

SPACs: Up, up, and... away?

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SPAC Market Update

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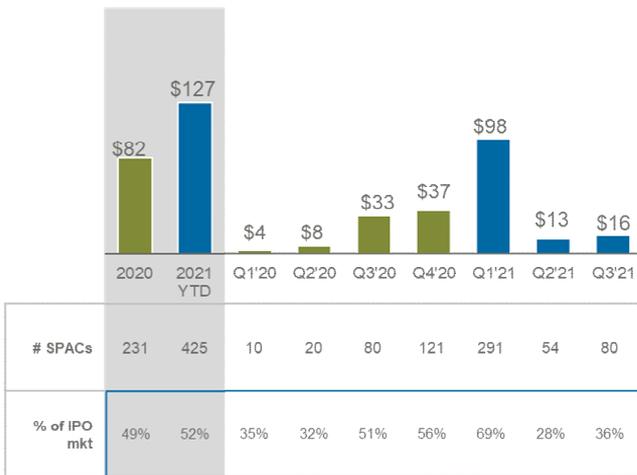
October 7, 2021 **SPACs: Up, up, and...away?**

J.P.Morgan

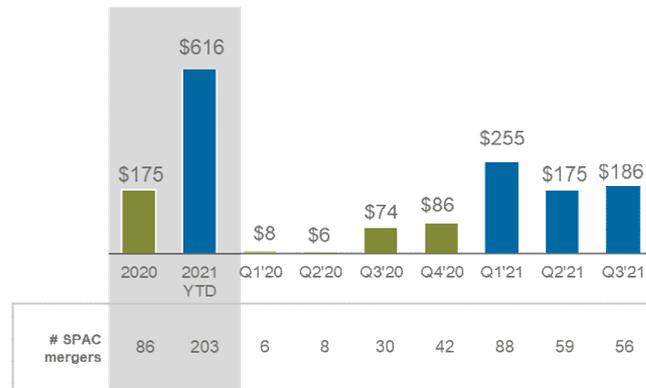
SPAC IPO and M&A Activity

2020 – 2021 YTD

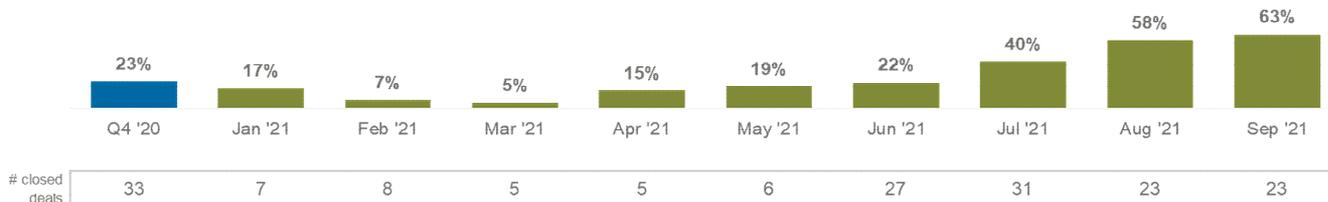
U.S. SPAC IPO volume (\$bn)



U.S. SPAC mergers (total equity value \$bn)



