Is it SPAC to basics in the British Virgin Islands?

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The special purpose acquisition company (SPAC) boom is over, but not the SPAC market, as it enjoys a "return to mean" and very possibly a soft landing in this part of the Caribbean.

The mood among influential market participants remains cautiously optimistic. After all, the SPAC remains a more efficient, quicker and price-certain route to market than most alternatives. Even in the current market, SPACs and de-SPACs still accounted for over 50% of US public market entries in 2023.

In this article, BVI partner Michael Killourhy looks at how SPACs went from boom to bust, how the market is recovering, and how offshore jurisdictions like the BVI might shape the SPAC market of the future.

The SPAC alternative

SPACs are essentially cash shells, formed with the sole purpose of acquiring an existing business from the proceeds of their own initial public offering (**IPO**), and usually with the combined entity then succeeding to the SPAC's market listing – making SPACs an alternative means of going public. Once formed and funded, a SPAC usually has between 18 – 24 months to find a suitable target or else liquidate and return the IPO funds to investors.

For targets, going public by being acquired by a SPAC (referred to as a "de-SPAC") can be a quicker, less invasive alternative to a traditional IPO because certain US Securities and Exchange Commission (**SEC**) regulations applicable to an IPO do not apply to a de-SPAC.

Additionally, in volatile markets a de-SPAC offers more price certainty because valuation is agreed directly between the SPAC and target months before closing, while in traditional IPOs valuation is ceded to the underwriters, who cannot guarantee any pricing until close. Time is also an attraction, the entire de-SPAC process can take as little as four months to complete, whereas most IPOs take over nine months with no price certainty.

From boom to bust

The popularity of SPACs skyrocketed in 2020 as pandemic induced market uncertainty fuelled demand for alternative investments. SPACs raised billions of dollars during 2020 and 2021, but by the end of 2022 the boom was over. SEC scrutiny, threatened new regulation, new taxes, increasingly cautious investors, too many SPACs and too few targets, brought "SPAC mania" to an end.

SPACs are not new, they have existed for decades. First emerging in the 1970s, SPACs were used extensively during the 1980s by small companies having trouble raising capital on the open market. But by the end of the decade, loosely regulated SPACs all but disappeared after a series of frauds and scandals. By the early 2000s, however, SPACs were back. A more regulated SPAC market emerged which, in 2007, accounted for almost 25% of all US IPOs, but this SPAC renaissance became victim to the 2008 Great Recession.

The current SPAC wave began around 2012 as businesses sort alternatives to private equity investment. After seven years of solid but unspectacular growth, SPAC IPOs surged during 2020. Fuelled by pandemic uncertainties and volatility, SPACs became hugely popular. To illustrate just how popular, consider that in 2019 59 new SPAC IPOs raised around US$13.6 billion, but in 2020 the number of new SPAC IPOs rocketed to 248, raising over US$80 billion. The 2020 figures were dwarfed by 2021's when new SPAC IPOs reached 613, with US$162.5 billion raised.[1] This was "SPAC mania", and SPAC entered the "celebrity phase". US sports stars such as Colin Kaepernick, Shaquille O'Neal, Larry Kudlow, and baseball legend Alex Rodriquez joined media personalities including pop star Ciara, Jay-Z, and lifestyle guru Martha Stewart as SPAC sponsors and investors.

By December 2022, however, the SPAC boom was over in what the Wall Street Journal referred to as a "frenzy of liquidation". Failed SPACs were quickly wound-up before year end, and planned ones were cancelled at an astounding rate. 2022 closed with just 86 SPACs raising only US$13.4 billion in total.

A number of factors contributed to bringing the SPAC boom to an abrupt end:

- the SPAC market had become oversaturated, many soon found it increasingly difficult to find suitable targets, while those that did performed badly after closei
- in March 2022, the SEC announced planned regulations which would increase the disclosure burden on SPACs and impose significant new restrictions on them
- SPACs just ceased to look like good investments, as interest rates rose against inflation, other investment hedges looked more profitable

- the new excise tax on share redemptions introduced by the US Inflation Reduction Act of 2022 (see below) conspired with the other factors to dampen their appeal

What is the future of SPACs?

The SPAC boom is over, the level of activity seen during 2020 to2022 will not return any time soon – but that does not mean that SPACs are dead. The SPAC remains a more efficient, quicker and price certain route to market than most alternatives. Even in the current market, SPACs and de-SPACs still accounted for over 50% of US public market entries in 2023.

