Weil

A Look at 2022

U.S. Sponsor-Backed

Going Private

Transactions

January 2023

Weil

2023

Private Equity

SURVEYS

INTRODUCTION

Welcome to the 16th survey of U.S. sponsor-backed going private transactions prepared by Weil, Gotshal & Manges LLP. We first published this survey back in 2007 and suffice to say the landscape has changed dramatically since then. This survey analyzes certain key transaction terms and trends (or expected future trends) of going private transactions signed in 2022 that we think are most relevant for U.S. sponsors. We are happy to discuss the detailed findings and analyses underlying this survey.

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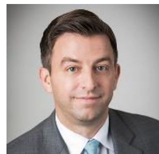

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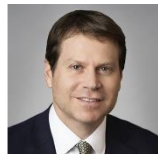

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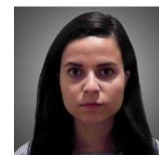

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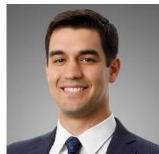

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RESEARCH METHODOLOGY

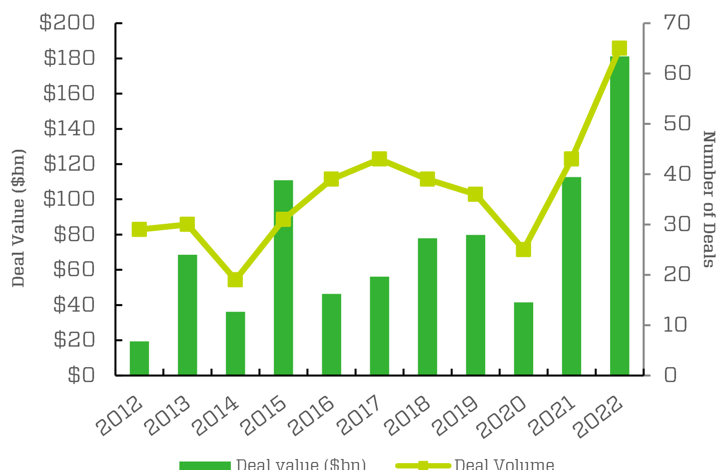
We surveyed 42 U.S. sponsor-backed going private transactions signed between January 1, 2022 and December 31, 2022 with a transaction value (equity value) of at least $100 million. The 42 surveyed transactions, many of which Weil advised on, were transactions involving the following target companies:

All dollar amounts and percentages referenced in this survey are approximate amounts and percentages. Unless otherwise noted, such amounts and percentages are based on the 42 surveyed transactions listed above.

HIGHLIGHTS OF 2022

GENERAL MARKET OBSERVATIONS

<u>Going Private Activity</u>. Despite the challenging global macro-economic landscape of 2022 (particularly as the year went on), sponsor-backed going private transactions reached a new high, both in terms of deal volume and deal value. As highlighted by the chart to the right, the number of U.S. sponsor backed going private transactions was up by 51% from the previous year, its highest over the past decade. In addition, the aggregate equity value of these transactions increased by 61% from the previous year, also its highest over the past decade.

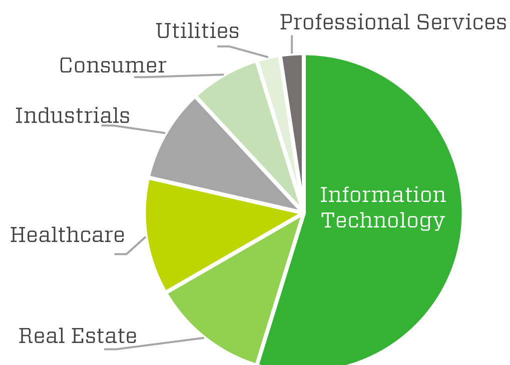


Source: Deal Point Data
Note: Deal value based on target equity value

Yet, as shown in the chart below, going private activity significantly slowed in the second half of the year. This is not surprising, as the momentum of the 2021 going private landscape bled into the first half of 2022 during which sponsors were able to continue to take advantage of the availability of cheap debt and the continued reopening of the global economy after the onset of the COVID-19 pandemic in 2020. However, deal volume dropped materially over the course of the year as sponsors were faced with heightened inflation, geopolitical uncertainty, the rising cost of debt and volatile post-COVID financial results and ensuing compressed EBITDA multiples.