Redemptions have been increasing in recently completed SPAC mergers



Source: Dealogic as of 10/01/2021
Includes SPAC IPOs ≥\$100mm since 2015

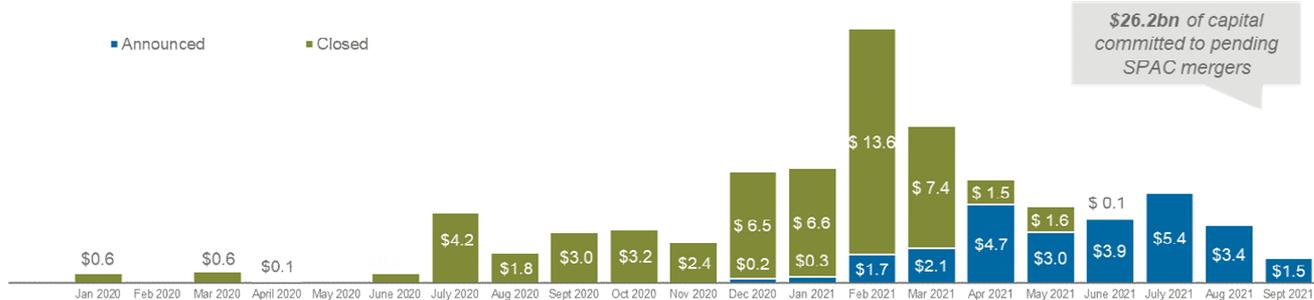
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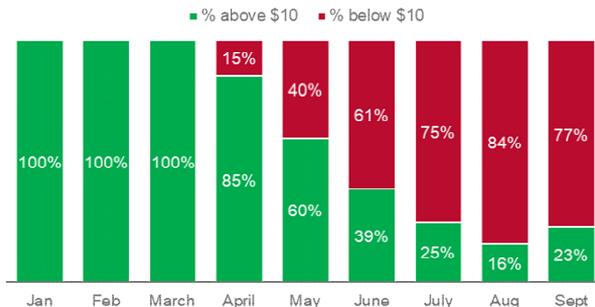
SPAC PIPE Activity

2020 – 2021 YTD

SPAC PIPE deal volume by ann. month 2020-2021 YTD (\$bn)



Announced pending de-SPAC transactions trading levels



Key PIPE headwinds

- Muted after market performance
- Significant capital committed to pending mergers
- Steady increase in redemptions
- Illiquidity of the PIPE

Source: FactSet and Bloomberg
 Note: Market data as of 10/1/21 close. De-SPAC represents Bloomberg index for SPAC deals announced but not closed
 PrivateRaise as of 10/1/21 Includes SPAC deals >\$50mm; excludes deals with no PIPE commitments

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Proceed with caution....

THE WALL STREET JOURNAL.

SEC Official Warns on Growth of Blank-Check Firms

Special-purpose acquisition companies have significant, undiscovered issues, says the acting director of the SEC's Corporation Finance division

APRIL 7 2021

FINANCIAL TIMES

Spac boom under threat as deal funding dries up

APRIL 9 2021

MarketWatch

SPAC investors worry about a 'stigma' after SEC warnings, surge in lawsuits

APRIL 12 2021



U.S. SEC official warns Wall Street of risks associated with blank-check companies

