Japan Corporate & Finance Insights February 2023

SPAC in Japan

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February 28, 2023

I. Introduction

Special Purpose Acquisition Companies (also known as "SPACs"), have been drawing attention in Japan recently after a SPAC sponsored by a major Japanese investment firm and another SPAC targeting Japanese companies were both listed on the American NASDAQ Stock Index in 2021, which has prompted the Japanese government to discuss the potential creation of a Japanese version of SPACs.

This article will first introduce general information on SPACs and their operations, outline the necessary considerations for De-SPACs when targeting Japanese companies, and finally provide an overview of current discussions surrounding what a potential Japanese version of SPACs may look like.

II. General

1. What is a SPAC?

A SPAC, also known as a "blank check company", is a public shell company with no operations and formed by a sponsor for the sole purpose of acquiring one or more non-listed, privately held companies. A SPAC will raise capital in an initial public offering ("IPO"), after which the SPAC will identify target companies and attempt to complete one or more business combination transactions with such acquisition candidates (the "De-SPAC").

SPACs are beneficial to investors, sponsors, and target companies. First, from the investors' perspective, a IPO via SPAC scheme ("SPAC IPO") offers the opportunity to invest in a company led by a sponsor experienced in a given field of investment. Second, from the sponsor or the target

company's point of view, a SPAC represents the opportunity to raise permanent capital to fund large acquisitions. Finally, for target companies, a SPAC presents a chance to be listed on a national stock exchange more quickly than through the traditional IPO process by allying with a well-known sponsor, who is actively working to promote the company and secure sources of further investment.

2. Phases Of a SPAC

In general, regardless of whether the target company is incorporated in the US, Japan or elsewhere, a SPAC will go through three phases in its lifespan: Formation, IPO, and De-SPAC (Note 1).

(A) Formation of a SPAC

In this stage, a SPAC is set up and funded by a sponsor. The sponsor will pay a nominal amount (usually USD 25,000) to purchase a number of common stock to be assigned to themselves ("founder's shares"), such funds being used as offering expenses like up-front payment of the underwriting discount and the SPAC's working capital.

The shareholding ratio of founder's shares is generally set at 20% of the total number of SPAC shares outstanding after the SPAC's IPO, and such founder's shares typically have an anti-dilution clause to ensure that the exchange ratio for the founder's shares will be adjusted to maintain that set ratio (again, usually 20%) in the event that additional public shares or equity-linked securities are issued in connection with the De-SPAC. The anti-dilution clause functions as an incentive for the sponsor, who plays a leading role in the formation of the SPAC and the De-SPAC process, as they expect to acquire a proportionally large number of shares for the amount they have invested in the first place.

The common stock sold to public investors and founder's shares are largely identical, except that founder's shares (i) have redemption waivers, and (ii) are locked up (i.e., unable to be sold) for a certain period.

(B) SPAC IPO

In a typical SPAC IPO, an investment unit sold to public investors is usually comprised of one common stock and a fraction of a warrant. The purchase price per unit is almost always USD 10.00. Although the units are not separable, the units become separable following a certain period (typically 52 days after the IPO), after which public investors can trade units, shares, or whole warrants, with each security listed separately on a securities exchange.

Units that contain common stock are usually accompanied with the right to redeem investors' shares for a prorated portion of the proceeds held in the trust account, which typically results in a redemption amount equal to approximately USD 10.00 per share.

The exercise price for the warrants in an investment unit is USD 11.50 per whole warrant (15% above the USD 10.00 per share IPO price) with anti-dilution adjustments for stock splits and stock and cash dividends.

The warrants become exercisable as of the later date between either (i) 30 days after the De-SPAC transaction, or (ii) the twelve-month anniversary of the SPAC IPO.

(C) De-SPAC

The De-SPAC process is similar to a merger between public companies, except that the buyer (the SPAC) is typically required to obtain the shareholder's approval in accordance with SEC proxy rules, whereas the target company (a private company) is not required to follow an SEC-compliant proxy process.

SPACs are required to either consummate a business combination or liquidate within a set period of time after their IPO. Stock exchange rules permit a set period as long as three years, but as a practical matter, most SPACs designate 24-months from the closing date of their IPO as their deadline.

III. Considerations Regarding De-SPACs Targeting Japanese Companies

1. What Transaction Structure to be Adopted

In the US, the typical transaction structure is said to be a reverse triangular merger using SPAC shares as consideration in the merger. Reverse triangular mergers are, however, not available under the Companies Act of Japan, and what transaction structure should be adopted in its place is therefore one of the most important issues to be analyzed when a De-SPAC targets Japanese companies.

