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We Haven't Heard The Last From SPACs, Panel Says

By Tom Zanki

Law360 (April 22, 2021, 8:25 PM EDT) -- Despite headwinds that are chilling the once red-hot market for special purpose acquisition companies, a panel of dealmakers on Thursday predicted that activity will rebound once accounting and related questions raised by regulators are resolved.

Lawyers, accountants and investment bankers active in SPAC deals addressed the market climate in a web event Thursday, responding in part to a recent increase in regulatory scrutiny that has coincided with — and some argue contributed toward — a slowdown in SPAC activity.

SPACs, also known as blank-check companies, are shell entities that raise money through an initial public offering in order to acquire another company and take it public, handing the target a ready-made listing. SPACs have exploded in the past year partly because they could offer target companies a faster and more certain path to public markets compared with a traditional IPO.

The U.S. Securities and Exchange Commission last week stated that warrants — which are sweeteners sold to investors of blank-check IPOs that grant them rights to additional shares — may need to be reclassified as liabilities rather than equities as was previously understood. The SEC's action has forced many SPAC teams with pending applications to revisit their filings to make sure their financial statements are properly recorded.

The SEC's statement, on top of other recent warnings, has helped put the brakes on the once torrid pace of blank-check offerings. Market participants at Thursday's panel said they expect the slowdown will be temporary as auditors and attorneys digest the SEC's guidance.

"Over the next month, there is going to be a lot more pain," David Bukzin, vice chairman of the auditing firm Marcum LLP, said in a web event organized by Raymond James Financial. "In the long term, I can tell you from the volume of inquiries for new SPAC transactions, it is not dissuading the market."

The surge in SPACs, once a niche in capital markets that now exceeds traditional IPOs, has introduced several risks to the marketplace that have caught the attention of regulators.

The SEC's statement on warrants was preceded by April 8 guidance from the agency's Division of Corporation Finance, which warned that companies going public through SPACs should not assume that they won't be held legally liable if they tout promising projections for their businesses that don't pan out. The ability to discuss forward-looking projections is considered an advantage of going public through a SPAC, thanks to a safe harbor applicable to mergers that is not available to companies going public through a traditional IPO.

Before that, the SEC cautioned that individuals should be wary of embracing investments simply because athletes and celebrities, which have joined the SPAC craze, are promoting them.

Ellenoff Grossman & Schole LLP partner Doug Ellenoff, whose firm is active in blank-check deals, said it's fair game for regulators to raise warning flags. He added there is also a "certain degree of regulatory hostility" in the current climate, which may be contributing to the slowdown.

"The conversation shouldn't be: How do we curtail the SPAC program?" Ellenoff said. "Even though it has probably come too far too fast. The conversation should be: How do we improve the SPAC program?"

Ellenoff said SPACs are benefiting capital markets by bringing more companies to public markets, reversing a yearslong decline in public companies that began in the early 2000s. Notable companies that went public through SPACs include sports-betting business DraftKings Inc. and spaceflight company Virgin Galactic Holdings Inc., plus many earlier-stage startups.

"The utility of the SPAC product has proven itself time and time again," Ellenoff said. "And notwithstanding some regulatory hurdles that we are going to have to go through over the next 60 to 90 days, I think the future is bright. Prospects keep coming in."

For now, the cooling of the blank-check market is sobering.

Only 10 blank-check IPOs have priced since April 1, raising $2.5 billion, according to data provider Dealogic. That followed a blistering first quarter of 2021 in which 298 blank-check IPOs — or more than a three a day — raised $96 billion through March 31. Still, the year-to-date total surpasses last year's proceeds of $83.3 billion, which exceeded the previous entire decade.

"Every company that thinks about going public now considers a SPAC as part of their options," Bukzin said.