Proskauer

SPAC Disclosures – SEC Focuses in on Conflicts of Interests

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On December 22, 2020, the staff of the Securities and Exchange Commission's Division of Corporation Finance issued new guidance with disclosure considerations for special purpose acquisition companies ("SPACs"). The new guidance is reflected in CF Disclosure Guidance Topic No. 11 ("Topic No. 11"). SPACs, or "blank check companies," become public reporting companies through initial public offerings ("IPOs") and raise money for use in the acquisition of one or more operating companies. SPACs have been an increasingly popular structure and, in 2020, there have been close to 250 SPAC IPOs raising over $80 billion in gross proceeds.

The SEC's new guidance follows earlier comments by then-Chairman Clayton, that the compensation and other interests that affect SPAC sponsors, directors, officers, and other affiliates (referred to in this alert collectively as "insiders") should be clearly disclosed so that public investors understand their financial incentives and other potential conflicts, both at the time of the SPAC's IPO and at the time of its business combination with an operating company. Topic No. 11 provides guidance on appropriate disclosure with respect to a number of potential types of conflicts of interest and highlights the importance of appropriate disclosure on the material potential conflicts of interests of various transaction participants, including insiders, underwriters and investors in private financings by the SPAC.

While not all SPACs will include disclosure with respect to each potential conflict addressed by the staff, Topic No. 11 provides a useful checklist that a SPAC should review when preparing its disclosure documents at the time of both its IPO and at the time of a potential business combination. The new guidance should be considered in anticipating comments from the SEC staff, mitigating litigation risk, and structuring transactions in the most optimal way. Topic No. 11 identifies the following areas where the staff expects to see clear and appropriately detailed disclosure with respect to these potential material conflicts.

Initial Public Offerings

- Insiders' existing fiduciary or contractual obligations to entities other than the SPAC, whether such obligations could present material conflicts, and how such conflicts would be addressed.
- Potential for a business combination with a target company in which insiders have a pre-existing interest and how any such conflicts would be addressed.
- Financial incentives of insiders to complete a business combination, including potential losses if a business combination is not completed.
- Level of control that insiders will have over approval of a business combination.
- Whether and how the SPAC may amend the terms of its governing documents to facilitate the completion of a business combination.
- Whether and how the SPAC may extend the time it has to complete a business combination and whether shareholders may redeem their shares in connection with an extension.
- Balanced disclosure regarding insiders' past experience with SPAC transactions, including the outcomes of such transactions.

Insider Financial Incentives

- Security ownership of insiders and how the securities held by the insiders differ from those sold in the IPO. If applicable, a detailed description of the terms of convertible securities held by the insiders.
- How security ownership of insiders may create financial incentives for insiders to complete a business combination transaction, even if the transaction may not be in the best interest of other shareholders.
- Compensation of insiders for services to the SPAC and whether any payments will be contingent on the completion of a business combination.

Potential Insider Conflicts in Connection with the Evaluation of a Business Combination

- Detailed description of identification and evaluation of the target and negotiations regarding the business combination and the material terms thereof, in particular the nature and amount of consideration.
- Material factors considered by the board of the SPAC in approving the business combination, including its evaluation of the interests of its insiders.
- Insiders' conflicts of interest in presenting the proposed transaction to the SPAC and the application of any SPAC policies to address such conflicts. Whether insiders have financial or other interests in the target operating company.

- Material benefits to insiders from the transaction, including material compensation payments, return on initial investment and continuing relationship with combined company.
- Insiders' fully diluted ownership in combined company, including through exercise of warrants and conversion of convertible debt.

Additional Financings

- Whether additional financing will be necessary to complete a proposed business combination and, if so, the terms of such financing, and any material interest of insiders. If the financing involves issuance of securities, a comparison of the price and terms of such securities with securities sold in the IPO.
- Terms of any forward purchase agreement including the potential dilutive impact on other shareholders, and whether the commitment is irrevocable.
- Terms of convertible securities and any material impact on the beneficial ownership of the combined company.

Potential Underwriter Conflicts

- Fees that IPO underwriters will receive upon closing of the business combination.
- Compensation for additional services provided by the underwriters and their affiliates.

Advice for Participants in SPACs

The above presents a high-level summary of certain of the questions that SPACs and their counsel should consider in preparing disclosures and evaluating the staff's new guidance. Participants in SPAC transactions should familiarize themselves with Topic No. 11, not only in order to anticipate comments from the SEC staff and addressing litigation risk, but also to take into account when structuring SPAC IPOs and "de-SPAC" business combinations with targets. Over the last year, market considerations and the desire to attract long-term investors have pushed certain SPAC sponsors to more closely align their financial incentives with the interests of shareholders, including by creatively adjusting the terms of SPAC securities held by insiders. Topic No. 11 provides a useful reference point as the SPAC market continues to evolve and find its place in the broader capital markets and M&A landscape.

Proskauer's attorneys advise clients in all stages of SPAC transactions, including IPOs, PIPEs, business combinations and beyond. Our team works across practice areas and regularly represents sponsors, private and public investors, underwriters, executives and operators, and target operating companies.

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