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Legal Practitioners and Arbitrators

GOING PUBLIC THROUGH SPECIAL PURPOSE ACQUISITION VEHICLE

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Understanding SPAC

Special purpose acquisition vehicle (SPAC) is regarded as a "blank check" company without any business interest or performance history, set up specifically for raising capital from the public for the purpose of acquiring a target company. A company can go public through the traditional initial public offering (IPO), or through the novel option of a merger with a (SPAC).

The SPAC undertakes the IPO and subsequently merges with the target company. A SPAC usually has between 18 to 24 months to acquire a company or return the funds to investors. At formation and IPO stages, the SPAC need not identify any target company but only an industry where the acquisition will take place. SPAC as an innovation officially debuted in 2003[1] , although the framework was first devised in 1993 by the Investment banker David Nusssbaum assisted by lawyer David Miller, at a time when blank check companies were prohibited in the US.

When compared to an IPO, SPAC offers private companies an opportunity of exiting at a higher price for lower costs. Over the years, SPAC has emerged and is gaining traction as an alternative way of gaining public listing rather than through the traditional Initial Public Offer (IPO). Although regarded as an alternative to traditional IPO, SPAC still involves an IPO, save that in SPAC, the target company is not involved in the IPO, and its attendant costs and rigours. Rather, another public company, called the SPAC goes public and then merges with or acquired the target company.

Why the SPAC trend?

Statistics show that SPAC has grown exponentially over the years. In US, as of October 2021, SPACs have raised capital in 498 IPOs. Between January and August 2021, the value of the funds SPACs raised surpassed 11 billion US Dollars[2]. In August 2021, Luminar Technologies announced that it would go public via a $3.4 billion merger with the SPAC, Gores Metropoulous Inc. In August 2021, Forbes also announced that it would go public with a merger with a SPAC Magnum Opus Acquisition and it is expected to be valued at $630 million. The deal is also expected to close in the fourth quarter of 2021 and the 1st quarter of 2022. SPAC popularity is linked to the advantages it offers to stakeholders in the SPAC cycle: sponsors, investors, and target company.

A group of entrepreneurs, experts or visionaries called SPAC sponsors, who wish to invest in a technology, industry or even an idea, but lack the funds to undertake the venture, could through a SPAC raise funds from the public, the endgame being to leverage their expertise in capital raising to meet the ultimate investment goal. The SPAC sponsors would usually invest the initial capital for setting up the SPAC and raise additional funds from the public. Another advantage of being a SPAC sponsor is that sponsors invest at a much lower price pre-SPAC and get bigger returns de-SPAC - at merger & acquisition with a target company. Also, they usually take a percentage of the equity of the target company, sometimes up to 20%.

For the investors, SPACs is a way of getting higher yield from their investments. Investors can also get in during SPAC IPO at a fair price and acquire equity in a target company and be able to determine the target company to be combined with the SPAC. A SPAC is usually set up by experienced management team with private equity, mergers & acquisitions experience, who deploy their experience and resources in managing and implementing the fund.

Upon acquisition of a target company, SPAC may permit the founders and management team of the target company to continue running the company, while the experienced management team of the SPAC take seats on the board of the acquisition company and play supervisory role in the management of the target company, thus ensuring return of capital to the investors.

For private/target companies, SPAC offers liquidity and funding options. It provides faster and less

1 Millstream Acquisition Corporation, a SPAC, had its IPO in 2003, and merged with Nations Health in September 2004
2 Statista "Number of SPAC IPOs in the US 2003-2021" https://www.statista.com/statistics/1178249/spac-ipo-usa/

technical means of going public at lower fees and fewer regulatory compliance issues. The volatility in the capital market exacerbated by COVID-19 globally made IPO a risky investment due to unpredictability of public participation. It is believed that by merging with a SPAC, the target company would eliminate the potential risks of price volatility since prices are determined beforehand. It also shortens the time frame for going public. So, while an IPO has a projected timeline of about one year, SPAC's merger takes about 3 to 4 months completion phase. The target company who now has shortened timelines, would gain the ability to make projections, while accessing additional capital[3].

SPAC is a viable option for companies with high debt ratio or highly leveraged companies who may not meet SEC regulatory requirement for an IPO but can scale through regulatory hurdles for a merger & acquisition. Let's consider the case of the American Apparel Inc. In 2006, the company required injection of funds.

A SPAC, Endeavor Acquisition raised $129.3 million in its December 2005 IPO. In a Press Release issued by US SEC on December 19, 2006, it was announced that Endeavor had signed a definitive merger agreement with American Apparel to acquire 32,258,065 shares of restricted stock and assume up to $110 million of net debt outstanding. The combined company retained both the name of American Apparel, and the companies CEO, Dov Charney as well as core members of the management team.

