Top 10 Practice Tips: PIPE Transactions by SPACs

A Practical Guidance® Practice Note by Anna Pinedo, Brian Hirshberg, and Ryan Castillo, Mayer Brown LLP

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This practice note discusses ten practice points that can help you, as counsel to a special purpose acquisition company (SPAC) or its placement agent, execute a private investment in public equity (PIPE) transaction alongside a SPAC business combination transaction.

For additional information on SPACs, see Special Purpose Acquisition Companies and Market Trends 2019/20: Special Purpose Acquisition Companies (SPACs). For additional practical guidance on PIPEs, see PIPE Transactions and Market Trends 2019/20: PIPEs.

A SPAC is a public shell company that uses proceeds from its initial public offering (IPO) to acquire a private company within a designated time frame. Recently, merging into a SPAC has become an attractive alternative for many private companies in lieu of undertaking a traditional IPO or direct listing. Following an announcement of a proposed business combination, the SPAC must offer its public investors the option to either redeem their common stock for the original purchase price or to sell their common stock to the SPAC in a tender offer. This redemption option inherently creates uncertainty as to the amount of cash available to the combined company following the initial business combination. Many SPACs have recently mitigated this concern by issuing new securities to institutional accredited investors in a PIPE transaction that is contingent upon the closing of the initial business combination. The capital raised in the PIPE transaction generally will be used to provide additional capital for the operating company to deploy following the consummation of the business combination. Below are ten practice tips to consider when representing a SPAC in a PIPE transaction:

1. **Set out roles and responsibilities in engagement letter.** The SPAC will often seek to engage one or more of the same investment banks that assisted the SPAC with its IPO as the placement agents for a PIPE transaction. Generally, due to the need to wall cross investors and maintain the confidentiality of the process, it will be preferable to have a sole placement agent. Notwithstanding the prior relationships with the SPAC, the bank selected as placement agent should follow its normal practice for a private placement engagement and enter into its customary form of PIPE engagement letter with the SPAC (the acquiring

company in the business combination), subject to addressing some special issues applicable to SPACs.

The engagement letter documents the fees and expenses to be paid by the SPAC in connection with the PIPE transaction. Given that there may be various investment banks advising the SPAC on capital markets advisory matters or on merger and acquisition introductions, and these banks may have certain fee arrangements in place, it will be important to address any other existing arrangements. If the engagement is not on an exclusive basis, the letter should acknowledge the inclusion and role of the other engaged agent(s) in the PIPE transaction and specifically allocate compensation between the agents to avoid any unintended overlap or dispute. Engagement letters with multiple placement agents often limit compensation to a percentage of the proceeds received from investors that were actually introduced to the SPAC by the particular agent. The private company target may also have banking relationships and may also have pre-existing commitments to include an adviser in the PIPE process. Usually the PIPE placement agent will want to consider a fee tail. The fee tail should be addressed in the engagement letter as well. There may also be a right of first refusal or a right of first offer included in the letter relating to future offerings undertaken by the combined company.

Generally, a PIPE engagement letter would include certain representations and warranties from the issuer relating to the accuracy of the diligence and other materials provided by the issuer to the placement agent. It may make sense to ensure that the private company target be included in such representations since the PIPE placement agent will rely on the diligence materials furnished by the private company target as well as the investor presentation, term sheet, or other materials prepared by the private company target to solicit potential PIPE purchasers.

Most form engagement letters will include a broad securities indemnification provision wherein the issuer indemnifies the placement agent and certain related parties in connection with losses arising in connection with the transaction. A SPAC will be limited in its ability to provide meaningful indemnification provisions given that the SPAC's proceeds from its IPO will have been deposited into the trust account, and the trust account cannot be accessed other than for limited purposes. Again, this may be another reason for joining the private company target as a signatory to the engagement letter. Another approach that may be considered is including the SPAC sponsor as a signatory to stand behind the indemnity and also for purposes of broader fee tail coverage.

2. **Consider deal structure.** Ideally, the public announcement of the execution of the initial business combination agreement will be timed to coincide with the public announcement of the PIPE transaction. In order to facilitate a combined public announcement, definitive commitments for the PIPE transaction must have been received concurrent with the execution of the business combination agreement. The commitment from the PIPE investors would be irrevocable but conditioned on the consummation of the business combination by a specified date (typically at least three months following the initial announcement of the business combination). The PIPE investor would bear the pricing risk between signing of the subscription agreement and closing. Most PIPE transactions undertaken in connection with SPAC business combinations will involve the sale of shares of common stock, without warrants, to the PIPE purchasers. Any shareholder approval requirement that is triggered by applicable stock exchange rules due to the size of the PIPE transaction may be addressed by adding a proposal to the proxy statement prepared to seek approval of the business combination from the SPAC's shareholders.

