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CORPORATE TRANSACTIONS

Avoiding Potential Pitfalls and Liabilities Following a Spin-Off

Spin-offs are attractive business separation transactions but do not come without risk. However, there are steps that companies can take to minimize their exposure to the most common potential liabilities.

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Spin-offs have become very common over the past few decades and there are no signs that suggest the appetite for these transactions is waning. Within the last few months, numerous companies across a wide range of industries have announced plans to spin off their subsidiaries, including the following:

- DDR Corp. (50 REIT assets)
- DowDuPont (three of its chemical businesses)
- EQT Corp. (its upstream and midstream natural gas businesses)
- Kering (its sports brand Puma)
- Altice NV (its American telecommunications unit)
- 21st Century Fox (portfolio of its highly rated news, sports, and broadcast businesses)
- Thomson Reuters (its Financial & Risk unit)
- Long Blockchain Corp. (its iced tea unit)
- DryShips Inc. (its gas carrier business)
- Netgear (its Arlo security camera business)
- Cogint, Inc. (its data and analytics business Red Violet)
- IDT Corporation (its pharmaceutical subsidiary Rafael Holdings, Inc.)
- FMC Corp. (its lithium business)

Numerous advantages of spin-offs[1] consistently drive decisions to pursue this type of business separation transaction. First, the market recognizes the value in spin-offs, as evidenced by the spike in the parent's stock price that often follows the announcement of a spin-off; the combined market value of the parent company and the spun-off subsidiary following the spin-off often exceeds the market value of the parent before the spin-off. Second, a spin-off allows a conglomerate with several lines of business to create focused management for each business to improve performance and productivity rather than maintain a unified management whose attention is necessarily divided. Third, the parent and the spun-off subsidiary can craft different compensation packages that are tailored to their respective businesses; equity incentive plans for a conglomerate often are tethered

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to its operations as a whole irrespective of the specific results of specific subsidiaries. Fourth, separating a subsidiary from its parent can enable both companies to attract bespoke financing and thereby improve their respective capital structures. Fifth, a spin-off provides the parent with a monetization opportunity: for example, the subsidiary takes out a loan or draws down on a line of credit, the proceeds thereof flow to the parent, and the parent ends up with more capital and/or the ability to reduce its indebtedness. Sixth, the spin-off structure can offer tax advantages in certain circumstances. Finally, a spin-off allows a parent to divest itself of assets that are not squarely within its main line business.

That said, spin-offs do not come without litigation risks and potential liabilities, which loom when financial disappointment for the parent and/or the spun-off subsidiary follows the transaction. The most common claims that arise out of spin-offs are for breach of fiduciary duty and fraudulent transfer, although claims alleging unlawful dividends, violations of the securities laws, preferential payments, recharacterization, equitable subordination, and substantive consolidation, among others, also can be asserted.[2]

Breach of Fiduciary Duties

Generally, corporate directors owe fiduciary duties to the company.[3] The company's shareholders are beneficiaries of those duties and may pursue causes of action belonging to the company for alleged breach of fiduciary duty.[4] If a company is deemed insolvent, the company's creditors also may enforce such alleged breach as a derivative cause of action.[5] After a company files for bankruptcy, the bankruptcy court may grant standing to other parties to prosecute the alleged breach of fiduciary duty on behalf of the bankrupty estate.

The primary fiduciary duties are the duty of care and the duty of loyalty.[6] The duty of care requires directors to be diligent and reasonably informed, and to exercise prudent and unbiased business judgment in conducting the affairs of the company.[7] In satisfying the duty of care, directors are entitled to rely in good faith on reports prepared by the company's management and outside experts.[8] Delaware courts apply a gross negligence standard in determining whether directors have met their duty of care.[9] To satisfy this standard of care, a board must follow a diligent and deliberative process to become reasonably informed before making its decisions.

