



# The De-SPACing Transaction

*PLI hosts:*

The SPAC Life Cycle: Business, Legal and Accounting Considerations Forum 2021

*April 2021 Panelists:*

Karim Anani

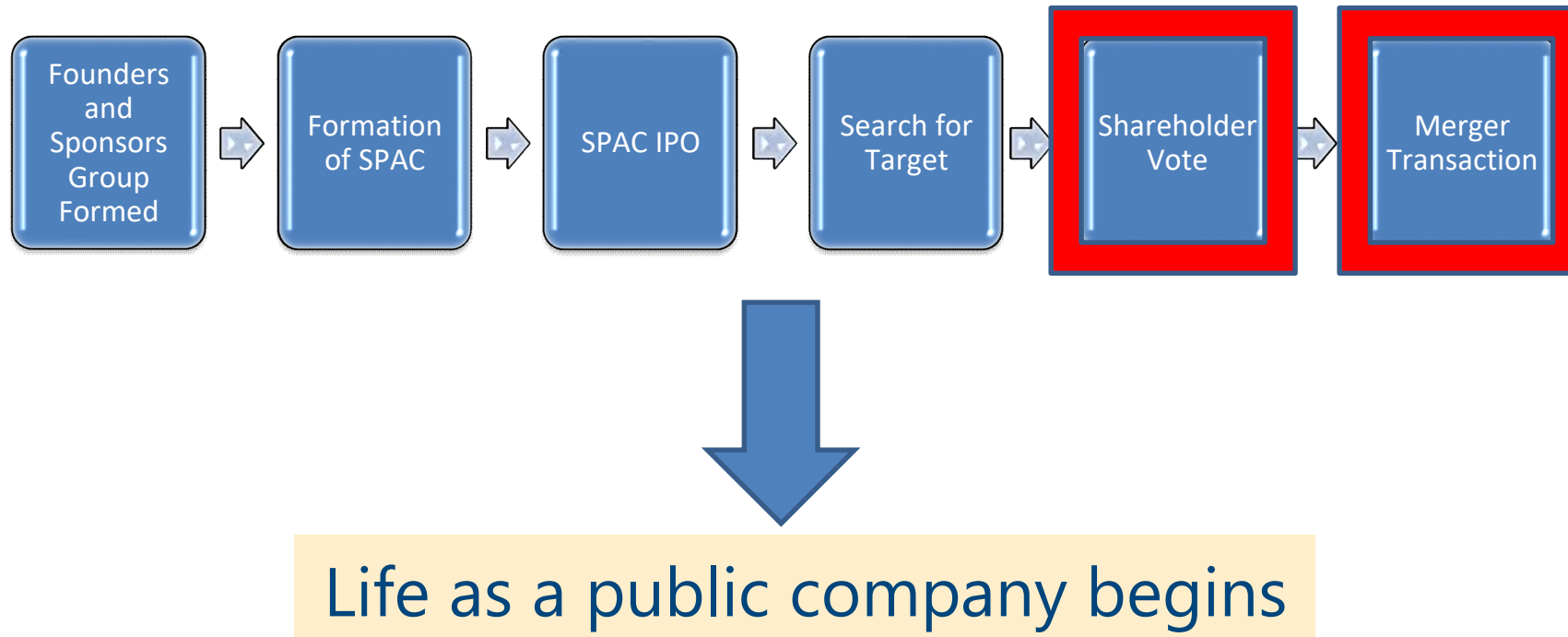
Edward S. Best

Adam Brown

Charlotte Westfall



# A Typical SPAC Life Cycle



# Discussion Outline and Overview

- Proxy and shareholder vote considerations
- Raising additional capital
- SEC reporting and accounting considerations – Reverse merger transactions
- Market communications during the de-SPACing process
- Financial statement requirements of the target company
- The “Super Form 8-K”
- Timing

# Proxy and shareholder vote considerations

# Proxy and shareholder vote considerations

- Once a SPAC identifies a target, it prepares a proxy statement to solicit shareholder approval for transaction aspects, including:
  - The business combination
  - The issuance of securities
  - The election of the board of directors of the combined company
  - Other organizational and governance-related matters

