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SPIN-OFF GUIDE

2013

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Spin-Off Guide

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I

Overview

A spin-off involves the separation of a company's businesses through the creation of one or more separate, publicly traded companies. Spin-offs have become increasingly popular because many investors, boards and managers believe that certain businesses may command higher valuations if owned and managed separately, rather than as part of the same enterprise. An added benefit is that a spin-off can often be accomplished in a manner that is tax-free to both the existing public company (referred to as the parent) and its shareholders. Moreover, recently, robust debt markets have enabled companies to lock in low borrowing costs for the business being separated and monetize a portion of its value. For example, in connection with its \$55 billion spin-off from Abbott Laboratories in 2012, AbbVie conducted a \$14.7 billion bond offering, the largest ever investment-grade corporate bond deal in the United States, at a weighted average interest rate of approximately 2%. Other notable recent spin-offs include ConocoPhillips' spin-off of its refining and marketing business, Valero's planned spin-off of its retail business, Penn National Gaming's planned spin-off of its real estate assets into the first-ever casino REIT, and Covidien's planned spin-off of its pharmaceuticals business. There were 265 spin-offs announced in 2011 and 172 in 2012, with an aggregate value of \$208 billion and \$14 billion in 2011 and 2012, respectively.

The process of completing a spin-off is complex and requires consideration of a myriad of financial, capital markets, legal, tax and other factors. The issues that will arise in an individual situation will depend in large measure on the degree to which the businesses were integrated before the transaction, the extent of the continuing relationships between the businesses after the transaction, and the structure of the transaction. Where the businesses were tightly integrated before the transaction and/or are expected to have significant business relationships following the transaction, it will take more time and effort to specify assets and liabilities, identify personnel that will be transferred, separate employee benefits plans, obtain consents relating to contracts and other rights, and document ongoing arrangements for shared services (*e.g.*, legal, finance, human resources) and continuing supply, technology sharing and other commercial or operating agreements. Where the parent is expected to own a substantial portion of the subsidiary after the closing, careful planning is also required with respect to the composition of the subsidiary board, independent director approval of related-party transactions, handling of corporate opportunities and other matters. In addition to these separation-related issues, spin-offs raise

the issues associated with bringing a company public, from drafting and filing the initial disclosure documents, to applying for listing on a stock exchange, to implementing internal controls and managing ongoing reporting obligations and the public investor relations function.

This guide is intended to help navigate the spin-off process, from the preliminary phases through completion of the transaction. Part II of this guide describes some of the initial planning considerations relating to spin-offs, including a discussion of the principal reasons for spin-offs and a comparison to other separation transactions. Part III examines a broad array of general corporate separation issues that may arise in a spin-off. Part IV discusses the transaction agreements commonly executed to implement a spin-off and govern the post-spin relationship between the parent and the spin-off company. Part V identifies the principal securities law matters. Part VI examines certain tax issues, which are critical given the tax-sensitive nature of separation transactions. Finally, Part VII reviews stock exchange listing and trading considerations. A sample illustrative timetable for a spin-off (that is not preceded by an initial public offering) is attached as Annex A. A discussion of post-spin limitations on strategic transactions is attached as Annex B.

II

Initial Planning Considerations

A. Reasons for Spin-Offs

The principal reasons often cited by companies for pursuing spin-offs include the following.

- *Enhanced business focus.* A spin-off will allow each business to focus on its own strategic and operational plans without diverting human and financial resources from the other business.
- *Business-appropriate capital structure.* A spin-off will enable each business to pursue the capital structure that is most appropriate for its business and strategy. Each business may have different capital requirements that may not be optimally addressed with a single capital structure.
- *Distinct investment identity.* A spin-off will create distinct and targeted investment opportunities in each business. A more “pure-play” company may be considered more transparent and attractive to investors focused on a particular sector or growth strategy, thereby counteracting the “conglomerate discount” and enhancing the value of the business.
- *Effectiveness of equity-based compensation.* A spin-off will increase the effectiveness of the equity-based compensation programs of both businesses by tying the value of the equity compensation awarded to employees, officers and directors more directly to the performance of the business for which these individuals provide services.
- *Use of equity as acquisition currency.* By creating a separately publicly traded stock, a spin-off will enhance the ability of the spun-off business to effect acquisitions using this stock as consideration.

Spin-offs also may involve a variety of risks that should be considered, including the potential loss of both revenue and cost synergies; disruptions to the business as a result of the spin-off; separation costs; and possible increased susceptibility to unsolicited takeover activity (given that the businesses of both the parent and the spin-off company will both be less diversified and smaller than the former parent).

B. Other Separation Transaction Structures

It is not uncommon for a company in the initial planning phases to consider other types of separation transactions in addition to a spin-off. Generally speaking, separation transactions can be divided into two categories: (1) a sale to a third party of the business being separated and (2) a sale or distribution of the stock in a new public company holding the business being separated. The decision as to which type of separation transaction to pursue depends on a variety of factors. A sale to a third party can often generate the largest amount of cash proceeds to the parent, but a sale or distribution of the stock in a new public company can often result in greater value to the parent's shareholders because (1) the public market may place a higher value on the business than a third party and (2) a distribution of stock in a new public company can be accomplished in a manner that is tax-free to both the parent and its shareholders, whereas a sale for cash would be a taxable transaction. Moreover, as compared to a spin-off, there is a greater risk that a sale to a third party cannot be consummated because it requires a third party to execute a binding agreement for the sale and there are typically closing conditions, including, for example, regulatory approval conditions, in such agreements. Purchase agreements with third parties also often include a variety of representations and warranties about the business supported by post-closing indemnities, whereas in a spin-off the business usually is transferred on an "as-is, where-is" basis.

Within the category of transactions involving the sale or distribution of the stock of a new public company, a variety of structures can be employed to accomplish different financial and legal objectives, including those summarized below.

1. 100% Spin-Off

In a typical 100% spin-off, all of the shares of the company being spun off are distributed to the shareholders of the parent via a dividend. This results in a full separation of the two entities in a single transaction. Examples of 100% spin-offs include Expedia's spin-off of TripAdvisor, Marathon Oil Corporation's spin-off of Marathon Petroleum Corp., Motorola's spin-off of Motorola Mobility Holdings, ITT's simultaneous spin-offs of Exelis and Xylem and IAC/InterActiveCorp's simultaneous spin-offs of Ticketmaster, HSN, Tree.com and Interval Leisure Group.

There are other corporate mechanics available for accomplishing a spin-off. For example, in 2005, IAC/InterActiveCorp spun off Expedia by a charter amendment that reclassified each share of IAC common stock into a share of IAC

common stock and a fraction of a share of mandatory exchangeable preferred stock that automatically exchanged into a share of Expedia common stock immediately following the reclassification. Because such a structure involves a charter amendment, it requires a vote of the parent shareholders, unlike a spin-off accomplished via a dividend, which, as discussed below under “General Separation Issues—Shareholder Vote,” is possible without a shareholder vote under the law of most jurisdictions.

2. Partial Spin-Off

In some cases, the parent may distribute fewer than all of the shares of the spin-off company. Typically, the parent would not intend to retain the remaining shares long-term, but rather would use them to generate cash proceeds, as discussed below under “General Separation Issues—Capital Structure Considerations.” However, as described below under “Tax Issues,” in order for a spin-off to be tax-free, the parent must generally distribute “control” (*i.e.*, at least 80% of the voting power of all of the shares and at least 80% of any non-voting shares) of the spin-off company and must establish to the IRS’s satisfaction that it has a valid business purpose for retaining any shares of the spin-off company. In addition, the parent must dispose of the retained shares of the subsidiary within five years following the spin-off for the transaction to be tax-free. Examples of this type of transaction include Valero’s pending spin-off of Corner Store Holdings, Ralcorp’s spin-off of Post Holdings and Cardinal Health’s spin-off of CareFusion. An example of a taxable partial spin-off is Atlas Energy, L.P.’s distribution of 20% of the units of Atlas Resource Partners, L.P.

3. Split-Off

In a split-off, the parent distributes shares of its subsidiary in exchange for the parent’s stock. It is therefore equivalent to a share buyback of the parent’s stock using stock in a subsidiary as the consideration instead of cash. A split-off is typically done after the spin-off company has been public as a result of an earlier initial public offering (“IPO”), so that the established trading value of the spin-off company’s shares can be used in pricing the split-off exchange ratio. Because the parent shareholders elect whether to participate in a split-off, ownership of the spin-off company following the transaction generally is not proportionate (unlike a spin-off, where shareholders receive a proportionate share of the spin-off company). An example of a split-off is MetLife’s split-off of its 52% stake in Reinsurance Group of America.

4. Carve-Out IPO

A spin-off or a split-off can be preceded by an initial public offering, in which a portion of the shares of the subsidiary are sold to the public in an underwritten offering, with the proceeds thereof either retained by the subsidiary or distributed to the parent. An IPO allows the formation of a natural investor base for the subsidiary in advance of distributing the remainder of the stake in a spin-off or split-off, whereas the persons entitled to receive shares in a spin-off are those who were shareholders of the parent on the record date for the spin-off dividend (and who may or may not wish to hold shares of the spin-off company). For the subsequent spin-off or split-off to qualify as tax-free, the parent must generally retain at least 80% of the voting power of the shares of the subsidiary after the IPO. An IPO followed by the distribution of the proceeds thereof to the parent is generally tax-free to the corporations involved, provided the amount of cash distributed is less than the parent's basis in the stock of the subsidiary and certain other requirements are met. In order to effect a tax-free spin-off the subsidiary in the future, an initial public offering should be limited to 20% of the stock of the subsidiary to ensure that the subsequent spin-off will satisfy the 80% control requirement. Issuing low-vote stock to the public may preserve the ability to spin-off the subsidiary in a subsequent step if it is desired to issue more than 20% of the value of the stock of the subsidiary to the public. However, the IRS will no longer issue rulings with respect to the tax consequences of a spin-off in which such a high-vote/low-vote structure is put into place in anticipation of the spin-off. If the distribution of proceeds exceeds the parent's aggregate tax basis in the stock of the subsidiary, the excess would generally be includible in income of the parent either when the distribution occurs or when the parent divests the subsidiary.

Some companies determine not to pursue a carve-out IPO because of the additional costs and complications involved in an IPO. There are additional underwriting fees associated with the IPO process. An IPO also raises governance issues because the parent continues to control the subsidiary between the time of the carve-out IPO and the later spin-off (or split-off), and, therefore, the parent will have fiduciary duties to the subsidiary's public shareholders. Examples of carve-out IPOs followed by spin-offs are the Sunoco/SunCoke Energy and Motorola/Freescale Semiconductor transactions.

