SPACs: A ReNew-ed Interest in US Listings

In 2020, over $80 billion was raised in the US from more than 200 SPACs (special purpose acquisition companies), with SPAC IPOs comprising over 50% of first equity offerings in that country.

With the number of SPAC IPOs in the US in 2020 being five times that in 2019 and 7.5 times the figure in 2017, the SPAC route has evolved from an alternative to a mainstream listing route having big-ticket sponsors/investors.

Prior to the ReNew Power transaction announced last week, very few Indian companies have successfully opted for the SPAC route to list in the US.

Briefly, a SPAC is a shell (or blank cheque) company, which raises capital in an IPO to acquire unspecified businesses or assets through a business combination such as a merger. IPO proceeds are held in a trust account to fund the acquisition and/or redeem shares sold in the offering.

After a target is identified and the acquisition agreement signed, the proposed acquisition will require approval of SPAC investors; investors who do not approve are given the option to redeem their SPAC shares.

Upon completion of the acquisition/business combination, referred to as the de-SPAC transaction, private businesses are taken public.

The SPAC typically raises additional funds [e.g., through the PIPE (private investment in public equity) route] in advance of an acquisition to address the risk of reduction in available funds caused by investor exits/redemption.

If an acquisition cannot be completed within specified timelines following the IPO (typically, 18-24 months), the SPAC is required to liquidate and return funds to investors.

A SPAC has no operating history and its target industry sectors may or may not be disclosed – its prospects are therefore tied to the credibility of its sponsors.

Advantages of the SPAC route to listing versus a direct US listing are many. One, there is a faster timeline to listing in the US with no requirement for a lengthy book-building process or intensive marketing.

Two, higher certainty prevails with regard to availability of funds in volatile markets (which has been of particular relevance during the pandemic).

Three, there is flexibility in deal pricing, deferred exits, earn-outs and other deal-specific mechanisms in the business combination agreement.

And, four, particularly for technology and ESG companies, there is the advantage of access to an offshore exchange and sophisticated investors that have a good understanding of the relevant sectors.

A SPAC cannot identify acquisition targets prior to IPO closing since any such identification would necessitate disclosure to the US Securities and Exchange Commission (SEC) in respect of the target, at which point the process would become similar to an operating company IPO.

For example, IPO filings made by RMG Acquisition Corporation II (the SPAC in the ReNew transaction) stated that no target had been selected and no substantive discussions had been initiated, directly or indirectly, with any target.

Therefore, the SPAC needs to identify and negotiate with a target, satisfy all conditions precedent, including regulatory approvals and financing, and close the acquisition within the specified timeline (typically 18-24 months).

While Indian laws have been amended to facilitate cross-border mergers, regulatory and taxation challenges restrict the ability of the parties to efficiently merge an Indian company with the SPAC.

For example, cross-border merger regulations require a couple of factors in respect of outbound mergers.

One, approval of the National Company Law Tribunal (NCLT) is needed – this process will involve review of the merger by all applicable Indian regulators, and given the novelty of, and lack of jurisprudence around, cross-border mergers, there can be no assurance that NCLT approval for a merger of an operating company with an offshore shell firm will be received in a timely manner or at all.

Two, market value of the offshore shares to be acquired by resident Indian individuals must comply with limitations prescribed under Indian exchange control regulations (relatively low cap of $250,000 per year).

And, three, Indian offices of the Indian merging company must function as branch offices of the foreign company, which, given the limited scope of permitted activities for branch offices, is likely to hinder Indian operations.

The SPAC route is therefore most suited for Indian firms that have a foreign holding company, that is, Indian firms that have externalised in a jurisdiction that permits cross-border mergers.

In order to complete a de-SPAC transaction within the 18-24 months typically available to a SPAC, the parties' objectives could be met through limited externalisation and careful structuring, as was done in the ReNew transaction.

Subject to Indian exchange control regulations, shareholders of the Indian company could swap their Indian shares for shares of the offshore resulting entity (at the closing or at a later stage), enter into sale/purchase transactions with the offshore resulting entity in respect of their Indian shares for cash and/or negotiate a deferred exit from the Indian company through option arrangements.

Challenges for resident Indian shareholders include limitations on the amount that can be invested by them to acquire offshore company shares ($250,000 per year in case of resident individuals) and a potential requirement for prior regulatory approval to invest in an offshore SPV that will in turn have an investment in India.