Some financial advisers have cautioned against SPAC for its anti-dilutive effect, the structuring of the shares and fall in share price post-mergers. Unlike an IPO where price is subject to a valuation, in a SPAC price is not based on valuation of any existing business. Once trading commences post-merger, the price may fall or rise, which is the risk associated with but not exclusive to SPAC merger/acquisition. It is advisable to consult a SPAC and M&A lawyer/consultant prior to investing or merging with a SPAC.

SPAC and de-SPAC process

SPAC commences by sponsors incorporating a public company and raising funds from the public through an IPO. All IPO proceeds are held in trust until acquisition/ merger target is met. Once the desired capital is raised, the SPAC has a period to identify and acquire the target company,[4] usually 24 months in most jurisdictions. Where the acquisition is not made, the capital is returned to the investors.

The target company may be chosen prior to the IPO, but that is not a regulatory requirement for setting up a SPAC. The investors are fully aware of the implications of investing in a SPAC, which is truly just a shell company.

Unlike in an IPO, the prospectus of the SPAC focuses on the founders and not on the performance of the company. The de-SPAC process (process of merging with a target company and exiting) involves a hunt for

3 Jdsupra "Key considerations for Target Companies in a SPAC merger" https://www.jdsupra.com/legalnews/key-considerations-for-target-companies-6646443/ accessed on 22 November 2021
4 Jdsupra "Key considerations for Target Companies in a SPAC merger" https://www.jdsupra.com/legalnews/key-considerations-for-target-companies-6646443/ accessed on 22 November 2021

and negotiations with a target company, shareholders' approval of the transaction and redemption offer to dissenting shareholders. Post-merger, the combined company may continue as a public or a private company.

Will SPAC be adopted in Nigeria?

African countries are taking baby steps to catch up with global SPAC trend. The first SPAC in Africa was Renergen Limited, which was listed in 2015 in Johannesburg Stock Exchange, South Africa.[5]

The adaption of SPAC in Nigeria has been slow due to laws that prohibits shell companies or companies without any identifiable business activity from going public. Prior to 2010, SEC Rules require any company trying to go public to have three years' operating track record for listing under the Main Board or 2 years track record for listing under the Growth Board.[6]

There was no other rule to go by except those. On 13th July 2020, the NSE passed draft Rules for Listing of Securities issued by Special Purpose Acquisition Companies (the Draft Rules), and SPAC was proposed and considered as a viable investment tool. Some notable provisions are:

- **Incorporation Requirement**

  Each SPAC shall be incorporated as a public limited liability company and must comply with all applicable Rules and Regulations of the Exchange. The memorandum of incorporation must clearly state that the SPAC is to be incorporated for matters related to the Transaction, which is the negotiation of a merger or purchase agreement and/or the acquisition of a business or assets. A SPAC is not required to carry out any business activity other than as stated in the draft rules.[7]

- **Minimum offering size**

  The Rules provide that if the SPAC is listed on the exchange via IPO or private placement, the minimum offering shall be N4 Billion. However, if listed on the Standard Segment of the Growth Board, the minimum listing requirement is N500 Million. All capital raised must be paid into an escrow account.[8]

