

Davis Polk

MESSY CARVE-OUTS AND THE LAWYERS THAT LOVE THEM ...

Presented by **Will Pearce | Gordon Milne**

17 October 2024

CARVE-OUTS: DIFFERENT THINGS TO DIFFERENT PEOPLE?

Public carve-out or spin off – demerger

Private sale of shares in one or more subsidiaries

Private sale of a business unit – usually ‘messy’ mixture of share and asset transfers

Corporate seller may ‘tidy up’ if it has time and is prepared to incur cost to achieve higher exit value

Sometimes even if corporate seller wants to ‘tidy up’, simply not possible – antitrust divestitures

WHAT ARE THE OBJECTIVES OF THE PARTIES?

CORPORATE SELLER

- Maximise value on disposal
- Obtain antitrust approval for a bigger transaction
- Respond to shareholder activist
- Clean separation of carve-out business
- Limited obligations – time and effort – to support the carve-out business
- Clean break – limited or no recourse for breach of warranties and no indemnities

PE BUYER

- Maximise upside on acquisition
- Obtain the ‘correct’ assets / liabilities
- Clear understanding of how the carve-out business will operate
- Support from seller through a TSA
- Recourse – either against seller or W&I policy – if there are undisclosed issues
- Ability to exit in 3 to 5 years without need for seller consent (or restrictions on potential buyers of the business)

DEFINING TRANSACTION PERIMETER AND TARGET BUSINESS

1. Critical that buyer and seller agree on the scope of the business to be carved out:
 - Definition of target business
 - Jurisdictions
 - Included and excluded assets and liabilities
 - Shared assets
 - Shared employees
 - Shared customers and contracts
 - Shared regulatory permits
2. Transaction perimeter will normally impact upon every aspect of the carve-out
3. Does seller have a clear idea of what it is selling? – clear definition of target business can help resolve subsequent negotiations around included and excluded assets and liabilities
4. Is seller only divesting the business in certain jurisdictions and will continue to operate in ‘retained’ jurisdictions? – critical to defining scope of restrictive covenants from seller
5. Need to understand how the business operates and, depending on the nature of the business, flow of goods/services between different jurisdictions and entities

KEY ELEMENTS OF THE TARGET BUSINESS

- Who is employer?
- Shared employees
- Transfer process eg. TUPE
- Consultation
- Alignment of benefits
- Seller restrictions

EMPLOYEES

- Change of control / assignment
- Shared contracts
- Counterparty leverage?
- Approach to consents

CONTRACTS

- Used 'exclusively' or 'primarily'?
- IP license
- Royalty payments
- Seller's rights if reputational damage, insolvency or change of control
- Buyer's rights to develop and amend IP
- Seller concern re competitors

INTELLECTUAL PROPERTY

- Key property located in a retained seller site?
- Rights of access / consent rights
- Issues with contaminated sites

