Special Purpose Acquisition Companies:
An Introduction
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This primer discusses general aspects of SPACs undertaking initial public offerings registered with the U.S. Securities and Exchange Commission.

Updated August 2020.
Introduction

Special Purpose Acquisition Companies (“SPACs”) are companies formed to raise capital in an initial public offering (“IPO”) with the purpose of using the proceeds to acquire one or more unspecified businesses or assets to be identified after the IPO. Since the beginning of 2010 through August 21, 2020, 78 SPAC IPOs have been completed, raising over $31 billion in proceeds, with another $6.4 billion of SPACs on file for IPOs. SPACs have become increasingly popular in recent years, and such popularity has substantially increased during the COVID-related market disruption, perhaps because of the flexibility of SPACs to pivot to attractive industries based on changing market fundamentals, and in part because SPAC IPO investors have the downside protection of redemption decisions.

SPAC IPOs by Quarter

2016 - Q2 2020

IPO Proceeds (Billions)

- Q1 2016: $0.6
- Q2 2016: $0.9
- Q3 2016: $0.9
- Q4 2016: $1.0
- Q1 2017: $2.3
- Q2 2017: $2.8
- Q3 2017: $2.5
- Q4 2017: $2.4
- Q1 2018: $2.1
- Q2 2018: $3.5
- Q3 2018: $2.6
- Q4 2018: $2.5
- Q1 2019: $3.4
- Q2 2019: $3.5
- Q3 2019: $3.3
- Q4 2019: $3.4
- Q1 2020: $3.9
- Q2 2020: $8.1
A SPAC will go through the typical IPO process of filing a registration statement with the U.S. Securities and Exchange Commission ("SEC"), clearing SEC comments, and undertaking a roadshow followed by a firm commitment underwriting. The IPO proceeds will be held in a trust account until released to fund the business combination or used to redeem shares sold in the IPO. Offering expenses, including the up-front portion of the underwriting discount, and a modest amount of working capital will be funded by the entity or management team that forms the SPAC (the "sponsor"). After the IPO, the SPAC will pursue an acquisition opportunity and negotiate a merger or purchase agreement to acquire a business or assets (referred to as the "business combination"). If the SPAC needs additional capital to pursue the business combination or pay its other expenses, the sponsor may loan additional funds to the SPAC. In advance of signing an acquisition agreement, the SPAC will often arrange committed debt or equity financing, such as a private investment in public equity ("PIPE") commitment, to finance a portion of the cash needed for the business combination and thereafter publicly announce the signing of the acquisition agreement and the committed financing. Following such announcement, the SPAC will undertake a mandatory shareholder vote or tender offer process, in either case offering the public investors the right to return their shares to the SPAC in exchange for cash roughly equal to the IPO price paid plus interest. If the business combination is approved by the shareholders (if required) and the financing and other conditions specified in the acquisition agreement are satisfied, the business combination will be consummated (referred to as the "De-SPAC transaction"), and the SPAC and the target business will combine into a publicly traded operating company.

### Three Phases in SPAC Lifespan

<table>
<thead>
<tr>
<th>Phase</th>
<th>Duration</th>
<th>Key Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Initial Public Offering Phase</td>
<td>8+ weeks</td>
<td>Engage counsel and auditors, Incorporate SPAC and sell founder shares, Prepare S-1, File S-1 and amendments responsive to SEC comments, “Testing the waters” meetings, Negotiate underwriting and ancillary agreements, Roadshow, pricing and closing</td>
</tr>
<tr>
<td>2. Target Search &amp; Negotiation Phase</td>
<td>Up to ~19 months</td>
<td>Regular periodic SEC filings, Identify target business, Conduct diligence and negotiate acquisition agreement, Potentially arrange committed PIPE and/or debt financing, Begin preparing proxy/tender offer document/S-4, Sign acquisition agreement and financing commitments</td>
</tr>
<tr>
<td>3. Approval/Closing Phase</td>
<td>3-5+ months</td>
<td>Announce acquisition agreement and financing commitments, File preliminary proxy/tender offer document, Meeting with SPAC investors to discuss transaction, Obtain shareholder approval, Redeem public shares of electing holders, Close transaction, File Super 8-K</td>
</tr>
</tbody>
</table>

Prior results do not guarantee a similar outcome.
As compared to operating company IPOs (referred to herein as “traditional IPOs”), SPAC IPOs can be considerably quicker. SPAC financial statements in the IPO registration statement are very short and can be prepared in a matter of weeks (compared to months for an operating business). There are no historical financial results to be disclosed or assets to be described and business risk factors are minimal. In essence, the SPAC IPO registration statement is mostly boilerplate language plus director and officer biographies. As a result, the SEC comments on the IPO registration statement are usually not particularly difficult. From the decision to proceed with a SPAC IPO, the entire IPO process can be completed in as little as eight weeks.

On the other hand, the De-SPAC transaction involves many of the same requirements as would be applicable to an IPO of the target business, including audited financial statements and other disclosure items that may not otherwise be applicable if the target business were acquired by a public operating company.

The over-allotment option in traditional IPOs (commonly referred to as a “green shoe” or just the “shoe”) typically extends for 30 days from pricing, while the option in SPAC IPOs typically extends for 45 days. Both, however, are 15% of the base offering size.

SPAC IPOs have an unusual structure for the underwriting discount. In a traditional IPO, the underwriters typically receive a discount of 5%-7% of the gross IPO proceeds, which they withhold from the proceeds that are delivered at closing. In a SPAC IPO, the typical discount structure is for 2% of the gross proceeds to be paid at the closing of the IPO, with another 3.5% deposited into the trust account and payable to the underwriters on closing of the De-SPAC transaction. If no De-SPAC transaction occurs, the deferred 3.5% discount is never paid to the underwriters and is used with the rest of the trust account balance to redeem the public shares.

In a traditional IPO, the sponsor and directors and officers sign a lock-up agreement for 180 days from the pricing of the IPO. For a SPAC IPO, the typical lock-up runs until one year from the closing of the De-SPAC transaction, subject to early termination if the common shares trade above a fixed price (usually $12.00 per share) for 20 out of 30 trading days starting 150 days after closing of the De-SPAC transaction.

