

Canadian CPCs, SPACs, and Shells Should Be Careful to Avoid U.S. Investment Company Status

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by Christopher L. Doerksen

On January 24, 2024, the SEC issued new guidance on when a special purpose acquisition company (SPAC) may run afoul of the U.S. Investment Company Act (the Act). While this guidance was directed at SPACs that register or file reports with the SEC, it is also instructive for other types of shell companies, including Canadian capital pool companies, SPACs, and similar shell companies that do not file reports with the SEC.

Why Care About the U.S. Investment Company Act?

If a Canadian issuer is deemed to be an investment company that has failed to register under the Act, it is prohibited from engaging in any business in the U.S. or offering or selling any securities in the U.S., its contracts may be voidable to the extent they are subject to U.S. jurisdiction, commonly used securities exemptions such as Regulation S are unavailable to it, and if it violates the Act, persons associated with it may be held criminally liable.

Registration is also not generally an option for Canadian issuers. The Act prohibits a non-U.S. entity from registering as an investment company absent special SEC action. Registration is also impractical for an operating company or a company that intends to become an operating company upon completing an acquisition.

Accordingly, avoiding investment company status is important for any Canadian issuer that intends to have any connection with the United States.

What is an Investment Company?

Subject to certain exceptions, the Investment Company Act defines an investment company to include any issuer which:

- is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities;

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- is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or
- 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% of the value of such issuer's total assets (exclusive of U.S. federal government securities and cash items) on an unconsolidated basis.

Operating companies typically avoid investment company status by having a different core business purpose – such as mining, drug development, or making widgets – and by having significant non-cash, non-investment assets.

Shell companies that do not have significant non-cash, non-investment assets, and that do not have an operational business, are at greater risk of being deemed an investment company.

What to Do?

To avoid investment company status, capital pool companies, SPACs, and similar shell companies that have, or intend to have, any connection with the United States should review the SEC's new guidance* and structure their assets and operations accordingly. Assuming that the company has the intention to become an operating company as soon as possible through an acquisition of an operating company whose business would become the company's primary business, it would be prudent for the company to:

- Describe itself and its intentions in a manner consistent with this purpose.
- Ensure that the company's directors, officers, and employees are actively engaged and focused on seeking and completing the transaction that would result in the company being an operating company.
- Complete its acquisition as quickly as possible. In its new guidance, the SEC stated that "while the duration of a SPAC is not the sole determinant of its status under the Investment Company Act, a SPAC's activities may become more difficult to distinguish from those of an investment company the longer the SPAC takes to achieve its stated business purpose." The SEC noted that an exemption under the Act for a transient investment company can be available for up to 12 months, and that escrow accounts of certain blank check companies with a term limited to 18 months were not regulated under the Act, before saying that a "SPAC that operates beyond these timelines raises concerns that the SPAC may be an investment company, and these concerns increase as the departure from these timelines lengthen." The SEC acknowledged that exchange listing rules contemplate potentially longer SPAC lifespans but said that those rules were adopted for a different regulatory purpose and do not address investment company status concerns.
- Pending the completion of its acquisition, avoid holding or investing in any assets that would be deemed "investment securities" under the Investment Company Act. This term is quite broad, and includes equity and debt securities, most government bonds, and several common types of term deposits. For this reason, shell companies should pay very close attention to the types of accounts they create with their banks, and the types of investments they hold pending their transformative acquisition. Cash and U.S. federal government securities are not "investment securities".
- Pending the completion of the acquisition, minimize the amount of time spent on

managing investments, and do not emphasize to investors the quality or return on such investments.

- Ensure that its acquisition target is not an investment company, and that it will be an operating company and not an investment company upon completion of the acquisition.

The analysis of whether a company is an investment company can be quite complex.

The above is only an overview of factors that could be relevant for determining whether a capital pool company, SPAC, or similar shell company is an investment company.

Companies should seek legal advice to determine their own status.

*The SEC's new guidance was included in the SEC's final release adopting new rules for SPACs, beginning on page 360. See [Final rule: Special Purpose Acquisition Companies, Shell Companies, and Projections \(sec.gov\)](#)