# LEGAL INTROSPECTION TOWARDS RECOGNIZING THE GOVERNING SPACS REGIME IN INDIA

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***Abstract***
*This study looked into the boom in acclaim of Special Purpose Acquisition Companies, especially in India, as well as the causes for this rise, as well as their concerns and offered remedies. In this paper, the author has highlighted the characteristics of SPACs and the operating environment which helped them bloom in the market al on with the benefits. Author has also highlighted the concerns related to operation of SPACs in India due to certain provioons of Indian Laws. However, at the end of the paper author has proposed the solutions to address the concern with the analysis.*

***Keywords*** *- Special Purpose Acquisition Companies, Legal dimensions, market benefits, challenges.*

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## INTRODUCTION

### 1. SPACs-AN INTRODUCTION

Special purpose acquisition companies ("SPACs") were in existence since a long time, but the year 2021 will be remembered as a watershed moment, with global SPAC IPO profits topping USD 100 billion. Through a SPAC listing, Renew Power, India's largest renewable energy provider, began trading on NASDAQ. The deal drew a lot of attention for a number of reasons, including its enormous valuation, which highlighted the sector's serious problems while also making it a particularly liquid investment because to NASDAQ's larger investor base.

In addition, for a long time, the traditional technique of obtaining money through an initial public offering (IPO) has been the best way for the established firms who wanted to generate funds and create liquidity. The IPO, on the other hand, has its disadvantages, particularly for newer businesses with substantial future growth potential but no track record of current profitability. This has created a hole that has been filled for decades by Private Equity investors, Venture Capital Funds, and Angel Investors. During the early years of these new age creative enterprises, when they could enjoy all these benefits alone for a very low price, a regular guy could not be a part of them.

The notion of Special Purpose Acquisition Companies ('SPACs') was born to address this void. They have created a win-win situation for both businesses who are having difficulty becoming listed and the general public who could not invest in startups having exponential potential of growth. As a result, corporations from all industries are increasingly chose the option of mergers with the SPACs instead of a traditional IPO route to raise public funding for corporate growth and expansion. Many corporations choose this alternative fast-track approach for issuing their shares because of the complexity of the traditional IPO procedure

### 2. WHAT IS SPAC?

SPAC means "Special Purpose Acquisition Firm," which is a corporation or company formed solely to raise money through an initial public offering, or IPO. Investors can put money into a fund that will eventually be used to buy an existing company through such firms. The most popular name for this type of organisation or enterprise is a bank. Because they have no core business, SPACs are usually referred to as shell companies. The funds raised by the SPAC are held in trust until the transaction is finalised. If the acquisition does not go through, the money will be refunded to the investors. According to the U.S.Securities and Exchange Commission (SEC), "ASPAC is created specifically to pool funds in order to finance a merger or acquisition opportunity within a set timeframe. The opportunity usually has yet to be identified"(Securities and Exchange Commission. n.d.)

### 3. HISTORICAL DEVELOPMENT

Due to no fault of their own, SPACs have had a difficult history. Since the 1980s economic Wild West, they've been bouncing around the financial markets in various shapes. In their early forms, they were a mostly unmanaged group of open-ended, ill-defined services, often with highly ambiguous commercial objectives and no explicit investment targets in mind — at least in compared to today's SPACs. In the absence of today's regulatory apparatus to keep them in check, fraud was rampant.

Blank check firms, which arose in the 1980s under the less-than-savory circumstances connected with "pump and-dump" schemes, were SPACs' forerunners. The “Securities Enforcement Remedies and Penny Stock Reform Act of 1990” effectively put an end to the 1980s' bogus blank check companies.

A banker named David Nussbaum established a new business form a little more than a decade after the “Penny Stock Reform Act” was passed, combining the fundamental structure of the blank check corporation with the protective concepts of Rule. He pioneered the structure in the 1990s, and during that time, twelve of his thirteen SPACs went public and completed acquisitions—all on a small scale. With the late-1990s internet bubble, it became simple for private enterprises to go public on their own, and the form was abandoned.

