

WACHTELL, LIPTON, ROSEN & KATZ

SPIN-OFF GUIDE

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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 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, in recent years, companies have been able to tap the debt markets 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 Penn National Gaming's spin-off of its real estate assets into the first-ever casino REIT, Energizer's spin-off of its household products business, Gannett's spin-off of its publishing business, DuPont's spin-off of its performance chemicals business, eBay's spin-off of PayPal, Baxter's spin-off of its biopharmaceuticals business, HP's separation of its PC and printer business and its enterprise business, W.R. Grace's separation of its construction products and packaging technologies businesses and its catalyst technologies and engineered materials businesses, and Yum Brands' planned spin-off of its China business. The volume of spin-offs in 2015 was a record-setting \$257 billion.

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 arise in an individual situation depend largely on the business goals of the separation transaction, 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. For example, if the businesses were tightly integrated before the transaction or are expected to have significant business relationships following the transaction, it will take more time and effort to allocate 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 information technology) and continuing supply, intellectual property sharing and other commercial or operating agreements. If 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, such as drafting and filing the initial disclosure documents, applying for listing on a stock exchange, implementing internal controls and managing ongoing reporting obligations and public investor relations.

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.

II.

Initial Planning Considerations

A. Reasons for Spin-Offs

There are several drivers of spin-off activity. 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 for part of the parent company’s businesses, a spin-off will enhance the ability of both the parent and the spun-off business to effect acquisitions using its stock as consideration.

Shareholder activism is another and more recent potential driver of spin-off activity. Shareholder activists have become an increasingly powerful force in the corporate landscape, and many activists agitate for “value maximizing” activity, including spin-offs. Activists are often a catalyst for spin-off activity, and the rise in shareholder activism may explain some of the increase in spin-off

activity. For example, Trian Fund Management ran a proxy fight for board representation at DuPont in 2015 and campaigned for a spin-off of DuPont's agriculture, health and industrial biosciences businesses. Although Trian did not win board representation, DuPont several months later agreed to merge with The Dow Chemical Company, which had also faced pressure from activist Third Point, and the two agreed that post-merger, they would separate into three new companies—an agricultural chemicals company, a material sciences company and a specialty products company.

Although spin-offs often have advantages, they also may involve a variety of disadvantages, including:

- the potential loss of both revenue and cost synergies due to the separation of the parent's businesses;
- disruptions to the business as a result of the spin-off;
- separation costs;
- reduced size and diversification, which could potentially result in greater cash flow volatility and reduced access to capital markets, and which may affect the company's credit rating;
- the potential reduction of equity research coverage and investor focus if the separated companies are too small;
- the possibility of short-term stock price volatility as the market adjusts to the distinct investment identities of the separated companies;
- potential stock market index exclusion depending on the size or nature of the companies; and
- the possible increased susceptibility to unsolicited takeover activity (given that the businesses of each of the two post-spin companies will be less diversified and smaller than the combined predecessor company).

B. Separation Transaction Structures

It is common for a company in the initial planning phases to consider other types of separation transactions in addition to a spin-off. 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. However, 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 to the parent's shareholders can be accomplished in a manner that is tax-free to both the parent and its shareholders. By contrast, a sale for cash would be a taxable transaction, and, as compared to a spin-off, there is a greater risk that a sale to a third party may not be consummated. Also, the parent can generally determine the terms and timing of a spin-off, but a sale to a third party requires due diligence by the buyer and the negotiation and execution of a definitive agreement with respect to price, timing and other terms, and the closing of such a sale will also typically be subject to various conditions, including, for example, regulatory approvals. Depending on the nature and size of the business to be separated, there could be a relatively small universe of buyers that may be interested in and able to acquire the business. Purchase agreements with third parties also often include various representations and warranties about the target business, supported by post-closing indemnities. In a spin-off, on the other hand, the business usually is transferred to the spin-off company 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 spin-off company are distributed to the shareholders of the parent as 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, Motorola's spin-off of Motorola Mobility Holdings, ITT's simultaneous spin-offs of Exelis and Xylem, IAC/InterActiveCorp's simultaneous spin-offs of Ticketmaster, HSN, Tree.com and Interval Leisure Group, ConocoPhillips's spin-off of Phillips 66, Covidien plc's spin-off of Mallinckrodt plc, Sears Holdings Corporation's spin-off of Lands' End Inc., Edgewell Personal Care Company's spin-off of Energizer Holdings, eBay's spin-off of PayPal and W.R. Grace's spin-off of GCP Applied Technologies.

There are other corporate mechanics available for accomplishing a spin-off. For example, in 2005, IAC/InterActiveCorp (“IAC”) spun off Expedia through 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 this structure involves a charter amendment, it requires a vote of the parent’s shareholders. By contrast, a spin-off accomplished through a dividend usually does not require 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 or to retire existing debt of the parent, 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 satisfaction of the Internal Revenue Service 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 spin-off company within five years following the spin-off for the transaction to be tax-free. Examples of this type of transaction include Valero’s spin-off of Corner Store Holdings, Ralcorp’s spin-off of Post Holdings, Cardinal Health’s spin-off of CareFusion and SUPERVALU’s planned spin-off of its Save-a-Lot discount grocery business.