5. Spin-Offs Combined with M&A Transactions

A spin-off can also be used in combination with a concurrent M&A transaction, although there are limitations on the type of such transactions that could be accomplished in a tax-free manner, as described in more detail in Part

VI.B below. For example, “Morris Trusts” and “Reverse Morris Trusts” effectively allow the parent to transfer a business to a third-party in a transaction involving stock consideration in a manner that is tax-free to the parent if certain requirements are met. In a traditional Morris Trust, all of the parent’s assets other than those that will be acquired by the third party are spun off or split off into a new public company and then the parent merges with the acquiror. By contrast, in a Reverse Morris Trust, all assets to be acquired by the third party are spun off or split off into a new public company and then the new company merges with the acquiror.

In order to be tax-free, the Reverse Morris Trust structure generally requires, among other things, that the merger partner be smaller than the spun-off business (*i.e.*, that the shareholders of the divesting parent own a majority of the stock of the combined entity). Recent examples of Reverse Morris Trust transactions include MeadWestvaco’s 2012 spin-off of its consumer and office products business and merger of such business with ACCO Brands, and PPG Industries’ 2013 split-off of its commodity chemicals business and merger of such business with Georgia Gulf (since renamed Axiall Corporation).

Part VI.B below provides an overview of the tax considerations relevant to post-spin acquisitions, and a more detailed explanation is attached as Annex B.

A spin-off also can be combined with a significant investment transaction in a so-called “sponsored spin-off.” In this type of transaction, the parent distributes the shares of the subsidiary in a tax-free spin-off concurrently with the acquisition by a sponsor of up to 49.9% of either the parent or the company being spun off. The sponsor’s investment allows the parent to raise proceeds in connection with the spin-off without having to first go through the IPO process, and can help demonstrate the value of the target business to the market. Sponsored spin-offs raise a number of complexities, including as to valuation, capital structure and governance.

C. Internal Process Considerations

In planning for a spin-off, it is important to understand the role of the various internal constituencies that will be involved. Some aspects of the spin-off are, in practice, often largely determined by the board and management of the parent—such as the basic decision as to which business(es) will be spun off, as well as the selection of the spin-off company’s directors. Other aspects of the spin-off may appropriately involve more input from the future directors and management of the spin-off company, such as the terms of its corporate documents such as committee charters, governance guidelines, insider trading

policies, codes of ethics and the like. Even on matters such as these, companies often decide to generally follow a “clone and go” approach, establishing a presumption in favor of using the parent’s documents as models to simplify the already-complex process of turning one public company into two (or more).

In some cases a company may choose to allow managers of the business to be spun off to take a more active role in planning for the spin-off, such as where the spun-off business and the remaining business are of relatively equal size and have historically been managed independently. However, companies should recognize that these managers may begin to view themselves in a quasi-adversarial position to the parent, as they begin to focus on positioning the business to be spun off in the most advantageous manner. In some cases, the question arises whether management of the business to be spun off should have separate legal representation in connection with negotiating the terms of the spin-off, either initially or when the process is closer to completion. Separate legal representation before completion of the spin-off generally is inappropriate as it would unnecessarily exacerbate internal divisions and is inconsistent with the notion that it is the duty of the parent’s board to establish the terms of the separation in a manner that serves the best interests of the parent shareholders (who, of course, will also be the initial shareholders of the spin-off company). Moreover, as to those matters that will not affect the parent following the spin-off (such as the spin-off company’s compensation policies), the spin-off company will be able to make whatever changes it desires following the spin-off, lessening the need for internal negotiations over these topics in connection with the spin-off.

The approach to be taken in any particular spin-off on matters such as these should be considered with appropriate thoughtfulness and sensitivity, balancing respect for the role of the future directors and officers of the company being spun off with the fundamental premise that the responsibility for the spin-off rests with the parent’s board and management.

III

General Separation Issues

A. Identification and Grouping of Businesses

An initial step for a spin-off is to determine exactly what is to be spun off. In the case of a spin-off of a subsidiary that has been operated as a standalone business, this may be a relatively simple process because the business to be spun off will have already been reasonably well defined. Even in that context, however, it may be necessary to add or remove operations from the subsidiary before the separation occurs. In addition, as discussed below, there may be important ongoing business relationships to be formalized between the parent and the company to be spun off and common support functions that will have to be divided, replicated or provided on an interim or transition basis before the company to be spun off will be ready to operate as a standalone, publicly traded company. Tax restrictions must be taken into account in structuring any such ongoing business relationships, as discussed below.

In the case of a spin-off of a division or portion of a business that has been operated through legal entities that also have operations that will remain with the parent, the corporate separation issues are far more complex because the assets and operations to be held by the spin-off company must be identified and intercompany transfers will need to be effected. These transfers often raise complex corporate and tax structuring issues, including determining the optimal corporate mechanic for effecting each transfer (merger, sale of assets, internal spin-off, etc.), the order and timing of various steps, required governmental and third-party consents, and many other issues that typically arise in connection with internal restructurings. Particularly where international operations are involved, such pre-spin internal reorganization plans can involve a large number of steps. It usually will be preferable to complete the internal restructuring steps later in the process, to minimize the risk that transactions may need to be unwound in the unlikely event that the spin-off were abandoned, though in some cases the need to complete a financing in advance of the spin-off may require that the restructuring be completed earlier, and in any event the restructuring should commence sufficiently early to ensure its completion before the spin-off. As discussed in "Transaction Agreements," separation and distribution agreements typically include provisions addressing the possibility that some transfers may not be completed by the time of the spin-off.

A spin-off will also be more complicated if the spun-off business does not have substantially the same assets, business and operations as one or more of the

parent's financial segments. In such cases, it will usually require significantly more time to prepare the financial statements and MD&A for the spun-off business that are required to be included in the Form 10 registration statement, as discussed below under "Securities Law Matters." Furthermore, a spin-off company that does not track one of the parent's financial reporting segments will not be eligible to use Form S-3 for 12 months after the date of the spin-off and affiliates of the spin-off company—including its directors and executive officers at the time of the spin-off distribution—will not be eligible to use Rule 144 for sales of that company's securities for 90 days.

B. Capital Structure Considerations

One of the key steps in preparing for a spin-off is to determine the capital structure of the parent and the spin-off company after the spin-off, as well as the steps to implement this capital structure. A company engaging in a spin-off will generally want to reallocate its existing cash and debt between itself and the spin-off company, as well as potentially raise additional cash.

There are a variety of techniques that can be used to accomplish the desired capital structure, and the strategy is often driven by tax considerations and the legal documents governing a company's existing debt. A common strategy is for the spin-off company to issue new debt in exchange for cash before the spin-off, and distribute such cash to the parent, which the parent may then use to retire its existing debt. The distribution of cash from the spin-off company to the parent can be effected, for example, by having the spin-off company make a cash distribution to the parent, redeem some of its own shares held by the parent in exchange for cash, pay off an intercompany payable owed to the parent, or pay cash to acquire assets from the parent. To retain favorable tax treatment, the proceeds of certain distributions made by the spin-off company to its parent must be further transferred by the parent to its shareholders or creditors. As an alternative, the spin-off company may assume some of the parent's indebtedness. However, the assumption of debt may be restricted by the parent's existing debt agreements. Each of these strategies raises complex tax issues, including potentially triggering gain recognition to the parent to the extent the payment or assumption of indebtedness exceeds the parent's basis in the spin-off company's stock or assets.

A parent may be able to extract value from the spin-off company in excess of the parent's basis in the spin-off company's stock without recognizing gain for U.S. federal income tax purposes. The techniques for doing so involve the parent's use of debt or equity of the spin-off company to retire the parent's indebtedness. While the variations are plentiful, the parent's use of the spin-off

company's equity for this purpose is often called a "debt-for-equity exchange," and the parent's use of the spin-off company's debt for this purpose is often called a "debt-for-debt exchange." In one variation, the parent distributes less than 100% of the stock of the spin-off company at the same time as it closes a debt-for-debt exchange, and then completes a debt-for-equity exchange at a later date. Another technique involves a spin-off with a simultaneous debt-for-debt exchange, but without a subsequent debt-for-equity exchange. As noted below, however, the IRS recently announced that it will not issue private rulings on the tax treatment of debt-for-debt or debt-for-equity exchanges in connection with spin-offs where the parent's debt that is exchanged for either debt or equity of the spin-off company was issued in anticipation of the spin-off. The inability to obtain a ruling where the parent debt is newly issued will likely lead to decreased use of this monetization technique. However, companies may consider undertaking debt-for-debt or debt-for-equity exchanges using historical parent debt. The IRS has not announced any changes in its ruling practice with respect to such exchanges. Yet another structure is an initial public offering through a debt-for-equity exchange, followed by a subsequent distribution of the parent's remaining shares in the spin-off company.

Spin-offs often require a significant array of related financing transactions—the incurrence of new term debt (in the form of a credit facility or notes) by the spin-off company, often used to fund a distribution to the parent in connection with the spin-off, the entry into a revolving credit facility or other line of credit by the spin-off company to fund future liquidity needs and, in some circumstances, the amendment or refinancing of debt of the parent in order avoid defaults or in connection with the right-sizing of the now-smaller parent's capital structure.

One significant complicating factor is that the parent and/or the spin-off company may have different creditworthiness and business plans than, and will have (sometimes significantly) smaller assets and earnings than, the combined predecessor company. As a result, the terms (including pricing, financial and operating covenants and required guarantees and collateral support) of the credit documents of the parent and spin-off company can be dramatically different than those of the predecessor firm; therefore, such transactions can require a significant amount of new drafting, negotiation and disclosure. As a result of these considerations, the negotiation and execution of spin-off related financing can take substantially more time than corporate officers have been accustomed to spending on similar transactions in the past.

Due to the factors discussed above, it is important that early in the spin-off planning process, companies begin to identify the optimal financing structure for

each of the parent and the spin-off company, begin to consider ideal terms of their debt instruments, initiate discussions with potential financing sources and rating agencies and begin to consider the timing of the financing transactions in relation to the anticipated effective date of the spin-off (especially in light of then-prevailing market conditions). Indeed, the financing considerations should play a critical role in the determination of the structure for the spin-off itself, as the size of the spin-off company and the parent and their capital structures and creditworthiness (including whether or not they will receive investment grade ratings) can dramatically affect their cost of capital and the terms of their debt.

And because the spin-off company's new debt documents are likely to govern its activities for five years or more, companies should also consider involving the spin-off company's future treasury and financial officers in the negotiations of the spin-off company's debt agreements, even if doing so might require identification of such officers earlier than might otherwise be planned.

In some cases, existing debt may logically "belong" with, or may be explicitly associated with, a specific business, such as debt used to fund the activities of a finance subsidiary or secured by assets used in a specific business. If the entity to be spun off has operated as a standalone subsidiary, an appropriate level of debt may already exist at the subsidiary level. In other cases, the parent debt may need to be allocated based on the desired balance of the capital structures of the businesses to be separated, as well as tax considerations.

