The Latham & Watkins Take-Private Guide: An overview of acquiring a US public company
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Introduction

This guide provides an overview of the processes, possible structures, and principal issues for consideration by an acquirer in connection with an acquisition of a publicly traded US company for cash (i.e., a “take-private” transaction). More specifically, the term “take-private transaction” often is used to refer to any of the following three types of transactions:

- **General take-private**: an acquisition of a public company for cash (i.e., such that the company ceases to be “public”), irrespective of the type of acquirer

- **Sponsor take-private**: an acquisition of a public company by a private equity sponsor, typically in a leveraged buyout transaction

- **Controller take-private**: an acquisition by a controlling shareholder of the remaining shares of a public company’s stock that it does not own

This guide primarily focuses on general take-private transactions, as well as additional considerations involved in Sponsor take-private transactions. For the most part this guide does not address Controller take-privates due to their relative infrequency and the number of structuring, disclosure, fiduciary duty, and other considerations that are specific to Controller take-privates.

Any take-private transaction involves a number of considerations for an acquirer, including those arising under the federal securities laws, the laws of the state of incorporation of the target company, antitrust laws, tax laws, and other applicable federal and state laws, in addition to business and financial considerations. Since over 50% of all US public companies are incorporated in the state of Delaware,¹ and since Delaware law often is looked to by courts in other jurisdictions, this guide focuses on key Delaware statutory provisions and case law relevant to acquisitions of public companies incorporated in that state.

Take-private transactions are inherently complex due to the number and types of issues and legal considerations implicated. In addition, take-private transactions are susceptible to shareholder litigation (as described below), and the applicable case law is constantly evolving, as are securities laws, tax matters, and other considerations. Accordingly, while this guide provides an overview of some of the more salient features of these transactions, it is not intended to be a comprehensive summary or analysis of all the legal and other considerations that may arise in the acquisition of a US public company, nor a strict road map of the course of a transaction. This guide, therefore, should not be construed as providing legal or other advice with respect to any particular situation or otherwise.

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**WHAT IS A US PUBLIC COMPANY?**

The term “public company,” as used in this guide, refers to a US company (most often a corporation) that has equity securities publicly traded on a US securities exchange, and that is required to file financial reports and other information with the US Securities and Exchange Commission (SEC) under the US Securities Exchange Act of 1934, as amended (Exchange Act).
The Basics: Transaction Structures

A take-private typically is structured in one of two ways: (1) a statutory merger governed by the law of the state in which the target company is organized; or (2) a tender or exchange offer followed by a “back end” statutory merger. Transactions involving only a statutory merger often are referred to as “one-step” transactions, while transactions involving a tender or exchange offer followed by a back-end merger often are referred to as “two-step” transactions.

The principal difference between the two structures is the ability, in certain circumstances, to complete a two-step transaction more quickly than a one-step transaction. However, as discussed below, there are a number of factors relevant to determining the appropriate structure in any given situation.

Regardless of whether an acquirer uses a one-step or two-step transaction structure, the acquirer in an acquisition of a US public company may pay in cash, stock of the acquirer, or other forms of consideration, or a combination of the foregoing. However, as noted above, this guide focuses on all-cash transactions and, for the most part, does not address transactions involving the issuance of equity securities. Moreover, in addition to the legal considerations described herein, other factors that are beyond the scope of this guide, including tax considerations, can have a critical impact on — and in some cases dictate — the structure used in any particular transaction.

One-Step: Statutory Merger

A one-step merger typically involves the following steps:

- Negotiation of a definitive merger agreement between the acquirer and the target
- Approval of the merger agreement by the target’s board of directors (and, sometimes, a special committee of the target’s board) and the acquirer’s board of directors, followed by execution of the merger agreement
- Filing with the SEC preliminary proxy materials to be used to solicit the approval of the target’s shareholders of the transaction
- Receipt of SEC comments (if any) and making any necessary revisions to the proxy materials and, following SEC clearance, mailing the definitive proxy materials to the target’s shareholders
- Adoption of the merger agreement by the target shareholders (most often at a shareholder meeting or, in some cases, by written consent)
- Closing of the merger upon satisfaction or waiver of the conditions to the parties’ obligations to effect the merger, including the receipt of required regulatory approvals

In most cases (including under Delaware law), the requisite shareholder vote requires approval of a majority of the target’s outstanding shares — although a greater vote may be required by the terms of a target’s organizational documents or applicable state corporate law, or if the target company has multiple classes of stock outstanding.

One-Step Structure

In the acquisition of a public company for cash, a one-step transaction structure usually takes the form of a “reverse triangular merger” (sometimes referred to as a “reverse subsidiary merger”). In a reverse triangular merger, the acquirer forms a subsidiary that merges with and into the target company. As a result of the merger, the target shareholders receive the merger consideration, and the target becomes a subsidiary of the acquirer.
A typical reverse triangular merger is structured as follows:

**REVERSE TRIANGULAR MERGER**

- **Before**
  - Target Shareholders
  - Target
  - Consideration
  - Merger subsidiary merges with and into Target

- **After**
  - Acquirer
  - Target

A one-step merger also can be structured as a forward triangular merger or a direct merger, although neither of these transaction structures is typically used in cash transactions absent special circumstances. In a Sponsor take-private, a Sponsor often will incur debt financing at the merger subsidiary level so that, effective at the closing of the merger, the target itself will become the borrower in the transaction.

**Shareholder Approval: Filing a Proxy Statement With the SEC**

Following the execution of a merger agreement, the target in a one-step merger typically is required to file with the SEC preliminary proxy materials (including a preliminary proxy statement and proxy card) on Schedule 14A. The proxy statement is the principal disclosure document for shareholders in a one-step transaction. Since the proxy statement includes information about the acquirer, the transaction, and the transaction process, the merger agreement typically provides that the acquirer has the right to review and comment on the filing (and, since acquirers have a vested interest in the contents the filing, acquirers should review its contents carefully). If the consideration in the merger includes acquirer securities, the issuance of those securities generally is required to be registered with the SEC and, in such instance, the acquirer would file a registration statement (which would include the proxy statement). These registration requirements are not applicable to a cash transaction.

Once the preliminary proxy materials are filed with the SEC, the SEC usually will notify the target within 10 calendar days if it intends to review the filing. If the SEC elects to review the filing, it typically will provide comments to the target within 30 calendar days of the original filing date, after which the target typically amends its preliminary filing to address those comments. The SEC may have comments on the amended filing, in which case the target will file one or more additional amendments to address and attempt to resolve the comments. This process can take several weeks or longer depending on the nature and extent of the SEC comments.

**Target Shareholder Approval**

Once all SEC comments are resolved, or if the SEC elects not to review the proxy statement, the target will determine the date of the shareholder meeting and the record date for the meeting (i.e., the date on which shares must be held to entitle the holder to vote at the meeting), and will send the definitive proxy materials to its shareholders. Delaware law requires that the shareholder meeting be held at least
20 days after notice of the meeting is sent to shareholders (which notice is contained in the definitive proxy materials). There may be additional requirements in the target’s organizational documents or provisions negotiated in the merger agreement that also govern the timing of and requirements for the shareholder meeting, in addition to practical considerations related to the proxy solicitation process itself. The target shareholder meeting is typically held four to six weeks after the target sends the proxy materials to shareholders.

**Consummation of the Merger**

Assuming all regulatory and other conditions to the merger have been satisfied at the time of the shareholder vote, the parties typically complete the merger promptly following shareholder approval. In the context of a Sponsor take-private, parties need to be mindful of the interplay between satisfaction of the conditions to the merger and the timing of the acquisition financing, including any “marketing period” provided for in the merger agreement to allow the acquirer sufficient time to market or syndicate any bank debt and/or debt securities as part of that financing. In any case, the merger process typically takes two to three months to complete from the time of signing the merger agreement. This time frame can be longer if there is a prolonged SEC review process or an extended time period for antitrust or other required regulatory approvals.