3. IPO Plus Spin-Off / The “Up-C” Structure

A parent may structure a separation transaction through an initial public offering of a portion of the common stock of the subsidiary to be separated followed by a distribution of the subsidiary’s common stock to shareholders of the parent. In the IPO, the subsidiary would sell a portion of its shares to the public in an underwritten offering, with the proceeds 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 parent’s stake in the subsidiary to the parent’s shareholders.

Creating an investor base in advance of a spin-off may be helpful because the shareholders of the parent on the record date for the spin-off dividend may or may not wish to hold shares of the spin-off company. An IPO also allows for a

trading market and market valuation of the spin-off company to be established before the distribution of the spin-off company stock to the parent's shareholders.

For the subsequent spin-off to qualify as tax-free, the parent must generally retain at least 80% of the shares of the subsidiary after the IPO, because the tax rules require the parent to distribute "control" (generally, 80% of the voting stock and 80% of each non-voting class of stock) of the subsidiary. An IPO followed by the distribution of the offering proceeds to the parent is generally tax-free to the corporations involved if the amount of cash distributed is less than the parent's basis in the stock of the subsidiary and certain other requirements are met. 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.

Issuing low-vote stock to the public may preserve the ability to spin off the subsidiary in a subsequent step if the parent wants more than 20% of the value of the stock of the subsidiary to be issued to the public. However, the IRS no longer issues rulings regarding 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. Accordingly, under current IRS practice, any such spin-off would have to be done on the basis of an opinion of counsel, rather than an IRS private letter ruling.

If the parent desires to sell to the public more than 20% of the stock of the subsidiary while preserving the ability to spin-off its remaining interest in the subsidiary subsequently in a tax-free manner, an alternative to the traditional high-vote/low-vote structure is to structure the subsidiary as an "Up-C." An Up-C structure generally has the following characteristics:

- the business to be separated is contributed to an operating company that is a limited liability company or limited partnership and is treated as a partnership for tax purposes;
- the public purchases low-vote stock in a newly formed corporation that holds a minority economic interest in the operating company and a majority of the vote and control over the operating company; and
- the parent holds both non-economic high-vote stock in the newly formed corporation giving it control over the corporation and at least a 50% direct economic interest in the operating company.

When the parent subsequently spins off its remaining interest after the IPO, the operating company merges with the corporation.

The Up-C structure allows the parent to sell up to 50% of the economics of the business being separated and, until it spins off the remaining interest, receive cash distributions from the operating company on a tax-efficient basis. Distributions can be received on a tax-efficient basis because the operating company is a partnership for tax purposes rather than a non-consolidated corporate subsidiary. The main downside of the structure is that the parent may pay tax on the upfront proceeds from the IPO of the corporation. As with the traditional high-vote/low-vote structure, the IRS no longer rules on spin-offs of corporations that have issued low-vote (or high-vote) stock in anticipation of the spin-off.

Some companies determine not to pursue a carve-out IPO because of the additional costs (such as underwriting fees), complications and uncertainty involved in an IPO. The timing of an IPO will depend in large part on equity market conditions, which could significantly delay the completion of the transaction. 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, resulting in fiduciary duties to the subsidiary's public shareholders.

Examples of carve-out IPOs followed by spin-offs are the Sunoco/SunCoke Energy, Motorola/Freescale Semiconductor and GE/Synchrony Financial transactions.

4. IPO Plus Split-Off / "Cash-Rich" Split-Off

In a split-off, the parent makes an offer to its shareholders to exchange their parent stock in exchange for all or a portion of the shares of the spin-off subsidiary. It is 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 taken public as a result of an IPO so that the established trading value of the spin-off company's shares can be used in pricing the split-off exchange ratio. In a split-off, the parent typically offers to purchase the parent stock at a premium relative to the trading price of the spin-off company's shares. Because the parent's 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, in which shareholders receive a proportionate number of shares of the spin-off company), and the transaction must be registered under the U.S. Securities Act of 1933 (the "Securities Act") because it involves an investment decision by the parent's shareholders. A split-off is also

an issuer tender offer under the U.S. Securities Exchange Act of 1934 (the “Exchange Act”), and, therefore, the parent must comply with the tender offer rules. Examples of split-offs include MetLife’s split-off of its 52% stake in Reinsurance Group of America, CBS’s split-off of its CBS Outdoor Americas business and Pfizer’s split-off of Zoetis.

A split-off can also be used to reacquire stock, generally from a large stockholder, in a transaction that is referred to as a “cash-rich split-off.” In this type of transaction, the parent company creates a new subsidiary and contributes an “active trade or business” (*i.e.*, an operating business that the parent has owned and operated for five years or more) to that subsidiary as well as cash. Assuming other tax requirements are satisfied, such as having a five-year active trade or business and a valid business purpose for the transaction, the parent can then exchange stock in the new subsidiary for the parent’s stock held by the large stockholder in a transaction that is tax-free. However, tax-free treatment will not apply if either the parent or the subsidiary own investment assets (generally, cash or other liquid or inactive assets) whose fair market value constitutes two-thirds or more of the fair market value of all the assets of the parent or the subsidiary, respectively, immediately after the distribution. Moreover, the IRS will no longer issue rulings as to the tax-free treatment of certain “cash-rich split-offs” (or spin-offs) where a very large percentage of the asset value of the parent or the subsidiary consists of investment assets, as described in more detail in Part VI.A.2. below.

5. Sponsored Spin-Offs

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 spin-off company. The sponsor’s investment allows the parent to raise proceeds in the spin-off without having first to 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 complex issues, including those related to valuation, capital structure and governance.

