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Everything You Wanted to Know About SPACs But Were Afraid to Ask

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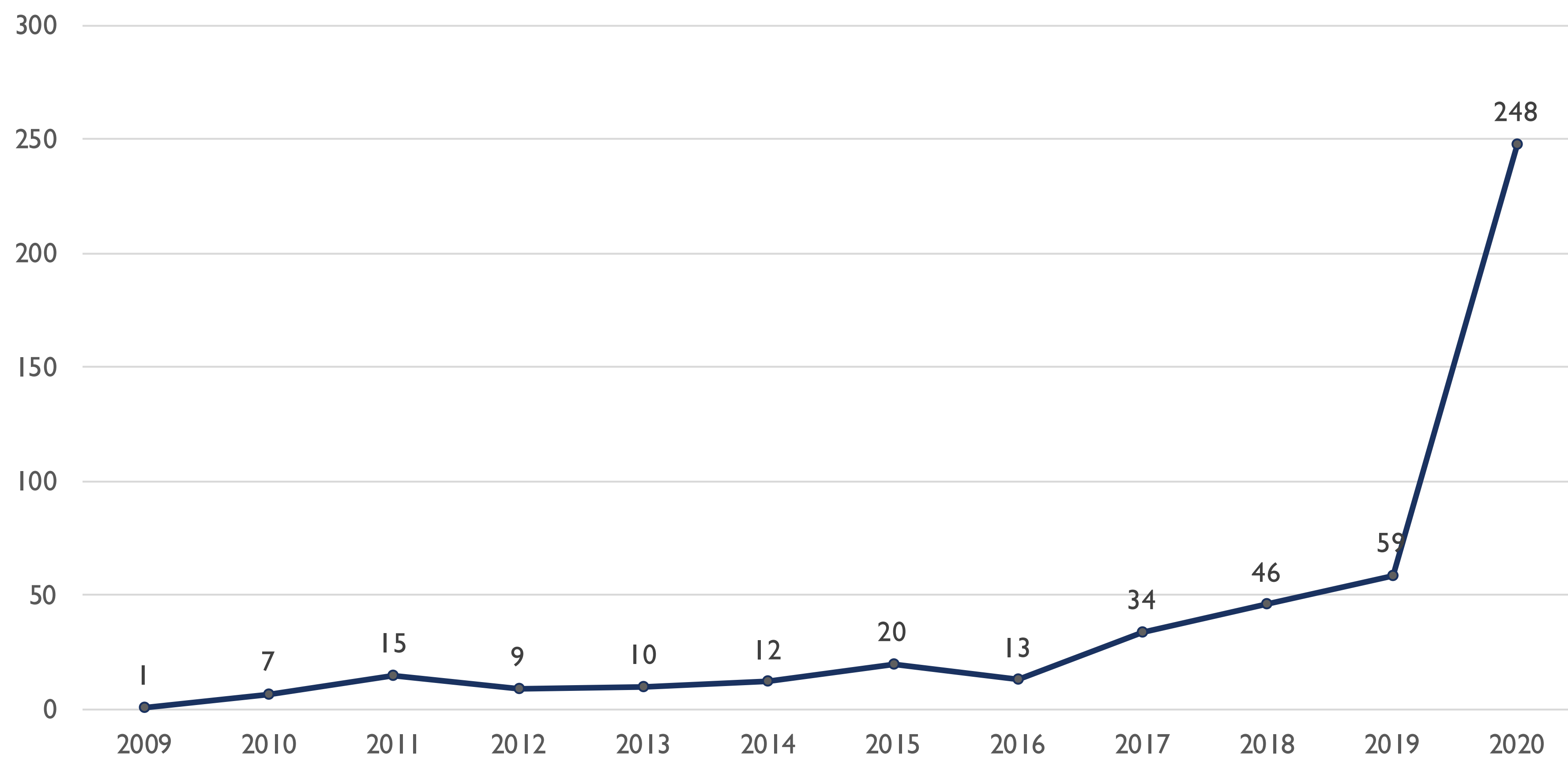
EVERYTHING YOU EVER WANTED TO KNOW
ABOUT SPACS
BUT WERE AFRAID TO ASK

WHAT IS A SPAC?

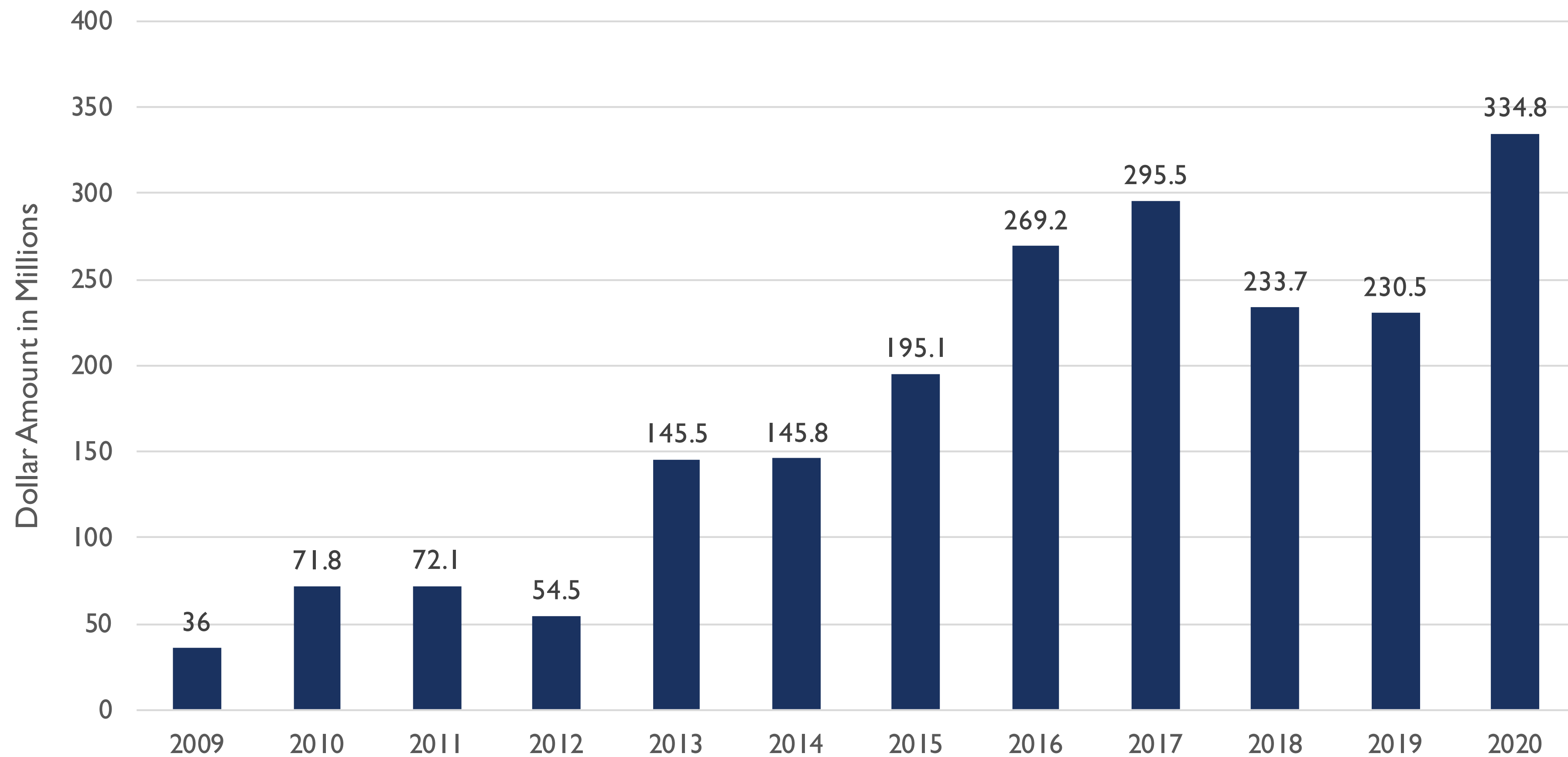
- A SPAC is a special purpose acquisition company, formed by a Sponsor for the purpose of acquiring a private company Target within a specified time period, usually 18-24 months, and listing the Target.
- SPACs are, in short, "double IPOs." The SPAC itself is a publicly listed company that uses the traditional IPO process to list its shares; through its acquisition of the Target in a transaction known as a "De-SPAC," the Target itself becomes a listed company in what amounts to an alternative to IPOs for the private company.
- SPACs have become phenomenally popular. *See* Chart A & B.

CHART A: NUMBER OF SPAC IPOS 2009-2020



Source:SPAC Insider

CHART B: GROWTH OF SPAC IPO SIZE FROM 2009-2020



Source:SPAC Insider

WHY ARE SPACS SO POPULAR?

- Perceived speed of SPAC deals:
  - SPAC IPO can be done in 8-10 weeks. Very quick timetable because the SPAC registration statement on Form S-1 is very simple: there is no business to describe and there are no detailed financials to present (other than a very simple balance sheet showing the cash raised).
  - The acquisition or "De-SPAC" phase (from an announcing a deal to closing) can be accomplished in as little as three months. Full IPOs, in contrast, from start to finish can take a year or more.
- Superior pricing of SPACs.
  - In a traditional IPO, the company going public needs to pay underwriters hefty commissions and typically sets an initial offering price that "leaves money on the table" so that the shares can rise in the aftermarket. SPAC deals are privately negotiated without these considerations and can yield a higher price for the Target than would be available in a regular IPO.
- Reduced market risk.
  - IPOs are typically only possible during "windows" when the market is amenable to new equity issuances. Windows can close suddenly because of sudden changes in market conditions or the geopolitical or economic environment. A great number of prospective IPOs are shelved because the window closes or events occur that render the IPO impossible to complete. In addition, IPOs are marketed through what are called "road shows" during which investors can ask questions and focus on risks that can derail the offering. SPAC/De-SPAC deals are privately negotiated without public scrutiny or involvement and without the risk of a "window" closing.

WHY ARE SPACS SO POPULAR? (CONT.)

- Reduced deal risk.
  - Investors in the initial IPO have the right to have their money returned if they are dissatisfied with the proposed acquisition and/or the terms of the De-SPAC deal. As a result, at least in theory, public investors can invest virtually risk-free in potentially very profitable transactions. *See* Charts C & D.
- Macroeconomic factors.
  - The number of public companies has been cut roughly in half over the past twenty years. *See* Chart E. At the same time, the amount of private capital on the sidelines ready to be deployed in acquisitions has doubled, going from $1 trillion to $2 trillion. *See* Chart F.

CHART C: PRICE HISTORY OF SPACS SEEKING A TARGET

Date of IPO	Name	Symbol	ROI	ARR
2021-03-09	SVF Investment Corp. 2	SVFB	3.3%	14,015,682.7%
2021-03-09	SVF Investment Corp. 3	SVFC	2.5%	820,650.0%
2021-02-26	ARYA Sciences Acquisition Corp IV	ARYD	7.7%	854.8%
2021-03-04	Khosla Ventures Acquisition Co.	KVSA	3.3%	620.7%
2021-01-08	SVF Investment Corp.	SVFA	15.5%	136.8%
2020-10-16	Bridgetown Holdings Limited	BTWN	33.6%	107.4%
2021-01-29	Brookline Capital Acquisition Corporation	BCAC	8.2%	104.4%
2020-10-09	Social Capital Hedosophia IV	IPOD	31.1%	91.5%
2021-01-26	Bridgetown 2 Holdings Limited	BTNB	7.4%	83.3%
2021-01-15	Group Nine Acquisition Corp.	GNAC	8.8%	76.8%
2021-01-15	Thoma Bravo Advantage	TBA	8.4%	72.5%
2020-10-09	Social Capital Hedosophia VI	IPOF	25.1%	71.1%
2020-12-09	Altitude Acquisition Corporation	ALTU	14.2%	70.3%
2021-01-07	Altimeter Growth Corp. 2	AGCB	9.3%	68.8%
2020-07-22	Pershing Square Tontine Holdings, Limited	PSTH	39.2%	68.7%
2020-10-01	Altimeter Growth Corporation	AGC	24.7%	65.5%

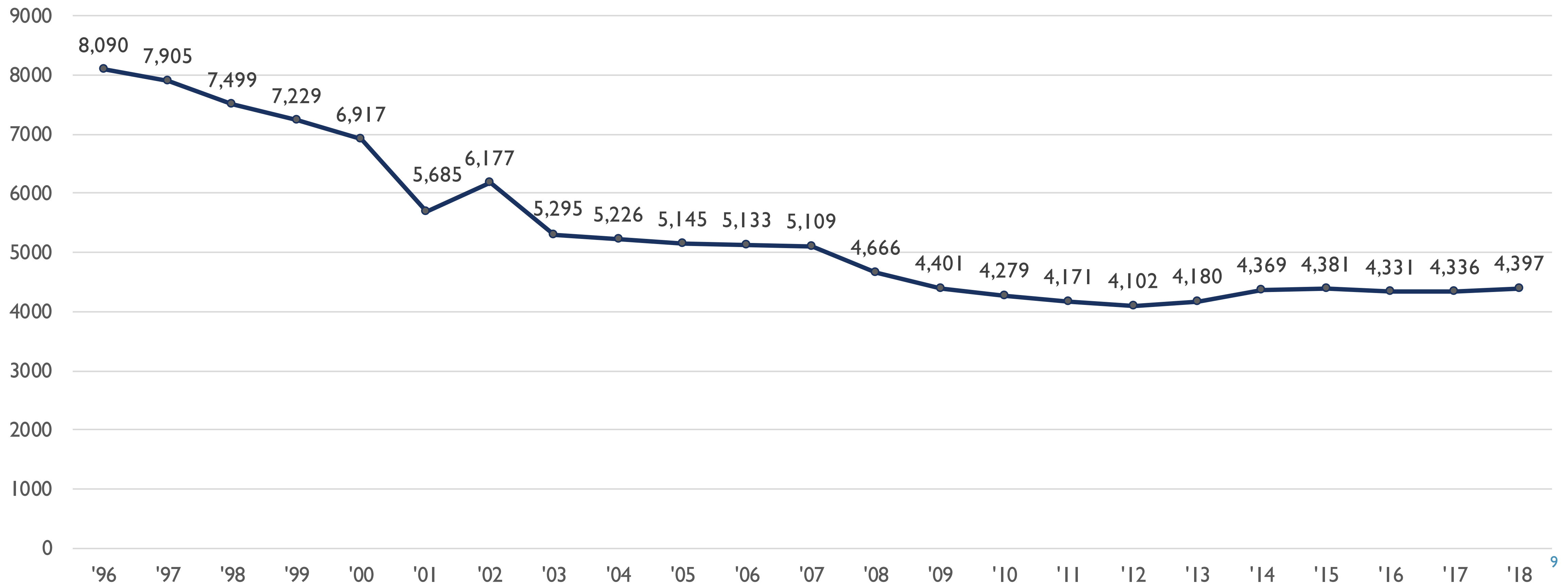
Source:SPAC Insider

CHART D: PRICE HISTORY OF SPACS AFTER ANNOUNCEMENT OF DEAL

Date of IPO	Name	Symbol	ROI	ARR
2021-01-26	Northern Star Investment Corp. II	NSTB	4.0%	40.5%
2020-12-11	Gores Holdings VI, Inc.	GHVI	66.2%	721.4%
2020-12-10	RMG Acquisition Corporation II	RMGB	7.9%	36.6%
2020-12-09	Nebula Caravel Acquisition Corp.	NEBC	2.8%	11.7%
2020-12-08	Revolution Acceleration Acquisition Corp.	RAAC	11.8%	56.4%
2020-12-02	Capitol Investment Corp. V	CAP	5.3%	21.4%
2020-12-02	Rodgers Silicon Valley Acquisition Corp.	RSVA	66.8%	585.6%
2020-11-25	Forest Road Acquisition Corporation	FRX	26.1%	125.5%
2020-11-25	Spartan Acquisition Corporation II	SPRQ	16.4%	70.1%
2020-11-24	10X Capital Venture Acquisition Corporation	VCVC	13.6%	55.5%
2020-11-19	Reinvent Technology Partners Z	RTPZ	11.0%	41.4%
2020-11-13	dMY Technology Group, Inc. III	DMYI	21.0%	82.3%
2020-11-13	CF Finance Acquisition Corporation III	CFAC	6.1%	20.4%
2020-11-11	Northern Star Acquisition Corporation	STIC	22.4%	86.9%
2020-11-10	TS Innovation Acquisitions Corp.	TSIA	37.1%	163.4%
2020-10-30	New Beginnings Acquisition Corporation	NBA	9.7%	29.7%

