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SPAC BUSINESS COMBINATIONS: AN ALTERNATIVE TO TRADITIONAL IPOS

SPACS are blank-check companies formed for the purpose of raising capital for use in a business combination with a company seeking to go public through a "de-SPAC transaction" as an alternative to a traditional IPO. In this article the author gives an overview of such transactions, focusing on the differences, processes, and challenges compared with a traditional IPO.

By Jeffrey A. Letalien *

KEY DIFFERENCES BETWEEN BUSINESS COMBINATIONS AND TRADITIONAL IPOS

A special purpose acquisition company ("SPAC") is a blank-check company formed for the purpose of effecting a business combination with one or more businesses (such as a merger or share exchange). SPACs are formed to raise capital in an initial public offering ("IPO") with the purpose of using the proceeds from the IPO to acquire an unspecified business after the IPO. The net SPAC IPO proceeds, a portion of the underwriting discount, and a portion of the concurrent private placement proceeds are held in a trust account until released to fund the business combination (as defined below).

After the IPO, the SPAC will pursue an acquisition opportunity and negotiate an acquisition of an operating business (the "Target") in a transaction commonly known as a "business combination" or "de-SPAC Transaction." As a result of the de-SPAC Transaction, the Target becomes a publicly traded company, most commonly listed on Nasdaq or the NYSE.

Although SPACs have been around for decades, they have grown in size, as well as in the prominence of the sponsors and underwriters, in recent years. In 2020, 237 SPAC IPOs raised approximately $80 billion[1] compared to 59 SPAC IPOs raising $13.5 billion in 2019.[2]

Despite recent SEC pronouncements creating challenges for SPACs, going public through a de-SPAC Transaction remains a popular alternative to a traditional IPO by the Target. Advantages of a de-SPAC

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[1] "2020 Has Been the Year of SPAC IPOs: Here Are the Prominent 4," NASDAQ (Dec. 28, 2020).

[2] Tomio Geron, "SPACs Offer Quick Exits for Venture Firms, but Potential Perils as Well," THE WALL STREET JOURNAL (Oct. 30, 2020).

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Transaction include earlier certainty of valuation, confidentiality of the transaction until executed and publicly announced, greater ability to use financial projections, and faster execution. However, the disclosure required to be prepared by the Target is no less complex and detailed than the disclosure required for a traditional IPO.

In a traditional IPO, the operating business submits a registration statement to the SEC (which may be submitted confidentially), engages in testing-the-waters meetings with institutional investors to gauge investor interest and develop a primary indication of valuation, and then, after several months of SEC review and responding thereto, launches a public offering with an indicative price range. The valuation of the operating business and price to the public are not determined until the completion of the SEC review process and public marketing period when the registration statement is declared effective and the pricing of the IPO is completed. Conversely, in a de-SPAC Transaction, the SPAC and the Target engage in private discussions with institutional investors in a private placement in public equity ("PIPE") transaction prior to execution of the business combination agreement, or any public announcement or SEC filings relating to the transaction. The subscription agreements for the PIPE transaction are executed concurrently with the execution of the business combination agreement and publicly announced in the same Current Report on Form 8-K filed by the SPAC with the SEC. This enables the SPAC, Target, and PIPE investors to agree upon the valuation and establish the terms of the transaction prior to any public disclosure thereof.

The de-SPAC Transaction and traditional IPO also differ in the use of financial projections. For various reasons, including the unavailability of the safe harbor for forward-looking statements under the Private Securities Litigation Reform Act of 1995, as well as the need for underwriters to obtain comfort from auditors or other forms of support for statements included in IPO materials, such projections are not provided in traditional IPOs. However, in a de-SPAC Transaction the Target provides financial projections to the SPAC for the use by its board of directors in evaluating the transaction and also includes such financial projections in the investor presentation provided to PIPE investors. As discussed more fully below, in a de-SPAC Transaction, the projections become publicly available through the disclosure of the investor presentation for the PIPE transaction and the inclusion of the information provided to the SPAC's board of directors in the proxy statement. In April 2021, the SEC's Acting Director of the Division of Corporation Finance issued a statement casting doubt on the availability of the safe harbor for the proxy statement for de-SPAC Transactions, contending that the business combination is really a form of IPO by the Target and that such proxy statement is effectively the Target's IPO-level disclosure. Nevertheless, the bespeaks caution doctrine continues to apply to provide some protection for forward-looking information that does not have the benefit of the safe harbor.