**Two-Step: Tender Offer Followed by a “Back End” Merger**

As with a one-step transaction, in a two-step transaction the parties also typically enter into a merger agreement. However, in a two-step transaction, the merger agreement provides for a tender offer to the target’s shareholders by the acquirer for the target’s outstanding common shares, followed by a “back end” merger to “squeeze out” those shareholders who do not tender their shares in the offer. A two-step merger typically involves the following steps:

- Negotiation of a definitive merger agreement between the acquirer and the target
- Approval of the merger agreement by the target’s board of directors (and, sometimes, a special committee of the board) and the acquirer’s board of directors, followed by execution of the merger agreement
- Commencement of a tender offer in accordance with the terms of the merger agreement, including disseminating tender offer materials to shareholders and filing those materials with the SEC
- Receipt of SEC comments (if any) on the tender offer materials and, if applicable, making any necessary amendments to the tender offer materials
- Closing the tender offer upon satisfaction or waiver of the conditions to the tender offer, including the satisfaction of any “minimum condition” (discussed below) and receipt of required regulatory approvals
- Effecting the back-end merger assuming the satisfaction or waiver of the conditions thereto

In the tender offer, each shareholder independently decides whether to sell (or tender) its shares to the acquirer in exchange for the tender offer consideration. If a sufficient number of shares is tendered in the first-step tender offer, the acquirer will close the tender offer, and immediately thereafter the target typically will merge with a wholly owned subsidiary of the acquirer in a statutory merger that does not require separate shareholder approval.
A typical two-step acquisition is structured as follows:

**TWO-STEP ACQUISITION**

**FIRST STEP**
- Target Shareholders → Consideration → Acquirer
- Target
- Merger Subsidiary

**SECOND STEP**
- Non-Tendering Shareholders → Consideration → Acquirer
- Target
- Merger Subsidiary

**AFTER FIRST STEP**
- Non-Tendering Shareholders
- Target
- Acquirer
- Merger Subsidiary

**AFTER SECOND STEP**
- Acquirer
- Target

**The Offer**
Following execution of the merger agreement (in a “friendly” transaction), an acquirer typically commences a tender offer by placing a summary advertisement, or “tombstone,” in a major national newspaper and distributing an “Offer to Purchase” to target shareholders. The Offer to Purchase is attached as an exhibit to a Schedule TO that is filed with the SEC on the date of commencement of the offer. Unlike a proxy statement, the Offer to Purchase and related offer materials can be distributed to shareholders prior to SEC review. The SEC has the right to comment on the offer materials in much the same manner that it does with respect to a preliminary proxy statement in a one-step merger. Any SEC comments will need to be resolved prior to completing the tender offer, however, the SEC comment process in the tender offer context typically is more streamlined than in a one-step merger and often does not result in material delays to the overall tender offer process.

The Offer to Purchase contains information about the terms and conditions of the offer, the procedures for tendering shares in the offer and for withdrawing them, certain effects of the offer and the merger, information about the target and the acquirer, and a description of the factual background of the transaction similar to that contained in a merger proxy statement.

Within 10 business days following the commencement of the offer, the target must file with the SEC a recommendation statement on a Schedule 14D-9. The Schedule 14D-9 sets forth the recommendation of the target’s board of directors to the target’s shareholders regarding the offer and the reasons for its recommendation, as well as a description of the factual background of the transaction similar to that contained in the Offer to Purchase. If the target’s board received an opinion regarding the fairness of the offer to the target’s shareholders from a financial advisor, a copy of the opinion typically will be attached.
as an exhibit to the Schedule 14D-9, and the opinion and related financial analysis will be summarized in the Schedule 14D-9 itself (which is comparable to the disclosure that would appear in a proxy statement in a one-step merger in such circumstance). In a negotiated transaction, the Schedule 14D-9 will generally be filed with the SEC contemporaneously with the Schedule TO and distributed to target shareholders contemporaneously with the acquirer’s tender offer materials.

If enough shares are tendered in the tender offer to satisfy the “minimum condition” (discussed below), and all other conditions to the acquirer’s obligation to close the tender offer have been satisfied, the acquirer will purchase the shares tendered in the offer. In most cases, the acquirer will then close the acquisition by completing a back-end merger to “squeeze out” the remaining shareholders.

Conditions to the Offer

The acquirer’s obligation to accept and pay for the target shares tendered is generally subject to a number of conditions, which are outlined in the merger agreement and the Offer to Purchase.

The most important condition is the so-called “minimum condition” to the offer. The minimum condition is the minimum number of target shares that must be tendered in order for the acquirer to be obligated to consummate the offer and purchase the shares. The minimum condition is generally based on the number of shares the acquirer needs to own to ensure it will have a sufficient number of votes to execute a back-end merger under applicable law and the target’s organizational documents. In most states, including Delaware, a merger requires the approval of a majority of the target’s outstanding shares and, therefore, the minimum condition typically is expressed as a majority of the target’s shares. However, in some cases, a target’s certificate of incorporation, or the law of the state of incorporation of the target, may impose a higher threshold (e.g., two-thirds of the shares) for shareholder approval of a merger. Other conditions to the offer are generally consistent with the conditions contained in a one-step merger, although sometimes they are formulated a bit differently.

Timing of the Offer

A tender offer in the acquisition context must remain open for at least 20 business days under applicable securities laws. Target shareholders may tender their shares, and have the right to withdraw their shares, at any time prior to the date of expiration of the offer. The merger agreement for a two-step transaction generally provides that the offer period may (and, in many cases, must) be extended by the acquirer for certain time periods if the offer conditions have not been satisfied. The parties may also be required by law to extend the offer period if there has been a material change in the terms of the offer or a material condition has been waived.

As previously noted, the acquirer can distribute the Offer to Purchase contained in the Schedule TO immediately after filing it with the SEC and prior to receiving and resolving any comments the SEC may have. If the SEC’s comments on the Schedule TO do not result in material revisions to the tender offer materials, the comments are addressed by filing an amendment to the Schedule TO with the SEC, without the need to redistribute an amended Offer to Purchase to the target’s shareholders. However, if the comments result in material revisions to the Offer to Purchase, the SEC may require the acquirer to mail a supplement to the Offer to Purchase to the target’s shareholders and, depending on when the offer is scheduled to expire, may also require an extension of the offer period for up to 10 business days.

Once the acquirer announces an intention to commence a tender offer, it cannot acquire shares outside the offer until the offer expires or is terminated.

Completion of the Transaction

Following the expiration of the tender offer, and assuming the minimum tender condition and other conditions are satisfied, the acquirer will purchase the tendered shares. In virtually every case, some of the target’s shareholders do not tender their shares in the offer, and thus a back-end merger is necessary to “squeeze out” the remaining shareholders so the acquirer can obtain ownership of 100% of the target’s shares. Accordingly, following completion of the tender offer, the acquirer and the target will consummate
a back-end statutory merger to cancel the remaining outstanding shares of the target. This back-end merger typically will convert those shares into the right to receive the same amount and form of consideration as that received by tendering shareholders in the tender offer.

The acquirer and target typically will consummate a back-end merger pursuant to one of the following two statutorily prescribed procedures if the conditions thereto are satisfied:

- A short-form merger if the acquirer owns shares sufficient to effect a short-form merger (which, in Delaware, is at least 90% of each class of the target’s outstanding voting shares after the consummation of its offer); or

- In the case of a Delaware-incorporated target, a merger satisfying the requirements of Section 251(h) of the Delaware General Corporation Law (DGCL), which include the requirements that (i) immediately following the consummation of the offer, the stock held by the acquirer and its affiliates (including any shares being “rolled over”) would be sufficient to approve a long-form merger (i.e., a majority of the outstanding shares or such higher approval threshold as may be included in the certificate of incorporation of the target), (ii) shareholders receive in the merger the same amount and form of consideration as that received by shareholders in the tender offer, and (iii) the merger agreement permits or requires that a merger be effected under 251(h) and that the merger will occur as promptly as practicable following consummation of the offer.

