REGULATORY & GOVERNANCE CHALLENGES ARISING DUE TO THE EMERGENCE OF SPECIAL PURPOSE ACQUISITION COMPANIES (SPACs) IN THE INDIAN CORPORATE ENVIRONMENT

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ABSTRACT

A confluence of many factors which drove the popularity of SPACs in the US post the COVID-19 pandemic, also managed to quickly attract the attention of many capital-starved global companies and market regulators across other jurisdictions. As the initial global scepticism surrounding the mechanism declined and the world balked at the pace with which the US SPAC juggernaut smashed all capital raising records in 2020, market regulators across various jurisdictions jumped aboard the SPAC bandwagon in announcing a framework for their domestic capital markets. Now, even as the US SPAC market, forced on its knees by the SEC, finally cools down, there seems to be no hesitation in many global markets in accepting the fact that SPACs are a risky, yet a viable fund-raising alternative. Recently, the Indian Market Regulator, SEBI, too set up an expert group under its Primary Market Advisory Committee (PMAC) to explore the possibility of a SPAC framework in India. While the current global sentiments seem to accept SPACs as more than just a passing fad, one cannot ignore that the SEC itself has time and again expressed frustration with certain quirky issues surrounding SPACs which also make them immensely popular. In this context, this article firstly attempts to understand as to what makes SPAC IPOs so special in comparison to the traditional IPOs. Secondly, this article breaks down the basic SPAC structure in the US which, in turn, helps in understanding the inherent sticky issues surrounding US SPACs. Lastly, the article, while highlighting the regulatory challenges for implementing SPACs in India, further analyses the inherent issues surrounding US SPACs in the Indian context and attempts to provide potential workaround solutions to potential governance issues arising from adopting a US style SPAC framework in India.

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I. INTRODUCTION – WHAT IS A SPAC?

A SPAC is in essence a company created by a sponsor that has no operations of its own (a shell company)[1] and which goes public to raise capital to acquire a non-listed operating company and in process, takes the non-listed company public via a reverse merger.[2] Since the initial capital is

[1] *See* DELOITTE, ACCOUNTING AND SEC REPORTING CONSIDERATIONS FOR SPAC TRANSACTIONS, 20(6) FIN. REPORTING ALERT (Feb. 10, 2021) https://www2.deloitte.com/content/dam/Deloitte/us/Documents/audit/us-accounting-and-sec-reporting-considerations-for-SPAC-Transactions.pdf [hereinafter Deloitte Financial Reporting Alert]; *See* David Curtiss, *Special Purpose Acquisition Companies*, LEXIS NEXIS, https://www.lexisnexis.com/lexis-practical-guidance/the-journal/b/pa/posts/special-purpose-acquisition-companies [hereinafter Curtiss].

[2] *See* Ivana Naumovska, *The SPAC Bubble is About to Burst*, HARV. BUS. REV. (Feb. 18, 2021) https://hbr.org/2021/02/the-spac-bubble-is-about-to-burst.

raised from investors who do not know their ultimate target companies, they are sometimes, referred to as 'blank check'[3] companies.

This article, in **Part – I**, provides a brief primer on the various stages that a typical US SPAC IPO undergoes in its lifetime, which form the basis of all subsequent analysis and discussions. **Part – II** explains the circumstances that led to the sudden uptick in the popularity of SPACs in 2020 and offers the first glimpse of the advantages of a SPAC route as against a traditional IPO route. **Part – III** of the article delves into the popularity of SPACs trickling into the Indian funding ecosystem and the nascent yet evolving regulatory initiatives that seek to create a domestic framework to incorporate SPACs as a viable funding alternative. **Part – IV** highlights the various perception related issues currently plaguing the traditional US SPAC framework when compared with the traditional IPO route, while **Part – V** highlights the additional set of regulatory and governance issues that would crop up, specific to the Indian market. Lastly, **Part – VI** attempts to offer potential workarounds to the expected set of regulatory and governance challenges that may be faced while designing a tailored regulatory framework catering to the Indian market.

II. PART – I: A PRIMER ON THE VARIOUS STAGES OF A TYPICAL US SPA

A. THE PRE-IPO STAGE

SPACs in US are usually set up by 'Sponsors'. The Sponsors are usually entities (either Individuals or institutions) that have credibility in the market irrespective of their background. These Sponsors initially designate around 25% of the pre-IPO equity (20% post-IPO) to themselves and such allotment to themselves is referred to as Sponsors'

3 *See* Tim Jenkinson & Miguel Sousa, *Why SPAC investors should listen to the market*, J. APPLIED FIN., 2 (2009).

'Promote'[4] or sponsor compensation for the work they do in hunting and acquiring target companies.