A de-SPAC Transaction can also be executed somewhat more quickly than a traditional IPO. The SEC filing for the approval of a business combination consists of a proxy statement, which is filed on Schedule 14A or as part of a registration statement on Form S-4 or F-4, depending upon the transaction structure. The preliminary proxy statement filing then commences an approximately 30-day SEC review period, after which the filer receives a comment letter. Similarly, a traditional IPO commences with the submission of a registration statement on Form S-1 or F-1, resulting in an approximately 30-day initial review period. However, because the traditional IPO process includes a later determination of valuation, while in a de-SPAC Transaction the valuation has already been determined prior to the filing of the preliminary proxy statement, the parties' ability to respond quickly to SEC comments and complete the later rounds of the SEC review process is greatly enhanced. Once the SEC review process is substantially complete in a traditional IPO, the company typically undertakes a roadshow for more than a week. In a de-SPAC Transaction, the completion of an SEC review results in the filing of a definitive proxy statement and mailing of the proxy statement to the SPAC's stockholders. The overall timing for the SEC review process for a traditional IPO is typically between four and six months. For a de-SPAC Transaction, it can be as short as two to three months.

The disclosure required in the proxy statement is a combination of the disclosure that would be required in an IPO registration statement for the Target and disclosure relating to the terms of the business combination. As a result, the proxy statement is a longer and more complex document than a traditional IPO registration statement. In addition to the disclosure about the Target's business, financial statements, MD&A, executive compensation and other items required in an IPO registration statement, such information is also provided with respect to the SPAC. The proxy statement also includes a number of stockholder proposals for approving the business combination and related matters, annual or special meeting logistical disclosures, and a description of the business combination and related documents. Nevertheless, the most challenging disclosures are those that also require significant time and effort to prepare in most public company M&A transactions. These include the background of the transactions; financial projections; a description of a fairness opinion and underlying analysis, if any; and unaudited pro forma financial information.

Following the completion of a de-SPAC Transaction, the company will be subject to many of the same securities law considerations of newly public companies following the completion of a traditional IPO, but with significant differences. A new post-IPO company will not qualify to use Form S-3 until one year after the completion of the IPO. A post-de-SPAC company will also not qualify for Form S-3 until one year after the filing of the "Super 8-K" — a Current Report on Form 8-K containing the information required by Form 10 with respect to the combined business. The SEC does not give a post-de-SPAC company credit for the reporting history of the SPAC prior to the business combination. The de-SPAC will also be subject to various disqualifications applicable to former shell companies that do not apply to other post-IPO companies. For example, Rule 144 will not be available until the first anniversary of the filing of the Super 8-K. In addition, Form S-8 will not be available until 60 days following the filing of the Super 8-K.

PROCESS PRIOR TO THE EXECUTION OF THE BUSINESS COMBINATION AGREEMENT

A de-SPAC Transaction is three transactions combined into one: a public company M&A transaction, a PIPE, and an operating company IPO. Although some Targets are not actively undertaking a sale process when approached by a SPAC, many Targets consider a traditional IPO and a de-SPAC Transaction on parallel paths, commencing preparations to be a publicly traded company. These include audited financial statements, drafting investor presentations and SEC disclosure with respect to the business and financial condition of the company, and establishing internal controls that are equally applicable to a traditional IPO company and a post-de-SPAC company. Such targets may also engage in a search process to identify SPACs that are potential bidders. Meanwhile, the SPAC has a mandate to identify a target business and complete a business combination within a specified period, and seeks to enter into nondisclosure agreements and conduct due diligence on several potential target businesses prior to entering into a definitive agreement.

The parties to the business combination begin negotiations by entering into a nondisclosure agreement that provides the SPAC with the ability to commence due diligence on the Target's business and financial information. If, following an assessment of the results of its due diligence, the SPAC is interested in acquiring the Target, the SPAC will make a proposal for the business combination. The parties then negotiate a letter of intent to reflect the terms of the proposed agreement. In addition to pricing terms, the letter of intent will indicate the mixture of consideration, whether cash or stock, to be received by the Target and its stockholders, as well as other terms of the transaction, often including the size of the PIPE transaction, a "minimum cash condition," and a requirement that the SPAC sponsor forfeit a portion of its equity to minimize dilution to the Target's stockholders. The minimum cash condition is a requirement that the SPAC have a minimum amount of cash available at closing, which cash is obtained from the proceeds in the trust account (net of redemptions) and proceeds of the PIPE transaction. The condition may be mutual or only for the benefit of the Target. The letter of intent will also indicate the structure of the transaction.