   Alternatively, the parties may instead publicly announce the execution of the business combination agreement in advance of obtaining the PIPE financing commitment. In this case, the PIPE market process would commence at a time when all the details relating to the business combination are already public. In either event, the PIPE transaction may be structured to have proceeds (1) delivered shortly after execution of the securities purchase agreement into an escrow account with the release subject to consummation of the business combination or (2) paid following receipt of shareholder approval of the business combination (and PIPE offering if applicable) and concurrent with the closing of the business combination.

3. **Implement accredited investor updates.** On August 26, 2020, the Securities and Exchange Commission adopted final amendments to the definition of "accredited investor" and related amendments to the definition of "qualified institutional buyer." The accredited investor definition is central to the regulation of exempt offerings, including PIPE transactions. The amendments broaden the categories of individuals and entities that qualify as accredited investors. As a result of the amendments,

any entity that has at least $5 million of assets or investments may be considered an accredited investor and participate as an investor in the SPAC's PIPE transaction so long as it was not formed solely to acquire the securities offered in the PIPE transaction. Counsel should ensure that the representations and warranties in the securities purchase agreement and qualification forms that are being used in the PIPE transaction are appropriately updated to include the new categories of accredited investors. These amendments will become effective on December 8, 2020.

4. **Implement wall-crossing procedures.** A PIPE transaction is typically marketed by the SPAC's placement agent to institutional accredited investors that have been "wall crossed" and have expressly agreed to a securities trading restriction (the trading restriction will prevent a wall-crossed investor from trading in the securities of the SPAC and, if applicable, the private company target, during the trading restriction period). This is usually accomplished through the use of a wall-crossing script by the placement agent's private placement team in which they provide limited information to the recipient.

   For example, the placement agent would not reveal the identity of the public SPAC until the investor agrees to maintain the confidentiality of the shared information and comply with the securities trading restriction. The placement agent must confirm the investor's undertaking with an email that requires an affirmative reply from the investor. The material non-public information shared in the wall-crossing process is often significantly more extensive in the case of a SPAC related PIPE transaction compared to a typical PIPE transaction due to the lack of public information relating to the private company. This may necessitate entry into a formal non-disclosure agreement. The parties often find it important to share a significant amount of information about the business combination (constituting material non-public information as it relates to the public SPAC). The script should use a trading restriction period that is limited to the securities of the public SPAC and is significantly longer than would be necessary for a typical PIPE transaction that does not involve a business combination.

   As an alternative to imposing a lengthy trading restriction on wall-crossed parties, the parties may wish to instead delay disclosing the identity of the public SPAC and only disclose information relating to the private company without detailing specifics as to the contemplated transaction. This may allow prospective purchasers additional time to diligence and review information relating to the private company without the need to wall cross such purchasers until the time that the public SPAC is ready to be identified. These issues should be considered carefully and fully vetted internally within the placement agent, as well as by the SPAC and its counsel and the private company target and its counsel. In the event that the SPAC has entered into a letter of intent with a specified exclusivity period with a private company, the end date of the wall cross should ideally coincide with the expiration of such exclusivity period. Counsel will need to determine when the shared information is expected to be made public and/or will become stale so the prospective purchasers are appropriately cleansed of the information upon the period's expiration or if a cleansing announcement will be required.

5. **Consider the impact of support agreements.** Public company investors in the SPAC that expect to participate in the PIPE transaction or that are affiliated with the SPAC's sponsor often agree to execute support or non-redemption agreements in support of the business combination and commit not to (or waive their right to) redeem their SPAC securities. These are commonly entered into concurrently with the execution of the business combination agreement and may be important as it relates to the PIPE transaction. A high percentage of supporting SPAC shareholders will lessen the redemption risk and need for proceeds from the PIPE transaction to mitigate this risk. The percentage of SPAC shareholders that have committed not to redeem their SPAC securities must be publicly disclosed with the form of agreement publicly filed by the SPAC.

   The public announcement of the business combination should include these commitments in order to support the marketing of the PIPE transaction. The commitments will also need to be disclosed in the proxy statement subsequently delivered to the SPAC's shareholders. As part of obtaining the support of its shareholders, the SPAC must be aware of all communications and ensure that they do not violate the proxy rules. Some SPAC shareholders also sign lock-up agreements restricting their ability to transfer securities in the company for a specified period of time following the consummation of the business combination. A significant number of locked-up shareholders will reduce the risk that the SPAC shareholders will immediately sell following the business combination. The PIPE investors will want to ensure that the resale registration statement (as described below) that covers their resale from time to time of the securities purchased in the PIPE transaction becomes effective prior to the release of the SPAC shareholder's lock-up agreement.