The duty of loyalty requires directors to act in good faith and in the best interests of the company, and to deal fairly with the company.[10] In essence, directors cannot elevate their individual interests, or those of a favored group or entity, above the interests of the company and its stakeholders. Notably for present purposes, neither the parent's directors nor those of the subsidiary owe fiduciary duties to the future stockholders of a spun-off subsidiary; rather, the directors of a wholly owned subsidiary owe fiduciary duties to the parent.[11]

The key defense that directors invoke to claims for breach of fiduciary duty is the business judgment rule, which creates the favorable presumption that

> in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.[12]

In reviewing director-approved transactions, a court will apply the business judgment rule in the first instance, but a plaintiff can rebut this presumption by introducing evidence of the lack of due care, fraud, bad faith, or self-dealing.[13] If the plaintiff fails to meet this burden of proof, then the business judgment rule will protect directors and the court will not disturb or second-guess the challenged decision if it can be attributed to any rational purpose.[14] In this context, courts evaluate the reasonableness of the decision-making process, not the merits of the decision.[15]

However, if a plaintiff's allegations are sufficient to overcome the presumption, then the burden

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of proof shifts to the directors to prove that the challenged transaction was "entirely fair" in order to escape liability.[16] This heightened standard of review, known as the "entire fairness" test, requires directors to prove that the challenged transaction was the product of fair dealing and resulted in a fair price.[17] In assessing whether the challenged transaction was the product of fair dealing, courts consider, among other things, how the transaction was initiated, negotiated, timed, and structured, what information was disclosed to directors, and how approvals were obtained. With respect to fair price, courts examine all relevant economic and financial considerations. This standard of review is, therefore, more onerous on directors than the deferential business judgment rule and requires courts to evaluate the merits of the decision.

Preparing a subsidiary for a spin-off and effecting the spin-off may well result in claims for breach of fiduciary duty (and for aiding and abetting such breach, if applicable) if the spin-off results in any damage to the parent and/or the spun-off subsidiary. The prudence of the decision to effect the spin-off may be questioned, or it may be argued that the directors had a conflict of interest because, for example, they simultaneously served on the board of the parent and that of the spun-off subsidiary when the transaction was effected or because they benefitted from consulting contracts with the parent and/or the spun-off subsidiary.

The best practice may be to have an independent committee of disinterested and independent directors approve the spin-off.

To minimize litigation risks and liabilities, directors should establish a substantive record that reflects a thorough and well-informed decision-making process by the board and demonstrates that the directors carefully considered and deliberated the proposed spin-off, the financial analysis supporting it, its risks and benefits, and viable alternatives. To satisfy the duty of care, the board should be sufficiently informed and involved, and obtain the advice and analyses of legal and financial advisors, including financial advisors, investment bankers, and valuation experts. To satisfy the duty of loyalty, a board should consider the disinterestedness and independence of each director and document any steps taken to ensure that approval of the spin-off is not tainted by the self-interest of a single director. For example, if certain directors are on both sides of the contemplated spin-off (such as if they serve on the boards of both the parent and the subsidiary) or may benefit from the spin-off (on account of a service contract with the spun-off subsidiary or any similar arrangements), those circumstances should be disclosed to the board. In such circumstances the best practice may be to have an independent committee of disinterested and independent directors approve the spin-off in order to insulate the other directors from any claim that they breached their duty of loyalty.

Fraudulent Transaction Claims

Fraudulent transfer litigation comes in two flavors: intentional fraud and constructive fraud. As to intentional fraud, a transfer of the debtor's property or the incurrence by the debtor of an obligation can be avoided if the transfer or incurrence of an obligation was made with the actual intent to hinder, delay or defraud any creditor of the debtor,[18] as evidenced by the so-called "badges of fraud."[19] As to constructive fraud, the debtor's transfer of property or incurrence of an obligation can be avoided if the debtor (a) received less than reasonably equivalent value and (b) either (i) was insolvent at the time of the transfer or obligation, or was rendered insolvent as a result thereof, (ii) had unreasonably small capital to operate its business, (iii) had more debt than it could pay off, or (iv) made the transfer or incurred the obligation for the benefit of an insider, under an employment contract, and outside the ordinary course of business.[20]

These two causes of action are available under both the Bankruptcy Code and state fraudulent conveyance statutes, which apply in the bankruptcy context. Generally, the main difference between the federal law and the corresponding state law is the statute of limitations; the Bankruptcy Code covers transfers made and obligations incurred within two years of the commencement of the debtor's bankruptcy case, whereas state limitations periods typically are longer, covering transfers and obligations within four to six years of the commencement of the bankruptcy case. To the extent such claims are successful, the debtor's estate can recover the transferred property or the value thereof from, or avoid the incurred obligation to, the initial transferee or the subsequent transferee.[21]

