

SPACs Considering German Targets Face Unique Challenges

Contributing Partner

Stephan Hutter / Frankfurt

Counsel

Caspar Schmelzer / Frankfurt

Takeaways

- German technology and mid-cap growth companies may find a combination with a U.S. SPAC appealing, but must prepare to meet public capital market requirements.
- Arranging adequate PIPE funding is crucial to the success of a de-SPAC combination, and German targets may be able to tap local institutions for support.
- PIPE shares and shares issued to the target shareholders at the time of the de-SPAC combination cannot be traded until a new SEC registration takes effect, which can take several weeks.
- Though combining with a SPAC is often portrayed as a simpler alternative to an IPO for a public-ready target, cross-border transactions are at least as expensive and time-consuming.

The enormous sums raised in SPAC IPOs in the U.S., and the competition to invest that capital during the SPAC's limited life, are contributing to record M&A activity in Europe, including Germany. Although German equity capital markets are at all-time highs, institutional investors favor large-cap companies for their liquidity, and small- and medium-sized technology and growth companies are valued more cautiously in Germany than in the U.S. Increasingly, they have been looking to access the U.S. capital markets and are therefore also open to offers from U.S. SPACs, which have been approaching multiple European IPO targets. Typically the buyers aim for valuations between \$500 million and \$1 billion. (For a discussion of the U.S. SPAC market, see "[Choppy Market for SPACs and PIPEs, Competition for Targets Spurs Deal Innovations.](#)")

A SPAC combination (a so-called de-SPAC transaction) is frequently viewed as a less risky and more efficient approach to access capital markets than an IPO. However, that is often not true, especially when the target is European, because implementing such combinations requires the European company to become U.S. capital-markets-ready, PIPE (private investment in public equity) financing must be arranged and complex holding company structures may need to be created.

Below are legal and practical lessons learned from transactions involving German targets in 2021.

Establish a structured process to identify a suitable SPAC partner. Currently, more than 450 U.S. SPACs are pursuing an acquisition target before the end of 2022 or early 2023. Not all combinations are suitable, and potential German targets should define criteria and implement a structured selection process. Companies should consider buyers' geographic or sector focuses, as well as a SPAC's size, PIPE strategy and adviser team. Other important issues are the willingness of SPAC founders to invest in the PIPE, the availability and size of earnout warrant or share structures for the target's current shareholders, as well as the quality of the SPAC's shareholder base, as an indicator of potential redemption levels.

Select an appropriate structure. Combining a U.S. SPAC with a German company poses challenging corporate law and governance issues because corporate law in Germany imposes more technical requirements and is less flexible than in the U.S. or other European jurisdictions.

One solution is the so-called "double dummy" structure, where both the U.S. SPAC and the German operating company become subsidiaries of a newly

This article is from Skadden's 2022 *Insights*.

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

One Manhattan West
New York, NY 10001
212.735.3000

established parent, most often formed under Dutch or Luxembourg law, which is closer to U.S. law. Nonetheless, each de-SPAC involving a German target is still bespoke and involves several restructuring steps, mergers and capital increases in a number of jurisdictions.

In addition, since American and German shareholders are subject to very different tax regimes, a successful transaction requires careful tax planning from an early stage. Ideally, the SPAC and the German target should share a common understanding of the fundamental deal structure before they enter into the letter of intent and agree to exclusivity.

Prepare for a comprehensive and lengthy PIPE process. The additional capital from institutional investors provided by a PIPE financing in connection with the combination is crucial to a successful de-SPAC. Raising capital from third parties validates the valuation of the target and ensures that, even if there is a high level of redemptions by the SPAC's shareholders, there is adequate cash available to the target following the combination.

German targets can often draw on their local investor bases for the PIPE, even as international institutional investors have been scrutinizing PIPEs more carefully. Marketing efforts for the PIPE take place prior to the signing of the merger agreement and remain confidential, which is a key advantage versus an IPO, but the target investor base for PIPEs is substantially the same as that for an IPO; investors who would not participate in an IPO of the German target will most likely be equally hesitant to invest in the PIPE for a de-SPAC merger.