6. **Ensure appropriate diligence review by placement agent and its counsel.** In the context of a Regulation D offering, Financial Industry Regulatory Authority (FINRA) Rule 2310 requires broker-dealers to conduct a suitability analysis when recommending securities to both accredited and non-accredited investors that takes into account the investors' knowledge and experience. Of course, now Regulation Best Interest imposes additional responsibilities in the case of retail investors. While many if not most PIPE investors likely will be institutional accredited investors and will be considered "institutional accounts" for FINRA purposes and may disclaim reliance on the placement agent for any recommendation or diligence, there are still reputational and other franchise issues to consider.

   In Regulatory Notice 10–22, FINRA reminded member firms of their diligence obligations in connection with Regulation D offerings. In order to ensure that it has fulfilled its suitability obligations, a broker-dealer in a Regulation D offering should, at a minimum, conduct a reasonable investigation of, among other things, the issuer, its management, its business prospects, its assets, the claims made by the issuer regarding its business and prospects, the intended use of proceeds of the offering, and related matters. The scope of the placement agent's obligation, according to the Notice, is expected to take into account other factors as well, including the circumstances of the offering.

   Similarly, under applicable FINRA rules, a firm that engages in a Regulation D offering also must have in place policies and procedures reasonably designed to ensure that, among other things, its registered representatives and other personnel engage in an inquiry that is sufficiently rigorous to comply with their legal and regulatory requirements. Most placement agents active in private placements will have their own applicable firm policies and procedures, including a commitment process and a diligence process for private placements. It is important to take into account that in connection with a PIPE transaction involving a SPAC, the potential investors largely will be focused on the business of the private company target. There will not be any publicly available information regarding the private company target as the proxy or S-4 disclosures will be prepared only following the entry into the initial business combination agreement. Significant placement agent diligence (undertaken by the placement agent and its counsel) will be required as to both the SPAC and the private company target. The investor presentation relating to the proposed PIPE transaction, the SPAC, the terms of the contemplated initial business combination and the business of the private company target will need to be vetted. In addition, as discussed below, the prospective PIPE investors often will be allowed access to a data room. All of the data room information should be vetted by the placement agent and its counsel. Finally, private placement transactions are subject to the antifraud provisions of the Securities Act of 1933, as amended, including Section 17(a), as well as the antifraud provisions of the Securities Exchange Act of 1934, as amended, including Section 10(b), and the state securities laws and state common law of fraud and negligent misrepresentation.

7. **Facilitate diligence review by prospective PIPE investors.** The prospective PIPE purchasers generally will initially review an investor presentation. The investor presentation will provide information regarding the transaction, the SPAC, the anticipated timing of the PIPE transaction and the initial business combination, the anticipated terms of the initial business combination, some discussion of the post-transaction capital structure and capitalization of the combined company, and a fairly detailed discussion of the private company target and its business.

   Often, the discussion of the private company target and its business will include some projections. These projections will be subject to a number of assumptions, which should be described. The projections will have been referenced and subject to due diligence in connection with the initial business combination; however, it will be important to understand the projections that would appear in the proxy or prospectus. A prospective PIPE investor generally will not want to receive information that will remain non-public and material following either announcement of the entry into the definitive initial business combination or the consummation of the initial business combination.

   As noted above, there will be a data room set up for the PIPE transaction. The type of information that is provided in the data room should be vetted carefully by the private company target and its counsel and the placement agent and its counsel. Certain prospective PIPE investors may be willing to enter into a separate non-disclosure and confidentiality agreement with the private company and agree to receive access to a broader array of diligence materials. As a result, there may be more than one data room set up for different investors subject to different confidentiality and trading restrictions.

8. **Focus on PIPE purchase agreement.** The securities purchase agreement or subscription agreement for the PIPE transaction usually will be entered into between the SPAC and the PIPE securities purchasers. Generally, the placement agent will not be a party to the purchase agreement, but will be expressly named as a third-party beneficiary, principally for purposes of the issuer representations and warranties and the purchaser representations. Depending on the structure of the transaction, the "issuer" of the securities may be a different entity, not the SPAC. Also, in some instances, it may make sense for the private company target to be a party to the agreement.

   As discussed above, the purchasers will enter into a definitive commitment to purchase the securities, which usually will be shares of common stock, contingent upon the closing of the initial business combination. The transaction also will be subject to other customary closing conditions, including delivery of a legal opinion of issuer's counsel, delivery of officers' certificates, and similar materials.

