Innovation in SPAC Market is Challenging

SPAC (Special-Purpose Acquisition Company). Maks Lab/Shutterstock

As the SPAC sector begins to thaw, some sponsors want change.

By Bill Meagher

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The SPAC sector has seen two notable attempts at innovation since 2021, one offered by serial SPAC sponsor Eagle Equity Partners, the other by Pershing Square Capital Management LP. But neither had attracted imitators.

In January 2021, Eagle Equity registered Spinning Eagle Acquisition Corp., a SPAC that aimed to raise $2 billion with Goldman Sachs & Co. LLC as sole underwriter. While the size of the raise and the single underwriter were notable, what set the registration apart was the SPAC's structure.

Eagle Equity proposed that if it didn't need all of its capital for an acquisition, it would spin off a second SPAC with the remaining capital. That SPAC could then do a second transaction. The proposed structure would give the SPAC the option of merging with a large target company or doing multiple deals. Any spinoff transaction would have to be completed under the timeline for the first SPAC.

Harry Sloan, a founding partner in Eagle Equity, said raising larger sums of money in a SPAC is desirable and that large de-SPACs perform better after closing. He added the proposed structure also gave investors additional flexibility.

Eagle Equity received guidance from the SEC and submitted a revised registration in June 2021. But the SEC didn't love Spinning Eagle, and Sloan, ever the realist, said that the timing was likely off, because the SEC was not at full strength as Chairman Gary Gensler was still not seated and the SPAC market was on fire.

Eagle Equity withdrew the Spinning Eagle registration in April 2022.

The SEC received a letter of support for Spinning Eagle from Cathie Wood's Ark Investment Management LLC. The hedge fund has been a PIPE investor in six SPACs including Ginko Bioworks Holdings Inc. (DNA), a target that merged with Eagle Equity vehicle Soaring Eagle Acquisition Corp.

But one veteran SPAC sponsor called Spinning Eagle "totally absurd," because this person thought doing more than one de-SPAC from a single SPAC made no sense.

And Doug Ellenoff, a partner at Ellenoff Grossman & Schole LLP said that the SPAC industry "will retain the standard structure."

Bill Ackman offered another attempt at innovation with Pershing Square SPARC Holdings Ltd. which the SEC approved Sept. 29. Though not a SPAC, the vehicle's origin stems from Pershing Square Tontine Holdings Ltd, which raised $4 billion in the largest SPAC IPO ever.

The SPAC agreed to buy a minority stake in Universal Music Group that failed to win SEC approval and drew a number of lawsuits. Ackman liquidated the SPAC July 11, 2022.

Pershing Square SPARC is a special purpose acquisition rights company and has a 10-year timeline rather than one of 12 to 24 months like a SPAC. Also, with a SPARC, investors do not invest at the time of the IPO as in a SPAC but delay investment until the SPARC has a target acquisition in place. Pershing Square SPARC plans to collect $1.5 billion from investors.

Investors in Pershing Square's SPAC own rights to the SPARC by design, but if other SPARC's go forward, rights will be distributed at the time a deal is announced. The SPAC investors also received checks after Ackman liquidated the SPAC.

Ackman has sought to make his SPARC more attractive by pledging Pershing Square will invest between $250 million to $3.5 billon as an anchor investor. The back-end cash is attractive to investors and targets, but it seems unlikely that other sponsors will create SPARCs, let alone or invest so heavily in them.

The Ackman SPARC doesn't offer investors warrants. That feature makes it less likely that hedge funds will invest in SPARCs as SPAC warrants give upside to hedge funds, which have long been major investors in SPACs and occasionally sponsors of them.

Pershing Square declined to comment for this story.

The SPARC, said Giovanni Carrusso, a partner at Loeb & Loeb LLP, is "a specialty structure to give investors from a failed deal something going forward. Because there is no underwriting and it's not publicly listed, I think it's unlikely to gain general acceptance."

A longtime SPAC lawyer said that the SPARC "has some merit, but it isn't for everyone. Ackman had the old Pershing Square shareholders and warrant holders that he arranged to issue the new SPARC rights to. If he didn't have that, who would be the SPARC rights holders? Also, he paid north of $30 million for his founder stake in the SPARC warrants. Next to nobody else is going to be able to do that."

The same lawyer said: "I am old-school on this, I don't believe the SPAC needs to be innovated. I think it needs to go back to its roots. Sponsors need to find undervalued targets."

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COMPANIES

Ark Capital Management | Ellenoff Grossman & Schole LLP | Ginkgo Bioworks Holdings Inc. | Goldman, Sachs & Co. | Loeb & Loeb LLP | New York Yankees | Pershing Square LP | Pershing Square Tontine Holdings Ltd. | SEC Newgate SpA | Soaring Eagle Acquisition Corp. | Social Capital | Sparks | Suvretta Capital Management LLC | Universal Music Group

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