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Jumping into the SPAC Race: Protecting the UK Retail Investor

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ABSTRACT

The year 2020 witnessed special purpose acquisition companies (SPACs) emerge as the hottest investment offering on the global capital markets. The popularity of SPAC structures can be attributed to a combination of factors such as the pandemic induced low interest rate environment, downturn in the business cycle and growing number of equity starved companies. Though traditionally associated with 'pump-and-dump' schemes, the SPAC wave of 2020 was characterised by SPACs backed by optimistic projections and celebrity endorsements, which attracted the attention of 'mom-and-pop' retail investors. It is argued in this paper that while SPACs provide retail investors a relatively 'riskless' investment option in volatile market conditions, such unsophisticated investors do not always understand the risk and reward structure of SPACs and the dangers of optimistic projections. Consequently, concerns regarding retail investor interest protection have led to increase in regulatory scrutiny and securities litigation in jurisdictions such as the United States. Despite these concerns, on 27 July 2021, the UK's Financial Conduct Authority introduced certain changes to the Listing Rules in a bid to enter the SPAC race. The paper analyses UK's changing SPAC regulatory landscape through the lens of agency issues and concerns regarding retail investor protection.

Keywords: special purpose acquisition company; retail investor; principal-agency issues; initial public offers; financial regulation

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I. Introduction: The SPAC Wave of 2020

The year 2020 saw special purpose acquisition companies (SPACs) emerge out of the shadows of the financial world[1] as the hottest offering on Wall Street.[2] SPACs dominated the US Initial Public Offering (IPO) landscape in 2020 with companies such as BuzzFeed Inc[3] and Nikola Motor Co.,[4] aiming to go public through the SPAC route. As of the first quarter of 2021, global IPO issuance was at $202.9bn, primarily fuelled by SPAC activity in the United States.[5] It should be noted that SPACs are not a product of ingenious financial engineering born out of the exigencies of the pandemic, but have been around since the 1980s.[6] Historically associated with 'pump and dump' schemes,[7] the SPAC boom of 2020 was characterised by investment vehicles backed by 'optimistic projections,' star-power[8] and popularity among retail investors.[9] Well known private equity and hedge fund operators along with celebrities such as Shaquille O'Neal,[10] Jay-Z,[11] Jennifer Lopez and Alex Rodriguez[12] are some of the popular names that backed SPAC structures. It is argued in this essay that 2020 saw a metamorphosis of SPACs into an

1 Miles Kruppa and Ortenca Aliaj, 'A Reckoning for SPACs: Will Regulators Deflate the Boom' *Financial Times* (New York, 4 May 2021) https://www.ft.com/content/99de2333-e53a-4084-8780-2ba9766c70b7 accessed on 25 July 2021.

2 Aaron Elstein, 'SPACK Attack' (2021) 37(6) Crain's New York Business <https://www.proquest.com/trade-journals/spac-attack/docview/2490739587/se-2?accountid=9630> accessed on 28 July 2021.

3 Benjamin Mullin, 'BuzzFeed Reaches Deal to Go Public Via SPAC, Acquire Complex Networks' *Wall Street Journal* (24 June 2021) <https://www-wsj-com.cdn.ampproject.org/c/s/www.wsj.com/amp/articles/buzzfeed-nears-deal-to-go-public-via-spac-eyeing-digital-media-rollup-11624485898> accessed on 25 July 2021.

4 Opinion Lex, 'SPACS/ Nikola: Fresh-baked Fruitcake' *Financial Times* (23 December 2020) <https://www.ft.com/content/6028238d-3b8d-40b0-9b9a-130574678d93> accessed on 25 July 2021.

5 PwC, *IPO Watch Europe Q1 2021* <https://www.pwc.co.uk/audit-assurance/assets/pdf/ipo-watch-europe-q1-2021.pdf> accessed on 25 July 2021.

6 Usha Rodrigues and Mike Stegemoller, 'Exit, Voice, and Reputation: The Evolution of SPACS' (2013) 37 Delaware Journal of Corporate Law 849, 875.

7 ibid 875.

8 Kruppa (n 1).

9 Harriet Agnew and Ortenca Aliaj, 'SPAC Boom is Creating 'Castles in the Sky,' Jim Chanos Warns' *Financial Times* (London, 25 June 2021) <https://www.ft.com/content/da44b18e-51e5-40ab-9e34-70879952edce> accessed on 25 July 2021.

10 Brooke Masters, 'Year in a Word: SPACS' *Financial Times* (December 31, 2020) <https://www.ft.com/content/80458983-1693-4022-ba23-113925d24d70> accessed on 25 July 2021.

11 Due Diligence, 'SPACs vs Short Sellers: The Great Money Grab of *2021'Financial Times* (New York, 18 March 2021) <https://www.ft.com/content/c94f51f5-c042-42a6-8ba1-81b5672d2820> accessed on 25 July 2021.

12 Kruppa (n 1).

investment offering appealing to the public markets, leading to concerns regarding the protection of retail investors.

The 2020 surge in SPAC activity can be attributed to uncertain market conditions, reduced IPO activity, need for capital and a low-interest rate environment caused by the COVID-19 pandemic.[13] The pandemic-induced downturn in the business cycle has dulled the hope for equity-starved companies to access the public markets.[14] SPACs have stepped in to fill this gap, offering a fuss-free way to listing and accessing equity. For sponsors, SPACs offer an attractive vehicle to deploy funds, given the current climate of low interest rates and high market valuations.[15] Furthermore, market distress caused by the pandemic has made it easier to find and acquire viable targets. Finally, SPACs have stepped in to provide the SPAC investor an alternative investment source, allowing for public participation and co-investment alongside an experienced sponsor in a private equity style deal. From a retail investor perspective, SPACs claim to offer a relatively 'riskless' investment in volatile market conditions with tremendous upside potential due to high levels of liquidity.

These factors coupled with the need to re-assess traditional IPO processes and chart alternate paths for companies to access the capital market, make SPACs an attractive offering. The deal that 'put SPACs back on the map' was the 2019 Virgin Galactic's merger with Social Capital Hedosophia, a SPAC sponsored by the Facebook alum Chamath Palihapitiya.[16] The deal gave the investment vehicle a stamp of credibility and publicity among capital market participants and opened the floodgates for SPAC incorporations, particularly in the United States. Optimistic press reports highlighting few successful and highly visible celebrity-backed SPACs further fuelled this wave.[17]

The renewed interest in SPACs in the US markets has resonated globally leading to increased confidence in SPAC structures among sponsors, investors, and targets.[18] This has led to regulatory competition among jurisdictions to emerge as SPAC incorporation magnets. In Europe, Euronext Amsterdam,

[13] Thomas Vita, Fiona Millington and Kevin Connolly, 'SPACs: The London Alternative' (*Norton Rose Fulbright Publications,* October 2020) <https://www.nortonrosefulbright.com/en-gb/knowledge/publications/94734f5e/spacs-the-london-alternative#section3> accessed on 25 July 2021.

[14] Hugh Osmond, 'Time for UK Regulators to Open Door to SPACs' *Financial Times* (London, 17 December 2020) <https://www.ft.com/content/b364f03e-b026-4ec5-82fb-3991400de851> accessed on 27 July 2021.