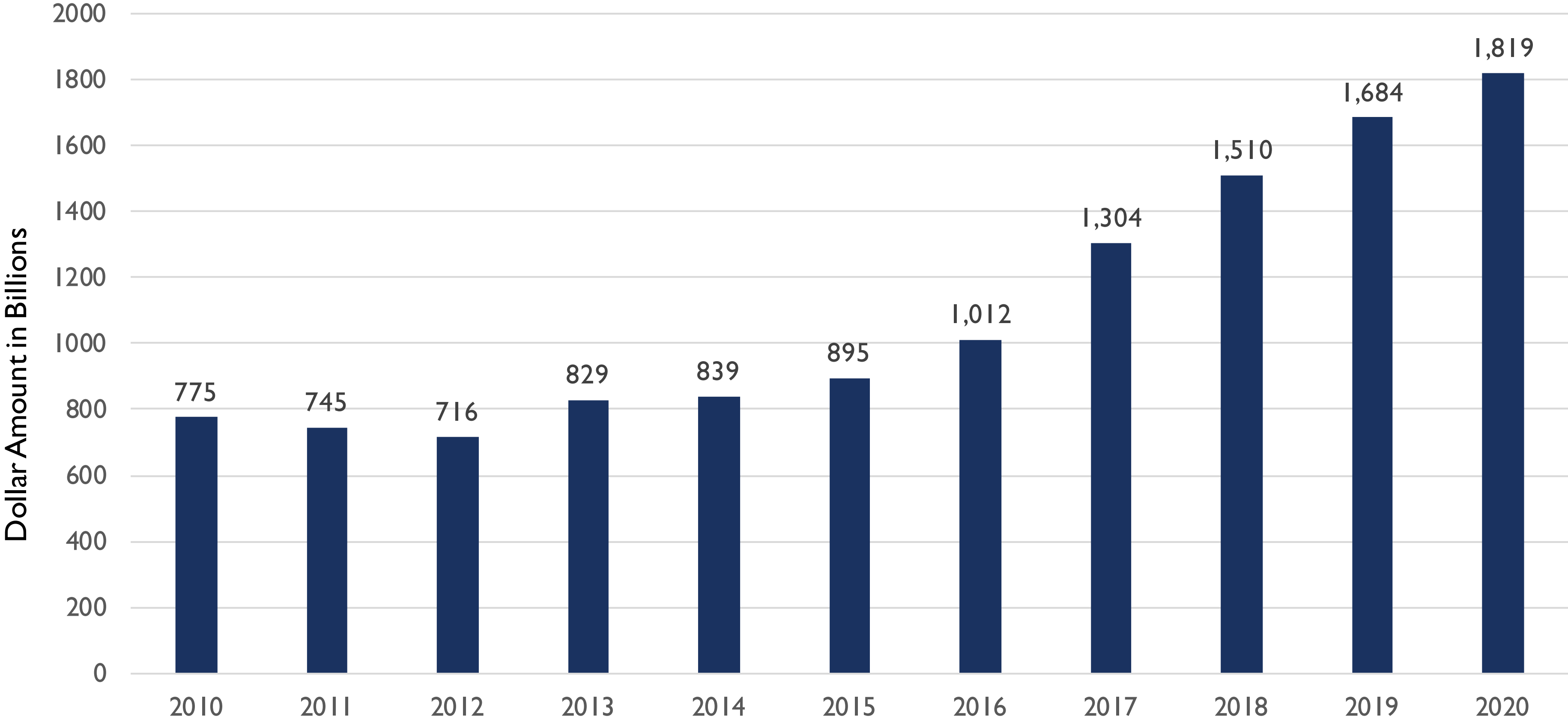
Source:SPAC Insider

CHART E: NUMBER OF PUBLICLY LISTED COMPANIES IN THE U.S. 1996-2018



Source: theGlobalEconomy.com

CHART F: PRIVATE EQUITY DRY POWDER 2010-2020



Source: Preqin

WHY ARE SPACS SO POPULAR?
SUMMARY

SPAC/De-SPAC IPO

- More cost-effective.
  - Lower direct expenses and indirect costs.
- Faster.
  - Initial IPO in 8-10 weeks; 3-4 months from Letter of Intent to closing for acquisition phase.
- More certain pricing.
  - Identify and agree on valuation ahead of time.
- More certain closing.

TRADITIONAL IPO

- Full range of direct expenses and indirect costs.
- 6-9 months from prospectus drafting to closing.
- Price is determined at the time of the IPO and more vulnerable to market risk.

WHY ARE SPACS SO POPULAR?
GREED

- **Greed**.

- To understand this point, it is necessary to take a detour into the history of SPACs.

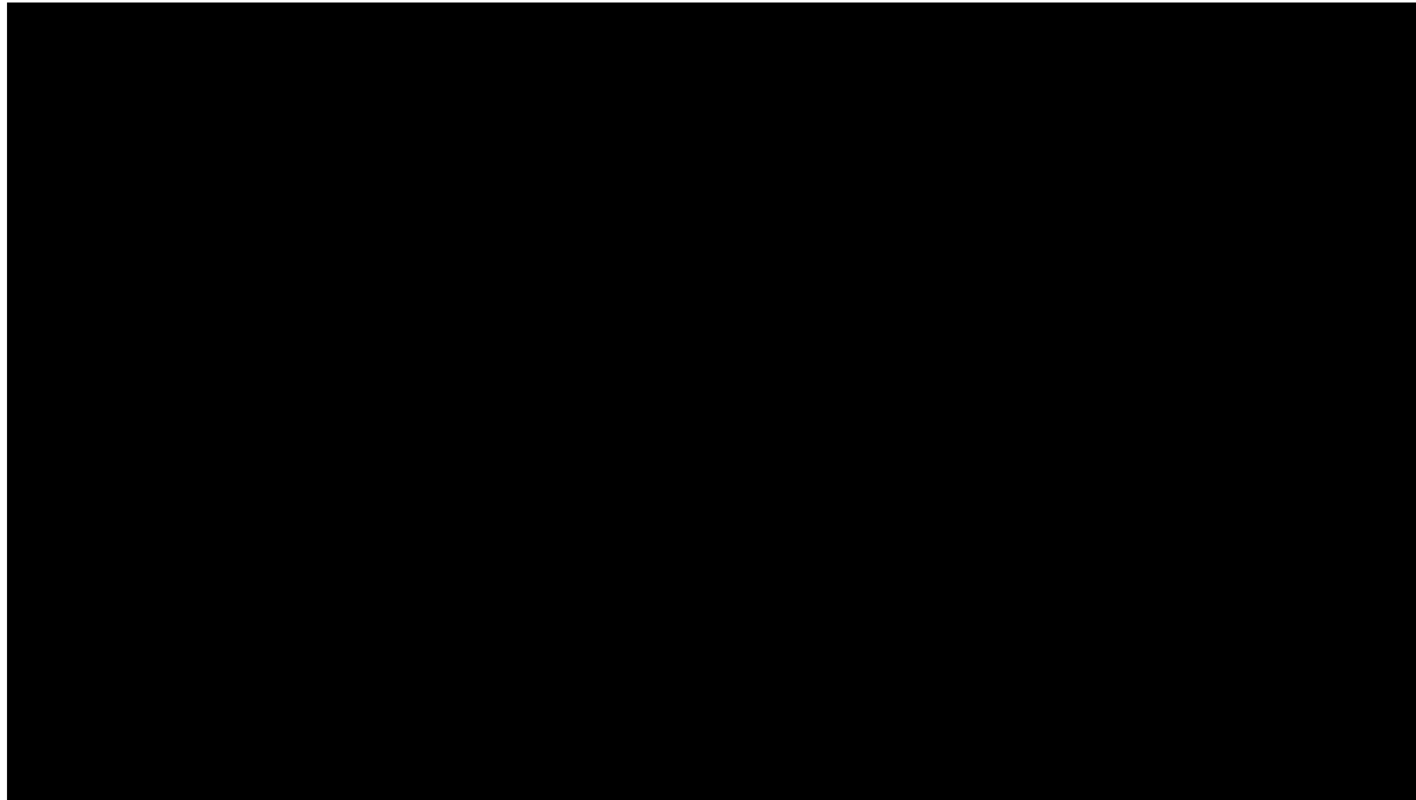
WHAT IS THE ORIGIN OF SPACS?

- SPACs are frequently described as "blank check" companies. This is not technically true, but it is very close to being true and gets at important features of SPACs.
- Blank check companies are defined in Rule 419 under the Securities Act of 1933 as:
  - "(i) A development stage company that has no specific business plan or purpose or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies, or other entity or person; and (ii) is issuing 'penny stock,' as defined in Rule 3a51-1 (17 CFR 240.3a51-1) under the Securities Exchange Act of 1934." **[Tab 1 – Rule 419]**
- Offerings by blank check companies were specifically regulated to address problems in the penny stock market in the late 1980s and early 1990s.
  - As the SEC stated, "To implement provisions of the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, the Commission today is adopting rules relating to registration statements filed by blank check companies offering penny stock. The rules include requirements to deposit in a special account securities issued and funds received in the offering, prohibit trading in deposited securities, disclose information regarding acquisitions by the blank check company, provide purchasers with the right to obtain a refund of deposited funds upon receipt of the information, and return deposited funds to investors if an acquisition meeting specified criteria has not been consummated within 18 months after the initial offering date." **[Tab 2 – SEC Blank Check Offering Adopting Release]**

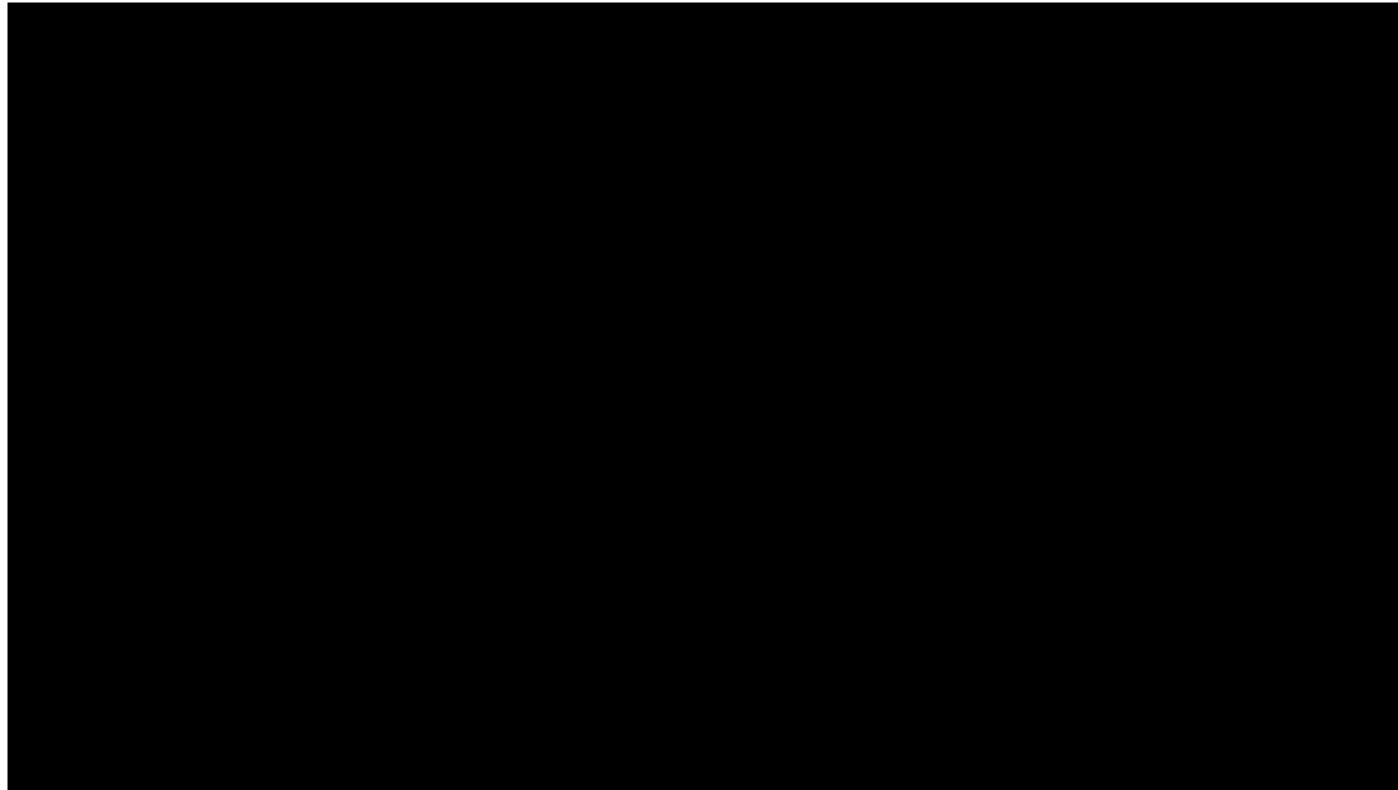
WHAT IS THE ORIGIN OF SPACS? (CONT.)

- Following the market crash of 1987, "penny stocks," literally stocks that trade for pennies and are not listed on an exchange but trade in the so-called "pink sheets," became increasingly popular.
- Penny stocks were marketed as get-rich-quick schemes, as immortalized in Scorsese's *The Wolf of Wall Street*. See Clip A.
- Penny stocks were often based on nothing more than "hot air" and one of the most widely used mechanism to sell them was through so-called "blank check" companies, which were empty "shells" that raised money to purchase penny stock companies. These blank check companies had virtually no effective protections for investors. *See* Clip B.

CLIP A: *THE WOLF OF WALL STREET*, PENNY STOCKS SALES SCENE



CLIP B: *THE WOLF OF WALL STREET*, BEACH PARTY IPO SCENE



WHAT IS THE ORIGIN OF SPACS? (CONT.)

