SPACs: Frequently Asked Questions

01.20.2021 | ATTORNEY PUBLICATIONS

Among other things, 2020 will be remembered as a year that saw a boom in the use of Special Purpose Acquisition Companies (SPACs) as a robust alternative to an initial public offering (IPO). A SPAC is a company formed to raise capital in a public offering, with the offering proceeds serving as a blind pool of funds held in trust to finance the acquisition of one or several unidentified targets. As SPAC IPOs have surged in 2020, many companies and investors are evaluating transactions with SPACs--referred to as “de-SPAC” transactions—as an alternative to traditional IPO or merger & acquisition (M&A) liquidity events. A de-SPAC transaction consists of a merger between a private operating company and a publicly traded SPAC, with the shareholders of the private company receiving shares of the SPAC and/or cash as consideration. The result is that the private company becomes a public company, with a shareholder base comprised of the rollover shareholders, the SPAC sponsor, the SPAC’s public investors, and any private investors that participate in the deal through private investment in public equity (PIPE).

We share here the answers to key questions about SPACs, with an emphasis on important considerations for target companies and their investors.

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PART I: UNDERSTANDING THE BASICS OF SPACS

1. WHO ARE SPAC SPONSORS?

Most SPACs are formed by institutional investors—such as hedge funds, private equity firms or venture capital firms—and executives with prior experience in the capital markets and industries that the SPAC has targeted. Many SPAC sponsors are serial players, launching multiple SPAC IPOs.

2. WHAT MAKES A SPAC ATTRACTIVE TO INVESTORS?

In order to raise a blind pool fund for acquisitions, a SPAC’s sponsors must successfully complete their SPAC IPO. An investment in a SPAC IPO is often attractive to investors because it can offer the upside of investing in a high-growth target company with downside protection since shares sold in the IPO may be redeemed at the time of the de-SPAC closing if the investor does not like the deal. A SPAC IPO is marketed based on a combination of the experience, credibility and track record of the sponsor, the investment thesis presented in the IPO prospectus, and the terms of the offering. Generally, all SPAC IPOs are priced at $10.00 per unit, but other economic terms can vary, such as the number of fractional warrants included in each unit sold in the offering and the anti-dilution protection given to the warrants.

3. WHEN DO SPACS START LOOKING FOR TARGETS, AND HOW DO WE KNOW WHICH SPACS ARE SEARCHING?

A SPAC cannot identify a specific acquisition target, or enter into discussions with potential targets, prior to the time of its IPO. If it did, it would need to include IPO-level disclosure about the target. Instead, SPAC IPO investors invest in a blind pool. SPACs can and do describe industries, sectors, or geographic locations in which the SPAC intends to focus its search for an acquisition partner. Since SPAC IPO prospectuses are publicly available, we can help companies identify SPACs that may be looking for acquisitions in a particular industry.

4. HOW ARE SPACS CAPITALIZED?

SPACs are capitalized with three key sources: (i) equity sold to the public in the IPO, (ii) equity sold to the SPAC sponsor in private placements and (iii) equity sold to sophisticated private investors in PIPEs.

- ***Public Offering:*** SPACs are initially capitalized through an IPO of units, with each unit typically consisting of one common share and a fraction of a warrant to purchase a common share. The funds raised from the IPO are placed in a trust account and may only be used to fund (i) the future business combination transaction, (ii) redemptions of common stock required by the public stockholders, and (iii) certain other limited expenses of the SPAC.
- ***Founder Equity:*** The SPAC sponsor will typically purchase common shares in an amount equal to 20% of the shares outstanding post-IPO for a nominal amount of as low as $25,000. These shares are often referred to as the "founder shares" or the "promote." In addition, sponsors will typically purchase warrants exercisable for common shares at the same strike price as the warrants issued to the public in the IPO. The proceeds from the issuance of these "founder warrants" are used by the SPAC to fund IPO costs and expenses and represent the sponsor's "at risk capital."
- ***PIPEs:*** In addition to the proceeds raised by the SPAC in its IPO, sponsors often raise additional capital through PIPEs, which funds may account for as much as two to three times the proceeds raised through the IPO. In some SPAC IPOs, investors will enter into forward purchase agreements, committing to invest in a future PIPE raised to fund the acquisition of the eventual target company. (See FAQ 5 of this Part I: "What role do PIPEs play in SPAC transactions?")

