at fair value, with changes in fair value reported in each period's earnings, and not as equity.

Tender Offer Provisions. GAAP also provides that if an event not within the entity's control could require net cash settlement, then the contract should be classified as an asset or liability. However, GAAP does not require this result if net cash settlement of a warrant can only be triggered in circumstances where the holders of the shares underlying the contract also would receive cash. The second warrant provided that in the event of a tender or exchange offer accepted by holders of more than 50% of the outstanding shares of a single class of common stock, all of the warrant holders would be entitled to cash for their warrants; however, only certain of the holders of the underlying shares of common stock would be entitled to cash. Therefore, the OCA concluded that the warrant should have been classified as a liability and not as equity.

The SEC noted that the reclassification of warrants from equity to a liability may be material enough to require a restatement of the registrant's previously-issued financial statements.

Conclusion.

As SPACs have become increasingly popular in both the IPO market and in business combinations with private operating companies, the SEC is likely to continue its focus on SPACs and publish additional guidance and potential limitations on both SPACs and the combined companies. Therefore, sponsors, potential investors in SPACs and owners of private operating companies being targeted by SPACs for a business combination should consider the SEC staff statements described above and be alert for additional SEC guidance.

For additional information, please contact any member of Haynes and Boone's Capital Markets and Securities Practice Group.