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The Journey to De-SPACing and Beyond

Key securities law considerations for former SPACs

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The market for initial public offerings by special purpose acquisition companies ("SPACs") has shown significant growth in recent years and is continuing this trend during 2020. As of September 2020, a record breaking 82 SPACs conducted initial public offerings ("IPOs") in 2020. With this growth in the SPAC IPO market comes a corresponding rise in the number of private operating companies who may soon find themselves in the midst of a business combination transaction with a SPAC. Unlike the early years of SPAC transactions in the 1990s, today's SPACs are characterized by high quality companies with experienced management teams and higher profile sponsors of the SPACs, including top tier private equity firms and investment banks. In many cases, these sponsors and other participants return to the SPAC market, launching multiple SPACs and seeing those SPACs from IPO to de-SPACing, the process, in connection with the business combination transaction, by which the former SPAC prepares for and, upon completion of the business combination, continues its life as a U.S. public company.

The preparation for and the continuation of the company's life post-SPAC is critical to the success of the post-business combination company and will lay the groundwork for the operating business's life as a public company. While much has been written in recent months about the veritable explosion of SPACs in the U.S. IPO market, relatively little attention has been paid to the post-business combination life of a former SPAC, especially as relates to certain of the key securities law and related matters that uniquely impact public companies who began their lives as SPACs. This article endeavors to provide insight into this less covered aspect of SPAC transactions and focuses on the post-SPAC life of the company, following completion of the business combination.

A SPAC is a blank check company that conducts an IPO to raise funds for use in a future business combination transaction involving a company in a previously identified industry or geographic area. Following the SPAC's IPO, the funds raised are kept in a trust account, for use in a business combination transaction to be identified and conducted at a later date, usually within two years (unless extended), of the SPAC's IPO.

Once an appropriate target company is identified for a business combination, the SPAC and the target undertake a merger, acquisition or other transaction that results, in most cases, in the operating business becoming a publicly traded company that effectively "takes over" the public company status of the SPAC and, as a result of this process, the SPAC is "de-SPACed" and continues its life as a public company.

Upon completion of the business combination, the newly de-SPACed public company and its board of directors and management team often find themselves in uncharted territory, especially for those individuals who have not previously been part of a de-SPACing transaction or a company that is a former SPAC. SPACs face a number of unique challenges and obligations upon completing the de-SPACing process and, in some cases, are subject to nuances of the U.S. federal securities law regime that are not applicable to most "normal" public companies.

From the reporting standpoint, the de-SPACing process commences and the new company effectively starts its life as a post-business combination public company by filing the so-called "Form 10" information.

Form 10 information

Refers to the requirement that public companies must provide robust disclosures to the market, similar to those required by registration statements on Form S-1, including financial statements and narrative disclosures about the company, its management and its securities, following the business combination transaction. This requirement is frequently met by newly de-SPACed companies through the filing by such companies of a Current Report on Form 8-K that includes the Form 10 information (a "Super 8-K"). As further detailed below, as the company continues its public company life, a number of the securities law restrictions and obligations applicable to it, as a former SPAC, are tied to the timing of the filing of Form 10 information.

Shell company status

While often thought of as synonymous with the SPAC and the de-SPACing process, relates to the day on which the company ceased to be a shell company. This date is generally a few days before the filing date of the Form 10 information on the Super 8-K and is the date of the closing of the business combination transaction.

After the completion of the SPAC business combination and the filing of the Form 10 information, and as part of beginning its new life as a public company, recently de-SPACed companies are often eager to make incentive awards to members of the new company's board of directors and management team. These grants, as with most public companies, are generally conducted pursuant to an equity incentive or similar award plan and registered on Form S-8 with the SEC.

For most companies, Form S-8 is one of the more straightforward SEC registration statements, as it may be used to register securities to be offered to employees of the company pursuant to any employee benefit plan, and is available for reoffers and resales of both securities owned by affiliates of the company and restricted securities, subject to certain restrictions and limitations. The Form S-8 is not reviewed by the SEC, is deemed effective immediately upon filing and is comparatively simple and inexpensive to use. That said, for former SPACs, the Form S-8 presents some specific challenges.

Form S-8

Is only available to former shell companies (including SPACs) if: (i) the company has not been a shell company for at least 60 calendar days prior to the filing of the S-8 registration statement, and (ii) the company has filed current Form 10 information with the SEC at least 60 calendar days prior to the filing of the S-8, reflecting its status as an entity that is not a shell company. These requirements generally result in former SPAC's facing a 60 day delay between the closing of the business combination and the filing of the Form 10 information and the SPAC's ability to file an S-8 registration statement, covering grants under a new combined company incentive plan.
In many cases, this leads to a commensurate delay in the company making certain incentive grants to its directors and officers, due to the need to register the relevant grants with the SEC.

As the former SPAC continues its life as a public company, it will invariably receive questions from investors, employees, affiliates and others who hold "restricted securities" or "control securities" in the company and are interested in selling those securities and/or transferring them to their brokerage or other investment accounts. In many instances, the first of these inquiries arise approximately six months after the de-SPACing transaction and take the form of company security holders asking the company or its transfer agent to remove the restrictive legends on their securities. Most of these holders will cite Rule 144 (further discussed below) as the basis for their request.

Rule 144

Provides an exemption from registration for certain resales of restricted or control securities if a number of conditions are met, including a holding period for the relevant securities and restrictions on the volume and manner of sales, in certain cases.
For former shell companies, including SPACs, Rule 144 imposes additional requirements including that the company: (i) has ceased to be a "shell company" as defined in the rule, (ii) is an SEC reporting company, (iii) has filed all reports required to be filed with the SEC during the preceding 12 months; and (iv) has filed current Form 10 information with the SEC, reflecting that the company is no longer a shell company and at least one year has elapsed from the filing of this Form 10 information. The requirement for current SEC reporting included above is referred to as the "evergreen provision." The result of the evergreen provision is that the current Exchange Act reporting requirement for former SPACs is perpetual.

