

IPO News Desk

IPO Professionals Speak:

Blank Checks IPOs - SPACs to Be Back in '07

2/20/07 – In 2004 we started to see the rise of Blank Checks offerings in the IPO market. In that year SIC Code 6770 designated offerings were fourth among all SIC Codes. By 2005, Blank Checks captured first place with 12% of the IPO market by number of IPOs with 28 offerings. That number was twice that of the next SIC Code classification (2834) Pharmaceutical Preparation companies with 14. This trend continued in '06 with 15% of all IPOs coming from SIC 6770 classified offerers. That dominance is continuing with the opening of the IPO market this year with six Blank Checks already public to date.

The Interviewees – We invited attorneys from three firms which have been active in Blank Checks/SPACs ["Specified Purpose Acquisition Company"] to answer a few questions on current and future prospects within the space. To get a West Coast perspective, we first brought in **Gian-Michele a Marca** and **Kenneth Guernsey** who together completed two Blank Checks in 2006 from their San Francisco office at **Cooley Godward Kronish LLP**. Then we turned to two stalwarts in Blank Checks representations from New York – **David Alan Miller of Graubard Miller** who worked on eight completed SPACs last year (the most of any attorney in the period), and **Mitchell Nussbaum of Loeb & Loeb LLP** who led all issuer's lawyers with the most completed IPOs in 2006 (five offerings, four being Blank Checks IPOs).



David Alan Miller is the managing partner of Graubard Miller and head of its Corporate and Securities Department. Mr. Miller has a wide-ranging practice that includes representing domestic and international clients, including many broker-dealers, in a variety of corporate transactions such as public and private offerings of equity and debt securities, mergers and acquisitions, and restructurings. He has represented clients in over 150 public offerings and many more private offerings of securities. Mr. Miller helped to create the financial product called a "SPAC," or "Specified Purpose Acquisition Company," in 1993. As a result, Graubard Miller has handled more SPAC IPOs and SPAC business combinations than any other law firm.

Do you see the steady stream of new Blank Checks registrations coming back or do you see this waning trend continuing and affecting the future pipeline of Blank Checks offerings?

The trend will definitely come back. In fact, it has started to already. There was a period of time in mid-2006 where the investors' appetite for SPAC IPOs dried up a bit. As a result, many deals which had been filed were "shelved." They were not withdrawn from registration; they were just held back pending a stronger SPAC market. That strong market returned at the end of 2006, so all the deals on the shelf are now getting done. Since there was already a built-in pipeline when the market rebounded, fewer deals were registered.

Based on your experiences with recent Blank Checks to what would you attribute the process becoming seemingly longer rather than shorter?

The process appears to be longer for the same reason as I explained previously. Deals were shelved and purposefully held back, thereby increasing the average time in registration. These were not delays caused by regulators; they were market driven. Accordingly, one can expect the time in registration to decrease soon.

What are the main legal issues which you have to address now as Blank Checks have evolved over their two year run?

First of all, the "run" is about 3 1/2 years, since **Millstream Acquisition Corporation** (8/25/03), the first SPAC of the new millennium, was declared effective in mid 2003. Secondly, this is actually the second "run" SPACs have made. Don't forget that, after we helped to invent the product in 1992, we consummated about 15 SPAC offerings between '93 and '96. During each of these two runs, issues arose when the structure was "tweaked." The regulators properly need to make sure that new tweaks don't run afoul of any law. There have been half a dozen or so times over the course of both runs where tweaks we have made have resulted in enhanced regulatory review before clearance was obtained.

Some of these tweaks would include adding the obligation of the insiders to buy warrants in the aftermarket and morphing that into the obligation of the insiders to instead purchase shares or warrants directly from the SPAC on a private basis at the time the IPO closes. Both require the SPACmeisters to have "skin in the game," but in the latter case, the sale proceeds go to the SPAC, thereby increasing the amount in trust for the public holders.

What trends in issues, legal or otherwise, surrounding Blank Checks IPOs do you see looming in the future? Other than the possibility of larger offerings, what other factors will affect the Blank Checks arena as bulge bracket investment banks increase their involvement in this IPO space?