REAL ESTATE

STANDING THE BUSINESS UP ON 'DAY ONE': SEPARATION AND TRANSITIONAL SERVICES

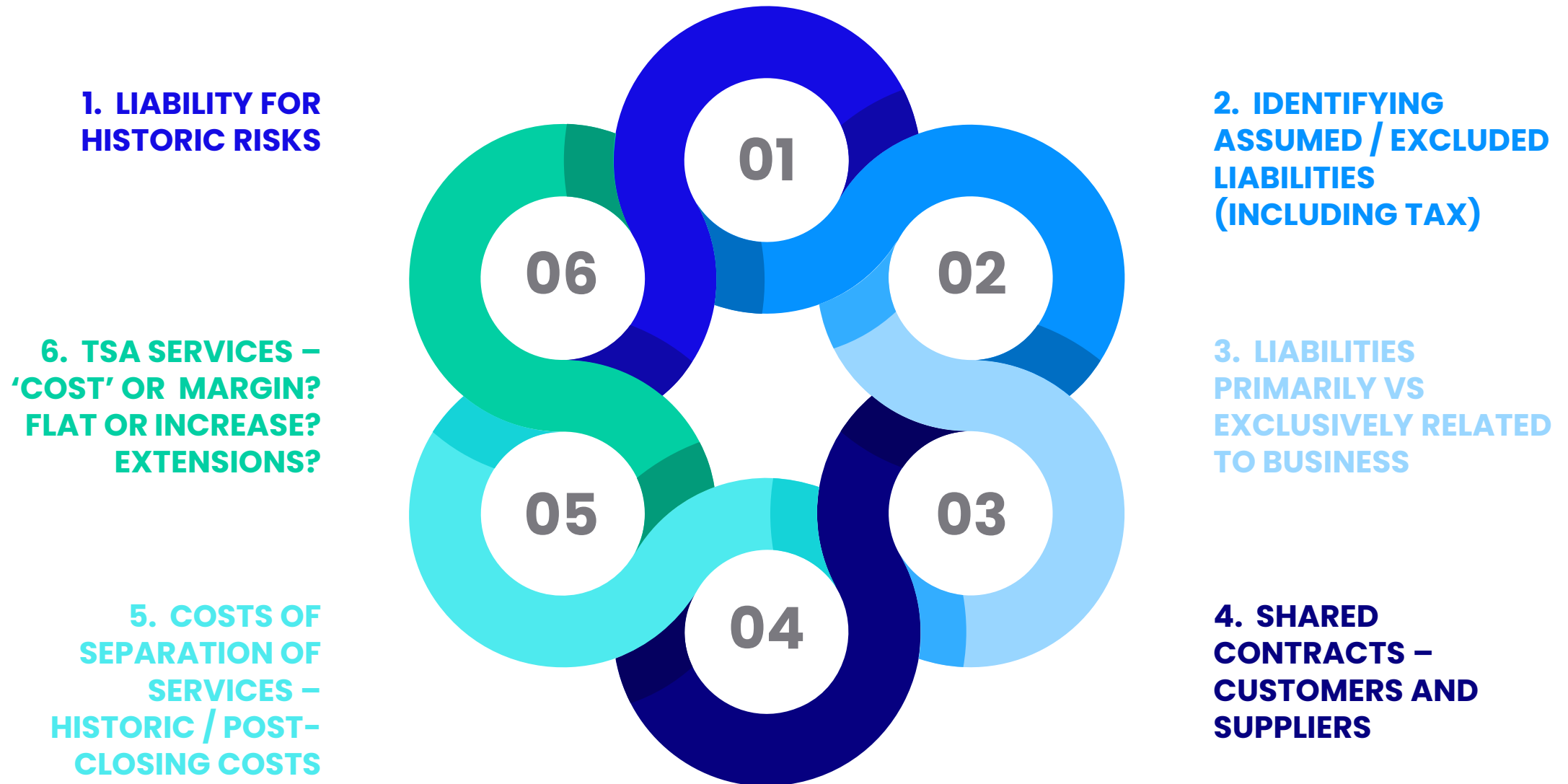


1. Need to **identify scope, extent and duration of services** – seller will want them limited in time
2. Does seller have **permission to provide shared services** or are third party approvals required?
3. Are **shared permits and licences** required to operate the target business – can they continue to be shared?

1. Need to understand **cost of transition, impact on how business operates, how costs impact EBITDA** (and implicitly whether paying 'correct' price for the target)
2. Ability to **benefit from services for as long as required** – satisfied that services can be separated / replicated
3. **Closing conditional on obtaining standalone permits and licences?**



ALLOCATING RISK AND COST



LOOKING FORWARD TO THE EXIT?

PE BUYER

- No fetter on ability to exit
- No requirements for seller consents
- May be willing to consider a ROFO provided doesn't undermine exit process

CORPORATE SELLER

- Will seller want a ROFO / ROFR?
- Anti-embarrassment provisions (less common these days)
- Restrictions on potential buyers (eg. competitors / access to IP)

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