

What is a Going Private Transaction? February 25, 2010

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What is a Going Private Transaction?

- ▶ Rule 13e-3 three-pronged test:
 - Transaction is a merger, tender offer, purchase of stock, sale of all or substantially all assets, reverse stock split, etc.;
 - Issuer or an "affiliate" of the issuer is "engaged in" the transaction; and
 - There a reasonable likelihood or a purpose of causing:
 - any registered class of equity securities to be eligible for termination of registration;
 - any registered class of equity securities to be eligible for termination or suspension of reporting obligations; or
 - any listed class of equity securities to cease to be listed

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What is a Going Private Transaction? *(cont.)*

- ▶ If series of transactions will have specified effects, compliance with Rule 13e-3 required before first step in the series
 - Must take into account past, current and planned transactions
 - May result in “accidental” going private transaction
- ▶ Exceptions in Section 13e-3(g), for example:
 - Certain second step clean-up transactions
 - Substantially equivalent securities
 - Cross-border exemption
 - Redemptions, calls or similar purchases pursuant to instrument
 - Chapter 11 solicitations

What is an Affiliate of the Issuer?

- ▶ Person “that controls, is controlled by or is under common control with” the issuer (directly or indirectly)
- ▶ No bright line test establishing ownership percentage that triggers affiliations
- ▶ Fact-specific inquiry as to whether acquiror is in a “control” relationship with the target company
 - Equity ownership
 - Common board members, officers or directors
 - Contractual relationships
 - Other factors
- ▶ Ability to exercise control, not necessarily the actual exercise

Does any Management Involvement Trigger a 13e-3 Transaction?

- ▶ Members of senior management and directors are considered affiliates, so it will depend on whether management is “engaged” in the transaction:
 - Will members of senior management or directors receive benefits not received by other stockholders (e.g., favorable changes in employment, equity participation)?
 - Will they hold a material amount of the post-closing equity or occupy seats on the board?
 - 2009 SEC C&DI: no formal arrangement between acquiror and management is required; a “general understanding” suffices to find engagement
- ▶ Unless the acquiror insists on management involvement (e.g., wants a minimum rollover of equity or a guarantee that management continue in their roles post-closing), to avoid triggering a 13e-3 transaction a target board should instruct the buyer not to contact management or engage in discussions with management regarding post-closing arrangements (unless a board member or counsel is also present)

Going Private Transactions and Schedule 13D

- ▶ Acquirors need to be mindful of requirement to “promptly” amend any Schedule 13D on file with the SEC and obligation to file a Schedule 13D 10 days after acquisition of >5% “beneficial ownership”
- ▶ Consider also whether a “group” has been formed
- ▶ Item 4 requires disclosure of “plans or proposals” relating to acquisitions or dispositions of securities of the issuer
 - *Tracinda* cease-and-desist proceedings and recent DE Chancery Court decision in *NAACO Industries* have made clear the importance of timeliness and accuracy in disclosure of “plans or proposals”
 - *NAACO Industries* court held that misleading Schedule 13D disclosure may support common law fraud claims
 - Recent SEC C&DI: “A plan or proposal . . . is not deemed to exist only upon execution of a formal agreement or commencement of a tender offer, solicitation or similar transaction. Generic disclosure reserving the right to engage in any of the kinds of transactions enumerated in Item 4(a) – (j) must be amended when the security holder has formulated a specific intention with respect to a disclosable matter” (citing *Tracinda*)

What Incremental Information Must be Disclosed?

- ▶ Rule 13e-3 is a disclosure regulation – it requires the target company and each affiliate engaged in the transaction (which may include the buyer) to file a Schedule 13E-3, which may be done jointly
- ▶ Key incremental information includes:
 - Disclosure whether each filing person reasonably believes that the transaction is fair to unaffiliated stockholders
 - All “reports, opinions and appraisals” that the target company or affiliate (which may include the buyer) received from any outside party that are “materially related” to the transaction
 - 2009 SEC C&DI: disclosure of all “reports, opinions, appraisals and negotiations” provided by a financial advisor that are “materially related” to the transaction, whether written or oral and whether or not addressing the fairness of the consideration, must be disclosed (or summarized in the case of oral matters)
 - More extensive discussion of factors addressing fairness (substantive and procedural) of the proposed transaction

Special Rules for Foreign Private Issuers

- ▶ Special rules apply to determine whether the third prong of test for going private transactions (reasonable likelihood eligible to terminate registration, etc.) is triggered for a foreign private issuer:
 - Average daily trading volume of the class of equity securities in the U.S. for a recent 12-month period has been no greater than 5% of the ADTV of that class on a worldwide basis for the same 12 months, or
 - Within 120 days before Form 15F filing date, the class of equity securities will be held of record by < 300 persons worldwide OR < 300 persons resident in U.S.
- ▶ The Rule 13e-3(g)(6) exception for foreign private issuers now includes all types of business combinations that meet the conditions for the cross-border exemptions (tender offers and Rule 802 exempt securities offerings as well as cash mergers, compulsory acquisitions for cash and schemes of arrangement)
- ▶ Application of Rule 13e-3(g)(2) exception when security holders receive “substantially equivalent equity securities” can sometimes be challenging for foreign private issuers

Impact of State Law

- ▶ Governs substantive and procedural fairness
- ▶ Different standards of review for going private transactions by means of a cash-out merger ("entire fairness") vs. going private transactions using a cash tender offer followed by a short-form merger
- ▶ *Hammons* and the importance of procedural safeguards (even in the case of a third-party offer)
 - Recommendation by disinterested and independent special committee
 - Approval by majority of the minority (non-waivable)
- ▶ State disclosure obligations
 - Judicial review – litigation may result in delay/injunction
 - Statutory in some states