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Get the Facts on SPACs

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Overview

- History and Current Landscape
- Key Features of SPACs
- SPAC or IPO?
- Key Features of a De-SPAC Transaction
- SEC Filings
- Other Considerations

History and Current Landscape

- A **S**pecial–**P**urpose **A**cquisition **C**ompany is a blank–check company formed for the purpose of effecting a business combination with one or more businesses
- SPACs are not new, but have increased in prevalence recently
  - The number of SPAC initial public offerings (IPOs) increased from 248 in 2020 to 613 in 2021. The total SPAC IPO proceeds also increased from $83 billion in 2020 to more than $160 billion in 2021.
  - In 2021, 267 de-SPAC mergers were announced and 199 closed.
  - As of December 31, 2021, more than 500 SPACs held in trust more than $138 billion in IPO proceeds and sought a mergers and acquisitions (M&A) target.
  - In 2022, the SPAC market is expected to encounter increased Securities and Exchange Commission (SEC) and other regulatory scrutiny and intensified competition for targets and funding sources (e.g., a tightened market for private investment in public equity (PIPE) financings).
- SPACs can list on either Nasdaq or New York Stock Exchange (NYSE)
  - Historically, most SPACs have listed on the Nasdaq because NYSE listing rules were more restrictive, but NYSE rules have recently changed

Key Features of a SPAC

- SPACs are formed to raise capital in an IPO with the purpose of using the proceeds from the IPO to acquire an unspecified business after the IPO.
- SPACs are formed by a **Sponsor** (typically a private equity fund, financial institution, or group of investors).
  - The Sponsor makes an initial (pre-IPO) investment of $25,000 in exchange for "founder shares," typically referred to as the **Promote**.
  - The Promote is a substantial portion of the SPAC's post-IPO equity. Frequently, the Promote is approximately 20% of post-IPO equity.
- Capital Structure
  - In its IPO, the SPAC typically issues equity that is structured to include one share of common stock and a warrant to purchase common stock.
  - Simultaneously with the IPO, the Sponsor acquires additional units, shares, or warrants in a private placement.
- Trust Account
  - The proceeds of the IPO and a portion of the concurrent private–placement proceeds are held in a trust account until released to fund the de-SPAC transaction.
  - SPACs generally invest such proceeds in low-risk, interest–bearing instruments.

Key Features of a SPAC (Continued)

- A portion of the proceeds of the Sponsor's private placement investment is held outside of the trust and is available to the SPAC for use in seeking a target for a business combination
- De-SPAC Transaction
  – Following the IPO, the SPAC will seek an opportunity to acquire an operating business (the **Target**). This is known as a **de-SPAC** or the **Business Combination**.
  – It allows a private company to become a US public company outside of the typical IPO process
  – Additional PIPE investors
  – Approvals and trust fund
    – The de-SPAC transaction requires approval from the SPAC's stockholders
    – The IPO investors have the option to convert their shares into a pro rata portion of the trust account and keep their warrants (**Redemptions**).

Key Features of a SPAC (Continued)

  - The portion of the proceeds of the Sponsor's private–placement investment deposited into the trust account is used to "gross up" the trust account for the underwriting discount so that the IPO investors receive the IPO price for the units, plus interest, upon redemption.
  - Investors may redeem their shares for a variety of reasons. For example, investors may redeem their shares if they are not in favor of the announced Business Combination (e.g., investors may want out if a SPAC intends to merge with a target in a highly speculative industry, such as commercial space flight). Investors may also redeem shares that trade below the IPO price for a pro rata portion of the proceeds held in the trust account (typically $10.00 per share).
- As a result of the de-SPAC transaction, the Target becomes a publicly traded company.

SPACs or IPOs

- Timing
  - Going public through a SPAC is typically faster than through an underwritten IPO.
  - The fastest IPO will take at least four months.
  - Some SPAC transactions close as quickly as two months following the execution of the de-SPAC merger agreement (although timing is significantly impacted by whether the Target has appropriate audited financial statements available).
  - Consider SPAC life span.

