**SPAC 2021 Year-End Review and 2022 Preview: Tailwinds, Headwinds, and Regulatory Landscape**
by Jeffrey Letalien, Sean M. Donahue, Jocelyn M. Arel, Morgan Mordecai

**Introduction**

The SPAC market has withstood many challenges throughout 2021, including softening of the private investment in public equity (PIPE) market for a majority of the year after a very robust first quarter for initial business combinations (de-SPAC transactions) and several adverse regulatory developments. 2021 was a record year for SPAC IPOs and the market for de-SPAC transactions also remained strong throughout the year.

Nevertheless, market and regulatory challenges continue and are expected throughout 2022. While the SPAC market remains healthy and SPACs are likely to be a major asset class for the foreseeable future, SPACs are still a relatively young product in light of their resurgence in recent years after a long post-Great Recession absence. We expect the SPAC market to remain fluid and dynamic in 2022, continuously evolving to address market and regulatory challenges.

We discuss key market trends, including changes in prevalent substantive terms of SPAC IPOs and de-SPAC transactions and regulatory, legislative and litigation challenges facing SPACs and potential target businesses during 2021 and the anticipated outlook for 2022 below.

**Market Update**

**IPOs**

The total number of SPAC IPOs reached record highs in 2021, increasing to 613 from 248 in 2020. There were 298 SPAC IPOs completed in the first quarter, declining to 60 in the second quarter, primarily as a result of the temporary slowdown resulting from the SEC staff’s April announcement of a change in interpretation of accounting requirements applicable to most SPAC warrants, as well as tightening of the PIPE market, rebounding to 89 in the third quarter and increasing further to 166 in the fourth quarter.

While the SPAC IPO market has rebounded considerably during the fourth quarter of 2021, the terms of such IPOs have developed in a manner that is considerably more favorable to IPO investors, but, in many cases, in a manner that may reduce the likelihood of a successful de-SPAC transaction.

Such changes in market terms include:

- **A sharp rise in the prevalence of “overfunded” trust accounts, particularly in the third and fourth quarters to 90% in the fourth quarter.** As a result of larger investments of “at risk” capital by SPAC sponsors, the amount of funds deposited in the trust account for the benefit of IPO investors to receive upon exercise of redemption rights in connection with the de-SPAC transaction or liquidation has increased to exceed the $10.00 per share IPO price, providing a greater incentive to public stockholders to exercise redemption rights and reducing the likelihood that the public shares will be trading above the redemption price at the time of the business combination.

- **Increased warrant coverage.** The number of shares that may be purchased by exercising warrants included in the units sold in the IPO has increased from approximately 75% with warrants exercisable for 1/3 or fewer shares per unit in the first quarter to over 90% with warrants exercisable for ½ or more shares per unit (including approximately 22% exercisable for ¾ or more shares per unit) in the fourth quarter.
• **Shorter duration of SPAC before deadline for business combination.** The deadline for completing a business combination has shortened from the previous market standard of 18-24 months to periods as short as 9 months, with over 90% of SPAC IPOs closed in the first quarter having a 24-month period compared to a majority of SPAC IPOs closed in the fourth quarter having a shorter than 18-month period.

The “overfunding” of trust accounts and the earlier deadlines for completing the initial business combination each reduce the likelihood of a successful de-SPAC transaction by increasing the likelihood of redemptions and shortening the length of time to identify a suitable target, negotiate and execute a business combination agreement, complete the SEC review process, obtain shareholder approval and close the transaction.