Although a crowding of the SPAC market has encouraged some sponsors to attempt to differentiate themselves by deviating from the traditional SPAC unit or promote structure, the capitalization structure described here largely remains the blueprint for SPAC IPOs.

Illustrative SPAC Cap Table (post-SPAC IPO, before acquisition of target)[1]

HOLDER	COMMON SHARES	WARRANTS
Public	30,000,000	10,000,000[2]
Sponsor	7,500,000	6,000,000[3]
PIPE	25,000,000[4]	0[4]

40%
48%
12%
Public
Sponsor
PIPE

[1] Assumes no warrant exercises.
[2] Assumes each unit sold in the IPO includes one-third of a warrant.
[3] The sponsor purchases the founder warrants for an aggregate purchase price typically equal to 2% of the gross IPO proceeds plus approximately $2 million to cover offering expenses.
[4] Assumes a $250M PIPE in which 25,000,000 shares are sold for $10 per share, without warrant coverage.

Illustrative SPAC Cap Table (post-closing after completion of de-SPAC)[1]

HOLDER	COMMON SHARES	WARRANTS
Target Company Shareholders	100,000,000[2]	0
Public	30,000,000[3]	10,000,000[4]
Sponsor	7,500,000	6,000,000
PIPE Investors	25,000,000[5]	0

15.4%
4.6%
18.5%
61.5%
Target Company Shareholders
Public
Sponsor
PIPE

[1] Assumes no warrant exercises. Does not give effect to any equity incentive pool.
[2] Assumes 100% stock deal and $1.0 billion equity value of shares held by target company shareholders.
[3] Assumes no redemptions.
[4] Assumes each unit sold in the IPO includes one-third of a warrant.
[5] Assumes a $250M PIPE in which 25,000,000 shares are sold for $10 per share, without warrant coverage.

5. WHAT ROLE DO PIPES PLAY IN SPAC TRANSACTIONS?

As discussed above, PIPEs are used to secure committed financing in advance of signing a definitive acquisition agreement. Funds raised through PIPEs provide additional consideration for completing the de-SPAC transaction and/or replenish funds paid out to SPAC shareholders that elect to redeem their shares, and are often necessary to secure the amount of cash required to meet the minimum cash condition at closing. (See Part III FAQ 3: "What happens after the business combination agreement is signed?" for more information on the minimum cash closing condition.) In addition to providing additional financing, PIPE investors play a role in validating the valuation of the target company that is negotiated in the de-SPAC transaction, as the sponsor and

target company will often market the PIPE transaction during the period between signing a letter of intent and signing the definitive agreement, negotiating with these investors to enter into subscription agreements to invest concurrently with the signing of the de-SPAC transaction.

In situations where the sponsor needs to obtain additional PIPE investment after a de-SPAC transaction has been signed and PIPE investors are not willing to invest at the valuation agreed to in the de-SPAC transaction, the sponsor may seek to renegotiate the terms of the transaction with the target company to secure the necessary investment.

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PART II: SPAC VS. TRADITIONAL IPO

1. WHY DO COMPANIES CHOOSE TO GO PUBLIC THROUGH A SPAC RATHER THAN AN IPO?

Many SPAC acquisition targets are high-growth companies that would be considered good IPO candidates but nonetheless choose to go public through a merger with a SPAC. In many respects, a de-SPAC transaction is similar to an IPO.

Like an IPO, a de-SPAC transaction is a means to raise capital and give existing investors liquidity through the public markets and, in some deals, the cash-out of shares. In a de-SPAC transaction where the target company's shareholders roll over their equity, the shareholders receive public company stock, with both the cash remaining in the SPAC's trust account and the proceeds of any concurrent PIPEs going to the operating company's balance sheet.

One of the principal advantages of a SPAC transaction, as compared to an IPO, is speed. In general, a SPAC transaction can be completed more quickly than an IPO. Maybe more importantly, the pricing of a SPAC transaction occurs relatively early in the process at the time the business combination agreement is signed, as compared to an IPO where the pricing occurs near the end of the transaction. Locking in pricing earlier in the process has been especially attractive in 2020, amidst markets roiled with uncertainty due to COVID-19 and the U.S. presidential election. As a cautionary note, there have been plenty of instances of SPAC transactions where pricing has been adjusted after the signing of the business combination agreement, which ensures that the business combination will have enough investor support to provide sufficient proceeds for the closing. Sponsors have their own de-SPAC roadshow in which they need to sell the transaction to their investors, who are required to approve the de-SPAC transaction.