From a diligence perspective, existing debt needs to be reviewed to determine the limitations on assumption of the debt by each of the businesses, as well the contours of any covenants that may limit the parent's ability to spin off major portions of its business, such as restrictions on dividends or ability to dispose of "all or substantially all" of the parent's assets, or financial maintenance tests. In some cases it may be appropriate to seek consents with respect to debt covenants. To the extent that covenants in the parent's existing debt prevent the desired allocation of debt among the various businesses, it may be possible to incur new debt at the level of the spin-off company and dividend the proceeds up to the parent (which proceeds may in turn be used to repay the parent's existing debt).

Finally, the need for new financing in connection with a spin-off has the potential to introduce conditionality and risk into the execution of the spin-off transaction. If market conditions or other circumstances prevent the issuance of the required debt, then the spin-off could be delayed, or even abandoned. Issuers can mitigate these risks in a number of ways, including by obtaining financing commitments (the conditionality of which will need to be negotiated) during the

spin-off planning process or by issuing debt or entering loan documents substantially in advance of completing the spin-off. These approaches, however, often come with their own risks, costs and considerations, which should be evaluated and discussed at the outset of the spin-off planning process.

C. Allocation of Other Liabilities

Allocation of liabilities other than debt, including contingent liabilities, similarly requires an analysis of the liabilities that logically belong with each business, as well as legacy liabilities that may be unrelated to any of the parent's current businesses. In some cases, the applicable liabilities may already reside in the appropriate legal entity. In other cases, the liabilities may need to be transferred amongst the relevant entities. Typically, liability allocations are reinforced through indemnities from one business to the other in the separation and distribution agreement or other transaction documents. The effectiveness of such indemnities, of course, depends on the creditworthiness of the indemnitor.

D. Solvency and Surplus

Care must be taken in allocating debt and liabilities in the spin-off context to ensure that the spin-off company (and the parent) are viable and that any solvency risks relating to either entity have been considered. In allocating debt and other liabilities, and ensuring viability, consideration will also need to be given to the allocation of cash, cash equivalents and financial instruments such as derivatives.

Spin-offs typically involve the payment of at least one dividend—the distribution of the stock of the spin-off company to the parent's shareholders—and often involve others, including in the form of a payment of cash from the spin-off company to the parent before the spin-off. Under both state fraudulent conveyance law and the federal bankruptcy code, dividends are subject to subsequent attack and recoupment by the payor or its creditors if a court later determines that the payor was insolvent at the time it made the distribution. In order to mitigate this risk, companies sometimes seek solvency opinions from valuation firms with respect to either or both of the parent and the spin-off company. Although these opinions are not necessarily dispositive in a subsequent litigation about the payor's insolvency, they can be helpful in establishing solvency (along with the far more important factor of contemporaneous market pricing data for the stock and debt of the payor, among other things) and demonstrate that the board of directors was focused on the issue. Whether the receipt of such an opinion is worth the costs ultimately depends on the specific

facts, including the creditworthiness of the payor after giving effect to the spin-off.

Under the corporate law of most jurisdictions, a company may make a distribution to its shareholders only out of surplus or earnings (and only to the extent the company is not insolvent and would not be rendered insolvent by payment of the dividend or distribution). Appreciation in the value of assets, though not reflected in book value generally should be taken into account in determining whether sufficient surplus exists. As with the solvency analysis, the company's board of directors could look to expert appraisal opinions, if appropriate, to determine the appreciation in the value of the company's assets and the availability of surplus. Some states will also provide a safe harbor for directors who rely on the company's financial statements to determine that the company has sufficient surplus to make the distribution.

E. Governance Considerations

1. Duties of the Parent Board

Under Delaware law, the parent board's decision to effect a spin-off typically will be protected by the business judgment rule. Under the business judgment rule, the court will defer to the substance of the directors' decision and will not invalidate the decision, will not examine its reasonableness, and will not substitute its views for those of the board if the latter's decision can be attributed to any rational business purpose. To be entitled to the protections of the business judgment rule, the directors must satisfy the familiar duties of loyalty and care and must act in good faith. In satisfying their duty of care, directors are entitled to rely on advice from management, financial advisers, legal counsel and other experts. In addition, many companies' charters provide for exculpation of directors for breaches of duty of care to the full extent of Delaware law.

The directors of a parent do not owe fiduciary duties to the spin-off company. Nor does the parent or its board owe fiduciary duties to prospective shareholders of the spin-off company in their capacity as shareholders of the spin-off company, even after the parent declares its intention to spin off the subsidiary. In structuring a spin-off transaction, directors owe their duties to the shareholders of the pre-spin company and may structure the transaction in a fashion that maximizes value for those shareholders. There is no duty of "fairness" as between the parent and the spin-off company. Accordingly, the parent board can make unilateral decisions as to the allocation of assets and liabilities between the parent and the spin-off company, subject to insolvency and tax considerations, before the spin-off is completed.

2. Corporate and Governance Structuring of the Spin-Off Company

Because a spin-off company is typically a wholly owned subsidiary or is created as a wholly owned subsidiary of the parent, its corporate structure, charter and by-laws can be established by the parent without holding a vote of public shareholders. The parent will need to select the jurisdiction of incorporation of the spin-off company, draft its constitutive documents such as its charter and by-laws, and determine the size and composition of the board of directors, as well as board compensation and the structure of board committees.

The parent will also need to decide whether members of the parent's board will be moved to (or sit concurrently on) the board of the spin-off company. It is possible for a parent and the spin-off company to have overlapping directors. Any overlap in directors between the parent and the spin-off company generally is limited to at most a minority of each board in order to preserve the tax-free nature of the spin-off. All of the facts and circumstances should be considered in determining the impact of overlapping directors on the tax treatment of the spin-off. If a company determines to have overlapping directors with a spin-off company, it should consider the possibility that conflicts may arise between the parent and the spin-off company that may make it appropriate for a director to recuse himself or herself from deliberations at each company's board. If it is possible that the parent and the spin-off company could become competitors of each other in the future, it should also be noted that Section 8 of the Clayton Act prohibits any person from serving as a director or officer of two or more competing corporations unless the sales of competing products or services of the two companies are less than certain *de minimis* thresholds. Finally, one should be mindful that, although Institutional Shareholder Services (ISS) and Glass Lewis do not have a stated view or policy on overlapping boards, they have general policies that a director who is not a CEO should not serve as a director of more than six public companies, and a director who is a CEO should not serve as a director of more than three public companies.

Often, the full slates of individuals who will serve as directors and executive officers of the spin-off company following completion of the spin-off are not formally appointed until relatively late in the process. Prior to that time, the spin-off company's directors and officers typically will consist of a small number of personnel of the parent company, to facilitate obtaining the necessary approvals and signing documents on behalf of the spin-off company.

3. Takeover Defenses

The takeover defense profile of the spin-off company should be carefully considered. In many spin-offs and IPOs, the spin-off company has more antitakeover provisions in its charter and by-laws than the parent. Some companies conclude that it is preferable for the newly public company to have antitakeover provisions from the outset as the new company's board could always seek to eliminate them later, whereas a decision to add antitakeover provisions made when the company is already public may face resistance from proxy advisory services such as ISS and governance activists. Such resistance could, in the case of protections, such as classified boards, that can be implemented only with shareholder approval, make it very difficult to adopt such protections following the spin-off or IPO. In addition, the spin-off company could be more vulnerable to hostile takeovers than the previously combined company because it has a smaller market capitalization.

A key antitakeover provision included in the charters of many spin-off companies is a classified board structure. A classified board is one of the most effective defenses available in the event of hostile attempts to acquire board control, because it provides the board with time to adequately consider a bid. Because only one-third of the board is up for election in any given year, a hostile acquiror or shareholder activist who runs a proxy fight to replace board members with its nominees would need to obtain shareholder support in two election years to replace a majority of the board members. With a classified board, directors will be under less pressure to make decisions that maximize short-term interests of activist shareholders at the expense of the long-term interests of the company. Another advantage of having a classified board is that it enables the company to require that directors may only be removed for cause. By contrast, if the board is not classified, then Delaware law requires that shareholders have the right to remove directors with or without cause. It should be noted, however, that shareholder activists are critical of classified boards and have submitted de-classification proposals to numerous companies.

Other takeover defenses include: no right for shareholders to call a special meeting; no right for shareholders to act by written consent (or requirement for actions to be adopted by unanimous written consent); blank check preferred stock authorization; inclusion of "fair price" provisions; advance notice provisions for shareholders seeking to make director nominations or otherwise bring business before a shareholders' meeting; limitation of shareholders' ability to amend by-laws; and exemption from state antitakeover statutes. In the case of a spin-off preceded by an equity carve-out, the charter may specify that some antitakeover provisions come into effect only upon the complete spin-off of the subsidiary.

Generally speaking, newly spun-off companies tend not to adopt shareholder rights plans upon the spin-off. Rather, as has been the trend in recent years with established companies, a newly public company often will keep a rights plan “on the shelf” and ready for deployment if and when needed.

Many recent spin-off companies incorporated in Delaware have also added a provision to their charters requiring that the Delaware Court of Chancery be the sole and exclusive forum for stockholder derivative actions, claims for breach of fiduciary duty and claims arising out of Delaware corporate law. This exclusive venue provision ensures that specified types of claims will be brought in courts that have considerable experience with the law governing the newly spin-off company’s affairs and a well-developed body of corporate case law that promotes predictability. Such provision also limits forum shopping by plaintiffs and lawsuits regarding the same matter being brought in multiple jurisdictions at the same time. It should be noted that the Delaware courts have not yet definitively ruled on the validity of forum selection clauses.

4. Governance Following a Carve-Out IPO

In a carve-out IPO the parent may continue to own at least a majority of the outstanding shares of the issuer. Ongoing board representation for the parent is appropriate in this context, but must be carefully calibrated to protect minority public shareholders and to comply with the requirements of the Clayton and Sherman Acts, as discussed further below under “Antitrust.” In the case of a company listed on the NYSE, provided that the parent owns at least a majority of the issuer after the IPO, the issuer would be a “controlled company” under NYSE rules and thus would be exempt from the NYSE requirements that a majority of its directors be independent, although it would not be exempt from the NYSE requirement that its audit committee be comprised exclusively of independent directors within one year of the date the registration statement becomes effective. One alternative with respect to board composition would be for the parent and subsidiary to agree (1) that the subsidiary will nominate a slate of directors including a percentage of parent designees based upon the percentage of common stock owned by the parent and (2) to cause a percentage of the subsidiary board to be composed of independent directors.

An additional consideration in forming the board of directors in a carve-out IPO is the duty of loyalty, which requires all directors to act in what they reasonably believe to be the best interests of the company and all of its shareholders. Importantly, while Delaware law permits a corporation, in its charter, to eliminate director liability for monetary damages for certain breaches of fiduciary duty, director liability arising from a breach of the duty of loyalty

may not be so eliminated. Courts usually examine a board of directors' decisions under the well-known "business judgment rule," which generally protects directors from being second-guessed by a court. However, where an inherent conflict situation arises, such as where directors are on both sides of a transaction, directors' decisions are not entitled to the protections of the business judgment rule. Instead, in such conflict situations, directors are required to demonstrate "their utmost good faith and the most scrupulous inherent fairness" of the transaction, and their decisions will be closely scrutinized by courts under a higher "entire fairness" standard. In addition, persons who are both directors or officers of the parent and directors of the former subsidiary owe the same duty of good management to both corporations. Such dual roles may create conflicts which require overlapping directors to abstain from participation in specific situations.