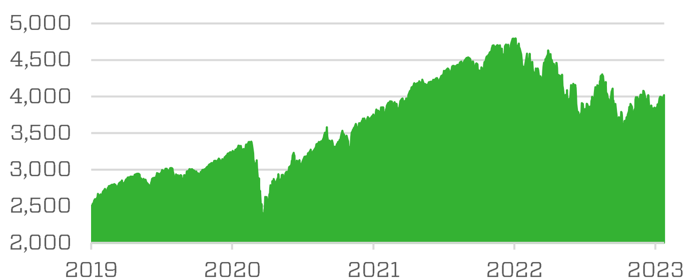
Source: Deal Point Data
Note: Deal value based on target equity value

But while going private activity did slow in the latter half of the year, sponsors continued to remain opportunistic, searching vigilantly for ways to deploy capital and deliver returns to their investors. This was most evident in the uptick in 2022 going private transactions within the technology / software industry, which continued even in the second half of 2022. In fact, and as shown in the chart to the right, over half of the target companies in the surveyed transactions were tech companies.



So why did sponsors focus on public company targets in 2022 (and deploy more capital than ever in doing so), even though the overall M&A deal market was in a sharp, and potentially prolonged, slump?

- Financial and geopolitical turmoil and the subsequent public market sell-off have placed acute pressure on public company valuations / stock prices, particularly technology companies, making them attractive potential targets for sponsors who believe in the fundamentals of these businesses and have a longer-term horizon necessary to allow the business to grow (and in certain cases, recover from the turmoil and challenges of recent years). The S&P Technology Index fell 25% in 2022 (vs. 19% for the S&P).
- On the heels of the spate of de-SPAC transactions and founders (and their backers) taking advantage of red-hot public markets leading up to 2022, many public companies have come to realize that being a public company, with the requisite disclosure obligations, quarterly reporting and the scrutiny that goes along with them, is not the right "fit" for all businesses. Private equity investors know that, and sponsors were there to provide a solution for businesses struggling with the weight and obligations that come with being public.
- Public company boards are reevaluating the long-term valuations of their companies. As the markets began to tumble in early 2022, boards were loathe to sell companies at prices below record highs. Boards were focused on these highs and held out hope that share prices would recover. However, as the market slump stretched on, boards began to realize that share prices may have been artificially inflated in 2020 and 2021, in part due to historic fiscal and monetary stimulus, and that those levels may not be achievable in the short or even medium terms. Public company boards have been more receptive to an acquisition offer from a sponsor at a premium to its *current* price (rather than its *record* price), and may have realized that such offers may in fact be the best opportunity to maximize stockholder value. Notably, the prices in several going privates have represented a discount to their 52-week high (while at the same time representing a premium to the high of a more recent time period).[1]

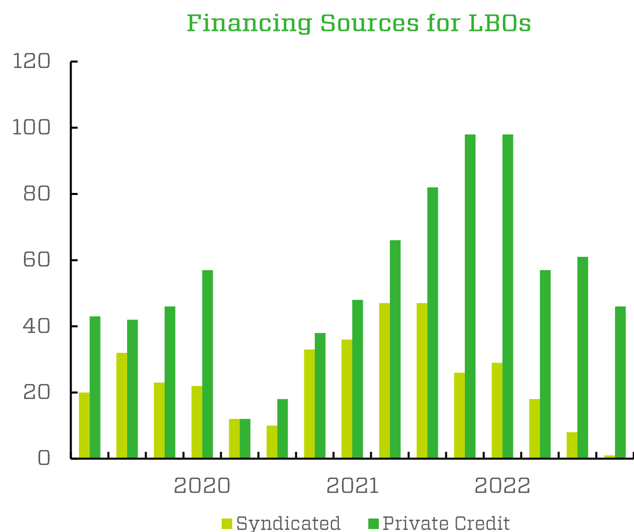


Source: Yahoo Finance

[1] Investors led by Elliot Management Corporation and Vista Equity Partners acquired Citrix Systems at a 28% discount; Vista Equity Partners acquired Avalara at a 51% discount; Thoma Bravo signed an agreement to acquire Coupa Software at a 50% discount (and a 79% discount if measured against its 24-month high).