[15] Vita (n 13).

[16] Elstein (n 2).

[17] Michael D Klausner and Michael Ohlrogge and Emily Ruan, 'A Sober Look at SPACs' (October 28, 2020). Yale Journal on Regulation, Forthcoming, Stanford Law and Economics Olin Working Paper No. 559, NYU Law and Economics Research Paper No. 20-48, European Corporate Governance Institute – Finance Working Paper No. 746/2021 <https://ssrn.com/abstract=3720919> accessed on 27 July 2021.

[18] PwC Report (n 5).

Frankfurt and Stockholm exchanges are emerging as hotspots for SPAC activity.[19] The UK, however, was slow to ride the SPAC wave. As of July 2021, there have been just over 50 SPACs listed on the London Stock Exchange (LSE), characterised by a small number of large listings.[20] The slow SPAC activity in the UK has been attributed to certain regulatory blockades in the Financial Conduct Authority (FCA) Listing Rules (Listing Rules)[21] that provide for trading of SPAC shares to be suspended once a target is identified.[22] This peculiar feature of the London market has made the UK SPAC unattractive to sponsors and investors.[23] Given, however, the increasing financial competitive edge of other European jurisdictions in a post-Brexit world, the UK Listing Review (Hill Review) was commissioned to propose revisions to the Listing Rules in a bid to transform London into an attractive listing venue for SPACs.[24]

The regulatory overhaul of the UK Listing Rules has, however, come during the ebbing of the SPAC wave on Wall Street, as regulatory authorities, sponsors and investors grow increasingly queasy about SPACs.[25] With a fall in total SPAC activity in the second quarter of 2021, many have questioned whether the SPAC wave was really just a bubble, bound to burst as interest rates improve.[26] Furthermore, there has been increasing concern regarding the protection of the interests of unsophisticated retail investors, who may be unaware of the risks and reward structure of SPACs and the dangers of optimistic projections.[27] The US has witnessed an increase in regulatory scrutiny of SPACs by the SEC[28] and increase in securities litigation by public shareholders alleging misstatements, fraud and breach of fiduciary duties by directors of companies that have gone public through the SPAC route.[29] Despite, however, the growing concern regarding retail investor protection, the UK is diving headfast into the SPAC race with the introduction of

[19] ibid.

[20] Financial Conduct Authority, *Investor Protection Measures for Special Purpose Acquisition Companies: Proposed Changes to the Listing Rules Consultation Paper,* April 2021 (CP 21/10) 12.

[21] FCA Listing Rules (July 2021) <https://www.handbook.fca.org.uk/handbook/LR.pdf> accessed on 1 August 2021.

[22] FCA Consultation Paper (n 20).

[23] ibid.

[24] Baker McKenzie, *H1 IPO Snapshot: Unfolding Trends for 2021,* <https://www.bakermckenzie.com/-/media/files/insight/publications/2021/06/ipo-h1-snapshot-2021_final.pdf?la=en> accessed on 23 July 2021.

[25] ibid 6.

[26] Ivana Naumovoska, 'The SPAC Bubble is About to Brust' (*Harvard Business Review,* 18 February 2021) <https://hbr.org/2021/02/the-spac-bubble-is-about-to-burst> accessed on 17 July 2021.

[27] Kruppa (n 1).

[28] Brooke Masters, 'Grab is Lunging for the Top of the SPAC Market' *Financial Times* (14 April 2021). <https://www.ft.com/content/df14b6f5-a967-4f0f-8441-a5ab48d66dec> accessed on 31 July 2021.

[29] Kruppa (n 1).

the FCA Policy Statement PS21/10 (Policy Statement) on 27 July, 2021, containing the final changes to the Listing Rules (Revised Listing Rules).[30]

Amid the growing SPAC buzz and revision of the Listing Rules, this paper attempts to re-focus attention to the agency issues in a SPAC structure and the concerns regarding the protection of retail investors. Section I of this paper analyses the concept and structure of a SPAC. Section III aims to identify the agency issues in a SPAC and explore the concerns regarding retail investor protection. Section IV analyses UK's changing SPAC regulatory landscape and whether the same adequately protects the interests of SPAC retail investors.

This paper aims to extend the literature on the agency issues in a SPAC. As far as the author is aware, there has been no comprehensive analysis of the concerns and protection of retail investors in the context of the SPAC wave of 2020 and the Revised Listing Rules.

II. The SPAC and the Retail Investor

SPACs have a notorious ancestry and are associated with blank cheque companies of the 1980s, which were used to defraud unsophisticated investors in the United States.[31] The US Securities Enforcement Remedies and the Penny Stock Reform Act 1990, along with strict regulation of blank cheque companies, lead to a decline of this investment form in the 1980s.[32] It was not until 1992 when the modern SPAC structure, with its various in-built investor protection mechanisms, was formulated in a bid to gain the approval of the US Security and Exchange Commission (SEC).[33] During the mid-2000s, a decline in traditional IPO activity in the United States, saw an increase in the use of the SPAC form.[34] Meanwhile, the UK witnessed a surge in SPAC activity after the financial crisis of 2008.[35]

In the UK, SPACs are considered as cash shell companies which do not meet certain independence and operating history requirements for premium listing. UK SPACs are listed mainly on the Standard segment of the Official List or on the Alternate Investment Market (AIM) of the LSE.[36] Given, however, certain

[30] Listing Rules (Special Purpose Acquisition Companies) Instrument 2021 (FCA 2021/29), Annex B <https://www.handbook.fca.org.uk/instrument/2021/FCA_2021_29.pdf> accessed on 1 August 2021.

[31] Derek K. Heyman, 'From Black Check to SPAC: The Regulators' Response to the Market and the Market's Response to the Regulation' (2007) Entrepreneurial Business Law Journal 531, 532; Rodrigues (n 6) 875.

[32] ibid 532; Rodrigues (n 6) 875.

[33] Derek (n 31) 540.

[34] ibid 532.

[35] Winston & Stawn LLP, 'SPAC to the Future: The Recent Resurgence of UK SPACS and Latest Trends' (2018) < https://www.winston.com/images/content/1/4/v3/142888/SPAC-to-the-Future-the-Recent-Resurgence-of-UK-SPACs-and-Latest.pdf> accessed on 31 July 2021.