One mechanism for reducing the legal issues raised by conflict transactions when directors are on both sides of a transaction is for outside independent directors to ratify material transactions between the parent and subsidiary, a mechanism that should be utilized for ongoing transactions between the parent and its former subsidiary following an IPO. See the discussion below under "Related Party Arrangements." This ratification mechanism, if properly applied, would generally shift the burden of proof regarding the fairness of such transactions from the former subsidiary and the interested directors to the challenging public shareholder.

An additional issue arising out of the duty of loyalty is the "corporate opportunity" doctrine. Under this doctrine, a director or controlling stockholder may not appropriate a business opportunity that rightfully belongs to the corporation. While there is no bright-line test for determining which opportunities "belong" to a majority owned subsidiary and which to its controlling stockholder, courts may consider a number of factors, including how closely the opportunity ties to their respective lines of business, the subsidiary's expectancy in the opportunity and the capacity in which the opportunity comes to the parent or subsidiary.

Under Delaware law, a corporation's charter may contain provisions modifying its fiduciaries' obligations regarding corporate opportunities. For example, the subsidiary's charter could contain provisions eliminating liability on the part of the parent (as majority stockholder) to the subsidiary or its shareholders for a breach of fiduciary duty for taking any business opportunity for itself or for failing to present the corporate opportunity to the subsidiary. In addition, the subsidiary's charter may contain provisions setting forth a procedure for allocating business opportunities between the parent and the subsidiary that

are offered to persons who are directors, officers, or employees of both parent and subsidiary.

F. Management and Employee Matters

1. Composition of Management

In the case of a subsidiary that has operated as a standalone entity, composition of management will likely be reasonably straightforward. Even in this case, however, the successful transition from a subsidiary to a separate publicly traded company may necessitate new or additional managers. In other cases, composition of management may pose more complicated decisions, especially where existing managers have responsibilities that overlap between businesses to be spun off and businesses to be retained, or have experience in and are valuable to both sides of the business. The needs of each business, as well as the desires of the individual managers, are important considerations in determining who is allocated to which business. Where managers have roles at both the parent and the spun off subsidiary following the spin-off transaction, care should be taken to comply with the requirements of the Clayton and Sherman Acts, as discussed further below under “Antitrust,” and to address potential areas of conflict.

2. Allocation of Other Employees and Employee Benefits

Most employees other than senior management will likely logically “belong” with one of the businesses. The issues inherent in separating the employee population are primarily legal, including the division of pension plans and related assets, the division of other benefit plans and related assets, the treatment of stock options and other equity-based awards, and the impact of any union contracts (including any contractual restrictions on the allocation of employees, benefits and benefit plan assets).

The spin-off company must also determine the compensation arrangements and employee benefit plans it will have after it becomes a separate company. If employees of the spin-off company or the parent participate in bonus or other performance-based arrangements that use consolidated parent performance targets and the transaction occurs other than at the end of a performance year, adjustments to those targets may be necessary to reflect the spin-off. And if employees of the spin-off company participate in parent employee benefit plans (medical, 401(k), nonqualified deferred compensation, etc.), the spin-off company generally will create its own plans to take over those benefits at the closing of the transaction. Those plans could accept transfers of

liabilities related to the spin-off company's employees from the related parent plans, as well as any associated assets.

3. Adjustments to Equity-Based Compensation Awards

The parent's equity compensation plans, as well as individual award agreements, should be reviewed to determine whether adjustments to equity-based compensation awards granted thereunder are required or permitted in connection a spin-off. Subject to any restrictions in such adjustment provisions, there are three potential methodologies for adjusting equity-based compensation awards of the parent in connection with a spin-off:

- *Concentration Method.* Parent awards held by specified employees (typically, employees who will be primarily dedicated to the spin-off company) can be converted into awards of the spin-off company, while the parent awards held by all other employees will continue to be awards based on parent equity and will be adjusted to reflect the decrease in value of parent equity upon the spin-off.
- *High Concentration Method.* All parent awards (regardless of employee) can continue to be awards based on parent equity, but will be adjusted to reflect the decrease in value of parent equity upon the spin-off.
- *Basket Method.* All parent awards (regardless of employee) can be converted into two awards: (a) an adjusted parent award and (b) a spin-off company award.

For options to purchase parent shares, both the number of parent shares underlying the award and the exercise price will be adjusted. The basket method is often chosen in recognition that equity award holders have contributed to the value of both companies and to make sure that employees reap the benefit of the value that they have helped create, regardless of which company they work for post-spin. In addition, this method is chosen to ensure that holders are treated like stockholders who receive shares in both companies. The concentration method is typically selected to ensure that employees are incentivized to maximize the value of the company for which they perform services. It should also be noted that the concentration method gives rise to fewer complications from an accounting and tax perspective than the basket method and, for this reason, has become slightly more typical in recent spin-offs.

Method of Adjustment. For tax reasons, regardless of the method chosen, the adjustment of parent options should preserve the aggregate spread of the options immediately prior to the spin-off. Although it may be possible to change the ratio of exercise price to equity price immediately prior to the spin-off, typically that ratio is preserved in the adjusted awards. The adjustment of other awards should preserve the aggregate value of awards immediately prior to the spin-off, based on the relative values of parent equity immediately prior to the spin-off and parent and/or spin-off company equity, as applicable, immediately after the spin-off.

Overhang/Dilution. Companies should consult their financial advisors regarding the effect of a spin-off on the overhang and dilution of each of the parent and the spin-off company.

Accounting Charge. The adjustment of parent awards may result in an accounting charge regardless of the method of adjustment used. As a general rule, (1) the excess, if any, of the fair value of the adjusted awards over the fair value of the awards prior to adjustment is taken as a one-time accounting expense in connection with the adjustment, and (2) unaccrued accounting expense will continue to accrue over the remaining vesting period of the award. Further charges could be required if the parent's equity plans do not require (as opposed to making optional) anti-dilution adjustments to awards in connection with the spin-off. Companies should consult their auditors for advice on the accounting effects of the adjustment of equity awards.

Blackout Periods. In connection with the adjustment of the parent awards to reflect a spin-off, parents typically impose a blackout period on option exercises and the settlement of other awards in equity for some period prior to the spin-off date and thereafter to give time to implement the spin-off adjustments. The parent should notify its award holders of this fact as far as practicable in advance of the commencement of the blackout period.

G. Consent Requirements

To the extent the spin-off company has not operated as a standalone entity, the separation may require the assignment of assets, contracts and other rights, including leases, guarantees, and letters of credit, into separate corporate entities. Material agreements must be reviewed to determine assignability and the degree to which consents to assignment will be required, or new agreements with counterparties will need to be entered into by both the parent and the spin-off company. Agreements must also be reviewed to ensure that there are no provisions that would be unacceptable following a spin-off or sale (e.g.,

provisions that require sharing of business plans with the entity to be spun off). Government contracts, both domestic and foreign, require particular attention for any novation rights and security clearance issues in connection with a proposed assignment or change of control. Companies should also analyze whether any domestic or foreign governmental consents will be required in connection with the separation of the businesses to be spun off and the ability to obtain such consents before the date of the spin-off.

H. Antitrust

Any IPO or spin-off involving overlapping ownership structures raises potential U.S. antitrust issues and should be analyzed from this perspective. These issues could arise under Section 1 of the Sherman Act (which prohibits concerted action among competitors) and Section 8 of the Clayton Act (which prohibits interlocking directors and/or officers in many competing corporations). In general, no filing under the HSR Act is required for a spin-off so long as the interests in the subsidiary are distributed *pro rata* to the parent's stockholders. Depending on the distribution of businesses and assets and the relationship of the two companies post-spin, however, antitrust questions could arise regarding non-compete agreements, transition services agreements, supply arrangements, and interlocking directorates.

I. Intellectual Property

If the business to be separated relies on intellectual property rights (*e.g.*, patents) held by or licensed to the parent, this intellectual property may need to be allocated to or shared among the appropriate businesses. This may raise the consent issues discussed above, but with even more complexity if the parent is a licensee or if both companies need to share the intellectual property. In addition, consideration may need to be given to the use of trademarks and tradenames by the businesses to be separated. If tradenames or marks are licensed by one entity to another, the licensing party must have some ability to control the use of the mark and the quality of the products or services to be sold or offered under the mark.

J. Related-Party Arrangements

Related-party transactions will have to be described in the securities filings required in connection with the spin-off. Following the separation and the listing of the spin-off company, the NYSE rules recommend that an audit committee or other independent body of the board approve all new related-party transactions. The SEC defines a related-party transaction as any transaction in

which the company was or is to be a participant and the amount involved exceeds \$120,000, and in which any related person had or will have a direct or indirect material interest. The definition of “related person” includes, among other things, any person who is the beneficial owner of more than five percent of the company’s voting securities. In addition, the spin-off company’s process for the review, approval or ratification of such related-party transactions will have to be described in securities filings on an ongoing basis.

K. Initial Disclosure of the Spin-Off

Consideration of the timing of a spin-off should take into account necessary financing activities, any planned stock repurchases and other disclosure issues. Absent these or similar circumstances, no public disclosure issue should arise until, at earliest, the company’s board of directors has determined to proceed with pursuing a separation transaction or spin-off. Early discussion with the board of directors may be desirable. Preliminary consideration by the board does not mandate public disclosure, and the timing of disclosure is not generally dictated by legal strategy. However, before disclosing an intended spin-off, companies should complete enough preliminary work to be confident that, once the anticipated spin-off has been announced, it could be completed; therefore, the company should have a general understanding of the expected costs of implementing the transaction and the likely time frame and confirm that there are no “show-stoppers” that would prevent completion of the transaction. While “no comment” is generally the best strategy in the event of rumors, such a situation would have to be evaluated based on all factors existing at the time. In addition, the seriousness of consideration of the potential transaction (including, for example, the implications of filing a confidential ruling request with the IRS), and the likelihood of its occurrence, need to be monitored in the context of any proposed purchases or sales of stock by executives having knowledge of the potential transaction.

L. Shareholder Vote

Under the law of most jurisdictions, a shareholder vote is required for the “sale or other disposition of all or substantially all” of a company’s assets. In Delaware, the shareholder vote requirement is triggered if the corporation wishes to “sell, lease or exchange all or substantially all of its property and assets.” Because a spin-off is effected by means of a dividend of shares of the spin-off company (as opposed to a sale of assets), there is law to support that a spin-off does not constitute a sale, lease or exchange within the meaning of the Delaware statute and, therefore, stockholder approval is generally not required. Consistent with this analysis, stockholder approval has not been sought in significant spin-

offs by Delaware companies. In other jurisdictions, however, such as New York and Maryland, the analogous statutes governing sales or transfers of substantially all of a company's assets potentially apply to spin-offs, and accordingly careful consideration should be given as to whether a shareholder vote is required.

