

# SPACs

## SPECIAL PURPOSE ACQUISITION COMPANIES CONTINUE TO SURGE IN POPULARITY.

BY STUART NEUHAUSER AND BRIAN LEE

When Endeavor Acquisition (AMEX: EDA) filed its definitive proxy statement on Nov. 28, 2007, it knew that there wasn't much time left to complete the acquisition of American Apparel. Endeavor acknowledged that there were "growing time constraints" and Endeavor needed to "secure the full cooperation of [American Apparel CEO Dov] Charney ... to ensure the successful completion of the transaction." Indeed, Endeavor was facing a tough race against the clock. Even though Endeavor had filed its preliminary proxy statement with the SEC in June, it wasn't until the end of November that it had cleared SEC approval. Endeavor then had only 17 days left to complete the deal, and if it didn't, its founders stood to lose millions of dollars and their efforts during the prior two years would have been all for naught.

Rather than jeopardize the deal, Endeavor sweetened the deal for Charney—to the tune of an extra 5,000,000 shares of common stock for him, an increase of 15% from a deal that was already agreed upon. However, there have been numerous other SPACs (special purpose acquisition companies) that encountered difficult situations during the lengthy SEC review process. By all accounts, Endeavor worked out for everyone involved. Endeavor's post-merger stock, even in the current bear market, has continued to trade above Endeavor's IPO price of \$8. Nonetheless, SPAC professionals sought to determine if there are ways to reduce or eliminate such a review process and be able to bring a better deal to stockholders.

### SPACs IN A NUTSHELL

Endeavor was a specified purpose acquisition corporation, commonly known

as "SPAC." A SPAC is a newly formed company, organized by a group of executives, with the sole purpose of going public and using the proceeds of the offering to acquire a business.

Since 2003, 153 SPACs have successfully completed IPO offerings, and these offerings have raised over \$21 billion. Of those 153 SPACs, 46 have acquired a business and an additional 34 have announced proposed targets. Of these 34 potential business combinations, 26 are currently under the SEC review process or awaiting shareholder approval.

SPACs typically raise between \$50 million and \$500 million to fund their acquisition strategies. The SPAC has a finite life of no more than 24 months (which can be extended up to 12 months) to identify and conclude an acquisition. Pending an acquisition, 99% or more of the IPO funds are held in a trust account with a major money center bank. In addition, the acquisitions are subject to approval by the

public stockholders of the funded SPAC.

SPACs have recently surged in popularity as an alternative to traditional acquisition vehicles owing to their ability to raise capital through the public equity markets to fund takeover acquisitions of private companies. The increasing list of well-known bankers—from UBS to Deutsche to Citigroup—have been jockeying to underwrite SPAC IPOs. Recently, the NASDAQ and NYSE have proposed rule changes to allow SPAC listings, which further indicates that SPACs have gained widespread acceptance within the financial and investment communities.

### FAST-TRACKING THE SEC PROCESS

Because SPACs are subject to the same regulatory requirements as other public companies, there is a larger degree of transparency, as they are required to file certain disclosure documents with the SEC. Traditionally, all

SPACs filed preliminary proxy materials with the SEC for review and approval, a process that has taken six months or more although recently ascending down to three or four months. However, a recent development in the program is that a “foreign private issuer” is exempt from the SEC proxy review process. A qualifying “FPI” SPAC may simply file its proxy materials (which satisfies local laws only) after it is mailed to stockholders in the United States.

An FPI is any foreign issuer whose majority of outstanding voting stock is held directly or indirectly by non-U.S. residents or any foreign issuer who does not have the following: (i) a majority of its executive officers or directors who are U.S. citizens or residents; (ii) a majority of its assets located in the United States; and (iii) its business administered principally in the United States.

#### WHAT'S IN IT FOR ME?

Structuring a SPAC as a foreign private issuer has the tremendous benefit of essentially extending the time frame

in which the SPAC has to complete a business combination. Because of the limited time frame for a SPAC to obtain stockholder approval and complete its business combination, the delay caused by the SEC review process can have a significantly adverse economic effect on the SPAC and, in the extreme case, jeopardize whether stockholders ever get to vote on the proposed transaction.

Potential target companies are aware of the limited time frame, and can use the pressure of the limited time frame to exact a higher acquisition price. Further, there exists a class of professional investors who also use the pressure created by the limited time frame to exact a form of “green mail” on SPACs when it seeks stockholder approval. Further, because of the extended approval process, most SPACs are unable to propose more than one business combination, and this can negatively impact the ability of the SPAC management team to review potential target companies and negotiate favorable terms. The

elimination of the SEC review process may enable the SPAC to present a second business combination, thus strengthening the SPACs bargaining position at the negotiating table—both with target businesses and potential green-mailers.

What's good for the SPAC is good for SPAC stockholders, too. If executed properly, SPAC investors should continue to receive the same level of disclosure in proxy materials as if it was subject to SEC review, because, among other reasons, underwriters and issuers alike would be wise to avoid potential liability by preparing proxy materials on par with SEC standards, all the while receiving the benefits that come with by-passing SEC review. Just how much of a benefit would this have for SPAC investors? At the very least, significant professional fees incurred during the SEC review process would be saved and possibly, under the right set of circumstances, save the SPAC 5,000,000 shares of common stock—and that's not exactly pocket change. **E**

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