# Proxy statement or proxy/prospectus

- If SPAC intends to register new securities as part of transaction, SPAC must also file a proxy/prospectus on Form S-4 (or F-4)
- Proxy statement or proxy/prospectus statement must contain:
  - Financial statements of SPAC, target, and any businesses, if any, acquired by Target
  - Description of post-transaction company and its management, directors, governance structure, and material contracts
  - S-X compliant pro forma financial information reflecting proposed business combination
  - Management's discussion and analysis for the SPAC and for Target
  - Selected historical data of SPAC and Target, including pro forma financial data
  - Comparative per share information, including pro forma per share data
- The type of information that is required of a target company is the same as what would be required if target company were to do an IPO

## Proxy statement or proxy/prospectus *(cont'd)*

- The SEC review of the proxy statement or S-4/proxy and the comment letter process also will be similar to that of an IPO
- There are several aspects of the proxy/prospectus that require close review:
  - When will a proxy statement be used?
  - Generally, if Target's stock is closely held, and the holders are accredited investors, the SPAC will use a proxy statement instead of a registration statement on Form S-4
  - However, if a proxy statement is used, the securities received by Target stockholders will be "restricted securities," and their resale will be limited to resales under Rule 144 (one-year holding period from consummation of merger) or resales pursuant to a resale registration statement
  - By contrast, securities issued to Target stockholders pursuant to a registration statement on Form S-4 will be freely transferable (unless held by affiliates or control persons)

## Proxy statement or proxy/prospectus *(cont'd)*

- The proxy/prospectus will usually contain a discussion of the background of the merger
  - Among other things, this section will provide a discussion of valuation for Target
  - In presenting the valuation, projections will be included
    - These projections should be diligenced; the projections usually also will be shared in a data room or in investor materials with PIPE investors
    - The investor materials used in connection with marketing the PIPE transaction will be made public at the announcement of the entry into the definitive merger agreement and the PIPE transaction's subscription agreements
  - While the SPAC is a public company and forward-looking statements will benefit from the safe harbor, careful consideration should be given to the forecasts for Target



# Early Preparation

- De-SPACing is an IPO in an M&A transaction's clothing
- As with any IPO, early preparation is the key to a smooth transaction
- Even before a SPAC partner is chosen, Target should begin drafting business description, MD&A and other portions of proxy statement/S-4
- Financial statements
  - If financial statements are not SEC compliant, they may need to be restated
  - If current auditor is not appropriate or would not be independent under SEC rules, new auditor may be to be engaged and re-auditing of financial statements may be required
- Any difficult disclosure issues
- Related party transactions will need to be disclosed and should be evaluated as to whether they are on market terms and/or whether they should be amended or terminated

## Early Preparation *(cont'd)*

- Loans to officers and directors must be paid off prior to closing
- Internal controls should be evaluated for future SOX compliance
- Outstanding equity linked incentives should be reviewed and terms revised if necessary prior to signing
- Adequacy of company's accounting and legal staff should be evaluated for public company reporting experience
- Determine if any material contracts will need to be filed

# Record Date & Mailing

- Setting record date for special meeting
  - Exchange notice requirements
- How much solicitation time do you need? Consider:
  - Applicable Sources of Authority:
    - Notice requirements under state's law that merger is being done
    - Notice requirements for state of incorporation of SPAC
    - SPAC's Charter and Bylaws
    - Existing exchange rules
  - Prudential considerations:
    - Needs of clients
    - How much of stock is retail?
    - How much of stock is reliably voting yes?
    - Proxy solicitor, financial advisors and, of course the clients will all have views
- For mailing, stay coordinated with printer, SEC, transfer agent and proxy solicitor