The structure may vary depending upon various business and legal considerations, including U.S. and foreign taxation. The SPAC may be the issuer of securities sent to the Target's stockholders and the surviving public company in the business combination, with the Target becoming a wholly owned subsidiary of the SPAC through a triangular merger. If the Target is closely held by a small number of sophisticated investors, the securities may be issued in a private placement and the proxy statement is filed on Schedule 14A. If the Target is more widely held, then the issuance of the securities will be registered under the Securities Act on Form S-4, which registration statement will include the proxy statement. In other structures, the Target may be the surviving public company and issue securities to the SPAC's stockholders under a registration statement on Form S-4 or F-4 (such structure

is most common when the Target is offshore and is seeking to qualify as a foreign private issuer and/or obtain a desired tax treatment of the transaction). Or the parties may form a newly created entity to survive as the public company parent of both of the SPAC and the Target through a "double dummy" merger of subsidiaries with each of the SPAC and the Target, where the newly created entity issues securities to the stockholders of both the SPAC and the Target under a registration statement on Form S-4 or F-4. If these alternative structures enable the Target to survive as a public company, then they may enable the Target to avoid the disqualifications of a former shell company. If the surviving public company qualifies as a foreign private issuer, then it may be subject to less onerous financial statement requirements, including the lack of requirement for quarterly financial statements, that are beneficial to the execution of the transaction.

Following the execution of the letter of intent, which is not a binding definitive agreement (other than with respect to certain confidentiality and exclusivity provisions) and does not result in the disclosure of the transaction on a Current Report on Form 8-K, the parties proceed to draft and negotiate the definitive business combination agreement and ancillary documents, including any sponsor share forfeiture agreement, voting agreements, and the registration rights agreement governing the registration rights of the Target's insiders and the SPAC's sponsor. Concurrently, the parties will commence the PIPE transaction.

THE PIPE TRANSACTION

The first steps in executing the PIPE transaction involve the preparation of an investor presentation, "wall cross" procedures, and a subscription agreement. The investor presentation contains information about the business combination and the Target business. Recently, it has become common to include summary risk factors as well. The information in the investor presentation should be supportable and consistent with the information to be included in the proxy statement, as the investor presentation will be made publicly available when filed as an exhibit to the Form 8-K registered upon execution of the business combination agreement.

The "wall cross" procedures govern the confidentiality obligations of the PIPE investors who are approached by placement agents acting on behalf of the issuer (usually the SPAC, but sometimes the Target or a newly formed entity, depending upon the structure). Pursuant to the "wall cross" procedures, the PIPE investors agree to maintain the confidentiality of the information received and not to trade the SPAC's securities until the business combination is announced. The "wall cross" procedures contain a deadline, after which the trading restrictions no longer apply and the SPAC becomes subject to an obligation to "cleanse" the PIPE investors of material nonpublic information by publicly disclosing any material information provided to them by the deadline or rendering such information immaterial to an investment decision with respect to the SPAC's securities by abandoning the transaction. Such deadline effectively serves as a time limit for execution of the business combination agreement. Meanwhile, since the transaction is conditioned upon a successful PIPE transaction, the timing of execution of the business combination agreement is often primarily driven by the time required to complete the PIPE transaction, with both the PIPE transaction and the business combination announced simultaneously. As the volume of de-SPAC Transactions has increased, the length of the PIPE solicitation period has grown, primarily as a result of the scheduling demands of PIPE investors solicited concurrently by multiple SPACs seeking investments.

