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A Primer on Planning, Negotiating and Executing Reverse Morris Trust Transactions

As business organizations and the market environments in which they operate invariably and inevitably change, a publicly traded company may find itself owning an appreciated business that no longer fits its larger strategy. In evaluating potential options for divesting the business, corporate decision makers and their advisors may consider various alternatives, including a taxable sale or a tax-free distribution of the business to stockholders.

In such circumstances, corporate decision makers may also consider opportunities to engage with a third party in a Reverse Morris Trust transaction. When available, such a transaction can be a tax-efficient method to potentially preserve and create value for both companies' stockholders in a manner relatively unique among structuring choices. In this Article, we will provide a high-level summary of the Reverse Morris Trust transaction structure, advantages, and tax requirements, as well as securities and corporate law issues associated with the structure, the legal documentation necessary to effect the transaction, and potential key items of negotiation between the parties.

Due to the technical requirements of the structure, only a handful of Reverse Morris Trust transactions are announced in any given year. Examples of recently completed Reverse Morris Trust transactions include:[1]

- Lockheed Martin Corporation's split-off and merger of its Information Systems & Global Solutions business with Leidos Holdings, Inc.;
- Hewlett Packard Enterprise Company's spin-off and merger of its enterprises services business with Computer Sciences Corporation to form DXC Technology Company; and
- Citrix Systems Inc.'s spin-off and merger of its GoTo business with LogMeIn, Inc.

Overview, Advantages and Other Considerations

In its most common, form a Reverse Morris Trust transaction involves a publicly traded company, referred to as Parent, and another publicly traded company, referred to as RMT Partner, entering into a series of interrelated agreements whereby Parent contributes the business to be divested into a new or existing holding company, referred to as Spinco, with Parent distributing all of the equity of Spinco to stockholders of Parent.[2] Immediately after the distribution of the Spinco equity, Spinco combines with RMT Partner—typically through a reverse subsidiary merger—with Parent stockholders

[1] Internal note: All three transaction have some level of Skadden involvement.

[2] Other variations of "Reverse Morris Trust" transactions include transactions where RMT Partner is not a publicly traded company, transactions where Spinco acquires RMT Partner, and transactions where a third company acquires both Spinco and RMT Partner.

BY J.A. GLACCUM, ESQ.

J.A. Glaccum is Counsel at Skadden in the firm's Washington DC office. He has represented acquirers, targets, investment banks, private equity funds and special committees in a number of significant transactions, including public and private acquisitions and divestitures, spin-offs, Reverse Morris Trust transactions, proxy contests, joint ventures and strategic alliances, and other transactional matters.

BY MATTHEW J. DONNELLY, ESQ.

Matt Donnelly is an Associate at Skadden in the firm's Washington DC office. He advises public and private companies on a broad range of U.S. federal income tax matters, with particular focus on domestic and international transactions. His practice includes significant work involving the tax aspects of corporate mergers and acquisitions, spin-offs and partnership transactions.

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receiving shares of RMT Partner stock in exchange for their shares of Spinco equity cancelled in the merger.[3] As described further below, Parent stockholders must own at least 50.1% of the combined entity and, as a result, the transaction structure effectively requires an RMT Partner that is on a valuation basis smaller than the Spinco business in order to meet these tests.

One principal advantage of the common Reverse Morris Trust structure is that the separation, distribution and subsequent merger is tax free to Parent and Parent stockholders. In other words, Parent is able to divest a business with significant built-in gain without the typical tax leakage from a taxable sale. This tax advantage may create transactional opportunity as Parent or RMT Partner may be willing to transact at a valuation that does not need to compensate Parent for the tax leakage and which could also give RMT Partner an advantage over other interested parties in a competitive process for the Spinco business. In addition, a Reverse Morris Trust transaction may afford post-transactional operational synergies—as opposed to the typical dis-synergies associated with a subsidiary IPO or spin-off—as usually RMT Partner is already a publicly traded company (notwithstanding integration costs borne by the post-transaction combined company and its stockholders).

