

3M: Separate Before the Obligations Are Settled?

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On June 22, 2023, 3M disclosed a proposed settlement of public-water-system claims involving PFAS. The proposed agreement called for \$10.5-12.5 billion in nominal payments over 2024-2036, subject to court approval, future testing, and opt-out conditions. 3M said it expected to record a \$10.3 billion pre-tax charge in the second quarter, representing the present value of the \$12.5 billion nominal case. The agreement did not admit liability. It covered specified public water systems' claims; it did not resolve every PFAS matter. [C3, Form 8-K Items 1.01 and 8.01; Exhibit 10.1, §§II-IV and Exhibit K.]

For this classroom exercise, assume you are advising 3M's board as it considers the planned separation of its Health Care business. The advisory assignment and your access to a board decision are teaching constructs; public sources do not establish that the board posed this question. The latest company filing said 3M continued to target closing by year-end 2023 or early 2024. That timetable now sat alongside a large, conditional settlement schedule, while detailed standalone financing and separation terms were not public in the sources reviewed by the cutoff. [C1, "Transaction Details"; C5, Note 3, "Divestitures and Previously Announced Divestitures."]

The decision

Recommend one of three paths, or define a fourth:

1. **Proceed on the announced timetable and planned capital structure.** Keep the proposed separation moving while setting financing, liquidity, and operating safeguards for both companies.
2. **Delay.** Wait for more information about the settlement and the companies' standalone funding needs before separating.
3. **Redesign the separation.** Continue toward a transaction but revisit its financing, retained ownership, timing, or transition protections.

The choice is how to balance managerial focus and capital-allocation autonomy against the parent's obligations and each company's need for a viable independent operating base. No public source in this case specifies final debt terms, a definitive liability allocation, standalone cash flows, or quantified separation and transition costs. Identify what you would require before authorizing a path; do not treat unknowns as zero.

A planned separation

In July 2022, 3M announced a tax-free spin-off of Health Care, which included wound care, oral care, health information systems, and biopharma filtration. Management cited sharper focus, tailored capital allocation, and more distinct investor profiles as potential benefits. It planned to retain 19.9% of Health Care temporarily and monetize that stake over time. The announcement forecast 3.0-3.5 times net leverage for Health Care at separation and said 3M expected to retain non-Health-Care litigation, including PFAS and Combat Arms Earplugs (CAE). These were management's plans, not executed terms. [C1, "Health Care" and "Transaction Details."]

By April 2023, 3M's Form 10-Q described the target as year-end 2023 or early 2024 and said closing remained subject to filings, tax rulings or opinion, financing, board approval, market conditions, and other conditions. 3M described itself as an integrated enterprise, with substantial intersegment cooperation, cost allocations, and inventory transfers. It cautioned that reported segment operating income should not be treated as the result those segments would have generated independently. [C5, Note 3; Note 15, "Business Segments."]

Health Care generated \$8.421 billion of 3M's \$34.229 billion 2022 sales, or 24.6% (calculated). At March 31, 2023, 3M reported \$3.992 billion in cash, cash equivalents, and marketable securities; \$15.960 billion in total debt; and \$11.968 billion in company-defined net debt. About \$2.7 billion of the liquidity measure was held by foreign subsidiaries and \$1.3 billion in the United States. These consolidated figures do not establish cash freely available to either post-separation company. [C2, Note 21, "Net Sales (Millions)," 2022 column; C5, MD&A, "Balance Sheet."]

The latest quarter offered mixed signals. Health Care sales were \$2.010 billion, down 5.6% from \$2.128 billion a year earlier; 3M reported a 19.2% decline in Health Care segment operating income. The rounded values shown in the segment table, \$360 million versus \$445 million, recompute to 19.1%. These are segment measures, not standalone results. Company-wide Q1 operating cash flow was \$1.275 billion and capital expenditures were \$475 million. Management cited favorable working-capital changes and expected full-year capex of \$1.5-1.8 billion, so one quarter is not an annual cash-flow forecast. [C5, Note 15, segment table and reported percentage; MD&A, "Cash Flows."]

Debt maturities also compete for cash. At March 31, 2023, 3M reported \$1.1 billion of commercial paper and \$14.848 billion of long-term debt. Scheduled long-term maturities were \$0.800 billion for the remainder of 2023, \$1.100 billion in 2024, \$1.865 billion in 2025, \$1.452 billion in 2026, \$0.846 billion in 2027, \$0.731 billion in 2028, and \$8.054 billion thereafter. These consolidated maturities do not show which obligations would support each post-separation company. [C5, Note 10, "Debt."]

