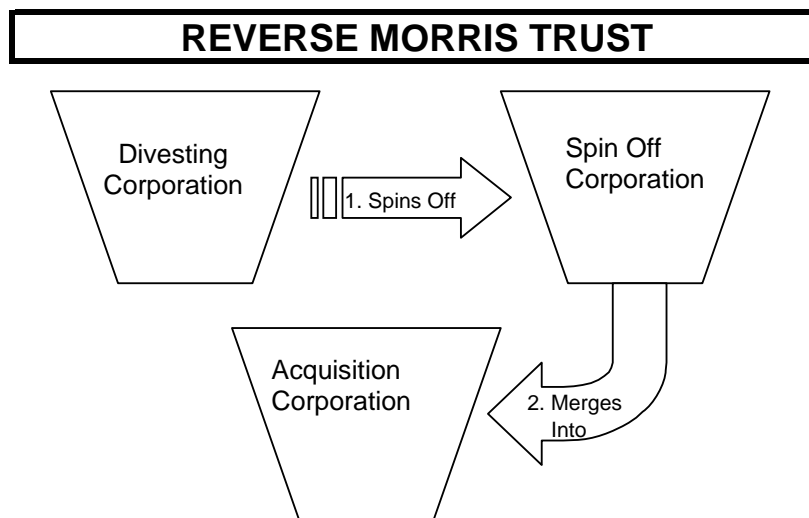


The Reverse Morris Trust

The “Reverse Morris Trust” is a tax-avoidance technique that, thanks to Wall Street’s financial wizards, is increasingly deployed by corporations seeking to sell off unwanted assets without paying taxes on their gains.

Under a Reverse Morris Trust, a parent corporation can spin-off a subsidiary into an unrelated company, tax free, if the shareholders of the parent end up controlling more than 50% of the voting rights and economic value of the resulting merged company. As graphically described below, the basic elements of this process are: A divesting corporation spins off a subsidiary which then merges into an unrelated acquisition corporation. To qualify for tax-free treatment, the shareholders of the divesting corporation must own a controlling interest in the post-transaction acquisition corporation.



Typically, the parent loads up its “spinco” with as much debt as it can support, while causing this subsidiary to “dividend-out” or otherwise pay the proceeds of the new debt to the parent or one of its affiliates immediately prior to the spin-off and merger.

Two recent examples of Reverse Morris Trust-driven transactions were the \$2.7 billion spin-off of Verizon Communications’ Northern New England wireline operations into FairPoint Communications and the \$2.4 billion spin-off of The Walt Disney Company’s ABC Radio business into Citadel Broadcasting Corporation. Verizon received \$1.7 billion in cash and securities – from new debt incurred by Spinco immediately prior to the transaction being consummated – while Verizon shareholders ended up owning 60% of the post-merger FairPoint. Disney retained \$1.35 billion in cash from the proceeds of new debt acquired by ABC Radio prior to the spin-off while its shareholders became owners of 57.5% of Citadel. Unfortunately, FairPoint and Citadel are now in deep financial distress, with both recently announced that they risk violating the financial covenants associated with the massive debt they acquired as part of the Reverse Morris Trust transactions.

In the proposed Frontier deal, Verizon will receive \$3.3 billion tax free money as a result of this tax loophole, while Verizon shareholders will end up as involuntary owners of about 68% of the increasingly debt-laden Frontier.