In addition, Reverse Morris Trust transactions are very complicated as they involve what is essentially a carve-out/subsidiary sale, spin-off and public company merger all in one negotiated transaction. Accordingly, both Parent and RMT Partner will expend significant time and resources to successfully plan, negotiate and execute a transaction. For RMT Partner, a Reverse Morris Trust transaction is a significantly transformative transaction requiring significant time and resources to integrate the two businesses. Last, the tax rules described below may limit the ability of both Parent or RMT Partner to effectuate certain types of integration and M&A transactions for a period of time post-closing.

Tax Requirements

A Reverse Morris Trust transaction derives its name from a transaction that was upheld upon a multi-faceted challenge by the Internal Revenue Service in *Commissioner v. Morris Trust*, 367 F.2d 794 (4th Cir. 1966). In the original form of the transaction—referred to simply as a *"Morris Trust"* transaction—RMT Partner combines with the distributing corporation in the spin-off or split-off transaction; in the "reverse" form of the transaction, RMT Partner combines with Spinco.

If properly structured, Parent does not recognize taxable income, gain or loss for U.S. federal income tax purposes on the formation of Spinco, nor on the distribution of Spinco to its stockholders. Further, the Spinco stockholders do not recognize taxable income, gain or loss for U.S. federal income tax purposes on their receipt of Spinco shares, nor (depending on the structure of the combination) on the exchange of those shares for shares of RMT Partner.

The foregoing summary greatly simplifies the tax issues presented by a Reverse Morris Trust transaction; even in its most simplified form, a Reverse Morris Trust transaction must satisfy numerous complex requirements of the Internal Revenue Code relating to the formation of Spinco, the distribution of the Spinco shares and the combination transaction. Of particular complexity are the rules under Section 355(a) of the Internal Revenue Code, which impose numerous requirements on the tax-free distribution, including the requirement that former Spinco stockholders receive only equity of RMT Partner in the transaction (except for cash in lieu of fractional shares), and Section 355(e) of the Internal Revenue Code, which presents the other principal limitation on Reverse Morris Trust transactions, i.e., the requirement that historic stockholders of Spinco own more than 50% of the combined company. As an initial matter, satisfying these rules requires analysis of prior transactions involving the shares of Parent and, depending upon the terms of the Reverse Morris Trust transaction, the economic arrangement of the parties may need to be altered if unknown facts regarding a planned pre-combination acquisition of Parent, or a planned post-combination acquisition of RMT Partner, come to light in the course of the transaction. For example, these rules effectively exclude from the numerator of the 50% fraction "historic" Spinco stockholders who acquired their Parent shares pursuant to a plan (or series of related transactions) that includes the distribution. Treasury Regulations provide safe harbors allowing corporations to demonstrate that certain acquisitions of their stock did not occur pursuant to a plan, but these safe harbors are not exhaustive and interpretative questions often arise. In addition, the same rules continue to apply to acquisitions of Spinco after the combination transactions (including indirect

[3] Tax lawyers and advisors refer to the Parent as "Distributing" and the entity to be distributed as "Controlled."

acquisitions of Spinco, e.g., as a result of acquisitions of shares of RMT Partner). Finally, although the RMT transaction itself does not typically contemplate an acquisition of Parent stock by any party to the transaction, the rules of Section 355 of the Internal Revenue Code described above generally apply in equal measure to Parent and therefore may present limitations on the ability of Parent to enter into certain transactions in connection with an RMT transaction.

Valuation and Economics

The amount of RMT Partner stock to be issued to Parent stockholders in the merger is typically reflected through a negotiated mechanism that determines the number of shares of Spinco common stock held by Parent immediately prior to being distributed to Parent stockholders in the distribution and converted in the merger at a fixed ratio. The importance of the mechanism and its various inputs is not just economic, but is also critical for ensuring the transaction meets the 50.1% ownership tax requirements. As a result, RMT transaction agreements may have a mechanism adjusting the number of shares ultimately issued to Parent stockholders in order to meet the 50.1% ownership tax requirements and may also include an allocation of the cost of such additional equity (e.g., to RMT Partner if as the result of a breach of specified representations in the agreement affecting the ownership test, or to Parent if as the result of actions taken by the Parent, by reducing the amount of value that Parent can extract from the Spinco business).

Although the pro forma ownership of the combined company is principally determined through negotiation of the relative combination values of the RMT Partner business and the Spinco business, taking into account the pro forma closing capital structure of Spinco and RMT Partner at the time of the merger, there are additional methods in which Parent and RMT Partner may structure the transaction to "right size" the value of Spinco and RMT Partner to ensure that the 50.1% ownership tax requirements are met, return additional value to Parent, Parent stockholders or RMT Partner stockholders, and otherwise achieve the desired post-closing capital structure of RMT Partner.