IV

Transaction Agreements

A. Generally

A parent typically enters into a number of agreements with the spin-off company to implement the spin-off and establish a framework for their relationship following completion of the spin-off. Typically, these include a separation and distribution agreement, a transition services agreement, an employee matters agreement and a tax matters agreement. In some cases, certain of these agreements may be combined (*e.g.*, employee matters may be addressed in the separation and distribution agreement), or alternatively may appear in separate agreements. For example, if one company will rely on the other company for the supply of services or systems, raw materials, equipment, etc., on a commercial basis, they may enter into separate commercial agreements governing those relationships. The terms of any intercompany arrangements, particularly any long-term arrangements, must be carefully structured and reviewed to ensure that they will not jeopardize the tax-free nature of the spin-off. Generally, long-term or commercial arrangements between the companies must be at arm's-length terms, including arm's-length pricing.

SEC rules require that forms of the material transaction agreements be filed as exhibits to the Form 10 registration statement, and as exhibits to the spin-off company's periodic reports following completion of the spin-off. The SEC may also require that schedules and other attachments to these agreements be filed, depending on the nature of the agreement and the information included in the attachments. Companies should be cognizant of the potential for public disclosure in determining the form and content of the agreements (including deciding whether to move provisions out of the separation and distribution agreement into a separate agreement) as well as their schedules, and consideration should be given as to whether and when confidential treatment should be sought with respect to any information in the agreements or schedules that the SEC may require to be filed.

B. Separation and Distribution Agreement

The separation and distribution agreement sets forth the agreements between the parent and the spin-off company regarding the principal corporate transactions required to effect the separation and other agreements governing the relationship between the parties. The separation and distribution agreement identifies assets to be transferred, liabilities to be assumed and contracts to be

assigned to each of the spin-off company and the parent in implementing the separation, and it provides for when and how these transfers, assumptions and assignments will occur.

Generally speaking, the asset and liability transfer provisions are structured similarly to those in an asset purchase agreement for a divestiture transaction. The agreement will define transferred assets, assumed liabilities, excluded assets and retained liabilities, in each case through a combination of categorical descriptions of the relevant assets and liabilities (*e.g.*, “all liabilities primarily related to [the spun-off business],”) and references to schedules (such as lists of real properties, patents, etc.). In drafting the categorical descriptions, decisions will need to be made as to the breadth of the defined categories (*e.g.*, “primarily related” vs. “exclusively related”). It is generally preferable to specifically list the relevant assets and liabilities in schedules to the agreement, unless doing so is unduly cumbersome or they clearly fall within the enumerated categories. In some cases, a separation and distribution agreement may include a working capital or other balance sheet adjustment, similar to those that are included in private M&A agreements.

As noted above, a separation and distribution agreement typically provides for the business to be transferred on an “as is, where is” basis—*i.e.*, without any representations as to financial statements, undisclosed liabilities, litigation or other matters that typically are addressed in representations and warranties in a purchase agreement with a third party. The separation and distribution agreement usually will provide for cross-indemnities designed to place financial responsibility for the obligations and liabilities of the spin-off business with the spin-off company and financial responsibility for the obligations and liabilities of the parent’s remaining business with the parent, among other indemnities. In general, each party to the separation and distribution agreement assumes liability for all pending, threatened and unasserted legal matters related to its own business or its assumed or retained liabilities.

Generally, similar to purchase agreements for a carve-out divestiture, separation and distribution agreements include provisions intended to account for the possibility that assets, liabilities, contracts, permits or other items contemplated to be transferred cannot be transferred at the closing due to the failure to obtain required consents or approvals or to make required notifications or, in some cases, delayed regulatory approval in non-U.S. jurisdictions. To this end, separation and distribution agreements typically include provisions intended to transfer the benefits and burdens of the relevant items to the applicable party until the consent, approval or notification (or non-U.S. regulatory approval) has been made or obtained, with legal title to follow when the transfer is completed.

These provisions also typically impose obligations to continue to use efforts to complete such transfers.

The separation and distribution agreement also governs the rights and obligations of the parent and the spin-off company regarding the distribution and sets out the conditions to the spin-off distribution. Usually, the conditions to the distribution include, at a minimum: effectiveness of the Form 10 registration statement; approval of the shares of the spin-off company's common stock for listing on the applicable stock exchange; receipt of a private letter ruling from the IRS and/or opinion of tax counsel as to the tax treatment of the spin-off; absence of injunctions prohibiting the spin-off; and a "catch-all" condition that there have been no adverse event that, in the judgment of the parent's board of directors, makes it inadvisable to complete the spin-off. Other conditions that are sometimes included are delivery of solvency/surplus opinions and completion of the distribution of financing proceeds obtained by the spin-off company, if applicable.

The separation and distribution agreement also generally outlines obligations with respect to retention of information and confidentiality and describes the circumstances under which the parent and spin-off company are obligated to provide each other with access to information. The agreement also often deals with insurance matters, including allocation among the parties of rights and obligations under existing insurance policies with respect to various claims or occurrences and procedures for the administration of insured claims.

As a result of the conditions to the distribution, as well as typically broad termination and amendment rights in favor of the parent, the parent will often retain great contractual freedom to modify, delay or abandon the transaction until it is completed. Moreover, in some cases, the separation and distribution agreement (and other transaction agreements) are not even entered into until very late in the process. However, significant deviation from publicly announced plans may be viewed unfavorably by the markets.

C. Transition Services Agreement

The transition services agreement typically will cover services that are shared by the businesses to be separated, such as legal, payroll, accounting or benefits, which may have to be continued on an interim or transition basis after the separation of the businesses. In some cases, only one party provides the services (from the parent to the spin-off company), whereas in other cases both parties provide services to each other. Pricing of these services as well as the

period of time over which they will be provided will need to be considered from both a business and tax perspective.

In order to preserve the tax-free nature of a spin-off, transition services agreements covering administrative and other support services should generally have terms of no longer than 12 to 24 months. The parties may often provide these services under such short-term transition services agreements on a cost or cost-plus basis, although the tax implications of the terms of such agreements will need to be considered in light of all the facts and circumstances. As described above, however, services that the parties will provide on a long-term basis or that are operational or commercial (and not administrative) in nature should be provided on arm's-length terms, including arm's-length (rather than cost or cost-plus) pricing.

As in a sale transaction, the body of the transition services agreement typically addresses matters such as service standards, termination and renewal rights, liability limitations and indemnification, while the scope and duration of the services are described in schedules.

D. Tax Matters Agreement

In connection with the separation, parties generally enter into a tax matters agreement that governs the rights, responsibilities and obligations of the parent and spin-off company after the spin-off with respect to taxes, including taxes, if any, imposed on the spin-off or related transactions (such as any internal transactions undertaken in anticipation of the distribution). Generally, there are two ways to allocate tax liabilities between the parent and the spin-off company. The first allocates liabilities on a pre- and post-closing basis (*i.e.*, the parent is responsible for all taxes related to the period before closing, and the spin-off company is responsible for all taxes in respect of the spun-off entities related to the period after closing). The second approach is more complex. It allocates liabilities based on a "line-of-business" split (*i.e.*, the parent is responsible for all taxes in respect of the businesses it retains and the spin-off company is responsible for all taxes in respect of the spun-off business, regardless of the time period to which such taxes relate). The tax matters agreement also assigns responsibilities for tax compliance matters, such as the filing of returns, payment of taxes due, retention of records and conduct of audits, examinations or similar proceedings. In addition, the tax matters agreement provides for cooperation and information sharing with respect to tax matters.

In order to protect the tax-free nature of the spin-off or related transactions, the tax matters agreement often contains restrictions on the spin-off

company's ability to take actions for the two-year period following the spin-off without the parent's consent. Such restrictions typically include restrictions on any transaction that would result in a significant change in ownership of the spin-off company (whether via a merger of the spin-off company or otherwise), a liquidation of the spin-off company, a sale of a substantial portion of the spin-off company's assets, and certain repurchases of the stock of the spin-off company. Moreover, the tax matters agreement generally will provide that the spin-off company is responsible for any taxes imposed on the parent as a result of the failure of the spin-off or related transactions to qualify as tax-free under applicable tax law if such failure is attributable to certain actions taken by the spin-off company or its shareholders, regardless of whether the parent consents to such actions.

E. Employee Matters Agreement

The parent and the spin-off company generally will enter into an employee matters agreement in connection with the separation to allocate liabilities and responsibilities relating to employment matters, employee compensation and benefits plans and programs, and other related matters. The employee matters agreement will typically specify whether equity-based compensation awards of the parent will be adjusted using the concentration method, the high concentration method or the basket method and will address the assumption by the spin-off company of any change of control or employment agreements between the parent and members of the spin-off company's management team.

V

Securities Law Matters

A. Principal Securities Law Filings

The primary disclosure document in connection with a spin-off that is not preceded by an initial public offering is a registration statement on Form 10 filed by the spin-off company. The Form 10 registration statement registers the class of shares being distributed under the Securities Exchange Act of 1934 (the “Exchange Act”). The Form 10 contains an information statement which is disseminated to all parent shareholders and provides disclosure with respect to the spin-off company similar to disclosure that would appear in an IPO prospectus. The Form 10 is typically given a full review by the SEC, which may take several months to complete. Although this review process may result in substantial revisions, the Form 10 becomes a public document upon its initial filing. The initial Form 10 also must include audited financial statements of the spin-off company, including two years of balance sheets, three years of income statements, three years of cash flows and three years of statements of shareholder equity, as well as unaudited stub period financials for interim quarters, if applicable, and five years of selected financial data. Therefore, if the spin-off company does not already have audited financial statements, audit work should commence on preparing carve-out financials in sufficient time to be completed for the initial Form 10 filing.