6. 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 can 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 combined with the third party are spun off or split off into a new public company and then the parent merges with the third party. In a Reverse Morris Trust, all assets to be combined with the third party are spun off or split off into a new public company and then the new company merges with the third party.

In order to be tax-free, the Morris Trust and Reverse Morris Trust structures generally require, among other things, that the merger partner be smaller than the business to be combined with the merger partner (*i.e.*, that the shareholders of the parent own a majority of the stock of the combined entity). One advantage of a Reverse Morris Trust structure over a Morris Trust structure is that a Reverse Morris Trust generally does not require approval by the parent shareholders for the spin-off or merger. In a Reverse Morris Trust transaction, the spin-off company is combining with the merger partner, and the parent entity approves this combination at the time when the parent entity is the sole shareholder of the spin-off company. By contrast, a Morris Trust transaction often requires approval by the parent's shareholders because the merging party (*i.e.*, the parent) is already a public company at the time that the merger is submitted for approval by the parent's shareholders. 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, PPG Industries' 2013 split-off of its commodity chemicals business and merger of such business with Georgia Gulf (since renamed Axiall Corporation), Dow Chemical's spin-off of its chlor-alkali business and merger of such business with Olin Corp and P&G's planned spin-off of certain beauty products and merger of that business with Coty. An example of a spin-off combined with a concurrent M&A transaction is Atlas Energy, L.P.'s taxable spin-off of its exploration and production business and merger of the remaining midstream business with Targa Resources Corp. A simultaneous spin-off and M&A transaction involves additional complexity because each transaction will typically be conditioned on the completion of the other. In addition, the acquiror and target will often engage in extensive negotiations of the key spin-off agreements prior to entering into the merger agreement so that both parties have a clear understanding of which assets and liabilities will be spun off and which will be retained.

In some cases, a spin-off may come after the closing of a M&A transaction. This approach allows parties to reap the benefits of a combination while also signaling to the market an intent to rationalize the portfolio of the combined company in the future. Examples of spin-offs that will follow a merger

include Johnson Controls' planned spin-off its automotive business, which is expected to occur after the closing of Johnson Controls' planned merger with Tyco International; WestRock's planned spin-off of its specialty chemicals business, which MeadWestvaco announced prior to merging with Rock-Tenn Company to form WestRock; and DuPont and Dow's planned merger and subsequent split-up into three separate companies. In addition, in the press release announcing Pfizer and Allergan's agreement to combine, the parties noted that the transaction preserves the opportunity for a potential future separation of the combined company's innovative and established businesses. In such transactions, if the "active trade or business" to be relied upon by either the parent or the spin-off company was conducted only by the legal target in the merger, the spin-off may not qualify for tax-free treatment if it occurs within five years of the merger.

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.

7. REIT Separation Transactions

Many companies have made substantial real estate investments in connection with their businesses. While real estate holdings give a company control over assets that can be critical from an operational perspective, they also tie up capital and may require significant management attention. One potential means of unlocking the value of a company's real estate is to split the company into an operating company and a separate real estate investment trust ("REIT") that owns the company's real estate. Long-term leases and other contractual relationships can be established between the two companies to ensure the operating business's ability to continue to use the real estate assets on satisfactory terms. Separation transactions involving REITs can be complex, given the rules that an entity must comply with in order to be treated as a REIT. Among other things, the REIT must have no earnings and profits from the pre-REIT period. Congress recently amended Section 355 of the Internal Revenue Code to provide that a spin-off in which only one of the spun-off company or the remaining company is a REIT cannot qualify for tax-free treatment, although a transaction where a REIT spins off another REIT or a REIT spins off a taxable REIT subsidiary may still qualify as tax-free. Examples of recent REIT separation transactions include CBS's IPO of its CBS Outdoor Americas business, Simon Property's spin-off of its strip center business and smaller enclosed malls into a REIT, Penn National Gaming's spin-off of its real estate assets into the first-ever casino REIT, and Ventas's spin-off of most of its post-acute/skilled nursing facility portfolio into a REIT.

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 (*e.g.*, 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 by 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 subsidiary that has historically operated as a standalone business, this may be a relatively simple process because the business to be spun off will already be 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 transitional 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 (contribution, 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, and careful planning is required to effect the internal reorganization in a tax-efficient manner. 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 or modified, though in some cases the need to complete a financing in advance of the spin-off may require that the restructuring be completed earlier. In any event, the restructuring should commence sufficiently early to ensure its completion before the spin-off occurs. As discussed below 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. 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 at least 12 months after the date the spin-off company's Form 10 registration statement becomes effective, and affiliates of the spin-off company—including its directors and policymaking 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 until 90 days after the date of effectiveness.

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 required to implement the desired 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 or repay some of its debt.

There are a variety of techniques that can be used to implement the desired capital structure, and the optimal strategy is often driven by tax considerations and the terms of the 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, however, 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 to its shareholders 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 of 100% of the stock of the spin-off company to the parent's shareholders with a simultaneous debt-for-debt exchange, but without a subsequent debt-for-equity exchange. As discussed below, the IRS's current practice is 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 reduces the attractiveness of this monetization technique. However, companies may also undertake debt-for-debt or debt-for-equity exchanges using historical parent debt, and the IRS has not announced any changes in its ruling practice with respect to such exchanges. Yet another structure is an IPO 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 to 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 pre-spin parent. 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 pre-spin parent, particularly if the parent is an investment grade issuer and the spin-off company will not be; 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 may have been accustomed to spending on similar transactions in the past.