Methods which generally reduce the relative equity value of Spinco by delivering value to Parent include:

- Retention by Parent of proceeds of new debt incurred by Spinco.
- Exchange by Parent of existing Parent stock or debt for new Spinco debt (so called debt-for-debt exchange), subject to various tax-driven restrictions.
- Pre-closing Spinco special dividend to Parent.
- Retention by Parent of certain assets of Spinco or assumption by Spinco of specified liabilities of Parent.

In addition RMT Partner may also desire to return value to its stockholders by paying a special cash dividend.[4] The above methods may be limited by contractual or other legal limitations (e.g., adequate "surplus" under state corporate law), the desired credit rating and capital structure of Parent and RMT Partner post-closing, the availability of sufficient cash and the availability to finance on commercially favorable terms.

Other negotiated areas affecting bottom line valuation, which can be allocated to Parent, RMT Partner, or shared jointly through Parent and RMT Partner stockholders indirectly through the combined company, may include:

- The amount of cash or working capital at Spinco at the time of the merger, or other similar traditional purchase price adjustments.
- Costs and expenses to separate and stand-up the Spinco business (e.g., IT systems, build out of facilities, third party consents, licensing of third party software/IP).
- Transactional expenses (e.g., debt fees, advisor and consultant fees).
- Post-closing integration costs, which may be addressed through the terms of the transition or similar services or license agreements entered into as part of the separation or, rarer, payment by Parent to Spinco if these costs exceed certain thresholds.
- Treatment in the transaction of Spinco or RMT Partner employee equity and other benefit programs.

Corporate/Securities Law Issues

Stockholder Approval.

For an RMT Partner the stock of which is listed on the NYSE or NASDAQ, RMT Partner stockholder approval will be required. Such approval may also be required under applicable state merger statutes depending on the structure of the merger or

[4] RMT Partner could also return value through pre-closing share repurchases. As a practical matter, share repurchases are difficult for RMT Partner to execute due to the likely requirement to conduct any repurchases through a tender offer under federal securities laws.

the state of incorporation of RMT Partner. No vote of Parent stockholders is required under Delaware law for the distribution of Spinco to Parent stockholders[5] and Parent will adopt the merger agreement while it is still the sole stockholder of Spinco.

Dividend/Solvency.

Parent must comply with state corporate statutes governing the payment of dividends (in the case of a spin-off) or the repurchase of stock (in the case of an exchange offer) in distributing Spinco to Parent stockholders, under which directors can be held personally liable for the unlawful dividend payment or repurchase of stock.[6] In addition, the transaction cannot leave Parent, Spinco or RMT Partner insolvent under federal or state fraudulent conveyance laws. Depending on the relative size of Parent and Spinco and their expected capitalization and financial condition at closing, Parent should determine whether it should obtain from a valuation firm a "solvency" opinion supporting the lawful distribution or repurchase of stock.

SEC Review.

If the distribution of Spinco is effectuated by Parent as a pro-rata spin-off meeting the requirements of SEC Staff Legal Bulletin #4, Spinco will typically file a registration statement on Form 10 to register its common stock under Section 12(g) of the Exchange Act. If the distribution is not pro rata, or does not meet the requirements of SEC Staff Legal Bulletin #4, then the distribution may be viewed as an offer and sale of securities and Spinco will file a registration statement on Form S-1. If the distribution of Spinco is effectuated by Parent as an exchange offer, Spinco will file a registration statement on Form S-4/S-1 and Parent will also file a Schedule TO under the tender offer rules of the Exchange Act.

Similarly, RMT Partner will file with the SEC a registration statement, usually on Form S-4, covering the offer and sale of RMT Partner stock to be issued in the merger and a proxy statement with respect to RMT Partner's stockholder vote to approve the transaction. In the event of a spin-off, the Spinco Form 10, the RMT Partner S-4 and the RMT Partner proxy statement will usually contain the same unified "Information Statement/Proxy Statement/Prospectus" and is mailed to both Parent and RMT Partner stockholders. In the event of an exchange offer, the Spinco Form S-4/S-1 and RMT Partner S-4 will contain the same unified "Offer to Exchange Prospectus" with respect to the exchange offer and the merger and is mailed to Parent stockholders only and the RMT Partner proxy statement will be a separate document sent to RMT Partner stockholders only.

