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Four Key De-SPAC Executive Compensation Issues

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In recent years, the number and value of so-called “de-SPAC” transactions have increased sharply. De-SPAC transactions are an alternative method of going public that may be faster and less costly than a traditional IPO. The typical de-SPAC transaction involves a publicly traded special purpose acquisition company (SPAC) that merges with a target private operating company, with the result that the operating company becomes publicly traded.

In 2021, through the end of the second quarter, more than 200 de-SPAC mergers were pending or had been completed, up from 78 in all of 2020 and 28 in 2019, and the total amount raised by SPACs in 2021 through the second quarter was more than $90 billion, up from $74.4 billion in all of 2020 and $12.6 billion in 2019.[1]

For compensation professionals, de-SPAC transactions involve some unique challenges and opportunities. Four of these are discussed below.

De-SPAC Transactions and Change in Control Protections

The de-SPAC transaction is typically structured as a merger or other corporate acquisition involving the target private operating company. A merger or acquisition is a common trigger for change in control protections, such as accelerated vesting of equity awards or enhanced severance, under executive compensation arrangements. However, depending on how the merger or acquisition is structured and on how materially the pre-transaction versus post-transaction share ownership changes in the de-SPAC transaction, it may or may not constitute a change in control. Prior to any de-SPAC transaction, the parties should examine the operating company’s compensation arrangements to determine whether the transaction will trigger any change in control benefits.

To the extent any enhanced change in control protections or benefits are triggered by the de-SPAC transaction, the parties should also analyze whether the excess parachute payment provisions under Sections 280G and 4999 of the Internal Revenue Code will apply. These tax provisions impose a 20% excise tax and disallow a deduction on so-called “excess parachute payments,” which are generally change-in-control payments or other benefits received by certain disqualified individuals. Each situation and transaction must be analyzed to determine whether the provisions apply and, if so, what steps might be taken to minimize their impact.

Some examples of arrangements that may be impacted and certain potential impacts are summarized below:

Compensation Plan or Arrangement	Potential Impact
Equity-based Compensation	• Accelerated vesting • Loss of future retention incentives • Excise taxes and nondeductibility under Code Sections 280G and 4999
Employment agreements	• Enhanced or single-trigger severance protections • Excise taxes and nondeductibility under Code Sections 280G and 4999 • Tax gross-ups
Retention or sale bonuses	• Loss of future retention incentives • Excise taxes and nondeductibility under Code Sections 280G and 4999
Deferred compensation	• Accelerated distribution • Unanticipated increase in taxable income

Potential Delay in Implementing Equity Compensation Program

For publicly traded companies, equity incentive awards are generally offered to employees and directors under a Form S-8 registration statement to comply with U.S. securities laws, which require that securities be registered with the Securities and Exchange Commission unless they qualify for an exemption. In a traditional IPO, a Form S-8 generally may be filed shortly after the completion of the offering, allowing equity incentive awards to be granted promptly.

Under the U.S. securities laws, however, SPACs are not permitted to file a Form S-8 until 60 days after they have ceased to be a "shell company." A SPAC is generally a shell company until the de-SPAC transaction is completed. Accordingly, in a de-SPAC transaction, a delay may be required in granting certain types of equity incentive awards until at least 60 days after the transaction has closed and certain public disclosures have been made. Because the terms of de-SPAC transactions often include a provision for equity incentive awards to be granted to management, this required delay can be perceived as an obstacle. However, if awards are valued based on the share price in connection with the closing of the transaction and recipients are given vesting credit for service since the closing, the recipients generally should not be adversely affected by the delay.

For companies that wish to implement an employee stock purchase plan in connection with a de-SPAC transaction, the 60-day waiting period may also require a delay before purchases may begin under such a plan.

Shareholder Approval of Equity Incentive Plans

The major stock exchanges generally require shareholder approval of equity compensation plans before certain types of awards may be granted (or exercised, in the case of stock options). It is common in connection with a de-SPAC transaction for a new equity compensation plan to be adopted, so it is important for the parties to a de-SPAC transaction to determine whether shareholder approval of the plan will be required and, if so, when the plan will be submitted to a vote. If shareholder approval of the de-SPAC transaction itself is required, then it may be most efficient to seek shareholder approval of the equity plan at the same time. If shareholder approval of the transaction is not required, then a separate vote of shareholders on the equity plan may be required.

New or Amended Employment Agreements

The parties to a de-SPAC transaction should consider whether new or amended employment agreements with key management members are desirable. If the target operating company has existing employment agreements, the agreements may include provisions that are not viewed favorably in the public company context by some proxy advisors or institutional investors, such as excessive perquisites, or provisions that are less favorable to executives than market practice, such as low severance multiples. In either case, the parties to the de-SPAC transaction may wish to amend or replace the employment agreements to address these issues. If the target operating company does not have employment agreements with key management, the post-SPAC company may wish to implement agreements as a retention tool.

This article highlights only a few of the unique executive compensation challenges and opportunities that are present in de-SPAC transactions. Because the management team is critical to a successful de-SPAC transaction, navigating these challenges and opportunities should be a high priority for everyone involved.

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[1] See CB Insights, What is a SPAC? (July 14, 2021)

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