Due to the factors discussed above, as well as the recent instability in the financing markets, 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 an extended period, 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 as 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 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, also 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. Additional consideration may also need to be given to general corporate liabilities or other shared liabilities that do not relate specifically to the parent or the spin-off company, such as shareholder litigation. In some cases, the applicable liabilities may already reside in the appropriate legal entity. In other cases, the liabilities may need to be assumed by other entities. Typically, liability allocations are reinforced through indemnities from one business to the other in the separation and distribution agreement or other transaction documents. In addition, the parent and the spin-off company often will release each other from various liabilities. The Delaware Court of Chancery has confirmed that such customary mutual releases are presumptively appropriate and enforceable.

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 financially viable and that any solvency risks relating to either entity have been considered. In allocating debt and other liabilities and ensuring financial 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 or even the declaration before the spin-off of a cash dividend payable by the spin-off company to its shareholders after the completion of 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 may 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 distribution). Appreciation in the value of assets, though possibly not reflected in book value, as well as contingent liabilities that may not be reflected on the balance sheet, should be taken into account in determining whether sufficient surplus exists. As with the solvency analysis, the company's board of directors could rely on expert opinions, if appropriate (in addition to the company's management), to determine the availability of surplus. The laws of some states 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 permitted by Delaware law.

The directors of the 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 of a solvent corporation 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 bylaws 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 bylaws, and determine the size and composition of the board of directors, as well as board compensation and the structure of board committees and whether to provide for “proxy access.” Identification and recruitment of the spin-off company’s directors can be a lengthy process to which ample time should be afforded.

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, although any overlap in directors between the parent and the spin-off company generally is limited to a minority of each board in order to preserve the tax-free nature of the spin-off. All other facts and circumstances should also be considered in determining the impact of overlapping directors on the tax treatment of the spin-off. If the parent decides to have overlapping directors with a spin-off company, it should consider the possibility that conflicts may arise between it and the spin-off company that may make it appropriate for any such overlapping directors to recuse themselves from deliberations at each company’s board. It is important to consider whether the parent and the spin-off company could become competitors of each other in the future because Section 8 of the Clayton Antitrust Act of 1914 (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 policies on overboarding generally. Currently, ISS recommends voting against or withholding votes from individual directors who sit on more than six public company boards or are CEOs of public companies who sit on the boards of more than two public companies besides their own (in which case ISS will withhold only at those outside boards). Starting in 2017, ISS will recommend voting against or withholding votes from individual directors who sit on more than five public company boards. ISS also recently considered, but did not implement, a limit of one outside public company directorship (as opposed to two) for CEOs, and an alternate limit of four total for non-CEOs, and it may revisit these policies in the future. Glass Lewis recommends a vote against a director who is on an “excessive” number of boards. This typically means a vote against a director who serves as an executive officer of any public company while serving on more than two other public company boards and any other director who serves on more than six public company boards. Like ISS, Glass Lewis will not recommend voting against a director at the company where he or she serves as an executive officer, but will recommend against at the other public companies where he or she serves on the board.

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, although they may have been identified earlier on. Prior to that time, the spin-off company’s directors and officers typically will primarily consist of a small number of personnel of the parent company, which facilitates 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 bylaws 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 will likely 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, particularly in the period immediately following the spin-off, during which the stock price of the spin-off company may experience relatively high volatility.

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 the 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; 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 on shareholders’ ability to amend bylaws; no exemption from state antitakeover statutes; and requirements that a supermajority of shareholders approve business combination transactions or changes to the company’s anti-takeover defenses. 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, 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 public companies, a newly public company often will keep a rights plan “on the shelf” and ready for deployment if and when needed.

Recently, governance advisors have increased their focus on newly public companies. ISS issued voting guidelines under which it generally will make adverse recommendations for directors at the first shareholder meeting of a newly public company if that company has bylaw or charter provisions that are “materially adverse to shareholder rights.” In making its assessment, ISS will

consider the level of impairment of shareholders' rights caused by the provision, the rationale for adopting the provision, the impact of the provision on the ability to change the company's governance structure in the future, the ability to hold directors accountable through annual elections and whether the company has made a public commitment to put the provision to a shareholder vote within three years of the date of the IPO. Unless an adverse provision is reversed or submitted to a vote of public shareholders, ISS will make voting recommendations on a case-by-case basis on director nominees in subsequent years. Glass Lewis' guidelines provide for a one-year grace period for companies that have recently completed an IPO in which Glass Lewis refrains from issuing voting recommendations on the basis of corporate governance best practices, except in egregious cases. However, Glass Lewis will consider recommending to vote against the members of the board who served when an antitakeover provision such as a shareholder rights plan or a classified board was adopted if the board (i) did not also commit to submit such provision to a shareholder vote within 12 months of the IPO or (ii) did not provide a sound rationale for adopting such provision. In addition, the Council of Institutional Investors issued a draft statement laying out investor expectations as to various governance features of newly public companies.

