The Governance of SPACs and DCS Companies

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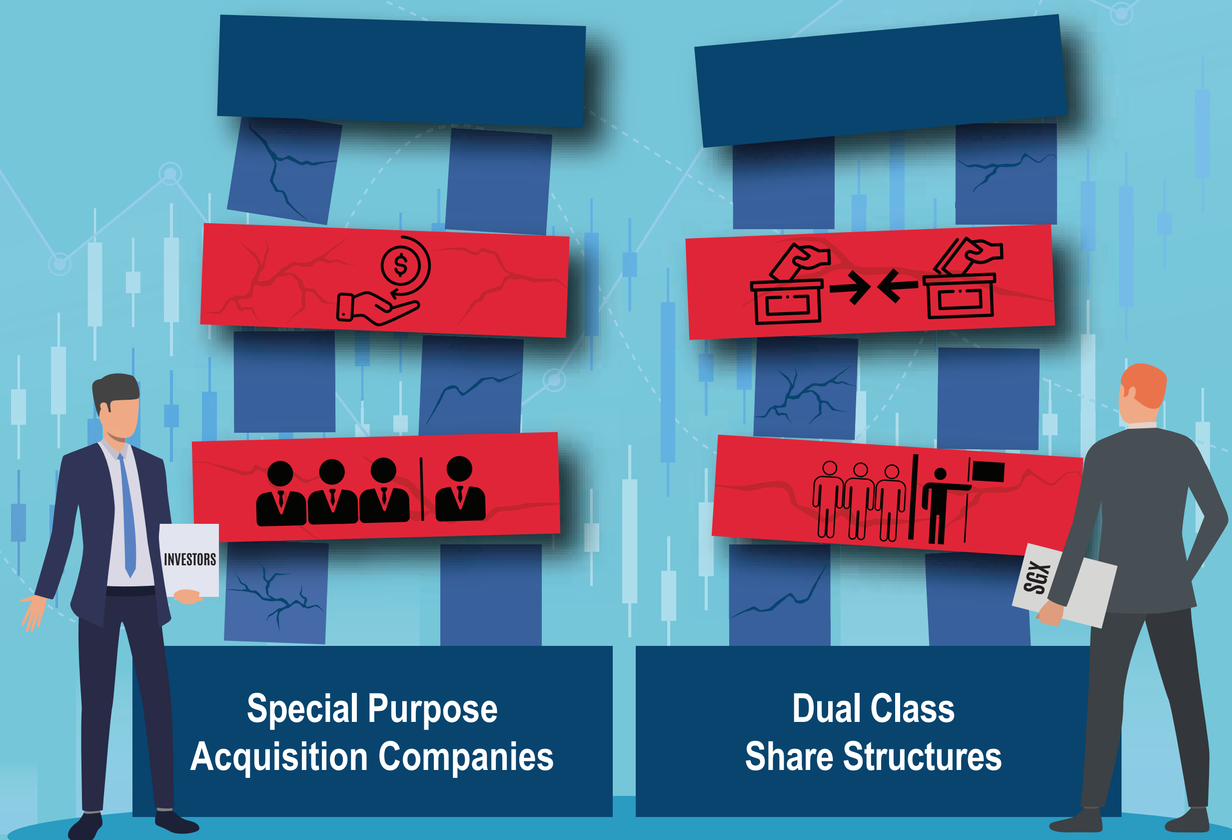


Growing interest from investors and sponsors has pushed efforts by Singapore regulators to offer alternative capital raising routes and make the city more attractive as a global listing venue. However, some of the recent structures, such as dual class listings and special purpose acquisition companies, have raised governance and other concerns.

In recent years, Singapore Exchange (SGX) has made attempts to boost activity in its sluggish initial public offering (IPO) market.

In 2018, it gave the go-ahead for companies with dual class share (DCS) structures to seek a primary listing on its main board. In 2021, it became the first exchange in Asia to allow listings by special purpose acquisition companies (SPACs). Allowing SPACs and companies with a DCS structure to list on SGX is one way to attract startups and technology companies to list in Singapore.

