



SPACs: Risks and Enforcement Trends

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December 9, 2020

Speakers

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Agenda

- I. Primer on SPACs
 - II. SEC on SPACs
 - IV. Litigation and Enforcement Risks
 - V. Case Studies
 - VI. Questions
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Primer on SPACs

What SPACs Are and Why They Matter

- “Blank-check companies” formed to raise capital through an initial public offering (IPO) to take an existing private company (“target company”) public via an acquisition.
- Recent surge in popularity.

*“SPACs have recently become known as a way to raise public funding more quickly than through a traditional IPO, particularly for high-growth, capital-intensive companies. . . . **The growth in SPACs’ popularity has only accelerated as the Covid-19 pandemic has worn on, prompting some industry observers to wonder whether this is the beginning of a new paradigm in the public markets — or a SPAC bubble waiting to pop.**”*

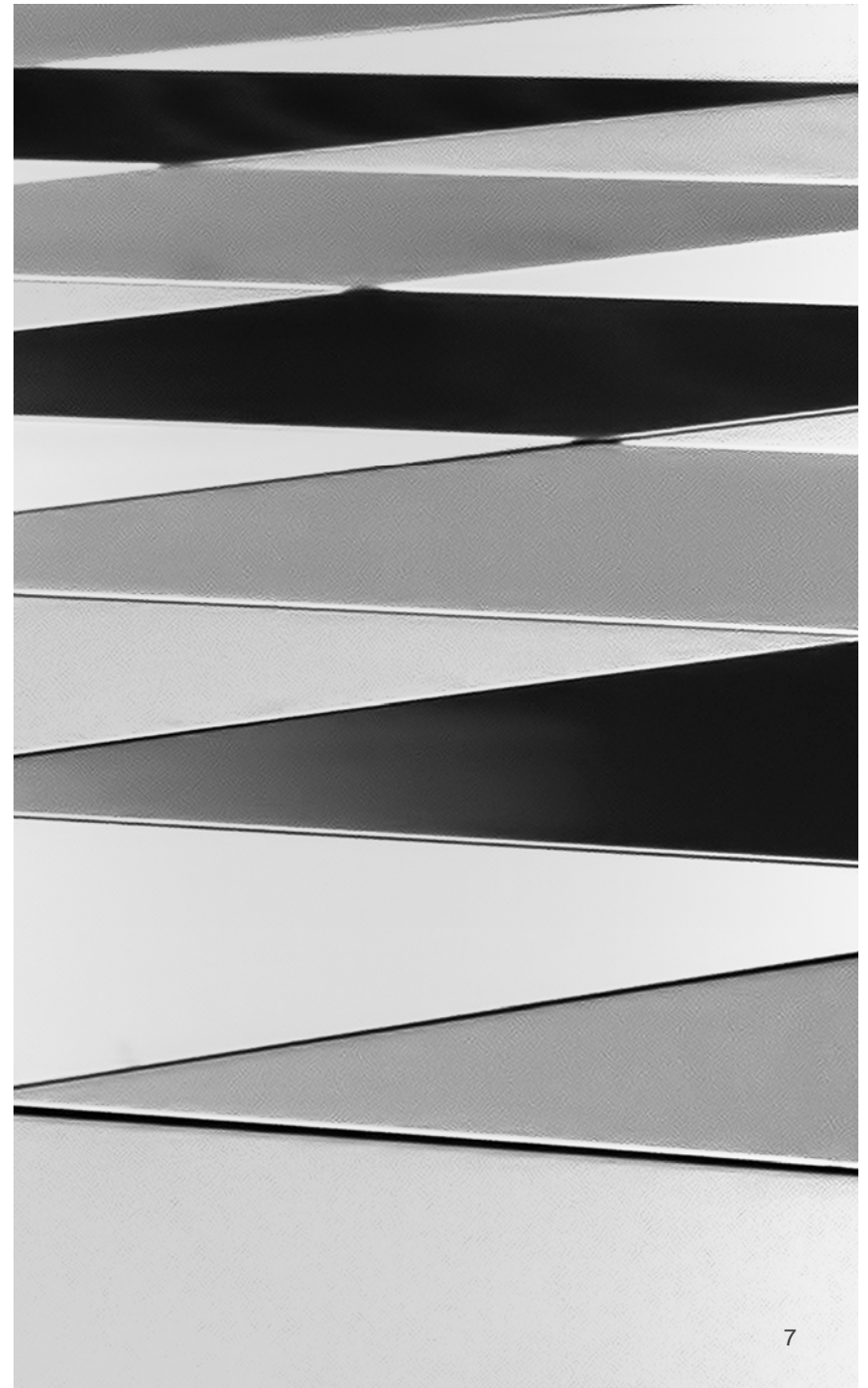
LA Business Journal, Sept. 21, 2020

Introduction to SPACs

- A SPAC goes through the typical IPO process with timing from commencement to closing of 10-12 weeks.

Introduction to SPACs, *Cont'd*

- During that time, the SPAC clears SEC comments and undertakes a road show marketing the sponsor, its vision for the market, and its ability to execute, followed by a firm commitment underwriting.



Introduction to SPACs, *Cont'd*

- After the IPO, the SPAC will pursue an acquisition opportunity and negotiate a merger or purchase agreement to acquire a business or assets (the “business combination”).