B. THE IPO STAGE

At the time of the IPO, Sponsors also purchase units of SPACs at the same rate as that of initial IPO investors, which is usually set at $ 10 per unit.[5] At this stage, the IPO Investors do not know details of the Target Company.[6] The only information that they possess is usually either the industry or the geography or both being targeted by the SPAC.[7]

C. POST IPO – THE HUNTING STAGE

Each unit of a SPAC held by an IPO investor usually consists of one share along with one 'share warrant'. The share warrant allows the IPO investor to further purchase a fraction of a share (usually between ¼ to 1 whole share) at a later stage, usually at a pre-set price of $ 11.50 per share.[8] The proceeds of sale of such units to the sponsor as well as to initial IPO investors are placed in an interest earning trust (by investing Treasury Notes).[9]

The SPAC usually has two years to hunt and acquire target companies and this may be extended by another year based on shareholder approval. During this time, sometime post listing, the shares as well as warrants of

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[4] *See* Richard Beales, *Breakingviews - The house always wins with SPACs*, REUTERS (Feb. 27, 2021) https://www.reuters.com/article/us-usa-spacs-breakingviews-idUSKBN2AQ2T8.
[5] *See What You Need to Know About SPACs – Updated Investor Bulletin,* INVESTOR ALERT AND BULLETINS, US SEC (May. 25, 2021) https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin [hereinafter Investor Bulletin, US SEC]; Michael Klausner et.al., A Sober Look at SPACs, (Eur. Corp. Governance Inst., Working Paper No. 746, 2021), https://ecgi.global/sites/default/files/working_papers/documents/klausnerohlroggeruanfinal.pdf [hereinafter ECGI Working Paper].
[6] Curtiss, *supra* note 1, at 1.
[7] Curtiss*, supra* note 1.
[8] ECGI Working Paper, *supra* note 5, at 2.
[9] *Supra* note 5.

SPAC trade separately on the exchange instead of being traded as a unit.[10] Furthermore, shares can be redeemed by the IPO investors at any point of time post listing, irrespective of how they vote in case of a prospective target company.[11] What is even more exciting is that even after redeeming their shares, IPO investors can hold onto their warrants for quite some time, which can be exercised at $ 11.50 per share if the merger is successful.[12]

If the SPAC is unable to acquire any target company within the timeline granted to it by the investors, the money is returned to the investors with interest that is earned by investment in Treasury Notes.[13]

D. DE-SPAC – THE REVERSE MERGER STAGE

Once a Target Company is identified, negotiations for a reverse merger can be completed within a couple of months and put to vote before the IPO investors.[14] Post shareholder approval, irrespective of how an investor voted, every investor has an equal right to redeem their shares even during the merger stage. The Merger stage is also known as the De-SPAC stage as the SPAC drops its name and takes on the name of its Target Company.[15]

Since, there is always a possibility that initial proceeds of the IPO may turn out to be insufficient due to subsequent high redemptions by IPO investors, the US SPAC framework envisions an alternative funding

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10 *See* Investor Bulletin, US SEC, *supra* note 5.
11 *Supra* note 5.
12 *Supra* note 5.
13 *See* Jason Ye, *Special Purpose Acquisition Companies (SPACs) – Part II*, S&P GLOBAL (Mar. 23, 2021) https://www.spglobal.com/en/research-insights/articles/special-purpose-acquisition-companies-spacs-part-ii.
14 *See* Raluca Dinu, *De-SPAC Process – Shareholder Approval, Founder Vote Requirements, and Redemption Offer*, GIGCAPITAL (Dec. 27, 2019) https://www.gigcapitalglobal.com/de-spac-process-shareholder-approval-founder-vote-requirements-and-redemption-offer/.
15 *See* Christopher Barlow et al., *The Year of the SPAC*, SKADDEN, ARPS (Jan. 26, 2021) https://www.skadden.com/insights/publications/2021/01/2021-insights/corporate/the-year-of-the-spac.

solution to replace the cash lost through redemptions in the form of Private Investment in Public Equity (PIPE)[16] Investors. Thus, the original proceeds along with the PIPE money are used to fund the merger as well as the post-merger working capital.

III. PART – II: THE SUDDEN SPAC BOOM - THE GLOBAL CONTEXT

Now that the various stages of a SPAC have been elucidated, it is important to first understand the circumstances that led to a sudden interest in SPACs in 2020 before comparing them to the traditional IPOs.

As a once in a century pandemic quickly engulfed the world at the start of 2020, it marked a watershed moment in history that not only tested the human resolve for social distancing but also fundamentally forced a rethink on how businesses must be run.[17] As survival became the first order of business in the face of the growing severity of the pandemic, by the second half of the year, 'cash preservation'[18] quickly gave way to 'capital raising'[19] for most companies across the world. However, given the initial paralysis of the global private equity funds, which chose to wait and watch how the pandemic unfolded[20], companies turned to the global

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[16] Dimitri Batsev & Jason Katz, *How SPAC Skepticism Has Given PIPE Investors an Edge*, LAZARD ASSET MGMT. (May, 2021) https://www.lazardassetmanagement.com/research-insights/lazard-insights/spac-skepticism-pipe-edge.

[17] *See* Mark John, *Over half Europe's small firms fear for survival, survey finds,* REUTERS (Oct. 22, 2020) https://www.reuters.com/article/uk-europe-economy-smallbusiness-idUKKBN27709T.

[18] *See Cash preservation in response to COVID-19*, MCKINSEY & COMPANY (May 26, 2020) https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/cash-preservation-in-response-to-covid-19#.

[19] *See* Chris Bryant, *Companies Should Grab Cash Now Because a Grim Winter is Coming,* BLOOMBERG (Aug. 13, 2020) https://www.bloomberg.com/opinion/articles/2020-08-13/the-coronavirus-has-made-raising-equity-fashionable-again.

