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SEC SLAPS SPAC FOR HIDING PRELIMINARY M&A TALKS

LESSONS FOR OTHER PUBLIC COMPANIES

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WHAT HAPPENED

On January 25, 2024, the SEC announced the settlement of cease-and-desist proceedings against Northern Star Investment Corp. II, a special purpose acquisition company (SPAC). The SEC alleged that the company failed to disclose preliminary de-SPAC negotiations with a target company in its IPO prospectus and falsely disclosed that it had not identified any potential targets or engaged in substantive discussions. The SEC also alleged that, after announcing a merger agreement with the target, Northern Star failed to adequately disclose those pre-IPO discussions in its Form S-4 filings for the de-SPAC transaction.

TAKEAWAYS

The lesson is clear – a SPAC should defer discussions with targets until it completes its IPO. The SEC will take seriously violations of the restriction on pre-IPO acquisition discussions by a SPAC without adequate disclosure. Further, such disclosures could result in delays, draw SEC comments and deter potential acquisition targets from engaging in acquisition discussions with a SPAC.

While this is particularly important for SPACs and blank check companies, other public companies should also take care in their SEC disclosures when addressing the potential for future mergers and acquisitions. For example:

- In capital raises, the description of Use of Proceeds should avoid suggestions there have not been any discussions when some may have taken place. Where appropriate, some companies acknowledge the existence of "various stages" of discussions while disclaiming that they relate to or involve "material" acquisitions or "definitive" agreements.
  - The instructions for Use of Proceeds (S-K Item 504) provide: "Where . . . the proceeds may, or will, be used to finance acquisitions of other businesses, the identity of such businesses, if known, or, if not known, the nature of the businesses to be sought, the status of any negotiations with respect to the acquisition, and a brief description of such business shall be included."

- If pro forma financial information is not required, the instructions permit certain information, such as the identities of the parties, not to be disclosed if the company "reasonably determines" that public disclosure would jeopardize the acquisition.

- In the 1988 case *Basic v. Levinson,* the Supreme Court established that (1) even if material, there is no general duty to disclose merger negotiations; (2) merger negotiations must be disclosed if the merger is material and non-disclosure makes other disclosures misleading; and (3) materiality depends upon the probability that the transaction will occur and the significance of the transaction to the company.
- Of course, a company's obligation to disclose negotiations can also be triggered if it buys, sells or otherwise trades in its own securities, such as with an open-market repurchase program, as illustrated in our October 2020 post: SEC Charges Andeavor LLC With Stock Buyback Controls Violations.
- Absent a duty to disclose – such as when (1) required by SEC rules, (2) the company or insiders trade in the securities, or (3) there's a duty to correct (or, in unusual circumstances, a duty to update, such as from prior inconsistent disclosures) – silence or "no comment" is generally acceptable when asked about M&A discussions. But if a company talks, it must be truthful.
- However, stock exchange rules and potential liability concerns from leaks or rumors can create pressure to disclose. Accordingly, companies should consult with legal counsel to navigate through these issues.

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Background of SEC Order

In late December 2021, Northern Star learned that the owner of Apex Clearing Holdings, LLC (later known as Apex Fintech Solutions, "Apex"), a custody and clearing business, was potentially interested in selling Apex to a SPAC. After preliminary discussions, the parties signed a nondisclosure agreement on December 31, 2021. Apex and the owner then shared confidential financial information, including projections, and informed Northern Star they were engaged in discussions with investment banks about valuation.

On January 6, 2021, Northern Star filed a Form S-1 registration statement for its IPO. The prospectus contained customary disclosure for SPACs:

> "We have not selected any business combination target and we have not, nor has anyone on our behalf, initiated any substantive discussions with any business combination target. Accordingly, there is no current basis for investors in this offering to evaluate the possible

merits or risks of the target business with which we may ultimately complete our initial business combination."

From January 16 through January 23, the parties discussed:

- Apex's valuation, comparable company valuations and the size of potential PIPE transactions.
- The processes for conducting SPAC and PIPE transactions.
- The timing of 2020 year-end audits for purposes of a mid-February de-SPAC transaction announcement.
- Northern Star's ability to deliver a particular investment bank as a customer for Apex by using it as sole placement agent for a PIPE offering for a de-SPAC transaction.
- Public relations firms that could be retained by Apex for a de-SPAC transaction.
- Logistics for an investor slide deck and the Form S-4 registration statement for a de-SPAC transaction.

On January 25, the SEC declared the Form S-1 effective and, on January 28, Northern Star completed its IPO, generating gross proceeds of $400 million. That same day, Northern Star sent the parties a detailed schedule for finalizing Apex's valuation and other tasks to allow public announcement of the de-SPAC transaction by the week of February 22.

On February 19, Northern Star's board of directors approved the merger agreement, which was signed on February 21 and announced, along with the PIPE, on February 22.

On April 8, Northern Star filed the Form S-4, which was amended five times through November. The S-4 and amendments:

- Indicated that substantive discussions between Northern Star and Apex regarding a potential business combination did not start until after January 25, the effective date of the IPO registration statement.
- Indicated that no one had contacted any prospective target business before January 25 on Northern Star's behalf regarding a business combination.
- Indicated that Northern Star's active search for targets only began after January 25.

The parties terminated the merger agreement on November 30 and Northern Star later withdrew the S-4, which was never declared effective.

In connection with special meetings called to approve an extension of time for Northern Star to complete a de-SPAC, most of the shareholders of Northern Star elected to redeem their shares for

cash plus interest.

Alleged Violation

The SEC concluded that Northern Star violated Section 17(a)(2) of the Securities Act, which prohibits material misstatements or omissions in connection with the offer or sale of securities.

Terms of Settlement

Without admitting or denying the SEC's findings, the company agreed to a cease-and-desist order and to pay a $1.5 million penalty in the event it closes a merger transaction. If the company liquidates its trust account and returns the funds to shareholders before April 30, 2024, the SEC agreed to forgo the penalty.

MEET THE TEAM

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