If a short-form merger is not initially available because the 90% threshold has not been satisfied and the conditions for use of DGCL Section 251(h) cannot be met, the acquirer generally has three other options to complete the back-end merger:

- The acquirer can attempt to reach the 90% threshold necessary to effect a short-form merger by using a “subsequent offering period,” which allows an acquirer to close the initial tender offer and thereafter pursue a subsequent offering period on the same terms to acquire additional shares.

- If provided for in the merger agreement, the acquirer can exercise a “top up” option, in which the target issues to the acquirer the additional shares necessary to achieve the 90% threshold. The adoption of DGCL Section 251(h) has significantly reduced the need for this option, and there are some legal and practical limitations on its utility in any case (including the need to ensure that the target has a sufficient number of authorized shares).

- The acquirer can effect a long-form merger using the same process previously described for a one-step merger. However, as discussed elsewhere in this guide, a long-form merger takes time and requires filing with the SEC and disseminating to the target’s shareholders a proxy statement. Moreover, even though shareholder approval of the merger is assured because the acquirer will have purchased a sufficient number of shares in the offer to ensure such approval, the target typically will remain publicly traded until the merger is closed and will be obligated to continue to file SEC reports during this time.

One-Step or Two-Step? Deciding Which Structure to Use

As discussed below, there are a number of factors relevant to determining the appropriate structure for a take-private transaction, including the type of take-private transaction under consideration.

Two-Step Is Generally Faster

The principal advantage of a tender offer is that it often can be completed in as little as 20 business days after commencing the tender offer (assuming the satisfaction of the conditions of the offer by such time, including there being no long-tailed regulatory approvals). In contrast, the one-step merger structure
requires a possible SEC review, a proxy solicitation period, and a shareholder meeting, which usually takes two to three months (and sometimes longer) to complete.

Accordingly, in a negotiated transaction that (i) is not expected to involve a lengthy regulatory approval process, (ii) will be financed by readily available cash, pre-existing credit facilities, or new credit facilities that can be implemented quickly, and (iii) enables the parties, following the tender offer, to complete a short-form merger or a merger under DGCL Section 251(h), the parties to a general take-private transaction often prefer the two-step tender offer/back-end merger transaction structure to the one-step merger structure. However, as described below, in most cases parties to a Sponsor take-private use a one-step transaction, primarily due to financing-related considerations.

An illustration of the principal transaction steps and potential timetables for each structure in the context of a take-private is included below.

**Extended Regulatory Review: One-Step Structure Is Preferred**

In a transaction involving a lengthy antitrust or other regulatory approval process, the timing advantage of the two-step structure is eliminated. In addition, as a tender offer cannot close until all material regulatory review processes have been completed, and target shareholders have the right to withdraw their shares at any time prior to the expiration of the offer, the acquirer remains at risk of a topping bid or a shift in shareholder sentiment against the deal during the extended offer period.

In a one-step merger, however, the shareholder vote to approve the merger can be held even if regulatory approvals are still pending and, once shareholder approval is obtained, the right of the target board to terminate the merger agreement and accept a higher offer ceases. For these and other reasons, in transactions in which the regulatory review process is expected to take longer than the shareholder approval process, or other factors dictate a potentially longer timeline, parties often prefer a one-step merger structure.

**Sponsor Take-Privates: One-Step Structure More Prevalent**

Although a two-step structure can be used for a leveraged acquisition of a public company, timing considerations and other aspects of an acquirer’s acquisition financing can raise incremental considerations relative to a one-step merger. For example, in leveraged acquisitions, the acquirer sometimes will negotiate for the right not to close the transaction until after an “inside date” to ensure the acquirer will have sufficient time to complete its financing. For similar reasons, acquirers in leveraged acquisitions, especially in larger transactions, also sometimes negotiate for the right not to close the transaction until the expiration of a “marketing period” so as to enable the acquirer’s debt financing to be...
marketed and/or syndicated within a reasonable window prior to closing. These timing considerations can sometimes impact the overall transaction timeline and may be a factor in determining the appropriate approach. In any case, the acquirer’s financing process must be carefully coordinated with the public company M&A process and the closing of the transaction, whether in a one-step or two-step transaction.

In addition, the SEC has taken the position that under the tender offer rules the satisfaction or waiver of a financing or funding condition constitutes a material change to the terms of the tender offer, which requires that the offer remain open for at least an additional five business days following the announcement of the change. Accordingly, acquirers in leveraged acquisitions using the two-step transaction structure must reconcile this SEC position with the process for the acquirer’s financing. Although true financing conditions are rare in take-private transactions, one approach is to include a technical “funding” condition in the offer (structured in a manner such that any failure of that condition gives rise to recourse comparable to that for a financing failure in a one-step merger, such as payment of a reverse termination fee). Since the SEC views technical funding and financing conditions the same way for purposes of the five business-day rule, if this approach is used, an acquirer may be forced to assume the financing risk between the satisfaction of the technical funding condition and when the tender offer closes at least five days later.

Another financing-related consideration is that if a short-form merger or a merger under DGCL Section 251(h) is not available, and the parties must pursue a long-form merger, the target’s assets generally cannot be used to secure a loan to finance the tender offer prior to full ownership of the target, and the US federal margin rules limit the acquirer’s ability to use the target company’s stock purchased in the tender offer as collateral.

In light of the above and other considerations, most leveraged acquisitions have been structured as one-step transactions. For example, between January 1, 2019, and December 31, 2020, approximately 83% of announced Sponsor take-privates were structured as one-step transactions.³

Acquirers in any take-private transaction — whether it is structured as a one-step or two-step transaction — should be mindful of the need to coordinate the timing of the marketing and funding of a bond offering, leveraged loan, or other financing with the consummation of the transaction and the applicable SEC and other considerations that potentially may be relevant.

Transaction Agreement Terms

Whether a take-private transaction is structured as a one-step or two-step transaction, the parties typically will enter into a definitive agreement styled as a merger agreement. A typical merger agreement for the acquisition of a public company contains the following provisions:

Purchase Price and Mechanics of Merger and Tender Offer. The merger agreement will set forth the consideration to be paid in the transaction, as well as the mechanics for the implementation of the transaction — i.e., a merger (in a one-step transaction) or a tender offer followed by a back-end merger (in a two-step transaction). The merger consideration in a take-private is agreed to and paid on a per share equity value basis rather than on an aggregate enterprise value basis (as would be customary with a private company acquisition). Accordingly, it is critical for the acquirer to understand the target company’s capitalization structure, particularly the total number of shares and other equity awards that will need to be cashed-out in the merger. Moreover, a public company merger agreement rarely contains purchase price adjustment mechanisms (such as for cash, working capital, indebtedness, transaction expenses, or similar items) that are often used in the private company context. The public company acquirer should complete thorough due diligence as to such items, and seek to include covenants in the merger agreement limiting the target’s ability to alter or incur such items between signing and closing (taking into account the expected length of the period between signing and closing).

Rollover. In the case of a Sponsor take-private involving a management rollover, from a mechanical standpoint such rollover typically would be addressed through separate rollover agreements and follow an approach similar to that in the private company context. However, as discussed below, parties may need
to navigate potential incremental disclosure, conflicts of interest, fiduciary duty, and other considerations in the public company context.

**Representations and Warranties.** Both the acquirer and the target make representations comparable to those in the private company context, with the target also making public company-specific representations, including that its public filings are accurate and comply with SEC requirements. The target’s representations are typically subject to a significantly greater level of materiality and material adverse effect qualifications than comparable representations in the private company context. Further, unless representations and warranties insurance is obtained, the target’s representations serve a more limited purpose given that post-closing indemnification for inaccuracy in the representations generally is not available in a take-private transaction.