[20] Ewa Skornas & Larisa Whitmore, *The Impact of the COVID-19 Pandemic on the Private Equity Market,* S&P GLOBAL (Sep. 14, 2020) https://www.spglobal.com/marketintelligence/en/news-insights/research/the-impact-of-the-covid19-pandemic-on-the-private-equity-market.

stock markets which, after bottoming out in the first few months, had restarted their climb which was carefully orchestrated by most major central banks which announced rock bottom interest rates along with various forms of quantitative easing.[21] Even then, given the high volatility of the global stock markets in 2020, traditional IPOs, which heavily depend upon underpricing the stock to achieve an 'IPO pop'[22], were deemed too risky given the jittery sentiments of investors in the markets.[23]

Thus, IPOs via Special Purpose Acquisition Vehicles or SPACs, an alternative to the traditional IPOs, surged in popularity in the US due to the confluence of the following factors:

- Under the US regulatory system, the timeline for listing via a SPAC was shorter than that of a traditional IPO.[24]
- Given the nature of a SPAC listing process,[25] companies did not have to resort to an elaborate roadshow for interested investors, unlike the case of a traditional IPO, which saved costs.
- A debatable perception that a SPAC listing would be better immune to volatility when compared to a traditional IPO.[26]

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[21] Press Release, US Federal Reserve, Federal Reserve announces extensive new measures to support the economy (Mar. 23, 2020), https://www.federalreserve.gov/newsevents/pressreleases/monetary20200323b.htm; Larry Elliot, *Bank of England pumps an extra £100bn into UK economy*, THE GUARDIAN (Jun. 18, 2020) https://www.theguardian.com/business/2020/jun/18/bank-of-england-uk-economy-quantitative-easing-coronavirus-crisis; *See* Silvia Amaro, *European Central Bank takes its pandemic bond buying to 1.35 trillion euros to try to prop up economy*, CNBC (June 4, 2020) https://www.cnbc.com/2020/06/04/european-central-bank-ramps-up-its-pandemic-bond-buying-to-1point35-trillion-euros.html.

[22] *Breaking the bubble - Top risks to the SPAC surge,* BAKER MCKENZIE (Apr. 28, 2021) https://www.bakermckenzie.com/en/insight/publications/2021/04/breaking-the-bubble-spac-surge.

[23] Deloitte Financial Reporting Alert, *supra* note 1.

[24] *See* Investor Bulletin, US SEC, *supra* note 5.

[25] *See* ECGI Working Paper, *supra* note 5; *Infra* note 32, at 6.

[26] *See* ECGI Working Paper, *supra* note 5; *Infra* note 32, at 6.

- Private equity funds which were sitting on 'dry powder' till now, quickly jumped on this opening and poured in huge capital into these SPACs[27]

Thus, the allure of an apparently quicker, cheaper and a less volatile listing process quickly took over the US stock market with around 165 global SPAC IPO listings between January and October of 2020, nearly double the number of SPAC IPOs issued in 2019 and five times that of 2015.[28]

IV. PART – III: THE INDIAN TEMPTATION

The sudden spurt in US SPAC listings quickly caught global attention, forcing market regulators across the globe to relook their frameworks for such an alternative.[29] India too jumped on the bandwagon with SEBI forming an expert group under the Primary Market Advisory Committee to explore the potential of an Indian version of SPAC[30] and IFSCA even

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[27] *See* Adam Lewis, *Private equity plays a starring role in 2020's SPAC boom*, PITCHBOOK (Sep. 17, 2020) https://pitchbook.com/news/articles/private-equity-spacs-2020s.

[28] Nessa Anwar, *SPAC listings hit a record high in 2020 — but what are these 'shell companies'?*, CNBC (Nov. 22, 2020) https://www.cnbc.com/2020/11/23/what-are-spacs-2020-saw-record-number-of-shell-companies-listed.html.

[29] *See* FIN. CONDUCT AUTH., INVESTOR PROTECTION MEASURES FOR SPECIAL PURPOSE ACQUISITION COMPANIES: PROPOSED CHANGES TO THE LISTING RULES (CONSULTATION PAPER CP21/10) (Apr. 2021), https://www.fca.org.uk/publication/consultation/cp21-10.pdf [hereinafter FCA Consultation Paper]; *See* SGX, CONSULTATION PAPER ON PROPOSED LISTING FRAMEWORK FOR SPECIAL PURPOSE ACQUISITION COMPANIES, SING. EXCHANGE (Mar. 31, 2021), https://www.sgx.com/regulation/public-consultations/20210331-consultation-paper-proposed-listing-framework-special; *See* Look Gannon, *SPACs – Possible New Gateway to Fundraising in Hong Kong?*, DLA PIPER (May. 10, 2021) https://www.dlapiper.com/en/hongkong/insights/publications/2021/05/spacs-possible-new-gateway-to-fundraising-in-hong-kong/.

[30] TNN, *Sebi, IFSCA look at setup for 'blank cheque companies' in India*, TIMES OF IND. (Mar. 12, 2021) https://timesofindia.indiatimes.com/business/india-business/sebi-ifsca-look-at-setup-for-blank-cheque-cos-in-india/articleshow/81457082.cms.

coming out with a bare bones framework for SPACs meant exclusively for the IFSC GIFT City.[31]

Though the recent pace of SPAC IPOs in US has dramatically cooled down in 2021 as compared to 2020, partly due to the US stock market regulator throwing a monkey wrench in the growth engine of SPACs[32] (elaborated in **Part – IV** of this article), they are being recognized as a viable alternative fund-raising framework from the point of many regulators[33] and companies[34] across the globe.

