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Foreign Private Issuers Get Less Scrutiny

Status Hard to Maintain, Can Pose Tax Problems

by Joshua Sisco

There are currently 20 to 25 SPACs in registration that are invisible to all but the lawyers and bankers involved in the offerings. These SPACs registering under the Securities and Exchange Commission's Foreign Private Issuer regulations are not required to publicly disclose information about themselves until their registration statements become effective. Nor do they have to file the 10-K's and 10-Q's required of domestic companies on U.S. markets.

But the primary advantage that foreign private issuers have over U.S. SPACs is the ability to send proxy materials to investors without first having to solicit the SEC's approval.

Bob Wray is a Tokyo-based attorney with **Skadden, Arps, Slate, Meagher & Flom**. He said he is currently working with one SPAC with foreign private issuer status and expects to advise others. The process is similar to that for U.S. issuers, but with a few notable differences, he said.

"The initial registration statement can be reviewed confidentially in order to resolve any difficulties out of public view," Wray said. Additionally the SEC does not require registration fees until a final statement has been approved and will be

filed on EDGAR.

SPACs with foreign private issuer status are subject to significantly less rigor from the SEC than U.S. SPACs. But the management teams of foreign SPACs almost always voluntarily subject themselves to the same standards as U.S. issuers, according to several attorneys interviewed for this article.

All foreign private issuer SPAC teams have agreed with their underwriters to voluntarily include in their proxy materials, all the information that would normally be required of U.S. issuers, according to David Miller, managing partner with the law firm of **Graubard Miller**. Foreign issuers' proxy material is also voluntarily filed with the SEC on Form 6-K.

SPACs with foreign private issuer status also use the same established structures as U.S. SPACs, with comparable amounts of money placed in escrow, and the same shareholder-approval thresholds and time limits to find mergers, according to Doug Ellenoff with the law firm of **Ellenoff Grossman & Schole**.

Though there are significant advantages held by foreign private issuing SPACs, it is not always easy to be granted and retain that status. There are a number of requirements that must be met, according to Wray.

Chiefly, less than 50% of the SPAC's voting shareholders must be based outside the U.S. That's not always an easy thing to ensure, Wray said. SPACs' shareholder bases turn over from the original risk-arbitrage shareholders who buy in at the IPO to the longer-term investors buying into the "story," and as managements buy out share-

holders who are likely to vote against proposed mergers. The majority of investors can easily shift to a U.S. base.

SPACs can be exempted from the majority foreign shareholder requirement if they meet other standards, however. To do this, a SPAC must be domiciled offshore (They usually are based in the Cayman Islands, though some are based in Hong Kong or the British Virgin Islands.); its escrow fund must be held in a offshore account; its board must have a majority of foreign directors; and its acquisition target must be a non-U.S. company.

One SPAC attorney said that it is not always easy to retain foreign private issuer status. He pointed to **Hambrecht Asia Acquisition Corp.**, which recently completed its IPO. Hambrecht started out filing the foreign, F-1 forms, but switched over to the traditional U.S.-issuer status.

Other differences according to Wray include more relaxed disclosure requirements for foreign private issuers. They are exempt from reporting executive compensation. They are not required to report beneficial ownership under Section 16 of the Securities Act. The rule requires disclosure of insider ownership of 10% or more.

Foreign issuers also don't have to comply with Regulation FD.

But despite the exemptions from regulations, most SPACs operating as foreign private issuers report all of the relevant information to all investors, according to Wray.

A Quicker Proxy

The principle benefit of this status is that the SEC doesn't review proxy statements for mergers by foreign private issuers. This can cut as much as three or four months from the time it takes to complete a merger, according to Ellenoff. That's especially helpful when negotiating deals in countries such as China, where unforeseen regulatory issues can mean the difference between a successful deal and liquidation.

"SPACs looking for acquisitions in China have every reason to operate as a foreign private issuer," Ellenoff said. "It does not make sense not to."

Foreign private issuer **ASM Acquisition Co.** could raise close to \$175 million in its planned IPO, including over-allotments. It plans to acquire a company in Asia.

The SPAC is not privately filing, however, as evidenced by its preliminary prospectuses, available on EDGAR.

ASM's underwriters and management decided that there is not a distinct advantage to privately filing, according to the person familiar with its offering. The SPAC will still have the benefit of being able to publish a proxy without SEC review. But the company and its underwriters were concerned that not making other filings with the SEC might lead prospective investors to think that ASM may be developing a different structure from other SPACs, or that it would not oblige all disclosure requirements.

Shanghai Century Acquisition Corp.'s experience illustrates the possible benefits of foreign private issuer status. In May 2007, Shanghai Century announced a deal to acquire Chinese pharma company **Kelun Pharmaceutical**. But Shanghai Century terminated the agreement this February after problems gaining Chi-

nese regulatory approval. Concurrently, Shanghai Century announced an agreement to merge with financial services company **New Goal International**. This was only possible because Shanghai Century was able to bypass SEC approval, according to investment bankers.

The Tax Man

Offshore SPACs classified as foreign private issuers and those subject to standard reporting requirements often have tax issues arising from their potential status as passive foreign investment companies (PFICs), according to partners at **Rothstein Kass**, a public accounting firm that serves SPACs.

The PFIC rules are designed to prevent investors from inappropriately deferring U.S. tax on investment income through offshore funds or companies.

A foreign private issuer SPAC will generally qualify as a PFIC during its pre-acquisition period. That's because a SPAC has no operations during that time and its total assets essentially consist of a "passive" pool of money that generates investment income, according to Dan Byrne, a tax partner at Rothstein Kass.

A U.S. investor in a SPAC that is a PFIC should make either a so-called "qualified electing fund" (QEF) election, or a "mark-to-market" election, according to Byrne. Otherwise, the investor's gain upon disposition of his or her SPAC shares and warrants, even several years into the operating company's existence, will be subject to U.S. tax at the 35% ordinary income tax rate, plus a punitive interest charge, rather than the 15% long-term capital gains tax rate that hedge fund investors pay on gains from similar long-term holdings.

Some foreign private issuer SPACs can avoid being classified as PFICs in their first year, however. The "start-up year exception" can generally be met if the SPAC makes an acquisition in its

first full year of existence, according to Jeff Somers, an audit partner at Rothstein Kass.

With a foreign-based SPAC, it is essential, from a U.S. tax perspective, that a deal be closed as soon as possible to qualify for the PFIC start-up year exception, Byrne and Somers said.

Hashing It Out with Amex

Until recently, the American Stock Exchange would not list the shares of SPACs unless their proxies had been reviewed by the SEC. Approximately three months ago, the Amex agreed to list foreign private issuer SPACs with no proxy review, according to Ellenoff. Previously, these SPACs would be listed on the Bulletin Board. **China Growth Affiance**, which recently filed its first public registration statement, is the first foreign private issuer SPAC to propose listing on the Amex.

Miller and Ellenoff said there were extensive negotiations between Amex staff and securities lawyers representing SPACs, to assuage the Amex's reservations about foreign private issuer SPACs listing on the exchange. Most notably, it was agreed that any foreign private issuer SPAC would file quarterly reports and any material announcements in addition to the required annual and semi-annual reports.

Miller said he expects the Nasdaq and New York Stock Exchange to eventually list foreign private issuer SPACs along with domestic SPACs.

"Back in 1993, we tried to get SPACs listed on Nasdaq, but were turned down at the last minute," he said. "It doesn't take a lot of guts for [Nasdaq and the NYSE] to now list SPACs in any form."

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