SPACs always qualify as “emerging growth companies” under SEC rules, entitling them to conduct “testing the waters” meetings with institutional investors at any time, but as “shell companies” under SEC rules, SPACs are unable to use graphic materials in roadshows or use recorded roadshows due to restrictions on using free writing prospectuses.
In connection with closing the IPO, the SPAC will fund a trust account with an amount typically equal to 100% or more of the gross proceeds of the IPO, with approximately 98% of the amount funded by the public investors and 2% or more funded by the sponsor. The funds in the trust account are typically invested in short-term U.S. government securities or held as cash and are released to fund (i) the business combination, (ii) redemption of common stock pursuant to a mandatory redemption offer (as described below in “De-SPAC Process — Redemption Offer”), (iii) payment of the deferred underwriting discount and (iv) if any amounts remain, to cover transaction expenses and working capital of the company post De-SPAC transaction. The trust agreement typically permits withdrawals of interest earned on the funds held in the trust account to fund franchise and income taxes and occasionally permits withdrawal of a limited amount of interest (e.g., $750,000 per year) for working capital.

The Trust Account Proceeds Are Used To:

- Redeem public shares tendered in connection with:
  - The De-SPAC transaction
  - Liquidation of the SPAC
  - Extension of the outside date
- Fund the De-SPAC transaction
  - Pay cash consideration
  - Pay transaction expenses
  - Delever target company
  - Fund working capital post De-SPAC transaction
Considerations for PE Sponsors:

- Ownership of sponsor by fund, or fund management
- Allocation of investment opportunities
- Restrictions on forming public or competitive vehicles
- Structure and terms of equity arrangement with SPAC management

Private equity managers contemplating sponsoring a SPAC face particular considerations, including where the sponsor should reside in the fund structure and whether the fund documents permit the formation of a SPAC. A common question is whether the sponsor should be a portfolio company of one or more existing funds or a subsidiary of the investment manager. Fund agreements may limit the ability of the investment manager to form a SPAC outside of an existing fund. Alternatively, the types of assets the SPAC is formed to pursue may not be within the investment mandate of an existing fund. In addition, the private equity manager will likely need to consider how to allocate investment opportunities between the SPAC and existing funds.

Private equity-backed SPACs often have independent management for the SPAC, such as a CEO or Chairman with pertinent publicly traded company and target industry experience. The private equity group and the management of the SPAC will often negotiate a private arrangement (usually contained in the organizational documents of the sponsor) dealing with, among other things, how much of the at-risk capital (as described below) each of the parties will fund, relative participation in forward purchase commitments (as described below), and vesting of equity (including incentive equity).
Public Units

In a typical SPAC IPO, the public investors are sold units, each comprised of one share of common stock and a fraction of a warrant to purchase a share of common stock in the future. The per unit purchase price is almost always $10.00. Following the IPO, the units become separable, such that the public can trade units, shares, or whole warrants, with each security separately listed on a securities exchange.

In addition, a minority of SPACs that went public in the last two years (generally those with smaller IPOs) have issued IPO investors rights to receive additional shares in connection with the De-SPAC transaction.

Public Shares

The common stock included in the units sold to the public is sometimes classified as “Class A” common stock, with the sponsor purchasing “Class B” or “Class F” common stock. For ease of reference, this primer refers to the shares and warrants included in the units sold to the public as the “public shares” and “public warrants,” and the shares and warrants sold to the sponsor as the “founder shares” and the “founder warrants.” The public shares and founder shares vote together as a single class and are usually identical, except for certain anti-dilution provisions described below.

Founder Shares

The sponsor will purchase founder shares prior to the SPAC submitting or filing the IPO registration statement with the SEC. The sponsor will pay a nominal amount (usually $25,000) for a number of founder shares that equals 25% of the number of shares being registered for offer to the public, inclusive of the traditional 15% green shoe. The holders of the founder shares will agree, to the extent the green shoe is not exercised in full, to forfeit a number of shares so that the number of founder shares equals 20% of the number of public shares actually sold to the public. This results in the founder shares equaling 20% of the total shares outstanding after completion of the IPO, including any exercise or expiration of the green shoe. The 20% founder shares are often referred to as the “promote.”

In many SPAC structures, the founder shares automatically convert into public shares at the time of the De-SPAC transaction on a one-for-one basis. However, if additional public shares or equity-linked securities (defined as securities of the SPAC or its subsidiaries that are convertible into or exchangeable for equity of the SPAC) are issued in connection with the closing of the De-SPAC transaction (excluding shares and equity-linked securities issued to the seller of the target business), the exchange ratio upon which the founder shares convert to public shares will be adjusted to gross the founder shares up to 20% of the total founder shares and public shares and equity-linked securities outstanding. This anti-dilution adjustment is routinely waived by the sponsor in connection with the De-SPAC transaction.
Warrants

The units sold to the public typically include a fraction of a warrant to purchase a whole share, while the sponsor purchases whole warrants. Recently, the most common structure has been that the units sold in the IPO would include a half warrant, although one-third of a warrant is more common in larger IPOs. In all cases, only whole warrants are exercisable. The offerings of the founder warrants and the shares issuable upon exercise of the public warrants and founder warrants are not registered at the time of the IPO, but are typically subject to registration rights.

The strike price for the warrants is $11.50 per whole warrant (15% above the $10.00 per share IPO price) with anti-dilution adjustments for splits and stock and cash dividends. The majority of SPACs since 2019 have included a “crescent term” — which is a provision to adjust the warrant strike price in the event of the issuance of additional securities below a specified threshold in connection with a business combination. The warrants become exercisable on the later of (i) 30 days after the De-SPAC transaction and (ii) the twelve-month anniversary of the SPAC IPO. The public warrants are designed to be cash settled — meaning the investors have to deliver $11.50 per warrant in cash in exchange for a share of stock. The founder warrants are by default net settled (also referred to as a “cashless exercise”) — meaning the holder is not required to deliver cash but is issued a number of shares of stock with a fair market value equal to the difference between the trading price of the stock and the warrant strike price. In addition, in a meaningful number of recent SPACs, the SPAC has the option to redeem the warrants for stock, with the amount of stock determined based on a grid of the period until expiration of the warrants and the fair market value of the common stock. The notice period required to exercise this feature is sufficiently long that warrant holders should have the ability to exercise the warrants for cash if they would prefer. In certain circumstances, such as the absence of an effective registration statement covering the common stock issuable upon exercise of the public warrants or at the option of management, the public warrants may also be net settled. If the public warrants are exercisable and the public shares trade above a fixed price (usually $18.00 per share) for a period of time, the public warrants will become redeemable by the company for nominal consideration, effectively forcing holders of the public warrants to exercise or lose the value of the warrants. The founder warrants are not redeemable. With the exception of the cashless exercise feature and the non-redeemability, the founder warrants and public warrants have identical terms.