As an example of De-SPAC targeting a Japanese company, Monex Group, Inc. ("Monex"), a major online securities company, announced that Coincheck Group B.V. ("CCG"), one of its subsidiary companies, will apply to be listed on the NASDAQ index by utilizing De-SPAC with the help of Thunder

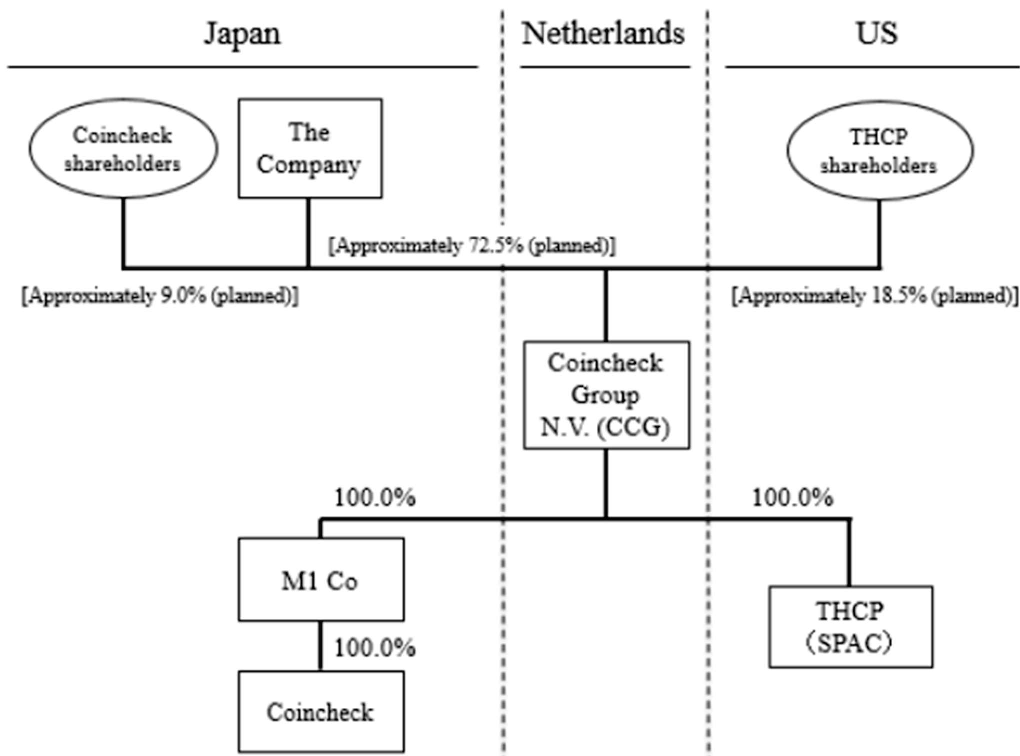
Bridge Capital Partners IV Inc. ("THCP"), a SPAC listed on the NASDAQ, through the following structure (Note 2). The structure of the said De-SPAC is set as follows according to the disclosure material of Monex:

(Step 1)

M1 Co G.K. ("M1 Co"), CCG's wholly-owned subsidiary, and Coincheck, Inc. ("Coincheck") will conduct a share exchange through which M1 Co will exchange shares of CCG for the outstanding shares of Coincheck, making Coincheck a wholly-owned, indirect subsidiary of CCG.

(Step 2)

Merger Sub (a wholly-owned subsidiary of CCG formed for the sole purpose of the Merger) and THCP will conduct a reverse triangular merger under Delaware law, in which Merger Sub will merge with and into THCP (the "Merger") and THCP will be the surviving corporation. As the result of the Merger, THCP's shareholders will receive CCG shares as consideration in the Merger, and any THCP's warrants held by holders thereof will be converted to warrants of CCG. In connection with the Merger, CCG will apply to be listed for trading on the NASDAQ.



Source: https://www.monexgroup.jp/en/news_release/irnews/auto_20220309503075/pdfFile.pdf

2. Filing Under Foreign Exchange Act

Under the Foreign Exchange and Foreign Trade Act of Japan (the “Foreign Exchange Act”), when foreign investors acquire shares or equity in a non-listed company (“inward direct investment”), if the target company’s business falls under the pre-notified business category, designated by the government of Japan, the foreign investors must notify the Minister of Finance and the competent minister in-advance regarding certain matters, such as the business purpose, the investment amount, and the time of execution of the inward direct investment, and must wait until 30 days have passed from the day on which the Minister of Finance and the competent minister receive the notification. The pre-notified category has been designated broadly by the authority recently, including software development, information processing service, etc.

In most cases, a SPAC is classified as a foreign investor under the Foreign Exchange Act, and if the De-SPAC scheme includes the acquisition of shares or equity of the target company by the SPAC, the SPAC will be subject to the above restrictions.

3. Target Size

SPACs typically target businesses for combination when such businesses are at least two to three times the size of the SPAC mainly for the following reasons (Note 3).

- Under stock exchange rules, the De-SPAC transaction must be with one or more target businesses or assets that, when combined, have an aggregate fair market value of at least 80% of the assets held in the trust account; and
- It is necessary to mitigate the dilutive impact of the founder’s shares, which are often around 20%.

In relation to Japan, Evo Acquisition Corp, a SPAC targeting Japanese companies for acquisition, raised approximately USD 125 million through an IPO, and intends to focus its search on companies with an enterprise value of approximately USD 250 million - 750 million (Note 4). Accordingly, the range of prospective target companies in Japan is limited.