[36] ibid.

requirements of the AIM regime such as shareholder approval for reverse takeovers, the Standard segment is the most popular option for UK SPACs.[37]

A. Spac structure

In the US, SPACs are designed to track the protective requirements of Rule 419 of the Securities Act, 1933. SPACs in most jurisdictions borrow heavily from the US SPAC structure with certain deviations. A typical SPAC is a blank-check or clean cash shell company with no assets or operating history.[38] A SPAC is founded by sponsors and taken public with the sole aim of acquiring a yet-to-be-identified target company (mostly private companies) within a short time-horizon,[39] usually twenty-four months. The target is then acquired by the SPAC and taken public through a reverse merger (De-SPAC Transaction).[40] Unlike in a typical IPO, the initial SPAC IPO is swift and relatively cheap due to the lack of lengthy disclosures and compliance with other listing requirements.[41]

In a SPAC IPO, a SPAC investor is usually offered a 'unit' that is, a combination of shares and share warrants.[42] The issue proceeds are usually held on trust in an escrow account.[43] Warrants are granted to enable SPAC investors a right to acquire additional shares of the post-acquisition company, at a specified time in the future, at a pre-agreed strike price, which is usually a 15% mark-up of the IPO share issue price.[44] Similar to traditional private equity, to ensure that SPAC sponsors and managers (hereinafter collectively, SPAC Sponsors or Sponsors) have adequate 'skin in the game,' Sponsors initially buy-in a percentage of the SPAC preferred shares (usually 20% of the post IPO equity) (Founder Shares) at a low valuation which is also then placed in escrow.[45] During the SPAC IPO, the Sponsors may be further issued a combination of ordinary, Founder Shares and warrants which is subject to a lockup period.[46]

Upon completion of a successful acquisition, Sponsors may end up owning 20% of the newly acquired company.[47] If the acquisition mandate, however, is not

[37] Vita (n 13).
[38] Rodrigues (n 6) 871.
[39] ibid.
[40] Rodrigues (n 6) 871.
[41] ibid.
[42] Magnus Blomkvist and Milos Vulanovic, 'SPAC IPO Waves' (2021) Economics Letters 197; Rodrigues (n 6) 871.
[43] Rodrigues (n 6) 871.
[44] Vita (n 13).
[45] Rodrigues (n 6) 871.
[46] Vita (n 13).
[47] ibid.

met in the given timeframe, Sponsors forgo their shares. [48] In addition to the above, SPAC Sponsors and certain other sophisticated SPAC investors may also purchase additional shares and warrants through private placement, which supplements the amount of their "skin in the game"[49] and helps flush the SPAC with additional capital, if required.

It must be mentioned that there are significant structural differences between a US and a UK SPAC. Firstly, with respect to the investor approval mechanism once a target is identified, in the US a SPAC shareholder may vote to either approve the acquisition or vote against it. If approved, the shareholder comes to hold shares in the acquired company, which then trades publicly through the reverse merger.[50] If the acquisition is not approved, the shareholders may elect to redeem their investment and are returned pro rata their share of funds in the escrow account. Given that the De-SPAC Transaction heralds the end of the SPAC, SPACs may often bargain for a positive vote on a proposed acquisition in several ways. For example, by promising to repurchase the shares held by the SPAC investor upon competition of the De-SPAC Transaction[51] or by an open market purchase of public shares by SPAC Sponsors.[52] Whereas for a UK SPAC listed on the Standard segment, there is no requirement of seeking shareholder approval for acquisitions. Instead, post-acquisition, there is a requirement for a prospectus of the combined entity to be re-filed for FCA approval.[53]

Secondly, under the Listing Rules, SPAC shares are suspended from trading from the date of announcement of the De-SPAC Transaction till the re-filing of the prospectus of the combined entity.[54] This means that once a potential target is identified, Investors in a UK SPAC are locked into their investments. Thirdly, UK SPAC investors are typically not granted redemption rights.[55] In the United States, under the NASDAQ and NYSE rules, those SPAC shareholders who vote against the acquisition proposal must be given an option for redeeming their shares.[56] From a US investor perspective, this redemption right makes SPACs a cheap and liquid investment. Fourthly, in the US, there is a strict investment criterion for the SPAC IPO proceeds.[57] These proceeds are invested in US treasury

[48] Rodrigues (n 6) 871.
[49] ibid 895.
[50] Rodrigues (n 6) 871.
[51] ibid 872.
[52] Tim Jenkinson and Miguel Sousa, 'Why SPAC Investors Should Listen to the Market' (2011) Journal of Applied Finance 38, 50.
[53] Listing Rules (n 21), LR 5.6.
[54] Listing Rules (n 21), LR 5.6.4R, LR 5.6.5A R and LR 5.6.5G.
[55] Thomas Vita (n 13).
[56] ibid.
[57] Ramey Layne and Brenda Lenahan, Vinson & Elkins LLP, 'Special Purpose Acquisition Companies: An Introduction' *Harvard Law School Forum on Corporate Governance* (6 July 2018)

bonds and earn interest. By contrast, the UK has no such investment requirement for the deployment of IPO proceeds and therefore offer significant flexibility on the short-term use of such proceeds. As will be explained in Section IV of this paper, these features of the UK SPAC presented additional challenges in ensuring that the interests of SPAC retail investors are protected and have subsequently been dealt with under the Revised Listing Rules.

The design of a SPAC vehicle enables it to serve the interest of a wide variety of market participants. Rodriguez and Stegemoller (2013) characterise SPACs as a 'poor man's private equity fund,' that offers a chance to 'mom-and-pop' investors to finance a management team's hunt for a target.[58] From the perspective of the SPAC Sponsor, SPACs offer a cheap method to access and raise money from the capital markets to finance their quest for a target.[59] Finally, through the De-SPAC Transaction, SPACs provide the management of a small private company retention of control while infusing cash and opening a back-door to the capital markets.[60]

B. The retail SPAC investor

The SPAC wave of 2020 witnessed a surge in SPAC listings and increased participation by retail investors. In the US, as of February 2021, retail investors accounted for 40% of all trading in SPACs.[61] According, however, to Mitchell Littman, a partner at a New York law firm, SPACs are only meant for certain types of investors. "This is not something that anybody should be putting their 401(k) or (individual retirement account) into," said Littman.[62] It is therefore important to explore the peculiar characteristics of SPAC retail investors that warrant special regulatory protection.

SPAC retail investors can be categorised into (a) mass retail investors; (b) mass affluent investors; (c) high net worth individual investors; and (d) ultra-high net worth individual investors.[63] While (c) and (d) are usually backed by

<https://corpgov.law.harvard.edu/2018/07/06/special-purpose-acquisition-companies-an-introduction/#2b> accessed on 1 August 2021.

58 Rodrigues (n 6) 874.

59 ibid.

60 ibid.

61 Ortenca Aliaj and James Fontanella Khan, 'Retail Investor Apathy Threatens to Derail SPAC Deals' *Financial Times* (New York, 10 March 2021) <https://www.ft.com/content/7554fead-6784-421a-8659-79afc8fbeeed> accessed on 17 July 2021.

62 Scott Malone, 'RPT-IPO View – Crunch Time Coming for Blank-Check Companies' *Reuters* (26 March 2006) <https://www.littmankrooks.com/pdf/Crunchtime-for-blank%20checkIPO.pdf> accessed on 31 July 2021.

63 Jonathan V. Beaverstock, Sarah Hall and Thomas Wainwright, 'Scoping the Private Wealth Management of the High Net Worth and Mass Affluent Markets in the United Kingdom's Financial Services Industry' (May 2010) <https://www.nottingham.ac.uk/business/who-we-are/centres-and-institutes/gcbfi/documents/researchreports/paper71.pdf> accessed on 31 July 2021.

sophisticated private wealth management teams, the concern of this paper is the 'mom and pop' retail investor, which lacks both financial sophistication and a large amount of capital at its disposal. Often such retail investors jump from one hot offering to another. For example, in 2020, Wall Street saw retail investors jump between big technology stocks, sustainable investments and SPACs.[64] Increased retail participation in SPACs has been attributed to this 'bandwagon effect' and a 'fear of missing out' on the action. Retail investors lack sophistication to understand the lifecycle, incentive and reward structures of SPACs and are often the risk bearers in a bad SPAC deal. These issues will be discussed further in Section III.