In addition, shareholder activists have pressured companies to remove, or agree not to include, several antitakeover defenses in spin-off companies' governance documents. After DuPont announced that its performance chemicals spin-off company, Chemours, would have a classified board and several other customary antitakeover protections for a spin-off or IPO company, Triun Fund Management criticized the DuPont board and subsequently launched a proxy fight. DuPont later revised Chemours' governance so that the classified board would be subjected to approval by the Chemours shareholders at the first annual meeting of Chemours stockholders. Carl Icahn has also entered into agreements with eBay, Manitowoc and Gannett that require their respective spin-off companies to, for a period of time after the spin-off, have an annually elected board, permit shareholders to call special meetings, and refrain from adopting a shareholder rights plan with a threshold below approximately 20% or a duration of more than a specified number of days without stockholder ratification.

Notwithstanding these developments, companies considering a spin-off or IPO should, as always, focus on how to structure the governance of the new company in a manner that maximizes long-term value creation. But they also should understand the governance landscape and the implications of their choices as they chart a course for the enterprises they are creating.

Spin-off companies incorporated in Delaware have also increasingly adopted charter or bylaw provisions requiring shareholders to bring suit in Delaware, in keeping with the general trend towards adoption of such exclusive forum provisions. Following the Delaware Court of Chancery's June 2013 decision upholding board-adopted exclusive forum bylaws, such provisions have become increasingly common. Courts throughout the country—including courts in New York, Texas, Illinois, Ohio, Louisiana and California—have enforced exclusive forum bylaws and dismissed or stayed litigation filed in violation thereof. Over 1,170 companies have now adopted exclusive forum bylaws or charter provisions. These provisions are not self-executing—if a plaintiff sues a company in a jurisdiction other than that which is stated in such company's organizational documents as the exclusive forum for adjudicating such a dispute, the company will need to litigate to enforce its forum selection provision.

Proxy advisory firms have generally been skeptical of exclusive forum provisions, although their policies and practices have been changing since the Delaware Court of Chancery's decision. ISS has stated that unilateral adoption by the board of an exclusive forum bylaw will be evaluated under ISS' policy on unilateral bylaw and charter amendments. As discussed above, in the context of a newly public company, this policy focuses on whether such a bylaw is "materially adverse to shareholder rights." Glass Lewis has stated that it will weigh the presence of an exclusive forum provision in a newly public company's bylaws in conjunction with other provisions that it believes will unduly limit shareholder rights such as supermajority vote requirements, a classified board or a fee-shifting bylaw.

Some companies undergoing separation transactions have considered providing for mandatory arbitration in the newly public company's organizational documents, which would require shareholders with claims against the company to participate in mandatory confidential arbitration. Such provisions may encounter resistance, however, as evidenced by the Carlyle Group's 2012 attempt to include such a governance provision in its organizational documents in connection with its IPO. Carlyle ultimately determined not to include this provision in the face of opposition by investors, lawmakers and the Securities and Exchange Commission.

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 Act and the Sherman Antitrust Act (the "Sherman Act"), as discussed further below under

“Antitrust.” In the case of a company listed on the New York Stock Exchange (the “NYSE”), the issuer would be a “controlled company” under NYSE rules for so long as the parent owns at least a majority of the issuer after the IPO and thus would be exempt from the NYSE requirement that a majority of its directors be independent. However, the spin-off company 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. Although 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 business judgment rule, but, 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. In such conflict situations, directors are required to demonstrate the “entire fairness” of the transaction. A parent company that continues to control its former subsidiary likewise owes fiduciary duties to the former subsidiary’s public shareholders. In addition, persons who are both directors or officers of the parent and directors of the former subsidiary owe the same duties 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 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. This ratification mechanism, if properly applied, would generally shift the burden of proof regarding the fairness of such transactions from the former parent 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 controlling 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 historically operated as a standalone entity, composition of management will likely be reasonably straightforward. Even in such a case, however, the successful transition from a subsidiary to a separate publicly traded company may necessitate new or additional managers, and compensation programs and levels will need to be evaluated in the context of new peer companies. In spin-offs of divisions that have not been operated on a standalone basis, 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, such as 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, the impact of any union contracts (including restrictions on the allocation of employees, benefits and benefit plan assets) and, for international operations, works’ council or other employee consultation requirements.

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 provide those benefits at the closing of the transaction. Those plans may also assume 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 with a spin-off. Subject to any restrictions in such adjustment provisions, there are two principal methodologies for adjusting equity-based compensation awards of the parent in connection with a spin-off:

- *Concentration Method.* The parent awards held by specified employees (typically, employees who will be primarily dedicated to the spin-off company) are converted into awards of the spin-off company, while the parent awards held by all other employees continue to be awards based on parent equity and are adjusted to reflect the decrease in value of parent equity upon the spin-off.
- *Basket Method.* All parent awards (regardless of employee) are converted into two awards: (1) an adjusted parent award and (2) a

spin-off company award. This method is sometimes referred to as the “shareholder method,” because the treatment closely mirrors the treatment of shares generally, or as the “bifurcated method.”

The basket method is often chosen in recognition of the contributions by equity award holders 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. The concentration method also gives rise to fewer complications from an accounting, securities law, and tax perspective than does the basket method.

Method of Adjustment. Equity award adjustments in spin-offs generally aim to preserve the economic characteristics of the pre-spin-off award, with the value of the shares subject to the post-spin-off award (or awards) generally equivalent to the value of the shares subject to the pre-spin-off award, 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. For options to purchase parent shares, both the number of parent shares underlying the award and the exercise price must be adjusted. 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.