The optimistic view is a "reversion to mean", the return of the solid but unspectacular SPAC era just before 2020: fewer SPACs, better targets, lower values, and fewer celebrities. This was certainly the hope emerging from the Annual SPAC Conference in New York earlier this year: as the market stabilises and the number of SPAC deals decreases, the quality of those deals and returns on investment increases, and the SPAC thereby reconnects with its roots and value. As SPACs do this there is hope that their ability to evolve in accordance with new markets (as shown since the 1970s) will keep their edge on traditional IPOs (which have not changed much in decades).

If future SPACs can evolve to meet the market and at the same time adhere to any new regulation (albeit that the threatened SEC measures were not implemented) and improve target selection and diligence, then the SPAC should remain a long-term dealmaking tool.

American exodus

While the majority of Nasdaq-listed SPACs have been Delaware corporations, offshore SPACs and BVI ones in particular are certainly not uncommon. For non-US sponsors seeking targets outside the US, a BVI incorporated SPAC can be advantageous - exposure to US related taxes is minimised while a number of SEC and Nasdaq rules concessions apply to non-US issuers qualifying as Foreign Private Issuers (**FPIs**), excluding them from certain financial, administrational and disclosure obligations which might otherwise apply.

As many believe that the muted but more substantive post-boom SPAC market is also likely to be more international, then we will likely see more SPACs established offshore as FPIs. The appetite for US-listed SPACs in Asia remains and is spreading beyond China and Hong Kong to India, Philippines, and Thailand. SPACs sponsored from and focussing on these jurisdictions, but still seeking a US listing, will likely look to BVI for incorporation, the historically popular jurisdiction for Asia.

But the appeal of offshore SPACs might not be just limited to those outside the US, there are also increasing attractions for domestic participants and speculation that Delaware's position as the jurisdiction of choice for US sponsors may be under threat.

The two most significant reasons for a potential exodus offshore are the Delaware Court's recent rulings on SPAC director fiduciary standards and, unsurprisingly, the new US federal excise tax on redemptions referred to earlier.

The MultiPlan fallout

The decisions of the Delaware Chancery Court in the cases of *re Multiplan Corp. Stockholders Litigation (2022)* and *Delman v. Gigacquisitions3, LLC, et al*. (2023) sent shocks through the SPAC industry. Both cases concerned the proper fiduciary standard to which SPAC directors should be held when approving a merger.

In each case the Delaware Court held that in certain circumstances SPAC boards are subject to a higher standard for the proper discharge of their fiduciary duties because of the potential for conflicts of interest between directors, sponsors, and public shareholders. The Delaware Court held that in such circumstance boards should act under an "*entire fairness standard*" rather the conventional "*business judgment rule*". The entire fairness standard requires boards to consider the fairness of their dealings to all investors, while under the business judgement rule the directors need just act reasonably in the context of a company's business interests and courts grant more deference to the opinion of the directors when considering whether this is met.

US Inflation Reduction Act Excise Tax

The US Inflation Reduction Act of 2022 imposed a 1% excise tax on the repurchase of corporate stock by a publicly traded US corporation after 31 December 2022. The excise tax would likely apply to many of the share redemption actions by US domiciled SPACs, including merger approval redemptions and lifespan extension redemptions (though there is still some debate on whether "end of life" redemptions, where the SPAC fails to find a suitable target and terminates, are included).

Soft landings in the British Virgin Islands

Given the above, whatever shape the SPAC market might take in the future, a significant part of that future may lie in offshore jurisdictions like the BVI.

For the present, there is no equivalent to the fairness standard doctrine in the BVI – where a form of the business judgment rule is still the only applicable standard for the discharge of fiduciary duties. Similarly, there is less risk of getting hit with the excise tax for a SPAC that is incorporated in the BVI.

Could these factors then lead to a real exodus of SPACs to jurisdictions like the BVI? That is certainly the conclusion of at least one senior US law firm partner, active in the SPAC market, who suggested that offshore SPACs incorporated in jurisdictions such as the BVI and Cayman Islands might outnumber Delaware incorporated ones in the not-so-distant future.

[1] All data taken from SPACInsider (https://www.spacinsider.com/). The SPAC industry's leading independent data source.

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Meet the Author

Michael Killourhy

Partner

British Virgin Islands

E: michael.killourhy@ogier.com

T: +1 284 852 7309

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