

Memorandum

SEC Staff Issues New Guidance on Potential Conflicts of Interest in SPAC Structures in Light of Ongoing Surge in SPAC IPOs

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Last year, in particular the second half of the year, saw a vibrant market for initial public offerings (“IPOs”) of special purpose acquisition companies (“SPACs”). Coming out of this surge in SPAC offerings, the Division of Corporation Finance of the Securities and Exchange Commission (the “Staff”) published new disclosure guidance on December 22, 2020.¹ With the publication of this guidance, the Staff sought to remind SPAC sponsors, underwriters and other market participants of key concerns they have noted in their comment letters for SPAC filings in connection with IPOs and business combination transactions.

This guidance is particularly focused on the potential conflict of interest between a SPAC’s public shareholders, on the one hand, and a SPAC’s sponsor, directors, officers and their affiliates (the “insiders”), on the other hand. The insiders’ economic interests in the SPAC often differ from the economic interests of public shareholders in a number of important ways. As the Staff notes, this difference may lead to conflicts of interest, in particular as the insiders evaluate potential targets for the SPAC’s initial business combination.

The Staff notes that, unlike in the traditional IPO process where a private operating company’s securities are valued through market-based price discovery, the SPAC insiders are solely responsible for deciding how to value potential targets. While this is often cited as a reason why SPACs provide greater certainty for private companies considering a traditional IPO, the Staff points out that this can lead to potential conflicts of interest and risks for the public shareholders of the SPAC. Therefore, the Staff repeatedly emphasizes the importance of clear disclosure regarding these potential conflicts of interest and the nature of the insiders’ economic interests in the SPAC.

The Staff’s guidance on disclosure considerations for SPACs related to potential conflicts of interest is summarized below.

Disclosure Considerations—Initial Public Offerings

The guidance on potential conflicts of interest in the context of the initial public offering of a SPAC is divided into five categories: (1) insiders’ competing fiduciary or contractual obligations to other entities, (2) the specified

¹ Special Purpose Acquisition Companies, Division of Corporation Finance, Securities and Exchange Commission, CF Disclosure Guidance: Topic No. 11, December 22, 2020, available here: <https://www.sec.gov/corpfin/disclosure-special-purpose-acquisition-companies>.

timeframe to complete an initial business combination, (3) deferred underwriter compensation, (4) economic terms of the insiders' investments in the SPAC and other financial incentives and (5) insider control of the SPAC and the terms of any securities of the SPAC that insiders purchase in a private placement. The Staff's concerns on each topic are summarized below.

The Staff's concerns on insiders' competing fiduciary or contractual obligations to other entities include:

- Ensuring that potential conflicts of interest impacting the insiders' ability to evaluate and present a potential initial business combination are clearly described, including how these conflicts will be addressed; and
- Disclosing whether a SPAC may pursue a business combination with a target in which an insider has an interest and if so, how such potential conflict of interest will be considered.

The Staff's concerns on the specified timeframe to complete an initial business combination include:

- Properly describing the financial incentives of the insiders and how they differ from the public shareholders, particularly in respect of any losses the insiders will bear if the initial business combination is not completed within the required timeframe;
- Disclosing the amount of control the insiders will have over approving the initial business combination;
- Covering whether and how a SPAC may amend its governing instruments to facilitate the completion of an initial business combination, including whether insiders have sufficient voting power to approve or significantly influence such amendments;
- Describing whether and how a SPAC may extend the initial business combination deadline and whether public shareholders will have redemption rights in connection therewith; and
- Providing balanced disclosure about insiders' prior SPAC experience.

The Staff's concerns on deferred underwriter compensation include:

- Ensuring adequate disclosure of (i) any additional services the IPO underwriters may provide to the SPAC in pursuit of its initial business combination, including identifying potential targets, providing financial advisory services, acting as a placement agent in a private offering or underwriting or arranging debt financing, (ii) whether payment for these additional services will be conditioned upon the completion of the business combination and (iii) any conflict of interest the underwriters may have in providing such services.