In spite of the surging global acceptance of SPACs as a viable alternative source of capital, the question that this article seeks to raise and attempt to answer is – *whether SPACs and the Indian capital markets are a match made for each other?*

This question is even more pertinent to raise given the recent unprecedented boom in traditional IPOs that the Indian capital markets has witnessed in 2021,[35] partly led by technology companies such as Zomato, an entity that is yet to turn a profit.[36] This traditional IPO boom

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31 INTERNATIONAL FINANCIAL SERVICES CENTRES AUTHORITY, CONSULTATION PAPER ON THE PROPOSED INTERNATIONAL FINANCIAL SERVICES CENTRES AUTHORITY (ISSUANCE AND LISTING OF SECURITIES) REGULATIONS, 2021 (Mar. 2021) https://ifsca.gov.in/Viewer/ReportandPublication/9.

32 *Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies ("SPACs"),* PUBLIC STATEMENT, US SEC (Apr. 12, 2021) https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs.

33 *Supra* note 13, at 3.

34 *See* Leah Hodgson, *As the US SPAC boom cools, Europe's is just heating up*, PITCHBOOK (May 17, 2021) https://pitchbook.com/news/articles/us-spac-boom-cools-europe-heats-up.

35 *See* M. Sriram, *The coming Indian internet IPO rush—what's at stake, decoded,* MONEYCONTROL (Feb. 19, 2021) https://www.moneycontrol.com/news/business/ipo/decoding-the-upcoming-indian-internet-ipo-boom-6542341.html.

36 Nupur Acharya & Baiju Kalesh, *Zomato, Paytm set to supercharge India's hot IPO market*, ECON. TIMES (July 14, 2021) https://economictimes.indiatimes.com/markets/ipos/fpos/zomato-paytm-set-to-supercharge-indias-hot-ipo-market/articleshow/84402405.cms.

by loss making companies would ideally threaten the perception around SPACs, which generally list to target and acquire these very companies in the technology, media and telecom, (*hereinafter* referred to as "**TMT industry**"), [37] leveraging the fact that they may not generate profits for years to come.

And yet, if, in a hypothetical scenario, these loss making Indian tech start-ups were given a choice between a traditional IPO and an Indian SPAC framework, as on the date of publication of this article, all of them would choose the hypothetical Indian SPAC framework in a heartbeat. This is clearly evidenced by the fact that many of these start-ups went so far as to check the viability of an IPO via a SPAC listing on the US stock exchanges,[38] until the SEC changed accounting policies surrounding SPACs in April, 2020 which ultimately cooled down the US interest in SPACs[39] (elaborated in **Part – IV** of this article).

Based on this Indian fascination to SPACs, one can draw two hypotheses:

- There exists demand for a potential framework for SPACs in India.
- Given the blind fascination surrounding SPACs in India which, when contrasted with the extent of apprehension and caution expressed by US market regulator on the SPAC boom in US,[40] the Indian market regulator would need to first address the chinks in the traditional US

[37] *See* Joseph Williams & Stefen Rasay, *Tech and SPACs: A dance of Wall Street darlings*, S&P GLOBAL (Mar. 16, 2021) https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/tech-and-spacs-a-dance-of-wall-street-darlings-63155224.
[38] *See* Harshit Rakheja, *After Grofers, Flipkart to Explore SPAC Route for Public Listing in US*, INC 42 (Mar. 05, 2021) https://inc42.com/buzz/after-grofers-flipkart-to-explore-spac-route-for-public-listing-in-us/.
[39] *See supra* note 32; *Supra* note 16, at 4.
[40] *See* Melanie Walker et al., *SEC focus on SPACs: Key takeaways from recent SEC statements and enforcement activity*, DLA PIPER (Apr. 28, 2021) https://www.dlapiper.com/en/us/insights/publications/2021/04/sec-focus-on-spacs-key-takeaways-from-recent-sec-statements-and-enforcement-activity/.

SPAC framework before making suitable changes in existing Indian laws for a smooth on-boarding of the Indian SPAC framework.

V. PART – IV: PERCEPTION AND REALITY OF A SPAC VIS-À-VIS A TRADITIONAL IPO

Even though the initial craze surrounding SPACs led many to believe this new alternative to be a superior fund-raising solution than a traditional IPO, new research has showed that there exist many previously unrecognized risks attached to SPACs including hidden costs of dilution due to redemptions and exercise of warrants,[41] which are subtle, opaque, and higher than has been previously understood.

A recent working paper Series by ECGI on SPACs (*hereinafter* referred to as '**the ECGI Paper**') has highlighted various flaws to the theory that SPACs are generally a better alternative to traditional IPOs. Generally, the advantages of SPACs over traditional IPOs discussed can be summed up as below:

- SPACs unlike traditional IPOs, do not under-price the public issue and hence offer better value for companies.[42]
- SPACs offer better certainty in relation to pricing the issue and are faster than traditional IPOs.[43]
- SPACs are essentially - a poor man's private equity,[44] i.e. anyone can bet on the skills of the sponsor/management in identifying attractive target companies and profit off of them.