MARCH 31 2021

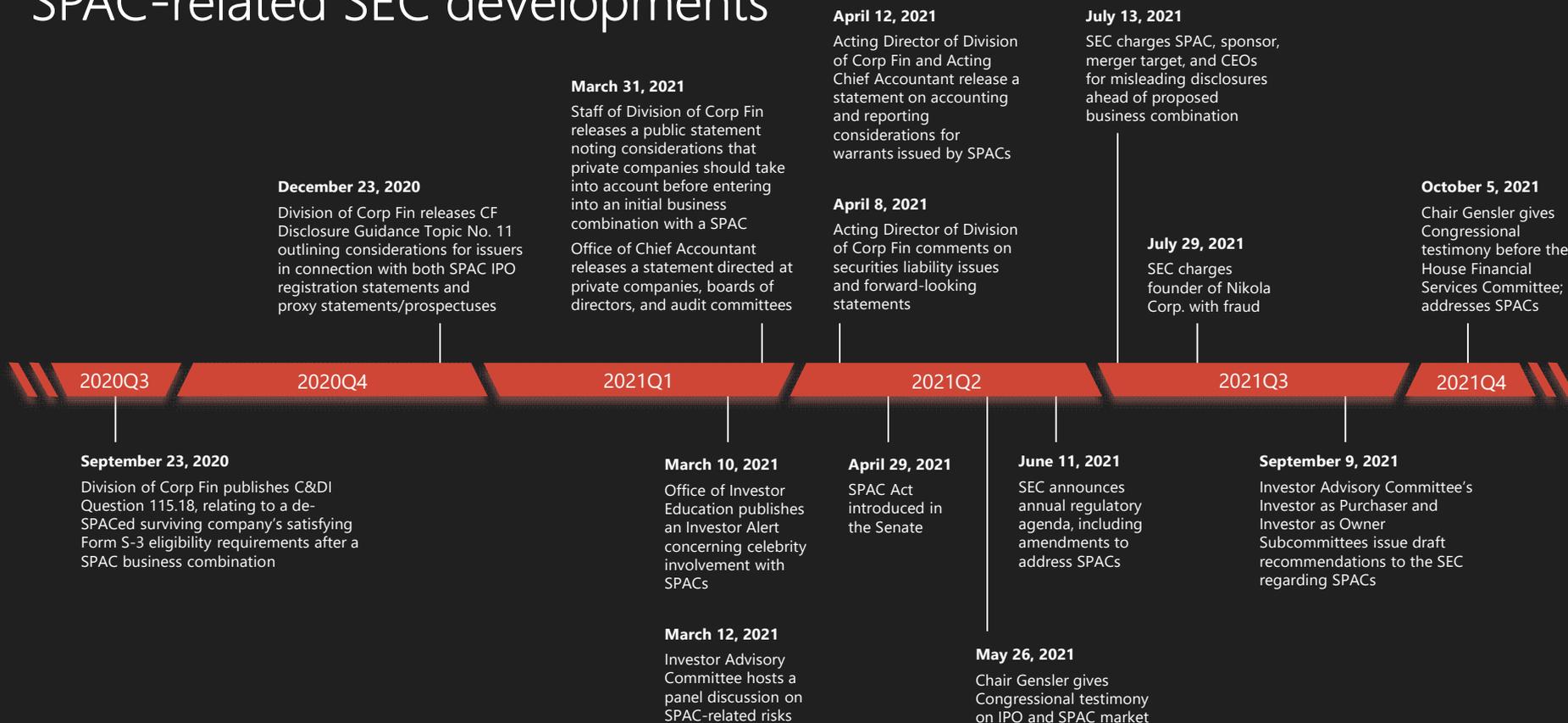
TheStreet.

Are we in a SPAC Investment Bubble Now?

MARCH 31 2021



SPAC-related SEC developments



SPACs: They're Not Perfect, But They're Not Investment Companies

Professor Joseph A. Grundfest

Stanford Law School and
The Rock Center for Corporate Governance

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ROCK CENTER **FOR** CORPORATE GOVERNANCE STANFORD

Outline

- Have two nicer law professors ever filed a weaker complaint?
- SPACs have problems, but they are not investment companies.
- The statutory definition: ICA 3(a)(1)
- The economic realities test
- The dictionary definition of “Primarily”
- The Question Presented
- Data Driven Approaches
- Promoter Incentives
- Market Disclosures and Course of Conduct
- Elizabeth Warren
- This is a very incomplete survey of the deep problems with the Investment Company Theory of SPACs.

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Investment Company Act Sec. 3(a)(1)

- (a) Definitions
 - (1) When used in this subchapter, “investment company” means any issuer which—
 - (A) is or holds itself out as being **engaged primarily**, or **proposes to engage primarily**, in the business of investing, reinvesting, or trading in securities;

- Obvious questions:
 1. What is a SPAC’s primary business?
 2. Is it primarily “investing, reinvesting, or trading in securities”?
or
 3. Is it primarily finding a merger partner that will be profitable for the promoters/investors?