Introduction to SPACs, *Cont'd*

THREE PHASES IN SPAC LIFESPAN

1 IPO Phase: 8+ weeks

- Engage counsel and auditors
- Incorporate SPAC and sell founder shares
- Prepare S-1
- File S-1 and amendments responsive to SEC comments – 6+ weeks
- Negotiate underwriting and ancillary agreements
- Road show, pricing and closing

2 Target Search and Negotiation Phase: Up to ~19 months

- Regular periodic SEC filings
- Identify target business
- Conduct diligence and negotiate acquisition agreement
- Potentially arrange committed PIPE and/or debt financing
- Begin preparing proxy/tender offer document
- Sign acquisition agreement and financing commitments

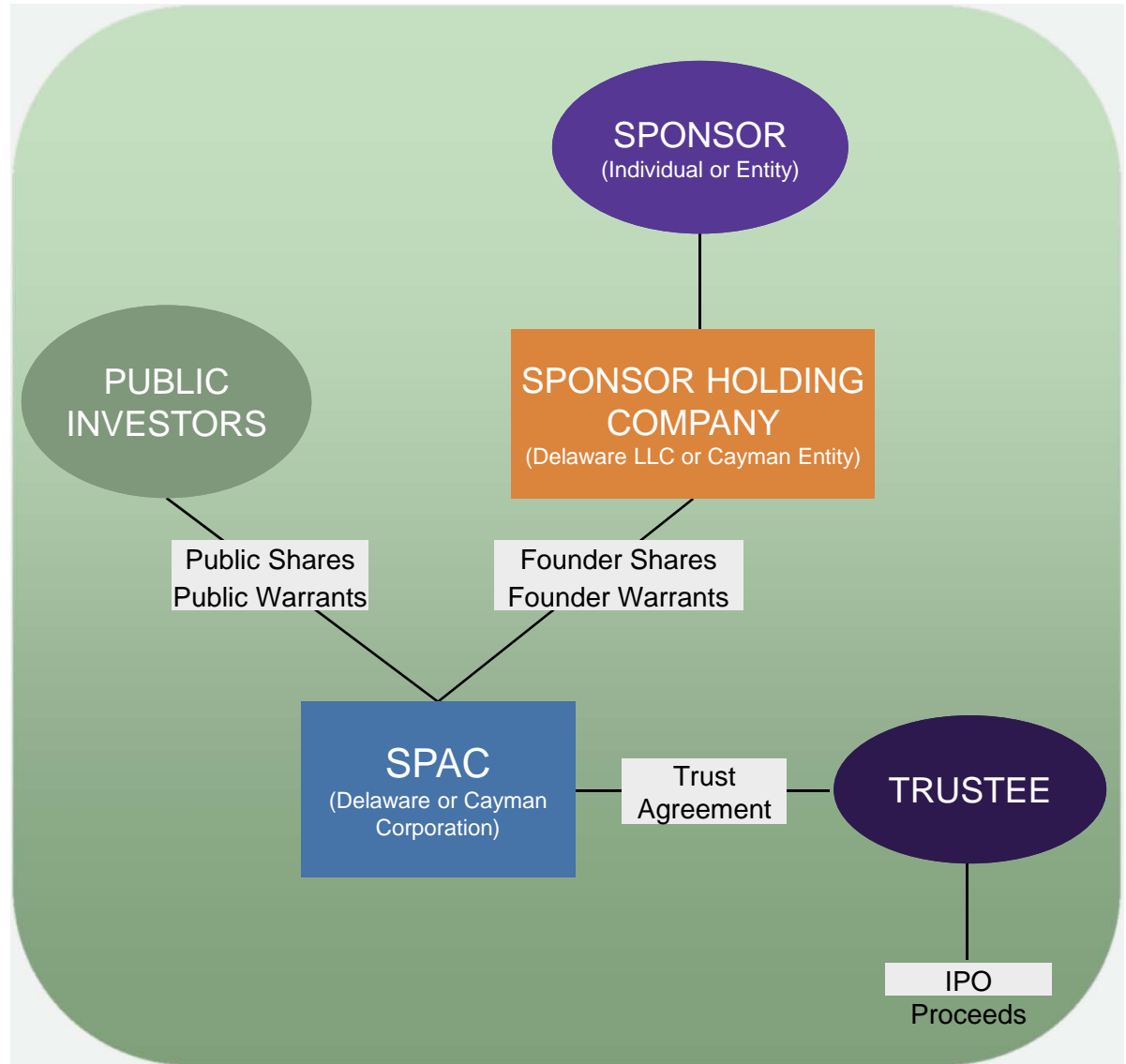
3 Approval/Closing Phase: 3-5+ months

- Announce acquisition agreement
- File preliminary proxy/tender offer document
- Meeting with SPAC investors to discuss transaction
- Obtain shareholder approval/renegotiate transaction or return to target search
- Redeem public shares of electing holders
- Close transaction
- File Super 8-K

<https://corpgov.law.harvard.edu/2018/07/06/special-purpose-acquisition-companies-an-introduction/>

SPAC Capital Structure

- Public shares equal 80% of the total shares outstanding after the IPO
- Founder shares equal 20% of the total shares outstanding after the IPO
- IPO proceeds are typically invested in short-term U.S. government securities



SPACs Specifics

Underwriter Compensation

Typical discount structure is 2% of gross proceeds to be paid at closing of the IPO (rather than IPO discount of 5%-7%), with another 3.5% deposited into the trust account and payable to the underwriters on close of business combination.

