

Special Purpose Acquisition Companies



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I. Overview and History

SPACs have been around since the 1990s, but they have recently gained significant popularity among investors and companies seeking to raise capital. In 2020, SPACs raised a then record \$83.4 billion which marked a significant growth in SPACs over recent history.^[1] Somewhat surprisingly, SPACs have already surpassed that figure in 2021 with over half the year remaining. This rapid growth illustrates SPACs' increasing popularity as an alternative to the traditional initial public offering (“IPO”) process.

“SPAC” stands for “special purpose acquisition company” and is referred to as a “blank check company” because SPACs are entities that are formed and taken public without any operational or financial history whatsoever. They are public shell companies. Institutional investors and sponsors form SPACs and raise capital by selling founder or sponsor equity initially and then by selling public stock through an IPO. All of the proceeds are then placed in an interest bearing trust account until a suitable acquisition target is identified and approved.

Sponsors take the SPAC public and list it on a national exchange (typically the NYSE or NASDAQ) with the intent to merge the SPAC with a private target company in the near future (usually no later than 24 months after the IPO). This merger transaction is referred to as the “De-SPAC” transaction. As a result of the De-SPAC transaction, the SPAC and the private target merge to become a publicly traded company. In the event the SPAC does not identify and merge with a private target company, all of the proceeds of the IPO

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that are held in trust are distributed back out to the public investors, but typically the sponsors lose their initial investment along with costs and time spent throughout the process.^[2]

II. Formation, Capital Structure, and IPO of the SPAC

Generally speaking, most SPACs are formed as Delaware corporations and upon consummating a public offering are listed either with NYSE or NASDAQ. SPACs must have a majority of independent board members. Directors of the SPAC are typically elected by the sponsor, and additional directors are appointed by the board. In most instances, a SPAC will not hold a public election for directors until the De-SPAC transaction and may provide that only the sponsor votes in director elections until then.

With regard to equity and capital structure, SPACs offer both public and private shares and warrants. The nature of the shares and warrants in the SPAC vary depending on whether they have been offered and issued before or at the closing of the IPO transaction. Prior to the SPAC's IPO, the sponsor purchases founder shares and founder warrants in the SPAC for nominal consideration. The sponsor's founder equity will typically represent 20% of the shares being registered for public offering and the founders will also receive anti-dilution protections to maintain this 20% equity stake in the SPAC after the IPO, after the De-SPAC transaction, and even beyond.

In addition to the public and private shares in the SPAC, both the founders and public are typically issued warrants. While the public units usually include a fraction of a warrant (perhaps one-half or one-third) to purchase an entire share, the founder warrants are whole warrants. Generally, the strike price for the warrants in the SPAC are a percentage above the IPO price per share and become exercisable at some fixed point in time measured by the date of the De-SPAC transaction and/or the anniversary of the IPO. All warrant holders are aligned in terms of structure and terms. The public warrants are issued to public investors at the IPO in exchange for their faith in the sponsor and their investment in a "blank check company."

Once the SPAC is formed and the founder equity is determined, the SPAC will move forward towards registration and its IPO. The SPAC will file a form S-1, but the required information relative to the IPO will be much more limited than a traditional IPO for a private operating company going public. As mentioned, the SPAC does not have historic financials or active operations, so the IPO process for the SPAC is considerably shorter and less burdensome. Additionally, the SPAC does not (and should not) have an established target for its De-SPAC transaction at the time of its IPO. Typically, the price per share of the SPAC will be set at \$10 and all funds raised through the IPO will be placed in the SPAC's trust account for the benefit of the shareholders.

III. De-SPAC Transaction^[3]

After the SPAC's IPO, the SPAC will have up to 24 months to identify a target private company and close on its De-SPAC transaction. As a part of the De-SPAC transaction structure, the SPAC and the target will merge at the closing of the transaction (usually through a structure referred to as a reverse triangular merger) and result in one single publicly traded company. At the closing, the applicable national securities exchange information will be updated as well. As a part of the De-SPAC transaction, there are required disclosures that must be made with regard to the private target and the transaction generally and this process typically takes much longer than the shortened IPO process for the SPAC. However, these disclosures and the process in general is much less burdensome than the traditional IPO process for any other operating private company.

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Once the SPAC has identified its private target, the parties begin to negotiate the De-SPAC transaction in a similar fashion as any typical merger or acquisition. In connection with the ongoing negotiations between the parties, the SPAC will need to get approval on the De-SPAC transaction from its shareholders. The shareholders are asked to approve the De-SPAC transaction by a majority approval but are also given the opportunity to redeem their interest in the SPAC and get their money back from the trust account (plus any interest that may have accrued while being held in trust). If the shareholders approve the De-SPAC transaction by majority vote, then the transaction can move forward and close. Those shareholders that do not approve the transaction are still given their redemption right as well. If the shareholders do not approve the De-SPAC transaction, then the SPAC and sponsor have to continue with the search process until they can identify an acceptable target.^[4]

Assuming the De-SPAC transaction is approved by the shareholders, the shares held in the SPAC and the private target will convert into public shares in the surviving entity as applicable. Additionally, if the SPAC requires additional capital to close the De-SPAC transaction beyond what was raised through the IPO, the SPAC can supplement with additional capital raised either through debt or through a private investment in a public entity (or “PIPE”) which involves selling shares of the public SPAC through a private transaction with a particular investor.

IV. Benefits, Risks and Conclusion

As mentioned, the SPAC is continuing to grow in popularity due to the shorter timeframe and less burdensome requirements as compared to a traditional IPO. Additionally, due to the structure of the De-SPAC transaction, the SPAC and its sponsor can negotiate the ultimate price and valuation of the resulting public company rather than being beholden to the public value through the IPO of an operating entity.

However, for both investors and sponsors, the SPAC does come with risks. First, investors are funding a “blank check company” with no operating history and no defined or established target for the De-SPAC transaction. At most, the SPAC will identify a geographic and/or industry target for the De-SPAC transaction. Additionally, sponsors run the risk of never identifying an approved target and losing their initial investments, costs, and time spent throughout the process. However, based on the amount of capital raised in 2020 and the amount raised thus far in 2021 to date, SPACs project to continue to grow in popularity and ubiquity.

[1] <https://www.forbes.com/sites/greatspeculations/2021/03/22/what-are-spacs-and-why-is-everyone-talking-about-them-right-now/?sh=6ba30dbd3260>

[2] <https://corpgov.law.harvard.edu/2018/07/06/special-purpose-acquisition-companies-an-introduction/>

[3] <https://corpgov.law.harvard.edu/2018/07/06/special-purpose-acquisition-companies-an-introduction/>

[4] <https://www.forbes.com/sites/greatspeculations/2021/03/22/what-are-spacs-and-why-is-everyone-talking-about-them-right-now/?sh=6ba30dbd3260>



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