Overhang/Dilution. Companies should consult their financial advisers 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. More significantly, 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, the parent will 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, interests in joint ventures or other partnerships, 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 or if the spin-off company will be organized in a jurisdiction outside of the United States. 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 Hart-Scott-Rodino Antitrust Improvements 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. Tax considerations also play a role if the parent and the spin-off company intend to enter into cross-licenses to allow each company to use intellectual property allocated to the other. In addition, consideration may need to be given to the use of trademarks and trade names by the businesses to be separated. If trade names 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 the 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. 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 can 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, 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.

A spin-off is typically preceded by an announcement that the parent plans to pursue a separation of a business. This announcement does not preclude other alternatives that may arise, including retaining or selling the business if warranted by the circumstances. For example, McGraw-Hill initially announced that it intended to spin off its education business and even filed a Form 10 registration statement before selling the business to affiliates of Apollo Global Management. Likewise, FMC Corporation initially announced a plan to spin off its mineral businesses and then subsequently sold the alkali portion of that business in an auction to Tronox and retained the lithium portion.

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 supporting the proposition 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, 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, systems, raw materials, equipment, etc., on a commercial basis, they may enter into separate commercial agreements governing those relationships. Companies also may enter into patent, trademark and other intellectual property license agreements. 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, 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,” “exclusively related” or “to the extent related”). The agreement will also typically reference the pro forma balance sheet of the spin-off company in defining its assets and liabilities. 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, which may be similar to those that are included in private M&A agreements, or may be more customized depending on the nature of the spun-off business and the desired capital allocation approach.

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. Some companies may also choose to split any liability for shared or corporate legal matters that cannot be easily allocated to one business.

Similar to purchase agreements for a carve-out divestiture, separation and distribution agreements generally 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. 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 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 of the spin-off company's shares and sets out the conditions to the distribution. Usually, the conditions to the distribution include, at a minimum: effectiveness of the Form 10 registration statement and delivery (by mailing or electronically) of the related information statement to stockholders; approval of the shares of the spin-off company's common stock for listing on the applicable stock exchange; receipt of an opinion of tax counsel as to the tax treatment of the spin-off (if it is intended to be tax-free); absence of injunctions prohibiting the spin-off; and a "catch-all" condition that there has 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 completion of the internal restructuring plan (if any), receipt of a private letter ruling from the IRS as to the tax treatment of specific issues in the spin-off, 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 or captive insurance arrangements 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.

Spin-off transaction agreements sometimes provide for arbitration of disputes, though the appropriate dispute resolution mechanism should be considered in light of the particular facts and circumstances and preferences of the company.

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, information technology or benefits, which may have to be continued on an interim or transitional basis after the separation of the businesses. In some cases, only one party provides the services (*e.g.*, 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, 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).

The tax matters agreement allocates tax liabilities between the parent and the spin-off company. One way to do so is 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). A 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). A third approach is to let taxes “lie where they fall” under the law (*i.e.*, the legal entity on which the tax is imposed under the law is also responsible for the tax as between the parties). Often, a tax matters agreement will adopt different approaches for different types of taxes. For example, federal income taxes might be allocated on a pre-closing/post-closing basis, while sales taxes might be allocated based on a line-of-business split and transfer taxes based on a legal entity approach.

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 obtaining either the parent’s consent or an IRS ruling or an opinion of counsel that the action will not affect the tax treatment of the spin-off or related transactions. 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 or a ruling or opinion is obtained permitting 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 typically specifies the method of adjustment of equity compensation awards (see discussion in Part III.F.3 above), and addresses any assumption by the spin-off company of any employee benefit plans or of employment or similar agreements between the parent and members of the spin-off company's management team, as well as any other assets and liabilities under parent employee benefit plans that are being shifted to the spin-off company.

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 IPO 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 Exchange Act. The Form 10 contains an information statement that 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. (The requirements for an “emerging growth company” are different, as discussed in Part V.C below.) 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.

If the spin-off company will have significant equity investees or has recently acquired significant businesses, the Form 10 may also need to include separate audited historical financial statements of these entities. Planning for the spin-off should include sufficient lead time to perform these audits and, if required, obtain the consent of the equity investee to publicly disclose its financial information in the Form 10.

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 Separation
Material U.S. Federal Income Tax Consequences
Description of Material Indebtedness
Description of the Spin-off Company's Capital
Stock
Audited Historical Financial Statements (including
accountants' audit opinion)

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

Charter
Bylaws
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
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 or prospectus, 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 or prospectus.

Registration of the dividend of the spin-off shares under 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 IPO:

- the parent stockholders do not provide consideration for the spun-off shares;
- the spin-off is made *pro rata* to parent's stockholders;
- the 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;
- the parent has a valid business purpose for the spin-off; and
- if the parent spins off "restricted securities," it has held those securities for at least two years (although this requirement does not apply where the parent forms the subsidiary being spun off, rather than acquiring the business from a third party).

In the case of a spin-off that is preceded by an IPO, the initial offering must be registered under the Securities Act, generally on Form S-1. The Form S-1 will contain disclosure similar to that described above for a Form 10 and is typically subject to a similar full review by the SEC. The Form S-1 will also typically include the same exhibits as a Form 10 as well as accountant consents and a legal opinion as to the shares being registered. 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, which require that the parent file a Schedule TO.