   There will usually be a lively discussion regarding the types of representations and warranties that are included in the purchase agreement. Most PIPE purchasers will want representations and warranties to cover the private company target or to cover the combined company at the time of closing of the transaction. Quite a number of PIPE transactions related to SPACs have been undertaken with very modest representations and warranties. Both, from the perspective of the placement agent and its diligence, and the perspective of traditional PIPE purchasers, more fulsome representations and warranties are typical for PIPE transactions. There is no reason to distinguish a PIPE transaction undertaken in connection with a SPAC initial business combination from the decades of PIPE transactions that have been undertaken with SEC-reporting companies that are operating companies. Also, the PIPE purchasers are likely to include dedicated sector investors and cross-over investors interested in acquiring a stake in the combined company. These investors often will be familiar with the private company target and may even have invested in the private company target or in peer companies in late-stage or pre-IPO private placements wherein the purchase agreements contained substantial representations and warranties. Finally, as with the engagement letter, the indemnification provisions of the PIPE purchase agreement may require special attention.

   At the time that the PIPE purchase agreement is signed, the "issuer" will be the SPAC, and the SPAC will be limited in its ability to provide meaningful indemnification. However, at the time the PIPE transaction closes, the concern about the trust account is no longer relevant. We discuss immediately below some of the special concerns arising in connection with registration rights.

9. **Pay attention to registration rights and reliance on Rule 144.** PIPE purchasers generally are quite focused on liquidity. A PIPE purchaser will expect that the issuer will undertake, whether in a separate registration rights agreement, or in the securities purchase agreement or subscription agreement, a commitment to file a registration statement that will cover the resale from time to time by the purchaser of the PIPE securities. Usually, for a traditional PIPE transaction, the issuer will be eligible to use a registration statement on Form S-3 and likely will not have many other contractual commitments pursuant to other registration rights agreements. However, generally, a SPAC will not be eligible to use a registration statement on Form S-3 for up to a full year following the completion of the initial business combination and the filing of the so-called "super 8-K" that contains the type of information that is required by Form 10.

   Likewise, generally a SPAC will have other registration rights to address. For example, a SPAC will have undertaken to file a registration statement relating to the resale of the shares of common stock underlying the public warrants and the founder's warrants. The SPAC may have issued shares to the private company target holders in a private placement and may be committed to file a resale registration statement or the stockholders of the private company target may have registration rights agreements that are triggered once that company becomes a reporting company. Also, upon completion of the initial business combination, the combined company may be required to prepare and file certain additional pro forma financial information or recast historical financial statements.

   All of this may complicate the timeline for the commitment to file the resale registration statement, the deadline for having that resale registration statement declared effective, and how to address any cutbacks, if any, and subsequent efforts to register the resale of any shares that were cutback. Also, given that, as we discuss below, a SPAC is considered a "shell company" (even after completion of the initial business combination), PIPE purchasers and their counsel will likely pay particular attention to the provisions relating to the issuer's ongoing obligation to maintain the effectiveness of the registration statement. As a shell or former shell company, stockholders cannot rely on Rule 144 (17 C.F.R. 230.144)) for their resales until a full year following the filing of the Form 10 information. Also, most counsel will not remove restrictive legends from shares even after a one-year period has elapsed given that for a shell or former shell company the availability of Rule 144 is dependent on the issuer's compliance with its Exchange Act filing requirements.

10. **Remember special considerations for compliance relating to transactions involving SPACs.** As noted above, a SPAC is a shell company as that term is defined in Rule 405 (17 C.F.R. 230.405) of the Securities Act. Therefore, a SPAC is an "ineligible issuer" under the Securities Act. As an ineligible issuer, it cannot use free writing prospectuses. This is important in connection with the SPAC's IPO, but also remains important for all follow-on offerings. Under Securities Act Rule 433 (17 C.F.R. 230.433), any roadshow that is a "written communication" is a free writing prospectus. Under Securities Act Rule 455 (17 C.F.R. 230.455), a "communication that, at the time of the communication, originates live, in real-time to a live audience and does not originate in recorded form or otherwise as a graphic communication, although it is transmitted through graphic means" does not constitute a written communication. In other words, a live, real-time roadshow to a live audience will not be considered a written communication, and therefore not a free writing prospectus.

    In the context of marketing for a PIPE transaction, it will be important to consider whether the presentations and communications are made by the private company target or are presentations and communications made by the SPAC that must be analyzed under these rules. If so, the presentations must be live, not taped.

    The compliance and legal teams of the placement agents also may want to consider a number of other important issues applicable in the context of engagements with SPACs. As shell companies and ineligible issuers, there are a number of communications safe harbors that are not available. These include the research safe harbors under Securities Act Rules 137 (17 C.F.R. 230.137), 138 (17 C.F.R. 230.138) and 139 (17 C.F.R. 230.139).

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