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The Rise of Special Purpose Acquisition Companies and "SPACulation" of What's to Come

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Special purpose acquisition companies (SPACs) have been used for decades as alternative investment vehicles for traditional initial public offerings (IPOs). However, in the last year or so, they have soared in popularity as management teams and investors have seen SPACs as an alternative to mitigate market volatility risk and potentially reduce the time and costs of traditional IPOs. SPAC IPOs skyrocketed from 59 in 2019, to 248 in 2020, to 388 in 2021.[1] Correspondingly, SPAC IPO proceeds have exploded from $13.6 billion in 2019, to $83.4 billion in 2020, to $116.4 billion in 2021.[2] Given the continuing increase of SPAC IPOs, many private operating companies have been merging with SPACs to raise capital rather than using traditional IPOs or other financing activities. In this article, we address: (i) the definition of a SPAC, (ii) some of the reasons for the recent rise in SPAC IPOs and business combinations, and (iii) the potential future of SPACs.

What Is a SPAC?

SPACs are "blank check companies" that have no commercial operations. A SPAC's only assets are the money raised in its own IPO, which will be used to acquire private companies and take them public within a specific time frame (often within 18 to 24 months of the IPO), and the experience and connections of the SPAC sponsor. Usually, a SPAC is created, or sponsored, by a team of institutional investors, industry experts, or professionals from the world of private equity or hedge funds. SPACs come in a variety of forms, with some SPACs focused on completing an acquisition in a particular industry, while others have no such mandate. However, SPACs cannot identify specific private companies as targets pre-IPO.

SPAC IPOs are very standardized—they are almost universally priced at $10 per unit, which consists of a share of common stock and warrants that can be used to acquire additional common stock in the future. The warrants are typically priced "out of the money," *i.e.*, at a higher price than the offering price of the unit in the IPO. Shortly following the IPO, the common stock and the warrants publicly trade separately alongside the units. In general, the SPAC's sponsor receives 20 percent of the SPAC's common stock (often called the "founder's shares") following the SPAC's IPO for nominal consideration as compensation. Until the initial business combination is completed, the founder's shares typically are subject to a lock-up agreement, and sponsors ordinarily do not receive management fees. Following an IPO, SPACs place 100 percent of their IPO proceeds into an interest-bearing trust account, which is generally accessible only to complete an initial business combination or to redeem investors under certain conditions. In addition, to funding the costs of the SPAC IPO, the SPAC sponsor will typically have private investors invest in private warrants, which are known as the "risk capital." This risk capital represents approximately 3.5 percent of the SPAC IPO proceeds.

Once a sponsor identifies a target, the SPAC typically is obligated to obtain stockholder approval to complete the proposed initial business combination. The SPAC will also offer investors the election either to redeem their common stock for the original purchase price plus interest or to sell their common stock to the SPAC in a tender offer. Investors may redeem their common stock regardless of a vote for or against the merger, and investors may retain their warrants even if they redeem their common stock. Following completion of the merger, the operating company is the surviving public company.

What Are Some of the Reasons for the Recent Rise in SPAC IPOs and Business Combinations?

As noted above, SPACs are not new—they have existed for nearly 30 years; however, SPACs have raised more than $116 billion so far this year, as of August 2, 2021, as compared to over $83 billion last

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1 SPAC Analytics, https://www.spacanalytics.com (last visited August 2, 2021).

2 *Id.*

year, and the SPAC capital raised in 2020 surpassed all that SPACs had raised cumulatively in their 30-year history.[3] Historically, due to regulatory hurdles and investor risk, SPACs were seen as an avenue of last resort for companies that sought to go public but had troubles securing underwriters or public investor interest.[4] However, the perception of the SPAC being a last resort for a company to go public has drastically changed in the last few years. The rise of SPACs can partially be attributed to various factors, including highly regarded sponsor teams, better understanding by the market of the SPAC structure, and the well-established complementary private investment in the public equity financing market being made by large institutional investors brought to the investment by all of the bulge-bracket investment banks.