Irrespective of the jurisdiction, concerns regarding retail investor protection in SPACs arise due to two main issues that is, collective action problem and the issue of information asymmetry. Firstly, like in the case of a company with dispersed shareholding, retail investors in a SPAC suffer from the collective action problem. This impacts the SPAC and investor dynamics in several ways. For example, in the US, where proposed acquisitions require shareholder approval, SPAC Sponsors face logistical issues in solicitation and engagement with retail shareholders, slowing down deals and extensions, thus affecting internal SPAC dynamics.[65] Secondly, opaque SPAC structures and reduced regulatory oversight exacerbate issues of information asymmetry which have given rise to several instances of litigation regarding securities in the US. For example, a petition was filed against Nikola Corp, the poster child of the SPAC 2020 boom, for making false and misleading statements to its retail investors.[66]

Considering the above issues, the US House of Representatives Sub-committee on Investor Protection, Entrepreneurship and Capital Markets agreed, on 24 May, 2021, on the need for SPACs to be regulated in the same way as traditional IPOs for the sake of protecting retail investors.[67] While regulators have become more sensitive to the protection of retail investors, there is a theory that such hyperactivity among retail investors is temporary and driven by the CoVID-19 pandemic. If so, once the ebb of retail investors crash, regulators need to ensure that investor protection measures put in place do not act as an effective barrier for

[64] Katie Martin and Robin Wigglesworth, 'Rise of the Retail Army: The Amateur Traders Transforming Markets' *Financial Times* (London, 9 March 2021) <https://www.ft.com/content/7a91e3ea-b9ec-4611-9a03-a8dd3b8bddb5> accessed on 17 July 2021.

[65] Aliaj (n 61).

[66] Claire Bushey and Ortenca Aliaj, 'Nikola Found Trevor Milton Charged with Making False Statements' *Financial Times* (Chicago, 29 July 2021) <https://www.ft.com/content/7469bb92-10c7-49a5-8646-193fb3777d2f> accessed on 17 July 2021.

[67] Joseph Williams, 'House Subcommittee Agrees More Investor Protections Necessary or SPAC Model ' *SNL Financial Services Daily* (25 May 2021) < https://www.proquest.com/trade-journals/house-subcommittee-agrees-more-investor/docview/2532412044/se-2?accountid=9630> accessed on 31 July 2021.

companies trying to access the capital markets through SPACs. Accordingly, keeping in mind this concern, Section IV of this paper will discuss the light touch investor protection regime proposed by the FCA in regulating SPACs in the UK and whether the same adequately protects the retail investor.

III. Retail Investors and Agency Cost Issues in a UK SPAC

The acquisition of a private target company by a SPAC is a form of a reverse merger.[68] In a traditional reverse merger, a successful private company is merged with a listed shell company, which is often a public virgin company incorporated for the sole purpose of the combination or a remnant of a previous operational public company.[69] In the case of SPACs, the cash-shell company is incorporated, flushed with public money with the sole objective of hunting private targets to take public. With no operating history or assets on which to base the investment decision, retail SPAC investors effectively purchase a management team and their ability to identify and purchase an acquisition target. Blomkvist and Vulanovic (2020) observe that this opaqueness is compounded by the 'one-shot-deal' nature of the SPAC entity, in which reputational factors of the SPAC Sponsor is no longer a tool to reel in agency costs and ensure investor protection.[70] Therefore, a SPAC is a blind pool of funds in which the SPAC investor does not know exactly what she is paying for.[71]

While the 2020 SPAC wave, backed by reputable sponsors and celebrity endorsements, solved the issue of reputation to a large extent, it is argued that even with an experienced management team, the structure of SPACs and nature of management incentives makes them replete with agency issues. Furthermore, as explained in Section II, it is argued that certain features of a UK SPAC such as (a) no investment guidelines on the proceeds of SPAC IPOs; (b) no shareholder approval process for proposed mergers; and (c) no redemption and weak exit rights for disapproving shareholders; exacerbate the issues of agency cost and protection of retail SPAC investors. This section will examine the misaligned interests of SPAC Sponsors and the retail SPAC investor and the consequent agency cost issues which require regulatory attention.

[68] Naumovoska (n 26).
[69] ibid.
[70] Rodrigues (n 6).
[71] Elstein (n 2).

A. SPAC IPO PROCEEDS AND THE PRPOBLEM OF FREE CASH FLOW

SPAC IPO proceeds constitute a source of free cash flow to the SPAC Sponsors, which are then utilised to hunt and acquire a target company. Jensen (1986) defines free cash flow as 'cash flow in excess of that required to fund all projects that have positive net present values when discounted at the relevant cost of capital'.[72] Jensen states that there exist managerial agency costs in ensuring that managers are motivated to utilise free cash flow responsibly, rather than wasting or investing the same below the cost of capital.[73] Developing on Jensen's idea of managerial agency costs relating to free cash flow, Schultz (1992) highlights that after a freshly-completed IPO, very strong incentives exist for managers to invest in negative net present value projects.[74]

To solve the issues of agency costs of free cash flow, SPAC issue proceeds are usually held in escrow. Furthermore, as per the SPAC prospectus, issue proceeds can be used only for certain purposes such as (a) acquisition of a company; (b) capital contribution to the merged company; (c) distribution in case of liquidation of the SPAC; or (d) redemption of shares.[75] Free cash flow can also lead to an issue of dilution for the SPAC investor if the SPAC utilises IPO issue proceeds for financing the operations of the acquired company or for redemption of shares.[76] To deal with this, SPAC Sponsors may often purchase additional SPAC shares and warrants through a pre-IPO private placement. This allows SPAC Sponsors to provide investors comfort that 100% of the issue proceeds will be kept in escrow and used to funding the acquisition, while the private placement proceeds will be used to finance the SPAC's operating expenses or fund the redemption of shares.[77] Additional funds to meet working capital arrangements may also be raised through Private Investment in Public Equity (PIPE) financing arrangements[78] or by disclosure in the prospectus, that IPO proceeds up to a certain percentage will be utilised for the purposes of working capital requirements.[79]

[72] Michael C. Jensen, 'Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers' (1986) 76 The American Economic Review 323, 323.

[73] ibid 323.

[74] Paul Schultz, 'Unit Initial Public Offerings: A Form of Staged Financing' (1993) 34 Journal of Financial Economics 199, 200.

[75] Klausner (n 17).

[76] Rodriguez (n 6) 873 and 925.

[77] Mark Bonenfant, 'Special Purpose Acquisition Companies' *Buchalter Nemer* <https://www.buchalter.com/wp-content/uploads/2007/12/Special-Purpose-Acquisition-Companies.Bonenfant.pdf> accessed on 19 July 2021.

[78] Klausner (n 17) 49.

[79] FCA Consultation Paper (n 20) 17.