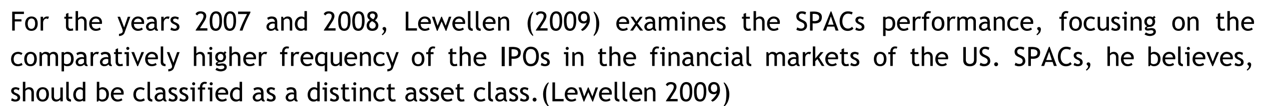
### 4. WHY SPACS ARE BACK?

The SEC moved in to place some much-needed restrictions on these shell companies, laying the groundwork for the current SPAC. During the 1990s, their popularity fluctuated depending on the

strength of the IPO market and the status of the economy. Due to law and the warm reception of investment banks and stock exchanges, including the Big Board itself, the New York Stock Exchange, SPACs have become an increasingly prominent component of the capital markets in recent years (NYSE). Despite its rough beginnings, a high-profile SPAC appears to be around every corner these days.
The modern SPAC is nothing like its forerunners, with 617 SPAC IPOs and 248 SPAC IPOs reaching the stock market last year (2020), an increase of almost 300 percent over 2019. From the perspective of capital markets, it has been termed "The Year of the SPAC."

## 5. LITERATURE REVIEW

There is a paucity of research on SPACs, particularly on how they have functioned and influenced markets. The majority of the research discusses the formation of SPACs in the context of the 1980s penny stock frauds. In his paper, Heyman1 examines how the fraudulent schemes of the 1980s defrauded the securities market, resulting in billions of dollars in losses for unsuspecting individual investors.
The formation of Onnix Financial Inc and the trading of its securities deserve special attention."Onnix exemplifies the blatant disregard of securities laws and audacious schemes that were prevalent in the penny stock market during the 1980s. Onnix is a particularly poignant example because of both the large number of investors who were affected and the international reach of the fraud."(Riemer 2007)
There have only been a few research on Special Purpose Acquisition Companies. Jog and Sun (2007) conducted the major initial research, explaining the basic framework of a blank-check companies and its development and implementation from the basics. Most significantly, Jog & Sun look into such company's returns to investors and founders.They discovered that SPAC investors lose money from the very next day till the announcement day, and incurred even more loss from the announcement to the final outcome day, when the shareholder vote on a deal is being announced.(Jog 2007)
Berger (2008) gives an overview of the transactions of SPACs as well as an introduction to them. He states three case based studies to demonstrate the benefits & transaction structures that can be realised as a result of the rapid explosion of SPACs SPAC investment vehicles, however most of these ostensibly favourable examples have since soured. The 2007 acquisition of American Apparel exemplifies how SPACs might be used as an alternative to traditional financial markets. Because of higher EBITDA to debt ratios, American Apparel was in breach of its present funding agreements, and it was negotiating additional debt covenant waivers for the months ahead.In addition, two employee lawsuits were filed against American Apparel, and its state and federal taxes were audited. The corporation was unlikely to be able to obtain further debt because it failed to meet its current debt onus. An IPO would have been problematic due to the financial crisis, as well as legal issues, as investors would have been wary. Unlike traditional IPOs, the SPAC are allowed to negotiate a deal structure and make concessions to make the investment more appealing. American Apparel was able to acquire the funding where they had put $8 million aside in the escrow accounts for covering the lawsuit and debt covenant violations. They also locked up the shares of their current owners.(Berger 2008)
Heyman (2007) presents a historical analysis of blank check firms and claims that SPAC companies existed from 2003 to 2006 in the market,who were able to overcome all of their predecessors' significant challenges from the 1990s. He also claims that the structure of SPACs ensures adequate investor protection, adhering to required SEC provisions, & serves as a lead of legal inventivenessin becoming a normal business entity that is traded on financial markets.(Heyman 2007)
SPACs, according to Riemer (2007), are a useful financial innovation since they act as an alternative for private equity firms. He attributed SPAC's growth in part to government policy, namely the limits put on small businesses to obtain funds from public markets by the Sarbanes-Oxley Act ,2002.(Riemer 2007)
The growth of SPACs, according to Davidoff (2008), is due to inconsistency in capital markets between demand and supply,which causes market distortions because portfolios of private equity and hedge funds cannot be replicated because of investors’ inability. As a result, investors' interest in SPACs stems primarily from a desire to engage in otherwise difficult-to-access private equity.(Davidoff 2008)