**Covenants.** The merger agreement includes covenants setting forth the actions required to be taken (or not taken) by the parties between signing and closing, including requirements that the target must conduct its business in the ordinary course and not take certain proscribed actions during this interim period, obligations of the parties to consummate the transaction (including to obtain required antitrust and other regulatory and third-party approvals), obligations with respect to the tender offer or shareholder meeting, as applicable, and various other matters. In the case of a Sponsor take-private or other leveraged acquisition, the merger agreement includes financing-related covenants similar to those in the private company context.

**Conditions.** The merger agreement specifies the conditions to each party’s obligation to consummate the merger and, in a two-step transaction, to close the tender offer. These usually include conditions relating to obtaining the requisite shareholder approval in a one-step transaction (or satisfying the minimum tender condition in a two-step transaction), receipt of required antitrust and other regulatory approvals, absence of injunctions or laws or orders that prohibit closing the transaction, the continued accuracy of representations and warranties, the performance of covenants, and the absence of a material adverse change regarding the target. The satisfaction of the closing conditions regarding the accuracy of representations and warranties and compliance with covenants is generally assessed by applying a materiality standard (which, in the case of the accuracy of the great majority of the representations and warranties in the agreement, usually is a material adverse effect standard).

**Indemnification.** A merger agreement providing for the acquisition of a public company generally does not provide any post-closing recourse or indemnification for inaccuracy of the target’s representations and warranties or failure to comply with its covenants. That said, in recent years, representations and warranties insurance has seen increased use by acquirers in take-private transactions.

**Deal Protection, No-Shops, and Go-Shops.** A merger agreement in a take-private transaction often contains a prohibition on the target soliciting competing offers, which is generally referred to as a “no shop” provision. However, until a merger is approved by the target company’s shareholders, or a tender offer for at least a majority of the target company’s shares is consummated, the board of directors of the target company has a fiduciary duty to the company’s shareholders under the law of the target’s jurisdiction of incorporation to consider unsolicited competing offers, which is sometimes referred to as a “window shop” provision. Accordingly, the merger agreement sets forth the circumstances in which the target board may consider competing offers. These circumstances include engaging in discussions with, and providing due diligence information to, competing bidders, as well as determining whether the initial acquirer has a right to match or exceed a competing bidder’s offer. In addition, the merger agreement sets forth the circumstances in which the target board can change its recommendation to shareholders and/or terminate the merger agreement and accept a superior offer, which is commonly referred to as a “fiduciary out” termination right.

Subject to the target’s board need (and right) under applicable state law to exercise its fiduciary duties, an acquirer generally negotiates for certain limited “deal protection” provisions in the merger agreement. Such deal protection measures often prevent or limit the target board from soliciting, facilitating, or accepting a competing offer, and require the target to pay the original acquirer a termination fee if the target company ultimately changes its recommendation to shareholders or terminates the merger.
agreement to accept a superior offer. Termination fees in this context typically range from 2% to 4% of the target’s equity value, and Delaware courts have indicated that a termination fee in excess of this range may be problematic to the extent that the fee acts as an inappropriate disincentive to higher, competing offers.

In some transactions, particularly those in which the target has engaged in exclusive negotiations with an acquirer and/or has not solicited or otherwise tested the market for competing bids prior to signing (referred to as a “pre-signing market check”), the target may seek a post-signing “go shop” period. This is a period (generally between 30 and 60 days) following the execution of the merger agreement during which the target is expressly permitted to actively seek competing offers. If a superior offer emerges during the “go shop” period and the target elects to accept the offer, the target can terminate the merger agreement with the original acquirer and enter into a definitive agreement with the topping bidder, subject to the obligation to pay the original acquirer a termination fee (which is usually less than the termination fee that would be payable in the absence of, or outside the context of, the “go shop” period).

**Voting Agreements.** If a target has a controlling or significant shareholder, an acquirer often will seek additional deal protection by entering into an agreement with that shareholder to vote in favor of the merger (in a one-step transaction) or tender its shares in the offer (in a two-step transaction). While not uncommon, voting agreements may raise additional considerations, including disclosure, conflicts of interest and fiduciary duty, and other considerations. For example, depending on its terms (including whether it is coupled with a proxy) a voting agreement may be deemed to confer beneficial ownership of the shareholder’s shares on the acquirer under applicable federal and state law. If the acquirer is deemed to have beneficial ownership of the shareholder’s shares under federal law and the acquirer’s and shareholder’s aggregate shareholdings exceed 5% of the target’s outstanding shares, a filing under Schedule 13D by the acquirer may be needed. Similarly, if a voting agreement is deemed to confer beneficial ownership of the shareholder’s shares upon the acquirer under applicable state law, this may implicate a state’s business combination statute, such as DGCL Section 203, which generally limits transactions between a company and a significant shareholder that are not approved prior to the shareholder’s ownership in the company exceeding a specified threshold.

Moreover, depending on the percentage of the target’s outstanding shares held by the shareholders party to the voting agreement, the transaction and/or the terms of the voting agreement (including the number of shares subject to the agreement and its termination provisions) may need to be structured so as not to run afoul of applicable case law, including the Delaware Supreme Court’s long-standing decision in *Omnicare v. NCS Healthcare*. That decision constrains the ability of parties to enter into such agreements if — taken together with the provisions of the merger agreement — they would result in the approval of a merger becoming effectively a *fait accompli* by eliminating the ability of the board (and the company’s remaining shareholders) to accept a superior offer prior to shareholder approval.

Accordingly, the terms and structure of any voting agreement, and its approval by the target’s board of directors, should be carefully considered with those implications in mind.

**Appraisal Rights.** The merger agreement typically contains provisions addressing the exercise of appraisal rights by target shareholders (which are discussed in more detail below). Appraisal rights statutes and the related merger agreement provisions generally provide that a shareholder who properly exercises appraisal rights will not receive the merger consideration at closing and, instead, will be entitled to receive “fair value” for its shares as determined by a court in the applicable jurisdiction. “Fair value” can be greater than, less than, or equal to the merger consideration provided for in the merger agreement. Although acquirers sometimes seek a closing condition that the number of shares in respect of which appraisal rights have been exercised does not exceed a specified maximum, this type of condition is perceived to increase closing risk for targets and appears only in a small minority of transactions. In the absence of a closing condition, assessment of the risk of an appraisal remedy and the likelihood of a significant number of target shareholders seeking appraisal in the context of the transaction process and target valuation is particularly important for Sponsor acquirers, as an appraisal award greater than the merger consideration effectively can function as a post-closing increase in the purchase price for the target for the shares subject to appraisal.
Additional Considerations for Sponsor Take-Private Transactions

Financing Considerations

Many of the financing considerations applicable to a private company leveraged acquisition also apply in the context of an acquisition of a public company. For example, in both cases the Sponsor’s investment funds typically provide the equity portion of the financing for the transaction pursuant to one or more equity commitment letters, and third-party lenders agree to provide the debt portion pursuant to one or more debt commitment letters. The Sponsor typically also provides a limited guarantee evidencing the Sponsor’s obligation to fund any reverse termination fee or damages payable upon termination of the merger agreement.

However, in a leveraged acquisition of a public company, certain additional considerations typically apply. For example, the interplay between the debt financing, on the one hand, and the closing of the tender offer and/or the merger, on the other hand, can be impacted by the public company acquisition process. Moreover, in determining the amount of required financing, a public company acquirer should be mindful of the different approach on purchase price formulations between private and public company acquisitions. In that regard, a Sponsor should be sure to take into account not only the purchase price, but also the other costs and expenses it will need to bear, such as the target company’s transaction expenses (including financial advisor and legal fees), any employee retention or change of control payments, and the cost of any deal-related litigation or remedies resulting therefrom.