Via warrants/units, sponsors pay 2% upfront cost upon closing of the SPAC IPO, as well as the IPO fees.

Trust Account

In closing the IPO, the SPAC will fund a trust account with an amount typically equal to 100% of the gross proceeds of the IPO (97% funded by public investors, 3% funded by sponsor via “at-risk” capital).

SPACs Specifics, *Cont'd*

Founders Shares

The sponsor purchases “founder shares” from the SPAC for nominal consideration, typically \$25,000. The founder shares typically represent 20% of the post-IPO outstanding stock—a stake that can be worth millions when an acquisition is closed.

Warrants

There are usually two types of warrants issued in the SPAC IPO. One type of warrant is issued to the public investors, and the other type of warrant is issued to the sponsor in exchange for its co-investment.

SPACs Specifics, *Cont'd*

Business Combination Timing

Must be completed in 24-27 months. The process is similar to a public company merger except the SPAC must obtain shareholder approval, which in reality is less relevant than the shareholder's option to redeem.

The target company is usually private. Although it therefore does not require an SEC compliant proxy process, most of the SPAC's proxy statement functions as an IPO registration statement of the target—making it critical that the target has ability to produce audited SEC compliant financial statements.

Redemption Rights

In connection with the proxy vote, SPACs are required to offer the holders of public shares the right to redeem their public shares for a pro rata portion of the proceeds held in the trust account. A holder of public shares can elect to redeem regardless of whether they vote in favor of or against the business combination.

Why Do a SPAC?

Sponsor

- Ability to quickly execute on opportunities
- Ability to pursue variety of investment strategies
- Alternative source of capital
- Public stock currency to implement acquisition strategy
- Structural flexibility provides competitive advantage
- Minimum upfront capital outlay with attractive upside

Seller

- Increased execution and pricing certainty
 - Ability to market projections
 - Price discovery done confidentially; agreed upfront
- Potential to monetize larger stakes
- Retain ability to participate in future story upside
- Partner with proven operator to grow business
- Provides capital flexibility

SPAC Business Combinations: Advantages and Disadvantages

	Vs. Traditional IPO	Vs. Traditional M&A Transaction
Advantages	<ul style="list-style-type: none"> ▪ Price certainty at signing <ul style="list-style-type: none"> ○ No exposure to IPO window closure ▪ Greater ability to cash out ▪ Ability to use earn-out to achieve increased valuation over time 	<ul style="list-style-type: none"> ▪ Greater ability to retain upside participation ▪ Liquid currency to pursue acquisition strategy ▪ Post-transaction support of SPAC management team
Disadvantages	<ul style="list-style-type: none"> ▪ Dilution caused by Sponsor economics and public warrants ▪ Use of PIPE to fund redemptions may result in illiquidity 	<ul style="list-style-type: none"> ▪ Dilution caused by Sponsor economics and public warrants ▪ Lack of certainty of funds; Use of PIPE to fund redemptions may result in illiquidity ▪ Less ability to cash out ▪ No recourse to Trust cash in the event of breach