The following outlines the primary sections of a typical information statement:

- Questions and Answers about the Separation
- Information Statement Summary
- Summary Historical and Unaudited Pro Forma
Combined Financial Data
- Risk Factors
- Cautionary Statement Concerning Forward-Looking
Statements
- Dividends
- Capitalization
- Unaudited Pro Forma Condensed Combined
Financial Statements
- Selected Historical Combined Financial Data
- Business

Management's Discussion and Analysis of
Financial Condition and Results of Operations
Management
Compensation Discussion and Analysis
Executive Compensation
Certain Relationships and Related Person
Transactions
Security Ownership of Certain Beneficial Owners
and Management
The Separation
Relationship with Parent Following the Distribution
Material U.S. Federal Income Tax Consequences
Description of Material Indebtedness
Description of the Spin-off company's Capital
Stock
Audited Historical Financial Statements

The Exhibits to be filed with the Form 10 typically include the following:

Charter
By-laws
Financing agreements
Material contracts (whether relating to the spin-off,
intercompany arrangements, or the business of the
company to be spun off)
Benefit plans, arrangements and contracts
Accountants' consents
List of subsidiaries

If the forms of transaction agreements and organizational documents of the spin-off company have not yet been completed by the time of the initial filing, they may be excluded from the initial filing. Likewise, the initial Form 10 filing need not identify initial directors and officers or set out the proposed dividend policy, capital structure or description of indebtedness. But, if the company plans to go to market with a bond offering, all material information will need to be disclosed in the offering memorandum, even if the offering occurs in advance of the effectiveness of the Form 10. It is advisable to file the initial Form 10 sufficiently in advance of the bond offering to have time to go through at least one round of SEC comments on the Form 10 before completing the offering memorandum.

Registration of the dividend of the spin-off shares under the U.S. Securities Act of 1933 (the “Securities Act”) is generally not required. The Staff of the SEC issued Legal Bulletin No. 4 in 1997 to address common securities law issues relating to spin-offs. The Staff specified five conditions that must be met to avoid registration under the Securities Act in a spin-off not preceded by an initial public offering:

- parent stockholders do not provide consideration for the spun-off shares;
- the spin-off is made *pro rata* to parent’s stockholders;
- parent provides adequate information about the spin-off and the subsidiary to its stockholders and the trading markets through a document such as a Form 10 information statement;
- parent has a valid business purpose for the spin-off; and
- if the parent spins off “restricted securities” of a business acquired by the parent from a third party, it has held those securities for at least two years.

In the case of a spin-off that is preceded by an initial public offering, the initial offering must be registered under the Securities Act, generally on Form S-1. The Form S-1 will contain similar disclosure to that described above for a Form 10 and is typically subject to a similar full review by the SEC. The company also will need to file a registration statement on Form 8-A before the IPO to register the class of shares being sold under the Exchange Act, which typically simply incorporates by reference the relevant information and exhibits from the Form S-1.

Where a spin-off follows a prior IPO, a full Form 10 filing is not required because the company is already subject to Exchange Act reporting obligations. Instead, upon distribution of the remaining shares in the spin-off company held by the parent, the parent only needs to provide more limited information about the spin-off to its shareholders, such as the tax consequences of the spin-off and treatment of fractional shares, and this document is not typically subject to SEC review. If a company disposes of its remaining shares in the spin-off company by means of a split-off, then the split-off exchange offer must be registered under the Securities Act, generally on Form S-4. The exchange offer also will be subject to the tender offer rules (including Rule 13e-4 under the Exchange Act, which

applies when a tender offer for securities of an issuer is made by its affiliate), and requires that the parent file a Schedule TO.

In the event of any violations of the securities laws in connection with an IPO, the spin-off subsidiary will be primarily liable. To the extent that the parent is a selling stockholder in the IPO, it may also be primarily liable for violations of the securities laws. Moreover, if the parent is not a selling stockholder, it may still be secondarily liable for primary violations of the securities laws under the doctrine of “controlling person liability.” Generally speaking, a Form S-1 is subject to more stringent liability standards than a Form 10.

B. Eligibility of Subsidiary to use Form S-3

A spin-off company may access to the public equity and/or debt markets soon after the spin-off is consummated, for example, to refinance short-term debt allocated to it. One of the eligibility requirements to use Form S-3, which reduces the time and expense needed to register securities, is that the issuer has timely filed Exchange Act reports for at least 12 months. The SEC Staff stated in Staff Legal Bulletin No. 4 that a spin-off company may consider its former parent’s Exchange Act reporting history if:

- it was eligible to use Form 10 in the spin-off under the conditions described above;
- the parent is current in its Exchange Act reporting; and
- the spin-off company will have substantially the same assets, business and operations as a separate segment in the parent’s financial reporting for at least 12 months before the spin-off.

C. Other SEC Filings

The spin-off company also typically files one or more Forms S-8 to register the issuance of equity under its employee benefit plans. If any former parent employees (excluding employees of the spun-off company and its subsidiaries) will hold equity awards over the spun-off company’s securities, then the spun-off company will probably need to file a Form S-1. The spun-off company typically would file such a required Form S-1 immediately after the information statement is finalized. The SEC typically would not comment on the Form S-1 extensively because the disclosures in the S-1 would largely correspond to disclosures contained in the Form 10 information statement.

In addition, the directors and executive officers and significant stockholders of the spin-off company will need to make Section 16 filings such as Forms 3 and 4. The parent, as sole stockholder, and the spin-off company's directors and executive officers serving on the day the SEC declares the Form 10 effective, must each file a Form 3 no later than the close of business that day. Directors and officers appointed after the Form 10 is effective need to file a Form 3 within 10 business days of their appointment. The parent will also need to file a Form 4 reflecting its disposition of the spin-off company's stock in the spin-off distribution. Although the SEC has issued no-action letters indicating that directors and officers generally need not file a Form 4 to reflect the *pro rata* adjustment of their equity-based compensation into awards of parent and spin-off company stock, the company and its advisers should analyze carefully the terms of directors' and officers' existing awards and the adjustment formulas to determine whether those individuals must file Forms 4.

Upon completion of the spin-off, the spin-off company typically files a Form 8-K reporting its entry into material definitive agreements with the parent, changes in board and executive officer composition, amendments to its organizational documents and any press release issued by the company to announce its entry into the public markets. Similarly, the parent typically files a Form 8-K reporting completion of the transaction. If the spin-off constitutes a disposition of a significant amount of assets within the meaning of Form 8-K item 2.01, the parent will need to file pro forma financial information reflecting such disposition on Form 8-K within four business days of the closing of the spin-off.

D. Obligations Once the Form 10 or Form S-1 Is Effective

Once the SEC declares the spin-off company's Form 10 effective—or, if the spin-off will be preceded by an initial public offering, once the SEC declares its Form S-1 effective—the company will be subject to the Exchange Act's periodic reporting requirements, including the requirement to file current reports on Form 8-K to report material events such as the appointment or resignation of directors and officers and charter amendments. Companies should consider the timing of actions undertaken in connection with the separation in light of these reporting requirements.

Moreover, following this time, the spin-off company will be required to be registered under Section 12 of the Exchange Act, subjecting it to the Exchange Act's proxy, insider reporting and short-swing profit liability provisions, and will be subject to the Sarbanes-Oxley Act, including provisions related to director independence, loans to executive officers and directors, and attorney "reporting up."

Newly public companies do not become subject to certain requirements relating to management's annual report on internal controls over financial reporting and the required auditor's attestation in a Form 10-K until the second annual report that it is required to file with the SEC. However, to the extent a newly formed public company seeks to use and is deemed eligible to use Form S-3 on the basis of another entity's reporting history as described in Part V.B, then the newly public company would be considered an accelerated filer and therefore required to comply with these requirements in the first annual report that it files.

Establishing the necessary internal controls over financial reporting, as well as disclosure controls and procedures more broadly, is a complex process that involves substantial planning and coordination among internal financial reporting and legal personnel, the board of directors (particularly the audit committee) and outside auditors. In some cases, the newly public company may need to upgrade its systems in connection with its separation, including purchasing computer hardware infrastructure, implementing additional financial and management controls, reporting systems and procedures and hiring additional accounting, finance and information technology staff. Moreover, the newly public company may be reliant on its former parent for services relating to some of its internal controls over financial reporting. Careful consideration will need to be given to these issues in order for the company to meet its obligations with respect to internal controls.

Following approval for listing on an exchange (which will occur before the commencement of "when issued" trading in the spin-off company's stock), the spin-off company will also be required to comply with the relevant exchange or association's quantitative and qualitative criteria for continued listing, including substantive corporate governance requirements. For example, even though the spin-off company will still be a wholly owned subsidiary of the parent, as of such listing date, the spin-off company must (1) have at least one independent director, (2) at least one independent member on its audit committee and (3) identify all of the directors to be appointed to the spin-off company's board and its audit, compensation and nominating committees as of the spin-off date.

As of the time of the spin-off, the spin-off company must have (a) at least three members on its audit committee, one of whom must be independent; (b) a compensation committee and nominating committee, each of which must include at least one independent director; (c) audit, compensation and nominating committee charters posted on its website; and (d) corporate governance guidelines and code of business conduct and ethics guidelines posted to its website. The NYSE has a phase-in rule that only requires that a majority of the spin-off company's board is independent within one year after the listing date, and other

phase-in rules regarding the independence of the spin-off company's audit committee and compensation committee.

E. Investor Relations Activities

In connection with a spin-off, it is often desirable to try to educate the investment community with respect to the company. Key time periods for approaches to the investment community should be identified and guidelines should be provided to assure compliance with securities law requirements. In the case of a spin-off preceded by a public offering, the blackout and waiting period requirements of a registered public offering will restrict the companies' activities in this area but Regulation F-D will not be applicable to disclosures made in connection with the registered offering. A spin-off does not involve similar blackout and waiting period requirements, but the general antifraud provisions of the securities laws will still apply. In addition, Regulation F-D will apply to disclosures that constitute material nonpublic information regarding the parent in connection with a spin-off on Form 10. Discussions with investors and analysts should be consistent with the publicly available information contained in the Form 10. Decisions will also need to be made as to the desirability and scope of "road show" activity once the information statement is mailed (including the scope of investment banker assistance on the road show).

VI

Tax Issues

A. Generally

1. Requirements for Tax-Free Treatment

In order for a spin-off to qualify as tax-free to both the parent and its shareholders for U.S. federal income tax purposes, it must qualify under Section 355 of the Internal Revenue Code. Section 355 aims to provide tax-free treatment to transactions that separate two operating businesses and not to transactions that resemble either (1) distributions of cash or other liquid assets or (2) corporate level sales. This Part VI.A. discusses requirements under Section 355 that are intended to bolster the first goal, while Part VI.B. below describes Section 355 requirements relating to the second goal.

Under Section 355, the parent must distribute “control” of the spin-off company (generally, stock representing 80% of the voting power and 80% of each non-voting class of stock) and must establish that any retention of stock or securities is not pursuant to a tax avoidance plan. In the spin-off, the parent can distribute stock or stock and securities of the spin-off company, and the distributees can be shareholders or shareholders and security holders. In addition, the parent and the spin-off company must each satisfy a five-year active trade or business test (*i.e.*, immediately after the spin-off each of the parent and the spin-off company must be engaged in an “active trade or business” that was actively conducted throughout the five-year period before the spin-off, with certain exceptions).

Further, the spin-off must be carried out for one or more corporate business purposes and not be used principally as a “device” for the distribution of the earnings and profits of the parent, the spin-off company, or both. Whether the spin-off is a “device” turns on whether the spin-off encompasses planned sales or exchanges of stock of the parent or spin-off company, or other transactions the effect of which would be to permit the distribution of corporate earnings without a dividend tax. This standard as to sales and exchanges may, in some cases, involve seeking representations by greater than 5% holders to the effect that such sales, exchanges or other distributions are not planned.