In part, the dramatic rise in SPACs could also be attributed to increased market volatility, especially created by the COVID-19 pandemic. The COVID-19 pandemic, along with increased market volatility, caused some companies to cancel or postpone traditional IPOs in 2020.[5] However, other companies chose the alternative route to an IPO by merging with a SPAC. In general, a SPAC merger allows a company to go public and receive a capital influx more quickly than it would have with a conventional IPO, as a SPAC acquisition can be closed in just a few months versus the more time-consuming process of registering an IPO with the Securities and Exchange Commission (SEC), which can take up to six months.[6] In addition, SPACs offer a firm valuation at the time of signing the business combination agreement as compared to the pricing of a traditional IPO at the end of the process.

What Is the Potential Future of SPACs?

Over the past several months, the SEC has increasingly focused on SPACs, issuing a series of investor alerts, disclosure guidance, and public statements alerting the public and market participants to potential issues in SPAC transactions. The SEC's Enforcement Division also has weighed in, launching several SPAC-related investigations.

On April 8, 2021, Acting Director John Coates of the SEC's Division of Corporation Finance issued a statement titled "SPACs, IPOs and Liability Risk under the Securities Laws" questioning the viability of the safe-harbor protection for SPACs, voicing concerns that such protection could potentially affect due diligence measures and mislead investors regarding the risk involved in purchasing certain securities.[7] Further, on April 12, 2021, Mr. Coates and SEC Acting Chief Accountant Paul Munter released a statement on accounting and reporting considerations for warrants issued by SPACs (the Statement).[8]

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3 Dave Michaels, Amrith Ramkumar, & Alexander Osipovich, *SPAC Hot Streak Put on Ice by Regulatory Warnings*, WALL ST. J. (Apr. 16, 2021), https://www.wsj.com/articles/spac-hot-streak-put-on-ice-by-regulatory-warnings-11618565403.

4 Dave Golden, *The rise of SPACs*, TECHCRUNCH (Nov. 22, 2017), https://techcrunch.com/2017/11/22/the-rise-of-spacs.

5 Maggie Fitzgerald, *Coronavirus and market volatility shuts down the IPO market for potential listings like Airbnb*, CNBC (Mar. 14, 2020), https://www.cnbc.com/2020/03/14/coronavirus-and-market-volatility-shuts-down-the-ipo-market-for-potential-listings-like-airbnb.html.

6 Tom Huddleston, Jr., *What is a SPAC? Explaining one of Wall Street's hottest trends*, CNBC (Jan. 30, 2021), https://www.cnbc.com/2021/01/30/what-is-a-spac.html.

7 Public Statement, John Coates, *SPACs, IPOs and Liability Risk under the Securities Laws* (Apr. 8, 2021) https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws. This statement represents the views of the Acting Director of the Division of Corporation Finance of the SEC. It is not a rule, regulation, or statement of the SEC.

8 Public Statement, John Coates & Paul Munter, *Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies ("SPACs")* (Apr. 12, 2021), https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs. This statement represents staff views of the Division of Corporation Finance and the Office of the Chief Accountant of the SEC. It is not a rule, regulation, or statement of the SEC.

The Statement was issued to highlight the potential accounting implications of certain terms that may be common in warrants included in SPAC transactions and to discuss the financial reporting considerations that apply if a registrant and its auditors determine there is an error in any previously filed financial statements. While these statements from the SEC temporarily jolted the SPAC IPO and SPAC business combination markets, the markets seemingly recovered quickly with 28 SPAC IPOs and 28 SPAC business combinations announced in June 2021.[9]

Conclusion

It is likely that the SPAC market will continue to receive increased scrutiny from the SEC and other regulators as evidenced by the SEC recently charging Stable Road Acquisition Corp.; its sponsor, SRC-NI; the space exploration company, Momentus Inc.; and two executives for misleading claims over their planned merger. However, notwithstanding increased scrutiny from regulators, the SPAC market shows no signs of ending soon, with, as of August 2, 2021, approximately 388 SPAC IPOs raising over $116 billion having been completed year to date and an additional 426 SPACs with over $128 billion in capital seeking acquisition targets.[10]

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9 SPACInsider, https://spacinsider.com/stats/ (last visited August 2, 2021).

10 SPAC Research, https://www.spacresearch.com/symbol?s=pre-ipo&sector=&geography (last visited August 2, 2021).