2. IS A DE-SPAC TRANSACTION CHEAPER THAN IPO?

It is sometimes said that going public through a SPAC is cheaper than an IPO. While that is probably not correct, IPOs and SPAC transactions do have different cost structures.

Going public with a SPAC saves on underwriters' fees, which are paid at a reduced rate in a SPAC and earned in installments, with a portion (typically less than half) paid by the sponsor at the closing of the IPO. The remainder is paid when the de-SPAC transaction closes. But in a SPAC transaction there will typically be investment banking fees similar to M&A deals, and there will be legal and accounting fees similar to an IPO. Perhaps most importantly, target companies must consider the dilution arising from the founder shares that the sponsor received for nominal consideration and the dilution that will occur if the public warrants and the founder warrants are exercised. In the case of the founder warrants, this will likely occur on a net exercise basis. (See Part I FAQ 4: "How are SPACs capitalized?") For this reason, many target companies negotiate with the sponsor to require the forfeiture or vesting of a portion of those founder shares as part of the de-SPAC transaction. (See Part III FAQ 2: "What are the key terms of a de-SPAC merger agreement?")

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PART III: OVERVIEW OF THE DE-SPAC TRANSACTION

1. HOW LONG DOES IT TAKE TO COMPLETE A DE-SPAC TRANSACTION?

From the time a target company signs a letter of intent to be acquired by a SPAC, the timeline to closing will likely take four to six months as outlined below:

STAGE	INDICATIVE TIME REQUIRED	KEY WORKSTREAMS
Negotiation and due diligence	4–6 weeks	• Business, financial, and legal due diligence • Negotiate business combination agreement and related documents • Secure additional financing through PIPEs or debt
Sign definitive business combination agreement		

STAGE	INDICATIVE TIME REQUIRED	KEY WORKSTREAMS
File and complete proxy/registration statement with SEC	12–24 weeks	• Draft SEC disclosure documents • Finalize target company financials • Revise SEC disclosure documents based on SEC comments • Prepare to operate as a public company (See FAQ 5 of this Part III: “What steps does a company need to take to be prepared to function as a public company?”) • Secure shareholder support through shareholder meeting or tender offer

2. WHAT ARE THE KEY TERMS OF A DE-SPAC MERGER AGREEMENT?

De-SPAC business combination transactions are often structured as mergers, effected pursuant to the terms of an agreement providing for the merger of the target company with the SPAC. Among the key terms negotiated in the merger agreement are the following:

- ***Valuation***: The valuation of the target company for purposes of calculating the merger consideration to target company shareholders is fixed in the merger agreement. Where the parties disagree on valuation, an earnout may be used to bridge the gap, allowing target company shareholders to receive additional shares if the company’s stock or operations meets certain milestones post-closing. Alternatively, or in addition, the parties may negotiate to subject a portion of the founder shares to vesting, with those shares being forfeited if milestones tied to stock price are not met.
- ***Form of Consideration:*** As noted above, in today’s market most de-SPAC transactions involve stock consideration as opposed to cash, but in some instances, at least a portion of the consideration may be in cash. Where the consideration will be stock, the target company should make sure that those shares are registered with the U.S. Securities and Exchange Commission (SEC).
- ***Recourse:*** Today, de-SPAC transactions are frequently “public-style” deals where the SPAC does not have recourse against target company shareholders post-closing. On the other hand, unlike in other M&A transactions, because the use of the IPO proceeds held in trust is limited to specified purposes, de-SPAC merger agreements typically provide very limited recourse for target companies against the SPAC itself. Reverse termination fees are not common in de-SPAC transactions.
- ***Fiduciary Out:*** Like in public mergers, the target company in a de-SPAC transaction will frequently be able to negotiate for a “fiduciary out” that will allow the target company to terminate the merger agreement, subject to payment of a termination fee, if the target company’s board of directors determines that an alternative transaction represents a superior proposal to the target company’s shareholders.
- ***Conditionality:*** De-SPAC transactions typically do not include extensive conditions to closing. However, a customary condition to the target company’s obligation to close the transaction requires the SPAC to have a minimum amount of cash available at closing. This condition is included to protect the target company from having to close a transaction in which redemptions by the SPAC’s public shareholders would result in the target company raising insufficient proceeds. SPACs will typically raise capital through PIPEs to ensure this condition will be satisfied at closing, but it may be a point of renegotiation if the PIPE proceeds are insufficient to make up the shortfall. Target companies should be prepared for this possibility of renegotiation and ensure that there is sufficient committed PIPE financing at the time of signing the business combination agreement.