# The Special Meeting

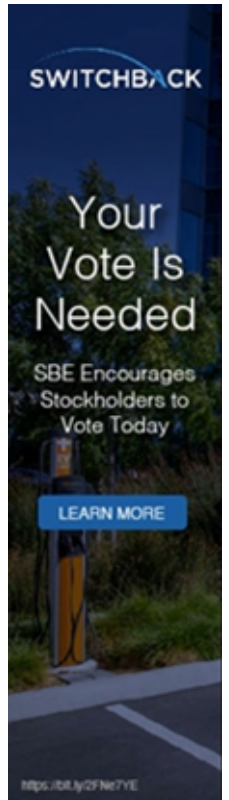
- With proper preparation can take only about 5 to 7 minutes
- Delaware allows all virtual stockholders' meetings (DGCL §211(a)(2)) but:
  - Check charter and bylaws for independent bar
  - (i) must implement reasonable measures to verify that each person deemed present and permitted to vote at the meeting by means of remote communication is a stockholder or proxyholder, (ii) must implement reasonable measures to provide such stockholders and proxyholders a reasonable opportunity to participate in the meeting and to vote on matters submitted to the stockholders, including an opportunity to read or hear the proceedings of the meeting substantially concurrently with such proceedings, and (iii) if any stockholder or proxyholder votes or takes other action at the meeting by means of remote communication, a record of such vote or other action shall be maintained by the corporation
  - Must make list of stockholders entitled to vote at the meeting available either online or at the company's offices at least 10 days before meeting. See DGCL §219(a).
  - Transfer agent is instrumental in making all this happen.

# The Special Meeting (cont'd)

- Ahead of meeting prepare:
  - Agenda and script
  - Oath of inspector of election
  - Report of inspector of election
- Do a “dry-run” with the client a few days before.
- Establish a way to communicate with client privately during the meeting.

# The Robinhood Effect

- A quorum of stockholders is required to take action at a meeting of stockholders
  - Unless a corporation's charter or bylaws otherwise provide for a lower amount (but not less than one-third), the presence, in person (online) or by proxy, of stockholders holding a majority of the shares entitled to vote at a meeting of stockholder typically constitutes a quorum
  - A stockholder's failure to vote by proxy or to vote in person (online) will not be counted towards the presence of a quorum
  - Abstentions will be counted towards the presence of a quorum
- If a SPAC has generated significant retail interest, it is not uncommon for a significant portion of the SPAC's to be held by small, retail investors
  - Small retail investors often do not vote
- For example, SwitchBack Energy Acquisition Corporation was forced to postpone its special stockholders meeting to vote on the acquisition of ChargePoint when only 45% of its shares were originally voted



# Raising additional capital

# Investor outreach

- More often than not, the de-SPAC PIPE transaction will be marketed to prospective investors while the M&A transaction is being negotiated so that both the M&A and PIPE transactions can be signed and announced together
- How will prospective PIPE investors be wall crossed?
  - The “usual” PIPE transaction wall cross script will need to be revised
    - Consider whether Target has any shares that trade, including shares trading on any foreign market or any private secondary market
    - Consider whether trading needs to be restricted in the securities of both the SPAC and Target
    - Consider the length of confidentiality obligation
  - What information will be used to market the deal and be provided to wall crossed investors?
  - What is the cleansing strategy? Under what circumstances is a cleansing release required?



## Investor outreach (*cont'd*)

- Usually, the PIPE transaction will be marketed using an investor presentation that will contain information about the SPAC, information about the proposed M&A transaction and information about Target
  - It is essential to consider whether the information that is included in the investor presentation will be either in the proxy/prospectus or whether the investor presentation (or some version of it) will be included in a Form 8-K when the M&A deal is announced
  - Specifically, consider the projections shared in the investor presentation versus the projections disclosure that will be included in the proxy/prospectus. Also consider whether any restatement of historical financials will affect the projections.
- PIPE investors will enter into subscription agreements with the SPAC. The subscription agreements will contain representations and warranties made by the SPAC, as issuer, at the time of execution, which will be brought down at the time of closing.
- PIPE investors generally expect that at closing the representations will be made as to the combined company.

# PIPE – Documenting the PIPE

- Subscription Agreements between PIPE Investors and the SPAC
  - The subscription agreements will contain representations and warranties made by the SPAC, as issuer, at the time of execution, which will be brought down at the time of closing.
  - PIPE investors generally expect that at closing the representations will be made as to the combined company.