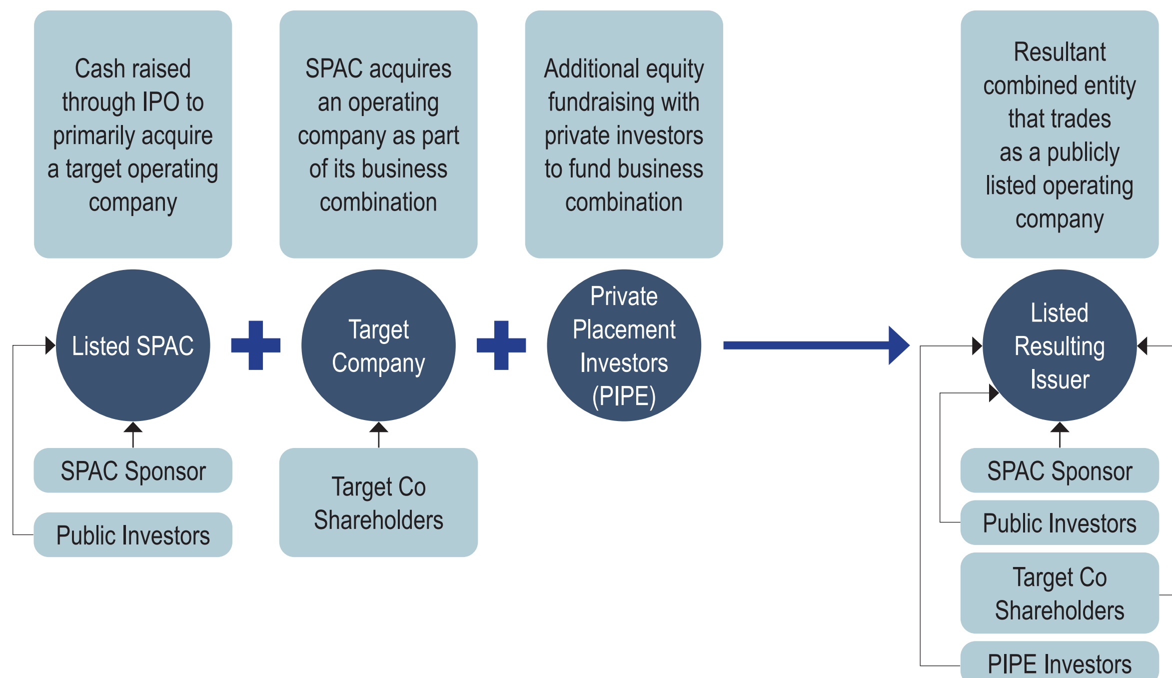
Compared with traditional IPOs, SPACs often provide higher valuations, greater speed to capital, and fewer regulatory demands. DCS companies also protect entrepreneurial management from the demands of ordinary shareholders. These structures tend to be attractive to technology companies because such companies are usually not profitable in the initial years and a SPAC generally provides for higher valuations.

However, SPACs and DCS listings have been associated with potential misallocation of capital and poor corporate governance practices. For instance, there could be conflicts of interest existing between target companies, SPAC sponsors and investors. A thin line exists between aggressive projections and misrepresentations during the de-SPAC (merger) process. (See box, "Typical SPAC Structure").

Moreover, there are potential corporate governance issues relating to SPACs and DCS companies.

Economic structure of SPACs

The economic structure of a SPAC creates an inherent conflict between a SPAC's sponsor



and its public shareholders. That conflict arises because the only decision a SPAC's management must make is to either merge or liquidate.

If a suitable target is identified, the sponsor would be keen for the SPAC to enter into a merger that is value-increasing for all shareholders, but the sponsor will nonetheless make money even in a merger that is a losing proposition for the SPAC's public shareholders. The latter is a real risk, given that under the SGX Listing Framework, the de-SPAC transaction must be completed within 24 months of the SPAC listing, subject to an extension of 12 months.

This puts time pressure on the sponsor to find a suitable target, even if there is none. On the other hand, in a liquidation, the sponsor loses its initial investment and gains nothing, while the public shareholders receive their pro-rata share of the SPAC's IPO proceeds.