Any sale of Indian shares by resident Indians to the offshore resulting entity for cash will be subject to pricing guidelines (floor price equal to fair value) and other Indian exchange control regulations.

Resident Indian founders/shareholders could also be issued a different class of shares in the offshore resulting entity, which gives them rights and benefits at that level commensurate with their residual shareholding at the Indian level.

Non-resident (that is, foreign) investors in Indian companies will be subject to lesser limitations under Indian exchange control regulations than those mentioned above, and will therefore have greater flexibility.

Irrespective of whether an Indian company has externalised, the Indian government's April 2020 amendment to foreign investment regulations will restrict transfer of beneficial ownership of the Indian company to investors from China (and other restricted countries) upon completion of the de-SPAC transaction.

SPAC investors will therefore need to be reviewed to ensure that prior government approval is not required for the de-SPAC transaction (the regulations currently do not specify a threshold for determining beneficial ownership).

There are likely to be delays in consideration of applications for investments from China, and there can be no assurance that government approval will be received within SPAC acquisition timelines.

In addition, anti-trust approval requirements will need to be assessed (e.g., this is a condition precedent to the ReNew transaction). While SPACs typically target private businesses, in case an Indian target is listed in India, any indirect change in control of the Indian target will trigger an open offer in India, which will add to transaction timelines and costs.

Apart from the regulatory and taxation challenges involved in a US listing through the SPAC route, Indian companies should also be prepared for several matters.

First is regarding requirements applicable to publicly traded companies in the US, including from a governance, internal controls, accounting and disclosure perspective.

For example, the de-SPAC transaction will require the SPAC to file a proxy statement or tender offer materials with the SEC, which include historical audited financial statements of the target company (audited under the American Institute of Certified Public Accountants (AICPA) rules), unaudited interim financial statements, pro forma financial statements and MD&A disclosures.

Further, shortly after completion of the de-SPAC transaction, historical financial statements of the target company, audited under the more stringent Public Company Accounting Oversight Board (PCAOB) rules, are required to be filed with the SEC, and PCAOB rules continue to apply going forward.

The second matter is that while marketing similar to traditional IPOs may not be required, Indian companies will need to be prepared to secure supplementary funding to mitigate the risk posed by investor redemptions.

Studies by Stanford and NYU professors indicate that mean and median redemptions for SPACs that merged between January 2019 and June 2020 were 58% and 73%, respectively, and a Goldman Sachs report indicates that most SPAC acquisitions completed in 2020 utilised supplemental equity financings through PIPEs or private placements.

Third, financial projections shared for purposes of securing supplemental equity financings, if any, may need to be made public following the de-SPAC transaction as a cleansing measure from an insider trading perspective.

Fourth, shareholders of the Indian target may be subject to contractual lock-ups – e.g., the founder and certain key executives of ReNew India are subject to a one-year lock-up. And, fifth, ESOP plans (and any roll-over or replacement) will need to be considered and structured.

Currently, an Indian company needs to first list its shares in India, and thereafter it can list offshore through depositary receipts. In May 2020, the Indian government permitted Indian companies to list their shares directly on offshore stock exchanges; however, this regime is yet to be operationalised.

Several Indian technology companies have plans to go public – they will need to consider the costs and benefits of accessing the US market through the SPAC route versus a direct listing.

It remains to be seen how many will opt for the SPAC route, which has increasingly emerged as an attractive option for companies around the world particularly in the technology and ESG sectors, and as demonstrated by the ReNew transaction, could be feasible for Indian companies despite challenges in the Indian legal and taxation environment.

In the meanwhile, the SPAC alternative could also well be explored by Indian regulators as a route for listing in India with appropriate safeguards.

*This insight has been authored by **Rajat Sethi** (Partner) and **Tanya Aggarwal** (Partner). They can be reached on rsethi@snrlaw.in and taggarwal@snrlaw.in for any questions.* *It was first published by VCCircle. This insight is intended only as a general discussion of issues and is not intended for any solicitation of work. It should not be regarded as legal advice and no legal or business decision should be based on its content.*

S&R ASSOCIATES ADVOCATES

NEW DELHI
64 Okhla Industrial Estate
Phase III
New Delhi 110 020
Tel: +91 11 4069 8000

MUMBAI
One Indiabulls Centre, 1403 Tower 2 B
841 Senapati Bapat Marg, Lower Parel
Mumbai 400 013
Tel: +91 22 4302 8000