Agency costs created by the problem of free cash flow is further attempted to be reeled in through the provision of unit offerings in a SPAC IPO. As mentioned earlier, the SPAC IPO typically consists of an offering of shares and warrants. Schultz (1992) highlights that share warrants are usually used as a 'sweetener,' to make an issue more attractive by incentivising investors to subscribe into an IPO which otherwise maybe unattractive.[80] In the case of SPACs, share warrants are used to incentivise SPAC investors with the promise of shares in the post-acquisition company at the warrant's exercise price. It is argued that share warrants have a disciplining effect on the management.[81] Given that the purchase price of shares of the acquired company is at the pre-determined warrant exercise price (which is often above the market value of the shares), SPAC Sponsors are deterred from squandering IPO proceeds under the pretext of 'finding an appropriate target,' thereby preventing dilution of shareholder value.

The more funds held in escrow and shielded from the SPAC Sponsors, the more attractive and safer the SPAC is for the retail investor. Escrowing of issue proceeds to a large extent solves the issues of free cash flow and helps reduce investment risks.[82] SPACs may also obtain guarantees from banks and waivers from vendors, or the target from any claim on the amounts held in escrow as a further measure to protect trust value and the interest of retail SPAC investors.[83]

B. Problem of founder shares and time bound acquisitions

As stated in Section II of this paper, once listed a SPAC has, subject to extensions, twenty-four months to find and acquire a target company. The SPAC structure is formulated such that it must work against the clock to complete an acquisition or else face liquidation.[84] Rodrigues and Stegemoller (2013) argue that time constraints associated with SPACs have a disciplining effect on SPAC Sponsors, as investor money is not held indefinitely by the management in escrow, thereby preventing a decline in the value of the trust fund.[85] It is argued, however, that such time constraints create an artificial pressure on the SPAC Sponsor to complete an acquisition within a short time-frame, irrespective of its merits.

SPAC Sponsors receive 20% interest in the SPAC, which becomes valuable only if an acquisition is completed. Given the escrowing of Founder Shares and the limited time period within which the acquisition must be completed, SPAC

[80] Schultz (n 74) 200.
[81] ibid 201.
[82] Rodriguez (n 6) 914.
[83] ibid 913.
[84] Eric J Savitz, 'The New Blind Pools' *Barron's* (12 December 2005) 21.
[85] Rodrigues (n 6).

Sponsors have strong financial incentives to push a deal through, irrespective of whether it is the optimal choice.[86] Furthermore, unlike in traditional private equity where managers are rewarded upon the realisation of profit, in case of SPACs, Sponsors enjoy a large payday upon completing the acquisition.[87] Managers may even be offered employment contracts contingent upon completion of the acquisition mandate.[88] Therefore, under the typical SPAC structure, Sponsor rewards are almost completely divorced from the profitability of the acquired target once it is listed and hinges almost entirely on completing an acquisition within the given time frame. It is noted that while the average SPAC stock sank by 36% post-merger, SPAC Sponsors were able to generate an average return of about 400%,[89] representing the severe misalignment of interests between the SPAC Sponsors and investors while selecting a suitable SPAC target. Given that there is no formal requirement for shareholder approval in an UK SPAC, the chances of SPACs Sponsors pushing a bad deal through are significantly higher.

It has been argued that co-investment by Sponsors through pre-IPO private placement solves this issue of SPACs pushing a bad deal.[90] Given, however, that Sponsor contribution to the fund is an average of 2.5% of the IPO proceeds, the motivation of realising their 20% stake works as a stronger incentive to see an acquisition deal go through. Unless the Sponsor's ability to realise their 20% share upon acquisition is not contractually reduced or delayed, the same continues to present an agency cost issue. Alternatively, a legal requirement for detailed due diligence of the target or of a mandatory percentage of institutional shareholder participation may solve the issue of acquisition of bad targets. The later of the two approaches has been adopted by the Revised Listing Rules, as discussed in Section IV of this paper.

Finally, given the large number of SPACs which have been incorporated in 2020 and are seeking to fulfil their acquisition mandates in the next few months, the hunt for quality target companies is fierce.[91] This competition among acquirers make it harder to find healthy targets to acquire at fair valuation.[92] Savitz (2005) argues that potential targets realise that SPACs have a time-bound investment mandate which is often used against SPACs in negotiations regarding valuation, leading to issues of over pricing of unhealthy targets.[93]

86 Derek (n 31) 549.
87 Rodrigues (n 6) 894.
88 Bonenfant (n 77).
89 Elstein (n 2).
90 Rodrigues (n 6) 896.
91 Lulu Yllun Chen, 'SPACs See Asia as Next Hunting Ground for Takeover Targets' *Bloomberg* (31 January 2021) <https://www.bloomberg.com/news/articles/2021-01-31/spac-spending-spree-moves-to-asia-as-funds-seek-out-new-targets> accessed on 27 July 2021.
92 Derek (n 31) 551.
93 Savitz (n 84) 22.

C. Issue of information asymmetry

The problem of information asymmetry can arise in various stages of a SPAC's lifecycle. This paper identifies two such instances. Firstly, at the point of the SPAC IPO and secondly at the point of acquiring a target company. As mentioned in Section II, at the point of the SPAC IPO, a SPAC investor effectively buys into a management's ability to identify and acquire a target company. Unlike in a traditional IPO, a SPAC has no previous operating history or financials to disclose, lowering the level of information available and consequently increasing information asymmetries for the SPAC investor. It is argued that these information asymmetries are compounded for the retail investor as she is exposed to optimistic press reports, projections and lacks the sophistication or ability to scrutinise the same.

The traditional view of SPACs is that they are advantageous to companies who wish to go public but may find it difficult to convey information to the market or have difficulty in terms of valuing.[94] In this sense, SPACs have a unique role in bringing companies which have unusual businesses or few market comparables to the public markets, thereby addressing the issue of information asymmetry between these companies and the public markets. It is argued, however, that in the absence of any legal requirement of conducting high standard due diligence on potential targets, regulatory intervention or shareholder approval process for proposed acquisitions, the SPAC presents a problem of grave information asymmetry for the retail investor. It is argued that this is further compounded if retail investors have weak voting and exit rights (discussed below). As noted above, SPAC Sponsors have more incentive to push a bad deal through than do no deal at all. To minimise such information asymmetries, SPAC investors should be given sufficient informational rights at various stages of the SPAC life-cycle.

IV. Revamping UK's SPAC Regulatory Landscape and the Protection of Retail Investors

A. Background

The Listing Rules applicable to SPACs provide for a rebuttable presumption of suspension of trading of shares when a reverse takeover is in contemplation.[95] LR 5.6.7G provides that such situations will include where (i) the SPAC has approached a target's board; (ii) the SPAC has entered an exclusivity

[94] Klausner (n 17) 5.

[95] Listing Rules (n 21), LR 5.6.8G.

period with a target; or (iii) where the SPAC has given a target access to begin due diligence. The FCA states that in such situations, suspension of trading is necessary as the SPAC is unable to accurately assess its financial position and inform the market accordingly.[96] The suspension of trading serves to protect public investors from insufficient publicly available information which may harm market integrity and lead to opportunism and issues of insider trading.[97] The Listing Rules provide that such suspension can be avoided if sufficient market disclosures are made available following approval from the FCA.[98] The suspension period, however, can be long, effectively locking in dissenting shareholders till the deal is finalised and a revised prospectus is filed. The presumption of suspension, requirement of FCA approval and additional disclosures have been identified as regulatory blocks for SPAC listings in the UK.

