Special Purpose Acquisition Companies (SPACs)

For Prelims: SPACs, Company Law Committee 2022, IPO, Shell Companies, Escrow Account, SEBI.

For Mains: Significance of the SPACs and ways to address the concerns.

Why in News?

Considering the recent recommendations of the **Company Law Committee 2022,** the government is looking at putting in place a **regulatory framework for Special Purpose Acquisition Companies (SPAC)** in the statutes to aid the possible listing of Indian companies in the country through this route.

- The Company Law Committee was **set up in 2019 to make recommendations** to boost **ease of doing business** in India.

What are SPACs?

- A **Special Purpose Acquisition Company (SPAC)** is a **corporation formed for the sole purpose of raising investment capital through an** Initial Public Offering (IPO).
    - At the time of their IPOs, SPACs have no existing business operations or even stated targets for acquisition.
- Such a business structure allows investors to contribute money towards a fund, which is then used to acquire one or more unspecified businesses to be identified after the IPO.
    - Therefore, this sort of shell firm structure is often called **a "blank-check company"** in popular media.
- Once the money is **raised from the public**, it is kept in an escrow account, which can be accessed while making the acquisition.
    - If the **acquisition is not made within two years of the IPO**, the SPAC is delisted and the money is returned to the investors.

What were the Recommendations of the Company Law Committee 2022?

- It recommends introducing an **enabling framework to recognise SPACs** under the Companies Act, 2013 and allow entrepreneurs to list a SPAC incorporated in India on domestic and global exchanges.
- In order to **align SPACs with the existing scheme of the Act,** the Committee has also recommended that an **exit option should be provided to shareholders** that do not agree with the choice of the target company.
- Further, it also **underscores the need to suitably modify provisions relating to striking off companies** in their application to SPACs, since they do not have any operating business of their own.

What is the Significance of the SPACs?

- **Cost Efficient:**
  - A company can go public within months if it merges or is acquired by a SPAC.
  - SPACs particularly position investors as unique opportunities to niche Indian businesses that intend **to get listed on foreign stock exchanges,** without incurring the mammoth costs associated with the process.
    - For instance, the recent listing of Renew Power Private Limited, an Indian renewable energy company, on NASDAQ (an American Stock Market) through an internationally incorporated SPAC in August 2021, speaks to the popularity of SPACs.
- **Minimize Risk and Assure Security:**
  - Listing through SPACs is considered remarkable since the entire process takes place pursuant to a **definitive agreement, with minimum risk and assured certainty.**
- **Provide Safeguard to Dissenting Shareholders:**
  - It also **safeguards the interests of the dissenting SPAC shareholders** as those that vote against the proposed acquisition are allowed to exit by selling their shares to the SPAC promotors.
- **Attractive to Investors:**
  - These are **attractive to investors**, despite them essentially being **shell companies**, as the blank-cheque companies are people sponsoring.
- **Opportunity for Exposure to Countries and Consumer Bases:**
  - For certain businesses, SPACs also **provide an opportunity for exposure to countries and consumer bases** where demand for such niche products exist, consequently allowing such companies to attain higher valuation.

Shell Companies

- A shell company is a **firm that does not conduct any operations in the economy**, but it is formally registered, incorporated, or legally organized in the economy.
- These are **sometimes used illegitimately**, such as to disguise business ownership from law enforcement or the public.

Initial Public Offering

- IPO is the **selling of securities to the public** in the primary market.
  - Primary market **deals with new securities** being issued for the first time. It is also known as the new issues market.
  - It is **different from the Secondary market** where existing securities are bought and sold. It is **also known as the** stock market or stock exchange.
- It is when an unlisted company makes either a fresh issue of securities or an offer for sale of its existing securities or both for the first time to the public.
  - Unlisted companies are companies that are not listed on the stock exchange.

Escrow Account

- It is a legal concept describing a financial instrument whereby an asset or escrow money is held by a third party on behalf of two other parties that are in the process of completing a transaction.
- The third-party holds the funds until both parties have fulfilled their contractual requirements.
- Escrow is associated with real estate transactions, but it can apply to any situation where funds will pass from one party to another.

What are the Concerns related to SPACs?

- **Can limit the returns for the Retail Investors:**

        - The boom in investor firms going for SPACs and then looking for target companies have tilted the scales in favour of investee firms. This has the potential, theoretically, to limit returns for retail (individual) investors post-merger.
- **Not Every SPACs are able to Attract Targets:**
    - Because the SPACs are **required to begin seeking a target entity after listing**, and the overall transaction is expected to be completed within a strict timeline, many **SPACs are scrambling to find appealing target businesses.**
- **Deal could result in Hasty Decision:**
    - The time-bound hunt – SPACs exist for two years – **for an attractive deal could result in hasty decisions,** thereby inducing dissenting shareholders to exit and reducing overall gains for investors.
- **Disappointing Results could Initiate Investigations:**
    - In multiple cases, **disappointing results have caused shareholders to commence class action suits and initiate investigations** against SPAC sponsors in the US.
        - The U.S. Securities and Exchange Commission has noted the need for more disclosures to investors and called for greater protection against fraud and conflict of interest.

Way Forward

- **India Should Reap the Benefits of SPACs:**
    - For India, it is to **tread SPACs with cautious optimism and greater regulatory oversight,** given that instances of underwhelming performances by SPACs have slowly begun to surface.
    - In order to strengthen the regulatory framework governing them and mitigate accompanying risks, it is **necessary to extend statutory recognition to such companies** and employ sophisticated safeguards to protect the interests of investors.
- **SPACs should also be allowed for Global Exchanges:**
    - It is essential that **SPACs incorporated in India should be allowed to list not only on domestic stock exchanges, but also on global exchanges**, to enable target companies to ride the SPACs wave and achieve their fullest possible potential.
- **Need to Analyse the Issues Related to SPACs:**
    - While **recognising SPACs within the contours of the Companies Act is a welcome step,** it may still require a more sophisticated analysis of SPAC-related issues based on prevailing market practices, in consultation with **Securities and Exchange Board of India (SEBI).**
        - Additionally, the foreign listing of Indian incorporated SPACs **can only be achieved after the commencement of Section 23(3) and Section 23(4) of the Companies Act,** which enables certain classes of companies to list their securities on stock exchanges in permissible foreign jurisdictions.

Source: IE