

## Life Sciences - Spin-Off Transactions

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There are various business reasons for public life sciences companies to consider a possible “spin-off” or “partial spin-off” transaction, which involves the distribution by the company to its shareholders of all or a portion of the stock of a subsidiary to which the parent company has contributed a particular technology and related assets. After the spin-off transaction, the subsidiary carries on as a separate public company independent of the parent company, subject to any shares in the subsidiary retained by the parent company in a partial spin-off, and any ongoing contractual arrangements between the parent and the spin-off subsidiary.

Common reasons for a spin-off transaction include:

- Disposing of unwanted or unexploited technologies and related assets that no longer fit with the focus of the parent company’s business;
- Allowing the parent company to concentrate its human and financial resources on the parent company’s core technologies and business; and
- Increasing shareholder value in the spun-off technology and other assets.

In some cases, the spin-off transaction also can be used to facilitate capital-raising to fund the continued development or commercialization of the spun-off technology and assets. There are many examples of a spin-off transaction creating substantial shareholder value in technologies or other assets that effectively have been abandoned or are sitting idle for one reason or another.

Spin-off transactions, however, are complicated, time-consuming and expensive, and can trigger lawsuits and other problems for the parent company if not planned and implemented carefully. This Client Alert discusses briefly some key regulatory and business matters to consider in contemplation of a possible spin-off transaction.

## Securities Act Registration Requirements

The parent company’s distribution to its shareholders of shares of the spin-off subsidiary must be registered under the Securities Act of 1933 (“Securities Act”) if it would involve a “sale” of the shares. The Securities and Exchange Commission (“SEC”) has published a Staff Legal Bulletin (“SLB”) setting forth the Staff’s views about the applicability of the Securities Act’s registration requirements to spin-offs.

In general, it is the SEC’s view that the spin-off need not be registered under the Securities Act if each of the following circumstances exists:

- the shareholders of the parent company do not give any value or consideration for the spin-off shares, which would nearly always be the case;
- the spin-off shares are distributed pro rata to the parent company shareholders, which would usually be the case, but may not be if third parties would be investing in the spin-off subsidiary in conjunction with the spin-off;
- the parent company furnishes adequate information about the spin-off and the subsidiary company to its shareholders and the trading markets, as described below;
- there is a valid business purpose for the spin-off as should be the case; and

- if the subsidiary's shares are "restricted securities," the parent company has held the securities for at least two years; however, this holding period would not apply where, as in many situations, the parent company formed the spin-off subsidiary.

Whether the information requirement, above, is satisfied depends on whether the subsidiary is a reporting company under the Securities Exchange Act of 1934 ("Exchange Act") or is a non-reporting company before and after the spin-off. If, as is usually the case, the subsidiary is a non-reporting company, the parent company will be deemed to have provided adequate information, if:

- it furnishes its U. S. shareholders a proxy or information statement that describes the spin-off and the subsidiary and that substantially complies with Regulation 14A or Regulation 14C under the Exchange Act; and
- the subsidiary registers its securities under the Exchange Act.

The SEC generally will not consider "no-action" requests from companies that do not intend to register the spin-off shares under the Securities Act, unless the spin-off presents novel facts or issues not addressed in the SEC's SLB.

## Applicability of Rule 145

If a spin-off includes the transfer of assets from the parent to the subsidiary that requires a vote of the parent company's shareholders, Rule 145 under the Securities Act is implicated. The SEC, however, believes that Rule 145 does not require registration of the spin-off of a wholly owned subsidiary solely because shareholders are asked to vote on the transaction.

## Status of Spun-Off Shares

The SEC is of the view that shares of a subsidiary distributed in a spin-off that meets the requirements described above generally are not "restricted securities" within the meaning of the Securities Act and can be freely transferred by the parent company's shareholders. Shares received in the spin-off by any controlling shareholder of the parent company may be deemed to be restricted securities. Even in this situation, however, the spin-off shares in the hands of non-control shareholders would not be restricted.

## Tax Considerations

The distribution of the spin-off shares generally would be "tax-free" to the parent company's shareholders only if the spin-off transaction meets the strict requirements of Section 355 of the Internal Revenue Code. Most spin-offs involving unwanted or unexploited technologies or other assets would not qualify under Section 355, and, as a result, the distribution of the spin-off shares generally would be taxable to the stockholders receiving the distribution. In many cases, the taxable nature of the spin-off transaction would not materially affect the decision to undertake the spin-off transaction, since the taxable value of the spin-off shares may be relatively small in light of the potential benefits of the spin-off. The valuation of the spin-off shares, however, can be complicated by the trading price of the spin-off subsidiary's shares in the aftermath of the spin-off.

## Other Considerations

Before undertaking a spin-off, the parent company would have to consider the potential "value" of the spin-off shares for tax and other reasons. For example, depending on their value in relation to the value of the parent company's retained assets, the spin-off may be deemed to constitute "substantially all" of the assets of the parent company under applicable state corporation law. If so, shareholder approval of the spin-off would ordinarily be

required under state corporation laws. In any event, the distribution would have to comply with state corporation laws dealing with the payment of lawful dividends by the parent company.

Importantly, spin-off transactions may trigger applicable anti-dilution protections under outstanding warrants or other securities of the parent company, rights of first refusal provisions or other contractual obligations of the parent company. If not thoroughly considered before undertaking a spin-off transaction, these contractual provision can lead to claims against the parent company in connection with the spin-off.

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If you would like to know more about spin-off transactions, please contact the TroyGould PC corporate attorney with whom you regularly work or any of our Corporate Department Members.