SPACs And The Business Combination Agreement

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Specified purpose acquisition companies, or SPACs, are companies formed to acquire an operating business in a business combination transaction. The following briefly examines key areas of the business combination agreement in the SPAC context.

Consideration

A SPAC's business combination generally must be with a target business having a fair market value equal to at least 80 percet of the SPAC's net assets. The purchase consideration paid to the sellers can be comprised of cash from the SPAC's initial public offering, its capital stock, debt or some combination of the foregoing.

Typically, a SPAC will utilise both cash and capital stock to acquire the target business. While SPACs may wish to have all the consideration paid in stock to conserve as much cash as possible, including a cash component has certain advantages. For instance, in today's marketplace, some SPAC stockholders will certainly vote no' against the transaction in order to elect conversion to cash. As a result, the sellers may wish to purchase the SPAC's securities in the open market prior to the vote in order to increase the likelihood of the transaction being approved. If the transaction consideration includes cash, the cash used to make these market purchases will be offset by the cash received by the sellers upon closing of the transaction.

Target sellers must understand that demanding 100 percent of the consideration be paid at closing often makes it less likely that the transaction will be approved by the SPAC's stockholders. SPAC stockholders are more likely to approve a transaction that may ultimately pay more to the sellers based upon the future success of the combined company than one based solely on past results of the target. Accordingly, SPACs often employ earnouts' by which sellers are paid a portion of the purchase consideration after closing only if certain targets are achieved. This contingent portion contains a premium to the amount that would have been paid had 100 percent of the consideration been paid at closing. Using earnouts, the SPAC is able to pay a lesser guaranteed amount to the sellers of the target business on the closing date and will have to pay the additional amounts only if the operating business meets or exceeds expectations. Although the sellers receive a smaller payment on the closing date, they have the chance to receive significantly more than they otherwise would have if they were being paid solely for the current value of the business. Earnout arrangements can therefore benefit both parties and increase the likelihood of the transaction being approved.

Earnout triggers often relate to the achievement of goals such as minimum revenue, EBITDA or stock price levels (often tied to the price at which the SPAC's warrants are redeemable). When structuring earnouts, the parties must consider a variety of factors including the time periods for the earnouts, the definitions used for the triggers, calculation procedures and dispute resolution mechanism. The parties also must consider how to handle situations such as where the combined company is later sold or makes additional acquisitions during the earnout period.

Representations

Given the defined life span of a SPAC, its target must make certain representations to ensure that the transaction is completed on a timely basis. For example, a key representation is that the equity holders of the target have executed the agreement and that their execution evidences either (i) due and proper binding approval of the proposed transaction by the requisite majority of the outstanding equity of the target or (ii) in cases where such approval would first require completion of a formal proxy and meeting process, an agreement to vote yes' at the meeting. In this latter case, where there is a need for a vote by the target stockholders, the parties must understand that there will be limitations on the SPAC's ability to go on road shows' to support the transaction during specified times.

The representations and warranties of the SPAC are fairly straightforward and painless for the SPAC to give as a result of its limited history and nominal operations. One of importance will be a representation as to the minimum amount of funds held in the SPAC's trust fund. The SPAC should be careful in how this representation is drafted so that it is clear that such funds will be diminished at closing by the amounts paid to SPAC stockholders electing conversion to cash, repayment of any insider loans and payment of deal costs, including professional fees and deferred underwriting commissions. Typically, the SPAC's representations die' at closing with no post-closing indemnification obligation.

Covenants

A significant covenant for a SPAC is the parties' agreement to use their best efforts to consummate the transaction on a timely basis. Additional specific covenants go to the heart of this undertaking, such as a covenant requiring the target to timely deliver its information, such as its MD&A and financial information, for the proxy statement to be used in connection with the SPAC's stockholder meeting and in the Form 8-K that must be filed with the SEC within four business days of executing the transaction agreement. Often, the parties seek to file the road show presentation, which must contain the basis of everything that is discussed on the road shows, with this Form 8-K so that the parties are able to immediately seize upon 'street' interest generated by the announcement of the deal and are able to deliver their message and answer questions about the transaction. A failure to have the road show presentation filed with the initial Form 8-K will create a window of 'dead air' that could destroy deal momentum.

It is likely that several months will pass from the time the parties execute the agreement until consummation of the transaction. Accordingly, a fairly expansive covenant should be included that requires the target to operate in a manner consistent with past practice and which provides for affirmative and negative covenants with respect to the target's operations.

The agreement should also contain a trust fund waiver covenant, which will require each target party to waive any right to proceed against the funds held in the SPAC's trust in any dispute.

While targets may be apprehensive in waiving these claims, such waiver is almost always required by the SPAC's IPO agreements and the target would not necessarily be without recourse as the waiver would not release the SPAC from claims that did not exceed the funds available to it outside of the trust. Additionally, if the SPAC completes a transaction with another target, the trust fund would be broken and the target would then be free to bring any available claims they had against the combined company.

A SPAC usually does not have the time or resources to battle with a rogue target that breaks its agreement in bad faith. Accordingly, the SPAC may wish to include covenants that reduce the likelihood of this happening such as exclusivity and no-shop covenants, break-up fees and/or specific performance clauses. Further, the SPAC should ensure that the termination section of the agreement works hand in hand with the performance covenants so that if a target is unable or unwilling to perform required actions, the SPAC can evaluate whether to terminate the transaction and seek a more viable target if time allows.

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