The spin-off company will be primarily liable for any violations of the securities laws in connection with an IPO. If 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 theory of “controlling person liability.” Generally, 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 desire 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 inherit its former parent’s Exchange Act reporting history for purposes of becoming eligible to use Form S-3 at the consummation of the spin-off 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. Emerging Growth Company Status

If the spin-off company qualifies as an “emerging growth company” under the JOBS Act, it will be able to take advantage of certain provisions of the JOBS Act that reduce the burden of being a public company. For example, the spin-off company will only need to include three (instead of five) years of selected

financial information in any Exchange Act registration statement or periodic report, need not include an auditor's attestation on the effectiveness of internal controls over financial reporting in its Form 10-K and may provide more limited executive compensation disclosure in the Form 10 and periodic and other reports. Emerging growth companies may also elect to opt out of the requirement to comply with new or revised accounting policies until they are also applied to private companies, and are exempt from rules on rotation of accountants.

A spin-off company can qualify as an emerging growth company if it had less than \$1 billion in total annual gross revenues during the most recently completed fiscal year. Once qualified as an emerging growth company, the spin-off company will retain the status until the earliest of: the last day of the fiscal year during which the company had total annual gross revenues of \$1 billion or more; the date on which the company has, during the prior three-year period, issued more than \$1 billion of non-convertible debt; the date on which the company is deemed to be a "large accelerated filer" under the Exchange Act; and the last day of the fiscal year following the fifth anniversary of the company's first registered sale of common equity pursuant to an effective registration statement under the Securities Act.

D. 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 persons who become employees of the spun-off company and its subsidiaries) will hold equity awards with respect to the spun-off company's securities, then the spun-off company will probably need to file a Form S-1 or, if eligible, a Form S-3. The spin-off company typically would file such a required Form S-1 immediately after the information statement is finalized (or, if eligible, would file a Form S-3 on the distribution date). If the spin-off company files a Form S-1, the SEC typically would not comment on the filing extensively because the disclosures in the Form 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 ten 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.

The parent company will typically file a Form 8-K when the parent board of directors declares the spin-off dividend. 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 spin-off 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.

E. Obligations Upon Effectiveness of the Registration Statement

Once the SEC declares the spin-off company's Form 10 effective—or, if the spin-off will be preceded by an IPO, once the Form 8-A is 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 (subject to limited exemptions prior to the completion of the spin-off). The spin-off company will also need to file an annual report on Form 10-K for the fiscal year in which the registration statement became effective, even if the deadline under the Exchange Act to file a Form 10-K for that fiscal year occurs before the completion of the spin-off. Moreover, following the effectiveness of the applicable registration statement, the spin-off company will be subject 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 loans to executive officers and directors (which, in the case of an IPO, actually become effective upon filing of the Form S-1, and not only at effectiveness), director independence, and attorney "reporting up." Companies should consider the timing of actions undertaken in connection with the separation in light of these requirements.

A newly public company does 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, if 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'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 the 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 (1) at least three members on its audit committee, one of whom must be independent, (2) a compensation committee and nominating committee, each of which must include at least one independent director, (3) audit, compensation and nominating committee charters posted on its website and (4) corporate governance guidelines and code of business conduct and ethics guidelines posted to its website. The NYSE has a phase-in rule that does not require a majority of the spin-off company's board to be independent until 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.

F. 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 an IPO, the blackout and waiting period requirements of a registered public offering will restrict the companies' activities in this area but Regulation FD 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 FD will apply to disclosures that constitute material nonpublic information regarding the parent in connection with a spin-off. 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 (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.1. 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 five percent holders to the effect that such sales, exchanges or other distributions are not planned. In addition, certain repurchases of the stock of the parent company or spin-off company following the spin-off may implicate the “device” requirement. However, IRS ruling guidelines with respect to share repurchases are quite liberal, and generally, the repurchases will not be viewed as causing the distribution to be considered a

“device” if (1) the repurchases are supported by a sufficient business purpose, (2) the repurchased shares are widely held, (3) the purchases are made in the open market, and (4) there is no plan for the aggregate amount of repurchased shares to exceed 20% of the parent’s or the spin-off company’s outstanding shares.

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.”

In some cases, a parent corporation having significant tax attributes, such as net operating losses or capital losses, may want a distribution to be partially taxable to the parent corporation in order to “refresh” these attributes in the form of amortizable tax basis in the hands of the spin-off company. In some cases, it may be possible to trigger gain at the corporate level while preserving tax-free treatment to shareholders. For example, if the spin-off company distributes cash to the parent corporation in excess of basis, the transaction is generally partially taxable to the parent. As well, the IRS has ruled on “busted 351” structures in which the taxpayer has been able to choose the assets with respect to which gain will be recognized.

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 the issues ruled upon, which may include aspects 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 the process of preparing the ruling request and obtaining the ruling once the request has been submitted as compared with seeking only rulings on the spin-off itself. 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. The IRS has over time limited the scope of spin-off related private letter rulings that it will grant. The IRS will no longer rule broadly on whether a transaction as a whole satisfies the requirements for tax-free treatment, but instead will only rule on “significant issues” embedded in the transaction. Furthermore, the IRS will not rule 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, the IRS will no longer issue private rulings with respect to certain structures that had previously 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. Similarly, absent unique and compelling reasons, the IRS will no longer issue rulings as to the tax-free treatment of a spin-off if the fair market value of the gross assets of the “active trade or business” on which either company is relying is less than five percent of the total fair market value of the gross assets of the company.

