

## SPACs: rebuilt and here to stay?

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Specified purpose acquisition companies (SPACs), which are companies formed to complete an initial public offering (IPO) and then acquire an operating entity in a business combination, have historically offered their targets a cheaper, quicker and more certain process to becoming publicly held than a traditional IPO. If the SPAC is unable to complete its business combination within a specified time period (typically two years), it is forced to return the IPO funds to investors.

In the early-to-mid 1990s, there were approximately 15 SPAC IPOs completed. Almost every one of these SPACs consummated its business combination, allowing the target businesses to become publicly-held without the need for their own IPO. In the late 1990s, the IPO window opened and it became increasingly easier for operating companies to consummate their own IPOs. As a result, SPACs receded into the background until 2003 when another lag in IPO activity left many investors with idle cash looking for attractive investments. SPACs came back with a vengeance and from 2003 until the middle of 2008, there were approximately 160 successfully consummated SPAC IPOs. Another decline in the financial markets, however, left SPACs, like most other investment vehicles, with very little opportunity to raise money and not a single IPO was consummated by a SPAC for most of 2008 and 2009.

Towards the end of 2009 and into 2010, SPACs have reappeared, with one IPO being completed in late 2009, several more in 2010 and a number of other SPACs currently in registration. There are several reasons for the recent re-emergence of SPACs. During 2008 and most of 2009, many SPAC investors' portfolios were saturated with

SPAC securities. At that time, a large number of SPACs had not yet found prospective target businesses to acquire but were not yet required to return investors' funds. Therefore, the capital that these investors had invested in SPACs represented 'dead capital' that could not be accessed until the SPACs either proposed business combinations or liquidated. However, by the middle of 2009, most SPACs had either completed their business combinations or failed to do so and were forced to return funds to investors. As a result, those same SPAC investors who had no available funds to invest in 2008 and the beginning of 2009 now find themselves flush with funds and looking for attractive investment opportunities.

The adoption of various changes in the structure of SPACs has also led to their re-emergence. These changes, discussed below in more detail, have made it more likely that SPACs will be able to consummate their business combinations. This in turn has made it more likely that the warrants sold by SPACs in their IPOs will continue to have value, providing more incentive for SPAC investors to invest their money in these offerings.

### **Changes to conversion and voting rights**

Historically, when a SPAC sought stockholder approval of its business combination, it would offer each public stockholder the right to convert his stock into a portion of the trust account in which a majority of the IPO proceeds were deposited. However, to be able to seek conversion, a stockholder had to vote against the proposed business combination. As a result, many SPAC business combinations were rejected because too many stockholders wanted their money returned and voted against the

transaction. To address this issue, SPAC investors have now been given the opportunity to seek conversion of their shares regardless of whether they vote for or against a proposed transaction. This has made it more likely that SPAC business combinations receive the required approval to be completed. Some SPACs have gone one step further – setting the conversion price for a stockholder that votes in favor of a proposed business combination higher than the conversion price for a stockholder that votes against it, thereby attempting to economically influence stockholders to vote in favor of a proposed business combination so that it may be completed.

In the past, if holders of more than between 20 percent and 40 percent of the total number of shares sold in the IPO sought conversion, the SPAC was not permitted to consummate its business combination. This percentage has now increased to the point where almost all of a SPAC's stockholders can seek conversion and the SPAC will still be permitted to consummate its transaction.

Certain limitations on stockholder voting and conversion rights have also been put in place to improve the chances of obtaining the necessary vote to complete a business combination. Public stockholders (together with any affiliate or any other group members) are now generally restricted from voting or seeking conversion with respect to 10 percent or more of the shares sold in the IPO. This restriction is designed to prevent a small group of stockholders from accumulating a large block of stock before the vote and attempting to use the voting or conversion rights as a means to force the SPAC or its management to purchase their shares at a significant premium to the then current market price.

#### **Avoiding the stockholder meeting to approve the transaction**

SPACs had previously been required to hold meetings at which stockholders would vote to approve or reject a proposed business combination even if holding such a meeting was not required by applicable corporate law. SPACs are now being given the flexibility to choose between holding such a stockholder meeting or to provide stockholders with the opportunity to sell their shares to the SPAC by means of a tender offer (avoiding the need for a stockholder vote). This choice to either hold a stockholder meeting or conduct a tender offer is left up to the SPAC and

is based on a variety of factors, such as whether the terms of the transaction would otherwise require the SPAC to seek stockholder approval under applicable corporate and securities laws. If the SPAC chooses to avoid the stockholder meeting and engage in a tender offer, the SPAC will be required to file tender offer documents with the SEC which will contain the same financial and other information about the target business as is required under the SEC's proxy rules, but the hope is that the tender offer process will be quicker than the traditional process of holding a stockholder vote.

#### **Permitted purchases of IPO shares using trust funds**

Historically, the funds held in a SPAC's trust account could not be released for any purposes prior to the successful consummation of the business combination or the SPAC's liquidation (except limited amounts of interest to pay for working capital requirements and tax obligations). SPACs are now permitted, after the completion of the IPO and prior to the consummation of the business combination, to have funds released from the trust account to purchase a certain percentage of shares sold in the IPO. All shares purchased would be immediately cancelled, thereby 'shrinking' the SPAC and decreasing the number of outstanding shares entitled to vote on any proposed business combination. The SPAC's ability to purchase shares increases liquidity for a public stockholder wishing to sell his shares. At the same time, by paying no more than the per-share amount then held in trust to purchase such shares, the resulting per-share conversion or liquidation price for all of the SPAC's other public stockholders increases (or at worst, remains constant).

#### **Conclusion**

Given the structural changes described above and the improvements in the financial markets generally, we believe it is likely that more SPAC activity will take place in the coming months. It is also possible that new and inventive terms may be proposed to make SPACs even more appealing to investors.

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