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Snapshot

JANUARY 5, 2021
SNAPSHOT 2020-02

CorpFin issues disclosure guidance for SPACs

The SEC's Division of Corporation Finance (CorpFin) issued CF Disclosure Guidance: Topic No. 11, *Special Purpose Acquisition Companies*. The guidance provides CorpFin's views on certain disclosure considerations for a special purpose acquisition company's (SPAC's) initial public offering (IPO) and subsequent business combination transactions.

The guidance highlights the importance of clear disclosures regarding potential conflicts of interest, as well as the nature of the economic interests in the SPAC held by its sponsors, directors, officers, and affiliates. The guidance also reminds SPACs to consider their disclosure obligations under the federal securities laws and provides a non-exhaustive list of considerations when providing such disclosures.

Initial public offering

Conflicts of interest

The guidance explains that conflicts of interest may arise since a SPAC's sponsors, directors, and officers may also have fiduciary or contractual obligations to other entities and may not be working exclusively on behalf of the SPAC to identify acquisition targets. SPACs should clearly disclose any potential conflicts of interest, including describing whether any of the conflicts relating to other business activities include fiduciary or contractual obligations to other entities, how these dual obligations may affect the ability of the sponsors, directors, and officers to evaluate and present a potential business combination opportunity to the SPAC and its shareholders, as well as how any conflicts will be addressed.

Specified timeframe

Typically, a SPAC must complete a business combination transaction within a specific timeframe or it must be liquidated. CorpFin reminds SPACs that as they near the end of the specified timeframe, their available options may narrow, allowing acquisition targets significant leverage in negotiating acquisition terms. Accordingly, SPACs should consider disclosing the following information related to completing a business combination:

- Financial incentives of SPAC sponsors, directors, and officers, as well as losses that those parties might incur if the SPAC does not complete a business combination transaction
- The amount of control that the SPAC's sponsors, directors, officers, and affiliates exercise over the approval of a business combination
- Whether and, if so, how the SPAC may amend provisions in its governing instruments or extend its timeframe to complete a business combination
- Balanced disclosure of prior SPAC experience by the sponsors, directors, officers, or affiliates

Underwriter compensation

The guidance states that if the underwriter of the IPO elects to defer its compensation until the closing of the business combination transaction, the SPAC should consider disclosing (1) any additional services that the underwriter may provide, (2) whether compensation for the additional services is conditioned on the completion of the business transaction, and (3) any conflicts of interest the underwriter might experience in providing the additional services given the deferred compensation.

Financial incentives

Generally, the economic terms of investments by the SPAC's sponsors, directors, officers, and affiliates are different from those of the SPAC's public shareholders. SPACs should consider disclosing the following information related to the financial incentives of their sponsors, directors, and officers:

- Securities owned, including the price paid; concurrent offerings of securities; and the difference between the price of securities previously sold and the IPO price
- Conflicts of interest as a result of securities ownership, compensation arrangements, and relationships with affiliated entities
- Compensation terms, including contingent compensation

Securities issuances

Similarly to the economic investments, the terms of securities issued to SPAC sponsors are generally different from the terms of securities issued to the public, and may provide the sponsor with substantial control. This practice could be the same for securities sold in private offerings compared to those securities sold in the SPAC's IPO. When a SPAC does issue such securities, it should consider disclosing (1) the terms of the securities held by its sponsors, directors, officers, and affiliates compared to the terms of the public shareholders' securities, including the terms of any convertible debt and the risks to public shareholders; (2) whether the SPAC plans to obtain or has obtained additional funding and how the securities will differ; and (3) the terms of a forward purchase agreement and its impact on other shareholders.

Business combination transaction

Additional financing

The guidance provides that if the SPAC becomes aware that additional financing is needed during the negotiation process, it should disclose (1) the additional financing needed and how the applicable terms may impact shareholders; (2) a comparison of the price and terms of new securities to the price and terms of securities sold in the SPAC's IPO; (3) whether the sponsors, directors, officers, or affiliates will participate in the additional financing; and (4) the terms of any convertible securities.

Conflicts of interest

If the SPAC's sponsors, directors, or officers have any interests or incentives related to the evaluation of potential targets that conflict with the interests of the SPAC's public shareholders, disclosure considerations should include

- Detailed information on the evaluation and decision to propose the identified transaction
- Material factors considered by the SPAC's board of directors to approve the identified transaction and the evaluation of the conflicting interests
- Conflicts of interests of the sponsors, directors, officers, and affiliates with the identified transaction and how the SPAC addressed these conflicts
- Detailed information on how the sponsors, directors, officers, or affiliates may benefit from the transaction
- Total percentage ownership interests that the sponsors, directors, officers, and affiliates may hold in the combined company

Underwriter compensation

If the underwriter of the IPO performed additional services and deferred compensation until the closing of the business combination transaction, the SPAC should consider disclosing (1) the fees that the underwriter will receive upon completing the business combination, including any contingent fees; (2) any additional services provided, including the relevant costs and how the SPAC compensated the underwriter; and (3) any conflicts of interest given the deferred compensation.

Grant Thornton insight

While the concept of becoming a public company by merging with a SPAC is not new, there is currently growing interest in the practice. As noted by SPAC Analytics, total U.S. IPO proceeds from SPACs increased from 19 percent in 2019 to 46 percent in 2020.

Former SEC Chairman Jay Clayton as well as other SEC staff have recently commented on the increase in SPAC activity. The disclosure considerations raised in the new guidance are consistent with Mr. Clayton's October 2020 public remarks, in which he highlighted the importance of good disclosures regarding the motivations of those involved in the transaction and particularly the compensation and incentives of the sponsors.

Given the complexity of SPAC-related transactions, we encourage companies planning a SPAC IPO or planning to merge with a SPAC to consult with qualified securities counsel.

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