Accordingly, as part of the Treasury's plan to strengthen UK's global financial position, the Hill Review chaired by Jonathan Hill was constituted to *inter alia* "improve the environment for companies to go public in London."[99] The Hill Review submitted its report on 3 March, 2021 and recognised that the UK had fallen behind the SPAC race, and required stronger public markets and an influx of growth company listings.[100] Accordingly, Recommendation 6 of the Hill Review states,

> Revise the Listing Rules which can require trading to be suspended in the shares of SPACs on announcement of a potential acquisition. Provide additional protections for shareholders at the time of the acquisition, such as a shareholder vote and redemption rights.

In light of the above recommendation, the FCA published its Consultation Paper CP21/10 in April 2021 (Consultation Paper). The Consultation Paper prescribed an "alternate route to the market for SPACs demonstrating higher levels of investor protection mechanisms."[101] The proposals were drafted by observing global market developments during the SPAC wave of 2020, recommendations by the Hill Review and stakeholder feedback.[102] The recommendations in the

[96] FCA Consultation Paper (n 20) 26.

[97] Financial Conduct Authority Technical Note, *Cash shells and special purpose acquisition companies,* (January 2018) <https://www.fca.org.uk/publication/ukla/tn-420-2.pdf> accessed on 19 February 2022.

[98] Listing Rules (n 21) LR 5.6.8G.

[99] UK Listing Review (3 March 2021) 11 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/966133/UK_Listing_Review_3_March.pdf> accessed on 31 July 2021.

[100] ibid 1.

[101] FCA Consultation Paper (n 20) 4.

[102] ibid 27.

Consultation Paper were aimed to remove barriers for listing of large SPACs and provide greater flexibility to SPACs which are backed by experienced management and have potential to reach a certain scale. Based on the responses received on the Consultation Paper, the FCA published its Policy Statement containing the Revised Listing Rules. The annexure to the Policy Statement contains the revised Primary Market Technical Note and the Listing Rules (Special Purpose Acquisition Companies) Instruments 2021 which amends the Listing Rules. These come into effect on 10 August, 2021. Considering the agency issues identified in Section III, this section will critically analyse whether the Revised Listing Rules properly protect the interest of retail SPAC investors in the UK.

B. Analysis of the Revised Listing Rules

(i) Exemption from the Presumption of Suspension of Trading

There exist strong incentives for SPAC Sponsors to push a deal through, irrespective of its merits, representing the misalignment of interest between the SPAC and its unsophisticated retail investors. As explained in Section III of this paper, these agency issues are exacerbated by a time-bound acquisition mandate and limited number of quality targets. It is argued that in such a climate, public investors need powerful signals to access the merits of a proposed acquisition.

The current regulatory regime for UK SPACs casts a presumption of suspension of trading of SPAC shares which locks in unhappy investors until a deal is closed. Currently, 40% of listed UK SPACs have their shares suspended.[103] It is argued that firstly, the lock-in deprives the retail SPAC investor of the advantages of high liquidity of the capital markets and imposes high opportunity costs on the retail investor who, could have otherwise withdrawn her investment from the SPAC. Secondly, SPAC investors are left in a period of uncertainty with limited or no information between the period of announcement and completion of the acquisition transaction. Thirdly, the lock-in has made the UK SPAC highly unattractive viz. other SPACs incorporated in US or Europe, which provide greater visibility, control, and liquidity to the public retail investor. Considering the points raised, it is argued that exemption from presumption of trading for SPACs with a higher degree of investor protection mechanisms, provides a valuable exit right for an unhappy retail investor and helps in the better allocation of capital in the public markets.

The Revised Listing Rules provide for a removal of the presumption of suspension of shares and thereby allows retail investors to react to the market.[104]

[103] FCA Consultation Paper (n 20) 26.

[104] Revised Listing Rules (n 30), LR 5.6.8(2).

Jenkinson and Sousa (2011) argue that the market can step in to provide signals to retail investors as to the exercise of their voting and exit rights between the period when a potential acquisition in announced and the decision date. Given that retail investors are unsophisticated, these market signals are valuable to solve the issue of information asymmetry and collective action. In an empirical study of US SPACs, it was observed that the SPAC share price between the acquisition announcement date and the decision date reflects the investors' assessment of the deal being proposed.[105] As on the decision date the SPAC share price reflects the market's evaluation of the proposed deal.[106] Subsequently, if the SPAC share is valued equal or below the trust value per share, the same is an indication of market signals that the deal is value destroying for the public shareholders. Conversely, a higher share price would indicate value creation. It is argued that such market signalling provides a good basis for retail investors to approve or reject a deal. It should be noted, however, that there are various methods in which SPACs can be structured to ensure that the deal is pushed through, irrespective of its merits. Furthermore, SPAC Sponsors may engage in vote buying from large institutional investors (who may be oppose to the proposed acquisition), closer to the approval date, in a bid to turn the vote positive. This would lead to an artificial demand in the SPAC's shares, thereby undermining the use of market signalling in the protection of retail investors.

(ii) Minimum Size Requirement

The Revised Listing Rules set a minimum size requirement for the aggregate gross cash proceeds raised in a SPAC IPO if it wishes to take the alternative route to suspension of trading. This has been set at £100m or more.[107] The purpose of the threshold is to judge a SPAC's ability to raise capital from large public investors. The FCA suggests that meeting such a threshold will require SPACs to have a high degree of institutional investment. The assumption being that institutional investors will (a) exercise a high degree of diligence when investing into a SPAC, without solely relying on inflated projections and celebrity optimism; and (b) heavily scrutinise potential acquisition proposals. The calculation of the threshold excludes any funds that SPAC Sponsors would have invested.

It is argued that an increased presence of institutional investors will lead to a higher level of due diligence at the time of the SPAC IPO and the De-SPAC Transaction. Presence of such sophisticated investors would lead to greater

[105] Jenkinson and Sousa (n 52) 41.
[106] ibid 42.
[107] Revised Listing Rules (n 30), LR 5.6.18A (1).

scrutiny of the investment proposals and provide adequate protection to the interests of retail investors. For example, the Financial Reporting Council's UK Stewardship Code, 2020 (Stewardship Code), lays down the framework for increased shareholder engagement and stewardship by large institutional investors. The Stewardship Code works on a 'comply or explain' basis where asset owners and managers must actively engage with issuers, holding them accountable on material issues, exercising rights and responsibilities with a view to create long-term value and sustainable benefits for the economy, environment, and society.[108] It is argued that an increased presence of public institutional investors in UK SPACs will help alleviate the issues faced by unsophisticated retail SPAC investors. As stated, however, in Section IV.B.(i), the role of large institutional investors in protecting retail investor interests must not be overstated. Moreover, the size of a SPAC is not relevant to the quality of its internal investor protection mechanisms or experience of its Sponsors.[109]

(iii) Ring-Fencing of SPAC IPO Proceeds, Redemption, and Repayment Process

The Revised Listing Rules provide that SPAC IPO proceeds should be 'adequately' ring fenced via an independent third party.[110] Furthermore, the purposes for which such ring-fenced funds can be used for are (a) funding an acquisition; (b) share redemptions; and (c) repayment of capital to public investors in case of SPAC liquidation or failure to meet the acquisition mandate. The Revised Listing Rules clarify that SPAC IPO proceeds may be used to fund working capital requirements, subject to adequate disclosure of specified amounts for such purpose in the prospectus filed at the time of the SPAC IPO.[111]

As highlighted in Section III of this paper, escrowing of SPAC IPO proceeds is essential to protect the interests of retail investors from managerial agency issues, dilution of the fund value and reducing the risks arising from the problems of free cash flow. To that extent, the Revised Listing Rules correctly identifies the requirement of ring-fencing SPAC IPO proceeds.