SPACs or IPOs (Continued)

- Access to additional funds beyond what the SPAC raised in its IPO
  - de-SPAC transactions often include a PIPE investment
  - The PIPE signs when the de-SPAC merger agreement is signed and funds when the de-SPAC merger closes
- Confidentiality
  - Traditional IPOs are made public when the company files its registration statement with the SEC
  - If the IPO is not consummated, such as because of market conditions, the company's disclosure remains public knowledge
  - In a de-SPAC transaction, if negotiations break down between the Target and the SPAC before signing, the potential de-SPAC transaction remains confidential

Foreign Company Considerations

- A few considerations on foreign SPACs
  - Most SPACs are formed as Delaware corporations, although it is not uncommon for SPACs to be formed in non-US jurisdictions
  - Foreign SPACs may allow for a more efficient de-SPAC structure for a foreign Target
  - Foreign companies interested in going public in the US markets should consider doing so with a SPAC formed outside of a US jurisdiction
  - Foreign SPACs require engaging local counsel for corporate law matters
  - A post–de-SPAC foreign company could qualify as a "**foreign private issuer**" under SEC rules and be subject to the SEC's foreign filing regime
- **Note:** An offshore structure may present additional tax issues, such as passive foreign investment company issues

Key Features of a De-SPAC Transaction

- Letter of Intent
  - The SPAC and the Target will enter into a letter of intent or term sheet and begin drafting and negotiating a merger agreement
  - The terms will include the consideration to be paid to the sellers of the Target, including the mix of cash and stock of the surviving company
  - Treatment of Promote
  - PIPE
  - Minimum cash condition
    - This is a requirement that the SPAC have a minimum amount of cash available at closing, which cash is obtained from the proceeds in the trust account (net of Redemptions) and proceeds of a PIPE transaction, the solicitation and negotiation for which occur in parallel with the merger agreement
      - SPAC stockholders may redeem their shares in exchange for a pro rata portion of the cash in the SPAC's trust account
    - Backstop from Sponsor or third party
- The terms also include restrictions on transfers of the founder shares and shares received by the sellers; registration rights for the Sponsor, sellers, and PIPE investors; the composition of the postclosing board of directors; and other matters

Key Features of a de-SPAC Transaction: PIPE Transaction

- In addition to the cash available in the SPAC trust fund, as part of the de-SPAC transaction, the SPAC and Target also will seek additional fundraising to fund a portion of the merger consideration and the cash available to the Target after the de-SPAC transaction
- PIPEs: private placements by public companies exempt from registration
- The SPAC and the Target will work with their financial advisors, often including a placement agent engaged by the SPAC, to prepare an investor presentation
- The investor presentation will be presented to institutional accredited investors who agree to maintain the confidentiality of the information and express interest in investing in the SPAC through a PIPE transaction
- The terms of the confidentiality agreement require that SPAC and Target publicly disclose the investor presentation concurrently with the announcement of the signing of the de-SPAC merger agreement to "cleanse" the PIPE investors from possession of material nonpublic information and enable them to trade SPAC securities
  - This investor presentation is similar to an IPO roadshow presentation and contains information about the Target's business and the terms of the transaction
  - Unlike an IPO roadshow presentation, it often also includes financial projections
- Simultaneously with the execution of the de-SPAC merger agreement, the PIPE investors and the SPAC will enter into a **subscription agreement** for the PIPE transaction, with funding to occur at the closing of the Business Combination (so closing conditions need to include the closing of the transactions contemplated by the **merger agreement**)

PIPE Transaction (Continued)

- The PIPE investors will have registration rights to sell their shares after closing of the de-SPAC transaction.
- Typically, the PIPE investors will negotiate for the ability to obtain liquidity in advance of other stakeholders. Not all PIPE investors will receive the same terms.
- To maintain a clear market for the PIPE investors, the Target's owners and Sponsor typically agree to transfer restrictions (lock-ups) on their shares for a period following the closing. The lock-up period is typically 180 days (similar to an IPO) but is occasionally tiered based on trading–price milestones.
- Similar to the de-SPAC merger transaction, the PIPE is only announced when signed.