Furthermore, the IRS will no longer issue rulings as to the tax-free treatment of certain “cash-rich” spin-offs (or split-offs), where a very large percentage of the asset value of the parent or the spin-off company consists of investment assets (*i.e.*, cash or other liquid or inactive assets, for this purpose, including a non-controlling stake in another publicly traded entity). Specifically,

the IRS will not rule if (1) the value of the investment assets held by either the parent or the subsidiary is at least two-thirds of the value of its total gross assets, (2) the value of the active trade or business of either company is less than 10% of the value of its investment assets, and (3) the ratio of the value of investment assets to non-investment assets of either company is at least three times such ratio of the other. This appeared to lead Yahoo! to abandon its planned tax-free spin-off of a company that would hold its stake in Alibaba.

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 with the spin-off. 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 after the spin-off 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.

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 potentially 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 on which exchange(s) 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 IPO). 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. A certification of approval for listing is typically filed by the stock exchange with the SEC in connection with the spin-off company's request for the accelerated effectiveness of the registration statement.

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 approximately 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. The 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 shares of the spin-off company, which allows parent shareholders to trade their entitlement to shares of the spin-off company without shares of the parent. "When-issued" trading with respect to the shares of the spin-off company ends on the last trading day before the distribution, and "regular-way" trading begins the next trading day.

If the spin-off is conditioned on another transaction that is itself conditioned on an event outside the parties' control, such as a merger or other M&A transaction that requires shareholder or regulatory approval, then the stock

exchange generally will not allow “when-issued” trading to begin until after the required approval has been obtained.

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 require 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]	<p>Review separation-related issues, including:</p> <ul style="list-style-type: none"> – identification of assets to be spun off; – determination of capital structure, liquidity requirements and availability of financing, particularly with respect to any new financing arrangements to be entered into in connection with the spin-off (<i>e.g.</i>, to pay a pre-spin dividend to Parent); – allocation of debt and other liabilities; – corporate structure, including the Spinco jurisdiction of incorporation; – consent requirements, including with respect to Parent and Spinco material contracts and financing arrangements; – solvency of Parent and Spinco following the spin-off (including whether to seek a third-party solvency opinion) 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-

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

Period/Event

Action

- spin (*e.g.*, shared services, technology sharing, intellectual property licenses and commercial arrangements);
- 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.

Determine what historical financial statements and pro forma financial statements 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).

Consider projected dividend levels for Spinco, if any.

Develop public and investor relations plan, including plan for presentations to:

- institutional investors;
- existing lenders;
- rating agencies;
- employees;
- customers and suppliers; and
- governmental and regulatory bodies.

Develop a strategy for communicating with Spinco employees regarding future benefits arrangements and Parent regarding effects of spin-off on remaining Parent employees.

Prepare board information package, draft board resolutions, management presentations and information concerning contingent liabilities.

<i>Period/Event</i>	<i>Action</i>
Board Meeting for Initial Approval	<p>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 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 projected dividend levels for Spinco.</p> <p>Determine on which exchange(s) Spinco will be listed.</p> <p>Prepare and distribute questionnaire to directors and officers of Spinco, if determined.</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, as well as stock exchange ticker symbol.</p>

<i>Period/Event</i>	<i>Action</i>
	<p>Parent and Spinco to review any required new lending relationships for Spinco and general liquidity requirements.</p> <p>Commence process of seeking any required third-party consents.</p> <p>Preliminary contact with rating agencies.</p>
Weeks 3–4 After Board Meeting	<p>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 separate tracks.</p> <p>Distribute drafts of historical financial statements and MD&A, if practicable.</p> <p>Begin preparing organizational documents and corporate documents for Spinco. Charter and bylaws take precedence as they ultimately will need to be filed with the Form 10; committee charters, policies, etc., can proceed on a separate track.</p> <p>Begin preparation of resolutions for Parent, Spinco and subsidiary boards of directors authorizing transfers of assets and related matters.</p>

<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> <p>Engage and negotiate agreements with distribution agent for the spin-off and transfer agent for Spinco stock post-spin.</p>

<i>Period/Event</i>	<i>Action</i>
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 to the Form 10.</p> <p>File preliminary listing application(s) with applicable exchanges.</p> <p>Prepare registration statements for employee equity plans of Spinco.</p> <p>Parent and Spinco boards of directors or authorized committees meet to approve the following (to the extent not previously approved):</p> <ul style="list-style-type: none"> – elect Spinco directors and officers; – approve Spinco charter and bylaws 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 other customary securities law matters relating to the spin-off; – approve form and authorize execution and delivery of various agreements concerning credit lines and debt agreements, if applicable; – 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

<i>Period/Event</i>	<i>Action</i>
	<p>steps in connection with the spin-off.</p> <p>Spinco executes agreements with transfer agent and registrar in form satisfactory to the securities exchanges on which Spinco is intending to list.</p> <p>Establish eligibility of Spinco common stock with DTC.</p>
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 blank Form 3s 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;

<i>Period/Event</i>	<i>Action</i>
	<ul style="list-style-type: none"> – 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 – receive updated reports from experts if needed. <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, or post information statement online and mail notice of availability 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</p>

Period/Event

Action

reflecting disposition of Spinco stock in the distribution.

File final securities exchange listing applications, if required by exchange.

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**.

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.