# SEC reporting and accounting considerations

- reverse merger transactions

# SEC reporting and accounting considerations - reverse merger transactions

- SPACs are considered “shell companies” under the Securities Act of 1933.
  - Shell companies and former shell companies are subject to certain restrictions and limitations in their use of certain forms, exemptions and safe harbors.
- Form S-8 Eligibility
  - Generally, a company files a Form S-8 to become effective immediately after the effectiveness of S-1 when competing a traditional IPO.
  - However, post-de-SPAC merger, the combined company, as a former shell company, is not eligible to register offerings of securities pursuant to employee benefit plans on Form S-8 until after 60 days from filing a Super 8-K, which contains Form 10 information.

# SEC reporting and accounting considerations – reverse merger transactions

- Form S-3 Eligibility
  - Post de-SPAC merger, the combined company may not rely on the reporting shell company's pre-combination reporting history to satisfy the eligibility requirements of Form S-3 during the 12 calendar months following the business combination.
  - The SEC Staff's position is that, quote
    - "Form S-3 is premised on the widespread dissemination to the market place of an issuer's Exchange ACT reports over at least a 12-month period. Accordingly, insituations where the combined entity lack a 12-moth history of Exchange Act reporting, the staff is unlikely to be able to accelerate effectiveness under Section 8(a) of the Securities Act, which requires the staff, among other things, to give "due regard to the adequacy of the information representing the issuer theretofore available to the public, ... and to the public interest and the protection of investors." [September 21, 2020]
    - See SEC Staff Guidance in the form of Compliance & Disclosure Interpretations Question 115.18. <https://www.sec.gov/corpfin/securities-act-forms>.

# SEC reporting and accounting considerations – reverse merger transactions

- Emerging Growth Company (EGC) Status

1. Financial statements of the target

- If SPAC has filed a Form 10-K, three years of target audited financial statements are required unless target is a smaller reporting company
- If the target would qualify as an EGC were it doing an IPO, and the SPAC is an EGC, and if the SPAC has not yet filed a Form 10-K, two years of target audit financial statements are required.

2. Post-de-SPAC merger

- The combined company may not have the benefit of the length of five years as an EGC, provided other requirements of Section 2(a)(19) are met.
- The combined company may not qualify as an EGC depending on the structure of the merger and how its gross revenues are assessed.

# SEC reporting and accounting considerations – reverse merger transactions

- Rule 144 Eligibility
  - Post de-SPAC merger, the target shareholders may not rely on Rule 144 for resale until at least one year from filing a Super 8-K, which contains Form 10 information.
  - The target shareholders who receive “restricted securities” of the combined company are advised to demand resale registration rights.
- Communications Safe Harbor Eligibility
  - Until three years after the combined company filing a Super 8-K, which contains Form 10 information, the following communications safe harbors are not available:
    - Research report safe harbors (Rules 137, 138 and 139)
    - Communications more than 30 days before registration statement is on file (Rule 163A).

# SEC reporting and accounting considerations – reverse merger transactions

- Note on Voting Support and Lock-up Agreement (Lock-up Agreement)
  - In a de-SPAC merger, a SPAC may ask certain shareholders of the Target to execute a Lock-up Agreement. If a shareholder holding less than 5% of the voting equity securities of the target, signs the Lock-Up Agreement, the shares it receives at de-SPAC merger are at the risk of being restricted securities that are ineligible for being registered on the subsequent of registration of the exchange on Form S-4.
  - See SEC Staff Guidance in the form of Compliance & Disclosure Interpretations Question 139.30 and Section 239. Securities Act Section 5 239.13 at <https://www.sec.gov/corpfin/securities-act-sections>.