Corporate Documentation and Corporate Approvals

- A de-SPAC transaction is an IPO for the Target, and a public company M&A transaction for the SPAC
- The SPAC and the Target will enter into a **merger agreement** and other deal documents
  - The merger agreement and other deal documents will look very similar to a public company merger agreement, but with certain key distinctions:
    - Earnout
    - Retained Equity (rollover; the Promote; warrants)
    - Indemnity
    - Limited Recourse
- Board Approvals
  - The merger agreement must be approved by the boards of directors of both the SPAC and the Target
  - The SPAC board must also approve holding the special meeting where SPAC stockholders will vote on whether to approve the de-SPAC transaction

Corporate Documentation and Approvals (Continued)

- Stockholder Approvals
  - SPAC Stockholders
    - SPAC stockholders will vote on whether to approve the de-SPAC transaction at a special meeting of stockholders.
    - The SPAC and the Target will prepare an investor presentation used to market the de-SPAC transaction to the SPAC stockholders in soliciting their approval. This presentation is largely identical to the presentation used in the PIPE transaction.
  - Target Stockholders
- Fairness Opinions
  - Fairness opinions have traditionally been rare for buyers in M&A transactions, including SPACs, but they are becoming increasingly more common. A copy of such fairness opinion and description thereof would be required to be disclosed in the proxy statement seeking approval by the SPAC's stockholders.
- Stockholder Litigation
  - Stockholder litigation has also been rare in SPAC transactions because of the inability of plaintiffs to access the funds held in trust. Such litigation, however, is becoming increasingly more common.

Required SEC Filings: The Signing 8-K

- The SPAC must file a Form 8-K within four business days of signing the merger agreement
  - Typically, this "Signing 8-K" is filed on the same day that the merger is announced via press release, and is the first public filing announcing the de-SPAC transaction
  - The Signing 8-K will include disclosures about the merger agreement, any voting agreements, the PIPE subscription agreement (if applicable), and any other material ancillary documents relating to the merger
  - The Signing 8-K will also include the investor presentation that will be used in discussions with investors and analysts
- Issuing the press release announcing the deal allows the SPAC and the Target to engage in discussions with the press, employees, investors, and analysts in compliance with Regulation FD
  - Regulation FD prohibits selective disclosure of material nonpublic information to investors, analysts, and other market professionals

Required SEC Filings: Proxy Statement/Form S-4

- The primary SEC filing relating to the de-SPAC transaction typically will be a **proxy statement**
  - If the transaction is structured as a share exchange, in which the SPAC's shares are exchanged for the Target's shares, then a registration statement on **Form S-4** will be used and the S-4 will include a proxy statement/prospectus
  - The disclosure requirements for both the proxy statement and the Form S-4 are similar
- The proxy statement contains the typical disclosures that would be required in any public company M&A transaction requiring stockholder approval and all of the typical disclosures provided in an IPO registration statement on Form S-1
- **Timing:** the parties will want to file the proxy statement (or S-4) as soon as possible after the signing of the merger agreement

Required SEC Filings: Additional Communications

- SEC rules require that any communications relating to the de-SPAC transaction be filed on the date the materials are first published, sent, or distributed to stockholders
  - *Any written communications relating to the de-SPAC transaction must be filed with the SEC on the date of first use*
  - Written communications that must be filed in accordance with SEC rules include, but are not limited to:
    - press releases and other public statements from the SPAC or Target about the Business Combination;
    - scripts and slides used in analyst presentations, conferences, and other similar meetings regarding the Business Combination; and
    - materials included on SPAC or Target website or social media regarding the Business Combination
- This requirement applies regardless of whether the parties filed a proxy statement or a Form S-4

SEC Staff Review

- The SEC Staff will conduct a full review of the proxy statement or Form S-4
- Usually, the SEC Staff takes approximately 30 calendar days to issue its first comment letter on the filing
- After receiving SEC comments, the de-SPAC deal team will work quickly to respond to the SEC comment letter by revising the disclosure in the proxy statement or Form S-4 and filing a revised or amended document that addresses the SEC's comments
- Also, the proxy statement or Form S-4 may require other updates to reflect the passage of time, such as updating financial statements or other data for the most recently completed fiscal quarter
- When the SPAC responds to the first SEC comment letter, the SEC Staff takes about 10 to 14 calendar days to review the revised or amended filing and respond with additional comments, if any
  - If the SEC Staff submits additional comments, the deal team will again work quickly to respond and revise the filing as necessary
- When the SEC Staff's comments have all been addressed, the Staff will give the go-ahead to file the definitive proxy statement or will take the Form S-4 effective, as appropriate
- **Note:** In our experience, SEC reviews of Form S-4 (which are filed under the Securities Act) typically take a little longer than reviews of a proxy statement (which are filed under the Exchange Act). This is because Form S-4 also covers the issuance of new securities, such as in a share exchange.