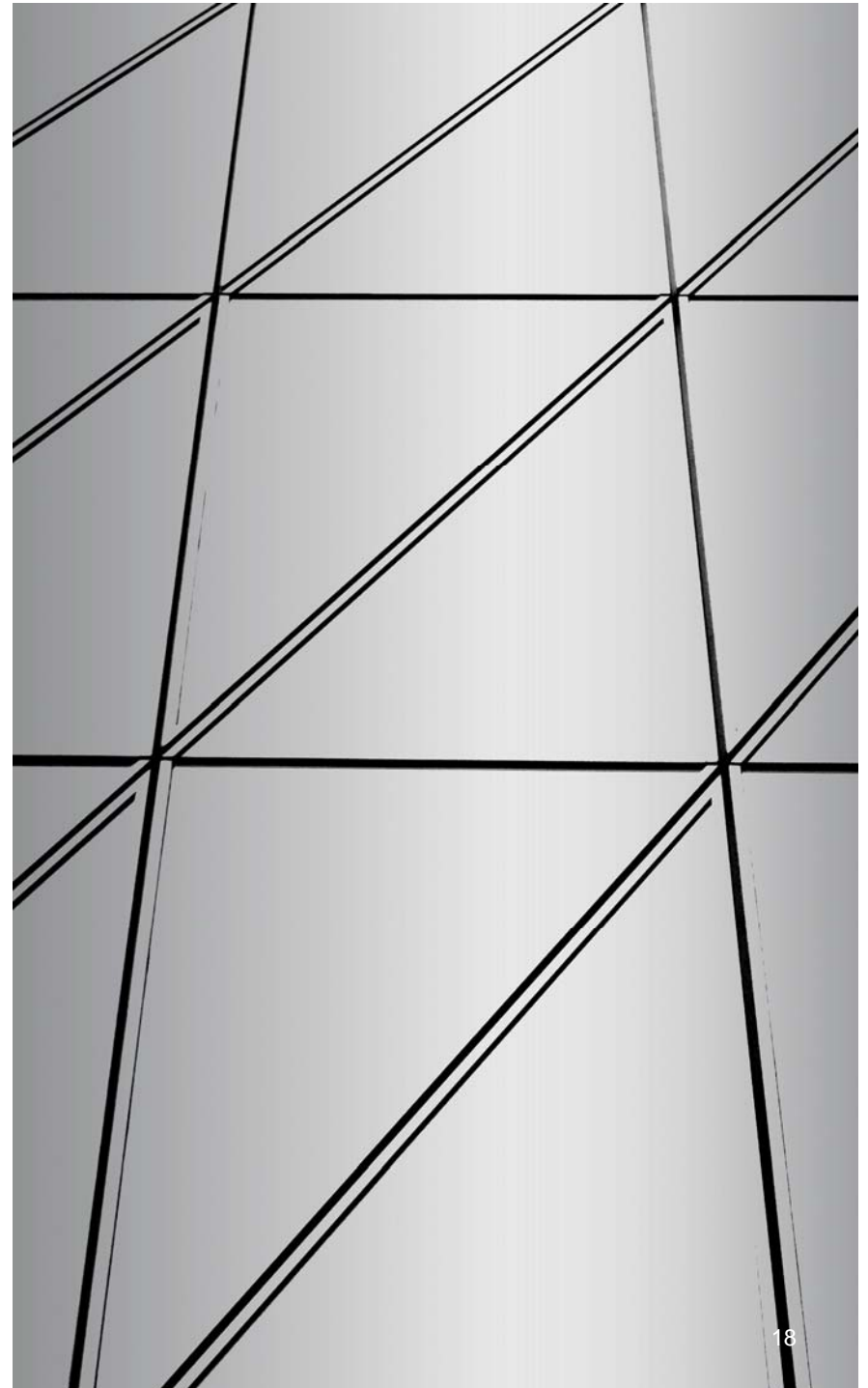
SEC's Recent Focus

SEC's Evolving View on SPACs



SEC's Initial Action

- 2008: SEC approves changes to listing rules on major exchanges.
- 2010: SEC requires additional disclosures regarding warrant purchases and requires additional disclosures representing that acquisition target has not been identified.



SEC on SPACs

SEC's Recent Focus

SEC Chairman Jay Clayton's statements on CNBC

The image is a screenshot of a CNBC video player. At the top left is the CNBC TV logo. The video title is "SEC Chairman Jay Clayton on disclosure concerns surround going p...". Below the title is a yellow banner that says "EXTENDED HOURS". The main content is a table of stock prices for SPACs, with a play button in the center. To the right of the table is a video thumbnail of Jay Clayton, SEC Chairman, with the text "ON THE PHONE JAY CLAYTON SEC CHAIRMAN". At the bottom left is a "SQUAWK EXCLUSIVE" logo. At the bottom center is a blue banner with the text "SEC CHMN. ON THE RECORD INSIDE THE 'SPAC' FRENZY". At the bottom right is the CNBC logo.

Company	Price	Change
DRAFTKINGS INC	49.00	[-2.23%]
NIKOLA CORPORATION	18.84	[-10.92%]
VIRGIN GALACTIC	15.48	[-1.59%]
PERSHING SQUARE TONTINE HOLDIN	22.52	[-0.79%]
FORTRESS VALUE ACQUISITION COR	15.19	[-2.32%]