When a SPAC proposes a merger, each public shareholder has the right to redeem its shares. Those who view the merger as yielding less will presumably redeem. If the volume of redemptions is high, there is a risk that a merger will not close. However, even if the merger closes, more redemptions will reduce the value of the sponsor's shares post-merger. A sponsor, therefore, has an interest in keeping redemptions low.

Governance issues in SPACs

There could be instances of weak corporate governance in SPACs, which may possibly lead to a claim for breach of fiduciary duties. If directors of SPACs are not vigilant, there could be a case made that the SPAC's directors did not adequately disclose information material to the shareholders' decision on whether to redeem their shares in the de-SPAC merger. The governance challenge for a SPAC is to protect its public shareholders from the conflicting interests of the sponsor in choosing to merge.

First is the shareholders' redemption right. The redemption right is central to the protection of a SPAC's public shareholders. It is supported by an escrow account that holds at least 90 per cent of the gross proceeds of a SPAC's IPO. Under the terms of the escrow account, shareholders who redeem their shares have the first claim to that cash.

The cash in the escrow account is not distributed to the SPAC until each public shareholder decides whether to retrieve their cash by exercising their redemption right. Once shareholders have made that decision, the escrow agent pays out the remaining cash to the SPAC. It is difficult for the redemption right to serve its function unless shareholders receive all material information (including any adverse information) related to the value of their shares in a proposed merger.

Second is for the sponsor to place independent directors in control of the SPAC's merger decision. Under the SGX SPAC Listing Framework, a majority of directors in the board committees (including the respective chairmen) must be independent of the SPAC promoters. However, a truly independent board will be put in place only if the sponsor so chooses.

If a sponsor fills the boards with individuals with whom it has strong financial or personal ties, the directors may be compensated in ways that align their financial interests with the sponsor's interest and not the public shareholders' interest. A typical arrangement is to give directors "founder shares", i.e. the class of shares the

sponsor holds. Those shares do not participate in a liquidation, so the directors share the sponsor's interest in accepting a value-decreasing merger rather than liquidating.

A SPAC governed by directors who have ties with a sponsor and who are compensated in this way is equivalent to a SPAC governed by the sponsor, and this could imply a breach of the duty not to fetter discretion.

Governance issues in DCS companies

There are also a number of governance issues with the DCS structure. An increasing number of newly-listed companies have introduced classes of shares with superior voting rights, which typically allow company founders and top executives to maintain company control even as their economic stake in the business may diminish. Such ownership arrangements pose risks to common shareholders as there is a discrepancy between control and economic ownership which reduces accountability to the economic owners of the business, by entrenching management and skewing incentives.

Proponents of the DCS structure contend that control is necessary to protect the company from the short-term pressures of the market and to allow management to focus on growth and long-term strategy. From a corporate governance perspective, investors generally favour the one-share, one-vote capital structure.

Companies with DCS structures are likely to lack independent board leadership. For instance, DCS companies may not have an independent lead director or an independent chair on their board. DCS companies may also appear to have concentrated CEO ownership, where the CEO of such companies has significant voting power.

Companies with DCS structures are also more likely to exhibit related-party transactions involving the CEO, which may raise concerns about potential conflicts of interest. DCS companies, which tend to be startups, are also less likely to disclose their director evaluation process, which may serve as an indicator of poor board accountability, renewal and diligence.

The ownership structure of a DCS company could undermine accountability over the long term. And the challenges faced by technology and venture capital firms highlight the need for robust governance and accountability.

Balancing interests

There is a possibility that SGX may regulate to address these issues. However, there is a balance to be struck. Over-regulation would mean that Singapore would lose SPAC and DCS listings to other markets.

At its core, the economic structure of a SPAC appears to create a conflict between its sponsor and its public shareholders over the decision to merge and over the public shareholders' decisions to redeem their shares. An ideal situation would be for a sponsor to organise the governance of a SPAC in a way that deals with these conflicts, by appointing truly independent directors to the SPAC board and compensating them in a way that aligns their interests with those of public shareholders.

Instead of recommending a total ban on DCS listings, companies with dual class structures could be required to implement a mandatory sunset clause, or, perhaps after a period of predetermined years, to gain approval from a majority of all shareholders to continue the dual class structure. ■