For the years 2007 and 2008, Lewellen (2009) examines the SPACs performance, focusing on the comparatively higher frequency of the IPOs in the financial markets of the US. SPACs, he believes, should be classified as a distinct asset class.(Lewellen 2009)

Thompson,(2010) compiled a list of 162 SPAC companies who went public between 2003 and 2010. Further Thompson claimed that SPAC's unusual structure helps to alleviate shareholder concerns regarding management's future investment selections. According to Thompson (2010), establishing a time restriction within which the process of acquisition must complete, which is important to aids in the mitigation of any difficulties. Furthermore, the power of shareholders vote on approval of acquisition wwhether in favour or against instils confidence in investors. Finally, SPAC management teams that heavily advocate acquisition and strive to eliminate vote and threshold processes do so at the expense of upcoming future profits.(Thompson 2010)

Kim,(2010) was the first one to describe performance and characteristics of SPACs in markets other than the United States. In comparison to securities of SPACs listed in the United States, more volatility and liquidity was present in the shares of Korean.He demonstrates higher underpricing around the time of IPO in Korean SPACs. According to report, market volatility and excess liquidity are caused by a restricted number of targets and retail investor competition, which calls for more institutional investors to enter the market.(Kim 2010)

Floros and Sapp (2011) look at how SPAC securities perform in comparison to normal reverse merger. With a sample lot of 111 SPACs that had gone public between 2004 &2008 and concluded that there os a negative return or loss post acquisition. traditional reverse mergers perform better than SPACs and investors' upside potential post-merger is limited.(Floros 2011)

Datar,Emm,&Ince(2012) examine 156 SPACs focusing on theriroperational &long-term performance from 2003 to 2008. 794 companies were compared with SPACs, who had standard IPOs throughout the same time period. Overall, they find that SPACs outperform industry peers and traditional IPOs in terms of operational performance with same time period. SPACs also smaller but have bigger debts. Aklso, if you invest less, there is less opportunities for gowth than benchmark companies.(Datar 2012)

D'Alvia (2014) compares the legal and institutional frameworks for SPACs for countries like the United States, Italy, and Malaysia. SPACs, according to the author, are a favourable for the mergers and aquisition market. He also points out the legal differences between the systems of these three countries.[1](D'Alvia 2014)

Kolb& Tykvová(2016) investigate characteristics of 127 modern-era SPACs and their 1128 IPO peers. They also claimed that SPAC acquisitions are a beneficial because they allow companies to reach the public market in bad times when other options, such as a traditional IPO, are prohibitively expensive. SPACs, on the other hand, drastically underperform ordinary IPOs in terms of performance and, as a result, are not value-creating investments.(Kolb 2016)

Vulanovic (2016) investigates how structural factors and contract sets which generates invectives for the SPACs affect their survival after the merger is completed.He discovers that SPACs' structural characteristics are essential in predicting post-merger results. The paper highlighted that SPAC management and underwriters' pre-merger commitment, as well as early favorable market performance, boosts the chance of survival after merger.Whereas, the risk of failure is more when there is high transaction cost and the focus is on the overseas.(Vulanovic 2016)

Anh Tran (2009) shows that opposite of what other authors have stated and explains SPACs acquisitions are beter, demonstrating that the SPAC structure has a significant benefit.Other bids in the same industry cost 7.6% less for SPACs, according to Officer's (2007) similar industry transaction technique. The paper also stated that private firm purchasers actually pay a lower premium than other public company buyers are also cited by Tran.He thinks,“SPACs benefit from their ability to make more targeted investments.” He also attributes some of the marginal earnings to the expertise and experience of SPAC management over their private equity counterparts. Many concerns concerning SPAC founders' conflicts of interest appear to be dispelled by this piece of literature.(Tran 20009)