ON THE PHONE
JAY CLAYTON
SEC CHAIRMAN

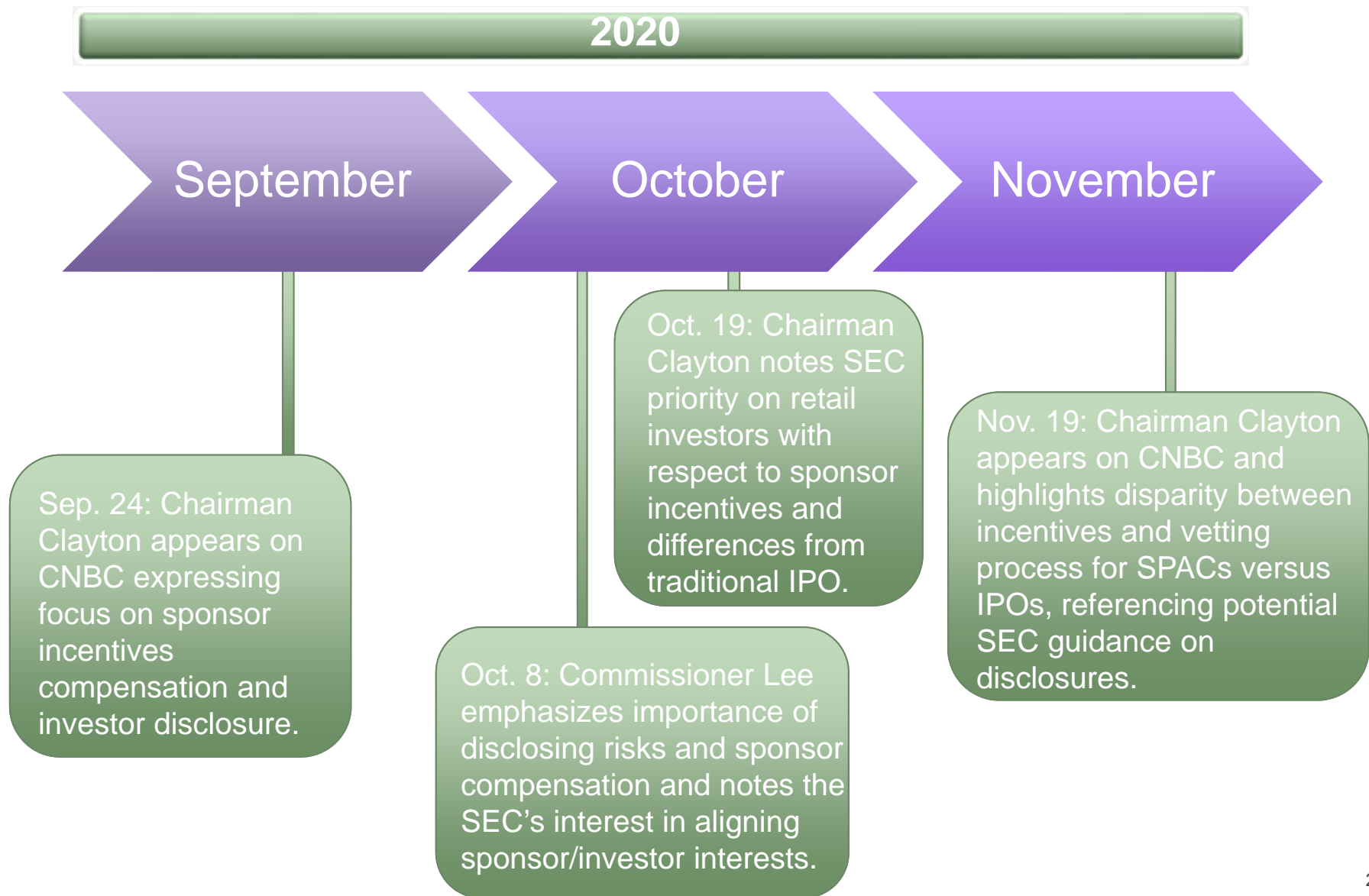
SQUAWK EXCLUSIVE

SEC CHMN. ON THE RECORD
INSIDE THE "SPAC" FRENZY

CNBC

<https://www.youtube.com/watch?v=vD6mtQSfIPc>

SEC's Recent Focus on SPACs



Media Reaction

Markets

Hot Blank-Check Companies Get SEC Scrutiny on Pay Structures

Bloomberg News

Yes, The SEC Has Noticed The Swarm Of SPACs Crawling All Over Wall Street

MARKETS

Blank-Check Firms Offering IPO Alternative Are Under Regulatory Scrutiny

Dealbreaker

Wall Street Journal

The SEC Is Sharpening Its Focus on SPACs

SEC Chairman Jay Clayton on disclosure concerns surround going public through a SPAC

Business Law Today

SPAC Stocks Fall After SEC Chairman Pushes For Additional Disclosures

CNBC

Benzinga

Regulatory Flashpoints



Litigation and Enforcement Risks

Litigation and Enforcement Risks

Section 10(b) of the Exchange Act and Rule 10b-5

Scienter Requirement

Plaintiffs must plead a “strong inference” of deceptive intent/recklessness.

Target Company Executive Liability

Officers and directors of the target company face potential liability for SPAC proxy statements or SUPER 8-K.

Business or sales data must be vetted.

Expansive Risk

The risks presented by failure to comply with Section 10(b) are not limited to SEC filings.



Elon Musk 
@elonmusk

Following



Am considering taking Tesla private at \$420.
Funding secured.

12:48 PM - 7 Aug 2018

Litigation and Enforcement Risks

Section 14(a) of the Exchange Act and Rule 14a-9

Mixed Scienter Requirement

If no scienter requirement, need only show that defendant know or should have known proxy statements contained false statements.

Standing

Only shareholders who were entitled to vote on proxy solicitation have standing.

Foreign Issuers Exempt

A foreign issuer company has greater than 50% of outstanding voting securities held by non-U.S. residents.

Litigation and Enforcement Risks

Other Federal Claims

Registration
Statement /
Section 11

Essentially strict liability claim against the issuer, officers, and directors for registration statements.

Prospectus or
Oral Statement
/ Section 12

Negligence-like claim against other sellers for misstatements or omissions in prospectus or oral communications.