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[41] *See* ECGI Working Paper, *supra* note 5; *Supra* note 32.
[42] *See* Katie Roof, *What is an IPO pop and why do VCs hate it so much?*, TECHCRUNCH (Nov. 20, 2017) https://tcrn.ch/3mcPsir.
[43] *A Surge of SPACs in a Turbulent Economic Climate*, BAKER BOTTS (July 27, 2020) https://www.bakerbotts.com/thought-leadership/publications/2020/july/a-surge-of-spacs-in-a-turbulent-economic-climate.
[44] *See* Shuli Ren, *Why SPACs Are So Popular: They're the 'Poor Man's Private Equity Funds'*, BLOOMBERG (Mar. 02, 2021) https://www.bloomberg.com/news/articles/2021-03-02/why-spacs-are-so-popular-they-re-the-poor-man-s-private-equity-funds.

The ECGI Paper,[45] on studying 47 US SPAC mergers between January 2019 and June 2020, found that although the median SPACs raised $10 per share from investors in their IPOs, by the time the median SPAC merged with its target, it held just $6.67 in cash for each outstanding share, which means less working capital for the target company than anticipated, which would also mean underperformance of the stock in the market.

A. Equity Dilution to Invested IPO investors – Redemptions & Exercise of warrants

The study found that the degree of stock market under performance was directly proportional to the dilution in the SPAC equity caused by the redemptions by IPO investors as well as exercise of warrants.

The study even found that by allowing redemptions even for investors who voted for acquiring a target, the redeeming investors gained an edge over the ones that continued to stay invested in the SPAC. This was largely because the redeeming investors still had a right to exercise their share warrants even after redeeming their shares thereby putting the invested shareholders at a disadvantage as the continuing investors' equity would be diluted both by the PIPE investors filling in for redemption as well as the share warrants exercised by investors who redeemed their shares.

B. Sponsor's Promote & Investment – Potential Conflicts of Interest

The Sponsor promote creates a divergence of interests between the sponsor and the IPO investors as the sponsor still ends up winning if the terms of the merger are unfavourable to the SPAC investors. If the SPAC gets undervalued in a merger, the post-merger shares correspondingly

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[45] *See* ECGI Working Paper, *supra* note 5; *Supra* note 32, at 6.

decline in value, due to the presence of promote. As a result, if the sponsor has failed to secure a merger near the end of a two year SPAC term, the sponsor is more motivated to propose a weaker deal for SPAC investors if its alternative is to liquidate.[46]

Furthermore, sponsors acquire a certain chunk of units at the IPO, apart from their promoters. As the proceeds of the SPAC IPO are also used to cover various expenses such as underwriting fees. If the SPAC is unable to find a target then all investments which were used for covering various expenses may be lost and thus, propel the Sponsor to merge with a target at weaker terms.

C. UNDERWRITING FEES – THE HIDDEN COSTS

SPAC underwriting fees in US are typically between 5% and 5.5% of IPO proceeds, which is slightly less than typical fees in a traditional IPO of comparable size.[47] Of that amount, about 3.5% of proceeds is typically conditioned on the SPAC consummating a merger, and payment is deferred until the merger is consummated.[48] However, underwriting fee is rarely adjusted in tune with the amount of redemptions, at the time of the merger. Thus, if the redemptions are high and even with PIPE investors, the final pool is smaller than the original pool, then the underwriting fees in terms of percentage shoots up.

D. FORWARD LOOKING STATEMENTS – SAFE HARBOUR & ASYMMETRY OF INFORMATION

Though there exist some inherent advantages for US SPACs when compared to a traditional IPO such as SPACs can avail themselves safe harbour against forward looking statements made to PIPE investors,

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[46] *See* ECGI Working Paper, *supra* note 5; *Supra* note 32, at 6.

[47] *Considering an IPO? First, understand the costs*, PRICEWATERHOUSECOOPERS, https://www.pwc.com/us/en/services/deals/library/cost-of-an-ipo.html#:~:text=Underwriting%20makes%20up%20the%20largest,directly%20attributable%20to%20the%20IPO (last visited Oct. 23, 2021).

[48] *See* ECGI Working Paper, *supra* note 5; *Supra* note 32, at 6.

traditional IPOs do not enjoy such luxury. Thus, these SPACs are more suitable to new age technology companies that may not have turned profitable yet.

However, as PIPE investment is nothing but a private placement, for which SPACs issue a private placement memorandum to PIPE investors, PIPE investors have traditionally more information and data as compared to original IPO investors.[49]

E. MYTH – SPAC POOR MAN'S PRIVATE EQUITY. REALITY - SPAC MAFIA HAVE THE CAKE AND EAT IT TOO

With respect to SPAC being a poor man's private equity, the study found that SPACs were dominated by large institutional investors as compared to retail investors. Due to the opportunity afforded by redemptions, a SPACs' investors some times change from the moment of an IPO to the time it reaches a merger deal. Thus, a SPAC awards IPO investors generously to get the SPAC up and running as a public company so that later investors can later buy shares once a target has been selected to bring public.[50]

The fact that units of SPAC split and trade separate post IPO means that if one were to redeem one's shares post IPO but keep the warrants, then these are essentially risk free investments. Thus, theoretically, fixed income investors such as hedge funds could sell the warrants to generate coupon like payments and when required redeem their investment and also earn the interest reward.