The Staff's concerns on the economic terms of the insiders' investments in the SPAC and other financial incentives include:

- Clearly describing the securities owned by, or being concurrently offered to, insiders and the prices of such securities in comparison to the public offering price in the SPAC's IPO;

- Stating, among other conflicts, that if the SPAC fails to complete a business combination within the required timeframe, the insiders may incur a substantial or total loss on their investment; and
- Disclosing compensation to insiders, including whether such compensation will be contingent on the completion of the initial business combination and quantifying all known amounts.

The Staff's concerns on insider control of the SPAC and the terms of private placements include:

- Ensuring the terms of securities, including any convertible debt, held by the insiders are clearly disclosed; in particular how they differ from the terms of the securities offered in the SPAC's IPO and the resulting risks to the public shareholders;
- Covering any private placements being made in connection with the SPAC's IPO and how the terms of those securities compare to those being offered in such IPO, as well as whether any insiders are participating in such financing; and
- Disclosing any forward purchase agreements, including any dilutive impact and whether such agreements are irrevocable.

Disclosure Considerations—Business Combination Transactions

The guidance on potential conflicts of interest in the context of the initial business combination transaction of a SPAC is divided into three categories: (1) any additional financing needed to complete the initial business combination, (2) the evaluation of potential targets and (3) other services provided by the IPO underwriters and deferred underwriting compensation. The Staff's concerns on each topic are summarized below.

The Staff's concerns on additional financing needed to complete the initial business combination include:

- Ensuring that any additional funding is described, including the price and terms of any securities to be issued, how any securities issued compare to the securities offered in the SPAC's IPO and if any insiders are purchasing such securities; and
- Describing the material terms of any convertible securities and any material impact they may have on the beneficial ownership of the combined company.

The Staff's concerns on the evaluation of potential targets include:

- Detailed disclosure of the process of selecting a business combination target, including the evaluation and decision-making process, why the target was selected over other potential targets, as well as the material terms of the acquisition, the amount and nature of the consideration and negotiations on the consideration;
- Covering the factors considered by the SPAC's board of directors in approving the transaction, including evaluation of potential conflicts of interest;

- Describing any conflicts of interest of insiders related to the potential transaction, any policies related thereto and any waivers of such policies, as well as any insider interests in the target;
- Providing detailed information on how insiders will benefit from the transaction, including quantifying material compensation, returns on initial investments and continuing relationships with the combined company; and
- Showing the ownership interest the insiders will hold in the combined company, including through the exercise of warrants and conversion of convertible debt.

The Staff's concerns on other services provided by the IPO underwriters and deferred underwriting compensation include:

- Disclosing the fees underwriters will receive upon completion of the initial business combination; and
- Describing additional services the underwriters expect to provide and the compensation for such services, including whether such compensation is conditioned on the completion of the initial business combination and whether the deferred underwriting commission may create a conflict of interest.

Implications for SPAC Sponsors

While this guidance does not create any new obligations or modify existing disclosure obligations, it does summarize a number of Staff concerns that have been reflected in previous SEC comment letters. As SPAC sponsors are normally quite keen to have their registration statements reviewed as expeditiously as possible, SPAC sponsors will need to consider their proposed SPAC structures and registration statements in light of the new guidance. As some serial SPAC sponsors have used similar structures and disclosures in each of the IPOs of their SPACs, they will need to revisit their precedent documentation to ensure it addresses the Staff's guidance to avoid unexpected delays in the SEC review process. In addition, some SPAC sponsors and underwriters have started to make innovations to the traditional SPAC structure to reduce some of the conflicts of interest between SPAC sponsors and public shareholders. As SPACs come under increasing pressure to consummate their initial business combination as they approach the end of their investment period, they will also need to take stock of the Staff's guidance to ensure that any proxy statement/registration statement related to the initial business combination adequately discloses the conflicts of interest of concern to the Staff.

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