Litigation and Enforcement Risks

State Law Claims

Business
Judgment
Rule

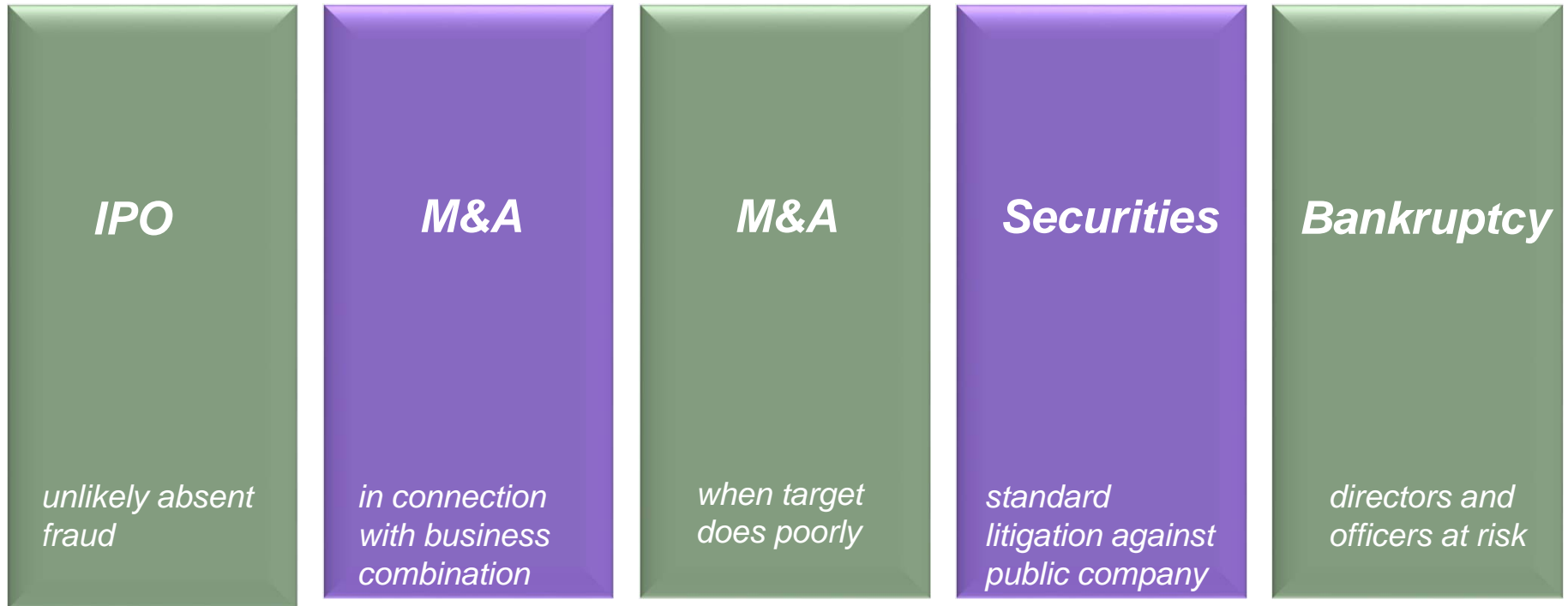
Business judgment rule does not overcome the failure to conduct due diligence.

Duty of Loyalty

Officers and directors must be wary of SPAC compensation structures that incentivize deal over protecting SPAC shareholders' interests.

Litigation and Enforcement Risks

Other Potential Lawsuits



Willkie Farr & Gallagher LLP

Case Studies

Case Study: Cambridge Capital Acquisition

SEC Charges Intelligence Communications Company and Top Executives With Defrauding Merger Investors

**FOR IMMEDIATE RELEASE
2019-103**

Washington D.C., June 20, 2019 — The SEC has charged Ability Inc., an Israel-based intelligence communications company, its wholly-owned subsidiary, and two of its top executives with defrauding shareholders of a Florida-based special purpose acquisition company (SPAC), a company formed to raise capital for a merger or acquisition within a set timeframe.

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NSU N. BANERJEE (*pro hac vice application pending*)
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19CV-5705

SECURITIES AND EXCHANGE
COMMISSION,

Case No.

Plaintiff,

COMPLAINT

vs.

ANATOLY HURGIN, ALEXANDER
AUROVSKY, ABILITY COMPUTER &
SOFTWARE INDUSTRIES LTD, AND
ABILITY INC.,

Defendants.

Plaintiff Securities and Exchange Commission ("SEC"), for its complaint against Anatoly Hurgin ("Hurgin"), Alexander Aurovsky ("Aurovsky"), Ability Computer & Software Industries Ltd. ("Ability"), and Ability Inc., alleges as follows:

SUMMARY

1. This action involves violations of the antifraud and proxy solicitation provisions of the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act") by Hurgin and Aurovsky, and the Israeli company they controlled, Ability, in connection with Ability's December 2015 merger with Cambridge Capital Acquisition Corporation ("Cambridge"), a U.S. publicly-traded special purpose acquisition company.