Mailing the Proxy Statement and Conducting the Special Meeting

- After the SPAC files the definitive proxy statement or the final proxy statement/prospectus, the document must be printed and mailed to the SPAC stockholders
  - Stockholders will have the opportunity to review the proxy statement before making an informed voting decision on whether to approve the de-SPAC merger
  - The shareholder approval process can take about three weeks from the filing of the definitive proxy statement or proxy statement/prospectus to the special meeting where stockholders of the SPAC will be asked to approve the de-SPAC merger

Closing the De-SPAC Transaction and Filing the Super 8-K

- When stockholders approve the de-SPAC transaction and the deal closes, the SPAC must file a Form 8-K with the SEC reporting the voting results of the special meeting and the closing of the transaction.
- This “Super 8-K” will contain disclosure about:
  - the completion of the merger;
  - any material agreements entered into in connection with the merger (such as employment agreements for executive officers or a new incentive plan); and
  - the post–combination company information required under Form 10 (much of this disclosure will be incorporated by reference to the proxy statement filed for the special meeting).
- **Note:** If the Super 8-K is filed after the Target’s most recently completed fiscal period but does not contain financial statements for that period, such financial statements will need to be included if the financial statements in the proxy statement are “stale,” or, if not yet stale, then the Super 8-K will need to be amended after the transaction closes to include updated financial statements for the most recently completed fiscal period (there is no 71-day extension for former SPACs) and updated pro forma financial statements.

Additional SEC Filings Postclosing

- The newly combined company will be required to complete additional filings related to the de-SPAC after the closing
- The company must file a **resale registration statement** to register the resale of the shares issuable upon exercise of the warrants issued in the IPO and the resale of the shares held by the Sponsor and sellers and shares issued in a PIPE
  - This resale registration statement must be filed on Form S-1 instead of Form S-3 because, according to the SEC Staff, the postcombination company is not S-3 eligible until it has 12 calendar months of Exchange Act reporting history
- The company must also file a **Form S-8** to register any shares that may be issued under equity plans to the combined company's employees
  - The Form S-8 cannot be filed until 60 days after the filing of the Super 8-K due to the combined company's former status as a shell company
- The SPAC and the Target must file **Forms 3 and 4** for **executive officers and directors** of the postcombination company as required by Section 16 of the Exchange Act

Remaining Considerations

- The postcombination company will be subject to SEC Rule 144(i), meaning that no resales can be conducted pursuant to Rule 144 for one year from the filing of the Super 8-K
  - This is due to the SPAC's former status as a shell company

Near-Term SPAC Outlook

- PIPE capital may become more limited, leading to alternative funding sources and arrangements to complete de-SPAC transactions
  - PIPE investors may grow more skeptical of Target valuations, size of sponsor Promotes, and other deal terms, reducing their willingness to fund de-SPAC transactions absent more favorable terms
  - Alternative funding possibilities include SPAC issuances of convertible debt or preferred stock (fixed returns and equity upside to investors upon conversion) and other third-party backstop funding arrangements
- Increased regulatory scrutiny
  - On March 30, 2022, the SEC proposed new rules and amendments intended to enhance disclosure and investor protections in SPAC IPOs and Business Combinations involving shell companies (such as SPACs) and private operating companies
  - The proposals would, among other things:
    - Require additional disclosures about:
      - SPAC sponsors, conflicts of interest, and sources of dilution
      - Business Combination transactions between SPACs and private operating companies, including disclosures relating to the fairness of such transactions
    - Make the liability safe harbor in the Private Securities Litigation Reform Act of 1995 for forward-looking statements, such as projections, unavailable in filings by SPACs and certain other blank–check companies
    - More closely align the required financial statements of private operating companies in transactions involving shell companies with those required in registration statements for an IPO
    - Deem underwriters in a SPAC IPO to be underwriters in a subsequent de-SPAC transaction when certain conditions are met

Biography

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Andrew corporate practice focuses on US and cross-border mergers, acquisitions, dispositions, and private equity investments in various industries, including infrastructure, power, media, manufacturing, and technology. He counsels both public and privately held companies in complex strategic transactions including joint ventures, commercial contracts, and general corporate and compliance matters.