**Quarterly SPAC IPO Statistics**

<table>
<thead>
<tr>
<th></th>
<th>First Quarter</th>
<th>Second Quarter</th>
<th>Third Quarter</th>
<th>Fourth Quarter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of IPOs</td>
<td>298</td>
<td>60</td>
<td>89</td>
<td>166</td>
</tr>
<tr>
<td>Average total proceeds (including over-allotment exercise)</td>
<td>$329.2 million</td>
<td>$217.2 million</td>
<td>$198 million</td>
<td>$178.5 million</td>
</tr>
<tr>
<td>Warrant Coverage</td>
<td>3% with more than ½ coverage</td>
<td>10% with more than ½ coverage</td>
<td>46% with ½ coverage</td>
<td>73% with ½ coverage</td>
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<tr>
<td></td>
<td>Approximately 75% with 1/3 or lower</td>
<td>Majority with 1/3 or lower</td>
<td>19% with more than ½ coverage</td>
<td>22% with more than ½ coverage</td>
</tr>
<tr>
<td>Trust overfunding</td>
<td>Less than 5%</td>
<td>25%</td>
<td>52%</td>
<td>91%</td>
</tr>
<tr>
<td>Deadline for business combination</td>
<td>Over 90% with a 24-month term; Only 3% with shorter than 18 months</td>
<td>Shorter than 18 months – 28%</td>
<td>Shorter than 18 months – 39%</td>
<td>18 months – 43%</td>
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<td></td>
<td>18 months – 8%</td>
<td>18 months – 27%</td>
<td>18 months – 21%</td>
<td>24 months – 1%</td>
</tr>
<tr>
<td></td>
<td>24 months – 63%</td>
<td>24 months – 34%</td>
<td>24 months – 2%</td>
<td>24 months – 2%</td>
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Source: SPACInsider

*Note: Percentages may not total due to rounding.*

**De-SPAC Transactions**

The market for business combinations remains strong, with 267 de-SPAC transactions announced in 2021 and the vast majority of those transactions completed within seven months after the announcement. Only 14 of the 149 de-SPAC transactions announced during the first half of 2021 have not closed. Five of those 14 de-SPAC transactions have announced shareholder meeting dates in January 2022. Only one SPAC has liquidated in...
2021, compared to two liquidations in 2020 and five in 2019. As such, despite some reports that the SPAC market has slowed down, SPACs are still able to find acquisition targets and close their initial business combination in the current environment rather than having to liquidate. That said, we do expect to see an increase in liquidations in 2022 as SPACs that completed their IPOs in 2020 and have yet to find a merger partner approach their 24 month limit and some SPAC sponsors reconsider their SPAC strategy.

Despite the large number of SPACs competing for targets, over one-third (100 of 298) of the SPACs that completed their IPOs in the first quarter have announced business combinations during 2021. After a very robust first quarter, with 88 de-SPAC transactions announced, the volume of de-SPAC transactions decreased in the second quarter to 61 transactions and remained relatively stable thereafter, with 59 transactions announced in the third quarter and 59 announced in the fourth quarter.

The average size of de-SPAC transactions has not fluctuated significantly for most of the year, with an average pro forma equity value of $2.5 billion in the first quarter, $2.2 billion in the second quarter and $2.8 billion in the third quarter before declining to $1.4 billion in the fourth quarter.

The range of time from announcement to completion of the business combination has been consistently between three and seven months throughout 2021, with a surge in closings between June and September reflecting a consistent lag time from the surge in announcements in late 2020 and the first quarter of 2021.

**Redemptions**

One of the most significant SPAC trends of the year has been the increase in redemptions in connection with the vote to approve the initial business combination. In the first quarter, the average redemption level was below 10%, with more than 75% of the de-SPAC transactions experiencing fewer than 1% redemptions and only 12.5% having redemption levels above 50%. In the second quarter, redemption levels increased to an average of approximately 25%, with more than one-third of de-SPAC transactions experiencing fewer than 1% redemptions, but 27% having redemption levels above 50%. However, redemption levels skyrocketed in the third quarter to an average of approximately 57%, with more than 65% of the de-SPAC transactions experiencing redemption levels above 50%, including more than 14% experiencing redemption levels of 90% or more. In the fourth quarter, redemptions averaged 60%, with more than two-thirds of the de-SPAC transactions experiencing redemption levels above 50%, including more than 10% experiencing redemption levels of 90% or more.