- There were approximately **2,700** blank check offerings during the 1987-1990 period alone. (After all, *The Wolf of Wall Street* is based on a true story.) The excess and fraud of the late 1980s prompted a response, which came in the form of tighter regulation of penny stocks and blank check offerings.
  - **[Tab 3 – From Blank Check to SPAC – The Regulator's Response to the Market and the Market's Response to the Regulation]**
  - **[Tab 4 – An Investment Masquerade: A Descriptive Overview of Penny Stock Fraud]**
  - **[Tab 5 – The Penny Stock Reform Act of 1990]**

WHAT IS THE ORIGIN OF SPACS?
THE NUSSBAUM REVOLUTION

- In 1993, an attorney named Gary Nussbaum invented the modern SPAC. Nussbaum's innovation was to take the protection that the SEC had designed for penny stock blank check offerings and to make use of them as structuring devices for acquisition vehicles that were focused on legitimate Targets, rather than penny stock companies.
  - SPACs, as devised by Nussbaum, would:
    - Deposit investor's funds in an interest bearing escrow account;
    - Offer investors the opportunity to redeem their shares before the consummation of a merger with a private Target;
    - Require an acquisition to occur within 18 months; ***but***
    - Price their shares above $5.00 so that they would not technically come within the regulation of blank check companies under Rule 419, which technically only applies to offerings involving penny stocks. **[Tab 3]**

WHY ARE SPACS SO POPULAR? (CONT.)

- Since modern SPACs have been around for nearly 30 years, the features of speed, superior pricing and lower market risk would not appear to explain the popularity of SPACs today. Rather, the answer would appear to be in the supply and demand of private equity capital and public investment targets. The amount of dry powder on the side lines that has been built up over years of "quantitative easing" combined with the reduction in publicly traded companies has created the "perfect storm" for the use of a vehicle that offers private equity sponsors superior returns and dangles the prospect of 1980's style "get rich quick" schemes in front of retail investors.

HOW DO SPACS WORK?
THE SPAC IPO

- SPACs deals can be divided into two phases: (1) the SPAC IPO and (2) the De-SPAC Transaction.
- In the SPAC IPO, a Sponsor creates the SPAC by subscribing for a percentage of its shares (usually 20%) for a price (usually of $25,000) and commits to funding the costs of the IPO and the subsequent search for an acquisition Target. In essence, by funding the start-up and deal costs of the SPAC IPOs, the Sponsor is rewarded first with what amounts to a significant free share in the SPAC and then in the new company to emerge from the De-SPAC transaction.
- SPACs are increasingly incorporated in the Cayman Islands or other off-shore tax havens, both to optimize the tax treatment of gains during the acquisition Target search phase and to provide flexibility in the pursuit of non-American targets. For tax and structuring reasons, Cayman Islands SPACs present tax benefits over Delaware SPACs for purposes of European and Asian acquisitions.
- The SPAC raises money by issuing "Units," a combination of shares and warrants that, together, are priced at $10.00. There is no regulatory reason for a SPAC Unit to be priced at $10.00 other than the desire to have shares priced above the penny stock threshold and precedent —Wall Street's true golden calf. However, the largest SPAC to date, Bill Ackman's Pershing Square SPAC, has priced its units at $20.00 per unit.

WHAT ARE SPAC UNITS?

- A SPAC issues Units, which consist of shares and warrants. The shares and warrants initially trade together, but after a certain period (anywhere from 30-60 days), the shares and warrants are separable and holders can elect to trade the warrants and shares separately or continue to hold combined Units. Typically, each Unit will only give its holder the right to a fraction of a warrant, so the initial investor is required to buy multiples of Units to acquire whole warrants.
- Warrants as an acquisition feature were prominent in the 1980s in the junk bond deals put together by Michael Milken and others. In the 1980s, warrants were considered the "equity sweetener" designed to make the junk bond more palatable and were also a key feature of the abuse of the market. **[Tab 6 – *The Golden Age of Junk*]**
  - Milken said that in order to get his clients to buy the securities, he had to have an "equity sweetener" in the form of warrants (i.e. guarantees that investors will be able to buy stock at a fixed price in the newly formed company). Most of the warrants, however, ended up not in his clients' portfolios but were acquired separately by McPherson Partners, a partnership created expressly to hold warrants, which was owned mostly by Milken, his brother, and their families. **[Tab 6 at 7]**

WHAT ARE SPAC UNITS? WARRANTS

- Warrants are a critical feature of SPAC Units and SPAC transactions overall. First, the warrants offer retail investors the opportunity of using leverage to obtain outsize returns. For example, the typical warrant is priced at around $2.00 per warrant. Each warrant gives the holder the right to purchase a share of the SPAC or the new De-SPAC entity typically for $11.50. If the warrants are exercised when the shares are trading for $18.00, the warrant holder will make a profit of $6.50 ($18.00 - $11.50) on the initial $2.00 investment, a 325% return. A shareholder who purchased a share for $10 would make $18.00 and so receive an 80% return, which is still excellent, but not as eye-popping as the return over three times greater.
- This leverage effect increases as the share price increases. If the share trades at $40.00 and the warrant has the same terms as above, the warrant holder would make a 1,425% return versus a 300% gain for the shareholder. Obviously, everyone is doing well in these scenarios, but this is to highlight that warrants offer explosive, cryptocurrency-type gains.
- Warrants are risky, however. Unlike shares, for which the purchase price is returned to the investor if the SPAC fails to locate a suitable acquisition Target, warrants become worthless if the SPAC fails to do a deal. In addition, even if the SPAC does do a deal, conditions still attach to the warrants that can render them worthless under certain circumstances.

WHAT ARE SPAC UNITS? WARRANTS (CONT.)

- Offering documents used in the SPAC/De-SPAC transaction typically provide the following risk factors :
  - ***Even if the Business Combination is consummated, the public warrants may never be in the money, and they may expire worthless, and the terms of the warrants may be amended in a manner adverse to a holder, if holders of at least 65% of the then outstanding public warrants approve of such amendment*.**

    The warrants were issued in registered form under a Warrant Agreement between [Trust Company], as warrant agent, and the [Company]. The Warrant Agreement provides that the terms of the warrants may be amended without the consent of any holder to cure any ambiguity or correct any defective provision, but requires the approval by the holders of at least 65% of the then outstanding public warrants to make any change that adversely affects the interests of the registered holders of public warrants. Accordingly, the Company may amend the terms of the public warrants in a manner adverse to a holder if holders of at least 65% of the then outstanding public warrants approve of such amendment. Although the Company's ability to amend the terms of the public warrants with the consent of at least 65% of the then outstanding public warrants is unlimited, examples of such amendments could be amendments to, among other things, increase the exercise price of the warrants, shorten the exercise period or decrease the number of shares of VGH, Inc. common stock purchasable upon exercise of a warrant

  - ***We may redeem your unexpired warrants prior to their exercise at a time that is disadvantageous to you, thereby making your warrants worthless*.**

    We have the ability to redeem outstanding warrants at any time after they become exercisable and prior to their expiration, at a price of $0.01 per warrant, provided that the last reported sales price of the VGH, Inc. common stock equals or exceeds $18.00 per share (as adjusted for share splits, share dividends, rights issuances, subdivisions, reorganizations, recapitalizations and the like) for any 20 trading days within a 30 trading-day period ending on the third trading day prior to the date we send the notice of redemption to the warrant holders. If and when the warrants become redeemable by us, we may exercise our redemption right even if we are unable to register or qualify the underlying securities for sale under all applicable state securities laws. Redemption of the outstanding warrants could force you to: (i) exercise your warrants and pay the exercise price therefor at a time when it may be disadvantageous for you to do so (ii) sell your warrants at the then-current market price when you might otherwise wish to hold your warrants; or (iii) accept the nominal redemption price which, at the time the outstanding warrants are called for redemption, is likely to be substantially less than the market value of your warrants.

- Typically, the restrictions on the warrants held by public shareholders are loosened for certain insiders, which has parallels with the manner in which Milken reserved the greatest warrant upsides for himself and his family.

HOW ARE SPAC DEALS STRUCTURED?

- We have already seen how the SPAC investors are the pre-IPO Sponsor and the public investors who enter the SPAC at the time of the IPO. The Sponsor frequently enters into a private placement warrant agreement with the company, pursuant to which the Sponsor agrees to purchase a number of warrants at a steep discount to the share price.
- Following the IPO, the SPAC pursues a Target. It is typically required to consummate a transaction within 18-24 months of its listing or return its cash from the IPO to the public investors. The Sponsor group will lose the entire value of its investment in the SPAC capital and the funding of its operating expenses if no deal is effected.
- Because there is a risk that individual investors will not approve any deal that is proposed by the SPAC, or because the cost of a proposed acquisition exceeds the amount the SPAC has in its trust account, the SPAC typically receives an additional infusion of cash through a PIPE (private investment in public equity).

HOW ARE SPAC DEALS STRUCTURED? PIPES

- Like warrants, PIPEs are a critical, and increasingly omnipresent, feature of SPAC deals.
- Typically, PIPEs are sold to institutional investors on a private placement basis with the institutional investors obtaining registration rights in the shares in the ultimately listed De-SPACed vehicle that survives the SPAC acquisition.

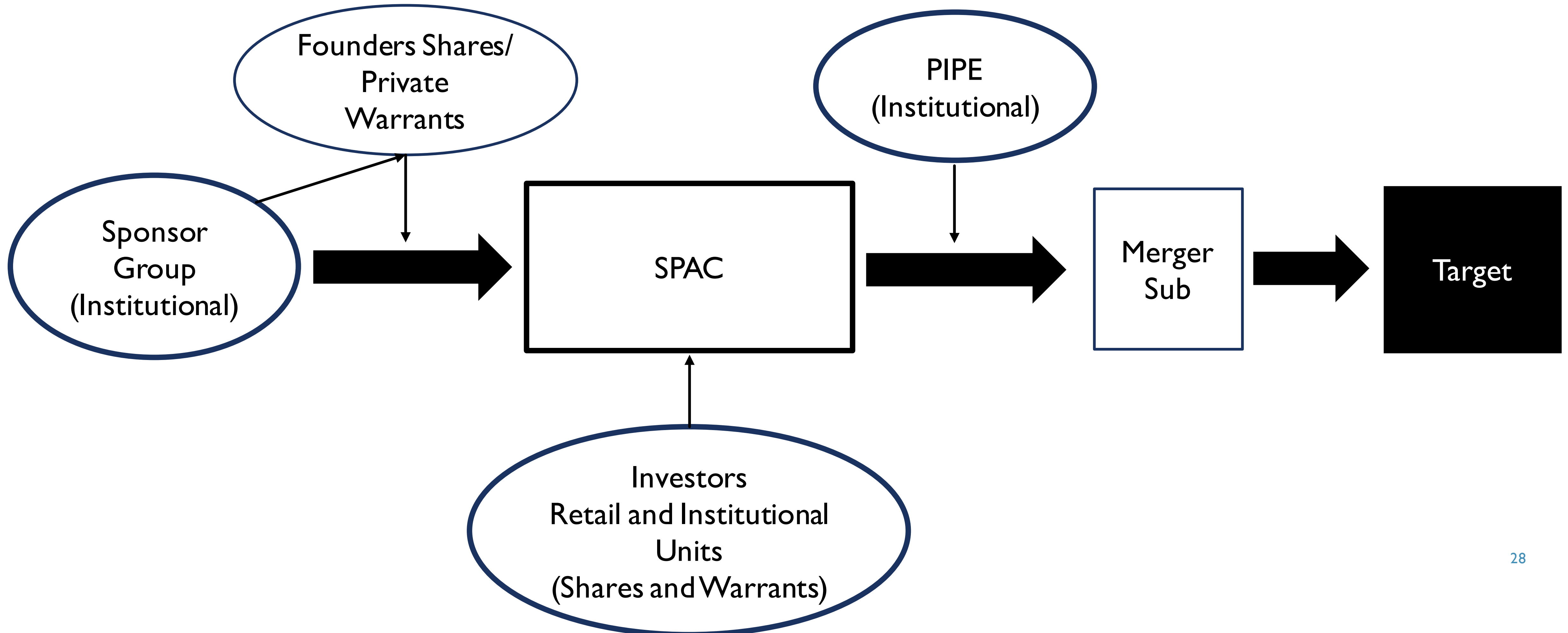
HOW ARE SPAC DEALS STRUCTURED?
PIPES (CONT.)

- In the recent Northern Star transaction, for example, Northern Star engaged Citigroup Global Markets Inc. as placement agent for a private placement of Northern Star Common Stock.
- On the date the Merger Agreement was executed, Northern Star entered into Subscription Agreements, pursuant to which Northern Star agreed, substantially concurrently with, and contingent upon, the consummation of the Mergers, to issue an aggregate of 45,000,000 shares of Northern Star Common Stock to the investors at a price of $10.00 per share, for aggregate gross proceeds to Northern Star of $450,000,000 (the "PIPE").
- The closing of the Subscription Agreements was conditioned upon, among other things, (i) the substantially concurrent consummation of the Mergers and (ii) the accuracy of all representations and warranties of Northern Star in the Subscription Agreements (subject to certain bring-down standards).
- Northern Star agreed that, as soon as reasonably practicable, but in no event later than 15 business days following the closing date of the Mergers, it would file a registration statement with the SEC covering the resale by the investors of the shares of Northern Star Common Stock issued to them in the PIPE and use its best efforts to have such registration statement declared effective as promptly as practicable thereafter.
- The shares of Northern Star Common Stock were offered and sold to the investors in reliance on the exemption from registration provided by **Section 4(a)(2)** of the Securities Act, based on the fact that the sale will have been made without any general solicitation or advertising and based on representations from each Investor that (a) it was an accredited investor (to the extent applicable), (b) it was purchasing the shares for its own account investment, and not with a view to distribution, (c) it had been given access to full and complete access to information regarding Northern Star, Apex, and the Mergers, (d) it understood that the offer and sale of the shares was not registered and the shares could not be publicly sold or otherwise disposed of without registration under the Securities Act or an applicable exemption therefrom, and (e) it understood that Northern Star is required under the rules and regulations of NYSE to seek shareholder approval of the issuance of the shares. **[Tab 7 – PIPE Subscription Agreement]**

HOW ARE SPAC DEALS STRUCTURED?
KEY REPRESENTATIONS IN PIPE SUBSCRIPTION AGREEMENTS

- Key representations in PIPE Subscription Agreements:
  - The issued and outstanding shares of Class A Common Stock are registered pursuant to Section 12(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and are listed for trading on NYSE under the symbol "NSTB" (it being understood that the trading symbol will be changed in connection with the Transaction Closing). There is no suit, action, proceeding or investigation pending or, to the knowledge of the Company, threatened, against the Company by NYSE or the Commission, respectively, to prohibit or terminate the listing of the Class A Common Stock on NYSE or to deregister the Class A Common Stock under the Exchange Act. The Company has taken no action that is designed to terminate the registration of the Class A Common Stock under the Exchange Act or the listing of such shares on the NYSE.
  - A copy of each form, report, statement, schedule, prospectus, proxy, registration statement and other document, if any, filed by the Company with the Commission since its initial registration of the Class A Common Stock under the Exchange Act (the "SEC Documents") is available to the undersigned via the Commission's EDGAR system. The SEC Documents were timely filed and, as of their respective filing dates, complied in all material respects with the requirements of the Securities Act and the Exchange Act applicable to the SEC Documents. None of the SEC Documents contained, when filed or, if amended, as of the date of such amendment with respect to those disclosures that are amended, any untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading; ***provided, that the Company makes no such representation or warranty with respect to the Proxy Statement/Prospectus filed in connection with the Transaction or any other information relating to Apex or any of its affiliates included in any SEC Document or filed as an exhibit thereto***.

