After the Ink Dries: Four Ways De-SPAC Activity Impacts Other Companies

By Stephanie Bignon, Alison LaBruyere, and Martin Oberst

The flurry of recent de-SPAC transactions has several implications for other companies, particularly companies with investments in those entities, including ongoing reporting obligations, impacts on the financial reporting process, policies, and procedures relating to designated board representatives and trading restrictions. Each of these issues is explored in more depth below. For public companies impacted by one or more of these matters, leveraging aspects of existing compliance programs and including cross-functional teams in those processes early on can prove beneficial.

Ongoing Reporting Obligations

Companies holding or acquiring interests in operating companies that complete de-SPAC transactions (de-SPACs) may find themselves subject to multiple reporting regimes under the Securities Exchange Act of 1934 (the Exchange Act) with respect to those investments.

- *Section 13(d)*: If a company is the beneficial owner of more than 5 percent of a class of equity registered under the Exchange Act, the company will need to evaluate its reporting obligations under Section 13(d). The company will need to determine whether to report its ownership on Schedule 13D or the shorter Schedule 13G. Due to the complex corporate structure used in many of these transactions, determining the applicability of Section 13(d) to a particular investment may not be straightforward. For this reason, it is advisable to consider this issue early in the transaction.
- *Section 16*: Companies beneficially owning more than 10 percent of a class of equity securities registered under the Exchange Act also will be subject to reporting obligations under Section 16, again a determination that may not be intuitive. To ensure relevant forms are filed correctly and in a timely manner, inclusion of these investments in a public company's existing Section 16 reporting process is prudent, as is establishing an ongoing dialogue with the business team(s) responsible for trading decisions.

  To the extent an investor has director designation rights, consideration also should be given to whether the investor is a "director by deputization" for purposes of Section 16. De-SPAC transactions also frequently include earnout provisions, and consideration should be given to the appropriate timing and manner in which to report this contingency, with careful analysis given to the possibility of a future Section 16(b) demand if earnout shares are reported within six months of a perceived matching transaction.
- *Section 13(f)*: Depending on the size of the company's investment portfolio, reporting on Form 13F also may be triggered. On its face, Form 13F may seem inapplicable because only "institutional investment managers" that exercise investment discretion over at least $100 million in Section 13(f) securities are obligated to make these quarterly filings.

  However, Securities and Exchange Commission (SEC) guidance makes clear that this term

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includes corporations that manage their own investment portfolio if the threshold of Section 13(f) securities is met, even though those corporations are not SEC-registered investment advisers. The SEC Staff publishes the Official List of Section 13(f) Securities on a quarterly basis, which includes, among other things, US exchange-traded stocks.

The form itself is straightforward, consisting primarily of a brief table listing the amount of each Section 13(f) security held by the reporting person, but coordination across multiple functional groups is likely necessary to complete it. Accordingly, maintaining a list of the company's investments in Section 13(f) securities (and updating it on a quarterly basis) as part of the company's existing investment management program can be useful.

Financial Reporting

Equity investments in de-SPACs will also impact a company's financial reporting, which may seem especially notable when fair value measurements are involved. Assuming consolidation is not required, the investor will need to determine whether to account for its de-SPAC investment under the equity method or the fair value method of accounting under US Generally Accepted Accounting Principles (GAAP).

Determining the appropriate accounting treatment of this ownership interest requires substantial judgment and is primarily focused on the investor's ability to exercise influence and control over the de-SPAC. The starting point in this evaluation is the investor's common stock ownership in the entity, but other important factors include board participation, the nature and significance of the investment as well as voting rights and other protective and participating rights.

A de-SPAC investment that is measured at fair value will be based on market prices or other observable transactions and inputs, which may result in additional volatility in the investor's financial performance. The investor must determine whether any non-GAAP adjustments are appropriate to allow its own investors to better understand its core operational performance. Such adjustments will need to comply with relevant SEC rules and guidance and require the company to prepare reconciliations to GAAP and, in the case of earnings releases and SEC filings, an explanation of why management believes these adjustments are meaningful to investors.

The financial reporting of equity investments is complex and often requires significant judgment. Public companies should enlist existing cross-functional reporting teams early on to evaluate ongoing accounting and reporting implications of de-SPAC investments.

D&O Implications

Depending on the investment size and negotiating leverage, a public company may have the right to designate a director to a de-SPAC board, which may be one of the public company's officers.

- *Policies and Procedures for Designated Director Representatives*: Companies are well-advised to outline the duties of the designated director representative vis-à-vis the investor and the de-SPAC at the outset and to consider potential conflicts of interest as well as permitted disclosures and related confidentiality arrangements, including who at the investor may receive information about the de-SPAC and whether any non-public information about the investor would be shared with the de-SPAC.

  In certain circumstances, the investor may want to separate the designated director representative from those employees or departments managing the investment. Because the designated director representative will owe fiduciary duties to the investor as well as the de-SPAC and *all* of its shareholders, the parties may wish

to consider in advance circumstances in which the designated director representative would seek recusal from board discussions or actions.

- *Overboarding*: The significant increase in de-SPAC transactions over the last two years, particularly when coupled with the enhanced focus on director diversity, has created new opportunities for existing public company representatives to serve on de-SPAC boards. This opportunity also presents the possibility for such directors to be identified by investors or proxy advisory firms as "overboarded." Before designating a director representative, the investor should consider the principal occupation of the proposed representative, any of that person's other public company board commitments and relevant investor and proxy advisor "overboarding" policies.

Trading Restrictions

Investors and their compliance teams need to give special attention to trading issues in connection with de-SPAC transactions. This includes Section 16 short-swing profit rules and insider trading, as both can limit the investor's ability to trade in the de-SPAC's securities.[1] Given the SEC's recent focus on enhanced disclosure requirements and investor protections against insider trading, these considerations take on increased importance.

At the outset, it is important for investors to clearly understand the de-SPAC's insider trading policy to determine if the investor is directly subject to the policy, which may include blackout periods and pre-clearance requirements, and to negotiate, where possible, exclusion from the policy and its administrative burdens. This exclusion, of course, does not eliminate the prohibitions on insider trading, and the investor's policies and compliance procedures need to include trading restrictions to address these circumstances.

When an investor designates a director to a de-SPAC board, insider trading issues may be heightened, as the designated director representative will be privy to material non-public information (MNPI) about the de-SPAC. Although the SEC presumes that a trader that has MNPI has used it in trading and violated insider trading rules, the SEC does recognize information barriers. As discussed above, it is important to have a well-defined plan for who at the investor, if anyone, may receive MNPI about the de-SPAC.

Again, with the SEC's recent focus on insider trading, including push-the-envelope theories such as "shadow trading," where confidential information about Company A can constitute MNPI about other companies in Company A's industry, it is prudent for the investor's compliance team to confirm that the designated director representative has a clear understanding of insider trading issues and to develop procedures for disclosing information internally about the de-SPAC.

Note

1. An investor's ability to trade following expiration of the lock-up period also would be impacted by the availability of an effective resale registration statement or an exemption from registration, with Rule 144 and Rule 145 unavailable for one year from the de-SPAC's filing of "Form 10 information" with the SEC.

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