**PIPE Financing**

Throughout most of 2021, SPACs and target businesses have encountered a number of challenges in announcing and completing de-SPAC transactions. In light of the trend towards increased redemptions described above, financing sources other than the funds held in the trust account are now more important than ever. A tightening of the market for investments in a private placement by institutional investors in equity financing announced concurrently with the execution of the business combination agreement beginning late in the first quarter of 2021 and continuing throughout the year has created more difficult conditions for executing de-SPAC transactions.

The tightening of the PIPE market is demonstrated by the lower size of the PIPE transactions relative to the amount of funds held in trust and the increased prevalence of convertible or other debt securities and warrants in recent transactions compared to the beginning of the year. A significant minority of recent de-SPAC transactions have not included PIPE financing committed as of the announcement date. Based upon our review of SPAC 8-K filings, in January 2021, each announced deal included PIPE financing, with average PIPE proceeds of approximately 113% of the amount held in trust, including approximately 44% with a PIPE larger than the trust account. Only one of such deals included securities other than common equity – approximately
20% of such PIPE was financed with convertible debt securities, with the remaining 80% financed through the issuance of common equity. Conversely, in December 2021, the average PIPE proceeds had declined to approximately 47%, with less than 10% of transactions raising proceeds in excess of the amount held in the trust account, while approximately 16% of de-SPAC transactions did not include any PIPE financing and, of those transactions with PIPE financing, 28% included convertible or other debt securities and/or warrants.

The trend towards the inclusion of convertible securities in lieu of common equity in the PIPE financing may create serious adverse consequences for de-SPAC companies. In order for convertible securities to not be deemed to be of the same class as the listed common equity for purposes of eligibility under Rule 144A(d)(3)(i), the convertible securities must have an effective conversion premium of at least 10%. In addition, under Nasdaq and NYSE listing and shareholder approval requirements, the conversion price must have a floor to ensure that the number of shares issuable upon conversion is not unlimited. As a result, the anti-dilution provisions in the convertible securities should be narrowly drafted to ensure the effective conversion premium is at least 10%. Of course, this conflicts with the preference of PIPE investors for price protection of their investment through the inclusion of “full ratchet” or “down round” protection provided by a conversion price adjustment if securities are subsequently issued at a lower price.

**Backstop Arrangements**

Another form of deal protection – ensuring the availability of adequate cash if there are substantial redemptions and the proceeds of the PIPE financing provide insufficient liquidity to the surviving company – can be provided through a backstop arrangement with the SPAC sponsor or a third-party investor. The backstop investor typically receives cash or equity compensation for its backstop commitment in the form of a cash fee equal to a percentage of the backstop commitment (regardless of whether such commitment is drawn upon to be funded) or equity. Equity compensation typically consists of a transfer of shares otherwise to be owned by the SPAC sponsor or the sellers of the target business in the business combination to the backstop investor, particularly if the backstop investor is a third-party rather than the sponsor and otherwise lacks any incentive to provide economic support to the transaction. Such transfer may occur directly through a transfer of shares of the surviving company or indirectly through an allocation of interests in the SPAC sponsor.

The frequency of backstop arrangements is largely unchanged since the beginning of 2021. In January 2021, 25% of the announced de-SPAC transactions included backstop or similar financing as of the deal announcement, though 75% of such financing had been pre-arranged through a forward purchase agreement entered into in connection with the IPO. In December 2021, approximately 16% of the announced de-SPAC transactions included backstop or similar financing, but with new arrangements becoming more common than pre-existing forward purchase agreements, including backstop agreements, structured products and non-redemption agreements.