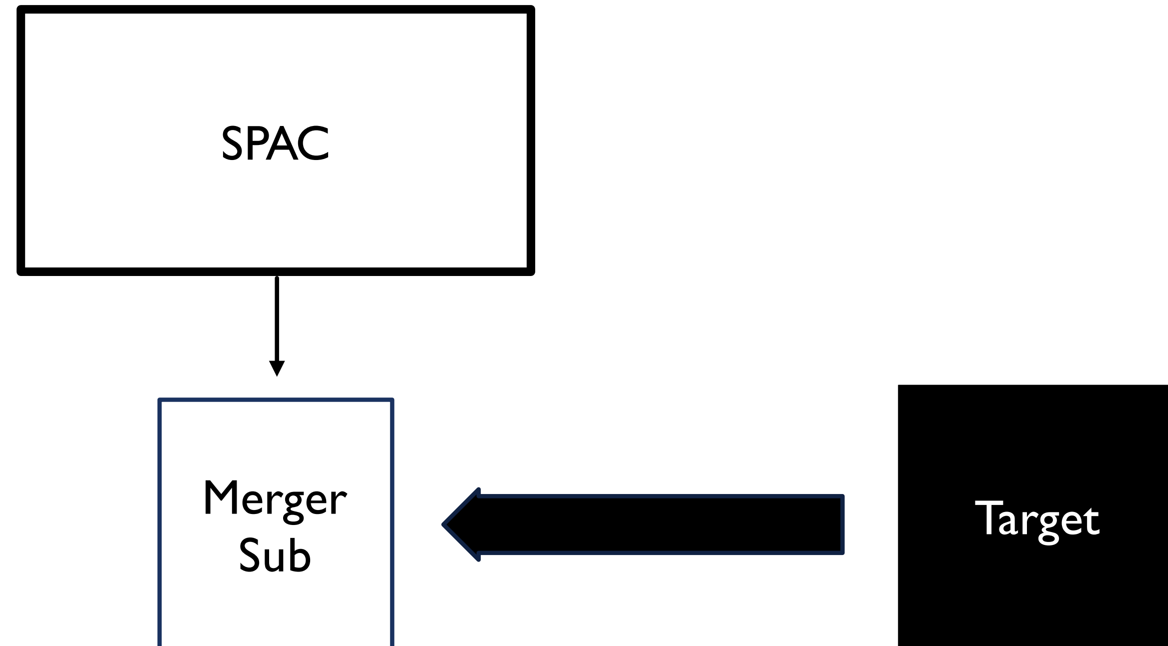
HOW ARE SPAC DEALS STRUCTURED? SUMMARY



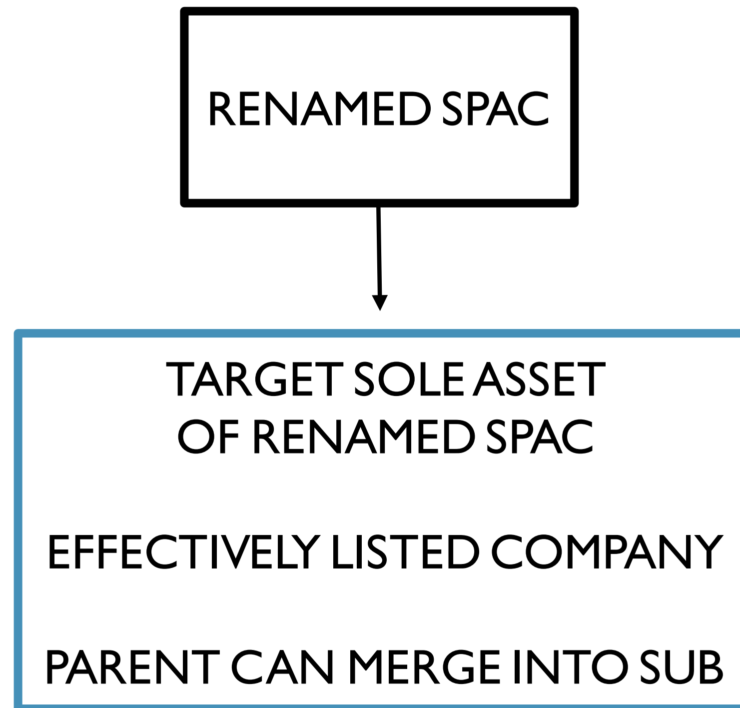
HOW DOES THE DE-SPAC TRANSACTION WORK?

- The purpose of every SPAC transaction is to find a suitable acquisition Target and to effect a Merger of the Target and an acquisition subsidiary of the SPAC.
- The Merger transaction is structured as a "reverse Merger" meaning that the SPAC subsidiary is merged with and into the Target so that the Target becomes a wholly-owned subsidiary of the SPAC. This is called a "reverse Merger," because in a regular "forward Merger," the acquisition subsidiary would swallow the Target, PAC-man style.
- Once the Target is a wholly-owned subsidiary of the SPAC, the SPAC changes its name to the name of the Target and usually the ticker symbol for the SPAC to match the initials of the Target so that the Target is now, effectively, the listed company or a wholly owned-subsidiary of similarly named holding company that has no assets other than the Target.

HOW DOES THE DE-SPAC TRANSACTION WORK?
STEP ONE



HOW DOES THE DE-SPAC TRANSACTION WORK?
STEP TWO



HOW DOES THE DE-SPAC TRANSACTION WORK CONTRACTUALLY?

- While the De-SPAC transactions are frequently portrayed as being relatively simple, at least in comparison with the traditional IPO process, from a contractual perspective, this is not entirely true. The following are the key documents that comprise the De-SPAC process:

- Merger Agreement
  - **[Tab 8 – Silver Spike Merger Agreement]**
- Subscription Agreement for PIPE
  - **[Tab 7 – PIPE Subscription Agreement]**
- Registration Rights Agreement
  - **[Tab 9 – Registration Rights Agreement]**
- Exchange Agreement
- Equity Incentive Plan

HOW DOES THE DE-SPAC TRANSACTION WORK CONTRACTUALLY? THE MERGER AGREEMENT

- The De-SPAC Merger Agreement contains a number of key provisions:
  - Recitals – These are the key to understanding the transaction; they are not "operative" provisions, in that they do not create substantive rights and obligations, but they do explain in detail how the transaction will work mechanically and contractually.
    - SPAC "domesticates" in a U.S. jurisdiction. If, as is increasingly common, the SPAC was formed offshore but then acquires a U.S. company, the SPAC will be domesticated, or relocated, to a U.S. jurisdiction, usually Delaware.
    - The domesticated SPAC files a Certificate of Incorporation, with two classes of shares (Class A and Class V).
    - The SPAC Merger Sub is merged with and into the Target company, which is now a wholly owned subsidiary of the domesticated SPAC.
    - If the Target is an LLC, the Operating Agreement will be amended to make the domesticated SPAC its Manager.
    - Certain of the original SPAC shareholders enter into Voting and Support Agreements with the SPAC.
    - The shareholders agree to vote in favor of the Merger.
    - SPAC and Sponsor execute a "Sponsor Letter Agreement." **[Tab 10 – Sponsor Letter Agreement]**
    - Sponsor agrees to vote in favor of the Merger. Provisions for deferral of some of the benefits of the overall transaction are agreed to if the PIPE transaction fails to reach a certain Target. In this case, 15% of the Sponsor Founder Shares and a corresponding number of the SPAC's Units in the Target are deferred or earned out over a period of time depending on stock performance: 25% when stock hits and remains at $12.00 for a 20-day period, 25% when the stock hits and remains at $15.00 for a 20-day period, and 50% when the stock hits and remains at $18.000 for a 20-day period.

HOW DOES THE DE-SPAC TRANSACTION WORK CONTRACTUALLY? THE MERGER AGREEMENT

- Effects of the Merger – The Merger Agreement spells out in detail the effects of the Merger on holders of Units (Shares and Warrants) of the SPAC.
  - There are very complicated contractual provisions to carry out the Merger so that:
    - The members of the Target receive shares of the SPAC in exchange for their membership interests in the Target.
    - The interests of the SPAC in its Sub are converted into interests in the Target.
    - The SPAC is admitted as a member and manager of the Target.
    - The SPAC owns 100% of the Target and the members of the Target become shareholders of the SPAC, which is now "De-SPACed" because it owns an actual operating company.

HOW DOES THE DE-SPAC TRANSACTION WORK CONTRACTUALLY? THE MERGER AGREEMENT: REPRESENTATIONS AND WARRANTIES

- Representations and Warranties ("reps and warranties") are designed to represent to the Buyer that all the material aspects of a Target's business and operations are in order.
- Reps and warranties are an important part of due diligence and also provide a basis for the Buyer not to close if reps and warranties were true at signing but not at closing. Normally this is an important aspect of an M&A deal. In SPAC/de-SPAC transactions, the Sponsor and Founders can expect to get (very) rich from the deal, so they may have incentives to minimize risk and push the deal through.
- Typically certain details and qualifications are set forth on a "Disclosure Schedule" that accompanies the Merger Agreement. A Disclosure Schedule does things like identify subsidiaries, identify intellectual property, disclose areas in which the reps and warranties are not true. In a normal M&A transaction, the Buyer carefully scrutinizes the Disclosure Schedule to make sure he or she understands all the risks of a transaction. However, in a SPAC deal, the Disclosure Schedule is confidential. In some ways, therefore, the SPAC shareholders do not know what they are buying. **[Tab 11 – Importance of Disclosure Schedules]**
- Watch out for Disclosure Schedule litigation.
  - Tender offer litigation – Can a SPAC shareholder seek a preliminary injunction to block a SPAC merger?
  - Post-transaction disclosure litigation – Can a shareholder of a SPAC who voted for a Merger challenge the transaction after the fact because the Disclosure Schedule was not made available?
  - General problem of asymmetry of information – the dealmakers have access to a great amount of non-public information on the Target, but is all that information made available to the shareholders when their approval is sought? There is a misalignment of interests between the insiders and the public shareholders.
- **[Tab 12 – When things go wrong, Annex C at 9-10]**
- **[Tab 13 – In re IBP, Inc. Shareholders Litigation][*See also*, *infra*, discussion of prominent shareholder cases in slides 70-82]**

HOW DOES THE DE-SPAC TRANSACTION WORK CONTRACTUALLY? THE MERGER AGREEMENT: COVENANTS

- Covenants are promises of the parties to do or not do certain things. Some covenants relate to the period between signing and closing. If the Target fails to honor these covenants, the Sellers can back out of the deal. Again, there is a problem of asymmetry of information and misalignment of interests. Generally, the issue that arises in Mergers is whether a breach of covenant was sufficiently material to permit termination of the transaction.
- If a shareholder learns of a breach of covenant, can a shareholder sue to enjoin the transaction or is the shareholder's only remedy to vote against the transaction and demand redemption of his or her shares?
- One or more of the parties can also make "post-closing" covenants or covenants to take or refrain from taking actions after the closing. For example, the SPAC can agree to let the Target shareholders review financial records after the closing or promise not to modify the terms of any PIPE arrangement.
- The parties will also make a number of joint covenants. Such covenants will include matters such as a mutual "no-shop" agreement between signing and closing and cooperation on tax and SEC filings after closing. **[Tab 7 at 81, 82]**

HOW DOES THE DE-SPAC WORK TRANSACTION CONTRACTUALLY? THE MERGER AGREEMENT: CONDITIONS PRECEDENT

- The consummation of the Merger is typically made contingent on the satisfaction of a number of conditions, including:
  - Hart-Scott-Rodino Act (HSR ACT) *(discussed in more detail in following slides)*. Applicable antitrust waiting periods (and any extensions thereof) under the HSR Act shall have expired or been terminated.
  - Applicable Law. There shall not be in force any applicable Law or Governmental Order enjoining, prohibiting, making illegal, or preventing the consummation of the Merger.
  - SPAC Shareholder Approval/Exchange Listing Requirements. **[Tab 14 – De-SPAC Process – Shareholder Approval, Founder Vote Requirements, and Redemption Offer]**
    - The shares of surviving public company (the SPAC if no domestication the domesticated SPAC otherwise) are to be listed and eligible for further listing as though the shares had never been listed prior to closing.
    - The De-SPAC process is similar to a public company Merger, except that the Buyer (the SPAC) is typically required to obtain shareholder approval, which must be obtained in accordance with SEC proxy rules.
    - Stock exchange rules do not always require a vote by the SPAC shareholders, but if the SPAC does not survive a Merger (*i.e.* through domiciliation) or if more than 20% of the voting stock of the SPAC is being issued in the De-SPAC transaction (to the Seller of the Target business, to PIPE investors or to a combination thereof), the stock exchange rules will require a shareholder vote.
    - This results in most of the De-SPAC transactions conducting a public vote by the SPAC's shareholders, which involves the filing of a proxy statement with the SEC, the review and commenting by the SEC, the mailing of the proxy statement to the SPAC's shareholders, and the holding of a shareholders meeting to tally all of the votes casted and record the voting result. **The proxy process can take three to five months to complete from the date a definitive agreement for the De-SPAC transaction is signed**.
    - As part of the De-SPAC process, the SPAC is 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,
    - The Sponsor and the SPAC's officers and directors will waive redemption rights with respect to their Founder shares (and any public shares they may purchase).

HOW DOES THE DE-SPAC WORK TRANSACTION CONTRACTUALLY? THE MERGER AGREEMENT: CONDITIONS PRECEDENT (CONT.)

- Target Shareholder/Member Approval.
- Effectiveness of Registration Statement. Because shares that will be publicly traded are being issued to the Target shareholders/members, the securities being issued must be registered under the Securities Act. The form used is Form S-4, which is usually a combined registrations statement for the securities and proxy statement for the shareholder approval being sought. *Discussed in more detail in the following slides.*
- Domestication. In transactions involving the domestication of a Cayman Islands or other off-shore vehicle in the United States, the domestication must be complete prior to closing.

HOW DOES THE DE-SPAC TRANSACTION WORK CONTRACTUALLY? THE MERGER AGREEMENT: CONDITIONS PRECEDENT (CONT.)

- The consummation of the Merger is typically made contingent on the satisfaction of a number of conditions:
  - Expiration of Hart Scott Rodino ("HSR") waiting period or receipt of HSR approval.
  - Potential, important anti-trust issues raised by SPAC/De-SPAC transactions.
    - Collusion or bid rigging **[Tab 15 – Not So Special: Securities And Antitrust Regulators May Increase Attention To SPACs In The Coming Year and Tab 15a – Antitrust and Regulatory Issues]**
- "Due to the explosive growth of SPACs, the demand for attractive private targets exceeds the supply. With so much competition for high-value targets, coupled with the inherent time pressure to complete acquisitions, the SPAC heightens the risk of 'collusion' or 'market allocation.'" For example, SPAC sponsors may be tempted to coordinate amongst each other to avoid having multiple bidders for the same Targets, which could reduce price competition while also giving priority to the bids of the SPACs that need to find a Target sooner.
  - This type of market coordination has been the subject of litigation and investigation in the past in a somewhat different context. In the years after the financial crisis, a number of large private equity firms allegedly colluded to avoid increasing the costs of corporate buyouts. A number of firms settled lawsuits brought by private investors alleging violations of Section 1 of the Sherman Antitrust Act by conspiring to suppress prices by avoiding bidding on the same buyout Targets. **[Tab 16 - K.K.R., Blackstone and TPG Private Equity Firms Agree to Settle Lawsuit on Collusion]**
  - The U.S. Department of Justice ("DOJ") also reportedly investigated the private equity firms at the time, but did not move forward with criminal charges.
    - Concentration risk from multiple acquisitions **[Tab 15 at 5]**

HOW DOES THE DE-SPAC TRANSACTION WORK CONTRACTUALLY? THE MERGER AGREEMENT: CONDITIONS PRECEDENT (CONT.)