It is argued, however, that the provision does not provide effective protection against misappropriation and excessive diversion of funds to working capital expenses. Firstly, the method in which such funds are to be 'ring-fenced' or the level of protection offered to such funds has not been specified for the purposes of 'flexibility.' It is argued that such flexibility and vague direction to

108 Financial Reporting Council, The UK Stewardship Code 2020, Principle 1 <https://www.frc.org.uk/investors/uk-stewardship-code> accessed on 1 August 2021.

109 Financial Conduct Authority, *Investor Protection Measures for Special Purpose Acquisition Companies: Proposed Changes to the Listing Rules Policy Statement,* July 2021 (PS 21/10), 12.

110 Revised Listing Rules (n 30), LR 5.6.18A (2).

111 ibid.

ensure 'adequate protection' fails to prevent misappropriation. The Revised Listing Rules fail to mandate the use of trust structures and/or escrow accounts for the purpose of ring-fencing proceeds and leaves the same to the discretion of SPAC Sponsors. Secondly, there is no independence criteria specified for identifying third parties with whom the SPAC IPO proceeds are to be ring-fenced. The Policy Statement clarifies that such independent third parties should be 'appropriate,' experienced and a separate legal entity, free from any control or influence of the SPAC.[112] This may lead to funds being deposited and misappropriated by unscrupulous and unregulated third parties or other connected parties. Thirdly, by failing to specify a percentage threshold of IPO proceeds which can be used to fund working capital requirements, the same is left open to the discretion of SPAC Sponsors. It is argued that mere disclosure of specified amount of issue proceeds to be utilised to fund working capital needs does not provide adequate protection, as compliance of the same can be engineered through clever accounting practices.

(iv) Time-Bound Acquisition Mandate

The Revised Listing Rules provide that once admitted to listing, a SPAC must find and acquire a target within two years, subject to an extension for another year, following approval by its public shareholders.[113] A further extension of six months without shareholder approval is allowed in limited circumstances where the transaction is at an advanced stage.[114]

The introduction of a time-bound acquisition mandate is aimed to help focus managers' attention to finding an appropriate target and preventing squandering of proceeds during the 'hunt'. As argued, however, in Section III of this paper, given the current climate of many SPAC listings and few quality targets, a time bound acquisition mandate creates artificial pressure on the SPAC Sponsors, exacerbating the misaligned incentives of the Sponsors to push any deal through. This is further compounded by issues of information asymmetry and no prescription for strict due diligence of target companies, which makes monitoring by institutional shareholders or meaningful exercise of shareholders' voting rights for approving extensions more difficult. Having stated the same, the author welcomes the provision relating to further extension by six months for De-SPAC Transactions which are at an advanced stage. It is argued that such short-term flexibility prevents half-baked deals, allowing for greater diligence and scrutiny.

[112] FCA Policy Statement (n 109) 13.
[113] Revised Listing Rules (n 30), LR 5.6.18A (3).
[114] ibid, LR 5.6.18A (3)(c).

(v) Increased Disclosure and Supervision by the FCA

The Policy Statement provides for various transparency and disclosure requirements for SPACs wanting to take the alternate approach to suspension of trading, thereby increasing the flow of information to the SPAC retail investor. Firstly, a SPAC which contemplates taking the alternate approach must disclose the same in the prospectus at the point of its listing.[115] This is a mandatory requirement which must be satisfied when applying to the FCA for an exemption from the suspension of trading. Furthermore, there is a continuing obligation on the SPAC to notify the FCA if it changes or removes any of the specified investor protection mechanisms and request a suspension of trading.[116]

Secondly, the Revised Listing Rules mandate increased disclosure regarding the SPAC structure at the time of target announcement.[117]These disclosures are in addition to complying with the UK Market Abuse Regulations and the transparency rules. At the point of announcing an acquisition, to the extent possible, disclosures *inter alia* on the proposed material terms of the transaction including their effects on the shareholding of public SPAC investors, description of target's business, valuation of the target etc must be made.[118] It is argued that the introduction of such disclosure requirements will allow SPAC investors to exercise their votes more effectively.

Thirdly, in cases where a member of the SPAC's board has a conflict of interest in relation to a target or its subsidiary, the Revised Listing Rules state that the board must furnish a board statement, in sufficient time ahead of the shareholder approval vote on the proposed transaction, that the transaction is 'fair and reasonable' as far as the rights and interests of public shareholders are concerned.[119] The statement is to be backed by an 'appropriately qualified and independent adviser.' The Policy Statement leaves open the question regarding the independence and qualification of such an adviser.

Fourthly, the Revised Listing Rules provide that disclosure must be made of 'any other material detail and information that the SPAC is aware of, or ought reasonably to be aware of, about the target and the proposed deal that an investor in the SPAC needs to make a properly informed decision.'[120] It is argued that this provides for an important general information right to the SPAC retail investor, which may help reel in agency costs. The effectiveness of this right and its influence over target approvals and time extensions, will greatly depend on institutional

[115] FCA Policy Statement (n 109) 27.

[116] Revised Listing Rules (n 30), LR 5.6.18F.

[117] ibid LR 5.6.18D.

[118] ibid.

[119] ibid LR 5.6.18C.

[120] Revised Listing Rules (n 30), LR 5.6.18.D(2)(f).

investors. It is argued that given the minimum size threshold mandate of £100m or more, the increased stake of sophisticated institutional investors is likely to incentivise more monitoring by such investors, leading to benefits for the retail SPAC investors.

Lastly, the Policy Statement provides for a greater supervisory role of the FCA and states that SPACs which incorporate the prescribed investor protection mechanisms would have to apply to the FCA before announcing an agreed or contemplated transaction to avoid the presumption of suspension of trading.[121] At the point of listing, the Policy Statement states that the FCA shall provide comfort to the SPAC that it has met the prescribed investment protection criteria to enable it to apply for an exemption at the point of acquisition.[122] Thus, the exemption from the presumption of suspension of trading is not automatic even if a SPAC meets all the specified investor protection measures at the time of listing. The Revised Listing Rules provide that the SPAC would have to make a 'board confirmation' to the FCA that it has met all the criteria regarding investor protection at the point of listing and will continue to do so post announcement and until the completion of the De-SPAC Transaction.[123] The FCA may require the SPAC to produce evidence to support the written confirmation.

(vi) Voting and Redemption Rights

To a large extent, financial contracting ensures that modern day SPACs are more sensitive to the misaligned interests of sponsors and retail investors, than their blank-cheque predecessors. Structural and contractual safeguards prevent the risk of a bad deal being transferred to the investor. Chief among them are the contractual provisions of investor voice and exit. These coupled with the liquidity offered by the public markets ensure that retail investors have the option to walk away from a bad deal.