Transaction planners should expect a level of review by the SEC staff approaching the level of review the SEC staff conducts in connection with an initial public offering. In connection with the RMT Partner stockholder vote and similar to the other public company merger transactions, the SEC staff may also focus and provide comments on the reasons for the RMT Partner and Parent boards of directors entering into the transactions, the "background" section regarding negotiations between the parties, and any Spinco or RMT Partner "projections" provided to the other party or its financial advisors or relied on by the RMT Partner board of directors or its financial advisor in considering the transaction.[7]

Audited Financial Statements.

Spinco audited financial statements substantially similar to those required in an S-1 for an IPO will be required for the filings with the SEC (i.e., two years' balance sheets and three years' income/cash flow statements unless Spinco meets requirements of an Emerging Growth Company and the distribution is registered under the Securities Act).

RMT Partner will also need to provide pro forma financial statements reflecting the Spinco acquisition as the significance tests under Regulation S-X are almost always exceeded due to the transaction structure.

As these financial statements are required in order to file the registration statements with the SEC, both Parent and RMT Partner should involve internal and external accounting and legal advisors early in the process prior to signing as the timetable to produce the financial statements may directly affect related provisions in the transaction agreements.

Documentation/Transaction Agreements

The number of separate transaction agreements necessary to effect an RMT transaction varies depending on the nature and size of the business to be separated. However, most transactions include the following agreements.

[5] If the distribution of Spinco is effected as an exchange offer, Parent stockholder approval could be required under Delaware law in the unlikely event Spinco represented "substantially all the assets" of Parent.

[6] Any RMT Partner special dividend or share repurchase would also have to comply with these statutes.

[7] In most cases, both Parent and RMT Partner boards of directors will receive customary fairness opinions from their respective financial advisors in connection with considering and approving the transaction. However, usually only the fairness opinion delivered to RMT Partner is summarized and included in the disclosure documents as Parent's stockholders typically do not adopt or approve the merger agreement.

Merger Agreement.

Entered into at signing by Parent, RMT Partner, Spinco and any required merger subsidiaries, the Merger Agreement is the principal agreement providing for the distribution of Spinco to Parent stockholders and the subsequent merger of Spinco with RMT Partner (or one its subsidiaries) and issuance of RMT Partner stock to historic Parent stockholders. In the Merger Agreement, Parent and RMT Partner will make certain representations and warranties, including those regarding the Spinco business and the RMT Partner business. In addition, the Merger Agreement generally contains the covenants of Parent and RMT Partner during the period between signing and closing (including with respect to obtaining government approvals, filing of registration statements with the SEC and obtaining RMT Partner stockholder approval), as well as the conditions of closing the merger and the termination rights of Parent and RMT Partner.

Separation Agreement.

The Separation Agreement is the principal agreement regarding the separation of the Spinco business from Parent's other business, including the allocation of assets and assumption of liabilities between Parent and Spinco. Under the Separation Agreement, Parent and Spinco generally release the other and agree to indemnify the other party with respect to assets and liabilities allocated to the first party. In addition, the Separation Agreement generally governs the relationship between Parent and Spinco with respect to post-separation matters to the extent not addressed in a separate transaction agreement. The Separation Agreement will often contain conditions to separating the business to the extent not addressed by the Merger Agreement and may also include provisions related to any pre-distribution corporate reorganization of Parent and Spinco.

Tax Matters Agreement.