3. WHAT HAPPENS AFTER THE BUSINESS COMBINATION AGREEMENT IS SIGNED?

Once the business combination agreement is signed, the SPAC and target company will work as quickly as they can to finalize and make the requisite filings with the SEC. For de-SPAC transactions where the merger consideration consists of shares of the SPAC, it is customary for the SPAC to file a registration statement on Form S-4 to register the shares issued in connection with the de-SPAC transaction and obtain the approval of its shareholders. In most cases, the SPAC solicits shareholder approval of the de-SPAC transaction through a proxy statement, which will typically be combined with the Form S-4 as a joint Form S-4 registration/proxy statement. Less frequently, the SPAC will conduct a tender offer, in lieu of shareholder approval, that gives the SPAC’s public shareholders the opportunity to tender their shares. How quickly the transaction can close will largely depend on the time it takes to get the S-4 registration/proxy statement on file with the SEC and complete SEC review of the filing.

At the same time, the SPAC will present the transaction to existing investors to ensure their support at the time of the shareholder vote and raise additional investment, if needed, to close the transaction. At the time that the SPAC shareholders have an opportunity to vote, they will have the option to redeem their shares in the SPAC. If redemptions come in at a level that would jeopardize the SPAC’s ability to complete the transaction because of a failure to satisfy the minimum cash condition, the sponsor may try to raise additional capital to replenish cash lost to redemptions, and if necessary, seek to revisit the terms of the acquisition with the target company. Once the acquisition closes, the SPAC will file a “Super 8-K,” effectively the equivalent of an

Exchange Act registration statement. Although the Super 8-K is a significant filing, the information required will mostly be the same information that was included in the S-4 registration/proxy statement or tender offer documents. It may, however, require additional financial statements for the target company.

4. WHICH FINANCIAL STATEMENTS ARE REQUIRED OF A TARGET COMPANY?

For private companies with audited financial statements, the financials are typically audited under the rules of the American Institute of Certified Public Accountants (AICPA). Although AICPA financial statements are permitted under the proxy statement and tender offer rules, the SEC has issued guidance and comment letters stating that the S-4 registration/proxy statement or tender offer materials must include two to three years of financial statements for the target company, audited in compliance with the rules of the Public Company Accounting Oversight Board (PCAOB). The Super 8-K filed after closing of the de-SPAC transaction requires three years of PCAOB compliant financials. As a result, even if the target company has audited financial statements, additional audit procedures will be required before its financial statements are ready to be filed with the SEC. Because preparation of these audited financial statements tends to be the gating item for the filing of the S-4 registration/proxy statement or tender offer materials, and thus dictates the timeline for completing the acquisition, SPACs will focus early on the target company's financial statements and audit review or readiness.

5. WHAT STEPS DOES A COMPANY NEED TO TAKE TO BE PREPARED TO FUNCTION AS A PUBLIC COMPANY?

The speed with which a de-SPAC transaction can come together means that target companies may find themselves transitioning to life as a public company more rapidly than if they undertook a traditional IPO process. A successful transition requires careful attention to a range of corporate functions, including:

- ***Accounting*****:** As discussed above, the target company should discuss in detail with its auditors the steps that should be taken to ensure that its financial statements and reporting processes are ready for the S-4 registration/proxy statement and ongoing public reporting. In addition, the target company should assess whether it has the staffing, procedures and IT systems needed to handle the demands of public reporting, including necessary internal controls and procedures and the speed and accuracy required for quarterly and annual reports.
- ***Corporate Governance:*** Adopt corporate governance policies, procedures, and practices that meet public company compliance requirements, including stock exchange rules.
- ***ESG*****:** Today more than ever, public companies are evaluated and scrutinized based on environmental, social, and governance (ESG) metrics. Target companies should assess the company's ESG practices and develop a plan for how to report and communicate these practices to the market.

