SPECIAL PURPOSE ACQUISITION COMPANIES (SPACs): Challenges and Opportunities

Baker McKenzie.

SPACs have gone from niche product to the mainstream, attracting well-known names in the financial industry as well as celebrity sponsors. Baker McKenzie represents SPAC sponsors in structuring SPACs and conducting SPAC IPOs, SPACs and target companies in de-SPAC business combination transactions and simultaneous PIPE transactions, and PIPE investors in SPACs. We regularly guide boards of directors with respect to fiduciary duties, corporate governance matters and material corporate transactions. We also represent management teams in connection with SPAC matters. We give you the head start you need to navigate the challenges and opportunities that SPACs present.

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Useful Resources:

- Global SPACs Guide
- De-SPAC Transactions: Considerations and Risks
- Cross-Border Listings Guide
- Global Public M&A Guide
- Global PIPE Guide
- SPACs: What private equity needs to know
- SPACs cross the Atlantic
- Top Tips for Financial Sponsors on Public Transactions
- United States: SPAC litigation gains momentum
- United States: Breaking the bubble - Top risks to the SPAC surge

Key Experience

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What are they?

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A SPAC is a special purpose acquisition company, typically sponsored by an experienced investor and/or management team. The SPAC has historically also been known as a "blank cheque" company or a "blind pool".

A SPAC has no prior business or operating revenue. A SPAC raises funds and lists its shares in an IPO and then seeks a target company to acquire.

Historically, most SPACs have listed on Nasdaq and the New York Stock Exchange (NYSE) but certain exchanges in Europe are now starting to emerge as alternative listing venues and there is interest from several Asia Pacific jurisdictions in allowing SPACs to list locally.

SPACs must meet the listing standards of the relevant stock exchange and must also comply with any specific SPAC-related requirements.

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Structuring a SPAC offering

The SPAC will be subject to the listing requirements of the particular exchange that it chooses to list on and may have a minimum raise amount requirement depending on the particular exchange. For investor protection, substantially all of the proceeds of the IPO are required to be put into a trust account while the SPAC looks for an acquisition target. SPACs raise capital by offering units comprising of a share and a warrant (or fraction of a warrant) to public investors and a private placement of warrants (or units) to the sponsor (to fund IPO expenses and working capital).

The sponsor typically makes an "at risk" investment through the purchase of warrants (or units) from the SPAC at the time of the IPO in a concurrent private placement. This is used to (i) pay upfront offering expenses and underwriting commissions and (ii) further incentivize the sponsor.

The SPAC founder or sponsor will typically be incentivized to find and complete an acquisition by purchasing founder shares (often referred to as the "promote") for a nominal value, which will represent around 20% of the SPAC equity post-IPO (but pre-business combination).

The promote serves as incentive for the SPAC management team to find and complete an acquisition before the SPACs contractual expiration (usually18-24 months). The founder shares become worthless if the SPAC is liquidated because it failed to complete an acquisition before its expiration.
The founder shares are generally subject to a lock-up that expires 6-12 months following the closing of the business combination transaction.

Consideration will need to be given to how the SPAC offering is structured, e.g., a single share class or a dual class structures with the founder's shares converting at the time of a business combination, sponsor lock-up, size of sponsor promote and treatment of warrants. Some deals may include an anti-dilution adjustment (or "crescent term") that resets the strike price for warrants if the SPAC issues additional securities at a price below a certain threshold, e.g., a dilutive private investment in public equity (PIPE). We can advise on how to structure the offering to maximize appeal to investors and support the sponsor's requirements.

Identify a target company

After the IPO, the SPAC will search for a target and either acquire or merge with the target company in a "de-SPAC" transaction. The IPO offering document typically states that the SPAC is looking for an acquisition target in a particular industry, market and/or geographic region but usually also provides the flexibility to pursue other acquisition strategies.

How long does a SPAC have to complete a business combination?

Shareholders will not want their investment tied up indefinitely. Therefore, SPACs are structured to have a specified period for the SPAC to consummate an acquisition. The time to consummate an acquisition (provided for in the SPAC's governing instruments) varies between deals (with most SPACs having an 18-24 month term), although there may be an extension if the governing instruments permit it. Relevant listing rules may also have to be considered as some exchanges prescribe a time frame for closing an acquisition.