The purchase price paid by the sponsor for the founder warrants represents the “at-risk capital” of the sponsor in the SPAC and is calculated as an amount equal to the up-front underwriting discount (typically 2% of the gross IPO proceeds) plus typically $2 million to cover offering expenses and post-IPO working capital. For that amount, the sponsor purchases founder warrants at a price of $1.50, $1.00 or $0.50 per warrant, depending on whether each unit sold in the IPO includes 1/3, 1/2 or 1 public warrant, respectively. There are also a number of recent examples where the units included 1/5 or 1/4 warrants, but the pricing of founder warrants in these examples does not follow a consistent pattern. In addition to the founder warrants purchased at IPO, most SPACs contemplate that an additional $1.5 million of warrants can be issued to the sponsor or other insiders at the De-SPAC transaction on conversion of any loans from the sponsor to the SPAC.

Both the sponsor and the public IPO investors receive warrants (although the sponsor typically owns a larger percentage of the warrants than shares), so the sponsor and the public IPO investors are somewhat aligned with respect to warrant structure and terms. The public warrants compensate the IPO investors for investing in a blind pool. The warrants essentially dilute any PIPE investors and any equity retained by the seller of the target business.
Illustrative SPAC Structure

- Public shares equal 80% of the total shares outstanding after the IPO
- Founder shares equal 20% of the total shares outstanding after the IPO
- IPO proceeds are typically invested in short-term U.S. government securities

Pershing Square Tontine Holdings: An Eleph-i-corn Hunter with Deviations from the Typical SPAC Structure

In July 2020, Pershing Square Tontine Holdings went public, as a SPAC focusing on “Mature Unicorns” that might need substantial liquidity or capital resources. It was the largest SPAC IPO ever, raising $4.0 billion, with another $1.0 billion under a committed forward purchase agreement and another $2.0 billion under options with the forward purchase subscribers. The SPAC has a number of notable aspects/features, which distinguish it from typical SPACs:

- It is considerably larger than existing SPACs
- It does not have the typical founder share structure, equal to 20% of the post-IPO shares. Instead the sponsor and directors purchase warrants to buy roughly 6% of the shares of the company (calculated on a fully diluted basis as of the closing of the De-SPAC transaction). The warrants are exercisable at $24.00 per share (20% above the IPO price) after 3 years
- The public warrants are a collective 1/3 warrant, but with a 1/9 warrant included in the unit having typical terms and a 2/9 warrant per IPO share having a “tontine” structure. To quote Monty Burns, “How many of you are familiar with the concept of a ‘tontine’?” Effectively, any 2/9 warrants of redeeming public shareholders are distributed among non-redeeming public shareholders, pro rata
- Underwriter compensation is considerably lower than typical, and there is no green shoe
- The Pershing Square Tontine SPAC was marketed as having competitive advantages over other SPACs due to its (1) larger amount of committed capital, (2) willingness to acquire a minority stake in a company, (3) ability to give a private company access to the public equity markets and (4) lower cost of capital compared to other blank check companies. The first (committed capital) and fourth (cost of capital) points have merit, while the second is less of a differentiator — most (62%) of the recent De-SPAC transactions referenced herein resulted in the SPAC shareholders (including PIPE investors) owning a minority interest in the resulting companies. The third point (access to public equity markets) is a feature of every SPAC, although there are examples where massive redemptions have resulted in the company effectively closing into a private transaction.
Forward Purchase Agreement

In a number of recent SPAC IPOs, affiliates of the sponsor or institutional investors have entered into a forward purchase agreement with the SPAC, committing to purchase equity (stock or units) in connection with the De-SPAC transaction to the extent the additional funds are necessary to complete the transaction. In cases where the forward purchase commitment comes from a private equity fund or other investor with a limited investment mandate, it may be appropriate to condition the obligation of the investor on the De-SPAC transaction satisfying the investment mandate of the investor. In a number of examples, the forward purchase commitment has been subject to approval by the forward purchaser or has been styled expressly as an option of the forward purchaser.

Illustrative Sources and Uses of IPO and Founder Warrant Proceeds
(in Millions)

<table>
<thead>
<tr>
<th>Sources</th>
<th>Uses</th>
</tr>
</thead>
<tbody>
<tr>
<td>IPO of Units</td>
<td>Fund Trust Account</td>
</tr>
<tr>
<td></td>
<td>$500</td>
</tr>
<tr>
<td></td>
<td>Up-Front Underwriting Discount (2%)</td>
</tr>
<tr>
<td></td>
<td>10</td>
</tr>
<tr>
<td>Total</td>
<td>$500</td>
</tr>
<tr>
<td>Sale of Founder Warrants</td>
<td>Fund Trust Account</td>
</tr>
<tr>
<td></td>
<td>$12</td>
</tr>
<tr>
<td></td>
<td>Fund IPO Expenses</td>
</tr>
<tr>
<td></td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Fund Post-IPO Working Capital</td>
</tr>
<tr>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>$12</td>
</tr>
</tbody>
</table>

Total Sources $512
Total Uses $512
Most SPACs are formed as Delaware corporations, but several have been formed in foreign jurisdictions (most frequently the Cayman Islands, but occasionally the British Virgin Islands or the Marshall Islands). If the SPAC may reasonably pursue a target outside the United States, a foreign SPAC may allow for a more efficient post De-SPAC structure if foreign assets are acquired, or the SPAC may redomicile into the United States if domestic assets are purchased. The offshore structure will introduce other tax issues, such as passive foreign investment company issues. Corporate law of foreign jurisdictions, such as the Cayman Islands, is not as well developed as its Delaware analog, and Cayman Islands law notably does not expressly permit waiver of the corporate opportunity doctrine.