# Market communications during the de-SPACing process

# Publicity after public announcement of business combination

- Rules 165 and 425 allow SPACs to avoid making prohibited offers, sometimes known as “gun-jumping”
  - Section 5(c) - Before a registration statement is filed – Offers for securities to be issued in a registered offering in a business combination may be made from the date of “first public announcement” of the transaction.
  - Section 5(b)(1) – Prospectus requirements after a registration statement is filed – Any written communication relating to a business combination transaction need not qualify as a Section 10 prospectus.
- Requirements: (1) written communications must be filed with the SEC on or before the date of first use and (2) specified legends.
- Written communications are still “prospectuses” and subject to anti-fraud rules
- Available to any party to a business combination transaction and their authorized persons.
- Similar flexibility for “solicitations” under Rule 14a-12

# Publicity after public announcement of business combination (cont'd)

- What needs to get filed? “Written communications” that are “Offers” or “Solicitations” – Communications to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy.
  - Press releases and other written public statements from SPAC or target regarding the business combination
  - Scripts and slides used in analyst presentations conferences and other similar meetings regarding the business combination
  - Written communications with or to stockholders, employees (including internal newsletters, broadly distributed emails and postings on internal message boards) providing information about the business communication
  - Materials included on SPAC or target website, posted to social media regarding the business combination
  - Newspaper articles that are linked to by SPAC or target relating to the business combination, including in a social media post or tweet.

# Publicity after public announcement of business combination (cont'd)

- What does not need to be filed?
  - Oral communications that are not recorded or if they are recorded are not made broadly available for playback.
  - Re-publication or re-dissemination of information already filed with the SEC.
  - Ordinary business communications that either don't refer to the business combination or do so in a "non-substantive way" See FN 45 of Rule 14a-12 adopting release.
  - Newspaper articles about the business combination that merely quote a SPAC or Target official (unless SPAC or Target controls or arranges for article to be published or SPAC or Target posts a link to it on social media or its website)
  - Responses to unsolicited inquiries that are not broadly disseminated and don't contain material information not otherwise available
  - Internal communications that are not broad based and limited to officers, directors and employees or representatives directly involved in the business combination

# Financial statement requirements of the target company

# Prospectus drafting - Financial statement upgrade procedures

- Areas that generally require additional analysis and disclosures:
  - No use of FASB Private Company accommodations
  - Earnings per share
  - Segment reporting
  - Income taxes
  - Prior business combinations
  - Debt/Equity securities
  - Regulation S-X disclosures
  - Interim F/S
- Audits must be performed in accordance with PCAOB standards
  - Auditors may be required to perform additional audit procedures under a different materiality threshold

## Financial statement and financial disclosures (*cont'd*)

- The proxy or S-4 will be required to include pro forma financial information. Preparation of pro forma financial information will require determination of the accounting acquirer, which will depend on:
  - Relative voting rights in the combined company
  - Board composition
  - Composition of management of the combined entity
  - Relative size of the combining entities
  - Terms of the exchange of equity interests
- More details about this process and the accounting ramifications later

# Prospectus drafting

- Drafting unaudited pro forma information
  - Document the business combination – provide overview of the transaction
  - Document accounting treatment – accounting acquirer
  - Prepare minimum and maximum redemption scenarios (include backstops, if any)
    - In a minimum redemption scenario, the post-merger ownership percentages and voting interests are displayed as though no redemptions of common shares occur
    - In a maximum redemption scenario, the post-merger ownership percentages and voting interests are displayed as though the maximum amount of redemptions have occurred which would not prevent consummation of the proposed merger
- Recapitalization accounting – specific standards of presentation of equity and EPS



# Pro forma financial information

- Pro forma financial information must reflect closing of the transaction (including the PIPE)
  - Historical information of the SPAC
  - Historical information for Target
  - Pro forma adjustments
  - Pro forma totals

# Pro forma financial information overview

- The pro forma financial information will give effect to all events and transactions contemplated in the merger agreement, including:
  - PIPE issuance
  - New financing arrangement
  - Forward purchase agreement or subscription agreement (if applicable)
  - Other significant acquisition/divestitures that took place during the pro forma period
- The below is an illustrative guide of what the pro forma balance sheet columns would show for the initial proxy.
  - If the SPAC is deemed the acquirer in the transaction, then an additional column will need to be added for purchase accounting adjustments.