In addition to the Separation Agreement and the Merger Agreement, the parties typically enter into a separate Tax Matters Agreement. Such agreements are commonly entered into by the parties to a tax-free spin-off or split-off transaction to memorialize the parties' agreement to cooperate post-transaction in completing tax returns, resolve audits and divvy up tax attributes. These agreements also assign certain of the risks associated with the tax-free status of the transaction between the parties, generally based on the party in the best position to most efficiently manage those risks. For example, if Spinco were to redeem a substantial portion of its shares for cash in connection with the transaction, such an event could jeopardize the tax-free nature of the distribution to both Parent and its stockholders. To prevent such an outcome, the Tax Matters Agreement typically contains (among others) a restrictive covenant on the ability of Spinco to engage in stock repurchases for a period of time (typically, two years) after the distribution; if Spinco causes the distribution to be taxable, Spinco is obligated to indemnify the distributing corporation, the cost of which could be material. In a Reverse Morris Trust transaction, the parties may pay special attention to ensure that direct and indirect acquisitions of Spinco shares after the distribution fall within regulatory safe harbors because completion of such transactions are typically conditioned on a high-level of comfort from the parties' tax advisors and, depending on the terms of the deal, there may not be much room for additional pre-"planned" acquisitions of Spinco.

Employee Matters Agreement.

In addition to the Separation Agreement, the Merger Agreement and the Tax Matters Agreement, Parent, Spinco and RMT Partner typically enter into a separate Employee Matters Agreement. The Employee Matters Agreement allocates liabilities and responsibilities relating to employee compensation and benefit plans and programs, including with respect to the treatment of equity and equity-based awards granted by Parent and held by Spinco employees. In addition, the Employee Matters Agreement sets forth the general principles relating to employee matters, including with respect to the assignment of employees, the assumption and retention of liabilities and related assets, expense reimbursements, workers' compensation, leaves of absence, the provision of comparable benefits, employee service credit, the sharing of employee information, and the duplication or acceleration of benefits.

Other Separation Agreements.

Other agreements typically entered into between Parent and Spinco include Transition Services Agreements (providing for transition services from either Parent or Spinco to the other party), Intellectual Property License Agreements (providing for a non-exclusive grant of intellectual property), and real estate related agreements (e.g., Sub-Lease, Access Agreements).

It's important to note that the various agreements are all interrelated and particular care in drafting and negotiating the agreements is necessary to avoid unintended conflict or dispute.

Key Negotiation Focus Points

Parent's position in negotiations is similar to that of a party to a public company merger as Parent is delivering Spinco as a "public company" and Parent stockholders will own more than 50% of the combined company, and therefore will share in costs and risks of the Spinco business and RMT Partner's business. By contrast, RMT Partner's position with respect to the transaction is more akin to the private acquisition of an operating subsidiary or a carve-out transaction. Naturally, how the parties ultimately resolve the following issues depends on the transaction, including the relative negotiating leverage of Parent and RMT Partner.

Level of RMT Partner Involvement and Review

In a typical spin-off, Parent typically can generally dictate to Spinco the various terms and conditions of the separation, reorganization steps, agreements, schedules and other documents and post-closing arrangements (including commercial arrangements) as it is only negotiating with its own internal constituencies.[8] In a Reverse Morris Trust transaction, Parent and RMT Partner will need to agree on what level of review and consent RMT Partner will have over these matters both before signing and during the period between signing and closing. As noted above, Reverse Morris Trust transactions are often entered into prior to the finalization of all reorganization steps, agreements, schedules and other documentation required to separate Spinco from Parent. However, in a majority of the precedent transactions, RMT Partner is not a party to the principal separation agreement and is usually not a party to every ancillary agreement. Parent, looking for the greatest flexibility to separate the business, will try to limit RMT Partner's approval and consent rights, whereas RMT Partner will attempt to obtain the broadest approval and consent rights.

Representations and Warranties and Post-Closing Remedies

Notwithstanding that Parent may argue it is delivering a "public company," at the time of signing, it usually isn't. As a result RMT Partner will push for more expansive representations and warranties regarding the Spinco business while maintaining the view that RMT's Partner's representations and warranties regarding its own business reflect a scope more similar to a "public company" transaction due to RMT Partner being a publicly traded company subject to the reporting requirements under Federal securities laws. In most of the precedent transactions, the representations and warranties made by the parties do not survive the closing without any indemnification rights. However, a few transactions have provided that a specified representation (e.g., sufficiency of assets) survive the closing with indemnification or other cure rights, and most transactions handle potential tax liabilities in a manner distinct from other potential liabilities.