As a result, despite holders having met the holding period and other requirements to sell the former SPAC's securities under Rule 144, no sales can take place, unless the company is current in its Exchange Act reporting. If the company misses a required Exchange Act filing covered by the requirements of the rule, it will cease to be current in its Exchange Act reports and will not meet this requirement for the use of Rule 144.
The further implication of this evergreen provision is, generally speaking, the restrictive legend present on "restricted securities" of the former SPAC can not be removed in advance of a sale. This can be burdensome and inconvenient for stockholders in the SPAC, as it can impact everything from transferring and holding shares of the subject company in brokerage accounts to the logistics and efficiency of potential sales.

Due to the evergreen provision of Rule 144 and the unavailability of Rule 144 for 12 months following the provision of Form 10 information, following the completion of the business combination, resale registration statements and the rights to such registration statements often form a critical part of the business combination negotiations and are likely to take on even greater significance due to the SEC's recent CD&I relating to S-3 eligiblity for former SPACs (discussed below). Historically, many former SPACs have found themselves facing resale registration statement obligations in the first weeks or months following the de-SPACing, though that may change going forward. Only attorneys who are experienced in the nuances and SPAC-specific complexities imposed by the U.S. securities laws, including those discussed in this article, are likely to recognize and address these points at the point of negotiating registration rights for a SPAC

S-3 eligibility

Is a critical issue to former SPACs, largely due to the limitations SPACs face on the use of Rule 144 and the eligibility question is likely to present challenges in negotiating registration rights in SPAC transactions going forward. On September 21, 2020, the SEC issued new guidance limiting the ability of former SPACs to satisfy the eligibility requirements of Form S-3.[1] The staff's guidance appears to limit former SPAC's ability to use Form S-3 during the 12 calendar months following the completion of the SPAC business combination transaction. The key question for a former SPAC is whether it is permitted to use the SPAC's pre-business combination SEC reporting history for purposes of determining S-3 eligibility, following the business combination. In the September CD&I, the SEC staff indicated that a former SPAC may not use Form S-3 in situations in which the post-business combination company is a "new entity" or "successor registrant" to the SPAC. In either of these cases, the CD&I provides that the company will not be eligible to use Form S-3 for 12 months following the business combination. The SEC's guidance further indicates that in cases in which the post-business combination entity is neither a new entity nor a successor registrant to the SPAC, the entity would have less than 12 months of post-combination reporting history and therefore the SEC staff would be "unlikely" to accelerate effectiveness on a registration statement on Form S-3. The result of this recent guidance, absent further clarification or explanation, appears to be that most former SPACs should expect that Form S-3 will not be available for 12 months following the completion of the business combination. This is likely to have a significant impact on SPACs going forward, as they and the private operating businesses they seek to combine with will have to address and contend with the increased costs and time required in using Form S-1 for the first year following the business combination transaction.

[1] See SEC CD&I 115.18, available here: https://www.sec.gov/corpfin/securities-act-forms#115.18.

On a related note, many former SPACs, especially those who have undergone a de-SPACing transaction in recent years, go on to be highly acquisitive or otherwise active public companies. As such, many of these companies return to the public securities markets for acquisition financing, general capital raising or other transactions conducted through the SEC's registration regime, all of which are likely to be impacted by the SEC's recent guidance and limitations on the use of Form S-3.

Furthermore, in the context of underwritten public offerings, companies frequently use "free writing prospectuses" ("FWPs"), or written communications that constitute an offer to sell or a solicitation of an offer to buy registered securities and are not a statutory prospectus under Section 10 of the Securities Act of 1933, as amended (the "Securities Act"). FWPs may take the form of printed materials, radio or television broadcasts, or electronic graphic media and may include information not contained in the company's registration statement, as filed with the SEC. Companies frequently use FWPs for their great flexibility in conveying information to the market. However, FWPs may not be used by companies who are "ineligible issuers."

Ineligible issuers

As defined in Rule 405 of the Securities Act, are issuers that are or, during the past three years, have been, blank check companies. This includes SPACs and, therefore, former SPACs are deemed ineligible issuers for a period of three years from the completion of the de-SPACing process. Ineligible issuer status precludes former SPACs from using FWPs during this time frame.

This, along with the challenges related to S-3 eligibility for former SPACs, may result in a more cumbersome, more restrictive and less fluid opportunity for capital raising through the SEC's registration process in the early years following de-SPACing and may require the companies impacted to consider alternative strategies and/or to invest additional time and resources to addressing these challenges.

If 2020 is any indication, SPACs are likely to continue to be a growth market and an attractive vehicle for private operating businesses to effectively "go public" in the U.S. on an accelerated timeline and without diverting as much of management's time and attention as is required for a traditional IPO process. We expect to see additional developments in the SPAC market and in the SEC staff's approach to and regulation of SPACs, as the market continues to grow and develop.

We are available to answer questions and provide guidance on this evolving area of U.S. securities law to those considering raising a SPAC, investing in a SPAC or entering into a business combination with a SPAC, to ensure that the transition from SPAC IPO to business combination to full public company status, post-business combination, is a more transparent, accessible and understandable process.

Contacts

Sarah Travis
Senior Counsel – New York
Tel +1 212 756 1186
sarah.travis@allenovery.com

Jeffrey Pellegrino
Partner – New York
Tel +1 212 610 6463
jeffrey.pellegrino@allenovery.com

Joe Bolognese
Associate – New York
Tel +1 212 610 6355
joseph.bolognese@allenovery.com

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