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## SPACs 2.0: New SPAC Rules Changes Approved By NASDAQ And NYSE AMEX And New Market Features Make SPACs A More Attractive Investment Vehicle In 2011

The last three quarters have seen a rebirth of initial public offerings by special purpose acquisition corporations ("SPAC") brandishing new features and creative solutions to the problems that contributed to the demise of the SPAC market in 2008. National securities exchanges have responded with new rules to facilitate new listings for SPACs.

*Background*

A SPAC is a blank-check company that raises capital in an initial public offering ("IPO") to use for a future undetermined business combination with one or more operating businesses or assets. To entice investors to buy, the SPACs offer units composed of shares of common stock as well as discounted warrants that can be sold shortly after the IPO, providing an opportunity for immediate return. For the protection of investors, SPACs are structured so that the proceeds of the IPO are held in trust until the SPAC uses the funds to consummate an acquisition. Historically, SPACs have had to obtain a super-majority vote of stockholders prior to consummating any acquisition and offer stockholders that vote against the acquisition the ability to redeem their shares of common stock in exchange for their pro rata share of the trust funds. If a qualified acquisition is not completed within a defined interval of the IPO (historically 18-24 months), the SPAC liquidates and distributes the funds held in the trust account to its common stockholders. The most prevalent investors in SPAC IPOs have generally been hedge funds, attracted to the locked-in rate of return achievable on a sale of the warrants and additional arbitrage opportunities for any warrants retained, low volatility of a mostly-cash balance sheet, minimal downside risk given the cash is held in trust and the potential large upside in the context of an acquisition.

The first SPACs could not qualify for listing on any U.S. exchange and were often quoted on the OTC Bulletin Board and were made to comply with the onerous rules for "black check" offerings under Rule 419 promulgated under the Securities Act of 1933.[1] In 2005, the American Stock Exchange, now known as NYSE Amex, began allowing SPACs to list under generic listing standards that did not require companies to have operating histories, and most subsequent SPAC offerings listed on that exchange. SPACs that listed on an exchange are not subject to the technical requirements of SEC Rule 419, although voluntarily complied with the principal restrictions. Just as the SPAC market was shutting in 2008, the New York Stock Exchange (NYSE) and NASDAQ proposed rule changes to allow SPACs on those exchanges.

In November 2010, the NYSE Amex adopted SPAC-specific listing standards that require:

- at least 90% of the gross IPO and other investment proceeds to be held in trust
- the SPAC to complete one or more business combinations within 3 years after the IPO with an aggregate value of at least 80% of the net value (after excluding deferred underwriter's fees and taxes payable on interest) of the funds held in trust
- the initial business combinations that satisfy the requirement above must be approved by a majority of the votes cast by public stockholders (subject to exclusions under NYSE rules for officers, directors and 10% stockholders)
- public stockholders voting against the proposed business combination to have the right to redeem their stock for a pro rata share of the trust funds if the deal closes, subject to a stated limit of the maximum number of shares that can exercise such redemption rights (which limit cannot be less than 10% of the shares sold in the IPO)

These NYSE Amex listing requirements were similar to NYSE and NASDAQ SPAC listing requirements. The NYSE imposed additional conditions, including that SPAC founders be required to waive their rights to liquidation proceeds for all securities issued to founders prior to the IPO or purchased in private placements in conjunction with the IPO and that SPAC underwriters must waive deferred underwriting discount in the event of a liquidation. NASDAQ added a requirement for business combinations to be approved by a majority of the independent directors as well as stockholders.