## 6. SPACSININDIA

There have been no SPAC listings in India to yet. The existing Indian legislation makes it difficult to establish a SPAC. This is essentially to safeguard the interests of the country's naïve small investors. According to the government, India's financial markets are not yet mature enough to invest in such vehicles. This isn't to say that SPACs haven't targeted Indian firms. The Indian economy, which is growing at one of the fastest rates in the world, is enticing foreign SPACs to merge with private Indian firms.

Several SPAC mergers have lately occurred around the country. TIL, which is a blank check corporation founded by N Vaghul who was a former ICICI Bank chairman, announced a reverse merger with Solar Semiconductors Ltd, a Hyderabad-based photovoltaic (PV) module producer, in October 2008.TIL paid $375 million for an 80 percent stake. TIL also inherited Solar Semiconductor's long-term debt of more than $50 million. TIL was founded in February 2007 and was searching for acquisitions in the bio sciences industry when it was listed on the AMEX. N Vaghul presided over TIL, lead by Nalluru Murthy,Bobba Venkatadri, &Sarath Naru.

In the same year, the Phoenix India Acquisition Corp has purchased a 65 percent stake in Citius Power Limited. Millennium India Acquisition Company, another AMEX-listed SPAC, paid $40 million for a 14.9 percent share in Delhi-based brokerage business SMC Global Two other SPACs are East India Company Acquisition Corp which has support of Mr.Dipak Nandi, Saurabh Srivastava amd Kary Shankarand Global Services Partners Acquisition by Avinash Vashista and Saurabh Srivastava).

## 7. THE BENEFITS OF SELECTING SPAC ROUTE OVER TRADITIONAL IPO FOR INDIA COMPANIES

### 7.1 LESS UNWIDELY:

The process of going public through SPACs is fasters for private firms than the IPO process is without a doubt the main reason for their recent popularity. As previously stated, an acquired firm can use the SPAC approach to get backdoor access to international stock markets. This will make it easier for Indian businesses to enter international markets.

### 7.2 LOW PRICED:

Generally, the fees for IPO is 7% of raised capital whereas it is 5.5 % for SPAC . As a result, the cost structure of the SPAC would be more advantageous to Indian enterprises.

### 7.3 TIME SAVING:

The acquired firm normally become a publicly-traded entity in 6 months via the SPAC,howeverit takes 18 months via IPO procedure. This short timescale could become a survival necessity for Indian enterprises looking to acquire capital rapidly.

### 7.4 THE DIFFERENCE IN TIMELINES:

Going public on the domestic market can take anywhere from four months to a year. SPAC enterprises are thought to be limiting these timeframes, which range from 4-6 months. Furthermore, clear covenants in the contract and merger scheme limit anything that is not in keeping with the normal course of business in traditional IPOs and mergers. SPAC firms have yet to see this type of organisation, which would allow them more flexibility.

### 7.5 WIDER ACCESS TO MARKETS:

In a traditional IPO, the company would have been placed on the local exchange market, but SPAC is listed on the US exchange market, giving it a higher chance of attracting investors.

### 7.6 DOCUMENTATION:

One of the most crucial elements to think about, especially for any. Because the disclosure requirements are less severe than those for initial public offerings (IPOs) in general,

**7.7 REDUCED MARKET RISK:**

The value of the company to be purchased is decided and negotiated by the sponsor/main investor, not the financing institutions. As a result, rather than frequent market value adjustments, pricing certainty is achieved.

**7.8 TAX:**

In domestic settings, certain tax requirements are perceived as ambiguous, raising the burden on stakeholders. To decrease such liabilities, improve access to international funding, and profit from tax-related privileged status for their business. To take advantage of such a tax climate, Flipkart, for example, is registered in Singapore. Cure Fit, a rapidly growing IT company, has taken advantage of this by registering in various nations.