A public company target in a leveraged acquisition, like a private company target, is focused on an acquirer’s ability to fund the purchase price and, consequently, the provisions in the merger agreement allocating financing risk. As noted earlier, a financing condition in a public acquisition is rare. Nonetheless, in light of the nature of a private equity acquirer, including its ability to control the funding of the equity portion of the purchase price, the vast majority of merger agreements in Sponsor take-privates provide the target with two principal avenues for recourse in the event of an acquirer debt financing funding failure (or other failure to close and fund when required to do so). One such avenue of recourse is a reverse termination fee, which typically provides that if (i) all the closing conditions have been (or will, upon closing, be) satisfied, (ii) the target is ready, willing, and able to close the transaction, and (iii) the acquirer fails to close the transaction within an allotted period of time from when it otherwise would be required to do so, the target can terminate the merger agreement and collect a reverse termination fee payment from the Sponsor. The other principal avenue of recourse, often referred to as a “conditional specific performance” or a “limited specific performance,” allows the target to specifically enforce the Sponsor’s obligation to fund its equity commitment and close the transaction in circumstances generally consistent with those in the reverse termination fee context, but with the added requirement that the Sponsor’s lenders are prepared to fund the debt portion of the financing at such time.

Since the financial crisis of 2007-08, the conditional specific performance structure, coupled with a reverse termination fee, has been the most common recourse approach in Sponsor take-privates. Target companies sometimes seek a “full recourse” approach, whereby the Sponsor is required to stand behind the entire amount of the purchase price in a manner similar to the approach taken by a strategic acquirer in a non-leveraged transaction. However, the full-recourse approach has been far less frequent, and when agreed is often driven by the specific circumstances of a transaction. That said, private equity Sponsors sometimes face intense competition from each other or from public company acquirers that may present targets with a different financing risk profile, and in certain circumstances, they may seek to be creative in offering targets greater certainty than the conditional specific performance model. As such, these terms may continue to evolve based on competitive dynamics, legal and market developments and other factors.
Consortium Considerations

Over the years, Sponsors have occasionally formed consortiums to enable them to undertake larger acquisitions and to spread the risk associated with a particular transaction among multiple Sponsors. In addition to post-closing governance matters and transfer restrictions, Sponsor consortiums often need to address certain pre-signing and pre-closing matters in a take-private transaction, including: (i) whether the equity commitment letter and/or limited guaranty will be executed by multiple Sponsors or just the “lead” Sponsor, with the other consortium members providing their portion of the equity (or limited guaranty obligations) pursuant to a “back-to-back” arrangement, (ii) the allocation of transaction expenses among consortium members in the event the transaction fails to occur, (iii) the consequences in the event one consortium member defaults on its obligation to deliver its portion of the equity or otherwise breaches its commitments to the other consortium members (particularly in circumstances that result in potential liability to the target company or another third party), (iv) the obligations of each consortium member with respect to obtaining any required antitrust and other regulatory approvals, (v) various restrictions on consortium members, including with respect to confidential information and acting outside the consortium, and (vi) the decision-making process among consortium members (including with respect to acquirer’s rights or obligations under the merger agreement) and the related dispute resolution mechanism. Moreover, in forming consortiums, Sponsors should be mindful of any restrictions contained in non-disclosure agreements with the target as well as antitrust considerations in conjunction with agreements with other Sponsors to bid or not bid in a transaction.

Management Considerations

The treatment of management is often an important consideration in any acquisition and, in some cases, the transaction can be driven by management. For example, a management buyout (MBO) is a form of a leveraged acquisition, often also involving a Sponsor, in which a public company’s management team leads, or has a significant role in, an effort to acquire the company. In an MBO, management often will partner with a Sponsor that will provide the equity capital needed to purchase the public shares. Even outside the MBO context, though, a Sponsor may want management (or another existing shareholder) to have a meaningful equity stake in the company, and thus may require management (and/or another shareholder) to “roll over” their existing equity in the public company into equity of the acquirer and/or otherwise invest alongside the Sponsor. Regardless of whether a transaction involves a more routine roll-over or an MBO with greater management involvement, it requires careful planning and consideration of appropriate procedural safeguards early in the process for the reasons discussed below, among others.

In any take-private transaction, particularly an MBO or other Sponsor take-private in which some directors or other members of management may continue to have a role with the target following the acquisition (whether as a member of management, as an equity holder, or in some other capacity), the actions of the target’s board may be subject to enhanced judicial scrutiny due to the actual or perceived conflict of interest of one or more directors in the transaction. To address these and other considerations, the target company’s board of directors may decide to form a special committee of independent and disinterested directors to consider the transaction on the company’s behalf and to represent and protect the interests of the non-affiliated public shareholders. A target board’s decision to form a special committee, and the authority granted to the committee, should be carefully considered by the board, since these matters can have a significant impact on the course and outcome of the transaction. A special committee may be empowered to decide whether to negotiate exclusively with the MBO group and its Sponsor, undertake a limited pre-signing market check, or pursue a broad-based sales process. In addition, the committee may be authorized to establish procedures to create a level playing field between the MBO group and other potentially interested parties by imposing on management rules regarding their participation in the sale process and their ability to enter into arrangements with potential buyers, as well as an obligation to cooperate with the ultimate buyer that prevails in the sale process.

The timing of any discussions between the acquirer and members of the target’s management and others regarding “rolling over” their target equity into equity of an acquisition entity, as well as discussions with management regarding future employment terms, compensation, and benefits arrangements, needs to be carefully considered in light of the fiduciary obligations of the target’s board of directors, as well as
disclosure considerations for the transaction. To minimize any actual or perceived conflict of interest and to address these other concerns, discussions between the acquirer and members of management are sometimes postponed until later in the process, after price and other transaction terms have been finalized and, in certain circumstances, after receipt of shareholder approval of the merger (in a one-step transaction) or the closing of the tender offer (in a two-step transaction). This is not always practical, however, and thus the parties should be mindful of the implications of holding these discussions early in the transaction process to the extent there is a need to do so.

Target Fiduciary Duties and Judicial Standards of Review

Take-Private Transactions Generally

Acquirers and targets in any take-private transaction need to be mindful of the fiduciary duties and related requirements applicable to the target company and its board of directors. In a transaction involving a sale of a public company for cash that results in a change of control of the target, as is usually the case with any take-private transaction (other than a Controller take-private), Delaware law typically requires the board to act reasonably to obtain the best price reasonably available to shareholders. This is often referred to as the “Revlon” standard in light of the well-known decision of the Delaware Supreme Court in Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc. The Delaware courts have indicated that deal protection mechanisms used in take-private transactions — such as “no shop” and related procedural requirements for the target to consider and potentially accept competing offers, as well as the amount of the termination fee that the target may be required to pay the initial acquirer to terminate the transaction and accept a superior proposal — must be reasonable so as not to unduly discourage competing bidders.

Notwithstanding the heightened scrutiny imposed by Revlon, in 2015 the Delaware Supreme Court held in Corwin v. KKR Financial Holdings that in a non-Controller transaction, the approval of a merger by disinterested shareholders based on a fully informed, non-coerced shareholder vote generally will result in application of the deferential “business judgment rule” standard of judicial review. As such, Corwin presents challenges for plaintiffs to sustain a breach of fiduciary duty claim against a board under those circumstances. A touchstone of satisfying Corwin’s requirements (as well as its tender offer analogue) is being able to satisfy the requirement for full disclosure to shareholders prior to their voting on the merger or tender of shares in a tender offer, thereby placing a premium on ensuring the adequacy of disclosure in the proxy statement or tender offer materials related to the transaction.