You have mentioned what I think is the biggest trend—that of bulge bracket firms entering the scene and doing larger and larger deals. What will dictate whether this trend continues is how well these first few larger SPACs perform. If **Marathon Acquisition Corp.** (8/24/06) and **Freedom Acquisition Holdings, Inc.** (12/21/06) knock the ball out of the park with great acquisitions, then larger deals will be done more often. If they do not, then deal size may not continue to increase. However, notwithstanding how well these two deals do, there will always be a market for the smaller SPACs because there are so many excellent "SPACmeister" teams out there whose sweet spot is the smaller deal.

Do you see more future Blank Checks created to focus on non-U.S. targets?

There is no better way to invest in a non-U.S. target than through a SPAC which is managed by a team of SPACmeisters who are expert at sourcing and due diligizing deals in that target's jurisdiction. That's why there has already been numerous SPACs focused on overseas targets and why that will continue.

There have been plenty already, so I am not sure they will necessarily be increasing. ■



Gian-Michele a Marca is a partner in the **Cooley Godward Kronish LLP** Business department and a member of the Public Securities, Public Offerings, Leveraged Buyout and Debt Securities practice groups. Mr. a Marca's practice is focused on the representation of public and private companies, investment banks and private equity funds. Mr. a Marca's transactional expertise includes initial and follow-on public offerings, PIPE financings, convertible and high-yield note offerings, leveraged buyouts and acquisition financings, and merger and acquisition transactions.



Kenn Guernsey is a partner in the **Cooley Godward Kronish LLP** Business department. Resident in the San Francisco office, he has practiced with the Firm since 1978, except for a five-year period during which he served as General Counsel and a venture capital partner with **Hambrecht & Quist** (now **J.P. Morgan**). He served as Cooley's chief executive from 1990 to 1996. Mr. Guernsey's practice is focused on the representation of public and private companies, investment banks and venture capital investors. Mr. Guernsey's transactional expertise includes initial and follow-on public offerings, PIPE financings, private placements, merger and acquisition transactions and complex strategic alliances.

Blank Check offerings have dominated the IPO market over the past two years. Their initial registrations ran at a fairly steady pace month to month last year as well. However, there has been only one Blank Checks registration among the 36 new IPO filers in December and January. In fact December was the first month since November '04 in which no Blank Checks registered to go public. Do you see the steady stream of new Blank Checks registrations coming back or do you see this waning trend continuing and affecting the future pipeline of Blank Checks offerings?

We've witnessed three distinct phases in the modern evolution of blank check companies. The 1990's through about 2004 represented the initial phase of the SPAC structure. Beginning in 2005 and continuing through 2006, we saw an explosion in the number of blank check IPO's in a new phase of this market (maybe we should call it SPAC 2.0), as more and larger underwriters and hedge funds became active in the market and the structure caught the attention of a broader range of management teams. During this phase, blank check structures became more refined, investors became more demanding with respect to elements of the structure and offering terms and the SEC took a more active interest in the area. The fad wore off somewhat in the second half of 2006, and the downturn was exacerbated by the demise of Amaranth LLC over the summer. More recently, many of the SPAC 2.0 blank check companies have tried to complete their back-end business combination transactions, with greater difficulty than expected and decidedly mixed results. As a result of these experiences, we see the market entering yet another phase (3.0?) in which the pace of new registrations comes down from 2005-6 levels as management teams and underwriters reassess the risk and benefits of blank check IPOs and back-end transactions and the higher stakes and greater demands of the market drive some potential blank check company management teams in other directions.

Based on your experiences with recent Blank Checks to what would you attribute the process becoming seemingly longer rather than shorter (legal issues, regulatory issues, other circumstances)?

The popularity of blank check offerings has drawn additional scrutiny from all of the parties involved, most notably the SEC. With so much attention on these IPOs, issuers, underwriters and the SEC are continually identifying structural issues or improvements – as a result, blank check IPOs have become much more complex and time consuming. The offering process for some blank check companies has also been extended as management teams and underwriters have modified structures and deal terms to adapt to shifting investment community demands.

What are the main legal issues which you have to address now as Blank Checks have evolved over their two year run?

Primary legal issues for blank check IPOs remain largely the same despite the recent changes in the market:

- the structure and source of funds for the management carry; and
- ensuring that the check is really “blank” (that is, that the management team hasn't gone too far in its pre-offering exploration of potential business combination partners).

However, for post-IPO blank check companies, the primary legal issues surround the process for obtaining stockholder approval of the back-end business combination. In some cases, this has become a showdown between management and hedge fund investors.