Accordingly, to prevent poor choice of targets and minimise conflict of interest issues, the Revised Listing Rules provide that potential acquisitions require SPAC board and shareholder approval.[124] Discussion and voting on such proposals would exclude a board member who (a) has a conflict of interest in relation to the target or its subsidiaries; or (b) is a director of the target company, its subsidiary or who has an associate that is a director of the target company or any of its subsidiaries.[125] Furthermore, the FCA introduces the all-important right for SPAC shareholders to approve the proposed acquisition through a majority voting

[121] FCA Consultation Paper (n 20) para 4.32-4.38.
[122] FCA Policy Statement (n 109) para 1.7.
[123] Revised Listing Rules (n 30), LR 5.6.18C.
[124] Revised Listing Rules (n 30), LR 5.6.18A (4) and (5).
[125] ibid LR 5.6.18A (4).

process. Under this, SPAC Sponsors are not allowed to vote on the issue of approving an acquisition, thereby avoiding issues of conflict of interest or vote manipulation (through market buy backs or private placement of SPAC shares). Derek (2007) identifies the various downsides of a blocked deal including wasted time and negotiations in hunting and structuring the potential acquisition and a blow to the reputation and ego of the SPAC Sponsor (who is left with worthless SPAC warrants).[126] It is argued that by empowering public shareholders with a right to reject potential acquisitions, issues relating to poor target choices can be reduced.

The Revised Listing Rules also state that SPAC shares should carry redemption rights, so that investors may exit their investment at any time prior to the completion of the acquisition and irrespective of whether the option holder voted in favour of the proposed acquisition.[127] This redemption right provides retail investors an important and cheap exit mechanism. When exercised, investors have a right to receive their pro rata share in the ring-fenced fund when the acquisition is completed.[128] Details of the redemption right is to be disclosed in the prospectus at the time of the SPAC IPO. The Policy Statement and the Revised Listing Rules indicate that the redemption option should specify a pre-determined strike price at which the option is to be exercised, fixed either as an amount or fixed pro rata share of issue proceeds which have been ring fenced.[129]

The power of the public investor to take control of the direction of the De-SPAC Transaction through voting and redemption rights, may lead many to believe that the modern SPACs should not be placed in the same category as its fraudulent black-cheque predecessor of the 1980s.[130] To an extent, SPAC Sponsors are maybe motivated to find quality targets driven by the fear of a negative vote on an acquisition proposal. It is argued, however, that the disciplining power of voice and exit of retail investors should not be overstated. Hirschman (1970) postulates that voice is an option for the dissatisfied only when exit is unavailable.[131] SPACs operate in an environment of high liquidity, allowing retail investors an exit if they do not like a deal. Unlike in private equity, where investors enjoy weak exit rights, investor exit rights in SPACs are strong and act, to an extent, as an alternative to the exercise of voting rights. Furthermore, for the SPAC retail investor, the ring-fencing of funds provides an attractive exit option, where

[126] Derek (n 31) 550.

[127] Revised Listing Rules (n 30), LR 5.6.18A (7).

[128] Rodrigues (n 6) 909.

[129] FCA Policy Statement (n 109) para 4.24.

[130] Derek (n 31) 550.

[131] Albert O Hirschman *Exit, Voice, and Loyalty: Response to Decline in Firms, Organisations, and States* (1st ed, Harvard University Press 1970) 34 <https://hdl-handle-net.gate3.library.lse.ac.uk/2027/heb.04043> accessed on 1 August 2021.

funds to finance the proposed acquisition are paid up front with an option to 'redeem' the same if not appealing.[132] Given the high coordination and information cost in exercising 'voice,' exit provides a cheaper route (relatively speaking) to an unhappy retail investor. Lastly, an exit reduces the funds available to finance the acquisition, making the target reluctant to go through with the deal, thereby disciplining SPAC Sponsors. It is thereby argued that in a SPAC, 'voice' of the retail investor is a residual option, whereas exit is a more powerful mechanism to deter opportunistic Sponsors.

As stated above, the issue of high information and coordination costs and a lack of effective monitoring of the SPAC Sponsor, make it difficult for the unsophisticated retail shareholder to make her voice heard. Thereby, any meaningful exercise of voting rights will be left to large and powerful institutional investors such as hedge funds. While discussing the power of voice and exit in US SPACs, it has been argued by Rodriguez and Stegemoller (2013) that the mechanisms of voice and exit created a holdout problem for SPAC Sponsors, which made it harder to get deals approved.[133] Post the financial crisis of 2007, hedge funds used this hold-out right to 'greenmail' SPAC Sponsors. Hedge funds used their voting rights to gain concessions from SPAC managers who were eager to close acquisition deals.[134] Rodriguez and Stegemoller (2013) argue that as a reaction, SPACs addressed the issue of shareholder voting right by effectively taking it away.[135] For example, in the United States, prospectuses of SPACs may not provide for shareholder approval of acquisitions and instead provide for a tender offer mechanism. Under this, the SPAC offers to buy back shares from dissenting shareholders,[136] thereby dimming the threat of a negative vote. Given that the FCA introduces a mandatory requirement ensuring shareholder approval of proposed acquisitions, such a tender offer route is unlikely to emerge in the UK. UK SPACs may still fall victim to the issue of hold-out by powerful institutional investors, who may force management to grant them concessions in exchange for votes, which may not always be beneficial for the retail investors.

V. Conclusion

The Consultation Paper and the Policy Statement recognise that the presumption of suspension of trading acted as a disproportionate barrier for both the SPAC investor and Sponsors, which kept UK from being an attractive destination for

[132] Rodrigues (n 6) 915.
[133] Rodrigues (n 6) 907.
[134] ibid 911.
[135] ibid.
[136] ibid.

SPACs.[137] In their analysis, the FCA concluded that the effectiveness of the proposed investor protection measures outweighs the advantages of the presumption of suspension of trading.

It is noted that SPAC structures have evolved overtime to imbibe various structural and contractual features that protect the retail public investor. The suggested investor protection mechanisms under the Revised Listing Rules are optional in nature and SPACs that meet the prescribed standards can apply to the FCA on a discretionary basis if the benefits of the same outweigh the costs. The changes draw from experiences in other SPAC-friendly jurisdictions during the wave of 2020 and have been drafted keeping in mind the protection of retail investors. The light-touch regulatory approach of the FCA is sensitive to the agency cost issues which have been highlighted in Section III of this paper. The Consultation Paper identified four issues which the Revised Listing Rules seek to address at various stages of the SPAC life-cycle (a) shareholder control; (b) conflicts of interest; (c) misappropriation of issue proceeds; and (d) options for issuers and increase investment opportunity for investors.[138] It is concluded that provisions such as ring-fencing of issue proceeds, increased transparency, additional disclosure requirements and introducing shareholder voting and redemption rights, goes a long way in addressing the four issues identified by the FCA and in protecting the interests of SPAC retail investors. This paper has also argued that an over-reliance on the participation and diligence of SPAC institutional investors in protecting retail investor interests is misplaced. Furthermore, it is yet to be seen whether such regulatory efforts, considering the ebbing of the SPAC wave, is nothing but an 'epic party followed by an epic hangover.'

[137] FCA Consultation Paper (n 20) 27.
[138] FCA Consultation Paper (n 20) 27.