Governance and Domicile

SPACs are required to have a majority of independent board members under NYSE/NASDAQ listing requirements, subject to the same phase-in exceptions as are applicable to all newly public companies. Directors of the SPAC are selected by the sponsor at IPO, and thereafter additional directors, if necessary, are appointed by the SPAC board. In most instances, a SPAC will not hold a public election for directors until the De-SPAC transaction or thereafter, and some SPACs provide that only the founder shares vote in director elections until the De-SPAC transaction.
Typical IPO Agreements

There is a standard set of contracts and documents entered into in connection with the formation of the SPAC and the SPAC IPO. Some, like the certificate of incorporation and registration rights agreement, have analogs in traditional IPOs of operating companies, while others are unique to SPACs.

**Charter**

Every corporation has a certificate of incorporation or similar constituent document (for example, Cayman Islands corporations have a hybrid charter and bylaws document titled the “memorandum and articles of association”). SPAC charters provide for the establishment of the public shares and founder shares, including the anti-dilution adjustment to the conversion ratio for the founder shares. They also limit the ability of the SPAC to utilize funds in the trust account, (excepting certain specified uses), require the SPAC to offer to redeem the public shares, and set the minimum size for the target business in a De-SPAC transaction. SPAC charters for Delaware SPACs typically waive the corporate opportunity doctrine as applied to the SPAC’s officers and directors.

**Securities Subscription Agreement**

The sponsor and the SPAC enter into a securities subscription agreement providing for the issuance to the sponsor of the founder shares for $25,000. The number of founder shares is sized to be 25% of the amount of public shares initially registered on the registration statement, but will be increased or decreased through a stock split, dividend or forfeiture to size the founder shares to 25% of the number of public shares ultimately sold.

**Warrant Agreement**

The SPAC and the transfer agent will enter into a warrant agreement that specifies the terms of the warrants. The warrant agreement also contains an obligation for the SPAC to register the issuance of public shares upon exercise of the public warrants. The warrant agreement provides that the terms of the public warrants generally can be amended with the approval of holders of 50% of the public warrants.

**Promissory Note**

All organizational and offering expenses are paid by the SPAC from proceeds of the IPO and sale of the founder shares and founder warrants. These expenses include the (modest) legal fees and expenses, printing expenses, accounting fees, SEC/FINRA expenses, NASDAQ/NYSE fees, travel and roadshow fees, D&O insurance premiums, and other miscellaneous fees. Prior to the closing of the IPO, the SPAC does not have sufficient cash to pay such fees, so the sponsor typically enters into a promissory note with the SPAC to loan funds to the SPAC until completion of the SPAC’s IPO. The promissory note covers any organizational or offering expenses until the SPAC can repay the loan from the proceeds of the IPO and sale of the founder warrants at the closing of the IPO.

**Sponsor Constituent Documents**

The sponsor is often a new limited liability company formed solely for the purpose of sponsoring the SPAC. The owners of the sponsor (e.g., a private equity fund and the independent management team of the SPAC) may document their relationship and relative participation in the SPAC, such as the relative amount of the founder warrant purchase price each will fund, and economic ownership of the founder warrants and founder shares in the constituent documents.
Letter Agreement
The SPAC enters into a letter agreement with its officers, directors and sponsor. The letter agreement may include, among other things, a voting agreement obligating the officers, directors and sponsor to vote their founder shares and public shares, if any, in favor of the De-SPAC transaction and certain other matters, a lock-up agreement, an agreement from the sponsor to indemnify the SPAC for certain claims that may be made against the trust account, an obligation to forfeit founder shares to the extent the green shoe is not exercised in full, and an agreement not to sponsor other SPACs until the SPAC enters into a definitive agreement for a De-SPAC transaction. The letter agreement also documents the agreement of the officers, directors and sponsor to waive any redemption rights that they may have with respect to their founder shares and public shares, if any, in connection with the De-SPAC transaction, an amendment to the SPAC’s charter to extend the deadline to complete the De-SPAC transaction or the failure of the SPAC to complete the De-SPAC transaction in the prescribed timeframe (although the officers, directors and sponsor are entitled to redemption and liquidation rights with respect to any public shares that they hold if the SPAC fails to complete the De-SPAC transaction within the prescribed timeframe).

Registration Rights Agreement
The SPAC enters into a registration rights agreement with the sponsor and any other holders of founder shares and founder warrants (typically the SPAC’s independent directors), giving the sponsor and such other holders broad registration rights for the founder shares, founder warrants and other equity the sponsor and such other holders own in the SPAC.

Private Placement Warrants Purchase Agreement
The SPAC and the sponsor enter into an agreement pursuant to which the sponsor purchases the founder warrants. The purchase price is funded one business day prior to the closing of the IPO and, again, one business day prior to the closing of any exercise of the green shoe.

Securities Assignment Agreement
Some sponsors compensate the independent directors of the SPAC through the sale of founder shares, at cost. For example, in several recent SPAC IPOs, the sponsor transferred founder shares to the SPAC’s independent directors. This provides compensation to the independent directors for their service, as SPAC independent directors are typically not otherwise paid for their service.

Administrative Services Agreement
The SPAC and the sponsor (or an affiliate of the sponsor) enter into an agreement pursuant to which the sponsor (or the affiliate of the sponsor) provides office space, utilities, secretarial support and administrative services to the SPAC in exchange for a monthly fee (typically $10,000 per month).

In addition to the contracts and documents described above, the SPAC also adopts bylaws in connection with its formation, which are relatively standardized among Delaware SPACs and contain customary provisions for a publicly traded Delaware corporation. The SPAC also enters into an investment management trust agreement with a trustee which governs the investment and release of the funds held in the trust account after the IPO. Finally, SPACs typically enter into agreements with their directors and officers to provide them with contractual indemnification in addition to the indemnification provided for in the charter.