6. WHAT LEVEL OF SEC REVIEW SHOULD BE ANTICIPATED?

SPACs and target companies should anticipate and prepare for a thorough SEC review of the S-4 registration/proxy statement that is similar to the review given to an IPO prospectus. Specifically, the SEC recently issued guidance regarding disclosure considerations for SPACs in connection with their IPOs and business combination transactions focused on conflicts of interest, economic interests and incentives, and compensation to the SPAC sponsors and affiliates.

7. WHEN DO A TARGET'S SHAREHOLDERS VOTE TO APPROVE THE TRANSACTION?

Although private companies generally have the ability to approve a transaction as soon as the merger agreement is signed, today target companies typically wait to hold a shareholder vote until the S-4 registration/proxy statement has gone effective. Postponing the vote until the registration statement is effective allows the target shareholders to receive registered shares and provides the target company with the flexibility during the period between signing and closing to approve an alternate transaction, should the target receive an offer that the board of directors determines to be a superior proposal. For target companies not required to pursue stockholder approval promptly following signing, the SPAC will require that the officers, directors, and, if they can, large shareholders, enter into support agreements pledging to vote their shares in favor of the transaction. These support agreements often include features that "ratchet down" the number of shares pledged in the event that the target company receives a superior proposal or the target company board changes its recommendation with respect to the SPAC transaction.

8. HOW DO PUBLIC REDEMPTIONS AFFECT CLOSING OF A SPAC?

SPAC shareholders have a right to redeem their shares in connection with the approval of a business combination, and in connection with a shareholder vote to approve an amendment to the SPAC's charter to extend the time period for the SPAC's completion of a business combination. In either case, the redemptions are funded from the SPAC trust account. As discussed above, SPACs will often raise PIPE investment in order to guard against the risk that redemptions will result in insufficient cash to close. However, in deals where closing depends on a meaningful amount of funds remaining in the SPAC trust account at closing (i.e., minimal redemptions), the shareholder redemption process is critical to the success of the deal and is often a driver for renegotiation of deal terms.

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PART IV: OWNING STOCK IN A SPAC POST DE-SPAC TRANSACTION

1. WHICH LOCK-UP RESTRICTIONS ARE TYPICALLY NEGOTIATED IN CONNECTION WITH A DE-SPAC?

As compared to the almost standard 180-day lock-up period in IPOs, the lock-up period for target company shareholders can range from 180 days to one year. Sponsors are typically subject to a one-year lock-up that may terminate early if the stock trades above a specified price for a specified period at any time after 150 days following completion of the de-SPAC transaction. The lock-up for target shareholders may be for a shorter period, to stagger the sales, or it may be for a one-year period to align the interests of the target shareholders with the those of the sponsor. In either case, the lock-up will typically be subject to the same performance exception granted to the sponsor.

2. WHICH REGISTRATION RIGHTS ARE TYPICALLY NEGOTIATED IN CONNECTION WITH A DE-SPAC?

Because SPACs are formed with no operations and only cash as an asset, a SPAC is considered a “shell company” under SEC rules. Holders of shell company shares cannot avail themselves of the resale safe harbor under Rule 144 for one year after the de-SPAC transaction is completed and the Super 8-K is filed. In addition, the SEC has recently provided guidance that SPACs will not be Form S-3-eligible for the 12 months following a business combination. For these reasons, it is critical that target shareholders receive registered shares in the de-SPAC transaction and/or broad registration rights. SPAC sponsors and PIPE investors are granted broad registration rights with respect to the founder shares and warrants and PIPE shares, respectively. Target shareholders that would be considered “affiliates” of the company should request registration rights irrespective of whether the merger consideration shares are registered.

3. WHICH CORPORATE GOVERNANCE RIGHTS ARE TYPICALLY NEGOTIATED IN CONNECTION WITH A DE-SPAC?

One of the most significant negotiations in a de-SPAC transaction will concern corporate governance rights. Among the issues to be considered will be the composition of the company’s board post-closing, including whether that board will be classified, how and by whom the various classes will be populated, and whether the company will implement a dual-class stock structure in order to give greater voting power to company founders and top executives. These control issues are key points for target company founders to consider when negotiating a de-SPAC transaction. The parties must consider the applicability of independence requirements under SEC and stock exchange rules on board composition, as well as how the agreed corporate governance structure will be viewed by the market, including institutional investors and proxy advisors, going forward.

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