The “business purpose” standard requires that a real and substantial non-tax purpose germane to the business of the parent, the spin-off company or both in fact motivated, in whole or substantial part, the spin-off. A shareholder purpose,

such as increasing shareholder value, will not in and of itself suffice, although the IRS has held in published advice that a spin-off motivated by the desire to increase the stock price satisfies the business purpose requirement where that stock will be used to make acquisitions or compensate management. If more than one spin-off is to occur, each spin-off must be supported by its own business purposes.

Business purposes that can support a spin-off include demonstrably improving intended access to capital markets for the parent or the new company (including enhancement of an initial carve-out IPO), allowing the parent or the new company to have a “single line of business” or a higher value public stock needed to make desired acquisitions, allowing the parent or the new company to have a “single line of business” or a higher value public stock to attract or retain employees, improving credit terms or enhancing “fit and focus.”

2. Procedural Considerations

A company planning a spin-off must determine whether to proceed solely on the basis of an opinion of tax counsel or whether to seek a private letter ruling from the IRS. A private letter ruling provides a high degree of assurance as to the tax results of a transaction and may also provide comfort on the tax treatment of internal restructuring steps that precede a spin-off or split-off.

Depending on the complexity of the transaction structure, the preparation of a ruling request could take several weeks or months as the ruling request includes detailed information regarding the entities and businesses involved. Typically, seeking IRS rulings as to numerous internal pre-spin restructuring steps slows down the process of preparing the ruling request and obtaining the ruling once the request has been submitted. The IRS will generally grant a request for expedited handling for rulings pursuant to Section 355. If expedited handling is granted, IRS guidelines state that a ruling will typically be issued within ten weeks of submitting the ruling request. However, depending on the complexity of the request, the process of obtaining a ruling may take approximately six months, regardless of whether expedited handling has been requested. Typically, supplemental submissions in addition to the initial submission of the ruling request are required, both to respond to questions and issues raised by the IRS and to update the IRS with respect to the status of the relevant transactions and any changes in the transaction structure.

The IRS has strict and sometimes unpredictable ruling guidelines. There is generally no assurance that a favorable ruling can be obtained, although a pre-submission conference with the IRS, as well as discussions with the IRS while the

ruling request is pending, provide feedback. Furthermore, as a result of changes to the IRS' ruling practices, it is no longer possible to obtain rulings on whether the "device" and "business purpose" requirements have been satisfied or whether the spin-off is part of a "plan" that includes a post-spin acquisition, as described in Part VI.B below and Part II.B above. Moreover, in a recent change, the IRS will no longer issue private rulings with respect to certain structures that have been utilized regularly in spin-off transactions, including debt-for-debt or debt-for-equity exchanges where the parent's debt is issued in anticipation of the spin-off and certain high-vote/low-vote structures at the company to be spun-off.

In connection with obtaining an IRS ruling, the parent will be required to make certain representations with respect to the transaction under penalties of perjury. An opinion of tax counsel will similarly rely upon representations made by an officer of each of the parent and the company to be spun-off.

B. Spin-offs Followed by Acquisitions

As described above in Part VI.A, certain requirements for tax-free treatment under Section 355 are intended to avoid providing preferential tax treatment to transactions that resemble corporate level sales. Under current law, a spin-off coupled with a tax-free or taxable acquisition will cause the parent to be taxed on any corporate level gain in the spin-off company's stock if, as part of the plan (or series of related transactions) encompassing the spin-off, one or more persons acquires a 50% or greater interest in the parent or the spin-off company. Acquisitions occurring either within the two years before or within the two years after the spin-off are presumed to be part of a plan or series of related transactions. IRS regulations include facts and circumstances tests and safe-harbors for determining whether an acquisition and spin-off are part of a plan or series of related transactions.

A detailed explanation of the tax considerations relevant to post-spin acquisitions is attached as Annex B. Generally, where there have been no "substantial negotiations" with respect to the acquisition of the parent or the spin-off company or a "similar acquisition" within two years prior to the spin-off, an acquisition of the parent or the spin-off company for acquiror stock will not jeopardize the tax-free nature of the spin-off. Substantial negotiations generally require discussions of significant economic terms. In general, an actual acquisition is "similar" to another potential acquisition if the actual acquisition effects a direct or indirect combination of all or a significant portion of the same business assets as the potential acquisition would have. The rules applying to post-spin acquisitions turn on whether such acquisitions were planned as part of the overall spin-off transaction.

Post-spin equity transactions that are part of the plan remain viable where the historic shareholders of the parent retain a greater than 50% interest (by vote and value) in the parent and the spin-off company after the merger transaction. Thus, a spin-off followed by a merger with a smaller company is feasible even if it is part of a plan or series of related transactions with the spin-off and has been the format of a number of significant recent transactions, as discussed in Part II.B. Where the merger partner is larger than the parent or spin-off company to be acquired, it may be possible to have the merger partner borrow funds to redeem or otherwise shrink its capitalization prior to the merger transaction.

Because post-spin transactions can cause the spin-off to become taxable to the parent corporation (and, in the case of taxable transactions, its shareholders), it is not uncommon for tax matters agreements to impose restrictions with respect to such transactions and to allocate any corporate tax liability resulting from the spin-off to the corporation the acquisition of whose stock after the spin-off triggered the tax, as described above in Part IV.D.

VII

Listing and Trading Considerations

A. Stock Exchange Listing

The parent and the company to be spun off will need to decide where the spin-off company's stock will be listed after the spin-off. A listing application with the exchange(s) chosen should then be filed shortly after the initial filing of the Form 10 with the SEC (or the Form S-1, in the case of a spin-off preceded by an initial public offering). Approval for listing upon notice of issuance should be obtained before the spin-off (or, if applicable, before closing the public offering) and will typically be a condition of closing.

B. "When-Issued" Trading

Typically, a company will seek to smooth the transition to post-spin trading of the shares of the parent and the spin-off company by establishing multiple trading markets during the period beginning up to two days before the record date for the spin-off and continuing through the date of the spin-off. At the parent level, this involves two markets in shares of parent common stock: a "regular-way" market and an "ex-distribution" market. The parent shares that trade on the "regular-way" market trade with an entitlement to the shares of the subsidiary to be distributed in the spin-off. Parent shares that trade on the "ex-distribution" market trade without an entitlement to shares of the subsidiary to be distributed in the spin-off.

During this same period, there is a "when-issued" market in the shares of the subsidiary to be distributed in the spin-off. "When-issued" trading refers to a sale or purchase made conditionally because the security has been authorized but not yet issued. The "when-issued" trading market is a market for the subsidiary to be distributed in the spin-off, which allows parent shareholders to trade their entitlement to shares of the subsidiary without shares of the parent. On the first trading day following the distribution date, "when-issued" trading with respect to the shares of the spin-off company ends, and "regular-way" trading begins.

C. The Distribution Ratio

The distribution ratio is the number of shares of the spin-off company to be distributed in respect of each share of parent common stock in the spin-off. The distribution ratio is determined by the parent's board of directors, in

consultation with management and its financial advisor, and is typically based on the target share price for the spin-off company.

D. Reverse Stock Splits

If the subsidiary being spun off comprises a significant portion of the value of the parent, the spin-off likely will result in a substantial decrease in the stock price of the former parent. A parent may implement a reverse stock split to move the per-share trading price of its stock back towards the pre-spin level. A reverse stock split is commonly effected by a series of amendments to the parent's certificate of incorporation, which, depending on state law, typically requires a shareholder vote.

ILLUSTRATIVE SAMPLE TIMETABLE FOR A SPIN-OFF¹Times and Actions

<i>Period/Event</i>	<i>Action</i>
Initial Consideration of Potential Transaction	Establish team consisting of key personnel from the parent (“Parent”) and, if appropriate, the spin-off company (“Spinco”) to review and resolve principal issues.
[minimum of one month before Initial Approval Board Meeting]	Review separation-related issues, including: <ul style="list-style-type: none"> – identification of assets to be spun off; – determination of capital structure; – allocation of debt and other liabilities; – corporate structure, including the Spinco jurisdiction of incorporation; – consent requirements, including with respect to Parent and Spinco borrowings; – liquidity requirements for Parent and Spinco and availability of financing; – solvency of Parent and Spinco following the spin-off and evaluation of contingent liabilities; – availability of surplus for spin-off distribution under applicable law; – identification of Spinco senior management; – board size and composition (including search process for director candidates); – if relevant, evaluate interlocks among Parent and Spinco directors and officers; – employee and management compensation issues, including treatment of benefit plans and employment arrangements; – identification of necessary intercompany arrangements post-spin (<i>e.g.</i>, shared services, technology sharing, intellectual property licenses and brand);

¹ This illustrative timetable is for a spin-off that is not preceded by an IPO.

<i>Period/Event</i>	<i>Action</i>
	<ul style="list-style-type: none"> – determination of whether tax opinion or a combination of tax opinion and IRS ruling will be relied upon (and initial preparation of ruling request); – determination of internal tax and corporate restructuring to effect separation in most tax-efficient manner; – determination of any required regulatory filings; – initial preparation of securities law filings; and – corporate name for each entity and right to use Parent name. <p>Determine what historical financial statements and pro formas will be required for Form 10 purposes and commence preparation. In any event, prepare standalone financial statements for Spinco and Parent (including allocation of existing goodwill and identification of reserves and transaction costs).</p> <p>Consider proposed dividend levels for Spinco.</p> <p>Develop public and investor relations plan, including plan for presentations to:</p> <ul style="list-style-type: none"> – institutional investors; – existing lenders; – rating agencies; – employees; – customers and suppliers; and – governmental and regulatory bodies. <p>Develop a strategy for communicating with Spinco employees regarding future benefits arrangements and Parent regarding effects of spin-off on remaining Parent employees.</p> <p>Prepare board information package, draft board resolutions, management presentations and information concerning contingent liabilities.</p>
Board Meeting for Initial Approval	Parent Board meeting to discuss and give preliminary approval of spin-off, subject to final board approval, and authorize Parent management to proceed with preparation therefor. Board meeting

<i>Period/Event</i>	<i>Action</i>
	<p>to include presentations from Parent management (including with respect to pro forma financial statements and adequacy of surplus), internal and/or outside counsel, and, if desirable, solvency expert and financial advisor.</p> <p>Notify Parent stock exchanges and issue Parent press release.</p> <p>File Form 8-K for Parent.</p>
Weeks 1–2 After Board Meeting	<p>Consider commencing public investor relations plan.</p> <p>Continue preparation of information statement and Form 10.</p> <p>Continue preparation of financial statements and MD&A for Form 10 purposes. Consider impact of spin-off on Parent financial statements.</p> <p>Commence drafting separation and distribution agreement, employee matters agreement, tax matters agreement, transition services agreement and other agreements concerning the relationship between Parent and Spinco, if applicable, such as intellectual property arrangements (the “Spin-off Documents”).</p> <p>Determine proposed dividend levels for Spinco.</p> <p>Determine on which exchanges Spinco will be listed.</p> <p>Prepare and distribute questionnaire to officers and, if determined, directors of Spinco.</p> <p>Survey of regulatory filings and approvals. Retain local counsel where necessary.</p> <p>Reserve Spinco name in proposed state of incorporation and elsewhere as necessary.</p> <p>Parent and Spinco to review any required new lending relationships for Spinco and general liquidity requirements.</p>

<i>Period/Event</i>	<i>Action</i>
	Commence process of seeking any required third party consents.
	Preliminary contact with rating agencies.
Weeks 3–4 After Board Meeting	Distribute drafts of the separation and distribution agreement and any other Spin-off Documents that will need to be considered by larger groups. Certain agreements that will involve smaller working teams may proceed on a separate track.
	Distribute drafts of historical financial statements and MD&A, if practicable.
	Begin preparing organizational documents and corporate documents for Spinco. Charter and by-laws take precedence as they ultimately will need to be filed with the Form 10; committee charters, policies, etc. can proceed on a separate track.
	Begin preparation of resolutions for Parent, Spinco and subsidiary boards of directors authorizing transfers of assets and related matters.