To the extent that any of the SPAC’s contracts and documents do not terminate at the De-SPAC transaction by their terms, they are often amended in connection with the De-SPAC transaction. For example, the warrant agreement can be amended by a vote of the warrant holders, the registration rights agreement can be superseded by a stockholders agreement, charters and bylaws are often amended, etc.
The Acquisition Target

SPACs are required to either consummate a business combination or liquidate within a set period of time after their IPO. Stock exchange rules permit a period as long as three years, but most SPACs designate 24 months from the IPO closing as the period.7

No Identified Target at IPO

SPACs cannot identify acquisition targets prior to the closing of the IPO. If the SPAC had a specific target under consideration at the time of the IPO, detailed information regarding the target would be required to be included in the IPO registration statement, potentially including the target’s financial statements, thus delaying the IPO and rendering it similar in form and substance to a traditional IPO. The SEC often requires8 disclosure in the IPO prospectus to the effect that the SPAC does not have any specific business combination under consideration and that the SPAC has not, nor has anyone on its behalf, initiated any substantive discussions, directly or indirectly, with any business combination target.

If there is unsolicited interest from potential targets, the SPAC and its officers and directors should refuse to engage and should respond that they will not consider the potential target until after the IPO is completed.

Example Disclosure Includes the Following:

“

We have not, nor has anyone on our behalf, taken any measure, directly or indirectly, to identify or locate any suitable acquisition candidate for us, nor have we engaged or retained any agent or other representative to identify or locate any such acquisition candidate.

We have not (nor have any of our agents or affiliates) been approached by any candidates (or representatives of any candidates) with respect to a possible acquisition transaction with us.

"
Target Industry

Most SPACs will specify an industry or geographic focus for their target business or assets. However, they will not be prohibited from pursuing businesses or assets in any industry sector or geographic location.

Target Size

Under stock exchange rules, the De-SPAC transaction must be with one or more target businesses or assets that have an aggregate fair market value of at least 80% of the assets held in the trust account (excluding the deferred underwriting discount and taxes payable on the interest earned on the trust account) at the time of signing a definitive agreement for the De-SPAC transaction. As a practical matter, SPACs typically target business combination targets that are at least two to three times the size of the SPAC in order to mitigate the dilutive impact of the 20% founder shares.

There is no maximum size of transaction for the De-SPAC transaction. However, the transaction will need to be structured in a manner so that the SPAC does not become an investment company under the Investment Company Act of 1940. To this end, most SPAC IPO prospectuses contain disclosure that the SPAC “will only complete [a] business combination if the post-transaction company owns or acquires 50% or more of the outstanding voting securities of the target or otherwise is not required to register as an investment company under the Investment Company Act of 1940.” Occasionally, readers of SPAC IPO prospectuses interpret this as a maximum size for a target business of two times the size of the SPAC. This is inaccurate. The Investment Company Act restriction does not mean that the SPAC investors have to own 50% of the voting stock of the surviving company, as the Investment Company Act merely requires that the public company control its operating subsidiaries (or have another means for exclusion from the Investment Company Act), and is indifferent to how much of the public company the owners of the SPAC comprise. In addition, there are a number of other exemptions that might be applicable to permit the company to be exempt from registration as an investment company.

Target Industry at IPO

January 1, 2016 — June 30, 2020

By Gross Proceeds (Billions)
As described below, the De-SPAC transaction will require a proxy statement meeting the requirements of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), or tender offer materials containing substantially the same information. Depending on the structure of the transaction or the specifics of the target shareholders, the transaction may require a Form S-4 registration statement in addition to a proxy statement. Depending on the timing of the transaction, the proxy statement or tender offer materials are required to include two or three years of audited financial statements of the target business, plus unaudited interim financial statements. The proxy and tender offer rules provide that the audited financial statements of the target business in the proxy statement or tender offer materials may be audited under the American Institute of Certified Public Accountants (“AICPA”) rules. However, the staff of the SEC has issued informal guidance, and comment letters, indicating that the SEC’s position is that the proxy statements and tender offer materials should contain financial statements audited under the Public Company Accounting Oversight Board (the “PCAOB”) rules, notwithstanding that the proxy and tender rules permit AICPA audits. The practice of the SEC appears to be to review initial submissions, and one amendment, of proxy materials with AICPA compliant audits, but thereafter to insist on PCAOB compliant audits before reviewing proxy materials further. The Super 8-K is required to have three years of audited financial statements of the target business audited in compliance with PCAOB rules. The PCAOB rules require that the auditor be registered with the PCAOB, meet qualification standards and be independent of the audited company and require a lower threshold for materiality. Most private companies either do not have audited financial statements or have financial statements audited under the AICPA rules. The necessary audit or reaudit of the target company’s financial statements is thus often a gating item for the De-SPAC transaction, and if the financial statements are not auditable, the target business is not suitable for a SPAC acquisition.

Key Takeaway

The staff of the SEC has issued informal guidance, and comment letters, indicating that the SEC’s position is that the proxy statements and tender offer materials should contain financial statements audited under the PCAOB rules, notwithstanding that the proxy and tender rules permit AICPA audits.
De-SPAC Process

Shareholder Approval

The De-SPAC process is similar to a public company merger, except that the buyer (the SPAC) is typically required to obtain shareholder approval, which must be obtained in accordance with SEC proxy rules, while the target business (usually a private company) does not require an SEC compliant proxy process.

Stock exchange rules do not always require a vote by the SPAC shareholders, but the structure of the De-SPAC transaction (e.g., if the SPAC does not survive a merger or is re-domiciling in a different jurisdiction) may require a vote, and if more than 20% of the voting stock of the SPAC is being issued in the De-SPAC transaction (to the seller of the target business, to PIPE investors or to a combination), the stock exchange rules will require a shareholder vote. This results in most De-SPAC transactions involving a public vote of the SPAC’s shareholders, which involves the filing of a proxy statement with the SEC, review and comment by the SEC, mailing of the proxy statement to the SPAC’s shareholders and holding a shareholder meeting. The proxy process often takes three or more months to complete from the date a definitive agreement for the De-SPAC transaction is signed.

Founder Vote Requirements

The sponsor and any other holders of founder shares will typically commit at the time of the IPO to vote any founder shares held by them and any public shares purchased during or after the IPO in favor of the De-SPAC transaction. As a result, at least 20% of the SPAC’s outstanding shares will be committed to vote in favor of a transaction, requiring only 37.5% of the public shares to achieve a majority vote and approve the transaction.

