

# SEC Restricts SPAC Managers' Warrant Purchases

## Regulators' Scrutiny Increasing on Acquisition Targets Also

Securities regulators are warning executives at blank check companies that a common feature of their initial public offerings could in some cases violate rules against stock manipulation.

The IPOs of many blank check companies have recently begun including commitments by management to purchase stock warrants after the public offering. The Securities and Exchange Commission has warned that such warrant purchase plans could sometimes violate Regulation M, which bans manipulative trading by underwriters of public offerings.

The SEC is raising concerns about the warrant purchases as it's ratcheting up scrutiny in general of Rule 419-exempt blank check companies, otherwise known as specified purpose acquisition companies, or SPACs. Regulators are looking more closely at these risky ventures as more than 30 SPACs are preparing for public offerings that may raise more than \$3 billion from stock market investors.

**"It's enough money that if one guy blows it and absconds with the money, there's going to be a lot of press saying 'Where was the SEC?'"** said Mitchell Littman, head of the corporate and securities department at the law firm of Littman Krooks in New York. **"I think they're nervous about being the watchdog and being accused of being asleep at the switch."**

Investment bankers and securities attorneys say that because a SPAC is such a speculative investment (buyers of the IPO don't even know what business they'll own), it's especially important for managers of such companies to demonstrate that their interests are aligned with those of regular shareholders. That's why the offering prospectuses filed by many SPACs include a "warrant purchase plan" for the managers and sometimes for the IPO underwriters.

**Investors "like the fact that the insiders go out and buy warrants,"** Littman said. **"It represents skin in the game."**

JK Acquisition Corp., for example, has filed forms with the SEC to raise \$54 million to acquire a manufacturing or distribution business. The forms show that CEO James Wilson and president Keith Spickelmier have agreed to pay as much as \$1.23 million, within 90 days after the IPO, for warrants that will allow them to buy 1.75 million JK shares for \$5

each. That could help support the price of JK's shares after the IPO. JK will sell 11.5 million units in its public offering, each consisting of one share of stock and two \$5 stock purchase warrants, for \$6 each.

Regulation M bars underwriters from buying securities after an IPO in ways that could create an inflated impression of demand among public market investors. The SEC has been

sending letters over the past two months or so to SPACs preparing for public offerings, suggesting to some that their warrant plans might be manipulative, securities lawyers say.

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The SEC wrote Oct. 12 to attorneys for Key Hospitality Acquisition Corp. outlining how its managers could avoid securities law violations in their warrant purchases. Other securities lawyers representing blank check companies are viewing the Key Hospitality letter as guidance as they craft warrant purchase agreements for their own clients. (See "Key Hospitality Comment Letter," p. 39.)

Key Hospitality filed forms in May to raise \$100.1 million in an IPO to buy a hospitality company. Maxim Group is acting as underwriter. The law firm of Mintz, Levin, Cohn, Ferris, Glovsky, and Popeo is providing legal advice to Maxim.

Key Hospitality's directors and special advisors have agreed to buy up to \$1.35 million in warrants after the offering, according to a letter that Mintz Levin attorney Kenneth Koch wrote to the SEC.

He stated the terms of the warrant purchase agreement will be fully disclosed in Key Hospitality's prospectus and filed as an exhibit to its stock registration statement. Key's directors and advisors will also follow SEC rules for buying warrants under pre-established agreements, won't sell the warrants until after Key makes an acquisition, and will disclose their warrant purchases in Form 4 filings with the SEC.

SEC assistant director James Brigagliano responded in a letter back to Koch that the Key directors' and advisers' warrant purchases will be legal, assuming that they meet the terms that Koch described and some other conditions.

Key managers also must not bid for or buy any warrants during the 60 days after IPO other than those covered by the purchase plan, Brigagliano wrote. Key and Maxim must also provide the SEC with daily, time sequenced schedules of warrant purchases upon request and Key and Maxim representatives must be available at the SEC's office in Washington to answer any questions about the purchases.

The SEC probably won't sanction older SPACs whose warrant purchase agreements didn't meet the same conditions as Key's, said Floyd Wittlin, a partner with the law firm of Bingham McCutchen in New York. He said that the SEC has only adopted its current thinking about SPACs and Regulation M in the past two months or so, based on comments it's made to other SPACs preparing IPO paperwork. The SEC's Brigagliano couldn't be reached for comment.

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### Acquisition Reviews Seek More Disclosure

At the same time the SEC has imposed more restrictions on warrant purchase agreements, it has also required more disclosure from SPACs about their efforts to find acquisition targets.

SPACs regularly say in SEC filings before their public offerings that they have yet to find a company that they would like to acquire. That's because it would be more difficult for a SPAC to go public if it found an acquisition target first. The SPACs' filings with the SEC would then have to include detailed disclosures about the target company's business and finances.

But some investors speculate that International Shipping Enterprises (ISHP.OB), a SPAC that went public in December 2004, may have skirted those rules.

International Shipping has raised suspicions in hindsight,

with its decision to boost the size of its public offering from \$102 million to \$171 million in late November.

The company stated in its final prospectus in December, that, "We have not conducted any discussions and we have no plans, arrangements, or understandings with any prospective acquisition candidates."

But only two months after completing its IPO, International Shipping announced it had entered exclusive acquisition

talks with Navios Maritime Holdings (NMHIF.OB). The agreement to buy Navios for \$607.5 million was signed by the end of February with International Shipping's chief executive Angeliki Frangou slated to remain in charge of the combined company. She didn't return a phone call seeking comment.

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that not only have they not identified an acquisition target, but that they also haven't identified a group of companies to choose an acquisition from, or even a set of criteria to identify an acquisition, according to Wittlin.

"We have not (nor have any of our agents or affiliates acting on our behalf) been approached by any candidates (or a representative of any candidates) with respect to a possible acquisition transaction with us," Oracle Health Acquisition Corp. stated in the more complete disclosure that it filed in September for a \$115 million SPAC IPO. "Additionally, we have not engaged or retained any agent or other representative to identify or locate any suitable acquisition candidate."

"There's certainly an emphasis from the staff of the SEC to make the issuers go to great lengths to certify that they don't have a target," Wittlin said.

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