

# Chapter 5A

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## Special Purpose Acquisition Companies

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## § 5A:1 What Is a SPAC?

### § 5A:1.1 Overview

#### [A] Definition

A special purpose acquisition company (SPAC) is a shell or blank check company formed for the purpose of acquiring or merging with an unidentified target (or targets) or asset (or assets). The SPAC completes an initial public offering (IPO), raising capital, which is placed in a trust account. The SPAC then must identify and initiate a business combination, known as a “de-SPAC,” with one or multiple targets in a specified time frame (typically twenty-four months, but stock exchange rules specify a maximum of thirty-six months<sup>1</sup>).

At the time of the de-SPAC, public shareholders who do not wish to continue to hold shares in the combined company have the opportunity to redeem their SPAC shares. This redemption right exists in current SPAC structures regardless of whether a shareholder vote on the merger is held by the SPAC and regardless of how the redeeming shareholder votes, if such a vote is held. If no merger comes to fruition during the specified time frame, the SPAC liquidates and returns the money in the trust account to shareholders on a pro rata basis.

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1. Nasdaq IM Rule 5101-2(b), <https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/nasdaq-5100-series>; NYSE LCM § 102.06(e), [https://nyse.guide.srorules.com/listed-company-manual/document?treeNodeId=csh-da-filter!WKUS-TAL-DOCS-PHC-%7B0588BF4A-D3B5-4B91-94EA-BE9F17057DF0%7D-WKUS\\_TAL\\_5667%23teid-10](https://nyse.guide.srorules.com/listed-company-manual/document?treeNodeId=csh-da-filter!WKUS-TAL-DOCS-PHC-%7B0588BF4A-D3B5-4B91-94EA-BE9F17057DF0%7D-WKUS_TAL_5667%23teid-10).

Few SPACs go beyond or below the twenty-four-month norm, with the exception of those that allow a three-month extension if a definitive agreement is signed within the twenty-four-month time frame.

## [B] Capital Structure

A typical SPAC offering consists of a unit. In the vast majority of SPACs, each unit has an offering price of \$10.00<sup>2</sup> and is made up of one common share and usually one-half or one-third of one warrant, though warrant coverage has been declining. The SPAC is free to create multiple classes of stock with varying powers and rights, including, most frequently, director election or appointment and removal rights. Units trade immediately after the offering, and shares and warrants comprising each unit become separable and begin trading individually within fifty-two days after the IPO.<sup>3</sup> The SPAC will announce the separation of the units at the time they divide. In certain cases, the units will separate shortly after the over-allotment option has been fully exercised and settled,<sup>4</sup> if that occurs.<sup>5</sup>

Exchange rules mandate that 90% of the IPO proceeds be held in a trust for the benefit of shareholders,<sup>6</sup> though in practice 100% of the gross proceeds are, with the up-front underwriting discount usually

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2. Very few U.S. SPACs vary from the \$10 offer price. By the end of 2020, the only ones that did were Medalist Diversified REIT, Inc. (follow-on offering; \$4.80 per share), Pershing Square Tontine Holdings Ltd. (\$20.00 per share), Tastemaker Acquisition Corp. (\$20.00 per share), Executive Network Partnering Corp. (\$25.00 per share), and Periphas Capital Partnering Corp. (\$25.00 per share), with the latter four all taking place in the second half of 2020. FACTSET FINANCIAL DATA AND ANALYTICS, [www.factset.com](http://www.factset.com). International SPACs diverge from the \$10 offering price somewhat more frequently, with twenty-one variations since 2018.
  3. SPAC RESEARCH, FREQUENTLY ASKED QUESTIONS, [www.spacresearch.com/faq#spac-trading-units](http://www.spacresearch.com/faq#spac-trading-units). While the fifty-two-day timeline is not a requirement, it is a very strong market custom from which very few SPACs diverge. *PE Jumps into the SPAC Markets*, 17 DEBEVOISE & PLIMPTON: PRIV. EQUITY REP. 2 (Fall 2017), <https://privateequityreport.debevoise.com/the-private-equity-report-fall-2017-vol-17-no-2/pe-jumps-into-the-spac-markets>.
  4. While the greenshoe option in a traditional IPO is thirty days, market custom is for forty-five days in a SPAC IPO. Ramey Layne, Brenda Lenahan & Sarah Morgan, *Update on Special Purpose Acquisition Companies*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (Aug. 17, 2020), <https://corpgov.law.harvard.edu/2020/08/17/update-on-special-purpose-acquisition-companies> [hereinafter Layne, Lenahan & Morgan].
  5. The SPAC is required to file a Form 8-K with an audited balance sheet within four business days after the closing of the IPO and, if required, depending on the extent to which the underwriter(s) exercise the over-allotment option, at a later date to reflect such later over-allotment option exercise. This is a prerequisite for the separate trading of the SPAC unit components to begin. *Id.*
  6. Nasdaq IM Rule 5101-2(a); NYSE LCM § 102.06, *supra* note 1.

topped up by the sale of private placement warrants<sup>7</sup> (generally, at least part of the underwriting discount will be deferred until, and be contingent on, the initial business combination). The proceeds are only released from the trust as described in the IPO prospectus, most commonly for the de-SPAC or liquidation.<sup>8</sup> To avoid the requirement to register as an investment company pursuant to the Investment Company Act of 1940, SPACs are essentially limited to investing in U.S. government treasuries and certain money market funds that invest in U.S. government treasuries.<sup>9</sup>

### **[B][1] Public Warrants**

Each SPAC share is accompanied by a number of warrants—usually a fraction of a warrant as described above—which together comprise the units sold in the SPAC’s IPO. Each whole warrant allows the holder to purchase one additional share following the business combination, and is usually exercisable at \$11.50 per share (assuming the customary \$10.00 per unit offer price). While SPAC units have in the recent past generally included one-half or one-third of a warrant, warrant coverage has, as noted above, generally decreased over time, leaving less equity overhang of the post-de-SPAC company for its future activities.