As of / For the period ended MONTH DAY, 20XX					As of / For the period ended MONTH DAY, 20XX		As of / For the period ended MONTH DAY, 20XX
SPAC (Historical)	OpCo (Historical)	Reclasses / Alignment	<b>Combined</b>	Pro Forma Adjustments (Assuming No Redemptions)	<b>Pro Forma Combined (Assuming No Redemptions)</b>	Additional Pro Forma Adjustments (Assuming Maximum Redemptions)	<b>Pro Forma Combined (Assuming Maximum Redemptions)</b>

# Pro forma adjustments

- The recently changed criteria for pro-forma adjustments provide for three types of adjustments:
  - Transaction accounting adjustments that reflect the accounting for the transaction under US GAAP or IFRS
  - Autonomous entity adjustments that are needed when a new registrant is being spun off from a larger entity
  - An optional third category of adjustments that include forward-looking information (e.g., expected synergies) that have “a reasonable basis” and are necessary for a “fair presentation”

## Pro forma adjustments (*cont'd*)

- Typical pro forma adjustments would include:
  - Usage of cash proceeds (e.g. payment of estimated transaction cost, payment of deferred underwriter fees)
  - Reclassification of cash held in the Trust Account that becomes available following the merger, elimination of interest income related to cash held in Trust Account
  - Proceeds from PIPE issuance or other agreements (i.e. backstops)
  - Repayment of historical debt or proceeds from new debt (if applicable)
  - Reclassification of SPAC common shares subject to possible redemption
  - Elimination of historical retained earnings (SPAC or operating entity depending on accounting acquirer determination)

# Prospectus drafting

- Other disclosure and MD&A
  - Presentation of pre and post merger ownership interests
  - Disclosure of material weaknesses in internal control (if any)
- SEC comment period
  - There are typically multiple rounds of comments from the SEC on the prospectus
  - In particular, determining the accounting acquirer, ownership interests in minimum and maximum redemption scenarios, and earnouts are points of emphasis.
  - It is important to consider the impact of multiple rounds of comments when planning for the timing of filings.

# Determining accounting acquirer

- The accounting acquirer analysis begins with an assessment of whether the Operating Company is a variable interest entity (VIE) or voting interest entity
  - If Operating Company is a VIE, then SPAC is the primary beneficiary and therefore the acquirer.
  - If Operating Company is a voting interest entity, further analysis is required (next slide).
- “Up-C structures” are frequently employed to facilitate tax-planning objectives
  - SPAC is typically the general partner; Operating company is the limited partnership.
  - The Operating Company may be a VIE because the limited partners lack kickout and participating rights.

# Determining accounting acquirer

- Determining accounting acquirer
  - Legal acquirer and accounting acquirer are not always the same
    - Is it a cash deal or a stock deal?
      - Cash deal – entity that provides the cash is the acquirer
      - Stock deal – generally the entity with majority voting interest
    - Composition of governing body of the combined entity
    - Composition of senior management of the combined entity
    - Other considerations, such as relative voting interest
    - Voting interests (including the impact of in-the-money options), is not by itself determinative
    - The terms of the exchange of equity interests
    - The acquirer usually is the combining entity that pays a premium over the precombination fair value of the equity interests of the other combining entity or entities
    - Relative size
  - Net assets of acquired company assigned new bases via typical purchase price allocation

## Determining accounting acquirer (*cont'd*)

- Accounting treatment based on accounting acquirer determination:

Entity determined to be the accounting acquirer	SPAC	Operating company
Accounting treatment	Forward merger	Reverse recapitalization
Accounting impact	The fair value of the operating company and its assets acquired and liabilities assumed are recognized in accordance with the guidance in ASC 805 (i.e., as a forward merger). The pro forma financial information included in the proxy statement will reflect purchase accounting and will require a preliminary valuation of the operating company's assets and liabilities	Merger will be treated as the equivalent of operating company issuing stock for the net assets of the SPAC, accompanied by a recapitalization. The net assets of the SPAC will be stated at historical cost, with no goodwill or other intangible assets recorded.



# Complex transaction areas

- Based on the specified terms in the Business Combination Agreement, common complex transaction areas are as follows:
  - SPAC founder shares
    - Will the founder shares be forfeited or replaced at close?
    - If they will be replaced, are there any earnout provisions associated with the replaced founder shares?
    - Are the earnout shares outstanding but subject to vesting restrictions?
  - Earnout considerations
    - Will there be earnout shares issued to the sponsors?
    - Will there be earnout shares issued to the operating company shareholders?
    - What are the earnout criteria? Will the earnout shares be forfeited if conditions are not met?
  - Modification on equity awards
    - Will the existing equity awards for the operating company be replaced at close?
    - Will the vesting of any equity awards be accelerated at close?
    - Will there be any changes in vesting terms for the equity awards?