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The Economic Realities Test

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- The Supreme Court frequently explains that securities law is interpreted in light of the “economic realities” of the transaction.
- “In discharging our duty, we are not bound by legal formalisms, but instead take account of the economics of the transaction under investigation.” *Reves v. Ernst & Young*, 494 U.S. 56 (1990) citing *Tcherepnin v. Knight*, 389 U.S. 332, 336, (1967) (“form should be disregarded for substance and the emphasis should be on economic reality”).
- Securities laws apply in light of “the substance—the economic realities of the transaction—rather than the names that may have been employed by the parties.” *International Broth. of Teamsters, v. Daniel*, 439 U.S. 551 (1979), citing *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 851– 852 (1975); *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967); *Howey*, 328 U.S., at 298, *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 80 (1959) (Brennan, J., concurring) (“[O]ne must apply a test in terms of the purposes of the Federal Acts . . .”).

Defining “Primarily”

- Courts regularly refer to dictionaries when interpreting statutory terms.
- “Primarily” is defined as “first, originally; mainly, principally,”
 - Source: Webster’s New World Dictionary of the American Language.
- This is quite distinct from the definition of “solely,” which means “only, exclusively.”

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The Question Presented

- What is the “economic reality” as to whether SPACs hold themselves out as being **engaged primarily**, or **proposing to engage primarily**, in the business of investing, reinvesting, or trading in securities?
- Three approaches to the question:
 - Data-driven
 - Incentive-driven
 - Disclosure-driven

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The Data

- Between January 1, 2009 and May 26, 2021, there were 826 completed SPAC transactions: 96.9% of those SPACs representing 98.5% of capital raised, successfully found merger partners.
- Obviously, the overwhelming percentage of SPAC dollars - 98.5% - are invested in operating companies, not in capital pools of the sort intended to be regulated by the Investment Company Act.
- Only 1.51% of the capital raised for SPACs was not invested in an opco.
- On a deal count basis, only 3.24 % of SPACs failed to find a partner.
- Many of the failed SPACs in this sample came in earlier years (2009 - 2015) when deal sizes were far smaller.
- Deal count: 26 fails of 803 SPACs launched.
- Proceeds: \$3.561m returned out of \$235.4275m raised.

Source: Kristi Marvin, SPACInsider.com

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Promoter Incentives

- Promoters gain significant returns only if they find merger partners.
- Absent a merger, the corpus is returned and they lose transaction costs and the opportunity cost of time spent in a failed merger hunt.
- There is an overwhelming incentive to close a deal and not to manage a collection of low-return assets subject to a two-year redemption.
- To assume that promoters start SPACs primarily to manage low-return assets on which they earn no fees for two years assumes that promoters are idiots.
- Discovery would demonstrate that promoters are overwhelmingly, not just primarily, in the business of identifying merger partners.
- Incentives to acquire are so strong that concern prevails that promoters recommend bad deals or overpay near sunset to avoid returning capital.

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Market Expectations

- The market is aware that the vast majority of SPACs find merger partners.
- The market is aware of promoter incentives.
- SPAC prospectuses emphasize the merger incentive: there is trivial emphasis on the ability to earn returns in the event of sunset.
- Descriptions of management's focus on deal execution and management, not on portfolio management
- The portfolios are managed in a very safe and largely non-discretionary, low-return manner. Emphasis is on safety, not returns.
- The Commission's staff is well aware of the ICA and of the issues raised by the Two Nice Professors. The Commission has nonetheless allowed hundreds of SPACs to go effective without raising this question.
- Does the Commission not know the law? Is the Staff asleep at the switch? Or is there no violation of the ICA?

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Senator Warren

- Senator Warren writes: “SPACs are publicly traded “shell companies that raise money with the sole purpose of buying a private company to take it public.””
 - Source: Letter from Senator Elizabeth Warren to Michael Klein, September 22, 2021, quoting Margot Patrick and Amrith Ramkumar, “Led by ‘Mr. SPAC,’ Credit Suisse Cashes In on Blank-Check Spree,” The Wall Street Journal, February 5, 2021, <https://www.wsj.com/articles/led-by-mr-spac-credit-suisse-cashes-in-on-blank-check-spree-11612527389>.
- “Sole purpose” is obviously stronger than the statutory “primary purpose.”
- Senator Warren seems persuaded that SPACs are not investment companies.
- QED.

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