Thus, later investors (such as PIPE investors) also bear the costs of such generous deal given to IPO-stage investors, and thus, arm twist the sponsor into giving them better terms for the deal, and the sponsors in

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[49] *See supra* note 16; *Supra* note 40, at 7.
[50] *See* ECGI Working Paper, *supra* note 5; *Supra* note 32, at 6.

turn offer side payments in exchange for a commitment from PIPE investors to not redeem their shares.[51]

Thus, the retail investor is in fact the biggest loser out of this deal as the 'Redeemers' and the 'PIPErs' always getting the better deal.

F. US SPAC WARRANTS AS PER FASB ACCOUNTING STANDARDS - EQUITY INSTRUMENT OR A FINANCIAL LIABILITY?

Another issue with respect to SPAC specific to the US is the recent clarification by SEC[52] regarding the classification of SPAC warrants as liability instead of equity, owing to the unique features of US SPAC warrants.[53]

This sudden clarification resulted in a chilling effect for all SPACs looking to list in the US[54] as the reclassification of warrants as liability instead of equity meant that any change in the fair market values in these warrants at a later stage would be recorded as income/loss in the companies' Profit & Loss Statement, meaning their earnings would be affected by their stock volatility in the market.

In fact, many Indian start-ups which were looking to list in the US via a SPAC gave up on the idea post the SEC reclassification of warrants because for Indian start-ups which sought to justify their sky high valuations via a US listing, controlling market perception in a foreign jurisdiction all the while slaving to turn profitable would have been asking too much!

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[51] *See* ECGI Working Paper, *supra* note 5; *Supra* note 32, at 6.
[52] *See supra* note 32; *Supra* note 16, at 4.
[53] *See* Matt Smith & Petar Tomov, *Providing Clarity Around SEC Statement on SPAC Warrant Accounting*, JDSUPRA (June 15, 2021) https://www.jdsupra.com/legalnews/providing-clarity-around-sec-statement-6697811/.
[54] *See* Pat Malo, *SPAC Deals Slow Dramatically After Move by SEC*, L.A. BUS. J. (June 21, 2021) https://labusinessjournal.com/news/2021/jun/21/spac-deals-slow-dramatically-sec-changes/.

VI. PART – V: AN INDIAN SPAC FRAMEWORK - REGULATORY AND GOVERNANCE CHALLENGES

This part will first highlight the existing legal and regulatory hurdles facing a potential Indian SPAC framework followed by identifying few governance challenges stemming from the nature of SPAC structures, including ones that would be unique to Indian capital markets and suggest workarounds for such issues.

A. REGULATORY HURDLES

The existing regulatory framework governing all Indian companies is the Companies Act, 2013 with SEBI regulating the process of listing on the stock exchanges by way of SEBI ICDR Regulations, 2018 as well as their continuous listing obligations by way of SEBI LODR Regulations, 2015. Apart from the above legislations, the other legislations most relevant when viewed from a potential Indian SPAC framework are the Income Tax Act, 1961 and Foreign Exchange regulations.

It is important to note that any change in the regulatory landscape concerning SPACs would require at least three regulatory/ nodal bodies, i.e. RBI, SEBI as well as the Ministry of Corporate Affairs to closely work together to amend the Foreign Exchange Regulations, the relevant SEBI regulations as well as the Companies Act, 2013 respectively. This tough ask, in itself, would be a big hurdle for any change in the regulatory landscape, as currently, SEBI is the only regulatory body that has taken an initiative to study a potential framework in this regard.

B. COMPANIES ACT & SEBI REGULATIONS

1. SPAC: A Shell Company

The first regulatory hurdle concerning SPACs in India is that the Registrar of Companies (RoC) is empowered to strike-off a company which doesn't start operations within 1 year of being incorporated.[55] This is in stark contrast to the very nature of SPACs which list as shell companies and usually take upto 2 years to find a target to merge with.

Though the Companies (Removal of Name of Companies from the Register of Companies) Rules, 2016[56] precludes such listed entities from being removed, given the fact that SEBI ICDR regulations[57] require a company to have net tangible assets of at least ₹ 3 Cr., average operating profits of ₹ 15 Cr. and net worth of a minimum ₹ 1 Cr.; in each of the three preceding years, this leads to a catch-22 situation as the SEBI thresholds mandate a record of at least 3 years prior to listing on the Main Board of the IPO while, the Companies Act only exempts listed entities from the wrath of a potential strike off from the RoC.

The SEBI ICDR, however, provides a framework for listing of companies that cannot fulfil a minimum three-year history requirement, by mandating that a minimum 75% of the offer be issued to Qualified Institutional Buyers (*hereinafter* referred to as "**QIBs**").

2. Objects Clause of a SPAC

Furthermore, with respect to the Objects Clause, since the Companies Act[58] has done away with the provision of Other Objects, a SPAC would have to mandatorily specify its objects in its Memorandum of Association which could be cumbersome for SPACs.

