Trusting SPACs During Difficult Times

By Douglas S. Ellenoff

The good news for SPAC investors is that trust accounts have been designed to provide investors and SPAC sponsors with a high degree of comfort knowing that neither the principal nor the interest should be subject to undue risk. Consequently, by all accounts, the trusts have held up according to plan during this period of financial stress.

Except where a SPAC successfully consummates its "SPACquisitions," SPAC investors want all of the trust proceeds available to them upon dissolution (net of taxes and permitted working capital). Interestingly, to remain exempt from the Investment Company Act of 1940, the types of permitted investments to be contained in the trust account are regulated and limited in nature to the most conservative financial instruments.

Pursuant to the investment management trust agreement entered into by the SPAC and its trustee upon the written instruction from management of the SPAC, the trustee will invest and reinvest the assets of the trust account in a specified "government security," or in money market funds selected by the SPAC to meet the conditions specified in the act as determined by the company.

A "government security," as defined in many but not all of these agreements, means any Treasury bill issued by the United States having a maturity of 180 days or less, or any open-ended investment company selected by the SPAC and registered under the Investment Company Act that holds itself out as a money market fund meeting certain conditions under the rules as determined by the SPAC.

However, investors are cautioned that certain agreements contain variations on this language and are encouraged to review the particulars of the permitted investments contained within each investment management trust agreement.

As a practical matter, we have not learned of any suffered losses by any of the funded SPACs that have concluded their IPOs. Even those SPACs that maintained their accounts with Lehman Brothers have been able to successfully and safely transfer those funds to other depositaries.

During the recent difficulties, audit committees and management teams have been dutifully reviewing their trust account arrangements. While many have elected to take no additional actions, management teams have appropriately been reviewing the details of the underlying securities and whether there are any counterparty exposures. Any questions or concerns ought to be addressed directly to the trustee of the account and the depository institutions holding the assets. We have found the representatives to be responsive and knowledgeable.

While concerns about the safety of the funds in trust has been weighing heavily on the minds of SPAC investors lately—particularly given the overall recognition by investors that their own money may not be as safe as they once thought—the more immediate concern has been that in a limited number of SPAC dissolutions, the funds have been returned more slowly than the investors had expected.

In certain cases, this is due to the need to secure stockholder approval for the plan of dissolution (typically SPACs with vintage older than November 2006—prior to the adoption of exploding charters), as well as in other cases where management seeks to convert from a SPAC into a "shell" company. These are not concerns about the return of principal, per se, but simply about the timing of the returned funds.

In summary, SPAC trust funds remain liquid and secure even in the most challenging economic environment. As such, the concept of the SPAC, pending approval of a business combination, as a risk-averse investment seems to have held up during these difficult times. **E**

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