The SPAC, Target, and placement agents will prepare a form of subscription agreement to present to PIPE investors. The SPAC and the Target seek to maximize flexibility by avoiding closing conditions that require the consent of PIPE investors to change any terms of the business combination agreement, or ancillary documents, or limit the SPAC's or the Target's ability to revise the disclosure in the proxy statement. Conversely, the PIPE investors seek to minimize potential changes to the terms of the transactions, obtain a fixed deadline for completion of the transactions that cannot be waived by the SPAC and the Target, and avoid disparate treatment through the negotiation of "most favored nation" provisions limiting differentiation in terms provided to other PIPE investors. The subscription agreement also provides for registration rights and tends to be highly negotiated, with many large PIPE investors providing separate comments and negotiating with the SPAC and the Target.

EXECUTION AND ANNOUNCEMENT

Upon completion of the PIPE transaction and the business combination agreement, the business combination agreement, subscription agreements, and certain ancillary agreements are executed and publicly announced. The SPAC and the Target issue a press release announcing the transaction and file a Form 8-K reporting the entry into material definitive agreements for the business combination and PIPE transaction, as well as any ancillary agreements executed at signing, and including various communications as exhibits, including the investor presentation that is filed in order

to fulfill the cleansing obligations to the PIPE investors. The management teams of the SPAC and the Target frequently conduct an investor conference call and file the transcript thereof as additional soliciting material pursuant to Rule 14a-12 under the Securities Exchange Act.

Following the public announcement of the transactions, the SPAC and Target continue to engage in marketing of the transactions, while also working to complete the proxy statement for filing with the SEC. Broadly disseminated written communications relating to the transaction may be deemed soliciting material under Rule 14a-12 (and Rule 425 under the Securities Act if the transaction includes an S-4 or F-4 registration statement). Such soliciting material is required to be filed with the SEC on the date of first use.

PROXY STATEMENT PREPARATION AND FILING

Within a short period ranging from the same day to four to five weeks after the public announcement, the SPAC and the Target will file the proxy statement with the SEC. As discussed above, most of the information with respect to the Target contained in the proxy statement is substantially similar to the information required in an S-1 registration statement for a traditional IPO. However, the parties will also need to describe the transaction and the applicable transaction documents. In addition, they will need to determine the accounting acquirer (almost always the Target since the SPAC has no operations and the Target's equity owners and management typically remain controlling persons of the surviving company) and prepare unaudited pro forma financial information.

As with other public company M&A transactions, the proxy statement will include a section on the background of the transactions. This section provides a detail of the SPAC's history of seeking a target for a business combination and of the negotiations relating to the business combination. The SPAC must be careful to avoid communications with potential target businesses prior to completion of its IPO, and can expect that preexisting relationships between its management team and sponsor on the one hand and affiliates of the Target on the other hand will be closely scrutinized by the SEC staff and potential plaintiffs for any possibility that there were impermissible pre-IPO communications. In order to facilitate the preparation of the disclosure, it is also advisable that the management teams of each party prepare and maintain records of their discussions and negotiations related to the transaction. The background discussion will reflect the SPAC's discussions with other potential targets, including whether such discussions progressed through execution of nondisclosure agreements and due diligence, and whether any offers were made and letters of intent were negotiated. The disclosure should also identify the advisors engaged by each party. Any fees paid to such advisors and conflicts of interest thereof can be another area of scrutiny by potential plaintiffs. In addition, the disclosure should demonstrate the history of the negotiations, particularly the material issues that required the most negotiation and involved trading of proposals, and indicate whether continued employment of either party's personnel was discussed or agreed upon.

While the background of the transactions section illustrates the decision-making process of the SPAC's board of directors, as does the disclosure of the reasons for the board's recommendation that the SPAC's stockholders approve the transaction, the proxy statement also includes disclosure of the financial projections provided by the Target and considered by the board in deciding to approve the transaction, as well as a description of any fairness opinion and analysis related thereto obtained by the SPAC. The disclosure of the financial projections should include any material line items and periods included in the information presented to the SPAC's board of directors and is primarily derived from the materials presented at the final board meeting to approve the business combination. The engagement of a fairness opinion advisor varies widely, but, if such an opinion is obtained, counsel to the provider of the fairness opinion will prepare the disclosure thereof. The parties should include as much detail as possible with respect to the inputs used in the analysis supporting the fairness opinion, including financial and trading price multiples of comparable companies and transactions, as demands for such detail are common in stockholder litigation with respect to public company M&A transactions, including de-SPAC Transactions.