- Under the Hart-Scott-Rodino Act, the DOJ and the Federal Trade Commission ("FTC") review proposed transactions above a certain financial threshold that affect commerce in the United States, and either agency can take legal action to block transactions that would "substantially lessen competition." Merger Review, FTC.Gov, https://www.ftc.gov/news-events/media-resources/mergers-and-competition/merger-review
  - Under the HSR Act, the FTC and the Department of Justice review most of the proposed transactions that affect commerce in the United States and are over a certain size, and either agency can take legal action to block deals that it believes would "substantially lessen competition." Although there are some exemptions, for the most part current law requires companies to report any deal that is valued at more than $94 million to the agencies so they can be reviewed.
  - After the companies report a proposed deal, the agencies will do a preliminary review to determine whether it raises any antitrust concerns that warrant closer examination. Because the FTC and the Department of Justice share jurisdiction over merger review, transactions requiring further review are assigned to one agency on a case-by-case basis depending on which agency has more expertise with the industry involved. **During the preliminary review, the parties must wait 30 days** (15 days in the case of a cash tender or bankruptcy transaction) before closing their deal. Based on what the agency finds, it can: **1) terminate the waiting period and allow the parties to consummate their transaction (this action often is referred to as an "early termination"); 2) let the waiting period to expire, which allows the parties to consummate the transaction; or 3) if the initial review has raised competition issues, the agency may extend the review and ask the parties to turn over more information so it can take a closer look at how the transaction will affect competition (this action often is referred to as a "second request.").**
  - The vast majority of deals reviewed by the FTC and the Department of Justice are allowed to proceed after the first, preliminary review.
  - However, **if a second request is issued, the companies must provide more information. Once the parties have certified that they have substantially complied with the request, the investigating agency has 30 additional days** (10 days in the case of a cash tender or bankruptcy transaction) to complete its review of the transaction and take action if necessary. The agency may decide at this point to: 1) close the investigation; 2) enter into a settlement with the companies; 3) take legal action in federal district court or through the FTC's administrative process to block the deal from going forward.

HOW DOES THE DE-SPAC TRANSACTION WORK CONTRACTUALLY? THE MERGER AGREEMENT: CONDITIONS PRECEDENT (CONT.)

- The SPACs themselves are shell companies and their acquisition of a single private company should not by itself reduce competition in any relevant market. Yet, the lucrative nature of this business has led to the rise of entities, and certain individuals, with business models with multiple SPACs and acquiring Targets. ***For example, Chamath Palihapitiya, a large Silicon Valley investor, has created six SPACs, which have already identified three Targets to take public***. Eric Newcomer, The Man with Six SPACs (Nov. 6, 2020), https://www.newcomer.co/p/the-man-with-six-spacs
- As Sponsors come to obtain interests in multiple Targets in the same industry, concerns over Mergers reducing competition, including increased opportunities for tacit collusion, may soon arise.
- DOJ and FTC review of acquisitions by private entity firms should provide a warning for firms or individuals that take large positions in multiple SPACs. As part of their broad mission to protect competition, these agencies will apply scrutiny to situations where an entity owns even a partial interest in two competing firms. By way of illustration, in 2007, the FTC objected to a transaction whereby a petroleum and gas provider would be taken private and controlled by two private equity firms. **[Tab 17 – F TC Challenges Acquisition of Interests in Kinder Morgan, Inc. by The Carlyle Group and Riverstone Holdings]**
- The FTC pointed to the fact that these two private equity firms already held a significant non-majority interest in a competing provider in the energy industry. The FTC imposed a series of conditions before allowing the transaction to proceed, including requiring the private equity firms to cede their Board seats at the competing provider and not assert any other control or influence over its operations. Even though not an outright rejection of an acquisition, conditions requiring relinquishment of control of an entity could significantly hinder the business goals of SPAC Sponsors.

HOW DOES THE DE-SPAC TRANSACTION WORK CONTRACTUALLY? THE MERGER AGREEMENT: TERMINATION

- The Merger Agreement can typically be terminated for the following principal reasons:
  - By written consent;
  - By the non-breaching party, if there is any material breach of any representation, warranty, covenant or agreement on the part of the other party, unless the breach is curable within a period of time (usually 30 days);
  - Drop dead date is not met (i.e. the closing has not occurred by a specified date, except if delay is due to a government shutdown);
  - The consummation of the Merger is permanently enjoined, prohibited, deemed illegal or prevented by the terms of a final, non-appealable Governmental Order;
  - The relevant exchange rejects the listing of the SPAC shares;
  - If the post-transaction shares drop below $10.00 shareholder litigation is a virtually certainty. Failure to exercise termination rights may be a theory.

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE S-1

- The initial listing of a SPAC is simply a streamlined IPO. It is an IPO because the shares are being sold to the public and streamlined and because the disclosure that can be made is limited. The SPAC has no assets other than the cash it raises from selling securities and its disclosure obligations are minimal.
- The form typically used for a SPAC is the Form S-1, the form used for large public issuers. **[Tab 18 – S-1 for Chamath Paliphatiya's Social Capital Hedosophia SPAC]**
- The S-1 discloses:
  - The name of the SPAC and its jurisdiction of incorporation.
  - The nature of the SPAC as an "emerging growth company." (*discussed in detail in following slides*)
  - Whether the SPAC has identified any Targets. If so, it would be required to include audited financials and risk factors for the Target and the SPAC approach would be impossible.
  - The sector of focus. The SPAC is not required to consummate a transaction in this sector. Chamath Paliphatiya's Social Capital Hedosophia SPAC disclosed, "We intend to focus our search for a Target business operating in the technology industries."
  - The nature of the securities, almost always Units, each consisting of one share and a fraction of a unit.
  - The price of each Unit, almost always $10.00, and the composition of each Unit. The Unit almost always consists of a single share and a fraction of a warrant. Each whole warrant grants the holder the right to purchase an additional share almost always at an exercise price an always $11.50, and terms, generally for a period starting on the later of 30 days after the completion of an acquisition or 12 months after the closing of the IPO for up to a maximum of 5 years.

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE S-1: DISCLOSURE

- The S-1 discloses:
  - The underwriters overallotment option, if any. A portion of the underwriter's commission is typically held in escrow and only paid upon completion of the De-SPAC.
  - The requirement that the proceeds of the offering be deposited into escrow and not be used until completion of the offering or redemption of the Units, with the principal exception of interest, a small portion of which can be used by the SPAC for operating expenses.
  - The Units redemption rights, or the right of the Unit holder to obtain the return of the original purchase price of the Units, plus interest minus any expenses taken out of the interest. Important: the holder is entitled to redemption at the IPO price of the Unit, not at the price he or she paid. **If the holder bought the shares for $15.00 in aftermarket, he or she would only be entitled to $10 per share. [Tab 19 – What the SEC thinks you need to know about SPACs]**
  - The timetable for completion of an acquisition, usually 18-24 months form the closing of the IPO.
  - The identity of the Sponsor and its commitment to purchase warrants at a price of $1.50 per warrant. Usually covers a modest investment of approximately $8-10 million. The warrants give the holder the right to purchase shares at a share price of $11.50. The Sponsor thus has some skin in the game because if no Target can be found or the price per share never rises above$11.50, the warrants would be worthless.
  - Initial shares held by the Sponsor, usually 20% of the initial share capital purchase for a nominal sum such as $25,000. The Sponsor thus has an extraordinary incentive to find a Target and complete the transaction, because it has acquired these "Founder's shares" essentially for free. The Sponsors shares are typically "Class B," Founder's shares that automatically convert into ordinary Class A shares upon the completion of an acquisition. The main special right of the Class B shares is the right to vote for the directors of the SPAC. Otherwise, the Class B and Class A holders vote together.
  - The rules of the NYSE provide that at least 90% of the gross proceeds from the offering and the sale of the private placement warrants be deposited in a trust account.
  - Separately, the Target of any acquisition must have a value equal to at least 80% of the funds in escrow.

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE S-1: DISCLOSURE (CONT.)

- The S-1 provides key information about the Sponsor. For example, the Social Capital Hedosophia Holdings ("SCH") S-1 discloses that it is a partnership between the investment firms Social Capital and Hedosophia. **[Tab 18]**
  - Social Capital is a Silicon Valley-based investment firm whose mission is to advance humanity by solving the world's hardest problems. It manages over $1.8 billion of capital across its investment platform and invests capital across the company life cycle, from early stage startups to transformational public companies.
  - Social Capital team members include technologists and entrepreneurs who have helped build and scale many of the world's most successful companies. Social Capital focuses on investing in fast growing companies creating significant disruption in multiple industries including healthcare, education, financial services, artificial intelligence and social media. Social Capital has been an early and active investor in companies that have demonstrated strong value creation, such as Box Inc. ("Box"), a company that completed its initial public offering in January 2015 and that had a market capitalization of over $2 billion as of June 30, 2017, and Yammer, Inc. ("Yammer"), a company purchased by Microsoft Corporation for $1.2 billion in 2012. Social Capital has also seen significant value creation through its investments in other companies such as Slack Technologies ("Slack"), SurveyMonkey Inc. ("SurveyMonkey"), Intercom, Inc. ("Intercom"), Netskope, Inc. ("Netskope") and Wealthfront, Inc. ("Wealthfront"). Not all of the companies in which Social Capital has invested have achieved the same level of value creation.
  - Social Capital was founded by Chamath Palihapitiya, who is the Managing Partner and was one of the original members of the Facebook management team. Drawing on the experience of Mr. Palihapitiya and other former Facebook employees now employed at Social Capital, the firm has created a growth platform that uses data science to identify investment opportunities, drive growth and improve portfolio company operational performance.
  - Hedosophia, a venture growth firm founded in 2012, manages approximately $1 billion of capital across its investment platforms and has offices in London and Hong Kong. Hedosophia has a broad remit to invest globally but focuses on consumer and technology companies in the United States, China and Europe, typically two to four years pre-IPO. Hedosophia provides targeted advice and guidance to portfolio companies, specifically on international expansion, market entry, strategic partnerships and joint ventures. and government and regulatory matters. Hedosophia also benefits from the network that its Co-founder and Chief Executive Officer, Ian Osborne, has established by virtue of the strategic advisory firm he founded, Osborne & Partners, and the financial advisory firm, Connaught, founded in 2009 and 2014, respectively, which have acted for eight of the fifteen most valuable private companies in the technology sector.
  - Hedosophia is managed by Chamath Palihapitiya, and Ian Osborne. Its Chief Operating Officer is Philip Deutsch, a Stanford Law classmate of Eden Quainton.
- SCH Investors are essentially betting on the ability of Mr. Palihapitiya to locate attractive targets. Interestingly, he does not appear to have any prior experience in aerospace.

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE S-1: DISCLOSURE (CONT.)

- The S-1 also describes the SPAC's philosophy and vision. SCH's vision is interesting and provides an intriguing explanation for the SPAC philosophy:
- **State of the Private Technology Company Landscape**
  - Private technology companies are fundamentally changing the world at an unprecedented pace by establishing new markets, creating new experiences and disrupting legacy industries. Key technological advances and practices, such as cloud computing, data analytics and intelligence platforms, open source software development, developer-focused software tools, and software-defined networking, storage and computing, are allowing technology companies to rapidly affect change in every major sector of the global economy. Agile private technology companies have embraced these advances and practices to create business models and address market needs that will enable them to reach significant financial scale and create shareholder value.
  - Over the last several years and in connection with a declining investable universe of public equities, private technology company valuations have increased reflecting investor interest in gaining exposure to the fundamental economic shifts and new business models that these companies are enabling. As of May 2017, we estimate there are approximately 150 private U.S. technology companies with a valuation, as of the last round of financing, in excess of $1.0 billion, commonly referred to as "unicorns." In comparison, there are approximately 200 public U.S. technology companies with a market valuation in excess of $1.0 billion.
- **The Current Technology IPO Paradigm**
  - Despite playing major roles in the global economy and achieving significant financial scale, there has been a range of factors over the last several years that have led many technology companies, to remain private. U.S. technology IPOs have decreased from an average of approximately 40 IPOs per year from 2010 to 2015 to approximately 30 IPOs per year during 2015 and 2016.
  - Vast capital availability in the private markets, first from traditional venture capital, and now from multiple types of investors, including hedge funds, mutual funds, sovereign wealth funds and corporates, has enabled companies to stay private longer. Historically the decision to access public markets through an IPO has tended to be driven by a desire for growth capital and a venue for efficient pre-IPO shareholder liquidity; however, it is now a strategic business decision as the evolution in private markets now allows for sufficient access to growth capital. Furthermore, the private market has matured to establish well-developed secondary markets that are capable of providing liquidity to founders, employees and investors.

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE S-1: DISCLOSURE (CONT.)

(continued)

- The traditional technology company IPO process, which has been largely unchanged for decades, has also acted as a driving force to deter private company management teams and their pre-IPO stakeholders from pursuing IPOs. **We believe management distraction, a sub-optimal price discovery mechanism and the resultant longer-term aftermarket impact have discouraged private technology companies from pursuing IPOs.** This tends to be true even for businesses that are otherwise operationally ready and of appropriate size to access the public markets.
  - **Management distraction:** Preparation for and execution of an IPO requires management teams to devote considerable time and attention to the lengthy IPO process, including document drafting, underwriter selection and extensive investor engagement. This significant commitment can potentially distract management teams from focusing on the company's product and growth strategies, a particularly challenging dynamic for high-growth technology company executives.
  - **Price discovery and shareholder base development:** The process for technology IPO demand generation often produces IPO order books that are significantly oversubscribed, but lacks an effective price discovery mechanism and encourages participation from many investors that are focused on short-term performance. Furthermore, **limited price discovery** and short-term focused investors can create a **misalignment of incentives** during the IPO share allocation process between technology companies and their underwriters. The average first day trading performance for U.S. technology IPOs from 1998 to April 2017 stands at over +25% as compared with U.S. non-technology IPOs at +15% over the same time period. **In 2016 the percentage differential in first day post-IPO performance between U.S. technology and non-U.S. technology IPOs reached a five year high of +242%, or +31% versus +13%, respectively**. The current technology IPO book-build process fails to deliver the requisite information to technology company management teams, pre-IPO stakeholders and underwriters to make informed judgements regarding IPO pricing and allocation decisions and alternatives.
  - **Longer-term impacts:** A technology IPO bookbuild that is characterized by ineffective price discovery and initial public shareholder base development can lead to material longer-term negative impacts for companies completing an IPO, such as shareholder base turnover and increased stock price volatility. These dynamics have far reaching effects on newly public companies and can impair a management team's ability to focus on long-term value creation.
- Nevertheless, we believe companies, at a certain stage in their development, will see material **benefits from being publicly-traded, including increasing brand and company awareness, developing a more liquid acquisition currency and diversifying funding sources and access to capital**. An acquisition by a blank check company with a management team that is well-known to, and respected by, technology company founders, their current third-party investors and their management teams, we believe, can provide a more transparent and efficient mechanism to bring a private technology company to the public markets.