If the SPAC fails to close a business combination within that time frame, the SPAC is liquidated and the SPAC funds held in the trust are returned to the shareholders. As the SPAC sponsor will not receive any of the proceeds from the trust upon liquidation, the sponsor is highly incentivized to complete an acquisition before the time limit expires. Moreover, upon liquidation, a SPAC's warrants expire and have no value.

The closer to the deadline the SPAC comes before agreeing the terms of an acquisition, the more a target company should question the sponsors on the valuation and its long term prospects. At the same time, if due to this timing concern the SPAC agrees to an unreasonable valuation or agrees to acquire an otherwise unattractive target, the risk increases that shareholders will decide that they would rather exercise their redemption rights. It may also increase the risk of future litigation.

Knowledge matters

The management team is key for a SPAC and the team's background and experience will form a large part of the disclosure in the offering document. Investors will be relying on the expertise of the sponsor and management to source an appropriate acquisition target, and, possibly, to be board members of such target post-acquisition. Given the high degree of competition between SPACs to acquire certain companies, the target company will also be closely assessing the SPAC team and their ability to deliver expertise in order to grow the business and succeed as a public company.

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Taxing choices

The domicile for a SPAC generally depends on where a sponsor is domiciled and where a target company is likely to be. In the past, most US SPACs have sought domestic targets and so have been organized in Delaware, but if a SPAC is likely to seek a target outside of the US then an offshore domicile may be more appropriate and efficient from a tax treatment perspective. Many SPACs are now domiciled in the Cayman or British Virgin Islands if targeting assets outside of the US. We can advise you on appropriate tax structuring and any complex tax issues.

Understand the SPAC sponsors' remuneration structure

Traditionally, SPAC sponsors will be remunerated though the ability to acquire shares in the SPAC at nominal value or close to nominal value. This can result in the sponsors obtaining a return in circumstances where the other shareholders will not. Some SPAC sponsors employ structures in which they will only make a return once the SPAC's share price exceeds a certain level. This incentivizes sponsors to seek targets that are likely to be successful. Careful structuring is required to ensure a balance between risk and reward.

Complex financing arrangements

Due to the redemption option that a SPAC provides to shareholders in relation to a proposed acquisition, there is a risk that the SPAC may not be able to satisfy a minimum cash closing condition contained in the definitive acquisition agreement.

To address this concern, a SPAC typically raises additional capital via a PIPE by selling equity securities of the SPAC in a private placement while it is negotiating the business combination. The PIPE and the business combination are typically announced at the same time.

Avoiding the regulatory crosshairs

The meteoric rise of SPACs is attracting attention from exchanges and regulatory authorities. While some jurisdictions hope to catch the wave by rapidly introducing SPAC frameworks, others are beginning to scrutinize existing regulations to ensure adequate investor protection. In the US, the Securities and Exchange Commission (SEC) has focused on information transparency, raising comments and issuing guidance on SPAC disclosures. The new administration seems to be signaling that disclosure guidance is not enough and that SPACs will be an enforcement priority. In the United States, the SEC has become increasingly vocal about SPACs. The SEC (or staff thereof) has:

- issued three statements on SPACs: (a) two questioning the readiness of their targets to go public and (b) one calling into question the accounting treatment of warrants they issue;
- sent requests to several Wall Street banks for information on SPAC deal fees, volumes, and what controls the banks have in place to police the deals internally. Whether this is merely a prelude to a formal investigation and further what sort of investigation that might be (e.g., insider trading v. disclosure or process concerns) is yet to be determined; and
- warned participants and their advisers in de-SPAC transactions that the Private Securities Litigation Reform Act, which provides issuers of securities a safe harbor for forward-looking statements in certain circumstances, only protects from private litigation — not SEC enforcement actions, and pointed out that the Act specifically excludes 'initial public offerings' from the safe harbor. While acknowledging that there is no definition of this phrase, John Coates, the Acting Director of the Division of Corporation Finance, suggested that it "may include de-SPAC transactions", raising the possibility that the SEC may be looking to clarify the term and limit the use of this safe harbor for de-SPAC transactions.