Sponsor Take-Private Transactions

In an MBO or other Sponsor take-private transaction with significant affiliate involvement (e.g., in which a majority of the target’s board of directors is viewed to have an actual or potential conflict of interest), the transaction may be subject to an enhanced level of judicial scrutiny. Depending on the facts and circumstances of a particular transaction, this enhanced level of scrutiny may result in the application of the “entire fairness” standard of judicial review under which (unless certain procedural safeguards are implemented) the burden is on the target board to demonstrate the “entire fairness” of the transaction — i.e., to demonstrate the fairness of both the price and process of the transaction.

To decrease the likelihood that such a take-private transaction will be subject to the entire fairness standard of review, the target board often implements procedural safeguards to represent and protect the interests of all the company’s shareholders, including (i) the creation of a special committee of independent, disinterested directors to consider the transaction on behalf of the target, and, potentially, (ii) the inclusion in the merger agreement of a provision requiring that the transaction be approved by the holders of a majority of the target’s outstanding shares who are unaffiliated with the acquirer. Use of one
of these procedural safeguards can shift the burden back to plaintiffs to prove that the transaction was not entirely fair. If the transaction is conditioned on both of these safeguards from the outset, the business judgment rule standard of judicial review may instead apply if following are satisfied:

- The special committee is independent of the controlling shareholder
- The special committee has power to reject the proposal and is free to retain independent advisors (legal and financial)
- The special committee satisfies its duty of care
- The minority vote is non-waivable, fully informed, and uncoerced

In a transaction with a special committee, the special committee members typically are not members of management, do not participate in the buyout group by rolling over shares or otherwise, and do not have material business relationships with the target company or the acquirer. The special committee typically hires its own legal and financial advisors, establishes the process for the sale of the company, and negotiates the merger agreement with the ultimate buyer (which potentially could end up being a third party unaffiliated with the management team or other group that may have initiated the process).

While these safeguards are implemented by the target, they can significantly impact the transaction and the interests of both parties. For example, a decision to subject a take-private transaction to the approval of a majority of the target’s public shareholders not affiliated with the buyout group can have a potentially decisive impact on whether shareholder approval is obtained. Similarly, the decision of the target board to establish a special committee of independent, disinterested directors to consider a take-private transaction shifts the board’s decision-making power to the handful of directors comprising the special committee, which can have a major impact on the ultimate outcome of the transaction, as well as the transaction process. As such, whether the acquirer conditions its willingness to pursue a take-private transaction on the implementation of certain procedural conditions or whether a target board insists on implementing certain procedural conditions to protect its unaffiliated shareholders and minimize director liability presents a complex, multifaceted set of considerations for both parties. Parties may therefore wish to consider these matters before commencing substantive negotiations with each other.

**Controller Take-Private Transactions**

Unlike a Sponsor take-private transaction, which may or may not be subject to the entire fairness standard depending on the facts and circumstances, a Controller take-private (which can include an acquisition by a significant or otherwise controlling shareholder, even one holding less than a majority of outstanding shares) will likely be subject to the entire fairness standard unless certain requirements are satisfied. More specifically, the transaction is typically required to be conditioned from the outset on the approval of the transaction by a special committee of disinterested directors and by the holders of a majority of shares who are not affiliated with the acquirer in a fully informed, non-coerced vote, which is commonly referred to as a “majority of the minority” condition. In the 2014 decision in *Kahn v. M & F Worldwide Corp.*, the Delaware Supreme Court held that if a Controller take-private transaction is conditioned from the outset on these two conditions, it generally will be subject to the deferential business judgment rule standard of judicial review rather than the entire fairness standard. Subsequent Delaware cases have clarified that in order for a Controller take-private transaction to be subject to the business judgment rule standard, these two safeguards must be in place prior to the commencement of substantive negotiations between the acquirer and the target (or a special committee on behalf of the target board), including negotiation of price. Particular care must be taken in early-stage discussions if the parties do not wish to foreclose their ability to avail themselves of *Kahn* and its progeny in structuring their transaction.
Considerations Regarding Financial Advisors and Forecasts

Generally, a target board (or a special committee on behalf of the board) will retain a financial advisor to assist the target with any sale process it may pursue and, importantly, render a “fairness opinion” that the consideration being offered in the transaction is fair, from a financial point of view, to the target’s shareholders. Under Delaware law and the laws of many other states, a director receives certain protections in relying in good faith on the advice of an outside financial advisor who has been selected with reasonable care. Accordingly, the financial advisor’s independence and lack of material conflicts (including by taking into account any role it may have in the acquirer’s financing), in addition to the financial advisor’s quality, reputation, and experience, can be important factors to support a determination that the target board conducted a fair process and satisfied its fiduciary duties to shareholders.

Parties should also be mindful that information about the financial advisor rendering a fairness opinion to the target board and a summary of the fairness opinion and analysis is included in the proxy statement or tender offer materials related to a take-private transaction. This information generally includes information about the financial advisor’s identity and qualifications, any material relationships between the financial advisor and the target company during the previous two years (including any consideration paid by the target company to the financial advisor during this period), compensation to be received by the financial advisor in the transaction, and most importantly a detailed description of the analysis on which the financial advisor’s fairness opinion is based. In some transactions, particularly technical “going private” private transactions subject to Rule 13e-3 under the Exchange Act as discussed below, the target company may be required to disclose all reports (including any oral reports), opinions, and appraisals from outside parties that are “materially related” to the transaction, in addition to the foregoing information relating to any fairness opinion it received.

In addition, acquirers should be aware that any financial forecasts or financial projections that are created by the target with respect to the future performance of its business and (i) shared with the acquirer (or other potential acquirers) as part of the sale process, (ii) used by the financial advisor in the preparation of its valuation analysis, or (iii) relied on by the target board (or a special committee) in its consideration of the approval of the transaction will similarly need to be publicly disclosed by the target in its proxy statement or tender offer materials related to the take-private transaction. Parties to a take-private transaction should be mindful that those forward-looking financial forecasts may imply a valuation or range of valuations for the target different than that paid by the acquirer in the transaction, and those forward-looking financial forecasts will be publicly disclosed.

Friendly or Hostile? Deciding on the Approach to a Target

The acquisition of a public company can be pursued on a negotiated (i.e., friendly) basis, pursuant to a definitive agreement negotiated between the acquirer and the target and its board of directors, or on an unsolicited or hostile basis, without the initial involvement or approval of the target’s incumbent board of directors. The success of any unsolicited or hostile bid may depend on the existence or implementation by the target of procedural and structural defenses designed to control the timing and process of, if not prevent, such an overture. The defenses may include (i) anti-takeover statutes in the target company’s jurisdiction of incorporation, such as DGCL Section 203, (ii) shareholder rights plans (also known as “poison pills”) which, if triggered, substantially dilute the shareholdings of hostile suitors who acquire more than a specified percentage of the target company’s share, (iii) a classified board of directors, (iv) limitations (or prohibitions) on the right of shareholders to call special meetings or act by written consent, and (v) advance notice bylaws for the nomination of director candidates and other provisions.

For example, a hostile acquirer might attempt to acquire all of the outstanding shares of a public company (without any involvement of the target in the acquisition process) through a tender offer for a sufficient number of the target’s outstanding shares to enable the acquirer to consummate a short-form or statutory merger. However, the target’s adoption of a poison pill may effectively prevent the acquirer from being able to acquire a sufficient number of shares in a tender offer to be able to obtain voting control or effect a back-end merger, and even if the acquirer is able to close a front-end tender offer for a sufficient number of target shares, DGCL Section 203 may preclude it from executing a back-end merger for three years.
after the closing of the tender offer. If these defensive measures continue to impede the acquirer’s ability to consummate a tender offer or merger, and the acquirer is unable to successfully negotiate the terms of the acquisition with the target board, the acquirer may consider undertaking a proxy contest to seek to elect a majority of directors to the board who will support the transaction. This can be a significant undertaking, and may require the election of directors at two annual meetings if the target has a classified board structure under which less than a majority (usually one-third) of the directors are elected annually.