The cash-flow definitions also matter. GAAP operating cash flow less PP&E purchases equaled \$800 million of company-defined free cash flow in Q1. 3M separately reported \$946 million of adjusted free cash flow. The \$146 million difference came from specified adjustments: \$116 million to operating cash flow and \$30 million to PP&E purchases, including adjustments related to special items and PFAS-product manufacturing. The adjusted measure is not GAAP free cash flow or fully discretionary cash. [C5, MD&A, "Free Cash Flow"; C6, Exhibit 99.1, "Adjusted Free Cash Flow."]

The CAE matter was also separate from the proposed public-water settlement. In its Q1 filing, 3M described \$1.0 billion placed in a trust and \$0.2 billion in projected expenses under its CAE-related arrangement, as well as an additional funding commitment. The filing said it had not recorded further liability under its then-current accounting assessment. These disclosures do not quantify all future litigation cash needs. [C5, Note 14, "Commitments and

Contingencies.”]

The proposed public-water settlement

The filed agreement specified payments to address defined public water systems’ claims related to PFOA, PFOS, and other PFAS, including certain AFFF-related water-system claims. It required preliminary and final court approval and included opt-out conditions that could allow 3M to terminate. Future testing affected Phase Two amounts. The \$10.3 billion charge was management’s expected accounting estimate based on the high nominal-payment case; it was not a cash reserve, an independent valuation, or a ceiling on all PFAS exposure. [C3, Form 8-K Items 1.01 and 8.01; Exhibit 10.1.]

Exhibit K set out **earliest possible** payment dates and amounts. The first listed date was July 1, 2024, with \$2.81625 billion, including the testing fund and a Phase One infrastructure payment. Payments were not due earlier than 60 days after the agreement’s effective date/final judgment, with a narrow exception of up to \$5 million for notice-administration costs after preliminary approval. Later annual amounts depended partly on testing and were subject to agreement terms and adjustments. Amounts below are derived sums of the schedule’s Phase One and Phase Two columns, before Stuart/Rome adjustments. [C3, Exhibit 10.1, Exhibit K, “Payment Schedule,” “Payment Dates,” and “Calculation of Phase Two Payments.”]

Payment year	Earliest listed amount (\$bn)
2024	2.81625
2025	1.79875
2026	0.44000
2027	1.80840-2.64840
2028	1.18756-1.64356
2029	0.52679-0.63079
2030-2031, each year	0.44495-0.56495
2032	0.38929-0.49329
2033	0.30514-0.36914
2034-2036, each year	0.11264-0.17664

The agreement’s stated floor and cap totals were \$10.5 billion and \$12.5 billion, respectively, subject to its terms and adjustments. Up to two of the twelve annual payments from 2025 onward could be delayed by up to 90 days under specified conditions, with interest and notice requirements. The table is not a prediction of actual payment dates or amounts. [C3, Exhibit 10.1, Exhibit K.]

Questions for your recommendation

Prepare a short board memorandum that:

- chooses a path and explains the strongest argument against it;

- distinguishes the present-value charge from nominal cash payments and earliest possible dates from contractual due dates;
- explains how the parent and Health Care could preserve funding for operations, investment, and obligations;
- lists the financing, cash-flow, liability-allocation, and transition information needed before closing; and
- identifies a measurable condition that would make you change course.

You may use scenario assumptions, but label each one. Do not assume the spin itself provides cash: distributing shares does not generate parent proceeds. A later sale of the retained 19.9% would be a separate transaction whose amount and timing were not established at the cutoff. Your analysis should not imply that the public-water settlement covers every PFAS claim or that the 2022 litigation-allocation statement is a final legal agreement. [C1, “Transaction Details”; C3, settlement agreement; L5, pp. 491-492.]

Selected sources

The case uses 3M’s July 26, 2022 spin announcement (C1); 2022 Form 10-K filed Feb. 8, 2023 (C2); June 22, 2023 Form 8-K, settlement, and Exhibit K (C3); Q1 2023 Form 10-Q filed Apr. 25 (C5); and Q1 results Exhibit 99.1 (C6). Academic lenses include Berger and Ofek (1995), Desai and Jain (1999), and Ahn and Denis (2004), cited in the source register. Full bibliographic details, versions, access depth, and locators appear there. The information cutoff is June 22, 2023; later outcomes are excluded.

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