

### Mergers & Acquisitions 2009

#### Preparing for “Carve-Out” Transactions: Real Property

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*We anticipate that the current economic climate will increasingly lead companies to engage in carve-out transactions (i.e., the sale of subsidiaries or divisions of a larger business enterprise). Not unlike the increase in distressed company acquisitions, we expect that carve-out transactions will be a dominant part of the M&A market over the next few years. Virtually every financial and strategic investor and intermediary will need to be well versed in these projects and the unique and challenging issues they present.*

*This LawFlash is one of a series of LawFlashes, each highlighting certain complex technical, financial, and legal issues that need to be addressed in splitting off parts of a larger business. Morgan Lewis, with its broad array of relevant practice areas such as technology outsourcing (technical transitional services having become perhaps the most difficult aspect of carve-out transactions), intellectual property, labor and employment, and sophisticated tax analysis, is positioned to skillfully assist with these increasingly complex transactions.*

A common theme present in all successful carve-out transactions is advance planning. Understanding the fundamental issues that are unique to a carve-out transaction—from the perspective of both the seller and the buyer—can mitigate unnecessary deliberations, costs, and fees. This is particularly true with respect to real property, whether such real property is owned or leased. Obviously, one of the most fundamental considerations when operating a business is identifying, financing, equipping, and maintaining the physical space that the business will occupy, and relocating the business in connection with a transaction has the potential to result in significant disruption to business functions.

It is not uncommon for a company with multiple business lines to operate all of its business units out of a single facility—or, in the case of a large corporation, multiple shared facilities. Such an arrangement has obvious advantages in terms of cost savings and accessibility. For purposes of a carve-out transaction, however, that shared facility presents unique issues, regardless of whether the property in question is leased or owned by the seller. The following is a short summary of some of the important issues raised in a carve-out transaction with respect to leased or owned real property:

- **Leased Real Property:** Where the divested business unit operates out of a shared leased facility and the buyer desires to utilize such facility going forward, two principal options are available. First, assuming that the lease agreement allows for subleasing (and even in the event

that it does, the landlord's consent may still be required prior to formalizing the sublease arrangement), the seller would need to enter into a sublease agreement for such facility. Considerations for the sublease are numerous, including the risks assumed by the seller. Moreover, in order to preserve deal value, the seller must carefully examine shared costs that will be split with the new subleasee—including maintenance, shared space (e.g., conference facilities, reception), security, and other hard and soft costs (e.g., HVAC, electricity) that need to be built into the financial terms of the sublease.

In addition, if the facility has an open floor plan, the seller will need to consider what space will be occupied by the buyer and whether modifications to the space are required to protect confidential information. From the seller's perspective in particular, it is important to examine all of these costs in advance so that they can be appropriately allocated to the buyer. A good deal can be soured by the legacy of a poorly drafted sublease. To the extent that the seller's lease agreement requires landlord consent for a sublease, obtaining such consent—and planning for the time involved in obtaining such consent—needs to be built into the deal process along with the negotiation of the sublease.

The second option is the entry by the buyer into a direct contractual relationship with the landlord. As with a sublease, deal professionals need to be sensitive to the timing required for the buyer to negotiate such a lease, particularly because it may involve the negotiation of a broader set of terms than in the negotiation of a sublease. In general, each party is best served by working together in order to avoid a situation where the landlord holds the deal hostage in an effort to extract higher rents. Generally, the current economic climate is not favorable for such strong arm tactics by a landlord, but the deal team should monitor the landlord relationship carefully in order to avoid any timing delays.

The seller may want to take advantage of the opportunity created by the new lease for the buyer to reopen discussions on its current lease. These discussions may in fact be necessary due to the reduction in space leased and allocation of certain costs to the carved-out entity. The timing of these discussions, however, needs to be considered carefully within the overall context of the deal, and should only be conducted after assessing the landlord's receptiveness to them. The goal of such discussions would not be to damage a healthy landlord-tenant relationship but rather to secure a market-appropriate lease for the seller and provide the landlord with long-term stability.

- **Owned Real Property:** If an owned site is shared by a business unit that is to be divested and business units that are retained by the seller. The first option is a lease of a portion of the owned site from the seller to the buyer, which presents many of the same issues described above. The obvious difference is the greater level of control the seller will have with respect to timing (because no landlord consent will be required) and terms of any lease entered into by the buyer. In this instance, the lease agreement can become a more central component of the transaction and the value derived by each party from such transaction. As in the sublease scenario presented above, the seller needs to consider all costs that will be allocated to the buyer. This planning can be started even prior to identifying a buyer and can have the added advantage of reducing costs in future transactions if additional business units at such facility are also candidates for divestiture.