- **Voting in support of Merger/Acquisition**

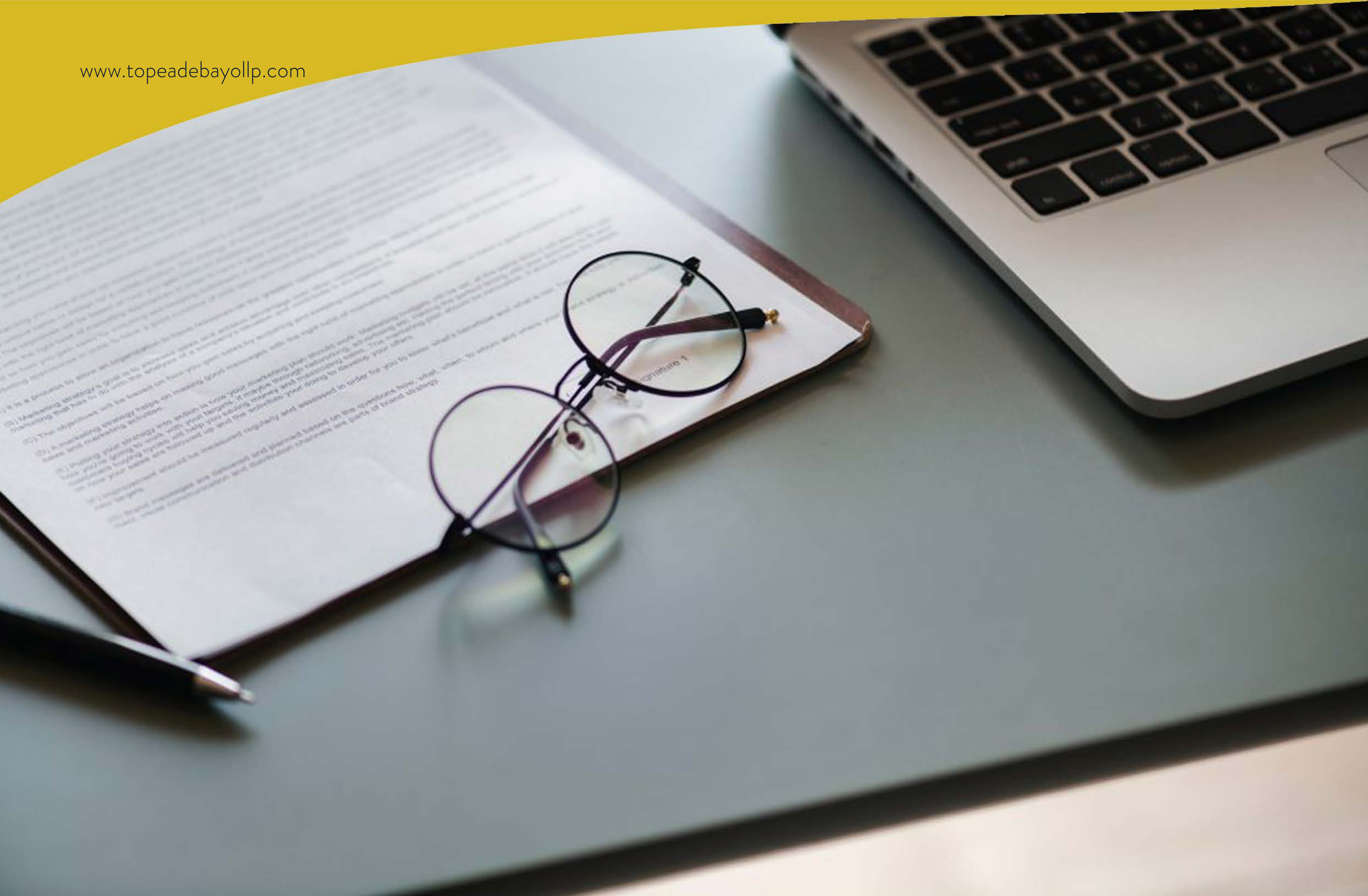
  The Draft Rules provide that at least 75% of the SPAC's shareholders must vote in support of the acquisition of a viable asset. The Rules also restrict the debt financing that a SPAC can acquire.[9]

- **Use of IPO proceeds**

  A SPAC is required to place a minimum of 90% of the IPO gross proceeds in an escrow account with an Escrow Agent. Prior to acquisition, the funds can only be invested in short-dated government treasuries/investment and cash deposits. The IPO proceeds must be utilized in an acquisition within 24 months from the date of closing of the IPO. If the SPAC fails to acquire within 24 months, the proceeds shall be distributed to the holders of the securities and the underwriters' commission shall also be part of the liquidation distribution.[10]

The Securities and Exchange Commission seems to be gearing up to jump on the bandwagon. In the Draft Recommendation released on August 26 2021 for discussion at the September 9 2021 by its Investor Advisory Committee (IAC), IAC offered recommendation for consideration and regulation of SPAC in Nigeria. Currently, the NSE draft Rules are yet to be incorporated into the NSE Consolidated Rules & Regulation. Also, IAC recommendation remains in the pipeline.

5 Oxford Business Group "Revised regulations leading to creation of new products in South Africa" https://oxfordbusinessgroup.com/analysis/new-players-new-tools-revised-regulations-are-leading-creation-new-products
6 Rules for Listing on the Growth Board of the Nigerian Stock Exchange
7 Rule 2.1.1
8 Rule 2.2.1
9 Rule 2.4.1 and 2.4.4
10 Rule 2.5



Conclusion

SPAC has the potential of providing lifelines to fast growing companies with tons of potential, but inadequate funds to guarantee successful performance. It is recommended that the regulation on SPAC be stringent to protect investors capital, but also flexible to provide a safe harbor for SPACs.

Issues such as disclosures on SPAC IPO, record keeping and accessibility to information post-SPAC, and the redemption right of dissenting shareholders to a proposal for merger & acquisition with trending companies should be incorporated in any SPAC policy to be adopted. SPAC is a viable option for companies seeking public funds, and Nigeria could benefit from SPAC transcending from a novelty to a norm, under the right regulatory ecosystem.

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