What trends in issues, legal or otherwise, surrounding Blank Checks IPOs do you see looming in the future?

We think there will be a variety of structural modifications relating to the stockholder approval process in response to the difficulties experienced by several recent blank checks in getting their deals approved, including the implementation of more detailed charter-based conversion procedures and changes to the 20% conversion threshold.

Other than the possibility of larger offerings, what other factors will affect the Blank Checks arena as bulge bracket investment banks increase their involvement in this IPO space?

If the bulge bracket firms increase their involvement, which we think is far from certain, the competition for investors will likely increase, meaning that the strength of management teams overall should increase as well.

Do you see more future Blank Checks created to focus on non-U.S. targets (China , Europe, India , Israel , etc.)?

Yes. Geographically focused blank check companies have so far been quite successful (in consummating their IPOs and finding business combination transactions) and we expect this trend to continue. Among other reasons for this, we believe management teams and investors will continue to believe the opportunity to find an attractive merger partner at a reasonable price is greater in less mature countries than in the U.S. ■



Mitchell S. Nussbaum is partner and chair of the Corporate Securities Practice Group of Loeb & Loeb LLP. He focuses on corporate and securities law, with particular emphasis on representation of U.S. and foreign public corporations, investment and commercial banks, private emerging growth companies in public and private financings (equity

and debt), and federal securities law compliance. He has had extensive experience with technology and other companies in the U.S., as well as a broad range of companies in Asia. Mr. Nussbaum has represented numerous Asian companies that have listed on U.S. stock exchanges. He provides general corporate, securities, and business counseling to corporate clients and their officers and directors. He advises investors and investee entities with respect to venture capital financings. He also negotiates and documents acquisitions, mergers, reverse mergers, proxy contests, tender offers, and control contests and has represented issuers and underwriters in more than 20 SPAC offerings.

Do you see the steady stream of new Blank Checks registrations coming back or do you see this waning trend continuing and affecting the future pipeline of Blank Checks offerings?

I believe you will see filings pick up quite a bit for the first six months of this year. There are probably three reasons for this. First there were several SPACs that announced acquisition targets that came to a vote towards the end of last year. I believe that the marketplace was sitting back waiting to see the results of these votes or see how a liquidation would be executed in the event of a negative vote. It appears that from the investor's perspective, a sufficient percentage of those deals that came to a vote were approved and those deals were consummated. For the transactions that did not get approved, investors did receive the return of their funds as promised. Second, SPACs have performed favorably in the marketplace. And, third, funds have tended to allocate more funds towards these deals towards the beginning part of the year.

Based on your experiences with recent Blank Checks to what would you attribute the process becoming seemingly longer rather than shorter?

I don't see that the offering process is becoming longer. I actually see that the offering part of the process is actually becoming shorter than some of the busy periods we had over the last couple of years. The merger proxy part of the process filed as part of the acquisition seems to me to be the challenge in terms of shortening the process. This process has averaged around six months and it would be beneficial to the product if this part of the process becomes more streamlined.

What are the main legal issues which you have to address now as Blank Checks have evolved over their two year run?

Over the past two years, the largest legal issues in this space related to (1) the ability of insiders buying in the offering while waiving liquidation rights so that trust fund percentages increase; (2) the company's ability to extend the acquisition period; (3) the accounting treatment of the public warrants; and (4) the Delaware requirements related to stockholder approval of the liquidation of the SPAC.

What trends in issues, legal or otherwise, surrounding Blank Checks IPOs do you see looming in the future?

It is difficult to project what the big ticket legal issues will be in the future but I believe that bankers, management teams and lawyers will continue to be creative with these structures so that they continue to provide additional value to investors and management teams. In my experience, this type of creativity involves working through significant legal issues before they can be implemented on a widespread basis.

Other than the possibility of larger offerings, what other factors will affect the Blank Checks arena as bulge bracket investment banks increase their involvement in this IPO space?

I believe that the principal factors effecting SPACs going forward will be new features and performance of the acquisition targets.

Do you see more future Blank Checks created to focus on non-U.S. targets?

Yes. SPACs need to be competitive with private equity firms and other private LBO firms. Due to some of the restrictions of the vehicle, i.e. time needed to complete the acquisition – I believe they are most likely to focus on areas that are less competitive with those firms. The emerging market countries are an excellent alternative. ■■

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