**Sponsor Equity Vesting, Lock-Ups and Forfeiture**

In addition to transfers of sponsor equity discussed above in the context of backstop commitments, increased redemptions have put pressure on SPAC sponsor economics. In January 2021, half of the de-SPAC transactions announced that month included forfeitures of sponsor equity, increasing to approximately 57% in December 2021. In January 2021, 25% of the newly announced de-SPAC transactions included unconditional sponsor equity forfeitures, with only 6% including forfeitures tied to redemption levels and 19% including forfeitures tied to the achievement of trading price earnout conditions. In December 2021, 20% of the newly announced de-SPAC transactions included unconditional sponsor equity forfeitures, with several of such transactions also including forfeitures tied to redemption levels or trading price earnout conditions. An additional 13% of such transactions provided for forfeitures if redemptions exceeded certain levels, either directly tied to redemption levels or indirectly by tying the forfeitures to the amount of available cash at closing,
the primary variable input for which is the level of redemptions. More than one-third of such transactions contained forfeitures tied to trading price earnout conditions (23% only provided for forfeitures tied to such conditions; 10% also provided for unconditional sponsor equity forfeitures and/or forfeitures tied to redemption levels).

The typical lock-up period for founder shares has also increased slightly. In January 2021, half of the newly announced de-SPAC transactions included lock-up periods of less than one year (most commonly 180 days), with the other half including lock-up periods of one year, but subject to early release if trading price conditions were satisfied. In December 2021, the percentage with lock-up periods of one year with such early release provisions increased to 63%.

**Legislative and Regulatory Scrutiny**

**Legislative Proposals**

The booming SPAC market has also attracted attention from Congress and the SEC. Many of the legislative proposals introduced in Congress, as well as SEC rulemaking and policy statements, reflect a perception that SPACs enjoy preferential treatment under the securities laws compared to traditional IPOs or present risks of abuse impacting retail investors.

To legislative proposals, H.R. 5910 and H.R. 5913, have passed the House Committee on Financial Services on party-line votes and await action by the full U.S. House of Representatives.

H.R. 5910 is aimed at eliminating the disparity of forward-looking information provided by issuers in a traditional IPO, where forward-looking information is discouraged because of potential liability to issuers if such information is later determined to be inaccurate, and in a de-SPAC transaction, where such information, including financial projections, is a central part of the de-SPAC process. As with any public company M&A process, the target business provides financial projections for use by the SPAC’s board and, in many cases, its advisors who may provide a fairness analysis and opinion. In addition, such projections are usually included in the investor presentation provided to PIPE investors. While such information is not provided to public investors for their reliance, under the proxy rules such information is required to be presented in the proxy statement in the disclosure regarding the SPAC board’s process in evaluating the transaction and, if applicable, in the disclosure regarding the fairness opinion provider’s analysis supporting its opinion. Under the Private Securities Litigation Reform Act of 1995, forward-looking information contained in a proxy statement for an M&A transaction is eligible for a safe harbor from liability for misstatements. However, statements contained in a registration statement for a traditional IPO are not eligible for such safe harbor. Accordingly, on a plain reading of the applicable securities laws, projections in the proxy statement for a de-SPAC transaction would be protected by the safe harbor, creating a disparity of information between a de-SPAC transaction and a traditional IPO. Several high-ranking SEC officials, including Chairman Gary Gensler and various senior SEC staff members, have made public statements challenging such interpretation, contending that a more principles-based approach to the interpretation, viewing the de-SPAC transaction as effectively the target company’s IPO, should apply. H.R. 5910 would disallow the safe harbor from being available in a de-SPAC transaction. Regardless of the merits of the proposal, its likely effect would be to reduce the information about the target business available to investors.

H.R. 5913 is a potentially more radical proposal, seeking to prohibit retail investor participation in SPAC IPOs unless certain requirements are satisfied. A universally accepted principle of securities regulation since the creation of the SEC in the 1930’s has been that investments should be open to all investors, regardless of financial means or sophistication, as long as adequate disclosure is provided. Under H.R. 5913, unless certain disclosures are provided, the requirements for which are delegated under the legislation to the SEC to
determine, retail investors (investors other than high net worth investors qualifying as accredited investors) would be effectively prohibited (through regulation of the ability of broker dealers to recommend or facilitate transactions for their customers' accounts) from purchasing shares of any SPAC for which the sponsor’s founder shares constitute greater than a 5% stake. As market practice is for the founder shares to constitute 20% of the post-IPO economics, H.R. 5913 would seek to cap the sponsor’s economic ownership at only a quarter of current market levels. Among other things, H.R. 5913 fails to consider that the sponsor’s ownership of founder shares is frequently renegotiated through the de-SPAC transaction process. Adoption of H.R. 5913 would severely limit the ability of the parties to a de-SPAC transaction to use the founder shares as currency in their negotiations with each other, PIPE investors or providers of backstop financing.