Sometimes offers to acquire a public company that begin on an unsolicited or hostile basis are successful and end up being consensual transactions approved by the target’s board due to pressure from the target’s shareholders to approve the transaction and/or because the board determines that the transaction is in the best interests of the shareholders. But other times target boards strongly resist such overtures and, in some of those cases, the target ultimately remains independent.

Historically, the vast majority of take-private transactions have been implemented on a negotiated basis. As noted above, hostile acquisitions can face a number of unique challenges, including the ability of a resistant target to use or implement structural and procedural defenses, the inability to conduct due diligence on non-public information of the target, and the possibility that shareholders will ultimately reject the offer. This does not mean a hostile transaction is never the appropriate or best strategy for the acquisition of a public company. However, the acquirer in a hostile transaction should understand the considerations, complexity, and risks involved (which are generally beyond the scope of this guide).

Disclosure Considerations

Proxy and Tender Offer Materials

Pursuant to SEC rules and regulations, merger proxy materials in a one-step transaction and tender offer materials in a two-step transaction must include specified information about the target, the acquirer, and the transaction including: (i) a description of the background and terms of the transaction; (ii) the principal terms and conditions of the merger agreement; (iii) the target board’s recommendation to shareholders as to how to vote on the transaction and reasons for the recommendation; (iv) a summary of any fairness opinion received by the target board; (v) a summary of financial projections relied on by the target board and its financial advisor or provided to the acquirer; (vi) information regarding the shareholder vote (in a one-step transaction) or the tender offer and back-end merger process (in a two-step transaction); (vii) share ownership of directors and officers; and (viii) information regarding potential conflicts of interest.

As discussed above, proxy materials (in a one-step transaction) and tender offer materials (in a two-step transaction) are filed with the SEC and disseminated to shareholders, with the SEC clearance process potentially impacting the overall timetable of the transaction (albeit more often in a one-step transaction).

Rule 13e-3 Disclosure and Management Involvement

In addition to the typical proxy statement or tender offer disclosure obligations present in any acquisition of a public company, Rule 13e-3 of the Exchange Act imposes certain enhanced disclosure requirements on the acquisition of a public company by a party deemed to be an affiliate of the company. Management members and significant shareholders of the target typically are considered to be affiliates of that company for purposes of Rule 13e-3 and, as a result, an acquisition of a public company by a Sponsor may be subject to Rule 13e-3 if the target company’s senior management is “engaged in” the transaction with the Sponsor by virtue of their negotiation of a significant management rollover or future employment arrangements. Sometimes management and the Sponsor are willing to defer negotiations of management’s equity and employment arrangements until after the shareholder vote so as to avoid application of Rule 13e-3 requirements. However, this is not always the case, as sometimes the interests of the parties in finalizing such items prior to signing a merger agreement will supersede concerns about enhanced Rule 13e-3 disclosure.
The heightened disclosure requirements of Rule 13e-3 are intended to address the actual or potential conflict of interest arising from the affiliate relationship between the acquirer (reflective of management involvement as described above) and the target. Specifically, in addition to the disclosure otherwise required in the proxy statement or tender offer materials, Rule 13e-3 requires disclosure in a Schedule 13E-3 of detailed information regarding the fairness of the transaction to the unaffiliated public shareholders (including the acquirer’s view as to fairness); reports, opinions, and appraisals materially related to the transaction; the purpose, rationale, and structure of the transaction; the affiliate’s view as to the fairness of the transaction; the post-transaction plans of the parties; the nature and amount of transaction expenses; and other incremental items not otherwise required but for the application of Rule 13e-3. In light of these and other requirements, parties to a take-private transaction — particularly one potentially subject to Rule 13e-3 — should be mindful of these disclosure considerations both early on and throughout the transaction process.

**Solicitation Materials**

Any written communication made following the public announcement of a merger but prior to the filing of a proxy statement or Schedule TO that relates to the merger (including press releases, slides, and similar materials, in addition to any materials posted by the target company or the acquirer on its website) must contain an appropriate legend and is typically required to be filed with the SEC on the date of first use. As such, acquirers and targets should be mindful that certain written communications — including with employees, customers, and suppliers who may also be shareholders — could potentially be subject to these requirements. While these rules typically only apply to “soliciting materials,” as there is no bright-line test for what constitutes such materials, any such communications should be reviewed by counsel to determine whether they need to be filed with the SEC. Notably, for Sponsors this may include communications about the transaction with existing or prospective investors in the Sponsor’s funds that may be shareholders of the target company.

**Stake-Building and Required Disclosures of 5%+ Stakes**

A party planning to pursue an acquisition of a public company may consider whether to acquire a stake in the target company’s shares prior to commencing discussions with the target. Building a pre-announcement stake may allow the acquirer to purchase some of the shares at a lower price than it will subsequently have to pay, and can represent a hedge (including a source of expense reimbursement) if the transaction is ultimately not consummated due to a superior offer or otherwise. In addition, acquiring a stake may allow the acquirer to vote those shares in favor of a merger or tender them in a tender offer. Despite these potential benefits, most prospective acquirers do not acquire a stake in the target prior to commencing discussions, since doing so has a number of implications, as discussed below.

The fact that a prospective acquirer knows of its intention to pursue an acquisition of the target company usually does not preclude it from purchasing shares in the target prior to commencing discussions about a possible transaction. In other words, such knowledge in and of itself should not constitute material, non-public information (MNPI) about the target that would result in a purchaser violating insider-trading laws by making such a purchase. However, other factors, such as obtaining non-public information about the target through due diligence or negotiations, or learning the target’s position or intentions regarding a possible transaction, could very well constitute MNPI, restricting the acquirer’s ability to trade in the target’s securities. Accordingly, the potential applicability of insider-trading laws to any purchase or sale requires careful consideration and close coordination with counsel regarding the facts of the situation.

Under Section 13(d) of the Exchange Act, a party or group that acquires beneficial ownership of more than 5% of any class of equity securities (generally common shares) registered under the Exchange Act, including securities convertible into such securities, with a view toward pursuing an acquisition of the issuer of the shares, must, with 10 calendar days of crossing the 5% threshold, make a public filing with the SEC on a Schedule 13D. In the Schedule 13D, the acquiring party must disclose information relating to its identity, the source and amount of funds used to purchase the shares, the purpose of the purchases, any plans or proposals involving the target company, and any agreements or arrangements...
it has with respect to the shares. A party that has filed a Schedule 13D is required to amend it promptly to
disclose any material (i.e., more than 1%) increase or decrease in the number of securities it beneficially
owns, or any change in its investment intent.¹¹

Federal laws, the laws of the state in which the target company is incorporated, and certain provisions
in the target’s organizational documents may limit the number of shares a prospective acquirer can
purchase in the target, or require certain approvals or clearances in connection with the share purchases.
These laws and provisions include the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR Act),
state anti-takeover statutes, anti-takeover provisions in the target’s certificate of incorporation, and poison
pills adopted by the target, as well as some of the other laws and provisions described herein.
Additionally, a prospective acquirer should be aware that purchases of more than 10% of any class
of equity securities (generally common shares) registered under the Exchange Act may be subject to
Section 16 under the Exchange Act, requiring additional filings and subjecting the prospective acquirer to
potential liability for short-swing profits related to transactions in those securities.

A prospective acquirer should be mindful as to whether any pre-announcement share purchases may
constitute a de facto or “creeping” tender offer that would be subject to the tender offer rules under
the Exchange Act. A series of share purchases is more likely to be subject to the tender offer rules if there
was active and widespread solicitation of the target’s shareholders, the offer included a premium over
the then-current trading price of the shares, and the terms of the offer were non-negotiable. Regular-way
purchases of shares through a broker on a US securities exchange typically do not implicate tender
offer rules.