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE S-1: EMERGING GROWTH COMPANIES

- Almost all SPACs are "emerging growth companies" as defined in Section 2(a) of the Securities Act of 1933, as amended, or the Securities Act, as modified by the Jumpstart Our Business Startups Act of 2012, or the JOBS Act.
- This means that SPACs are entitled to certain benefits, including:
  - Exemptions from auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act;
  - Reduced disclosure obligations regarding executive compensation in periodic reports and proxy statements;
  - Exemptions from the requirements of holding a non-binding advisory vote on executive compensation and shareholder approval of any golden parachute payments not previously approved ("say on pay"). Say on pay is one of the major enhancements of corporate governance and shareholder protection movements of the last number of years; and
  - Delaying the adoption of certain accounting standards that apply to public companies.
- SPACs can remain "emerging growth companies" until the earlier of
  - (1) the last day of the fiscal year (a) following the fifth anniversary of the completion of SPAC offering, (b) in which the SPAC has total annual gross revenue of at least $1.07 billion, or (c) in which it is deemed to be a large accelerated filer, which means the market value of its ordinary shares that is held by non-affiliates exceeds $700 million as of the end of the prior fiscal year's second quarter, and
  - (2) the date on which it has issued more than $1 billion in non-convertible debt securities during the prior three-year period.
- The most famous SPAC that would not be an emerging growth company is Bill Ackman's Pershing Square SPAC.

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE S-1: OFFERING DETAILS – PUBLIC WARRANTS

- The S-1 describes the main features of the SPAC offering including the number of units offered, the underwriters, underwriting commission and when separate trading of the shares and warrants will begin.
  - Typically, the warrants begin trading anywhere from 30-52 days after the listing of the SPAC Units.
  - The underwriters can determine that earlier separate trading is appropriate, provided that the SPAC files an 8-K and issues a press release notifying shareholders that separate trading is beginning earlier.
  - Shares to be issued upon exercise of the warrants are not registered at the time of the IPO. The SPAC undertakes to effect such registration after the acquisition of a Target or to require that exercise be effected on a "cashless" basis.
  - The warrants can be redeemed by the company for nominal consideration (usually a fraction of a penny) if they are not exercised after the share price exceeds $18.00 per share for 20 days out of a 30 day period. **This is a trap for the unwary. Purchasers of the warrants could lose everything if they do not pay attention to this feature**.

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE S-1: OFFERING DETAILS – PRIVATE WARRANTS

- Sponsor commits to purchase private placement warrants generally at a price of $1.50 per warrant, which is sufficient to represent an investment in excess of $10 million. In the SCH SPAC, the Sponsor agreed to purchase $8-9 million warrants for an investment of $12 to $13 million, depending on whether the underwriters exercised their overallotment offering. The underwriters almost always exercise the overallotment option in a successful offering. The theory behind the overallotment option is that it gives the underwriters buying power to sustain the stock price in the after-market.
- The purchase price of the private placement warrants are added to the proceeds from the offering to be held in the trust account. If there is no SPAC transaction, the warrants expire worthless. The private placement warrants are not redeemable as long as they are not transferred except to permitted transferees (essentially other officers or directors, family members, heirs). The warrants expire worthless if a business combination transaction is not completed within 24 months.

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE S-1: FUNDING OPERATIONS

- Until the completion of the De-SPAC transaction, no proceeds held in the trust account are available for operating expenses, except the interest, a small portion of which can be used to pay taxes.
- The SPAC can pay its expenses from the 10% of the offering not held in escrow.
- Any additional funds would have to come from the Sponsor, members of the management team or other third parties. The offering proceeds in the trust fund cannot be used to guaranteed any loans.

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE S-1: FORM 8-A

- SPAC files a Registration Statement on Form 8-A with the SEC to voluntarily register its securities under Section 12 of the Securities Exchange Act of 1934.
- This is a very simple form that incorporates by reference the material in the S-1 and reflects the structure of the US securities laws that have one main law, the Securities Act of 1933, that governs the issuance of securities and one main law that governs stock exchanges on which securities are listed for trading.

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? RULE 144

- A core principle of U.S. securities law is that shares cannot be publicly traded absent an exemption from registration.
- There is a broad range of exemptions that cover different situations, but for public companies such as SPACs the most important is Rule 144. **[Tab 20 – Rule 144]**
- Rule 144 is designed to address a technical problem in the functioning of the U.S. securities laws. Under Securities Act of 1933, one of the main exemptions for purchases and sales of securities is Rule 4(1), which exempts registration from any transaction by someone other than the issuer, underwriter or dealer. Most purchasers will obviously be neither issuers nor dealers, but what about "underwriter" status? What does this word mean? There is a popular understanding of "underwriter" to mean the banks who conduct an offering of shares for an issuer. But the Securities Act broadly defines "underwriter" to include anyone who purchases securities from the issuer or an affiliate of the issuer "with a view to distribution" (*i.e.*, with a view to resale). Attorneys developed guidance for clients to help determine whether or not a person was purchasing with a "view to distribution" and one of the key conditions was the purchaser be purchasing with investment intent and keep the securities for a "holding period" of varying length depending on the circumstance. This remained unsatisfactory and vague, so the SEC promulgated Rule 144, which has been modified several times. **[Tab 20a – Rule 144 Amendment Adopting Release]**
- Currently, Rule 144 provides that non-affiliates (*i.e.*, people who do not "control" the issuer, like you and me) can resell restricted (*i.e.*, unregistered) securities of a reporting company (such as a SPAC) after a six month holding period without limitation, provided there remains current public information about the issuer for at least another six months after such resale. Affiliates of the issuer, like the Sponsor of a SPAC or its management, must wait one year before selling their securities and can only "dribble out" securities according to a formula established by Rule 144 (to simplify a bit, no more, during any three-month period, than the greater of 1% of the issuer's outstanding securities or the average weekly trading volume in such securities). **[Tab 20b – Rule 144 Summary Chart]**

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? RULE 144/REG S

- Rule 144 is not an issue for public investors in the SPAC shares and warrants.
- However, investors in the SPAC Sponsor or members of management who hold private (unregistered) SPAC shares and warrants need to be aware that Rule 144 is not available to holders of restricted (private) SPAC securities until ***one year*** after the closing of the De-SPAC transaction. In addition, this holding period is calculated not from the date of closing, but from the date of filing of a so-called Super 8-K within 4 days of closing that provides business and financial information about the Target, among other things. *See infra*, slide 65. Thus, even if a holder of restricted SPAC shares has satisfied the one-year holding period requirement and even if it would be advantageous to sell the securities into the public market, the investor will be restricted from engaging in any such sale until one year after the De-SPAC deal closes.
- PIPE investors as well need to be mindful that shares and warrants acquired in the PIPE can only be resold pursuant to a registration statement or in compliance with an exemption from registration. Rule 144 is only available one year after the closing of the De-SPAC transaction.
- Holders of restricted SPAC securities could resell their securities outside the United States under Regulation S, which provides a resale exemption for sales of securities outside the U.S., unless such resale is part of a scheme to evade the application of the U.S. securities laws. Any sort of agreement that provides for the "round-trip" of restricted securities outside the United States to "wash off" the restrictions is not legal. If attorneys see any such proposed documentation, they should realize that is an immediate red flag.

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE REGISTRATION RIGHTS AGREEMENT

- Insiders may wish to sell their shares more quickly than the private placement rules permit. As a result, various parties, including PIPE investors and Target shareholders, require registration rights as a condition to their investment. **[Tab 9]**
- Registration rights come in two basic forms "demand" registration rights and "piggy-back" registration rights.
- Demand registration rights represent the right to demand (require) the issuer to register a holder's shares, while "piggy-back" rights represent the right to participate in a registration of securities the issuer is undertaking pursuant to the demand of another holder. Both types of registration rights are typically required. Generally, the Company must file the registration statement within 45 days of receiving a demand and must make the demand known to other shareholders within 10 days.
- Holders typically get three such demands, but only a registration statement that has actually been declared effective counts towards this limit. In other words, if a shareholder makes a demand and the company files a registration statement but the registration is withdrawn for some reason, the shareholder will still have his three demand registrations left.

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE S-4

- A De-SPAC business combination requires registration under two separate provisions of the U.S. securities laws. First a De-SPAC transaction involves the issuance of unregistered securities. Under the Securities Act of 1933, "transactions" are registered. What this means is that the Units that were sold in the SPAC IPO have been registered, but the Company Units that were not sold in the IPO and may be used as part of the consideration to acquire the Target have not been registered. As a result the securities issued in the De-SPAC transaction must be registered under the Securities Act of 1933. In addition, the existing shares of the SPAC may become technically different – for example in a domestication – and the shares of the new public company would have to be registered as well.
- Separately, the rules of the major stock exchanges require that transactions involving more than 20% of the shares of a listed company must be put to a vote of the shareholders. With public companies, votes are solicited by means of proxies, or forms, authorizing a vote at a shareholders meeting as shareholders from around the country will not physically attend the shareholders meeting at which a merger or business combination is voted on. The Securities Exchange Act of 1934 provides that if proxies are solicited from public shareholders, a "proxy statement" containing certain information about the transaction and the Target must be filed with the SEC (the Securities ***and*** Exchange Commission).
- The S-4 Registration statement is thus a combined prospectus for newly issued securities and a proxy statement for the transaction and is referred to as containing a "Combined Prospectus/Proxy Statement." **[Tab 21 – SCH S-4]**

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE S-4: DISCLOSURE

- The prospectus component of the S-4 identifies, first, the shares being registered pursuant to the De-SPAC business combination. There are two main variations to be aware of: (1) De-SPACs involving domestication of an offshore Sponsor vehicle, most commonly incorporated in the Cayman Islands and reincorporating (or domesticating) in a U.S. jurisdiction, usually Delaware and (2) De-SPACs involving a U.S., usually Delaware, incorporated Sponsor vehicle.
  - In the domestication scenario, all the existing SPAC shares must be re-registered simultaneously with the merger because technically the shares of the new reincorporated entity are shares that have not yet been registered. In addition, any shares being issued as Merger consideration need to be registered. **[Tab 21]**
  - In the "already domesticated" scenario, only the shares that are being used as consideration to effect the Merger or business combination need to registered. **[Tab 21a – Nikola S-4]**

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE S-4: DISCLOSURE

- The proxy statement component of the S-4 describes
  - Matters on which the vote of the shareholders is being sought (primarily to approve the proposed Merger, the domestication, if there is one, election of new directors, updating and adopting the company's equity incentive plan, and various ancillary agreements, depending on the terms of the transaction). In the SCH S-4, the Target had the right to require Chamath Palihapitiya to purchase an additional $100,000,000 in shares at the IPO price. This additional "skin in the game" could also be viewed as an additional gift to Mr. Palihapitiya and further dilution to the existing shareholders, since the $10 share price represented a 15% discount from the price on the date the repurchase commitment was signed.
- The terms of the shareholders redemption rights and, notably, their right to seek redemption of their shares even if they vote in favor of the combination, provided that a request for redemption be made no later than two days before the date set for the De-SPAC business combination. In addition, the redemption rights of large individual or groups of shareholders are typically limited.
  - Typical language for this point is:
    - Notwithstanding the foregoing, a public shareholder, together with any affiliate of such public shareholder or any other person with whom such public shareholder is acting in concert or as a "group" (as defined in Section 13(d)(3) of the Securities Exchange Act of 1934, as amended ("Exchange Act")), will be restricted from redeeming its public shares with respect to more than an aggregate of 15% of the public shares. Accordingly, if a public shareholder, alone or acting in concert or as a group, seeks to redeem more than 15% of the public shares, then any such shares in excess of that 15% limit would not be redeemed for cash.
- Recommendation of the SPAC's Board with respect to the transaction (obviously, ***for***).
- A detailed Q&A section purporting to answer all a shareholder's questions.

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE S-4: DISCLOSURE – Q & A

- The Q&A portion of the S-4 is a particular feature of the American public Merger process and represents an attempt to present the complexities of a Merger to retail investors, with questions posed from the perspective of the investor, such as
  - Why am I receiving this proxy statement/prospectus?
  - What proposals are shareholders of the SPAC being asked to vote upon?
  - What will the Target receive in return for the SPAC's acquisition of all of the issued and outstanding equity interests of the Target?
  - What are the recommendations of the Board of Directors?
  - How does the Sponsor intend to vote their shares? ***Obviously in favor.***
  - What vote is required to approve each proposal at the extraordinary general meeting? ***The answer depends on the specific item being put to the shareholders for a vote. Some items, such as the Merger, typically only require a vote of a majority of the shareholders, while other items, such as a domestication or changes to the SPAC's organizational documents require a 2/3 super-majority.***
  - Can I change my vote after sending in my proxy card? ***Yes.***
  - What happens if I fail to take any action with respect to the extraordinary general meeting? ***You will automatically become a shareholder of the combined entity if the Merger is approved. You will remain a shareholder of SPAC if the Merger is not approved. In this latter case, the shares would become worthless.***
  - What happens if I sell my ordinary shares before the extraordinary general meeting? ***This question gets at a problem of the "record date." In a Merger, only shareholders of record on the "record date," a date some specified time before the Merger, are entitled to vote. If the shareholder sells before the record date, he or she loses the right to vote at the meeting. If he or she sells after the record date, he or she retains the right to vote, but loses the redemption right, which passes to the transferee.***

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE?
THE S-4: DISCLOSURE – SUMMARY OF THE PROSPECTUS/PROXY STATEMENT

- The key items in the Summary of the Prospectus/Proxy Statement are:
  - Summary of the combined company's (really the target's) business;
  - The parties to the Merger;
  - The Merger consideration – in some deals, the consideration is just a huge chunk of shares in the new combined entity; the cash from the IPO is not actually used to buy the shares of the Target shareholders but is available to the new company for capital expenditures and development. In the SCH transaction for example, the sellers received 130 million shares, valued at $10 share, for aggregate consideration of $1.3 billion, even though the share price was trading above $10 a share at the time the transaction was approved. At the peak valuation, the Sellers' shares were worth over $6.5 billion. It is very unclear whether a direct IPO would have been possible;
  - The shareholder proposals;
  - The Board of Directors' rationale for pursuing the transaction;
    - This section is essentially the marketing case for acquisition of the Target. This section does not appear to be scrutinized by shareholders with the same rigor as it would be by the investors in a regular IPO, in which the company tries to sell its securities to investors via a road show. Here, the key Buyers (the Sponsor and members of management) do not need to be sold because they already know the Target and stand to make immense profits from the transaction. The shareholders of the SPAC are not given much information beyond that in the proxy statement/prospectus and their best guide to the value of the transaction is how the market appears to be reacting to the deal (*i.e.*, if the SPAC shares are rising or not). There is a potential for manipulation here because, again, the incentives are perverse and skewed towards the consummation of the transaction because of the potential profits for the insiders.