Case Study: Cambridge Capital Acquisition, *Cont'd*

SEC Settles Charges Against Former CEO of a Special Purpose Acquisition Company

ADMINISTRATIVE PROCEEDING

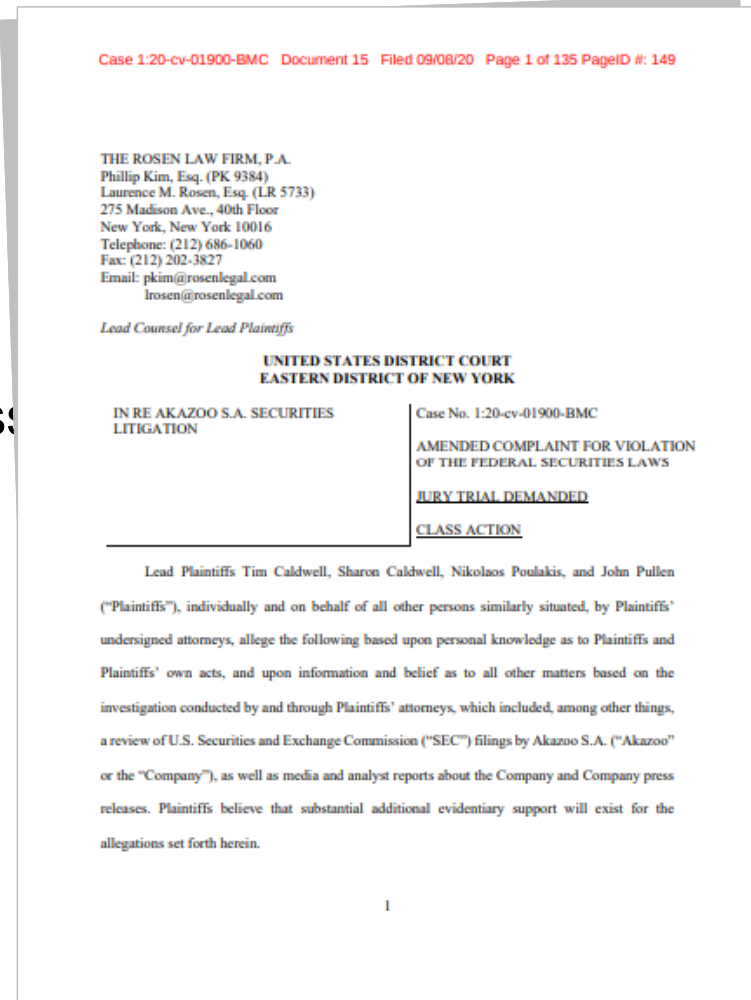
File No. 3-19210

June 20, 2019 - The Securities and Exchange Commission filed today settled administrative charges against Benjamin H. Gordon of Palm Beach, Florida, the former CEO of a Florida-based Special Purpose Acquisition Company, or "SPAC," related to the SPAC's merger with an Israel-based intelligence communications company. SPACs are companies formed specifically to acquire a yet-to-be identified company and usually raise capital for the acquisition through an initial public offering.

- **Lesson: conduct due diligence with specific respect to target's information to ensure accurate information to shareholders.**

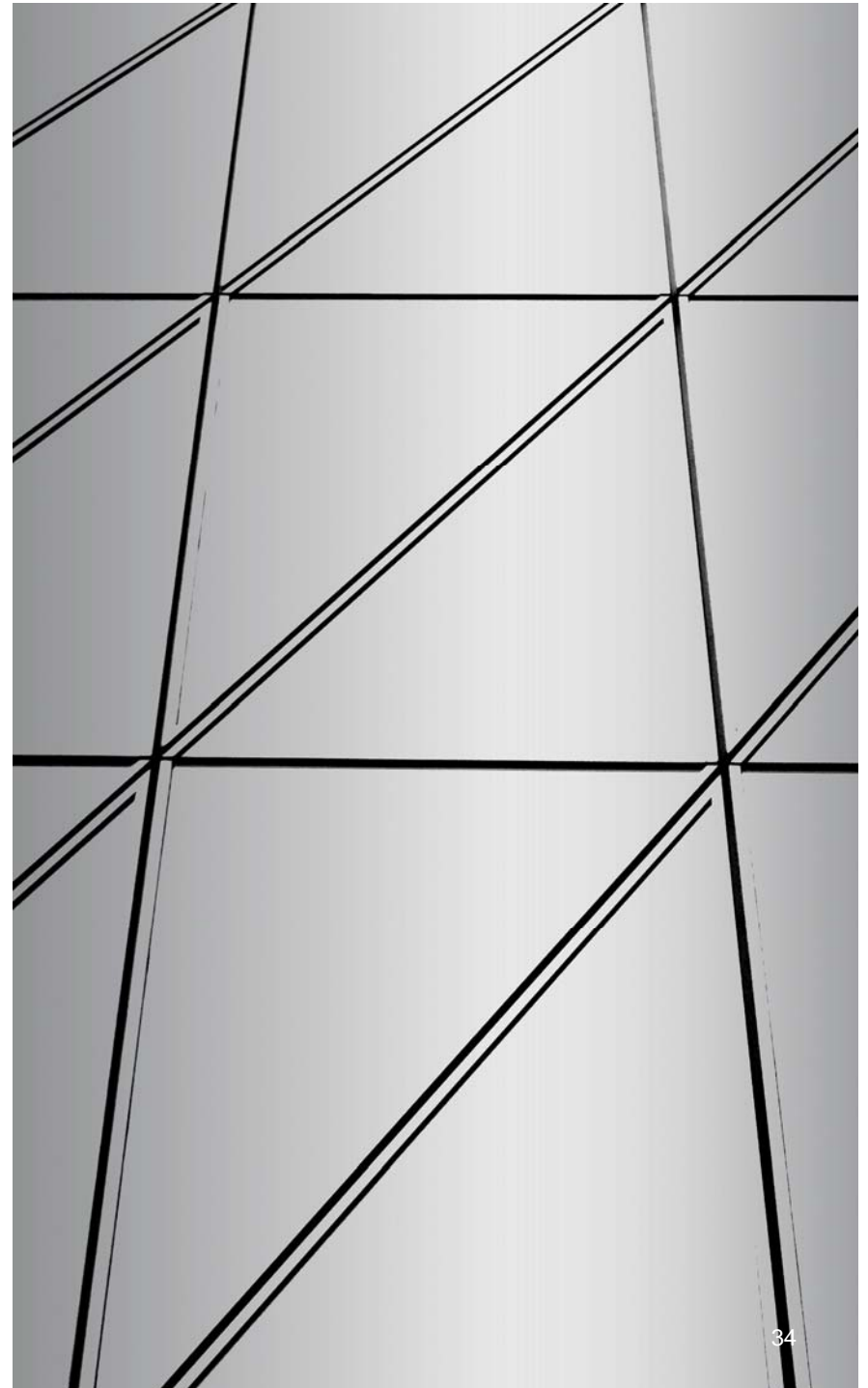
Case Study: Akazoo Ltd. & Modern Media Acquisition Corp.