# Complex transaction areas (cont'd)

- Classification and valuation of preferred equity instruments
  - What will happen to the preferred equity for the SPAC at close?
  - What will happen to the preferred equity for the operating company at close?
- SPAC warrants
  - Will the warrants be forfeited or replaced at close?
- Change in control provisions
  - Are there any agreements (i.e. debt agreement, employment agreement) with a change in control provision?
  - Does the transaction trigger the contractual change in control provisions?

# Complex transaction areas (cont'd)

- Redemptions
  - Are there any clause in the business combination agreement or any other agreement that limits the number of maximum redemptions?
- In the event of a reverse recapitalization, shareholders' equity of the accounting acquirer is presented as the equity of the combined company as follows:
  - **Capital stock** — The capital stock account of the target is carried forward in a reverse recapitalization. However, the balance is adjusted to reflect the par value of the outstanding capital stock of the SPAC, including the number of shares the SPAC issued to effect the acquisition
  - **Additional paid-in capital** — The additional paid-in capital account of the target is carried forward and adjusted for any change in par value of the outstanding capital stock and is increased to reflect the effective issuance of shares to the SPAC shareholders in the transaction
  - **Retained earnings** — Retained earnings of the target are carried forward

# Target financial statements – Areas of focus

- Revenue
  - Significant judgment related to implementation of ASC 606 considerations
  - Significant judgment related to the identification of the customer
- Equity & stock-based compensation
  - Significant judgment involved in the estimation of common stock fair value, including the attribution of value to the company's various classes of shares
  - Complex valuation considerations related to milestone grants to co-founders
  - Computation of EPS and determination of weighted average shares outstanding
- Related party transactions
  - Broader definition of what entities represent related parties and stricter disclosure requirements
- Adoption of new accounting standards
  - Validate that SPAC has opted-out of public company adoption timelines (e.g. Leases and Credit Losses standards)
- PCAOB uplift procedures, including SEC independence procedures (issuance of 3526 letter)

# Post-merger

- Audit considerations
  - Potentially difficult upgrade of accounting operation to meet SEC reporting requirements, resulting in more audit/review investment
  - Effectiveness of internal control timing dependent upon the consummation of the merger
  - First year public company rules do not apply if SPAC has already filed first Form 10-K
- Secondary registration of shares
  - There may be a lock-up period for each common share, or other shares exchanged in the transaction, requiring a secondary offering
  - Potential comfort letter engagement
  - May involve multiple accounting firms and/or bookrunners.