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE S-4: DISCLOSURE – SUMMARY OF THE PROSPECTUS/PROXY STATEMENT

(continued)

- Shareholder structure after the transaction;
- Conflicts of interest:
  - This section typically describes accurately the nature of the conflicts of interest but often does not spell out the extent of the conflict in terms the average person can understand.
  - In the SCH S-4, for example, the extraordinary upside potential of the private placement warrants purchased by the Sponsor is not disclosed. Chamath Palihapitiya's individual ownership stake in the Sponsor is not disclosed.
- Selected and Summary Financial Data, including selected income statement and balance sheet items for the full preceding two years and any "stub period" for the year in progress. For SCH, the striking feature of the financials is the sheer enormity of the losses incurred by Virgin Galactic, nearly $150 million per year. **[Tab 21 at 26]**

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE S-4: DISCLOSURE – RISK FACTORS

- The risk factors for a De-SPAC are typically extremely off-putting. While risk factors in an IPO are also typically very negative, there is a much greater information asymmetry in a SPAC/De-SPAC transaction vs. that of an IPO. In an IPO, at least in theory, investors, including sophisticated institutional investors, are presented with the business case and the risks of an investment and have the experience (again in theory) to evaluate the IPO story. In contrast, in an S-4, the risk factors sit alone and are included as part of a massive 600-page document the recipients may not understand. A few of the risks in the SCH deal with Virgin Galactic ("SCH/Virgin Galactic deal") are highlighted below:
- ***We have not yet tested flights at our anticipated full passenger capacity of our spaceship.***
  - To date, only one of our test flights included a crew member that was not a pilot. The success of our human spaceflight operations will depend on our achieving and maintaining a sufficient level of passenger capacity on our spaceflights. We have not yet tested flights with a full cabin and it is possible that the number of passengers per flight may not meet our expectations for a number of factors, including maximization of the passenger experience and satisfaction. Any decrease from our assumptions in the number of passengers per flight could adversely impact our ability to generate revenue at the rate we anticipate.
- ***Due to the inherent risks associated with commercial spaceflight, there is the possibility that any accident or catastrophe could lead to the loss of human life or a medical emergency.***
  - Human spaceflight is an inherently risky activity that can lead to accidents or catastrophes impacting human life. For example, on October 31, 2014, VSS Enterprise, an earlier model of SpaceShipTwo manufactured and operated by a third-party contractor, had an accident during a rocket-powered test flight. The pilot was seriously injured, the co-pilot was fatally injured and the vehicle was destroyed. As part of its 2015 accident investigation report, the National Transportation Safety Board (the "NTSB") determined that the probable cause of the accident related to the failure by a third-party contractor to consider and protect against the possibility that a single human error could result in a catastrophic hazard to the vehicle.
- ***Failures in our technology infrastructure could damage our business, reputation and brand and substantially harm our business and results of operations.***
  - If our main data center were to fail, or if we were to suffer an interruption or degradation of services at our main data center, we could lose important manufacturing and technical data, which could harm our business. Our facilities are vulnerable to damage or interruption from earthquakes, hurricanes, floods, fires, cyber security attacks, terrorist attacks, power losses, telecommunications failures and similar events.

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE S-4: DISCLOSURE – RISK FACTORS – THE FAIRNESS OPINION ISSUE

- ***Neither the SCH Board of Directors nor any committee thereof obtained a third party valuation in determining whether or not to pursue the Business Combination.***
  - Neither the SCH Board of Directors nor any committee thereof is required to obtain an opinion from an independent investment banking or accounting firm that the price that we are paying for the VG Companies is fair to us from a financial point of view. Neither the SCH Board of directors nor any committee thereof obtained a third party valuation in connection with the Business Combination. In analyzing the Business Combination, the SCH Board of directors and management conducted due diligence on the VG Companies. The SCH Board of directors reviewed comparisons of selected financial data of the VG Companies with their peers in the industry.
- ***Since the Sponsor and SCH's directors and executive officers have interests that are different, or in addition to (and which may conflict with), the interests of our shareholders, a conflict of interest may have existed in determining whether the Business Combination with the VG Companies is appropriate as our initial business combination. Such interests include that Sponsor will lose its entire investment in us if our business combination is not completed.***
  - When you consider the recommendation of SCH's Board of directors in favor of approval of the BCA Proposal, you should keep in mind that the Sponsor and SCH's directors and executive officers have interests in such proposal that are different from, or in addition to, those of SCH shareholders and warrant holders generally.
- Typically, in public mergers and acquisitions, the Board of Directors will obtain a ***fairness opinion*** from an independent appraisal firm that the consideration paid in a transaction is fair from a financial point of view. This opinion is considered necessary for the Board of Directors to be able to establish a defense to any shareholder litigation that they did not breach any duties of care or loyalty. However, De-SPAC deals frequently do not include fairness opinions.
- The thinking in not seeking fairness opinions in De-SPAC transactions appears to be that courts are likely to be deferential and apply the business judgment rule – highly deferential to Board members – rather than the "entire fairness" doctrine, which requires an evaluation of whether the transaction is "entirely fair" to the SPAC shareholders. **[Tab 22 – SPACs and Entire Fairness.][Tab 23 – AP Services, *LLP v. Lobell*]**
- This view does not appear to fully take into account the degree of enrichment the Sponsor can get from closing a transaction and the exceptional incentive that exists to pursue a deal even if it is not in the long-term interest of the stockholders. Once the insiders have cashed out, any losses would be on the shareholders.
- This is an area to watch closely. The most recent New York case of which we are aware signals that SPACs should be cautious. ***See also, infra*, the discussion of *AP Services v. Lobell*, slides 77-79. *In our view, a fairness opinion would be advisable in the context of De-SPAC transactions.***

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE S-4: DISCLOSURE – RISK FACTORS – THE WARRANTS

Typical warrant restrictions include, taken here from the SCH S-4:

- ***Even if the Business Combination is consummated, the public warrants may never be in the money, and they may expire worthless and the terms of the warrants may be amended in a manner adverse to a holder if holders of at least 65% of the then outstanding public warrants approve of such amendment.***
  - The warrants were issued in registered form under a Warrant Agreement between Continental Stock Transfer & Trust Company, as warrant agent, and SCH. The Warrant Agreement provides that the terms of the warrants may be amended without the consent of any holder to cure any ambiguity or correct any defective provision, but requires the approval by the holders of at least 65% of the then outstanding public warrants to make any change that adversely affects the interests of the registered holders of public warrants. Accordingly, we may amend the terms of the public warrants in a manner adverse to a holder if holders of at least 65% of the then outstanding public warrants approve of such amendment. Although our ability to amend the terms of the public warrants with the consent of at least 65% of the then outstanding public warrants is unlimited, examples of such amendments could be amendments to, among other things, increase the exercise price of the warrants, shorten the exercise period or decrease the number of shares of VGH, Inc. common stock purchasable upon exercise of a warrant.
- ***We may redeem your unexpired warrants prior to their exercise at a time that is disadvantageous to you, thereby making your warrants worthless.***
  - We have the ability to redeem outstanding warrants at any time after they become exercisable and prior to their expiration, at a price of $0.01 per warrant, provided that the last reported sales price of the VGH, Inc. common stock equals or exceeds $18.00 per share (as adjusted for share splits, share dividends, rights issuances, subdivisions, reorganizations, recapitalizations and the like) for any 20 trading days within a 30 trading-day period ending the third trading day prior to the date we send the notice of redemption to the warrant holders. If and when the warrants become redeemable by us, we may exercise our redemption right even if we are unable to register or qualify the underlying securities for sale under all applicable state securities laws. Redemption of the outstanding warrants could force you to: (i) exercise your warrants and pay the exercise price therefor at a time when it may be disadvantageous for you to do so (ii) sell your warrants at the then-current market price when you might otherwise wish to hold your warrants; or (iii) accept the nominal redemption price which, at the time the outstanding warrants are called for redemption, is likely to be substantially less than the market value of your warrants.
  - None of the Private Placement Warrants will be redeemable by us so long as they are held by our Sponsor or its permitted transferees.

HOW DO SPACS WORK FROM A SECURITIES LAW PERSPECTIVE? THE "SUPER 8-K"

- The SEC requires that information relating to certain current events be filed on Form 8-K within four days of the occurrence of the event. **[Tab 24 – Form 8-K]**
- Following the completion of a De-SPAC transaction, the combined entity is required to disclose information under items 2.01 and 5.06 of Form 8-K.
- Item 2.01 provides that the matters below must be disclosed following a business combination:
  - (a) the date of completion of the transaction; (b) a brief description of the assets involved; (c) the identity of the person(s) from whom the assets were acquired or to whom they were sold and the nature of any material relationship, other than in respect of the transaction, between such person(s) and the registrant or any of its affiliates, or any director or officer of the registrant, or any associate of any such director or officer; (d) the nature and amount of consideration given or received for the assets and, if any material relationship is disclosed pursuant to paragraph (c) of this Item 2.01, the formula or principle followed in determining the amount of such consideration; (e) if the transaction being reported is an acquisition and if a material relationship exists between the registrant or any of its affiliates and the source(s) of the funds used in the acquisition, the identity of the source(s) of the funds;
  - and (f) **if the registrant was a shell company, other than a business combination related shell company, as those terms are defined in Rule 12b-2 under the Exchange Act (17 CFR 240.12b-2), immediately before the transaction, the information that would be required if the registrant were filing a general form for registration of securities on Form 10 under the Exchange Act**. Most of the information required under Form 10 will already have been disclosed in the S-4, but there is certain financial information that may not have been disclosed.
- Item 5.06 provides that if a registrant was a shell company that has completed a transaction with the effect of causing it to cease being a shell company, it must disclose the material terms of the transaction.
- Together, the requirements of Item 2.01 and 5.06 are referred to as the **Super 8-K** requirements and the 8-K that includes them is called a "**Super 8-K**." The Super 8-K is important not only because it includes some disclosure that was not previously made, but also because certain requirements applicable to SPACs, such as the running of the one-year holding period after the consummation of a business combination for restricted securities, run from the date of the Super 8-K, not from the closing of the business combination. **[Tab 25 – Special Purpose Acquisition Companies - An Introduction]**

WHO GETS RICH IN A SPAC OFFERING? THE SPONSOR

- Let's put together what we have seen so far to assess who get rich in a SPAC/De-SPAC transaction.
- The most obvious party to get rich – indeed fantastically rich – is the Sponsor, at very little risk.
- Let's take the SCH/Virgin Galactic deal:
- The Sponsor was required to invest $12 million to acquire 8 million shares guaranteed against dilution. The highest post De-SPAC trading price was $54.53. The value of 8 million shares was $436,240,000. The Sponsor had to pay the $11.50 exercise price, or $92 million. The total profit is thus $436,240,000 - $104,000,000 (purchase price + exercise price), or $332,240,000. **Over $300,0000,000 profit on a $12,000,000 investment**. Even at today's price of $27.29, which has cratered unexpectedly, the 8,000,000 shares could be sold for $218,320,000, for a profit of $114,320,000, 10 times the initial investment, or what is known, colloquially, as a 10-bagger.
- In addition, the Sponsor received14,375,000 shares essentially **for free**. This represents an additional profit of $783,868,750 at the high price or $392,006,250 at the low. In other words, at the peak post De-SPAC price, the Sponsor had turned an approximately **$10 million investment into over $1 billion**, a 10,000% return on investment.
- Forget everything else you have heard – all the other arguments – ***this*** is why SPACs are so popular.
- The risk to a sponsor is very low, since the Sponsor only loses if it cannot find a suitable Target. But it has every incentive to find a Target and push through a deal, given the vast sums involved.

WHO GETS RICH IN A SPAC/DE-SPAC DEAL? THE PIPE INVESTORS

- Although the PIPE investors do far less well than the Sponsors, they still stand to profit handsomely from a De-SPAC deal.
- Generally, the PIPE investors purchase their shares at the redemption value of the shares (*i.e.*, the $10 per share paid by the initial SPAC IPO investors.) But the PIPE investors agree to make this investment at the closing of the De-SPAC transaction at a price set when the S-4 goes effective.
- For example, in the SCH deal, Boeing agreed to invest $20 million at $10 per share on October 7, 2019 and the S-4 Registration Statement went effective on October 9, 2019. Shareholder approval was obtained on October 23, 2019. The deal closed on October 25, 2019.
- On the date Boeing agreed to make its investment, the share price was $11.22 and had been steadily rising for the few days previously. Boeing effectively purchased its shares for a 10% discount, with very little downside risk and all the upside of the Virgin Galactic shares, to approximately $54 at its peak and to approximately $27 today. Not a get-rich-quick scheme but a very profitable investment, at a discount to the market price, with little downside risk.

WHO GETS RICH IN A SPAC/DE-SPAC DEAL? THE OWNERS/INSIDERS OF THE TARGET

- As we saw in the excerpts from SCH's S-1, the underlying economic benefit of the process is meant to be a superior return to the Target companies than could be obtained in a regular IPO.
- The superior return is not simply reflected in the higher price for the shares, but the related impact on the options previously issued to management. Because options provide leverage, an increase in the share price has an exponential impact on the shares owned by insiders.
- These options are required to be issued at a price that was their fair market value at the time of issuance. Under IRS Rule 409A, there are a number of safe harbors for the valuation of options in privately held business, the most widely used being an independent appraisal.
- The most recent independent appraisal of a private company will include an "illiquidity discount," meaning that the shares are less valuable than they otherwise might be because of the difficult of finding buyers for privately held shares.
- In addition, assuming the arguments of Chamath Palihapitiya are accurate, a negotiated De-SPAC deal provides an even greater rise in valuation than could be expected through a traditional IPO.
- There appears to be a practice gaining traction for potential SPAC Targets to aggressively issue options even if the independent appraisal is relatively stale so as to maximize the "pop" from a letter of intent and a SPAC deal. This is an important issue because the 409A safe harbor only provides a rebuttable presumption that the options were issued at fair market value. The more evidence there is that management was aware of the possibility of a deal (perhaps because of an announcement relating to a competitor or a business in the same general industry), the more the IRS could overcome the rebuttable presumption. Purchasers in the SPAC could also potentially bring claims against the Managers of the Target because the issuance of greater amounts of what amounts to "cheap stock" has a dilutive effect on the SPAC shareholders post-Merger.

WHO GETS RICH IN A SPAC/DE-SPAC DEAL? "MOM AND POP"

- The SPAC machine depends on the receptivity of the public markets, which means average retail investors or the large pension and other funds managing their money.
- So what about "mom and pop" or "Joe Mainstreet?" How do they fare in SPAC?
- The argument is that, although they may not make the stratospheric returns of the Sponsors, they still do very well indeed and can use the leverage of warrants to do very well indeed.
- How well is this claim holding up? Chamath Palihapitiya recently tweeted out the performance of his SPACs. **[Tab 26 – Palihapitiya's SPAC performance]** Overall, the performance of his SPACs since inception is relatively strong, although there is a great deal of volatility and his companies have all recently taken a beating.
- Generally, the problem for retail investors is that the De-SPAC targets are almost all money-losing vehicles in need of capital to grow and expand. While some money losing companies make tremendous sense as investments – *see* Facebook, CP's claim to fame – a market frenzy for money-losing private companies seems to carry tremendous risk. In addition, without the massive upsides provided to the Sponsor and the Target insiders, and the nearly guaranteed returns to the PIPE investors, betting on high-risk, high-return private companies is, well, risky.
- One of Palihapitiya's SPACs, Clover Health, illustrates the problems. After getting a 70% "pop" from the De-SPAC process, the company is now trading at $7, down nearly 30% since inception. The warrants jumped over 200% as soon as they began trading separately but are now back down close to $1.50. Investors who bought into the warrants once they began trading have lost significant amounts. Also, the redemption feature of the warrants makes them extremely risky for average investors. Remember: if the underlying stock trades at $18 for any 20 days in a 30-day period, the warrants can be redeemed essentially for nothing and become worthless. An investor who is not paying close attention could lose everything overnight.

