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UK Securities Law Update – Cash Shell/SPAC regulatory developments

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Introduction

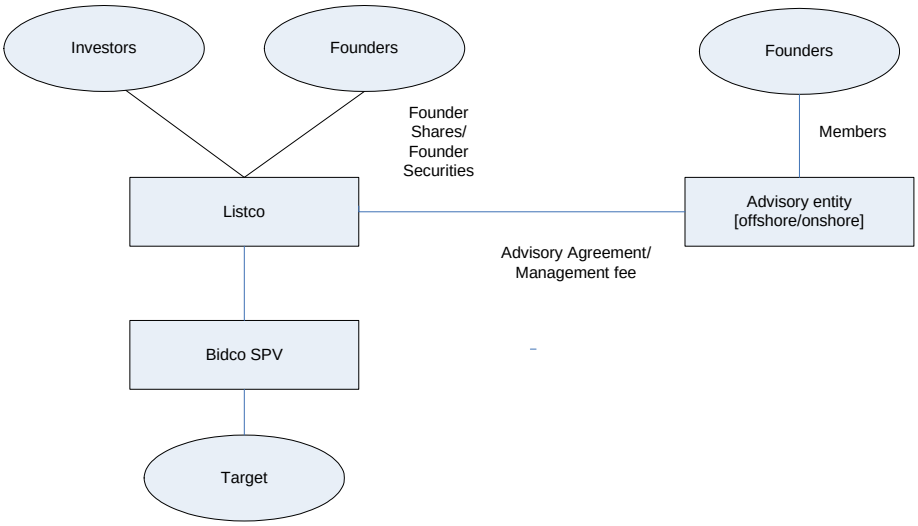
The UK Financial Services Authority ("FSA") has issued a consultation paper setting out various proposed amendments to its Listing Rules, Prospectus Rules and Disclosure and Transparency Rules which will be of fundamental importance to cash shells or special purpose acquisition companies ("SPACs") with or seeking a UK main market listing.

In its consultation paper the FSA has highlighted various concerns it has with the typical UK-listed cash shell structure and, in particular, the tendency for such structures to outsource significant management functions of the issuer to an off-shore advisory firm.

This *Stay Current* sets out the FSA's proposals and considers the legal and practical implications they may have for these structures going forward. It will be of interest, amongst others, to those contemplating raising funds via a cash shell or SPAC and considering the various structuring and listing options available.

Background to the FSA's concerns

The FSA's proposals are driven by its concerns regarding the "external management" component of cash shells, which typically have the following investment structure[1]:



[1] Structures can vary in that the "promote" or "incentive allocation" can be taken beneath the Listco level.

In many respects UK cash shell structures resemble a typical set-up for a private equity style fund. Whilst it has been common for UK cash shell structures to be set up with a purely non-executive board function, recent structures (such as Vallares, Vallar and Justice Holdings) have also tended to have the key individual sponsors appointed to the board of the listed vehicle, usually on a non-executive basis, but in some instances recognizing that they may step up to perform an executive function once an acquisition has been made.

Under the typical UK cash shell structure, an advisory entity (beneficially owned by the sponsors) is commonly (although not exclusively) set up to advise the listed cash shell and provides various services to the listed vehicle, such as formulation of strategy, decision-making on acquisitions and negotiations and subsequent integration management, in return for a fee.

The FSA's principal concern is that, substantively, it is the advisory firm that is providing the executive management of the listed company and not the board. By not maintaining the executive functions exclusively within the listed vehicle, as would be common for other listed commercial companies, there are various key provisions within the premium listing regime which would only apply to the board of the listed company and would not extend to the "executive" within the advisory company. Examples include: prospectus liability, related party rules and transparency requirements related to board remuneration and dealings. The FSA's concern is that this is fundamentally at odds with the expectations of stakeholders in the UK premium listed regime.

The FSA's proposals

In light of the above considerations, the FSA has proposed two changes to the Prospectus Rules ("PRs") and Disclosure and Transparency Rules ("DTRs") in order to bring the executives of the advisory entity within the ambit of some of the same rules in relation to accountability and transparency to which the executives of a listed company are otherwise subject. In this regard, the FSA is proposing to make the principals of the advisory entity primarily responsible for any prospectus published by the listed company (PR 5.5) and separately to make it clear that principals of the advisory entity can fall within the definition of "persons discharging managerial responsibilities" such that they would then be within the ambit of the DTR requirements to disclose information relating to their share dealings (DTR 3.1), notwithstanding that they are not directors or senior executives "of the issuer".

However, and more significantly, the FSA is also proposing to amend its Listing Rules to make clear that a cash shell adopting this structure cannot be eligible for a commercial company premium listing (an investment funds premium listing would still be open for the vehicle, though amongst other things this would require it to have an investment policy consistent with the object of spreading risk, which tends not to be the model for UK cash shells). Before a cash shell makes an acquisition it is ineligible for a premium listing as it does not have an independent business with the requisite three year track record and, as such, these vehicles typically seek a standard listing on admission. The cash shell will then commonly look to seek to migrate to a premium listing after it makes an acquisition on the basis of the target's track record. Whilst a premium listing brings with it additional "super-equivalent" obligations on an issuer over the EU-directive minimum, a premium listing may allow for a lower cost of capital for an issuer and also allows for FTSE index inclusion, which a standard listing does not.

Implications for the market and future cash shells

At this stage the FSA's proposals are at the initial stages of a consultation. However, if implemented, the changes could have profound effects for those looking to raise funds by way of a UK cash shell model.

On a practical level, if the FSA's changes go through and a premium listing is important to the cash shell once an acquisition is made, then a structure involving the separate advisory entity would only be feasible for the period from launch of the cash shell through to the making of an acquisition and the advisory structure would need to be unwound at the point of seeking a premium listing. If the sponsors do not believe that the advisory entity model should fall away once an acquisition is made, then a premium listing will not be available, and in that case it would need to consider whether another listing regime, such as a standard main market listing or a listing on AIM, might be more appropriate or beneficial. There would therefore be an important trade off between the tax and corporate structuring, which could include a consideration of the personal tax affairs of the sponsors, and the benefits that a premium listing might ultimately be expected to bring.

It is also worth noting that the "outsourcing" of the executive function is one of the principal differences between a typical UK cash shell structure and Euro-SPAC structure (such as Liberty International, Helikos, Italy1 and Germany1), which tends to have both executive and non-executive directors sitting on the board of the listed vehicle. The Euro-SPAC market has been relatively quiet recently compared to London, which has been the venue of choice for these vehicles over the past few years. Although we do not expect the FSA's proposed changes, if implemented, to be the principal driver of structure and listing for these vehicles, sponsors will be nevertheless be conscious of this development when considering which structure and venue to opt for. It may be that, going forward, the London market adopts more of the Euro-SPAC style structure as regards governance and board composition, than it has done to date.

The FSA's consultation can be found here and closes on 26 April 2012.

A copy of our previous briefing on cash shell listings in the UK can be found here.

A copy of our previous briefing on the general structure of the UK listing regime can be found here.

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If you would like any further information in relation to the developments above, please contact your usual Paul Hastings contact or any one of the lawyers below. Paul Hastings has considerable experience advising sponsors and issuers on the structuring and admission of cash shells and SPACs across the UK, Europe and the U.S. and would be pleased to discuss any of these issues with you.

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