Closing Conditions; Efforts to Close

Although the parties negotiate over the same customary closing conditions present in public company transactions, there is particular focus over the closing conditions related to ensuring that the transaction receives the desired tax treatment, typically through the receipt of an IRS private letter ruling or tax opinion at closing. If the transaction is to be conditioned only on the receipt of an opinion of counsel, the parties will be focused on the level of comfort the opinion affords (i.e., the highest level "will" opinion compared to the lower level comfort of a "should" opinion). Because the effects of a "busted" tax-free distribution are borne by the Parent (absent a contractual arrangement between Parent and RMT Partner), Parent will typically advocate for the higher "will" level opinion where RMT Partner may advocate for the "should" level opinion in order to provide more certainty that the transaction will close. In addition, in light of the litigation stemming from the 2016 termination of the merger between The Williams Companies, Inc. and Energy Transfer Equity, L.P., we may see more transactions requiring Parent to obtain tax opinions from alternative counsel in the event Parent's primary tax counsel is unable to deliver the required tax opinion.

Spinco Assets, Business and Liabilities and Indemnification

Defining what constitutes the assets, business and liabilities that will be transferred to or assumed by Spinco (and indirectly by RMT Partner in the merger) is heavily negotiated by the parties. Similar to carve-out transactions and spin-offs, assets and liabilities are typically defined descriptively, as well as by reference to schedules or to a carve-out balance sheet of the Spinco business.

Typically, Parent's initial position will be that the Spinco assets will be the assets held or used "exclusively" in the Spinco

[8] Although under Delaware law Parent and pre-distribution Spinco boards of directors do not owe fiduciary duties to future stockholders of Spinco (see Anadarko Petroleum Corp. v. Panhandle E. Corp., 545 A.2d 1171, 1174 (Del. 1988)), Parent's ability to dictate the various terms and conditions of the separation is subject to practical, market and legal limitations. Parent may subject itself to potential litigation in the event Spinco is ultimately insolvent or non-viable (see, e.g., In Re Tronox Inc. 450 B.R. 432 (Bankr. S.D.N.Y. 2011).

business in order to limit any collateral effect to Parent's remaining businesses. RMT Partner will typically advocate that the Spinco assets will be the assets held or used "primarily" in the Spinco business in order to ensure that Spinco will have sufficient assets to run the business going forward and therefore reducing the amount and cost of post-closing transition services or post-closing stand-up costs. Other areas of specialized allocation of assets can include owned and leased real estate, intellectual property, IT systems, shared facilities, office equipment, personal computers and communications devices, permits, inventory, rights to bring lawsuits, contracts, and books and records, among others.

Although the allocation of liabilities between Parent and Spinco may generally track the standard used to allocate assets or arising out of such assets, the absence of post-closing indemnification for breaches of representations and warranties in the merger increases the likelihood that RMT Partner will negotiate for special allocations of contingent liabilities to Parent. Other areas of specialized allocation of liability can include environmental, disposed businesses, securities laws, stockholder suits arising from the transaction, and failure to obtain third party contract or license consents, among others.

Spinco Business Audited Financial Statements.

As discussed above, audited financial statements for the Spinco business will be required in order to register Spinco's equity securities under Federal securities laws. In our review of the precedent transactions, a sizable minority of transactions were entered into without audited financial statements for the Spinco business available at signing. Early in the transaction process, potential RMT Partners should confirm with Parent the exact timetable to produce Spinco business audited financial statements as the absence of financial statements prior to signing will likely lead to additional due diligence and contract negotiation to ensure that there are no revenue or liability "surprises" with the Spinco business as well as to ensure a correct allocation of assets and liabilities between Parent and Spinco. If Spinco business financial statements will not be available at the time of signing, Parent will have an obligation to deliver SEC compliant financial statements post-signing.

Tax

Parties to a Reverse Morris Trust transaction must determine responsibility for the pre-closing taxes of Spinco and control of related audits, and the scope of these covenants is typically a key point of negotiation. In addition, as the tax-free status of a Reverse Morris Trust transaction can be impacted by transactions entered into by RMT Partner after the transaction (with the resulting liability falling on Parent), Parent typically negotiates for pre-approval of a list of transactions by RMT Partner (including buybacks, internal reorganizations, dispositions and business combinations) for a period after the closing.

Employee Related Assets and Liabilities and
Treatment of Employment Plans and Equity Awards.