The most common affirmative defense against fraudulent transfer liability is that a transferee took the property or the obligation in good faith and for value.[22] The transferee bears the burden of showing, by an objective standard, that it is entitled to invoke this defense. To establish good faith, the transferee must show that it lacked knowledge of the debtor's insolvency or financial distress, fraud, or other reason that could render the transfer or obligation avoidable.[23] To establish value, the transferee must show that value was exchanged or the debtor received an economic benefit.[24] Unless the court finds actual fraud (which negates good faith), a transferee who proves a transfer occurred in good faith and for value may obtain a lien on or may retain the transferred property to the extent of the value given by the transferee. Put another way, the transferee's liability is offset by the value that the transferee gave to the debtor.[25]

Litigation over fraudulent transfer claims can be long and costly. If successful, such litigation can result in substantial recoveries based on the value of the transfers—a feature that makes this type of litigation particularly attractive. In addition, the facts underlying such claims are often complicated, and because the inquiry is necessarily fact-intensive, such claims more often than not survive motions to dismiss and motions for summary judgment. Discovery also can be time-consuming and costly, and a trial further protracts the litigation. Ultimately, the cost and length of the litigation frequently motivate parties to settle these claims.

Spin-offs are vulnerable to fraudulent transfer claims given the transfer of assets and liabilities, the likelihood of new debt, and the risk of insolvency for both the parent and the spun-off subsidiary following the spin-off. In the bankruptcy context, fraudulent transfer claims are often brought by creditors' committees, trustees, or litigation trusts created specifically for this purpose and tasked with recovering assets for the benefit of the estate or trust beneficiaries. These parties are highly incentivized to bring such claims, to the extent that their complaint can be pled in a way that survives a motion to dismiss. The considerable time and expense required to defend fraudulent transfer claims, coupled with the uncertainty of the outcome and the potential for substantial recoveries, make such claims appealing to plaintiffs and hazardous for defendants. For these reasons, companies should consider and prepare for the possibility of fraudulent transfer litigation while planning and effecting the spin-off to mitigate, if possible, the risk of such claims.

To reduce the specter of fraudulent transfer litigation in the aftermath of a spin-off, companies should consider how they would address issues of solvency and reasonably equivalent value, and prepare the groundwork for a good-faith value defense. A solvency opinion from a valuation firm or financial adviser is recommended and can undermine a claim of insolvency as part of a constructive fraud allegation, but it is not a guarantee of protection from liability. Independent, third-party valuations of the parent—taking into account market values—and the subsidiary to be spun off, and their respective assets, should be considered when determining whether both entities can be projected to survive and thrive independently. Such valuations also can support a showing that the transaction involved an exchange of reasonably equivalent value and also can establish the good-faith value defense.[26] A deliberative process that shapes the contemplated spin-off and a record documenting this process can

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demonstrate good-faith efforts[27] to design a transaction intended to culminate in two viable entities.

Other Common Claims

Liability for Unlawful Dividend

Directors face personal liability in most states for failing to follow dividend statutes and declaring dividends that they knew or should have known were unlawful. Unless a director was absent at the time a dividend was declared and registered his or her dissent thereafter, all directors are jointly and severally liable for the full amount of any unlawful dividend.[28] A director facing such a claim has the right to seek contribution from the other directors.[29] Additionally, the parent has a claim against stockholders who knowingly receive an unlawful dividend, subject to certain limitations, and directors who are found liable also are subrogated to the rights of the parent against such stockholders.[30]

The structure of a spin-off includes the distribution by the parent of the equity in the spun-off subsidiary to the parent's stockholders in the form of a dividend. Under most corporate statutes, allowable dividends are limited to the company's surplus. Determining whether a parent has surplus sufficient to support a dividend resulting from a spin-off requires a valuation of the parent, including a valuation of the subsidiary to be spun off. If the value of the subsidiary exceeds the calculation of the parent's surplus, a dividend may be difficult to justify. For this reason, third-party valuations rather than reliance exclusively on book value may be useful for confirming surplus and compliance with the applicable dividend statutes.[31]

Violations of Securities Laws

The most common securities claims arising from a spin-off involving a publicly traded company are for fraud pursuant to Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act)[32] and SEC Rule 10b-5[33] based on alleged material misstatements and omissions in connection with the sale or purchase of securities. In the spin-off context, if either the parent or the spun-off subsidiary underperforms after the spin-off has been completed, and the stock price of either entity drops, stockholders of either entity may sue, claiming that the spin-off disclosure documents failed to disclose material risks. Similarly, stockholders of either entity may claim that the SEC filings following the spin-off (e.g., 10-Ks, 10-Qs, and 8-Ks) contain material misstatements or omissions. There also are a host of other securities issues—including disclosure requirements in connection with the registration of securities—that may result in claims under other provisions of the Exchange Act or under the Securities Act of 1933.[34] The best defense against securities claims are well-drafted disclosure documents, including fulsome disclosures of risk factors associated with the spin-off.