Due to the complexity of applicable federal and state laws, as well as the provisions of a target’s
organizational documents (which may be implicated by any purchase of a target’s shares by a
prospective acquirer), counsel should be consulted in advance of any such pre-announcement share
purchase.

Shareholder Litigation

The vast majority of acquisitions of public companies involve one of two forms of shareholder litigation:
so-called merger “strike suits,” and appraisal actions. In a strike suit, which is the more common form of
shareholder litigation, law firms that specialize in this type of litigation typically issue press releases
seeking to identify one or more shareholders of the target to serve as the named plaintiff before filing a
lawsuit. This type of litigation often alleges flaws in the disclosure regarding the transaction contained in
the principal SEC disclosure document (i.e., the proxy statement in a one-step transaction or the offer to
purchase and Schedule 14D-9 in a two-step transaction), and sometimes also challenges the sale
process. Plaintiffs increasingly bring claims in federal court under the federal securities laws, often along
with state law breach of fiduciary duty claims. Plaintiffs frequently name as defendants the target
company, the board of directors of the target company, and, less frequently — based on an “aiding and
abetting” theory — the acquirer. These complaints generally seek, among other relief, an injunction
preventing or delaying the closing of the transaction, corrective disclosure, and damages for the alleged
harm caused to the shareholders. In most (but not all) situations, these cases are resolved prior to the
shareholder vote on the transaction (or tender offer expiration), often by the target making additional, or
supplemental, disclosures to the shareholders.

In appraisal actions, plaintiffs utilize statutes in many states (including Delaware) that generally permit
target shareholders to demand a judicial determination of the “fair value” of their shares in lieu of the
consideration paid in the merger. In Delaware, appraisal rights are generally available in a merger in
which all or a portion of the consideration consists of cash or unlisted securities, subject to certain
exceptions.¹² To exercise appraisal rights in Delaware, a shareholder generally must (i) vote against
(or abstain from voting on) a merger in which all or a portion of the consideration consists of cash or
unlisted securities, and (ii) comply with various notice and other statutory conditions to exercise appraisal
rights. In a two-step transaction, shareholders who do not tender their shares in the tender offer can
exercise their appraisal rights in connection with the subsequent back-end merger. Fair value in appraisal
actions is determined by the applicable state court and may be more than, equal to, or less than the merger consideration. Shareholders exercising appraisal rights only retain the right to payment, in cash, of the fair value of their shares.

In 2016, the Delaware legislature adopted amendments to the state’s appraisal statute intended to limit the use of the statute for appraisal arbitrage cases in which plaintiffs’ firms pursue appraisal claims as an independent investment opportunity, including amendments that (i) impose minimum ownership thresholds on shareholders seeking to pursue appraisal claims (1% of the total shares or US$1 million in value), and (ii) allow companies to make a payment to claimants early in the litigation of all or a portion of the value of the transaction consideration in order to terminate the accrual of statutory interest on that amount. The courts also issued a series of decisions that helped curb the trend of appraisal arbitrage, including key holdings emphasizing the significant deference that should be given to the deal price absent material conflicts or other process flaws.

While recent decisions and statutes have changed the landscape of shareholder litigation in public company acquisitions, it remains a feature of most take-private transactions, with plaintiffs continually exploring ways to challenge transactions. In that regard, plaintiffs have particularly focused on disclosure challenges in Delaware as a means to overcome the “full disclosure” requirement of *Corwin* (discussed above), including by using various discovery mechanisms, such as Section 220 books and records demands, to seek information to support allegations of inadequate disclosures.

**Regulatory Approvals and Other Considerations**

Several other important legal considerations arise in public company transactions, including the specific filing and disclosure requirements of the federal securities laws as discussed above; limitations on trading in the target’s (and in some cases the acquirer’s) securities while in the possession of MNPI; rules regarding the disgorgement of short-swing trading profits; and, in leveraged transactions, federal banking regulations regarding margin stock.

In addition, an acquisition of any company — whether public or privately held — may require regulatory review and approval under various statutes and regulations, including clearance under the HSR Act and, if the acquirer is a non-US person, review under the Exon-Florio Amendment to the Defense Production Act of 1950 (a so-called CFIUS review). Other approvals may be required depending on the size of the target, and the target’s and the acquirer’s industries. Moreover, with respect to a US target with assets, operations and/or revenue outside the US, clearances under global merger notification regimes, foreign direct investment filings, and other US and non-US regulatory and other clearances potentially can apply. Certain of these are described briefly below.

**HSR Act.** Under the HSR Act, an acquisition that results in the acquirer owning more than a certain dollar value of the target’s assets or voting securities (in 2021, the amount is US$92 million; this amount is indexed annually for inflation) generally cannot be completed until a statutory waiting period has expired. Absent early termination, the requisite waiting period under the HSR Act is 30 calendar days for all transactions other than tender offers, and 15 calendar days for tender offers.

**CFIUS.** When a non-US investor seeks to acquire a US target that operates in certain sensitive sectors or presents other national security risks, the parties may be required (or may determine) to file a notification of the transaction under CFIUS. When the parties to a transaction make a CFIUS filing, they generally do so jointly, and the submission includes information about all parties and the transaction itself. The CFIUS review process can take anywhere from 30 calendar days (under the recent short-form “declaration” process) to four months or longer, largely depending on the extent of the national security risks associated with the transaction.
Other Regulatory Regimes. A number of other US federal regulatory regimes and agencies may be implicated by the acquisition of a US company. These include:

- The Foreign Corrupt Practices Act (FCPA) and Office of Foreign Assets Control (OFAC), particularly for companies with overseas operations
- The Federal Energy Regulatory Commission (FERC) for target companies operating in the energy or power space
- The Federal Communications Commission (FCC) for target companies operating in the communications space

In addition to these and other US federal regulatory regimes, the acquisition of a public company may implicate state regulatory requirements in the US, as well as foreign regulatory requirements around the globe. These may include requirements under any number of non-US regulatory regimes that could apply to a target with operations outside the US. Moreover, the industry of the target and/or the acquirer may implicate additional industry-specific regulatory requirements that must be considered when effecting a transaction.

Conclusion

The acquisition of a publicly traded US company is a significant transaction for both the acquirer and the target. Given the import and potential complexity of such a transaction, parties should begin to evaluate the numerous strategic, legal, and practical issues early in the process, and be mindful of the implications thereof as the transaction progresses.
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**CFIUS & US National Security**
Endnotes

1 Delaware Secretary of State.
2 This time period is dictated by Regulation 14E under the Exchange Act.
3 Deal Point Data.
4 818 A.2d 914 (Del. 2003)
5 506 A.2d 173 (Del. 1986).
6 125 A.3d 304 (Del. 2015).
7 In re Volcano Corp. S’holder Litig., 143 A.3d 727 (Del. Ch. 2016), aff’d, 145 A.3d 697 (Del. 2017).
8 In re MFW S’holders Litig., 67 A.3d 496, (Del. Ch. 2013).
9 88 A.3d 635 (Del. 2014).
10 A person is deemed to have “beneficial ownership” of shares if if has the power, directly or indirectly, to vote or dispose of the shares.
11 Certain investors, including institutional investors, that have a passive investment intent and hold less than certain specified thresholds of the class of shares in question may be able to file a Schedule 13G rather than a Schedule 13D. Schedule 13G requires the disclosure of less information than Schedule 13D and, in some cases, can be filed 45 days after the end of the calendar year in which the shares were acquired. However, a party that intends to pursue an acquisition of the issuer of the shares will typically be required to file a Schedule 13D.
12 One common exception to appraisal rights in many states, including Delaware, provides that shareholders of a publicly traded target corporation with stock held of record by more than 2,000 shareholders will not be entitled to appraisal rights in transactions in which the consideration to be received by those target shareholders consists solely of the securities of the acquirer. This exception generally applies only when the acquirer is also a publicly traded corporation with stock held of record by more than 2,000 shareholders.