Redemption Offer

In connection with the De-SPAC transaction, SPACs are required to offer the holders of public shares the right to redeem their public shares for a pro rata portion of the proceeds held in the trust account, which typically results in a redemption amount equal to approximately $10.00 per public share. Under stock exchange rules, if a shareholder vote is sought, only shareholders who vote against the De-SPAC transaction are required to be offered the ability to redeem their public shares, but SPAC charter documents typically require the offer to be made to all holders. The redemption offer does not apply to the public warrants — they remain outstanding regardless of whether the originally associated public share is redeemed or not, until they are exercised or otherwise cancelled or exchanged pursuant to their terms or a vote. In addition, if the SPAC hits the outside date for consummating the De-SPAC transaction or seeks to amend its charter documents to permit an extended period to consummate the De-SPAC transaction, it will be required to redeem the public shares (or offer to redeem, in the case of a charter amendment) for their pro rata portion of the amount held in the trust account. Effectively, if the De-SPAC transaction never occurs, the public shareholders get their money back and the public warrants, founder shares and founder warrants expire without value.
In the rare event that a SPAC shareholder vote is not required, the SPAC will be required under its charter documents to conduct a tender offer to redeem the public shares and to file tender offer materials containing substantially the same information as would be required in a proxy statement. Even if a shareholder vote is not legally required, the SPAC could elect to put the De-SPAC transaction to a shareholder vote for business reasons.

The sponsor and the SPAC’s officers and directors will waive redemption rights with respect to their founder shares (and any public shares they may purchase) in connection with the De-SPAC transaction or a charter amendment to permit an extended period to consummate the De-SPAC transaction, effectively agreeing to stay invested in the SPAC through the closing of the De-SPAC transaction or until liquidation.

**Super 8-K Material Disclosure**

- Description of Property
- Description of Business
- Risk Factors
- Financial Information, including:
  - Three Years of Audited Financial Statements
  - Selected Financial Data
  - MD&A
  - Quantitative and Qualitative Disclosures About Market Risk
- Director and Executive Officer Biographical Information
- Executive Compensation
- Security Ownership of 5% Owners, Directors and Executive Officers
- Transactions with Related Persons
- Material Pending Legal Proceedings
- Description of the Registrant’s Securities

**Super 8-K**

SEC rules require that SPACs file a special Form 8-K within four business days following completion of a De-SPAC transaction. This Form 8-K is known as a “Super 8-K” and must contain all the information that would be required in a Form 10 registration statement (the registration statement for companies that become public reporting companies other than through a registered IPO). Much of the information in the Super 8-K will already have been included in the SPAC’s proxy statement or tender offer materials for the De-SPAC transaction, but the Super 8-K may require additional financial statement information for the target business.
SPACs and target companies considering De-SPAC transactions face an involved process. A De-SPAC transaction combines elements of a public company merger with considerations not generally applicable to transactions between operating companies and strategic or private equity buyers. These special considerations include limited recourse to the SPAC’s IPO proceeds if the transaction does not close, the requirement for the SPAC to make redemption offers to its public shareholders and the SPAC’s outside date. However, from the operating company’s point of view, merging with a SPAC may be an attractive alternative to an IPO due to market conditions, the amount of cash consideration offered relative to cash proceeds from an IPO, and speed of execution. From the SPAC’s point of view, a De-SPAC transaction is its raison d’être, so the complexities and considerations are what they are, but some De-SPAC transactions are simpler and more easily closed than others.

Each SPAC and target will present unique considerations for the De-SPAC transaction. Not every SPAC is a suitable acquisition candidate for every target and vice versa. Key issues for SPACs and targets participating in a De-SPAC transaction include obtaining the financial statements necessary for SEC filings, addressing the financing of the transaction, increasing transaction certainty, and evaluating and negotiating post-closing equity and governance structures. Due to the requirement of the shareholder vote and redemption offer, as well as the typical need for substantial third-party capital, both SPACs and target companies should be prepared for the potential renegotiation of the merger consideration or terms and ownership of the founder shares and warrants.

Between January 1, 2017 and December 31, 2019, 47 De-SPAC transactions have closed for SPACs that had IPO proceeds in excess of $100 million (an aggregate value of roughly $15.5 billion), with an aggregate consideration paid, excluding earn-outs and value of warrants, of approximately $38 billion. In this section, references to the “recent De-SPAC transactions” are to those 47 completed De-SPAC transactions.

**SPAC Size and Transaction Value**

While there is no maximum size of a target company, there is a minimum size (roughly 80% of the funds in the SPAC trust account), so a relatively small company would not be a suitable acquisition candidate for a relatively large SPAC unless combined with another sizable target. Occasionally, SPACs acquire multiple small targets simultaneously, where the individual targets are not sufficiently large to justify a bilateral transaction. SPACs typically seek to combine with target companies that have a value of two to four times the amount of their IPO proceeds in order to reduce the dilutive impact of the founder shares and warrants. Of the recent De-SPAC transactions, the average post De-SPAC equity capitalization (excluding earn-outs) has been approximately 2.9 times the size of the post-IPO SPAC capitalization.
<table>
<thead>
<tr>
<th>Event Description</th>
<th>Days</th>
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<tbody>
<tr>
<td>Identify and Screen Potential Targets; Conduct Initial Diligence; Negotiate LOI</td>
<td>414</td>
</tr>
<tr>
<td>Execute LOI</td>
<td></td>
</tr>
<tr>
<td>Negotiate M&amp;A Agreements</td>
<td>43</td>
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<tr>
<td>Negotiate with Capital Sources (e.g., Wall Cross PIPE Process)</td>
<td>29</td>
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<tr>
<td>Execute M&amp;A and Financing Agreements</td>
<td></td>
</tr>
<tr>
<td>Announce Transaction (Press Release/Investor Calls)</td>
<td></td>
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<tr>
<td>Prepare Proxy/S-4</td>
<td>51</td>
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<tr>
<td>HSR Filing</td>
<td></td>
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<tr>
<td>File Proxy/S-4</td>
<td></td>
</tr>
<tr>
<td>SEC Review; Amend Proxy/S-4 in Response to SEC Comments</td>
<td>77</td>
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<tr>
<td>Analyst Day/Investor Roadshow</td>
<td>15</td>
</tr>
<tr>
<td>Clear SEC Comments; SEC Declares S-4 Effective (if Applicable)</td>
<td></td>
</tr>
<tr>
<td>Proxy is Mailed to SPAC Shareholders</td>
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<tr>
<td>Proxy Solicitation Period</td>
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<td>Redemption Decisions Due</td>
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<tr>
<td>SPAC Shareholder Vote</td>
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<tr>
<td>Closing of Merger and PIPE</td>
<td></td>
</tr>
<tr>
<td>SPAC Files Super 8-K</td>
<td></td>
</tr>
</tbody>
</table>

Typical Range: ~7-40 Months
Outside Date

As discussed, each SPAC has an outside date by which time it is required (by its charter) to either consummate a De-SPAC transaction or liquidate. The outside date for each SPAC is different and is generally based on the SPAC’s IPO date. However, some SPACs include contingent extension provisions that can lengthen the SPAC’s life upon the occurrence of certain triggering events, such as the signing of a definitive purchase agreement or letter of intent or the contribution of additional funds into the trust account by the sponsor.