## 8. KEY DIFFICULTIES IN INTRODUCING A SPAC REGIME IN INDIA

**Regulatory framework in India**

The IFSCA has published its Listing Regulations. It is one of the distinctive regulation in India for regulatory recognition of SPACs. Similarly, in March 2021, the Securities and Exchange Board of India (SEBI) has appointed the expert panel to investigate the viability of SPACs in India. But,there has been no more progress so far. The regulatory landscape for SPACs in India is dominated by the following factors:

1) TheCompaniesAct,2013(Act)
2) SEBI(IssueofCapitalandDisclosureRequirements)Regulations,2018(ICDR)
3) ForeignExchangeManagement(CrossBorderMergers)Regulations,2018(CBMR)
4) IncomeTaxAct,1961

## 9. CHALLENGES UNDER THE LEGISLATURE

**Initial stage- Incorporation**

"Object clause' of the SPAC's Memorandum of Association (MoA) needs to specify the purpose which is to acquire other company, which will remain anonymous until it is listed. This raises the question of whether merely stating that the company was founded for the purpose of acquisition is sufficient, or whether the industry in which the company wants to make the acquisition should be indicated as well. Furthermore, Section 10A of the Companies (Incorporation) Rules, 2014, read with Rule 23A, requires a director to provide a declaration indicating the company has commenced business within 180 days of incorporation.The Registrar may commence a strike-off process if the aforementioned condition is not met.

In the case of SPACs, it's unclear exactly when they'll be able to start doing business. How a director of a SPAC may make such a declaration when they have no other business than the acquisition of another potential corporation is up for debate. Given the nature of SPACs and the fact that they have a 36-month window to discover and acquire a target company, it's understandable that some changes to the existing laws would be required.

## 10. Approval for Scheme of Arrangement

"Compromise or settlement between the company and its creditors or between the company and its members is governed by Sections 230 to 232 of the Companies Act, 2013". It can take the form of a capital reorganization, a corporate restructuring that includes the sale of assets or the firm's entire business, or a merger with another company.

The Hon'ble National Company Law Tribunal must approve the scheme of arrangement, which is a complex procedure including multiple rounds of approval from various stakeholders such as shareholders and regulatory authorities. The parties to such an agreement must go through a variety of procedures, including summoning meetings of creditors, members, or any class of creditors, accounting treatments, newspaper advertisements, and getting any other sectoral regulatory permissions that may be required. These activities are both costly and time intensive.

While a typical SPAC acquisition time period varies from 18 to 24 months, it is questionable that SPAC can fit in under the current framework.

### 11. RBI Approval for Cross Border Merger

"The Companies Act, 2013, Section 234 governs the merger or amalgamation of an Indian company with a foreign entity. Every foreign firm that wants to merge with an Indian corporation must first get permission from the Reserve Bank of India, and vice versa."

Another stumbling block for SPAC purchases, as all such transaction would require regulatory permission, which, based on prior history, is not easy to come by. SPAC is concerned about a short time frame once again, as the main aim is to eliminate procedural obstacles and speed up the purchase process.

### 12. FEMA Compliances

The Foreign Exchange Management (Cross Border Mergers) Regulations, 2018 and the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2014 also apply to cross-border mergers. Outside, where the SPAC is listed

The terms of the aforementioned legislation would apply if an Indian SPAC received investment from international investors. The regulations state that after the NCLT approves the merger scheme, the target company's Indian office will be considered the combined entity's branch office.

A resident individual may buy securities outside of India if the fair market value of the securities is less than USD250,000 per fiscal year, as defined under the Liberalized Remittance Scheme and the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004..