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7. See, e.g., CBRE Acquisition Holdings, Inc., IPO Investment Prospectus (Form S-1) (Nov. 9, 2020), <https://sec.report/Document/0001193125-20-288585>.
  8. U.S. SEC. & EXCH. COMM’N, WHAT YOU NEED TO KNOW ABOUT SPACs—INVESTOR BULLETIN (Dec. 10, 2020), [www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin](http://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin) [hereinafter SEC, WHAT YOU NEED TO KNOW ABOUT SPACs].
  9. These are funds that meet the requirement under Rule 2a-7 of the Investment Company Act and that invest only in direct U.S. government treasury obligations, among other requirements.

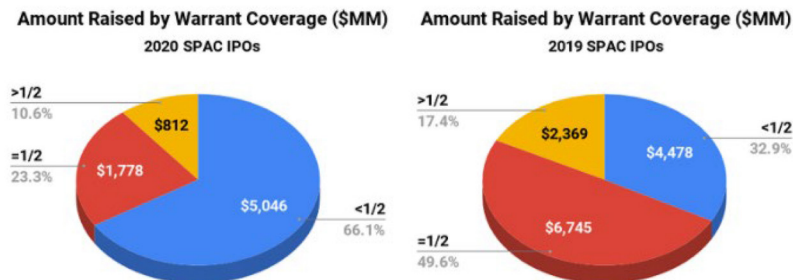
**Figure 5A-1**  
**Rolling Average Warrant Coverage**



Source: *Market Weakness, SPAC RESEARCH*, [www.spacresearch.com/newsletter?date=2021-03-29](http://www.spacresearch.com/newsletter?date=2021-03-29).

For example, there are now instances of SPACs with only one-quarter, one-fifth, or even less warrant coverage in each unit.

**Figure 5A-2**  
**Amount Raised by Warrant Coverage, 2019–2020 SPAC IPOs**



Source: *More on SPAC IPOs, SPAC RESEARCH* (May 8, 2020), [www.spacresearch.com/newsletter?date=2020-05-18](http://www.spacresearch.com/newsletter?date=2020-05-18).

Furthermore, the “make-whole” redemption option, which allows the company to redeem the warrants for shares, based upon the Black-Scholes option value of the warrants, started to appear in SPACs in 2017–2018, and is now prevalent in most SPAC structures.<sup>10</sup> This

10. Layne, Lenahan & Morgan, *supra* note 4.

provides the post-de-SPAC operating company with greater flexibility to pursue a transformative transaction.

### **[B][2] Founder Shares**

As part of the SPAC's formation process prior to the IPO, the entity or group that forms the SPAC (the "sponsor") purchases founder shares. These are purchased for a nominal amount, usually \$25,000 (or approximately \$0.01 or less per share), and are generally seen as compensation for the sponsor's expenses and unpaid work managing the SPAC both prior to the IPO and leading up to the de-SPAC transaction. Founder shares are the basis for the sponsor's profit in the company if there is a successful de-SPAC. Traditionally, the key feature of founder shares is the stipulation that they provide the holders with 20% of the equity raised in the IPO following their conversion at the time of a successful business combination, although some recent SPACs have been adopting innovative structures changing this mechanic, including those that mimic certain private equity approaches to sponsor compensation.<sup>11</sup> Generally, founder shares are automatically converted to public shares upon completion of the de-SPAC transaction. If necessary, dilution is limited by grossing up the founder shares as part of the conversion, though this is often a subject of negotiation in the de-SPAC.

### **[B][3] Private Placement Warrants**

Private placement warrants are sold to the sponsor and, in certain circumstances, to the directors and officers of the SPAC, as part of their compensation, and provide working capital to the SPAC. The number of private placement warrants is set to cover the up-front underwriting discount and IPO and de-SPAC expenses, and they are usually sold at \$1.50 per warrant, with the number of warrants sold adjusted to match the expected capital needs of the SPAC. The aggregate purchase price of the private placement warrants is known as "at risk" capital. Sponsors typically net-settle their warrants; instead of paying cash for stock upon exercise, they receive an amount of common shares less the number of shares equal to the market value of the strike price. As with public warrants, founder warrants expire worthless in the event of a liquidation.

These warrants provide working capital for the SPAC and top up the trust account for the up-front 2% underwriting discount paid to the IPO underwriters at the closing of the IPO. The working capital is used for two purposes. First, it pays off the pre-IPO working capital loan made by the sponsor (usually \$300,000, but this has been scaled

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11. See *infra* section 5A:6.