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## The blank check: A new model for capital formation

Blank-check offerings have become a popular way for managers in the private equity business to raise capital for middle-market acquisitions. A

### INSIDER VIEW

William F. Griffin Jr.  
and  
Andrew D. Myers

blank-check company, or “special purpose acquisition corporation,” is an investment vehicle that raises funds in an initial public offering with a view to locating a business acquisition.

A blank-check offering turns the typical private equity investment cycle on its head by putting the exit strategy first. Rather than (a) raising equity capital via a private placement, (b) locating and acquiring a target company, and (c) exiting the investment years later via an IPO, the owners of a blank-check company (x) raise equity capital via an IPO, (y) locate and acquire a target company and (z) have an immediate exit via the existing public market for their shares.

Most recent blank-check offerings feature a strong management team, experienced in locating, negotiating and consummating acquisitions within an industry focus. Also, nearly all of the IPO proceeds are escrowed in a trust account invested in Treasury securities until the company completes an acquisition. Public shareholders who disapprove of an acquisition may convert up to 20 percent of the outstanding shares into a pro rata share of the trust account. If the company fails to make an acquisition within 18

to 24 months, the trust account is liquidated and the proceeds distributed exclusively to the public shareholders.

### Some practical considerations

- **Stock exchange listing.** Registration of a public offering of securities of a blank-check company under state securities (Blue Sky) laws is challenging, due to the many restrictions on blank-check offerings adopted in the wake of the penny stock scandals of the 1980s. However, a federal exemption from Blue Sky registration requirements is available for “covered securities” listed on a national securities exchange or on the Nasdaq National Market System. The American Stock Exchange has proven hospitable to blank-check companies, with the result that an AMEX listing is now a typical feature of recent blank-check deals.

- **Compliance.** Federal securities laws affect the selection of a target company, as well as the blank-check company. Targets must typically have three years of audited financial statements and internal controls that comply with federal securities laws.

- **No acquisition discussions prior to IPO.** As a rule, blank-check companies will not engage in any discussions for a specific acquisition prior to the IPO. Such discussions are subject to disclosure in the IPO prospectus, which would contravene a target’s general desire to maintain

the confidence of acquisition discussions and of information that it may disclose to management of the blank-check company.

- **Private placements.** Many recent blank-check offerings feature a private placement of stock or warrants to the management team at the time of the IPO to augment the trust account for the benefit of the public shareholders. Great care must be taken to avoid “integration” of the private placement with the IPO, which could violate securities laws.

- **Shareholder approval.** Blank-check companies commit to obtain shareholder approval for any business combination, whether required by state law or not. This involves the preparation of a detailed proxy statement that is filed with and reviewed by the SEC. This review process can take several months, which slows the acquisition timetable.

A modern blank-check company provides a new opportunity for private equity managers to shorten the investment cycle by creating a built-in exit strategy for a middle-market acquisition. The advantages offered to private equity managers and investors may cause blank-check offerings to be an increasingly popular investment vehicle for years to come.

**WILLIAM F. GRIFFIN JR.** and **ANDREW D. MYERS** are attorneys at Davis, Malm & D’Agostine PC in Boston.