Of the recent De-SPAC transactions, the average time from signing of the definitive agreements for the De-SPAC transaction to closing of the transaction was approximately 4.5 months. Accordingly, a SPAC that has a short duration until its outside date often needs to amend its charter (which must be accompanied by a redemption offer to its public shareholders) to extend its outside date to provide the necessary time to close the De-SPAC transaction.

Of the recent De-SPAC transactions, the duration from IPO closing to signing and announcement of the De-SPAC transaction ranged from approximately 3.5 months to almost 35 months, with an average of approximately 15.5 months. Generally, the De-SPAC transactions that have the shortest duration from signing to closing are those where the proxy statements are filed shortly after signing the business combination agreement. Approximately one third of the recent De-SPAC transactions closed past the SPAC’s original outside date, requiring a shareholder vote to extend the date. One SPAC had a contingent extension feature permitting it to close the De-SPAC transaction past the original outside date without a charter amendment. Where an extension of the outside date is required, the extension vote is typically held within a few days of the original outside date and the SPAC must offer to redeem the public shares. Of the recent De-SPAC transactions completed after an extension and redemption offer, redemptions in connection with the extension averaged approximately 40% and ranged from a de minimis number to 100% of the public shares.

Where a SPAC has a business combination announced at the time of the extension vote, the SPAC can often obtain an extension without providing any incremental value to public shareholders. However, where the SPAC does not have a business combination announced, the SPAC will often provide for additional cash to be contributed to the trust account (for example $0.033 per non-redeemed share per month) to provide an economic incentive for shareholders not to redeem. These funds are most commonly provided by the sponsor.

Capital Structure and Contractual Arrangements

The specifics of a SPAC’s post De-SPAC capital structure and contractual arrangements will be important to the SPAC’s sponsor, management, financing sources (including the public shareholders) and, if the sellers will receive equity consideration in the SPAC, the target company shareholders. The dilutive effect of the founder shares, particularly as applicable to a backstop or PIPE investment, should be understood and may need to be modified. In some recent transactions, the seller, PIPE investors, backstop investors, or debt financing sources received a portion of the founder shares or founder warrants. Where the dilutive effect of the founder shares is too large, the sponsor can forfeit a portion of the founder shares or relinquish them subject to specified earn-in rights.

30 of the 47 recent De-SPAC transactions had founder shares forfeited, made subject to forfeiture or vesting, forfeited with conditional re-issuance or transferred to PIPE or debt investors. Of the 30 transactions with forfeiture, vesting, etc., on average 37% of the founder shares were forfeited or made subject to vesting, etc.

More than half of recent De-SPAC transactions involved forfeiture or conditional forfeiture of founder shares; of these, 37% of the founder shares were forfeited, conditionally forfeited or transferred to other investors.
The above charts reflect an illustrative average of the adjustments in the 47 recent De-SPAC transactions, normalized to assume a hypothetical $500 million IPO. Post-IPO, the public owns 50 million shares in the SPAC and the sponsor owns 12.5 million shares, for the standard 80%/20% split. On average, the sponsor forfeited 3.6 million shares (27% of its 12.5 million) and the public redeemed 26.7 million shares (53% of their 50 million), inclusive of redemptions in connection with extension and redemption offers. On average, SPACs issued an incremental 23.8 million shares of common stock (or convertible preferred equity) in a PIPE to fund cash consideration and the seller received 91.5 million shares of common stock as stock consideration.
Available Capital

One of the most important considerations or constraints applicable to participants in the De-SPAC transaction is availability of capital. All of the SPAC’s IPO proceeds will generally be unavailable for the SPAC to pay deposits, break-up fees, expense reimbursements, etc., because the proceeds will be held in the SPAC’s trust account. In certain circumstances the SPAC may have a small amount of cash on hand after its IPO or interest income it can withdraw from the trust account, but this amount will often be insufficient for the SPAC to pay its own expenses, let alone the expenses of the target company or a deposit, commitment fee or break-up fee.

A key differentiator among SPACs is whether the SPAC has an affiliate or third party willing to commit to backstop redemptions and purchase additional equity to the extent necessary to fund the cash necessary for the De-SPAC transaction. These parties may also be willing to enter into alternative purchase agreements with the target company, commit to purchase SPAC common stock on the market (and agree not to redeem such shares), fund transaction fees and expenses, and provide capital for termination fees if the De-SPAC transaction does not receive the necessary approvals or is otherwise not consummated.

Of the 47 recent De-SPAC transactions, 38 were funded with common equity only PIPEs, six had common and preferred equity PIPEs, and one had a preferred equity only PIPE. The amount of cash raised in these 38 transactions ranged from roughly 3% of the IPO size to 358% of the IPO size.

Resulting Form and Domicile

All SPACs to date have been structured as corporations, whether domiciled in Delaware, the Cayman Islands, or another jurisdiction, and all SPACs have been subject to U.S. federal income tax. The choice of post-IPO jurisdiction is driven by a strategic decision of where the ultimate target business may reside, balanced with certain tax considerations.

As a general rule, U.S. domiciled SPACs will face inversion issues in transitioning to a foreign domicile in the De-SPAC transaction, and all SPACs will be practically prohibited from converting from corporate to pass-through taxation. Accordingly, the entity resulting from a De-SPAC transaction will:

- likely be a corporation for U.S. federal income tax purposes;
- likely be a U.S. domestic entity if it was a Delaware SPAC, although there are exceptions to this general rule (of the recent De-SPAC transactions, 30 were Delaware SPACs and five of these redomesticated to the Cayman Islands, The Bahamas, Jersey (the Channel Islands), the Netherlands or Luxembourg); and
- be able to domesticate into the U.S. or other jurisdictions if it was a non-U.S. SPAC (of the recent De-SPAC transactions, 17 were non-U.S. SPACs and 11 redomesticated to Delaware, Maryland or New York).