IV. Discussions About Japanese Version Of SPAC

1. Status of Discussions in Japan

It was in *Action Plan of the Growth Strategy* ("Action Plan") by the Growth Strategy Conference, an advisory board to the Japanese government on June 18, 2021, that the necessity of the introduction of a Japanese version of SPACs was first pointed out. The Action Plan shows the government's sense of urgency, stating "with an eye on the world 'with COVID-19' and 'post COVID-19,' Japan needs to create an environment that encourages companies to enter untapped fields and become leaders in growth," and "the government will consider the development of regulations to allow the listing of SPACs."

In response to the Action Plan, the Tokyo Stock Exchange ("TSE") set up the "Study Group on SPAC etc." on September 27, 2021, which has discussed the necessity and significance of SPACs in Japan and the issues to be addressed.

2. Central Issues Under Discussion in the Study Group of TSE

Pursuant to the discussions in the Study Group, on February 16, 2022, the TSE published a paper titled "Issues regarding investor protection in the SPAC listing system," which explains the progress of discussions with respect to investor protection issues as follows (Note 5):

(A) Target Investor Group

In the case of listing a SPAC on the public market (i.e., a market where public investors participate in trading), it is necessary to establish an appropriate investor protection framework for the SPAC system in its design, disclosure, and requirements for operators. On the other hand, it has been pointed out that the system could be designed with more flexibility to accommodate SPACs entering the market for specific investors, following the guidance of the Financial Instruments and Exchange Act in Japan.

(B) Disclosure on Sponsors/Eligibility of Sponsors

At the time of the SPAC IPO, there is no specific business track record or merger plan, and investors are required to make investment decisions based solely on the prospect of future mergers and acquisitions; therefore, there should be a requirement of necessary and sufficient disclosure of the sponsor's past performance and capabilities, investment policies (including the expected target industry and size), the status of concurrent business activities (including investment activities in vehicles other than SPAC), and the design of remunerations and other incentives, such as sponsor promotions. The Study Group also suggests that, in addition to the disclosure system, a framework for pre-screening of sponsors' eligibility might also be worth consideration.

(C) Institutional Design and Listing Requirements

As is the case in foreign countries, such as the US, it is necessary to ensure sufficient liquidity of shares by establishing liquidity requirements, such as the number of shareholders, the ratio of shares in circulation, and market capitalization in the market, in order to ensure fair and smooth price formation in the market. It has also been noted that a framework for trading and settlement of units needs to be considered.

(D) Governance of Mergers and Acquisitions

The SPAC system contains the potential for conflict between interested public investors and sponsors arising from (i) the sponsors' strong incentive to realize the De-SPAC (for example, there could be a reputational risk if a De-SPAC is not completed within the designated timeframe), (ii) the design of the sponsor's shares, and (iii) the possibility of sponsors targeting companies in which they already invest. It is therefore important to consider mechanisms that will ensure the De-SPAC is beneficial for shareholders. The following list provides some examples of such mechanisms:

- Granting cash redemption rights to dissenting shareholders to ensure the effectiveness of the procedure, subject to the confirmation of shareholder intent;
- Obligation to preserve all or most of the funds raised for the purposes of ensuring the effectiveness of cash redemption rights and preventing fraudulent activities, such as misappropriation of funds by SPAC sponsors;
- Supervision of merger terms by external directors;
- Additional funding obligations equivalent to PIPEs in the US;
- Appointment of external advisors; and
- Assessments made by third parties independent of management teams and directors.

(E) Listing Eligibility of Target Companies/Disclosure by Target Companies

Companies after a De-SPAC will be able to realize an IPO on the public market without going through the traditional IPO process. From the perspective of maintaining the credibility of the exchange financial instruments market, it is necessary to confirm that companies after a De-SPAC have a similar listing eligibility to that of a traditional IPO. It is also worth pointing out that, in order to enable investors to obtain sufficient information to make investment decisions, disclosure requirements in the De-SPAC process should also be equivalent to those in the process of a traditional IPO.

It is necessary to pay attention to the future development of discussions at the TSE regarding the issues mentioned above.

Note 1: This section is chiefly based on: Ramey Layne and Brenda Lenahan, *Special Purpose Acquisition Companies: An Introduction* (July 6, 2018), Harvard Law School Forum on Corporate Governance, https://corpgov.law.harvard.edu/2018/07/06/special-purpose-acquisition-companies-an-introduction/

Note 2: https://www.monexgroup.jp/en/news_release/irnews/auto_20220309503075/pdfFile.pdf

Note 3: Layne and Lenahan, *supra* note 1

Note 4: https://www.sec.gov/Archives/edgar/data/1834342/000121390021003113/fs12021_evoacquisition.htm#T10, at page 73

Note 5: https://www.jpx.co.jp/equities/improvements/spac/nlsgeu000005s68v-att/nlsgeu0000066ga8.pdf

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