*What precipitated the demise of SPACs in 2008?*

In early 2008, as the financial crisis reached its peak, the IPO market for SPACs closed, the number of acquisitions completed by SPACs dropped significantly and certain inherent flaws in the SPAC structure were exposed and magnified. Finding deals within the parameters identified in the IPO prospectus often proved challenging, and getting through SEC reviews of proxy materials was difficult, time consuming and expensive. Perhaps worse, hedge funds and other activist investors used their ability to vote against a proposed acquisition as leverage to obtain additional consideration not available to other stockholders. Hedge funds could negotiate the sale of their interest in the SPAC for a premium over their pro rata share of the trust funds, using the threat of withholding their vote, which could in turn defeat a deal in process and force a liquidation of the company and total loss to SPAC founders (who typically had significant investments in the SPAC). These problems made SPACs unattractive buyers compared to private equity funds and strategic investors, who could complete deals more quickly and more assuredly than SPACs. While several creative structures emerged to help SPACs consummate a business combination notwithstanding these challenges, the efforts required and risks incurred made SPACs unattractive to founders, underwriters and investors with smaller stakes.

*What Changed?*

On October 22, 2010, NASDAQ filed a proposed rule change to change its current SPAC listing standards[2] to allow, in lieu of a stockholder vote on an acquisition, a cash tender offer after the public announcement and before the completion of an acquisition. A stockholder vote would still be required if otherwise required by law. The SEC approved the rule change on December 23, 2010. On January 12, 2011, NYSE Amex filed similar proposed rule changes,[3] and on January 21, 2011 the SEC approved the proposed rules.

Henceforth, SPACs listing on NASDAQ or NYSE Amex may either obtain a vote on a business combination or conduct a tender offer, unless a vote is otherwise required by law. Stockholders who oppose the transaction may tender their shares in exchange for their pro rata share of the SPAC's trust fund. A SPAC conducting a tender offer must comply with Rule 13e-4 and Regulation 14E under the Securities and Exchange Act of 1934, including filing tender offer documents with the SEC. The tender offer documents contain substantially the same information about the business combination and the redemption rights as required for proxy statements associated with business combinations, and are subject to SEC review.

Although NYSE Euronext owns and operates NYSE Amex, the NYSE is a separate trading market from NYSE Amex with separate listing rules, and the NYSE has not yet proposed a similar rule change.

*What new features make SPACs worth reconsidering?*

Since the late summer of 2010, the SPAC vehicle has reemerged with new features, including smaller sponsor promotes (reduced from 20-25% to 10-15%), much lower maximum redemption thresholds (reduced from 70-80% to 12% or less), and longer windows to get a deal done (extended from 18 to 36 months). While hedge funds will still be attracted to SPACs for the ability to sell the warrant and lock-in gains, the most difficult obstacles to executing a business combination have been removed, which should make it a more palatable vehicle for potential sponsors and management teams.

*What’s next?*

Many had written off the SPAC vehicle due to the large number of liquidations witnessed in 2008, 2009 and 2010 as SPACs that had succeeded in raising money before the market shut down could not succeed in consummating a business combination. With the new NYSE Amex and NASDAQ rules no longer requiring the super-majority vote and new features that remove the hurdles to completing a business combination, the SPAC is proving to be a more attractive vehicle for promoters to raise money in the public markets for business combinations.

*What if you have questions?*

For any questions or more information on these or any related matters, please contact Louis Lehot, Kevin Rooney, John Tishler or Camille Formosa.

*Disclaimer*

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[1] The requirements of Rule 419 include :

- offering proceeds must be deposited in an escrow or separate bank account until an acquisition of fair market value at least 80% of the maximum offering proceeds
- offering proceeds must be invested in FDIC-insurable bank deposits, money market funds or U.S. issued or guaranteed securities
- the proceeds held in escrow may not be released until completion of the business combination or return of the escrow to investors due to failure to consummate a business combination within the allotted time
- no trading of the securities issued until completion of the business combination
- a maximum of 18 months to complete a qualifying acquisition
- filing a post-effective amendment to the registration statement to describe the business proposed to be acquired, and mailing the same to investors
- a right of investors to redeem their investments plus interest and dividends hat blank check issuers SPACs listing on exchanges voluntarily adopted many but not all of the requirements of Rule 419 in order to make the SPAC attractive to investors.

[2] NASDAQ Listing Rule IM-5101-2.
[3] Section 119 of the NYSE Amex LLC Company Guide.