In April 2021, a member of the US Senate introduced a bill - the Sponsor Promote and Compensation Act - that would require the SEC to issue rules requiring enhanced disclosures for blank check companies, including SPACs, during the IPO and pre-merger stages.

Regulation and legislation is fast moving and should be closely monitored and considered for any impact on your transaction.

Redemption rights for shareholders

A key feature of a SPAC is that public shareholders typically have the opportunity to redeem their shares and receive their pro rata share of the amount of funds in the trust account at the time that the shareholders vote on the business combination transaction. The public shareholders can redeem their shares even if they vote in favor of the transaction. Upon redemption of shares, investors are entitled to retain the warrants that they purchased as part of a unit and still have upside even though their investment has been repaid (with interest).

Theoretically, the redemption right creates a risk that the SPAC may not have enough cash to complete an acquisition leading to deal uncertainty. In reality, shareholders are incentivized to vote in favor of the acquisition because they can still redeem their shares but also hold onto any related warrants.

The warrants will only be of value if the business combination is consummated. Regardless of whether the public shareholders choose to redeem their shares, they are incentivized to approve the transaction because of the potential upside of exercising their warrants if the de-SPAC transaction is successful.

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Don't forget continuing disclosure obligations

As a public company, the SPAC is subject to relevant reporting requirements for public companies.

For example, in the United States a domestic SPAC must make periodic SEC filings, such as its Form 10-Q and Form 10-K, as well as current reports on Form 8-K, and, a non-US SPAC must make periodic reports on Form 20-F and Form 6-K.

We can advise and assist on any reporting obligations.

Litigation risks

While the IPO of the SPAC provides only a limited opportunity for disclosure-based litigation due to the fact that the SPAC has no operating history to disclose, as SPACs increase in popularity we may see more litigation around the de-SPAC transaction. This could relate to financial projections, details around negotiations, e.g., the pursuit of other potential acquisition targets, reasoning for not hiring a financial advisor and financial analyses considered by the SPAC's board. Claims around material omissions or misstatements are likely to be the main focus.

SPACs may also be susceptible to fiduciary duty claims owing to the conflicts of interest of SPAC sponsors. Sponsors may be incentivized to rush into an acquisition regardless of the quality of the target or they will lose their initial investment as well as the chance of obtaining a significant economic upside from their "promote". It will be important to identify and disclose any conflicts whenever they arise.

Engage experienced advisors

As specific matters may vary between jurisdictions based on local rules and regulations, we encourage you to speak to us as early as possible to discuss any local requirements and restrictions that may impact your transaction.

To facilitate best execution, you should look to engage:

- Transactional advisors able to assist in the development of an optimal SPAC strategy and advise on all aspects of the transaction in a rapidly evolving regulatory environment; and
- Legal advisors with robust SPAC and de-SPAC experience. Our leading, multi-disciplinary practice groups are comprised of lawyers with transactional and advisory experience in SPAC, de-SPAC and PIPE transactions across a wide range of jurisdictions — please visit our **website** for more information.

Key Experience

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Aurora Acquisition Corp

USD 200 million

Advised Aurora Acquisition Corp. on its USD 220 million SPAC IPO on the Nasdaq. We also advised Aurora on its subsequent USD 6.9 million de-SPAC with Better.

BYTE Acquisition Corp

USD 300 million

Advised the "risk capital" shareholders/sponsors behind BYTE Acquisition Corp., a SPAC targeting Israeli technology, on its USD 300 million IPO listing on the Nasdaq.

Aligro Planet Acquisition Company AB

SEK 1 billion

Advised Aligro Planet Acquisition Company AB in its SEK 1 billion IPO on Nasdaq Stockholm Main Market.

Tbd30 AB

SEK 800 million

Advised tbd30 AB on a private placement of shares and subsequent IPO on Nasdaq Stockholm.

New Amsterdam Invest NV

EUR 50 million

Advised New Amsterdam Invest NV on IPO listing on Euronext Amsterdam, with an aim of acquiring an operating company in the commercial real estate sector.

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