The main object of a SPAC at its IPO stage is acquiring a target to merge with. However, post the merger, a SPAC adopts the objects of a target company. Furthermore, any amendment to the Memorandum or any change in name of the Company would require the approval of the

[55] Companies Act, No. 18 of 2013, §248(1) (Ind.).
[56] Companies (Removal of Name of Companies from the Register of Companies) Rules, 2016, Gazette of India, pt. II sec.3(i), Rule 3 (Dec. 26, 2016).
[57] Securities and Exchange Board of India (Issue of Capital & Disclosure Requirements) Regulations, 2018, Gazette of India, pt. III sec. 4, Reg. 6 (Sep. 11, 2018).
[58] Companies Act, No. 18 of 2013, §4(1)(c) (Ind.).

shareholders as well as Central Government approval,[59] which would further lengthen the process of merger. This may not be ideal for a SPAC which would most likely have a narrow frame of time for any potential merger.

C. TAXATION & FOREIGN EXCHANGE REGULATIONS – APPROVALS GALORE!

While a cross border outbound merger with a Foreign SPAC (where the resultant Company is a foreign entity) would not only be not tax neutral (such capital gains tax would be levied at the hands of the Indian shareholders), the whole transaction would only proceed post the approval of the NCLT,[60] and also attract relevant Foreign Exchange laws and thus, require RBI approval as well, thereby lengthening the process as well as time taken for such approval.

In case of an acquisition of an Indian target company via transfer of shares instead of a scheme of merger, Indian shareholders holding the target's shares would be subject to RBI's Liberalized Remittance Scheme which only allows a remittance of upto $ 250,000 per financial year,[61] thus creating a potential bottleneck for any big ticket Indian shareholders.

In case of cross border mergers, the Company would need to meet the set RBI criteria with respect to operations through proper branch offices.[62]

Lastly, a typical NCLT approval for a scheme of merger usually takes a minimum of 6 months and can sometimes even extend to more than a year depending upon representations made by various stakeholders

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[59] *Id.,* §14.
[60] *Id.*, §234.
[61] RES. BANK IND., LIBERALISED REMITTANCE SCHEME, FREQUENTLY ASKED QUESTIONS (Feb. 13, 2019), https://m.rbi.org.in/scripts/FAQView.aspx?Id=115.
[62] Foreign Exchange Management (Cross Border Merger) Regulations, 2018, FEMA.389/2018-RB, Reg. 4(2) and Reg. 5 (3) (Mar. 20, 2018).

including Income tax authorities, Registrar of Companies, etc., i.e. almost half of the shelf life of a SPAC. This duration may increase substantially in case of cross border mergers. Thus, a fast track merger approval process specifically tailored for SPACs would also need to be created.

1. SPACs under the International Financial Services Centre Framework

The IFSCA (International Financial Services Centres Authority), a unified regulatory body with exclusive authority to regulate India's first and only IFSC, a special economic zone that largely caters to cross border transactions between international as well as domestic customers, has recently notified the IFSCA (Issuance and Listing of Securities) Regulations, 2021,[63] wherein a SPAC (a specified IFSC private company) would be eligible to raise capital through an IPO of specified securities worth a minimum $ 50 million on recognized stock exchanges in IFSC Gift City with the sponsor holding a minimum 20% of post issue paid up capital and which would be required to acquire a target for merger within 3 years of listing (extendable upto 1 year).

However, even with the unique nature of the IFSC (due to its *de jure* 'offshore status'), which boasts of applicability of foreign exchange control regulations to such listed entities on par with any other listed entity located in other foreign jurisdictions, restricted applicability of the Companies Act[64] and a securities law governed by IFSCA instead of SEBI,[65] the author is of the view that it will be a while before companies actually list a SPAC at IFSC as it is still new territory for all stakeholders. Even if SPAC listings do happen in the near term, they would be limited

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[63] International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021, Gazette of India, pt. III sec. 4 (July 19, 2021).

[64] MINISTRY OF CORP. AFFAIRS, NOTIFICATION G.S.R. 08(E), Gazette of India, pt. II sec. 3(i) (Jan. 4, 2017), https://www.mca.gov.in/bin/ebook/dms/getdocument?doc=NzY0OQ==&docCategory=Notifications&type=open.

[65] International Financial Services Centres Authority Act, No. 50 of 2019, § 13 (Ind.).

in number, as only those issuers who intend to seek out foreign investors or foreign entities for merger would prefer an IFSC listing.

Moreover, the author is of the opinion that mandating a 15 - 20% sponsor capital[66] in the abovementioned IFSC Regulations itself may not be in the best interests of all stakeholders (elaborated in Part – VI of the article). The Regulations also appear silent on any potential offer of share warrants along with shares at the time of IPOs and their subsequent treatment under the framework. Thus, the author is of the opinion that the major shortcomings of the IFSC Regulations appear similar to the US SPAC framework.

VII. PART – VI: THE WAY FORWARD - CORPORATE GOVERNANCE CHALLENGES & POTENTIAL WORKAROUNDS

While the author is quite confident that any draft framework for SPACs in India by SEBI would in any way seek to highlight and solve the above mentioned regulatory hurdles as many of the above hurdles are known issues in the capital markets sphere in India – it would be the governance challenges that would take centre stage as the common SPAC problems would metamorphose to issues unique to Indian markets, given that the Indian business environment is fundamentally different from other advanced economies.

