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Spin-Off Guide

Posted by Kobi Kastiel, Co-editor, HLS Forum on Corporate Governance and Financial Regulation, on Tuesday April 1, 2014

Editor's Note: The following post comes to us from Gregory E. Ostling, partner in the Corporate Department at Wachtell, Lipton, Rosen & Katz, and is based on the introduction to a Wachtell Lipton memorandum by Mr. Ostling, Deborah L. Paul, Nelson O. Fitts, and Jeremy L. Goldstein; the complete publication, including annexes, is available here.

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 been 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, which at the time was the largest ever investment-grade corporate bond deal in the United States, at a weighted average interest rate of approximately two percent. Other notable recent spin-offs include ConocoPhillips' spin-off of its refining and marketing business, Penn National Gaming's spin-off of its real estate assets into the first-ever casino REIT, Sears Holding Corporation's planned spin-off of Lands' End, FMC's planned spin-off of its minerals division, Rayonier's planned spin-off of its performance fibers division, Simon Property's spin-off of its strip center business and smaller enclosed malls into a REIT, and Darden's planned spin-off of Red Lobster. There were 201 spin-offs announced in 2013 and 176 in 2012, with an aggregate value of $33 billion and $41 billion, 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 spin-off company after the closing, careful planning is also required with respect to the composition of the new company's 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 various issues associated with taking 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, and includes 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.