Preference Liability

In bankruptcy, a trustee or debtor in possession, can avoid transfers that were made within 90 days (or one year, if made to the debtor's insider) of the commencement of a bankruptcy case on account of an antecedent debt.[35] Spin-offs that include payments or other transfers by either the parent or the spun-off subsidiary in satisfaction of a debt incurred as a result of the spin-off are susceptible to preference liability if the entity that made the transfer files for bankruptcy protection. The primary defenses against a preference action are that the challenged transfer was accompanied by contemporaneous value or subsequent new value,[36] or was made in the ordinary course of business.[37] To the extent that value is exchanged in a spin-off, a third-party valuation may facilitate the application of the value defenses.

Recharacterization and Equitable Subordination

A bankruptcy court may recharacterize a claim as an equity interest where the court determines that the parties intended the loan as a disguised equity contribution.[38] Similarly, a bankruptcy court may equitably subordinate a claim below other claims if the claimant

has engaged in inequitable conduct that either injured other creditors or conferred an unfair advantage on the claimant.[39] Although courts often hold insiders to a more stringent standard when evaluating the equities of their conduct, claims for recharacterization also may extend to non-insiders.[40] In the spin-off context, a parent's claim for the value of assets transferred to the spun-off subsidiary, for example, may be recharacterized as an equity investment or subordinated in priority to other claims. Sufficient documentation and treatment of the spin-off obligation as a debt may provide a defense against any recharacterization, whereas good-faith, arms' length negotiations may insulate the spin-off obligation from equitable subordination.

Substantive Consolidation

Substantive consolidation is an equitable remedy that results in the consolidation of the assets of two separate entities to satisfy the consolidated liabilities of both entities.[41] Absent consent, this remedy is invoked sparingly on a case-by-case basis because it can reduce dramatically or eliminate the rights, interests, and recoveries of various parties in interest. In the spin-off context, a court may, for example, substantively consolidate the assets and liabilities of the parent and the spun-off subsidiary such that both become liable for their collective debts and neither will owe the other on account of any intercompany obligations, including those incurred as part of the spin-off. Because courts often consider substantive consolidation as being akin to piercing the corporate veil, demonstrated respect for corporate formalities is helpful in the defense against such a claim.

Current Litigation Resulting from the Noble/Paragon Spin-Off

The lawsuit filed against Noble Corporation plc in the chapter 11 case of Paragon Offshore plc, now pending in the U.S. Bankruptcy Court for the District of Delaware, serves as a current example of post-spin-off litigation.

On August 1, 2014, Noble spun off its standard-specification offshore oil drilling business to Noble's shareholders as a new entity—Paragon—while retaining its high-specification offshore oil drilling business.[42] As is typical for spin-offs, and at a very high level, the deal involved the incurrence of debt by Paragon, the transfer of assets to Paragon by Noble, and the payment by Paragon to Noble for those assets using the proceeds of the new financing. Within a few months, oil and gas prices plummeted as a result of a global recession.

On February 14, 2016, Paragon filed for chapter 11 protection.[43] On June 7, 2017, the bankruptcy court confirmed Paragon's chapter 11 plan, which provides for a loan of up to $10 million for a litigation trust to pursue claims against Noble on behalf of certain secured creditors of Paragon.[44] On December 15, 2017, the Paragon Litigation Trust filed a complaint against Noble and certain directors of Noble and Paragon, seeking, among other things, full recovery of the funds Paragon transferred to Noble as part of the spin-off and as payment for the assets Noble transferred to Paragon.[45]