<i>Period/Event</i>	<i>Action</i>
Weeks 5–9 After Board Meeting	<p>Drafting Sessions for Information Statement and Form 10.</p> <p>Finalize financial statements and MD&A for Form 10 purposes.</p> <p>Finalize ruling request and file with IRS if ruling is to be sought.</p> <p>Continue drafting Spin-off Documents.</p> <p>Determine the treatment of any tax-qualified retirement plans.</p> <p>Begin drafting employee benefit and equity plans for Spinco.</p> <p>Consider blue sky issues.</p> <p>File Form 10 with the SEC.</p> <p>Issue press release regarding filing, if desired.</p>
Weeks 10–13 After Board Meeting	<p>Receive and respond to SEC comments.</p> <p>Continue drafting Spin-off Documents. File forms of material agreements, when ready, as exhibits to the Form 10.</p> <p>Finalize employee benefit and equity plans for Spinco.</p> <p>Begin confidential discussions with applicable stock exchange regarding listing application process and draft preliminary listing application(s) and other documents relating to exchange listing.</p> <p>Obtain third party consents and state and foreign regulatory approvals.</p> <p>Negotiate bank and/or other credit facilities with lenders.</p>
Weeks 14–18 After Board Meeting	<p>Receive and respond to additional SEC comments.</p> <p>Finalize Spin-off Documents. File forms of documents as exhibits</p>

Period/Event

Action

to the Form 10.

File preliminary listing application(s) with applicable exchanges.

Prepare registration statements for employee equity plans of Spinco.

Parent and Spinco boards of directors or authorized committees meet to approve the following (to the extent not previously approved):

- elect Spinco directors and officers;
- approve Spinco charter and by-laws and adopt any related board or shareholder resolutions;
- authorize transfers of assets and liabilities, if necessary;
- approve form of separation and distribution agreement and other Spin-off Documents;
- ratify Form 10; authorize execution and delivery of the other securities law-related documentation; appoint attorney in fact to sign the registration statements required for Spinco employee benefit plans; and authorize such other customary resolutions with respect to securities law matters in the spin-off;
- approve form and authorize execution and delivery of various agreements concerning credit lines and debt agreements;
- appoint transfer agent and registrar acceptable to applicable stock exchanges on which listing will be made;
- authorize compliance with blue sky laws as required and adopt resolutions concerning blue sky authorities;
- authorize listing of Spinco common stock;
- authorize name changes and filings to effectuate them;
- approve employee benefits, stock option and other incentive compensation and benefit plans of Spinco; and
- authorize all steps previously taken and the taking of all further steps in connection with the transactions.

Spinco executes agreements with transfer agent and registrar in form satisfactory to the securities exchanges on which Spinco is intending to list.

<i>Period/Event</i>	<i>Action</i>
	Establish CUSIP eligibility of Spinco common stock with DTC.
Weeks 19–25 After Board Meeting	<p>Receive and respond to additional SEC comments. Clear all outstanding comments and submit request for acceleration of Form 10 effectiveness.</p> <p>Receive notice of approval for listing from securities exchanges.</p> <p>Form 10 declared effective by the SEC.</p> <p>File Form 3 for Parent (as stockholder of Spinco) and current executive officers and directors of Spinco on day the Form 10 is declared effective.</p> <p>File Form 8-K and issue press release for Parent as to effectiveness.</p> <p>File registration statement(s) regarding Spinco employee equity plans.</p> <p>Continue investor relations plan with respect to the spin-off.</p> <p>Finalize Spinco’s bank and other credit facilities.</p> <p>Receive solvency opinion with respect to solvency of Spinco following the spin-off. Solvency firm may give a bring-down opinion at closing.</p> <p>Parent board of directors acts to:</p> <ul style="list-style-type: none"> – authorize distribution of Spinco common stock to Parent shareholders, distribution ratio and method of handling fractional shares; – set record and distribution dates for stock dividend effecting spin-off and declare spin-off dividend; – appoint distribution agent; – designate an officer or committee of Parent with power to approve all matters in connection with the proposed distribution, if desired; and

<i>Period/Event</i>	<i>Action</i>
	<p>– receive updated reports from experts if needed.</p> <p>Give notice of record and distribution dates to transfer agent and distribution agent.</p> <p>Print and mail final information statement to Parent stockholders.</p> <p>File any necessary name changes in appropriate states.</p>
Weeks 26–29 After Board Meeting	<p>Receive opinion of tax counsel and, if applicable, IRS ruling.</p> <p>“When-issued” trading market commences two days before record date of the distribution and continues until the distribution date.</p> <p>Distribution date and closing of spin-off.</p> <p>Parent and Spinco execute Spin-off Documents.</p> <p>Issue Parent and Spinco press releases and file Parent and Spinco Forms 8-K regarding closing. (Spinco 8-K typically includes executed versions of the material Spin-off Documents.)</p> <p>Notify distribution agent and other required parties of closing.</p> <p>Distribute stock of Spinco to Parent shareholders and implement approved mechanism for handling fractional shares on distribution date.</p> <p>File Form 3 for executive officers and directors of Spinco appointed at the closing of the spin-off. File Form 4 for Parent reflecting disposition of Spinco stock in the distribution.</p> <p>File final securities exchange listing applications, if required by exchange.</p>

ANNEX B

POST-SPIN LIMITATIONS ON STRATEGIC TRANSACTIONS

As described in Part VI.B. above, when a parent spins off a subsidiary in a tax-free transaction, the tax rules impose certain restrictions on subsequent acquisitions of the parent or the spin-off company. The following chart summarizes these restrictions and is followed by additional explanation and discussion. The summary chart is for ease of reference only and should be read in conjunction with the discussion that follows it.

Circumstances	Acquisition of 50% or more of the parent or the spin-off company in stock transaction	Acquisition of 50% or more of the parent or the spin-off company in cash transaction
No agreement or “substantial negotiations” with respect to acquisition or a “similar acquisition” (see below) within two years prior to completion of spin-off	No post-spin waiting period	Facts and circumstances test as to whether spin is a “device” to distribute earnings (see below)
Spin-off motivated by valid business purpose, and no agreement or “substantial negotiations” with respect to acquisition or a “similar acquisition” within one year prior to completion of spin-off	Six-month post-spin waiting period	Six-month post-spin waiting period, plus facts and circumstances test (see above)
Substantial negotiations within one year prior to spin-off, but no agreement, understanding or arrangement concerning the acquisition or a “similar acquisition” at the time of the spin-off	One-year post-spin waiting period	One-year post-spin waiting period, plus facts and circumstances test (see above)

“Substantial negotiations” generally require discussions of significant economic terms (*e.g.*, price or exchange ratios).

In general, an actual acquisition is “similar” to another potential acquisition if the actual acquisition effects a direct or indirect combination of all or a significant portion of the same business assets as the potential acquisition would have.

Under the “device” rules, a spin-off is taxable at the corporate level and at the shareholder level if the spin-off is principally a device for the distribution of earnings and profits (*i.e.*, if the spin-off is principally a means to get cash to shareholders at capital gains rates). The “device” rules are discussed below.

Discussion

I. Section 355(e) Rules

Under the “anti-Morris Trust” rules of Section 355(e) of the Internal Revenue Code, a spin-off is taxable at the corporate level (although not at the shareholder level) if the spin-off is part of a “plan” that includes the acquisition of 50% of the vote or value of the parent or the spin-off company.

- Under the statute, a spin-off and an acquisition of stock are presumed to be part of a plan if the acquisition occurs within two years before or after the spin-off.
- Under regulations, an acquisition of the parent or the spin-off company within two years after the spin-off will not be deemed to be part of a plan if:
 - There was no agreement, understanding, arrangement, or “substantial negotiations” regarding the acquisition or a “similar acquisition” **within the two-year period ending on the date of the completion of the spin-off; OR**
 - The spin-off was motivated in whole or substantial part by a corporate business purpose other than to facilitate an acquisition of, or issuance of stock by, the acquired company (the parent or the spin-off company), and there was no agreement, understanding, arrangement, or “substantial negotiations” regarding the acquisition or a “similar acquisition” during the period that **begins one year before the spin-off and ends six months after the completion of the spin-off; OR**

- There was no agreement, understanding or arrangement concerning the acquisition or a “similar acquisition” **at the time of the spin-off** AND there was no agreement, understanding, arrangement, or “substantial negotiations” regarding the acquisition or a “similar acquisition” **within one year after the completion of the spin-off**.
- “Substantial negotiations” generally require discussions of significant economic terms (*e.g.*, price or exchange ratios).
- In general, an actual acquisition is “similar” to another potential acquisition if the actual acquisition effects a direct or indirect combination of all or a significant portion of the same business assets as the potential acquisition would have.

II. “Device” Rules

Under the “device” rules, a spin-off is taxable at the corporate level and at the shareholder level if the spin-off is principally a device for the distribution of earnings and profits (*i.e.*, if the spin-off is principally a means to get cash to shareholders at capital gains rates).

- A sale or exchange of stock of the parent or the spin-off company following a spin-off is evidence of device, except in the case of an exchange pursuant to an all-stock acquisition. Thus, the “device” rules come into play in the context of a spin-off followed by a cash acquisition (or an acquisition for cash and stock). Generally, the shorter the period between the spin-off and the sale, the stronger the evidence of device.
- A post-spin sale or exchange that was discussed by the buyer and the seller before the spin-off and was reasonably to be anticipated by both parties will ordinarily be considered “substantial” evidence of device.
- Absence of accumulated earnings and profits is evidence of non-device.