When de-SPAC transactions involving German targets fail, it is typically due to an unsuccessful PIPE fundraising. It is therefore vital for the SPAC and the target to develop a mutual understanding as early as possible — ideally by the letter-of-intent stage — regarding the best way to attract PIPE investors.

Focus on the capital-market-readiness of the German target. Ensuring that the private target is ready for the public equity markets is essential. It must be able to comply with the auditing, accounting and internal control standards for foreign private issuers, including preparing financial statements in compliance with standards set by the U.S. Public Company Accounting Oversight Board (PCAOB). It must also implement and follow market-standard internal control and compliance processes and establish risk management and governance structures.

In practice, this means that it is necessary to perform thorough due diligence and prepare disclosure documents comparable to those required for a conventional IPO before the transaction is marketed to PIPE investors and the American registration process commences. If weaknesses in the company's processes and structures are first identified by PIPE investors or regulators, that could significantly delay the de-SPAC transaction, or result in its termination.

Using the de-SPAC to finance an acquisition is challenging. At least one de-SPAC transaction involving a German target has been used to finance a large cross-border acquisition of another business. When structuring such a transaction, the parties need to prepare for the possibility that redemptions by initial SPAC shareholders could leave the company formed by the de-SPAC with insufficient funds to pay the cash portion of the purchase price and meet the minimum cash condition for the combined entity.

If there is a risk of a cash shortfall, it will be even more important to execute a successful PIPE transaction. As further protection, the M&A buyers should build in flexible consideration options so they can substitute additional equity for cash consideration depending on the available cash at the de-SPAC closing.

The target and the SPAC may also seek irrevocable voting agreements from

significant SPAC shareholders, committing them to support the de-SPAC transaction and not exercise their redemption rights.

Shareholders of the target may also be called on to provide an additional PIPE commitment in the event of high redemption levels. Properly structured, these arrangements can backstop and de-risk the transaction.

The combination of the completion of a de-SPAC and a large acquisition raises complex financial history issues and may require pro forma financials, further complicating the transaction. Close cooperation is needed among the auditors of the SPAC, the German SPAC target and the M&A target of the German SPAC target to take into account potentially different fiscal years, applicable auditing standards and other complexities. Since the de-SPAC requires registration with the Securities and Exchange Commission (SEC), any such M&A documentation by the German SPAC target should provide for a flexible closing date and the M&A parties should stay away from unrealistic long-stop/drop-dead deadlines.

These transactions inevitably are costly and time-consuming. A combination between a U.S. SPAC and a German target is generally more complex structurally and more document-intensive than the conventional U.S. IPO process. In most cases, it will require at least five or six months to implement. Depending on the time required for the German target to prepare PCAOB-level audited financials (assuming it qualifies as an FPI) and to ensure the German target's internal systems are ready for the U.S. public markets, as well as the corporate restructuring, merger and capital increases required to incorporate a typically utilized Dutch or Luxembourg holding company, the de-SPAC of a German target can also take nine or 12 months. Consequently, the transaction costs for the German SPAC target will likely far exceed those for a traditional U.S. stock exchange listing. If the de-SPAC by the German target

coincides with a simultaneously executed M&A transaction by it, the overall transaction costs will run even higher.

Share trading remains restricted after completion of the de-SPAC. Unlike in a typical non-U.S. de-SPAC merger or IPO, the new shares issued in connection with the SPAC merger to existing shareholders of the German target and new PIPE shareholders of the combined entity remain restricted by U.S. law at de-SPAC closing because they are not included on the registration statement on Form F-4

for the de-SPAC merger. In order for such shares to become publicly tradeable they must first be registered with the SEC on a registration statement on Form F-1 (for an FPI), which registration typically takes place within 30 days of the de-SPAC closing and, depending on the extent of SEC review, can take a few weeks to become effective.

The public trading restriction applies to all newly issued shares to German target shareholders and new PIPE shareholders. In addition, the existing shareholders

of the German target typically have a six-month lockup, with some limited exceptions. German companies and investors may not be familiar with the required additional SEC registration process and the delay in the ability to publicly trade, so the legal constraints' restrictive implications should be explained well in advance of the de-SPAC closing.