Despite being a corporation for U.S. federal income tax purposes, the resulting entity could use the Up-C structure to permit pass-through tax treatment for the owners of the target business and other participants.
Did you know you can get more information by visiting the following pages?

**SPACs**
velaw.com/practices/special-purpose-acquisition-companies/

**IPOs & Equity Offerings**
velaw.com/What-We-Do/IPOs---Equity-Offerings/

**Mergers & Acquisitions**
velaw.com/What-We-Do/Mergers---Acquisitions/

**Private Equity**
velaw.com/What-We-Do/Private-Equity/
SPAC Regulatory Treatment and Transition from Shell Company Status

SPACs, as registrants with assets consisting solely of cash and cash equivalents, are “shell companies” under the Securities Act of 1933, as amended (the “Securities Act”), and forms and regulations thereunder. SEC regulations prohibit or limit the use by shell companies (SPACs) and former shell companies (former SPACs) of a number of exemptions, safe harbors and forms that are available for other registrants. Some of these restrictions were adopted by the SEC in 2005 in response to the perceived use of certain shell companies as vehicles to commit fraud and abuse the SEC’s regulatory processes. The restrictions apply to SPACs and former SPACs for varying periods depending on the specific rule.

For example, a former SPAC is not eligible to register offerings of securities pursuant to employee benefit plans on Form S-8 until at least 60 days after it has filed a Super 8-K.

In addition, stockholders of former SPACs are required to hold their equity for a period of twelve months, measured from the date of the filing of the Super 8-K, before they can rely on Rule 144 under the Securities Act, and the current public information requirements of Rule 144 in perpetuity.

Further, SPACs and former SPACs (i) are not eligible to be well-known seasoned issuers or to use Free Writing Prospectuses (other than those limited to a description of the offering or the securities) until at least three years after the De-SPAC transaction and (ii) are limited in their ability to incorporate by reference information into long-form registration statements on Form S-1. In addition to special treatment under SEC regulations, the SEC has also adopted several positions applicable to former SPACs, including a position that former SPACs are not eligible to use Form S-3 until twelve full calendar months from the filing of the Super 8-K.
NYSE and NASDAQ listing requirements would permit an amount less than 100% of the gross IPO proceeds to be funded into the trust account, but market practice is to fund 100% or more so that, when the SPAC liquidates or conducts redemption offers, the public shareholders should receive at least $10.00 for each public share purchased.

Other investments raise Investment Company Act of 1940 considerations for the SPAC during the period before it completes its De-SPAC transaction, as well as risk issues around whether the trust account will have sufficient cash to return $10.00 per public share to public shareholders on a redemption or liquidation.

Occasionally, the unit includes a whole warrant to purchase a fraction of a share of common stock, rather than a fraction of a warrant. The difference is largely mechanical, impacting how the warrants trade and are exercised.

Although the shares issued upon conversion of the founder shares are of the same class as the public shares, their resale would need to be registered under the Securities Act or eligible for an exemption from the registration requirements.

Essentially, the crescent term provides that if the SPAC issues additional shares of common stock or other equity-linked securities for capital raising purposes (i.e., in a PIPE) in connection with its business combination and the price of those securities is below a specified threshold (generally, $9.20 or $9.50 per share), then the strike price for the warrants will be adjusted to 115% of the higher of (i) the market value or (ii) the price of the newly issued securities. In addition to the threshold requirement above, certain of the SPACs that included a crescent term also require that the gross proceeds of any such additional issuances exceed 60% of the IPO proceeds held in the SPAC trust account (plus interest and net of redemptions) for the strike price of the public warrants to be adjusted.

As discussed above, some SPAC IPO units include a whole warrant to purchase a fraction of a share of common stock, rather than a fraction of a warrant.

Some SPACs have shorter periods to consummate the De-SPAC transaction, with examples as short as 12 months, or more frequently 18 or 21 months. Many contain features to automatically extend the period if a definitive agreement or letter of intent is signed by the end of the specified period or upon contribution of additional capital into the trust account by the sponsor.
Prior results do not guarantee a similar outcome.

8 For example, “Please expand [your] disclosure, if accurate, to affirmatively confirm that no agent or representative of the registrant has taken any measure, direct or indirect, to locate a target business at any time, past or present. If any party, affiliated or unaffiliated with the registrant, has approached you with a possible candidate or candidates, then so disclose or advise the staff. Please note that, in particular, we are not seeking simply whether a potential business combination candidate has been “selected” but, rather, are looking more to the type, nature and results to date of any and all diligence, discussions, negotiations and/or other similar activities undertaken, whether directly by the registrant or an affiliate thereof, or by an unrelated third party, with respect to a business combination transaction involving the registrant. We may have further comment.”

9 The proxy rules provide that target business financial statements must be audited for the most recent year “only to the extent practicable,” and earlier years need not be audited if they were not previously audited. However, the SEC staff’s position is that De-SPAC transactions require audited financials for all years.

10 SPACs are often described as “blank check companies.” Even the SEC occasionally refers to them as blank check companies rather than shell companies. However, under applicable definitions contained in the Securities Act rules, SPACs are not blank check companies because SPACs have charter restrictions prohibiting them from being “penny stock” issuers (the term “penny stock” generally refers to a security issued by a very small company that trades at less than $5 per share). This difference means that SPAC equity may trade on an exchange prior to the SPAC’s business combination, brokers are not subject to heightened requirements on trades in SPAC securities, SPACs have a longer time period to complete their business combinations and SPACs are not prohibited under SEC rules from using interest earned on the trust account prior to the business combination.

11 In addition, as a technical matter, former SPACs may not use the “Baby Shelf Rule” (which permits registrants with a public float of less than $75 million to use short-form registration statements on Form S-3 for primary offerings of their shares) for twelve months after the Super 8-K filing. However, the SEC Staff’s position that former SPACs are not eligible to use Form S-3 until twelve full calendar months from the filing of the Super 8-K renders this technicality moot.
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