CLOSING AND RELATED ITEMS

Following the filing of the proxy statement, the parties will continue marketing the transaction (and filing soliciting material as it is used) while awaiting SEC comments. After approximately 30 days, the SPAC and the Target will receive their first SEC comment letter and seek to respond thereto, as well as provide any necessary business updates and, depending upon the calendar and financial statement staleness dates, updated financing information. After additional rounds of SEC review, comment, and response, once the SEC review period is completed, the SPAC may schedule the stockholder meeting to approve the transaction and mail the proxy statement to its stockholders. After a several-

week proxy-solicitation period, the length of which depends upon the amount of time recommended by the proxy solicitor based upon the composition of the SPAC's stockholder base (more time is required if there is a significant retail investor component), the stockholder meeting occurs. Redemption requests from SPAC stockholders are due two business days prior to the stockholder meeting.

If the redemption requests do not result in a failure to satisfy the minimum cash condition, and the stockholders have approved the business combination and all other required conditions have been satisfied, including the receipt of regulatory approvals, the parties can proceed to close the PIPE transaction and the business combination. The PIPE investors will be required to fund their commitments and receive the shares purchased in the PIPE transaction. The business combination will be completed, and the surviving company will begin trading as a new public company, listed on Nasdaq or the NYSE under a new name and trading symbol. The surviving company will file the Super 8-K within four business days after closing, disclosing the required Form 10 information and starting the clock on eligibility for Forms S-3 and S-8, and Rule 144.

POST-CLOSING: RESALE CONSIDERATIONS AND CHALLENGES

Pursuant to the registration rights granted to the PIPE investors in the subscription agreements and to the SPAC sponsor and the Target's insiders in the registration rights agreement, the surviving company will file a resale shelf registration statement within a short period after closing (typically less than 30 days pursuant to the deadlines in the registration rights agreements). The registration statement will permit the resale of the securities held thereby from time to time. However, the ability of the Target's insiders and the SPAC sponsor to sell thereunder is usually limited by contractual lock-up commitments agreed to under the terms of the business combination in order to permit PIPE investors to have a clear market in which to sell prior to any insiders of either party to the business combination.

Holders of a large number of shares of the surviving company may have demand registration rights for underwritten offerings exercisable after the expiration of the applicable lock-up periods. However, underwritten offerings during the first year after the completion of the business combination when the surviving company is not yet eligible for Form S-3 must contend with additional complications. The resale S-1 is ineligible for forward incorporation by reference unless the surviving company is a smaller reporting company. As a result, the registration statement must be updated for new information by prospectus supplement or post-effective amendment. As Rule 430B, which is often relied upon in order to update the information in a registration statement through a prospectus supplement, is not available for offerings on Form S-1, certain changes to the plan of distribution and other information may only be made by post-effective amendment, requiring SEC approval prior to the effectiveness thereof. The requirement to use post-effective amendments can result in a much slower offering process than the typical underwritten shelf takedown process for an S-3-eligible issuer. Such process, as well as certain language in Rule 430A, which is relied upon by issuers on Form S-1 to update the registration statement through a prospectus supplement, prohibiting the use thereof in offerings by competitive bidding, also renders unavailable the popular secondary offering structure of a "block trade" for which bids from multiple underwriters are solicited by the selling stockholder.

Nevertheless, in light of the unavailability of Rule 144 for post-de-SPAC companies during the first year after the business combination, registration rights remain critically important for the insiders of the Target and the SPAC sponsor, despite the challenges of resales on Form S-1.

CONCLUSION

Despite a recent slowdown in certain sectors of the SPAC market, including new SPAC IPOs, as well as saturation of the PIPE market and a series of SEC pronouncements expressing concern about SPACs and presenting challenges therefor, SPACs remain a popular investment vehicle. A de-SPAC Transaction may present a compelling alternative for a Target considering a traditional IPO. The disclosure required in a de-SPAC Transaction is greater than in a traditional IPO, as it includes the same disclosure required in a traditional IPO plus disclosures required in a public company M&A transaction. There are also additional burdens on the ability of the holders of shares of a post-de-SPAC company to resell such shares because of the unavailability of Rule 144 and Form S-3 for a year. Nevertheless, such challenges may be outweighed by the numerous benefits of a de-SPAC Transaction, including earlier certainty of valuation, confidentiality of the transaction until executed and publicly announced, greater ability to use financial projections, and faster execution. ■