The Trust asserted claims against Noble for actual and constructive fraudulent transfers under both the Bankruptcy Code and state law, recharacterization of the debt incurred and payments made by Paragon to Noble as equity, and unjust enrichment. In sum, the Trust alleges that Noble jettisoned an old fleet of outdated, less desirable drilling rigs in exchange for $1.7 billion from Paragon, an amount that the complaint alleges far exceeded the value of the rigs. In its pleading, the Trust cited a litany of allegations and references to documents supporting its allegations of misconduct by Noble. For example, the Trust alleged that Noble falsely inflated the data supporting the valuation of Paragon's rigs, misrepresented the longevity of Paragon's contracts with its two biggest customers, and ultimately caused Paragon to become insolvent. The Trust also asserted claims against certain directors of Paragon for breach of fiduciary duty, and against certain directors of Noble for aiding and abetting such breaches.

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On February 15, 2018, Noble filed its answer, asserting that Paragon received value in exchange for its payments and denying the allegations that Paragon was or became insolvent as a consequence of the spin-off.[46] Noble can be expected to rely on a third-party valuation of Paragon rigs to support its value defenses and on a solvency opinion to support its denial of Paragon's insolvency. In anticipation of these defenses, the Trust's complaint calls these third-party analyses into question, asserting that Noble withheld information or otherwise misled the outside experts involved in the spin-off.

Noble also filed a motion to dismiss the claims related to the breach of fiduciary duty and for unjust enrichment in favor of arbitration as mandated by the spin-off agreements, and to stay the remaining fraudulent transfer claims pending resolution of the arbitration.[47] As of the date of this article, the court has not yet ruled on this motion.

Structuring a Spin-Off to Minimize Potential Litigation Risks and Liabilities

Without the benefit of 20/20 hindsight, transaction planners should consider a variety of corporate, financial, and process issues when structuring spin-offs.

Corporate Issues

It is important for a company considering a spin-off to define and document the business lines it seeks to retain and those it seeks to spin off, and whether such business lines should be spun off through an existing subsidiary or a new subsidiary. New entities require new corporate documents to be filed with the applicable secretary of state. If the parent is a public company, then the subsidiary's stock must be prepared for listing on the appropriate exchange, and the subsidiary should consider appropriate corporate governance mechanisms before going public. Regulatory approvals and/or third-party consents may be needed in advance of the spin-off to ensure compliance with legal and contractual obligations. Directors and officers will need to be selected and appointed, and it is important that they be in a position to negotiate the terms of the spin-off on the subsidiary's behalf. If any directors also serve on the parent's board, it is prudent to ensure that a committee of independent directors makes the spin-off decision in the event that it is later questioned.[48] Finally, it is critical that the parent file sufficiently informative disclosure documents describing all potential risk factors that could affect the success of both entities following the spin-off.

Financial Issues

The most important financial decision in a spin-off is the allocation of assets and liabilities among the parent and subsidiary to be spun off because it will have a substantial impact on the performance of the entities following the spin-off. Although a good company/bad company spin-off may be tempting, it is advisable to structure a spin-off that is intended to result in two viable entities, each of which will have a positive net worth and sufficient capital to operate its business and satisfy its obligations. Reliable financial data, including valuations and projections, are helpful when assessing the likely economic consequences of the spin-off for the parent and spun-off subsidiary. Investment bankers, financial advisors, and valuation experts normally are engaged to supply independent, third-party asset valuations, cash flow projections, and capitalization—with comparison data for similar companies in the industry, if possible. Because such advisors often rely on management projections and data, it is important that they be provided with sufficient information. A parent should consider such analyses when allocating assets and liabilities and attributing value to transferred assets to ensure that the contemplated transactions will withstand scrutiny.

Process Issues

A well-run, thoughtful, and informed deal structuring process provides the best opportunity for minimizing risks related to spin-offs, especially when

the aftermath of a spin-off presents unexpected difficulties for the parent and/or spun-off subsidiary. In addition to documenting the decision-making process by the boards of the parent and its subsidiary, this process should include good-faith negotiations of the spin-off transaction agreements. The agreements that are ultimately executed should be defensible (arm's length, market terms, etc.). Again, companies are advised to engage counsel, investment bankers, financial advisors, and valuation experts to ensure that their boards are sufficiently informed when making the spin-off decision.[49]

Conclusion

Spin-offs remain attractive business separation transactions and can be quite lucrative for both the parent and the spun-off subsidiary. But when financial distress follows a spin-off (even if not immediately), the stakes can be quite high. Accordingly, care must be taken with spin-off transactions to avoid the most common pitfalls as discussed above.