As discussed above, and similar to spin-offs and other carve-out transactions, the parties must allocate liabilities and responsibilities related to, and the transfer of, Spinco employees from Parent to Spinco. A key point in the negotiation regarding the allocation of employee-related liabilities and the transfer of employees is the allocation of any transfer-related liabilities, including any potential severance that may be incurred as a result of the transfer. Early in the transaction process, Parent should identify the employees who will be transferred to Spinco and, especially where the employees are in non-U.S. jurisdictions where a legal vehicle is not transferring in the transaction, determine the mechanism to transfer the employees to Spinco.

Parent typically negotiates with RMT Partner regarding comparability of post-closing compensation and benefits and the establishment of Spinco benefit plans and arrangements. While this negotiation generally results in Spinco establishing benefit plans and arrangements that are similar to those provided by Parent prior to the closing, key negotiation points are the level of comparability between the Parent and Spinco plans and the length of any post-closing protected period for compensation and benefits.

In addition, special consideration is generally given to the treatment of Parent equity or equity-based awards held by Spinco employees. While it is generally the case that each type of award (e.g., a stock option or restricted stock unit) need not be treated similarly, two common approaches to the treatment of Parent equity or equity-based awards held by Spinco employees are to either convert the awards into similar RMT Partner awards or to have the awards remain outstanding as Parent awards.

Day-One Readiness of Spinco Business;
Transition and Other Services.

Similar to other carve-out transactions, the parties will focus on the ability of the Spinco business to operate "day-one" as part of RMT Partner's organization. Prior to the closing, the Spinco business will have been relying on Parent or shared systems, properties or other assets (and in some cases Parent is relying on Spinco business systems properties and other assets) to operate its business. Although in many cases Spinco or Parent access to shared assets being allocated to the other party can be provided as a post-closing service, certain systems may need to be replaced prior to closing.

Agreed-to terms at signing around what services will be provided post-closing varies from transaction to transaction depending on the amount of pre-signing transition work conducted by the parties. Although a form of services (or similar) agreement is often agreed to at signing, the key work around services schedules (including scope, duration and cost) is often deferred to the period between signing and closing.

In certain cases, both Parent and RMT Partner may need access to or use of certain systems, properties or other assets (e.g., shared intellectual property) critical to the businesses of both Parent and Spinco or it may be desired to enter into longer-term commercial arrangements. Under the tax rules governing Reverse Morris Trust Transactions, continuing relationships between Parent and Spinco are subject to special scrutiny and therefore transitional arrangements between Parent and RMT Partner generally must be priced at fair market value and be of a limited duration.

Both Parent and RMT Partner should take into account the various costs expected to be incurred in connection with "day-one" readiness or the provision of post-closing services as part as the broader negotiation over valuation.

Combined Company Governance.

With Parent historic stockholders owning at least 50.1% of the combined company post-closing, Parent will often advocate for the right to designate or recommend designees to the board of directors of RMT Partner at closing with the exact number and other requirements negotiated between Parent and RMT Partner. Generally, a higher post-closing ownership of Parent historic stockholders of the combined company results in higher number of Parent designees as a percentage of the total board. However, in a majority of the precedent transactions the number of Parent designees is limited to a number that would be a minority of the total board, and in some cases Parent has no right to any designees. In any case, under the tax rules governing Reverse Morris Trust Transactions, it is generally considered advisable for all board members, whether designated at closing or existing, to stand for election in the ordinary course. In addition, the identity of certain key officers of RMT Partner or the right of one party to recommend key officers may be set forth in the transaction agreements.

Perspectives and Conclusion

In December 2017, President Trump signed into law a bill commonly referred to as the Tax Cuts and Jobs Act of 2017, which reduced the federal corporate income tax rate to 21% (among other changes). Although the Tax Cuts and Jobs Act of 2017 did not change the rules governing qualification as a tax-free Reverse Morris Trust transaction, the lowering of the rate and other changes under the Act could affect considerations favoring a Reverse Morris Trust transaction. As three Reverse Morris Trust transactions have been in announced in 2018 as of our writing, we anticipate that these considerations will have only a marginal effect on parties' willingness to engage in Reverse Morris Trust transactions going forward. With the right transactional circumstances and parties, the Reverse Morris Trust transaction will continue to be a potentially tax-efficient method to divest a non-core business and return value to each party and their stockholders.

The opinions expressed in this article are those of the author(s) and do not necessarily reflect the views of Skadden or its clients.