Finally, legislation introduced in both the House and Senate would impose a 1% surtax on companies that buy back their own shares. While such legislation may be intended to apply to companies that voluntarily decide to conduct share buybacks, as drafted, such legislation would apply to companies that conduct redemptions of their outstanding shares as a result of requirements in the terms thereof or contractual requirements. We believe that such a tax would have a material adverse effect on the ability of SPACs to satisfy redemptions.

Regulatory Statements and Proposals

On December 9, 2021, Chairman Gensler reiterated his belief and the belief of other high-ranking SEC officials that increased disclosure requirements relating to conflicts of interest in SPAC transactions are needed, as well as concerns about the de-SPAC marketing process and lack of traditional “gatekeepers” in the de-SPAC process compared to a traditional IPO process.

The SEC has indicated that the development of SPAC regulatory proposals are on its agenda for 2022. Based upon Chairman Gensler’s public remarks, we expect that these proposals will take aim at asymmetries between de-SPAC transactions and traditional IPOs. Although registration statements for SPAC IPOs, as well as proxy statements for de-SPAC transactions, already contain extensive disclosures of the sponsor’s conflicts of interest, including that their investment will be worthless if no transaction is completed and quantifying the value of their investment if the transaction is completed, we expect that the SEC will propose additional specific disclosure requirements.

Other proposals are likely to restrict the ability of SPACs and target companies to market the de-SPAC transaction to PIPE investors through the use of an investor presentation that is quite similar to an IPO roadshow presentation. Current SPAC market practice involves “wall crossing” PIPE investors through a process in which institutional investors receive limited information about the transaction and the target company, subject to an obligation of the SPAC to “cleanse” such investors by making such information public once the transaction is announced in order to enable the investors to trade without possession of material non-public information. Gensler has expressed concern that the publication of the investor presentation upon announcement of the de-SPAC transaction has provided the market with incomplete information upon which secondary trading occurs. If the SEC prohibits the publication of the investor presentation, the SPAC market will likely be presented with two unpalatable alternatives – invest the time, money and other resources in preparing and completing a proxy statement for filing concurrently with announcement of the de-SPAC transaction, which would require a substantial investment before any significant level of deal certainty has been obtained, or require PIPE investors to be locked up from trading for a significant interval between announcement of the de-SPAC transaction and filing of a preliminary proxy statement.

Additionally, the SEC focus on “gatekeepers” is likely to involve increased scrutiny of the placement agents who assist the SPAC and target company in raising capital from PIPE investors. Unlike in a traditional IPO where the issuer markets, offers and sells shares through an investment bank serving as an underwriter with liability for misstatements in the registration statement for the IPO and with due diligence responsibilities, there
is no intermediary between the SPAC and its shareholders who decide whether or not to vote to approve the transaction and/or whether to exercise redemption rights. The SEC may seek to impose obligations on the placement agents to fulfill this role. The PIPE market has already shifted somewhat throughout 2021 in response to SEC staff statements in this regard, including with the increased frequency of risk factor disclosure in the PIPE investor presentation.

Non-U.S. Market Developments

While U.S. elected officials and appointed regulators take aim at the SPAC market, seeking to curb what many view as an excessively active market with a high risk of potentially fraudulent activity, many markets with which the U.S. capital markets compete are opening up to SPAC listings.

Most recently, in December, the Hong Kong Exchanges & Clearing Limited announced that it would welcome SPACs for listing, as long as certain minimum listing requirements, including financial criteria and board expertise, are satisfied. In addition, unlike in the U.S., such investments would only be open to institutional investors. Hong Kong joins Singapore, which welcomed SPACs for listing in September, as well as the United Kingdom.