Notes

1. For purposes of this article, the term "spin-off" refers to the classic transaction where a parent company that operates several businesses disposes of one of those businesses by moving the assets or liabilities associated with that business to a subsidiary, and then distributes the stock in such subsidiary to its stockholders in the form of a dividend. The end result of the lengthy set of transactions that effectuate the spin-off is two independent entities: the parent company and its spun-off subsidiary. There are related business separation transactions, including partial spin-offs, split-offs, split-ups, Morris Trust, and Reverse Morris Trust transactions that are not discussed in this article.
2. This is necessarily a non-exhaustive list of claims that can arise from spin-offs; plaintiffs have great capacity for developing claims.
3. Fiduciary duties also are imposed on officers and controlling shareholders, but this article focuses on the fiduciary duties of directors.
4. Rales v. Blasband, 634 A.2d 927, 932 (Del. 1993).
5. *See, e.g.,* North Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 103 (Del. 2007) (holding that creditors may sue directors of insolvent corporations derivatively but not directly); Geyer v. Ingersoll, 621 A.2d 784, 787 (Del. Ch. 1992) ("Fiduciary duties to creditors arise when one is able to establish the fact of insolvency.")
6. This article focuses on corporations and does not contemplate the waivers of any fiduciary duties in the context of limited liability companies.
7. Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985).
8. Del. Code Ann. tit. 8, § 141(e).
9. *Smith*, 488 A.2d at 873.
10. Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987). The duty of good faith is a subsidiary element of the duty of loyalty. Stone v. Ritter, 911 A.2d 362, 369-70 (Del. 2006).
11. Anadarko Petroleum Corp. v. Panhandle Eastern Corp., 545 A.2d 1171, 1172 (Del. 1988) (holding that prior to the date of spin-off distribution but after a parent declares its intention to spin off a subsidiary, directors of a wholly owned subsidiary do not owe fiduciary duties to the prospective stockholders of the subsidiary to be spun off).
12. Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 457 (Del. Ch. 2011) (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).
13. Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 64 (Del. 1989). "As a general matter, the business judgment rule presumption that a board acted loyally can be rebutted by alleging facts which, if accepted as true, establish that the board was either interested in the outcome of the transaction or lacked the independence to consider objectively whether the transaction was in the best interest of its company and all of its shareholders." Orman v. Cullman, 794 A.2d 5, 22 (Del. Ch. 2002).
14. Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993), *decision modified on reargument*, 636 A.2d 956 (Del. 1994); *Reis*, 28 A.3d at 457; Odyssey Partners, L.P. v. Fleming Cos., Inc., 735 A.2d 386, 407 (Del. Ch. 1999).
15. Pfeiffer v. Leedle, No. CV 7831-VCP, 2013 WL 5988416, at *5 (Del. Ch. Nov. 8, 2013) ("So long as corporate fiduciaries act in the procedurally responsible manner outlined by the business judgment rule, the substance of their decisions is relevant only in exceptionally rare circumstances.").