WHAT ARE THE MAIN LITIGATION ISSUES FACING SPACS/DE-SPACS? SECTION 10(B) OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 10(B)(5) THEREUNDER

- *Bortenau v. Nikola Corp., et al.*, 18-cv-1797. **[Tab 27 – *Bortenau v. Nikoa Corp. et al.* Complaint]**
- In this case, the Company complied with its securities laws filing obligations, issuing the required press releases, filed the required 10-K and then Form S-4 . However, after the merger was completed, a research analyst published a report describing allegedly material false statements about anticipated cost reductions and production capacities in the Company's public filings and statements. A few days later, the research analyst published a second report claiming that the Company's response to the first report was a tacit admission of securities fraud. Based on these facts, the Plaintiff, who was an individual purchaser of the SPAC securities who had voted in favor of the merger, brought a class action suit on behalf of all similarly situated plaintiffs, alleging;
- Defendants violated §10(b) of the 1934 Act and Rule 10b-5 thereunder in that they:
  - employed devices, schemes and artifices to defraud;
  - made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
  - engaged in acts, practices and a course of business that operated as a fraud or deceit upon plaintiff and others similarly situated in connection with their purchases of Nikola securities during the Class Period.
- Members of the Sponsor group face "control person" liability under 20 under the Securities Exchange Act.

WHAT ARE THE MAIN LITIGATION ISSUES FACING SPACS/DE-SPACS? SECTION 11, 12(2) AND 15 OF THE SECURITIES ACT OF 1933

- *Welch v. Meaux*, 19-cv-01260. **[Tab 28 – *Welch v. Meaux* Complaint]**
- This case involved the acquisition of an online mobile food ordering and delivery service from restaurants known as Waitr. Inc. ("Waitr"), whose CEO and co-Founder was Christopher Meaux. The Company experienced rapid growth but also strong competition from competitors, such as GrubHub, DoorDash, and UberEats. Waitr was acquired by a SPAC called Landcadia, which had conducted an IPO for $250 million. The Complaint alleged that the SPAC's co-Chairman faced substantial pressure to complete an acquisition within 2 years. One of the co-Chairmen was also the CEO of a global investment bank Jefferies Financial Group. Jefferies acted as the underwriter in the SPAC IPO and faced pressure to complete an acquisition because a substantial portion of the underwriting's commissions in the IPO was dependent upon a completion of an acquisition. Two weeks before the deadline for completing acquisition, Landcadia agreed to merge with Waitr. The Plaintiffs alleged that the SPAC was facing the end of its redemption period and combined with an immature under-developed company that would otherwise have remained private, not because of the deal economics, but to preserve the value of the insider's interests. Plaintiffs also alleged that none of the additional risks was properly disclosed. In particular, Plaintiffs claimed that Defendants' pricing advantage was illusory because its business model was based on providing delivery service to small restaurant operators in "underserved" markets—at a loss. Ultimately, the share price declined after the merger and ultimately, approximately a year after the De-SPAC transition, collapsed entirely, falling over 50% in a single day.
- Plaintiffs asserted claims under Sections 11, 12 and 15 of the Securities Act of 1933. Section 11 prohibits the making of any misleading statement in a Registration Statement, Section 12(2) imposes similar liability in connection with a prospectus and Section 15 imposes control person liability.
- Plaintiffs also asserted claims under Section 10 and Rule 10(b)(5) under the Securities Exchange Act and control person liability. The big difference among claims asserted under Rule 10(b)(5), Section 11 and Section 12 in the Securities Act is that the Act claims do not require a showing of scienter, or an intent to deceive.

WHAT ARE THE MAIN LITIGATION ISSUES FACING SPACS/DE-SPACS? CONSOLIDATION OF CLASS ACTION CASES

- The Akazoo cases actually involved two separate cases (*Caldwell v. Akazoo and Soe v. Akazoo*) that were ordered to be consolidated. The order provided that the cases would be consolidated as follows. **[Tab 29 – Class Action Consolidation Order]**
- The docket in Case No. **1:20-cv-01900-BMC** shall constitute the Master Docket for this action.
- Every pleading filed in the consolidated action shall bear the following caption:

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

Master File No. 1:20-cv-01900 (BMC)
CLASS ACTION

---X

In re Akazoo S.A. Securities Litigation,

---X

WHAT ARE THE MAIN LITIGATION ISSUES FACING SPACS/DE-SPACS? CONSOLIDATION OF CLASS ACTION CASES: VIOLATION OF SECTION 14(A) OF THE EXCHANGE ACT AND RULE 14A-9

- In re Akazoo S.A. Securities Litigation, 1:20-cv-01900-BMC. **[Tab 30 – In re Akazoo Securities Litigation Amended Complaint consolidating cases]**
- Akazoo, a SPAC formerly known as Modern Media Acquisition Corp. (MMAC), raised approximately $290 million on an IPO, on May 7, 2017. As with all SPACs, the Target business that MMAC acquired or merged with had to have a fair market value equal to at least 80% of MMAC's net assets. MMAC only had eighteen months to complete a business combination from the closing date of the IPO, which could be extended to 21 months under certain circumstances. The SPAC was required to redeem 100% of the public shares if it did not complete a business combination on time. The initial shareholders of the SPAC acquired 5,175,000 shares at a nominal price of $25,000 and the Sponsor purchased 7,320,000 warrants. If MMAC did not meet its deadline, the initial stockholders' shares and warrant would be rendered worthless. On January 24, 2019 MMAC announced that it had reached a Merger Agreement with a company named Akazoo Limited, a private company and "global music streaming platform," specializing in emerging markets allegedly "with 4.3 million premium subscribers in 25 countries throughout Europe, South East Asia, South America and Africa." Under time pressure to avoid their shares and warrants becoming worthless, the MMAC founders and Sponsor called a special shareholders meeting to extend the deadline to complete the business combination by 4 months and then the shareholders voted to grant the extension. As a result of the multiple extensions to complete the business combination and the accompanying share redemptions, MMAC needed additional funds to complete the transaction and on July 29, 2019, the Merger Agreement was amended to provide for a private placement offering (the "PIPE Financing") whereby approximately 4.8 million of the SPAC ordinary shares would be sold with a 20% discount a $8.00 per unit including a one-quarter "incentive share" for each share purchased.

WHAT ARE THE MAIN LITIGATION ISSUES FACING SPACS/DE-SPACS? CONSOLIDATION OF CLASS ACTION CASES: VIOLATION OF SECTION 14(A) OF THE EXCHANGE ACT AND RULE 14A-9 (CONT.)

(continued)

- At this point, MMAC was under incredible, ever-mounting pressure to complete the business combination by its twice-extended September 17, 2019 deadline.
- Investors were told that Akazoo Limited's subscribership and revenues had shown meteoric growth over the last three year, stressing again the company's unique, "'hyper-local'" focus and abilities" and "lucrative partnerships." Based on these glowing descriptions of the Company's business and prospects, the merger was approved by the shareholders. However, slightly more than 6 months after the merger, an analyst report based on investigations into the Company claimed that (1) Akazoo had grossly overstated its users, subscribers, revenue and profit; (2) Akazoo had greatly overstated the size of the of the Company and its services; (3) Akazoo had overstated where its services were actually available; and (4) Akazoo was and had been closing offices and losing employees for quite some time despite claiming it had multiple offices located around the world. Following the analyst's report, Akazoo's share price plummeted, collapsing to $1.16 at the close of business on April 24, 2020. At the same time, two of the company's directors and members of the audit committee resigned, recommending an independent, forensic, and thorough investigation. The company terminated its CEO and formed an independent special committee that concluded "members of Akazoo's management team and associates defrauded investors." On June 2, 2020, Akazoo's stock was delisted from the NASDAQ exchange, rendering the stock effectively worthless.

WHAT ARE THE MAIN LITIGATION ISSUES FACING SPACS/DE-SPACS? CONSOLIDATION OF CLASS ACTION CASES: VIOLATION OF SECTION 14(A) OF THE EXCHANGE ACT AND RULE 14A-9 (CONT.)

- *In re Akazoo S.A. Securities Litigation*, in addition to the claims under Rule 10(b)(5) alleged in other litigations, also asserted violations of Section 14(a) of the Exchange Act and Rule 14a-9 thereunder. Section 14(a) liability is stated as follows:
  - The Defendants named herein violated Section 14(a) of the Exchange Act and Rule 14a-9 thereunder in that these Defendants solicited proxies from Plaintiffs and other members of the Class by means of a Proxy Statement that through Defendants' negligence contained statements which, at the time and in the light of the circumstances under which they were made, were false and misleading with respect to material facts, and omitted to state material facts necessary in order to make the statements therein not false or misleading.
  - Plaintiffs and other members of the Class were misled by the Section 14 Defendants' false and misleading statements and omissions, were denied the opportunity to make an informed decision in voting on the merger, and approved the merger without having been advised of material facts. Accordingly, Plaintiffs and other members of the Class did not receive their fair share of the value of the assets and business of the combined entity, suffered damages when the Company's stock price decreased, and were prevented from benefitting from a value maximizing transaction.

WHAT ARE THE MAIN LITIGATION ISSUES FACING SPACS/DE-SPACS? SEC ENFORCEMENT ACTIONS

- Benjamin Gordon and Cambridge Capital Acquisition Corporation
- In addition to liability from private placements under the Securities laws, the SEC can also bring separate enforcement actions, which it did recently in a case involving Benjamin Gordon.
- The SEC found that Benjamin Gordon, who was the former CEO of a SPAC called Cambridge Capital Acquisition Corporation, had negligently failed to take reasonable steps and conduct appropriate due diligence to ensure that Cambridge shareholders voting on proposed De-SPAC transaction with Ability Computer & Software Industries, Ltd. ("Ability") were provided with material and accurate information concerning Ability's business prospects, including Ability's purported ownership of a new, game-changing cellular interception product, ULIN, Ability's so-called backlog of orders from its largest customer, a police agency in Latin America, Ability's lack of actual purchase orders backing its backlog, and Ability's pipeline of possible future orders from customers. **[Tab 31 - SEC Enforcement Action Press Release]**
- Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, and Section 9(b) of the Investment Company Act, Gordon was ordered to (i) cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act and Section 14(a) of the Exchange Act and Rule 14a-9 thereunder; (ii) be suspended for a period of 12 months from association with any broker, dealer, investment adviser, municipal securities dealer, and any other securities advisors; and (iii) pay a civil money penalty in the amount of $100,000 to the SEC. **[Tab 32 – SEC Order against Benjamin Gordon]**

WHAT ARE THE LITIGATION ISSUES FACING SPACS/DE-SPACS? COMMON LAW BREACHES OF FIDUCIARY DUTY

- SPAC and De-SPAC transactions also involve substantial potential state law liability, particularly with respect to Board members' fiduciary duties of care and loyalty.
- The leading state law case in New York is *AP Services, Inc. v. Lobell*, 2015 WL 3858818, Docket No. 651613/12 (NY. Sup. Ct. , June 19, 2015). **[Tab 23]**
- AP Services was a derivative action brought on behalf of a shareholder trust of Chem Rx, the company resulting from a De-SPAC transaction in which a SPAC named Paramount Acquisition Corp. ("Paramount") acquired and was then merged into Chem RX. The shareholder trust alleged that the Board of Directors of Paramount had breached their fiduciary duties of loyalty and due care.
- All directors are required to act in a way that places the interests of the Company and its shareholders above their personal interests (the fiduciary duty of loyalty). Directors are also required to exercise due care and exercise their reasonable judgment (the so-called "business judgment" rule) in supervising the affairs of the company.
- The shareholder trust of Chem RX, the surviving entity after the De-SPAC, alleged that in approving the transaction, the directors of the SPAC were self-interested and had ignored obvious "red flags" in the rush to complete the deal.
- As in virtually all SPAC transactions the directors were also members of the SPAC Sponsor and had purchased shares for a nominal value and had received warrants that would be of no value if a transaction were not consummated.
- The shareholder trust alleged first, that in their desperation to get a deal done, the directors approved a transaction at a valuation of roughly **double** the target's true value, layering untenable amounts of debt onto the Target in the pressure in their eagerness to close a transaction.

WHAT ARE THE LITIGATION ISSUES FACING SPACS/DE-SPACS? COMMON LAW BREACHES OF FIDUCIARY DUTY – THE DUTY OF LOYALTY VS THE DUTY OF CARE

- The Defendants argued that the duty of loyalty was not implicated in this case, and that their acts in recommending approval of the transaction were protected by the business judgment rule.
- In addressing the Defendants' arguments, the Court began by reiterating black letter law that the business judgment rule "is an acknowledgment of the managerial prerogatives" of directors under Delaware law and "it is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." Specifically, the court underscored that the plaintiff "must allege facts that raise a reasonable doubt as to whether the Board breached either its duty of care or its duty of loyalty to the corporation."
- The Court went on to note that, under Delaware law, stock ownership by decision-makers does not, by itself, create a conflict, but rather aligns those decision-makers' interests with stockholder interests in maximizing price in a merger or acquisition.
- However, in this case, the Court recognized that the Plaintiff had alleged that the **directors' interests were different from those of stockholders**, because shareholders had a right to redemption of the proceeds in the escrow account in the event a transaction failed to close, whereas the directors would lose everything.
- Thus, according to the court, the Plaintiff thus "adequately allege[d] that the directors had a financial interest, which was not aligned with the stockholders' interest, in entering into the…Transaction by the looming merger deadline, notwithstanding the alleged red flags as to the soundness of Chem Rx and the transaction itself."
- And the money holding:
  - "**this pleading rebuts the presumption of the business judgment rule and shifts the burden to defendants to prove the entire fairness of the transaction to the trier of fact**."
- Based on the holding in *AP Services*, it would appear advisable for a Board to receive a fairness opinion before endorsing a proposed acquisition in the SPAC/De-SPAC context.

WHAT ARE THE LITIGATION ISSUES FACING SPACS/DE-SPACS? COMMON LAW BREACHES OF FIDUCIARY DUTY- THE DUTY OF CARE

- Plaintiff also alleged that the Directors breached their duty of loyalty in willfully ignoring "obvious" red flags. Defendants countered, that Paramount's charter document expressly barred suits for breaches of the duty of care, Plaintiff's theory was essentially dressing up a breach of duty of care claim and Defendants could not be sued under such a theory.
- In rejecting the Defendants' arguments, the Court noted that
  - "There is substantial authority that a duty of loyalty claim may be premised on willful disregard of red flags, whereas a duty of care claim may be premised on gross negligence in failing to heed red flags [even] where the certificate of incorporation exculpates the directors from ordinary negligence. . . .The Delaware Courts have repeatedly held that directorial liability may be predicated on the duty of oversight where the failure to exercise oversight rises to the level of failure to act in good faith. Such failure in turn may be found where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties."
- Applying the law to the facts, the Court first concluded that the Plaintiff had first adequately alleged the existence of "red flags" with respect to the abrupt resignation of the target's CFO and his retention by the SPAC for millions of dollars in additional compensation and his replacement by a small, unknown accounting firm.
- Second, the Court held that the Plaintiff also adequately alleged the existence of actionable "red flags" in the payoff of a security interest over the Target by one of the target's owners and the owner's simultaneously receipt of a payment of $11 million for "facilitating" the De-SPAC transaction, effectively causing the SPAC to use its own funds to pay off the target's creditors.
- Third, the Court held that the abrupt withdrawal of two intermediaries who had promoted the transaction raised a fact issue that could not be decided on a motion to dismiss.
- Finally, the Court held that the issuance of $30 million in put options to the Defendants raised a "red flag" that required further discovery. Put options are the right to sell shares back to the Company (or another shareholder) at a fixed price and are (in essence) a bet **against** a company. It is indeed unusual that the insiders in a SPAC transaction, who are normally incentivized to the upside, would also receive downside protection – indeed downside "upside," as it were.

- ***AP Services* thus stands as a stark warning to SPAC insiders that their duties of loyalty and care are at risk in De-SPAC transactions and that they can no more safely forego a fairness opinion than they can ignore obvious "red flags."**

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