Litigation and SEC Investigations

De-SPAC transactions continue to attract litigation, including disclosure claims typical in non-SPAC M&A transactions based upon alleged omissions in the proxy statement.

SEC Investigations

The most high profile cases early this year involved blatant misstatements and a lack of due diligence. In July, the SEC settled an administrative action titled In the Matter of Momentus Inc. against a SPAC, its sponsor the target and the target’s CEO for monetary and other damages, for misstatements. The target falsely claimed that it had successfully tested its rocket propulsion technology in space, when it had actually failed. The SPAC was liable for repeating the misleading claims and for failing to conduct due diligence to verify such claims. Such issues are neither endemic nor unique to the de-SPAC structure, but demonstrate the lack of a gatekeeper performing adequate due diligence. From July through October, the SEC also obtained settlements with other SPACs, targets and executives relating to misstatements inflating the success of the target business, including electric vehicle manufacturer Nikola, with the December 2021 Nikola settlement being the SEC’s largest SPAC settlement yet, in the amount of $125 million.

Electric vehicle manufacturer Lucid Motors is one of the most recent high profile targets of SEC action, following the initial actions against Nikola, as well as Lordstown Motors and Canoo. Lucid Motors completed its de-SPAC transaction with Churchill Capital Corp IV in July, with an estimated transaction value in the top five transactions completed in 2021. On December 6, Lucid Motors’ parent company, Lucid Group, announced receipt of a subpoena believed to be related to an SEC investigation into the de-SPAC transaction and certain projections and statements.

Federal Securities Class Actions
There was also a significant increase in de-SPAC-related securities class action lawsuits in 2021. With thirty-one lawsuits filed, these cases represent approximately 15% of all securities class action lawsuits filed in 2021. These lawsuits share many common features. Most involve claims under Section 10(b) and Rule 10b-5 of the Exchange Act, which prohibit intentional or reckless material misstatements or omissions in connection with the purchase or sale of a security. Many of the public companies targeted with these lawsuits were either the subject of short-seller reports or stumbled out of the gate as public companies with their post-business combination financial reports, and/or fell short of the financial projections disclosed in pre-business combination SEC filings. Many of these cases also include former directors and officers of the SPAC as named defendants as well as the post-de-SPAC companies.

**Breach of Fiduciary Duty Lawsuits**

In addition to these federal securities class actions, there has been significant focus on several breach of fiduciary duty lawsuits filed in the Delaware Court of Chancery, most notably *In re Multiplan Corp. Stockholders Litig.*, C.A. No. 2021-0300-LWW, a suit alleging conflicts of interests and disclosure failures in connection with Churchill Capital Corp. III’s business combination with data analytics company, Multiplan.

On January 3, 2022, Vice Chancellor Will issued a long-awaited decision ultimately denying defendants’ motion to dismiss. In relevant part, the court found that plaintiffs pleaded direct claims centering around the purported impairment of their redemption rights due to materially misleading disclosures. And, in a matter of first impression for the court, Will determined that the entire fairness standard of review applies due to inherent conflicts between the SPAC’s fiduciaries and public stockholders “in the context of a value-decreasing transaction” (where public stockholders exchanged their right to $10.04 per share — held in trust for their benefit — for an interest in the newly public entity). Although the court clarified that its “conclusion does not address the validity of a hypothetical claim where the disclosure is adequate and the allegations rest solely on the premise that fiduciaries were necessarily interested given the SPAC’s structure,” this decision highlights the importance of strong corporate governance for SPACs, exacting processes and documentation in connection with de-SPAC transactions, and robust disclosures for such transactions in 2022 and beyond.

**Conclusion**

While the SPAC market has withstood many challenges throughout 2021, the market has rebounded strongly in the second half of 2021 from a slowdown mid-year in response to a tightening PIPE market and adverse regulatory developments. Nevertheless, market and regulatory challenges continue and are expected throughout 2022. We expect the SPAC market to remain fluid and dynamic in 2022, continuously evolving to address market and regulatory challenges.

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