SPACs, UP-Cs and Reverse Mergers – an Overview

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SPAC Rules

- 90% of offering proceeds must be placed in a trust account
- Within 36 months, the company must complete one or more acquisitions with a value of at least 80% of the trust account value
- Unless a stockholder vote is required under state law or another exchange rule (e.g., issuance of more than 20% of the company’s shares in the acquisition), the SPAC will not need to get stockholder approval of the acquisition, but it must give dissenting stockholders the right to redeem their shares for a pro rata portion of the trust account balance
UP-C Diagram

Historical Partners

OpCo (Tax Partnership)

governance and conversion rights

PubCo

Managing member

Public Stockholders
Through an acquisition or IPO, a public company (PubCo) is put on top of a historical business (OpCo) taxed as a partnership.

The historical partners retain their direct interests in OpCo, but receive rights to convert their OpCo interests into an equivalent number of PubCo shares.

- This provides a mechanism for them to achieve liquidity but defer tax on gain from the sale of the business until they are ready to sell.
- No entity level tax on OpCo business while the historical partners retain their stake.
- As the historical partners convert into PubCo shares, PubCo receives a basis step-up on OpCo’s assets, and the benefit is frequently shared.

Regardless of the size of its stake, to avoid Investment Company Act issues PubCo is made the managing member of OpCo.

- PubCo consolidates OpCo into its financial statements.
- The historical partners are frequently given governance rights over PubCo and OpCo commensurate with their economic stake in OpCo.
Reverse Mergers

- Defined to be the merger of an OpCo into a public shell company
- The resulting company cannot list on an exchange until it has traded over the counter and timely filed all reports for one year following the “Super 8-K” relating to the transaction
  - The Super 8-K must contain audited financial statements for OpCo and unaudited pro forma financial statements for the combined company
  - These rules do not apply to SPACs
  - Quality/usefulness of the shell depends on the size of its stockholder base, its reporting history, and its listing status
  - Because SPACs go through the IPO process and typically come with strong management teams, they often carry greater liquidity and valuations than reverse merger companies
- When an unlisted OpCo merges into a listed OpCo giving rise to a change of control of the listed OpCo (a “backdoor listing”), a new listing application must be submitted with respect to the post-transaction entity