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16. Krasner v. Moffet, 826 A.2d 277, 287 (Del. 2003) ("[W]hen the presumption of the business judgment rule has been rebutted, the entire fairness rule is implicated and defendants bear the burden of proof.").
17. *Cede*, 634 A.2d at 361. Courts also apply the business judgment standard when reviewing a challenged transaction that was approved by fully informed and uncoerced equity holders. Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 312–13 (Del. 2015) ("[W]hen a transaction is not subject to the entire fairness standard, the long-standing policy of our law has been to avoid the uncertainties and costs of judicial second-guessing when the disinterested stockholders have had the free and informed chance to decide on the economic merits of a transaction for themselves.").
18. 11 U.S.C. § 548(a)(1)(A).
19. "[C]ourts look for common indicia, or badges of fraud, which have frequently bespoken fraudulent intent in the past. Some badges of fraud are: (1) actual or threatened litigation against the debtor; (2) a transfer of all or substantially all of the debtor's property; (3) insolvency on the part of the debtor; (4) a special relationship between the debtor and the transferee; and (5) retention of the property by the debtor after the transfer." Kelly v. Armstrong, 141 F.3d 799, 802 (8th Cir. 1998).
20. 11 U.S.C. § 548(a)(1)(B).
21. 11 U.S.C. § 550(a).
22. 11 U.S.C. § 548(c).
23. *See, e.g.,* Brown v. Third National Bank (*In re* Sherman), 67 F.3d 1348, 1355 (8th Cir. 1995).
24. *See, e.g.,* Perkins v. Haines, 661 F.3d 623, 626–27 (11th Cir. 2011).
25. See *Good Faith for Value Defenses: Understanding the Use of Good Faith and Value Concepts in Fraudulent Transfer Cases*, 26 No. 1 J. Bankr. L. & Prac. NL Art. 1 for discussion of this defense.
26. Notably, a solvency opinion typically is supported by financial projections supplied by the parent's management, such that its reliability may be questioned if such projections are later attacked. An independent valuation that is not tethered to management projection may be less vulnerable to attack.
27. Although it is common for a parent to not provide separate counsel for the subsidiary to be spun off in the negotiation process, and for public filings to disclose that the spin-off was not an arms' length transaction, both of these issues may be raised by plaintiffs and considered by courts in subsequent litigation.
28. *See, e.g.,* Del. Code Ann. tit. 8, § 174.
29. *Id.*
30. *Id.*
31. As a practical matter, the likelihood of dividend problems in most public company spin-offs is relatively low absent unusual circumstances.
32. 15 U.S.C. § 78j(b).
33. 17 C.F.R. § 240.10b-5.
34. 15 U.S.C. § 77a *et seq.*
35. 11 U.S.C. § 547(b).
36. 11 U.S.C. § 547(c)(1).
37. 11 U.S.C. § 547(c)(2).
38. *See, e.g., In re* SubMicron Sys. Corp., 432 F.3d 448, 454 (3d Cir. 2006) ("We join those courts that have concluded that a bankruptcy court has the power to recharacterize a claim from debt to equity.")
39. 11 U.S.C. § 510(c).
40. *In re* Lothian Oil Inc., 650 F.3d 539, 544 (5th Cir. 2011).
41. *See, e.g., In re* Meruelo Maddux Props., Inc., 667 F.3d 1072, 1075 (9th Cir. 2012) ("Substantive consolidation is an uncodified, equitable doctrine allowing the bankruptcy court, for purposes of the bankruptcy, to combine the assets and liabilities of separate and distinct—but related—legal entities into a single pool and treat them as though they belong to a single entity.") (internal quotation marks omitted) (citation omitted).
42. Noble Corporation plc, Annual Report, Form 10-K (Dec. 31, 2014); Paragon Offshore plc, Annual Report, Form 10-K (Dec. 31, 2014). Noble explained that high-specification rigs, unlike standard-specification rigs, are designed to drill in deepwater and ultra-deepwater markets and in harsh environments. Noble Corporation plc, Annual Report, Form 10-K (Dec. 31, 2013).
43. Chapter 11 Voluntary Petition, *In re* Paragon Offshore plc, Case No. 16-10386 (CSS) (Bankr. D. Del. Feb. 14, 2016), ECF No. 1.
44. Findings of Fact, Conclusions of Law, and Order Confirming the Fifth Joint Chapter 11 Plan of Paragon Offshore plc and Its Affiliated Debtors, *In re* Paragon Offshore plc, Case No. 16-10386 (CSS) (Bankr. D. Del. June 7, 2017), ECF No. 1614.

45. [Redacted] Complaint, Paragon Litigation Trust v. Noble Corporation plc, Adv. Proc. No. 17-51882-CSS (Bankr. D. Del. Dec. 15, 2017), ECF 1.
46. Corporate Defendants' Answer and Affirmative Defenses to Adversary Complaint, Paragon Litigation Trust v. Noble Corporation plc, Adv. Proc. No. 17-51882-CSS (Bankr. D. Del. Feb. 15, 2018), ECF 18.
47. Defendants' Motion to Dismiss in Favor of Arbitration and to Stay the Proceeding, Paragon Litigation Trust v. Noble Corporation plc, Adv. Proc. No. 17-51882-CSS (Bankr. D. Del. Feb. 15, 2018), ECF 23.
48. A D&O insurance policy with adequate coverage is recommended.
49. As noted above, it is uncommon in practice for the subsidiary to be spun-off to be represented by separate counsel, but complaints frequently allege this fact as evidence that the spin-off was not a good faith, arms' length transaction.

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