# "Super Form 8-K"

# Super 8-K filing

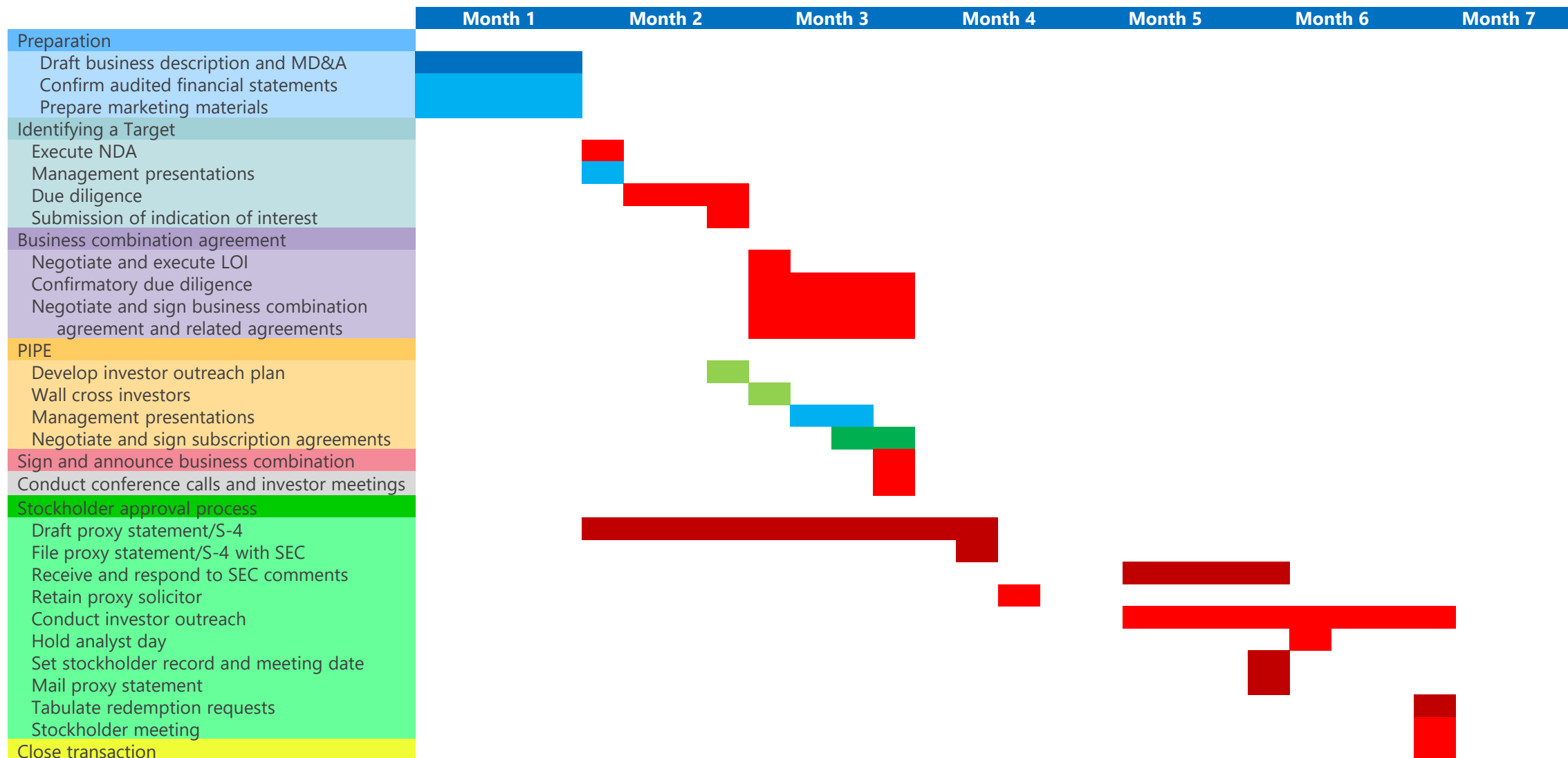
- Within four days of the SPAC merger, the combined company must file the super 8-K that includes:
  - Item 2.01 Completion of Acquisition or Disposition of Assets
  - Item 5.01 Changes in Control of Registrant
  - Item 5.06 Change in Shell Company Status
  - Item 9.01 Financial Statements and Exhibits
- Essentially requires all Form 10 registration statement information, which may require updating (due to age requirements) financial statements and requires updated pro forma financial information
- Much of the information in the Super 8-K will already have been included in the SPAC's proxy statement

# Super 8-K filing *(cont'd)*

- Purpose
  - Former SPAC is not eligible to use Form S-8 until 60 days after it has filed a Super 8-K
  - Stockholders of former SPACs may not rely on Rule 144 until twelve months after the filing of the Super 8-K
  - Former SPACs (i) are not eligible to be “well-known seasoned issuers” until at least three years after the De-SPAC transaction, (ii) are limited in their ability to incorporate by reference information into long-form registration statements on Form S-1, and (iii) may not use the “Baby Shelf Rule” (which permits registrants with a public float of less than \$75 million to use short-form registration statements on Form S-3 for primary offerings of their shares) for twelve months after the Super 8-K filing.



# Timing



SPAC  
Target  
SPAC Counsel  
Target Counsel  
Bankers  
SPAC Investors



MAYER | BROWN

SQUIRE  
PATTON BOGGS