**Issues under the SEBI ICDR**

According to the ICDR, SPACs will have to overcome the following obstacles in order to launch an IPO:

**"The eligibility requirement pursuant to Regulation 6:**

- Net tangible asset of at least INR 3 crore in each of the preceding three years (earlier requirement of maximum of 50%tobeheld in monetary assets has been done away with in case the entire public offer is through sale).
- Minimum average consolidated pre-tax operating profit of INR 15 crore during any three of the last five years.
- NetworthofatleastINR1croreineachofthelastthreeyears."[2](Securities and Exchange Board of India 2018)

SPAC companies cannot meet this condition because they have no business and were founded only for the purpose of purchasing another firm. They may, however, be eligible to make an initial public offering if the issue is made through the book-building procedure and at least 75% of the net offer is allocated to qualified institutional buyers (QIBs).

Although Special Rights (SR) equity shares are permitted, the application of the same to SPACs is unclear. In the case of SPACs, there are two sorts of shares: founder shares and units offered to investors, as previously mentioned. Both have the identical rights, with the exception of the right to choose directors, which is reserved, and voting rights on this topic can only be exercised by holders of founder shares.

If the foregoing falls under the SR shares category, the ICDR stipulates that certain additional requirements must be met in the case of SR shares, as detailed in Regulation 6. (3). SPACs face the following challenges based on a cursory examination of the requirements:

- The issuer must use technology, information technology, intellectual property, data analytics, biotechnology, or nanotechnology extensively to produce products, services, or business platforms that provide significant value. SPACs don't appear to fit under any of these, nor does it appear that the abovementioned condition will be regarded met if the SPAC's acquisition target meets any of these requirements. Nonetheless, an adjustment will be required to allow SPAC to operate.
- Only the promoters/founders who occupy an executive position in the issuer company received

SR shares. Issuing SR shares to body corporate sponsors could be a challenge.
- Prior to the filing of the red herring prospectus, the SR equity shares had been held for at least 6 months. In some situations, SPACs may rush to file for an IPO in order to make this deadline, and so may fall short of this criterion.

## 13. INVESTORS' RISK FACTORS, POSSIBLE REGULATORY AMENDMENTS, AND THE FUTURE OF SPAC

Even if SPACs make it faster and easier for start-ups to list, it also means that the lengthy and costly listing process is avoided, putting regular investors at risk. Listed companies may not be able to redeem their shares under existing rules because India lacks a specified structure for SPACs. India may, once again, take a leaf from the United States of America and amend rules to permit the investors to redeem their shares or get a refund of their investment prior to the purchase. One more challenge is that SPACs must surmount is stamp duty duties. Because it is more cost-effective, startups prefer the SPAC route to listing.

On the other side, transactions through SPAC take the form of a reverse merger, which is subject to substantial stamp charges. As a result, the merger proposal must be launched and approved by the tribunals, posing a storm of compliance challenges under the Companies Act, 2013. A potential stamp duty exemption for SPAC transactions could be a good way to encourage people to choose the SPAC route.

## CONCLUSION

SPAC's growth is being hampered by some of India's present policies and restrictions. Some of them are out of date and need to be revised in light of the Indian economy's present state. Shell corporations must be defined, and public perceptions that they are primarily used to launder money must be dispelled. A special committee should be established to look into the impact of SPAC in other countries, especially in terms of reviving their startup sectors. Because SPACs are not the same as typical public businesses, they require unique legislation.

A distinct chapter of the Companies Act should be dedicated to the formation of SPACs and their compliance and governance issues involving all the stakeholders like management, board, and shareholders. After completing its purchase, a SPAC can rule on traditional terms. All applicable legislation and listing requirements, on the other hand, necessitate separate provisions/chapters.

In many ways, India's taxation system is anti-SPAC as well. For instance, the Tax authorities of India restricts investment invest in Indian start-ups by internationally listed SPACs without paying capital gains tax. As a result, the shareholders benefit from the capital gain. It is very challenging to permit SPAC transactions in Indian market. As the SPAC and the target company both are situated in India, the transaction would rather be considered as merger under the scheme of amalgamation rather than SPAC transaction which would be tax-free. This will ensure that no tax responsibility isbeing imposed on the investors involved.

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