

# UK, Brexit, and SPACs: the promise of a shell-company revolution

*SPACs (special purpose acquisition companies) are shell companies set up with a special purpose: to conduct an acquisition. The UK would like to position itself as the new, sophisticated jurisdiction for accommodating SPAC sponsors' and investors' needs. However, SPACs entail risks, like any other investment. **Daniele D'Alvia** writes that if those risks are contained through proper contractual risk allocation and enhanced governance, the UK can become the new "SPAC hub" in Europe.*

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SPACs are cash-shell companies set up, as their name indicates, with a special purpose: to conduct an acquisition. By the end of 2020, more than 240 SPACs listed in the US, on NASDAQ and NYSE, raising a record \$83 billion, according to SPAC Research. SPACs have already surged past last year's record in the first quarter of 2021, raising \$98.1 billion.

The [Lord Jonathan Hill Review](#) of the UK's listing regime is the London Stock Exchange (LSE) much-needed answer to the 'SPAC boom' in the US that started in 2020. This historical reform would like to introduce, for the first time, specific listing requirements for SPACs in the UK.

## The SPAC financial engineering

With SPACs, the capital is raised via an initial public offering (IPO) of unit securities composed of common shares and warrants. The proceeds are put into an escrow account until the acquisition takes place. The acquisition phase in which the capital is drawn down is defined in SPAC jargon as "de-SPAC", which will end with the listing of the new merged entity by virtue of a reverse takeover. The mechanism is simple: once the SPAC finds a suitable target company, it undertakes a reverse merger. In most cases, this results in the operating business becoming a publicly traded company that effectively "takes over" the public company status of the SPAC.

The acquisition and the subsequent release of funds for the acquisition generally take place between 24 and 36 months from the incorporation of the SPAC. This period can vary, depending on the practices of the exchange and jurisdiction in which the SPAC is listed. In case of failure of the acquisition, the SPAC will be wound up and the funds returned to investors.

## Analysing the proposed SPAC regime

Under the current UK legal regime, there is a presumption that a SPAC has to suspend the trading of shares once a target is acquired, because of reverse takeover rules. Hence, investors are locked in, even if they do not approve a potential purchase. The Hill Report calls for the removal of this presumption and introduces new safeguards, such as the right of SPAC shareholders to vote on the acquisition, and the right to redeem their initial investment prior to the completion of the business combination. Furthermore, the following more general recommendations, among others, will facilitate the listing of SPACs:

1. Lowering the limit on the free float of shares in public hands to 15 per cent. This means that SPAC sponsors will need to sell fewer shares to list.
2. Allowing dual-class share structures even for premium listed companies. These will allow SPAC founders to retain control through stock that carries more than one vote.
3. The UK Government shall examine those recommendations, many of which require consultation with the Financial Conduct Authority (FCA). The FCA opened its [consultation paper](#) on 30 April 2021.

## Final remarks

The Hill report focuses on capital markets' flexibility: this is a key feature for any cash-shell company. However, some additional SPAC features also merit consideration and shall be further analysed, such as the percentage of IPO proceeds to be held on trust and the possibility of including the appointment of independent directors in SPACs' board of directors. The Hill Report, as well as the FCA's consultation paper, are silent on those features. By contrast, since 2008, NASDAQ's rule IM-5101-2 and NYSE's rule 102.06 govern the escrow account proceeds. Additionally, NASDAQ expressly requires the appointment of independent directors in SPACs' board of directors.

In SPACs, the redemption right aims to facilitate the completion of the business combination. It would help if the FCA further clarified two relevant aspects before the new SPAC regime enters into force:

a) Whether the so-called decoupling mechanism is going to be available in the UK too. Consider that in the US, in the de-SPAC phase, SPACs are required to offer shareholders the right to redeem their shares for a pro-rata portion of the proceeds held on trust. This possibility was originally reserved only to shareholders who voted against a proposed business combination. Since 2015, SPACs grant a redemption right to every shareholder no matter how they vote on the business acquisition, and while also retaining their warrants. In other words, the redemption right has been decoupled from voting against the business combination.

b) Whether warrants shall be tradeable until the completion of the business combination. This can constitute a challenge to new SPAC dynamics in the UK because "aggressive" investors such as hedge funds might find in the business combination announcement an opportunity to redeem shares, cashing in the pro-rata amount of the escrow account while still retaining the warrant. This allows speculators to obtain new higher-priced shares after the business combination by simply exercising the warrants at the pre-established strike price.

SPACs undoubtedly entail risks, like any other investment. However, those risks can be contained through proper contractual risk allocation and enhanced governance, for instance by mandating independent directors and/or the decoupling mechanism. Only if those issues are properly addressed can the UK become the new "SPAC hub" in Europe.



Notes:

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