- *In re Akazoo S.A. Securities Litigation*, No. 20-cv-1900, Dkt. No. 15 (E.D.N.Y. 2020)
- Consolidated federal securities class action in E.D.N.Y. against Akazoo, S.A., and officers/directors.

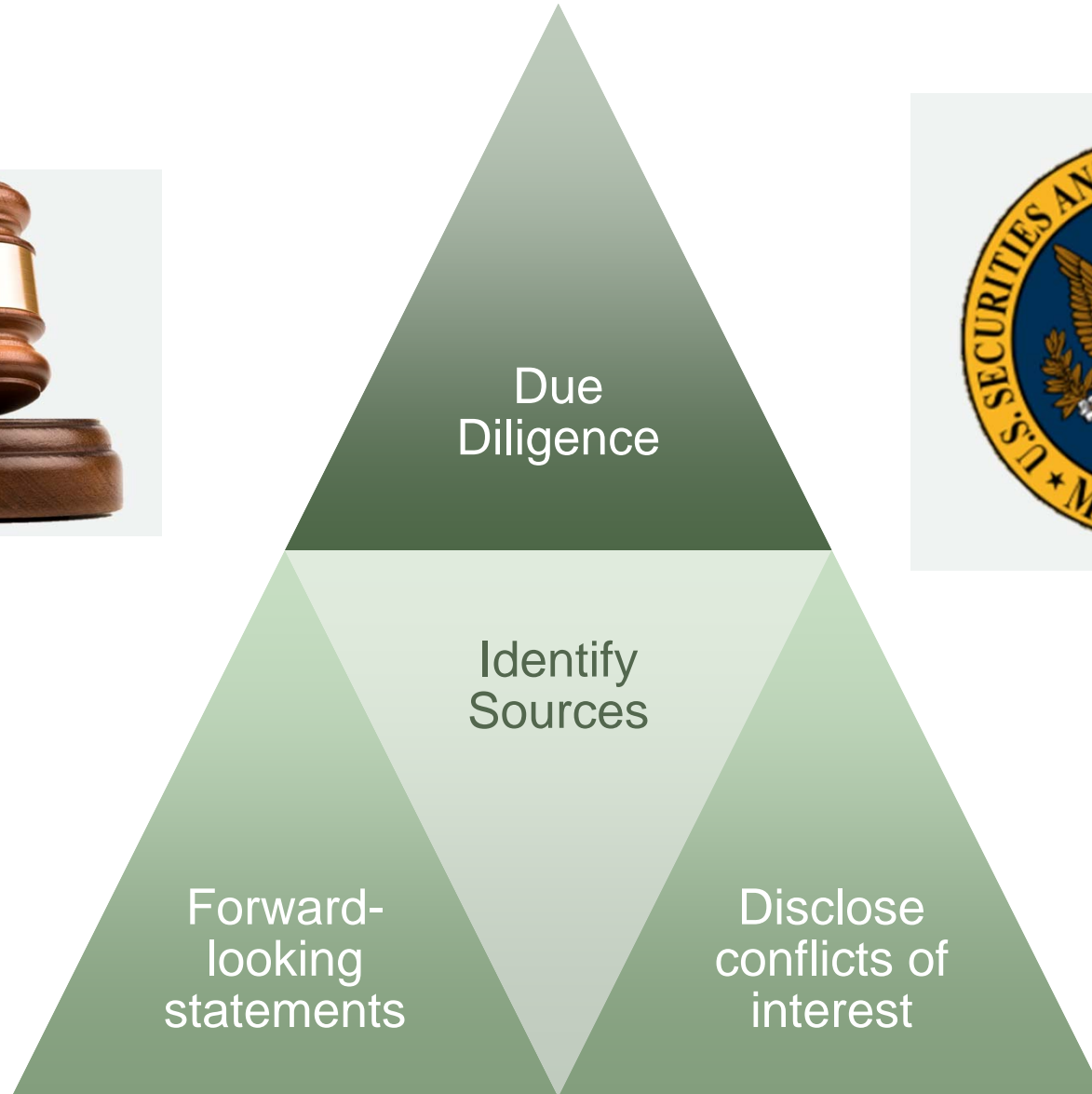


Case Study: Akazoo, *Cont'd*

- Complaint alleged liability for false statements relating to financial results, geographic reach, and number of Akazoo subscribers
- Overlap in alleged false statements between registration statement and proxy/prospectus.
- As a result, overlap in liable conduct—Akazoo for registration statement, other defendants for failing to investigate the statement.
- **Lesson: potential *strict liability* for registration statements issued along with merger.**



Lessons Learned



Willkie Farr & Gallagher LLP

Questions

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