A. THE MAIN CHALLENGE - AVOIDING A PROBLEM OF PLENTY

If the rapid US boom in SPACs followed by a sudden SEC mandated cool down – has taught us anything, the listing of too many SPACs at a time can lead to high pressure and competition to identify and acquire

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[66] *See* International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021, Gazette of India, pt. III sec. 4 (July 19, 2021), Reg. 75.

target companies[67], which may not always lead to the best results for SPAC shareholders. As per Wall Street Journal, there are about 260 SPAC companies with $87 billion on hand that face merger deadlines in the first three months of 2023.[68]

A solution to check the problem of plenty can be via two methods which both focus on one key player, i.e., the sponsor.

The first method would be to prescribe a minimum limit on the size of a SPAC IPO, as envisaged by the UK regulator, which mandated a minimum IPO size of 200 million pounds in its recently released consultation paper on SPACs, so that only quality SPAC sponsors set up IPOs.[69]

The second would be via mandating minimum sponsor related requirements.

B. SPONSOR CREDIBILITY REQUIREMENTS - ESPECIALLY IN A PROMOTER DRIVEN INDIAN ECONOMY

It has been observed that the success of SPAC IPOs boils down to the experience and expertise of sponsors[70]. Thus, stringent thresholds surrounding the credibility, experience, capability and track record[71] of sponsors ought to be put in place. This takes much more precedence in

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67 *See* Richard Henderson, *Glut of Spac issuance makes hunt for deals more competitive*, FIN. TIMES (Oct. 17, 2020) https://www.ft.com/content/3258285a-00c2-445e-a318-3e760c298698.

68 Amrith Ramkumar, *SPAC Pullback Pressures Creators to Find Quality Mergers,* WALL STREET J. (June 1, 2021) https://on.wsj.com/3pF28ko.

69 *See* FCA Consultation Paper, *supra* note 29; *Supra* note 13, at 3.

70 *See* Yun Li, *For SPACs, one factor seems to determine investing winners from losers*, CNBC (Jul 12, 2021) https://www.cnbc.com/2021/07/12/for-spacs-one-characteristic-seems-to-determine-the-investing-winners-from-losers.html.

71 Rule 102.06, Minimum Numerical Standards - Acquisition Companies, NEW YORK STOCK EXCHANGE RULES, https://nyseguide.srorules.com/listed-company-manual/document?treeNodeId=csh-da-filter!WKUS-TAL-DOCS-PHC-%7B0588BF4A-D3B5-4B91-94EA-BE9F17057DF0%7D--WKUS_TAL_5667%23teid-10 (last visited Oct. 23, 2021).

the Indian scenario where most businesses are promoter driven, unlike in US where most businesses are professionally managed. The mere experience of being a promoter of a listed entity may not suffice as many promoter-driven listed entities in India have a poor track record when it comes to corporate governance practices.

C. SPONSOR'S PROMOTE – LINKED TO THE PERFORMANCE OF THE SPAC POST IPO

As stated earlier, the author is against the idea of a mandated minimum threshold of 20% promote for Sponsors as this may result in conflict-of-interest issues whereby Sponsors would be tempted to take weaker deals for mergers via SPAC as deadlines for SPAC acquisition near.

One way to incentivize Sponsors all the while protecting minority shareholder interest would be having conditional Promotes which would be locked in for a couple of years and can only be exercisable when their investments are 10-20% out of the money. A classic example to look upto in this regard would be the US SPAC deal surrounding the Pershing Square Tontine Holdings[72] which invested $ 65 Million in exchange for warrants that were 20% out of the money and without any sponsor promote. Thus, their investments would only receive a positive return only if the company would perform up to expectations.

D. DILUTION DUE TO REDEMPTION – LEVELLING THE PLAYING FIELD

Another concern would be the dilutive effect of redemption by shareholders post IPO but prior to the acquisition of the target. One possible workaround would be to reward the warrants of the redeeming

[72] *See* ECGI Working Paper, *supra* note 5; *Supra* note 32, at 6.

investors to non-redeeming investors, as envisaged by the Pershing Square Tontine Holdings SPAC,[73] thereby levelling the playing field.

Another option would be to cancel the warrants of redeeming shareholders, so as to safeguard dilution from such exercise later on.

E. RING-FENCING THE PROCEEDS FOR ACQUISITION AND REDEMPTION

In order to protect the interests of the minority shareholders, one can envisage a system wherein redemption would only be allowed post a successful shareholder approval for a prospective target and since, in a successful approval, the maximum percentage of dissenting shareholders would be 25%, such equity amounting to 25% of the overall equity can be ring fenced for the purposes of redemption and separate from the proceeds needed for the acquisition.

F. FORWARD LOOKING STATEMENTS - SAFE HARBOUR

While SEBI ICDR clearly states that there can be no forward-looking statements that cannot be substantiated (largely in line with US rules pertaining to IPOs), the very reason why most technology companies look to SPACs for an IPO is that in US, such SPACs that provide a forward-looking statement enjoy safe harbour, which becomes very vital for a technology company that is yet to turn profitable. This feature of the US SPAC framework is what made it popular for technology start-ups in the first place. Thus, the author is of the view that the regulator must take a view on this issue only post extensive consultation with the market participants and the industry at large as this issue may very well decide the degree of a potential success or failure of an Indian SPAC framework in the near term.

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[73] *Supra* note 32.