SEC Offers Guidance in Response to Increase in SPACs

Throughout 2020, special purpose acquisition companies ("SPACs") were at the top of the minds of investors, as a record amount of capital was raised through initial public offerings by these types of investment vehicles. On Dec. 22, 2020, the Staff of the Division of Corporation Finance (the "Staff") at the Securities and Exchange Commission (the "SEC") made it known that it had not forgotten about SPACs amid all the frenzy, as it issued CF Disclosure Guidance: Topic 11 – Special Purpose Acquisition Companies (the "Guidance"). The Guidance provides the Staff's views about certain disclosure considerations for SPACs in connection with their initial public offerings and subsequent business combination transactions.

Given that the economic interests of the SPAC's "sponsor" (the sponsor, together with the SPACs directors, officers, and affiliates, the "Insiders") often differ from the economic interests of public shareholders, and the fact that the Insiders are generally responsible for negotiating the terms of the SPACs business combination transaction, the Staff expressed its belief, in the Guidance, that clear disclosure regarding potential conflicts of interest and the nature of the economic interests of Insiders in the SPAC is particularly important.

As a result, the Staff advised SPACs and their Insiders to carefully consider their disclosure obligations as they relate to potentially conflicting or differing interests when preparing disclosure documents in connection with an IPO or business combination transaction. As the SPAC boom continues through 2021, SPACs would be well advised to heed the Guidance.

Disclosure Considerations in Connection with an IPO

In connection with an IPO, the Guidance raised questions for SPACs to consider when preparing their disclosures to be contained in documents filed with the SEC, including registration statements on Form S-1, regarding the following five key areas:

Conflicts of Interest Generally. Given that SPAC Insiders may have arrangements with, or fiduciary or contractual obligations to, persons or entities other than the SPAC, the Guidance urges SPACs to ask whether they have clearly described the potential conflicts of interest that Insiders may have, which description should include how these activities may affect the ability of Insiders to evaluate business combination opportunities, and how these potential conflicts will be addressed. SPACs should also address the possibility that they will pursue a business combination with a target in which an Insider has an interest, and if so, how any potential conflict will be considered.

Incentives to Complete the Business Combination. In general, if a SPAC does not complete a business combination within a specified timeframe (usually 18 to 24 months), it must liquidate and make a pro-rata distribution of the proceeds held in the trust account to its public

shareholders. If the SPAC liquidates, any securities held by Insiders will lose their value, and Insiders will incur a substantial (if not complete) loss on their investment in the SPAC. This economic damage, as well as any reputational damage arising from the fact that the Insiders could not complete a business combination, would be a bad result for Insiders.

As a result, the Guidance asks SPACs to consider whether they have clearly described (and, to the extent practicable, quantified) the financial incentives of Insiders to complete a business combination, including how those incentives may differ from the interests of public shareholders. This would include disclosure of items such as the amount of control that Insiders have over approval of a business combination, how Insiders can amend the SPAC's governance instruments to facilitate the completion of a business combination, and how the SPAC may extend the time it has to complete a business combination (and whether public shareholders may redeem their shares in connection with any such extension). If Insiders have prior SPAC experience, SPACs should provide balanced disclosure about the outcomes of such prior experience.

Underwriter Conflicts. Often, the underwriter of the SPACs IPO agrees to defer all or part of its compensation until the closing of the business combination. The Guidance urges SPACs to describe any other services that the underwriter may provide to them following the IPO – such as identifying potential targets, providing financial advisory services, or acting as a placement agent – and to disclose the fees that they may pay for such services. If payment for these additional services will be conditioned on the completion of the business combination, they should so state. SPACs should also disclose any conflict of interest the underwriter may have in providing additional services to the SPAC, given any deferred IPO underwriting compensation.

Conflicts Regarding Insider Investments. Recognizing that Insiders may have financial incentives that differ from public shareholders due to the fact that the economic terms of the investments made by Insiders usually differ from those of the public shareholders, and that such differences may lead to conflicts of interest when evaluating potential business combination transactions, the Staff encouraged SPACs to clearly disclose the amount, terms and price of securities owned (or to be owned) by Insiders, and to describe any financial incentives that may thereby be created to complete a particular business combination even if it may not be in the best interest of the public shareholders. The Guidance also asks for disclosure regarding the compensation of Insiders for services to the SPAC, including the amount of such compensation (if known) and a discussion of whether such compensation is contingent on the closing of the business combination.

Conflicts Regarding Non-Public Securities. The securities held by Insiders and other private investors who may invest in the SPAC prior to the closing of the business combination often

contain terms that differ from those of the securities that are issued to the public shareholders. To help IPO investors better evaluate these differences, SPACs should clearly disclose the terms of the securities held by Insiders (including, if applicable, convertible debt), discuss how those terms differ from the terms of the IPO securities and discuss any risks that may arise from such differences. SPACs should also disclose their plans for additional funding following the IPO, including a discussion of how the anticipated terms of any securities that may be issued in such financing transactions compare to those of the IPO securities, whether Insiders can participate in any such financing, the anticipated dilutive impact of any such financing, and whether the commitment of the investor(s) in any such financing is irrevocable.

Considerations in Connection with a Business Combination

In connection with a business combination transaction, the Guidance raised questions for SPACs to consider when preparing the related disclosure documents, including registration statements on Form S-4, regarding the following three key areas:

Need for Additional Financing. The Guidance asks SPACs to disclose clearly any additional financing necessary to complete the business combination and to discuss the terms of any securities to be issued in connection with such financing, the anticipated impact of such financing on public shareholders, and on the beneficial ownership of the combined company, and whether Insiders will participate in such financing.

Selection and Evaluation of Target. When presenting potential business combinations to shareholders, SPACs should provide detailed information about how they evaluated and why they selected the proposed target. They should also explain the material terms of the proposed transaction, including a discussion of how they determined the nature and amount of consideration to be paid. The Guidance requests that SPACs describe any conflicts of interest of Insiders (and how those conflicts were addressed), any interests that Insiders may have in the target company, and any anticipated benefits to Insiders from the proposed business combination (including quantifying any material compensatory payments and the return on their initial investment, as well as any continuing relationship they will have with the post-merger company). Disclosure should also be provided regarding the beneficial ownership of Insiders in the combined company.

Underwriter Fees and Services. As noted above, the underwriter of a SPAC's IPO may defer a portion of its underwriting compensation until after the closing of the business combination or provide additional services to the SPAC following the IPO. Consequently, SPACs should disclose the fees that the underwriter will receive upon completion of the business combination (including the amount in fees that are contingent upon such closing) and should describe any additional services that the underwriter provided to the SPAC. The disclosure

should address whether payment for the additional services was conditioned on the completion of the business combination and whether the underwriter had any conflicts of interest in providing such services given any deferred underwriting compensation.

Conclusion

The past calendar year was a banner year for SPAC transactions, and all indications suggest that this trend will continue in 2021. With the SEC having already signaled that it will focus more closely on SPAC disclosures, and with the likelihood of additional enforcement and disclosure concerns arising from incoming leadership at the SEC, SPACs and their sponsors would be well served to heed the Guidance, and to seek appropriate legal advice, when preparing disclosure documents in connection with their upcoming IPOs and business combination transactions.

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