Andrew routinely advises clients in acquisition and divestment deals involving a range of assets, from container terminals, power generation facilities, and regulated water and wastewater plants to enterprises in the international energy services sector, various manufacturing industries, and logistics operations.

Biography

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Thurston focuses his practice on corporate and securities matters, primarily representing issuers and investment banks in public and private corporate finance transactions. His experience encompasses registered offerings of debt and equity securities, Rule 144A and Regulation S transactions, high-yield and investment grade debt offerings, follow-on and secondary equity offerings, initial public offerings, special–purpose acquisition companies, and liability management transactions. In addition, Thurston counsels on securities law compliance, public company reporting, corporate governance, and other general corporate matters.

Biography

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Caitlin focuses her practice on advising private equity sponsors and their portfolio companies, public and private companies, and emerging market companies on domestic and cross-border mergers and acquisitions, asset purchases, divestitures, private–equity investments, and other corporate transactions. She also advises clients on general corporate and compliance matters. Caitlin has experience dealing with a broad range of industries, including healthcare, technology, and financial services.

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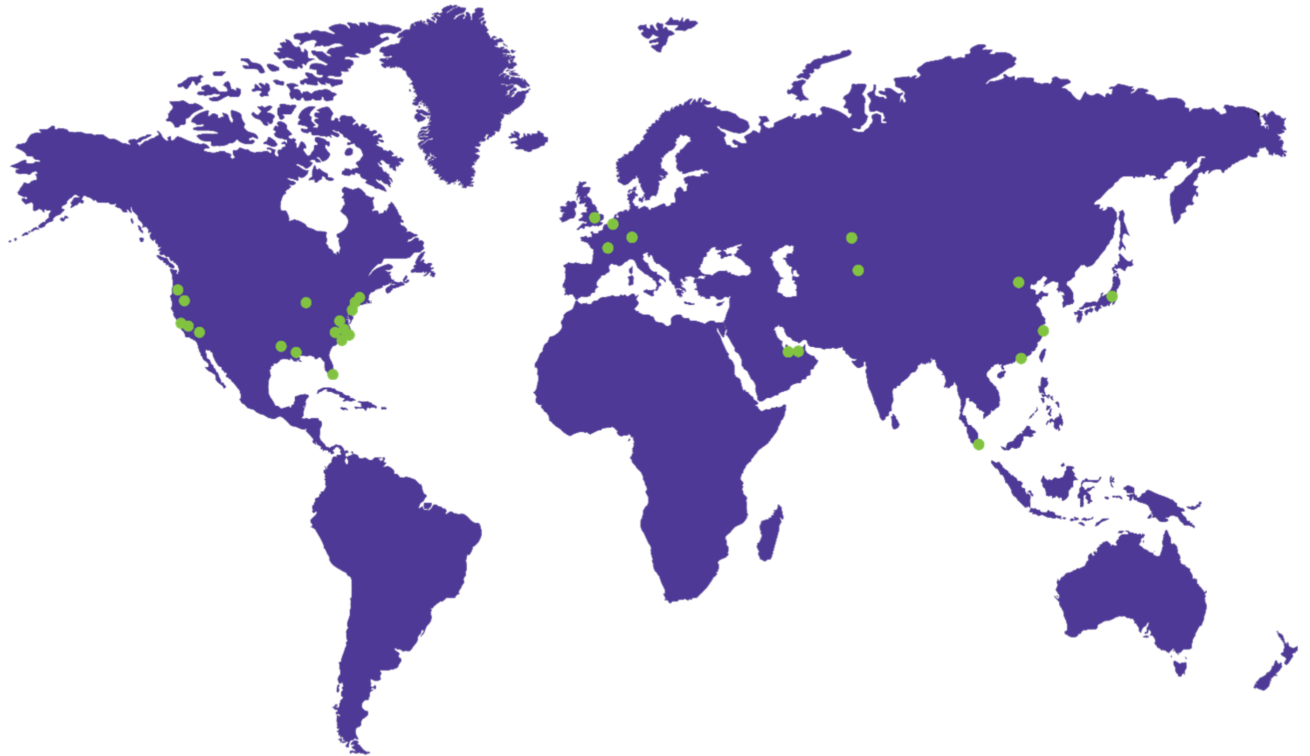

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