Debt Financing Markets. Notwithstanding the resilience of going private transactions as noted above, the state of the debt financing markets made the execution of going private transactions more difficult as 2022 wore on. Momentum in the leverage financing market from a vibrant 2021 continued in the early months of the year, with the announcement of several large public-to-private transactions, including Elliott Management's acquisition of Citrix and Apollo's acquisition of Tenneco. But Russia's invasion of Ukraine in February, coupled with inflationary pressures, supply chain disruptions and rising interest rates, chilled demand for distributed loans and bonds, giving rise to a backlog of hung deals (including Citrix and Tenneco) that the underwriting banks struggled to offload over the course of the year. And with bulge bracket banks pre-occupied by the need to offload existing exposure[2], broadly-placed loans and bonds became scarcely available late in 2022 as a debt financing source for new deals.

Direct lenders stepped into the void by funding sizeable transactions that, a few years prior, would have only been financeable with syndicated loans or bonds. Once known as alternative lenders to smaller closely-held companies, private credit providers have become a reliable, primary funding source for sponsors in larger going private deals. Indeed, in 2022, Thoma Bravo's acquisition of Anaplan and its pending acquisition of Coupa, Vista's acquisition of Avalara and the acquisition by Hellman & Friedman and Permira of ZenDesk, among others, were all funded, in part, with proceeds of unitranche term loans having individual quanta of $2 billion or more.



Note: Fourth quarter through December 8, 2022
Source: PitchBook LCD (via The Wall Street Journal)

But private credit was not immune to the impact of the market dislocation. In spite of rising yields, direct lenders have had less capital available to finance new transactions. While lenders can generally rely on the fact that borrowers will refinance a portion of their portfolio every year to replenish their capital pools, the rate environment effectively froze opportunistic refinancing activity, diminishing the supply of recyclable funds in the market. Moreover, recessionary fears and concerns over interest coverage capabilities gave rise to more stringent underwriting standards, which limited both the number of financing sources willing to participate in a given transaction and the size of the commitment that a lender was willing to provide.

And so as 2022 progressed, it became more challenging to find debt financing for potential going private transactions. Where financing was available, we found the market dynamic generally yielded less favorable terms. Sponsors seeking debt commitments were forced to cast a wider net as individual lenders were generally unwilling to underwrite all or, in many cases, a large portion of a particular transaction. As a result, many financings required participation from a number of institutions, and some deal points were driven to the "lowest common denominator" in favor of lenders.

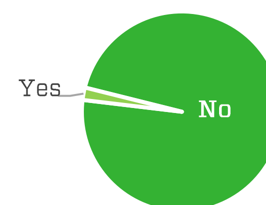
In summary, while declining public company valuations created a number of attractive going private targets over the course of 2022, dislocation in the broadly syndicated loan market and structural constraints in private credit made it more difficult for sponsors to finance those opportunities.

[2] The tally of backlogged financings was estimated to be as high as $43 billion by some sources.

REPRICED TRANSACTIONS

In light of the impact of the COVID-19 pandemic on the operations of businesses across the world in 2020 and 2021, parties to M&A transactions generally became more focused on interim operating covenants – and in particular, the consequences of breaches (or alleged breaches) of interim operating covenants. Such consequences have included renegotiation of purchase price (a "repriced" deal) or termination (or threatened termination) of the purchase agreement. For example, in 2020, Sycamore Partners relied on alleged breaches of the interim operating covenants by Bath & Body Works, Inc. (formerly known as L-Brands, Inc.) to terminate its purchase agreement to acquire approximately 55% of Victoria's Secret, a subsidiary of L-Brands, Inc. at the time of the proposed transaction, by arguing that the company failed to maintain normal business operations amid the COVID-19 pandemic. That allowed them to terminate the purchase agreement without paying a reverse termination fee.

Change in purchase price after signing of merger agreement

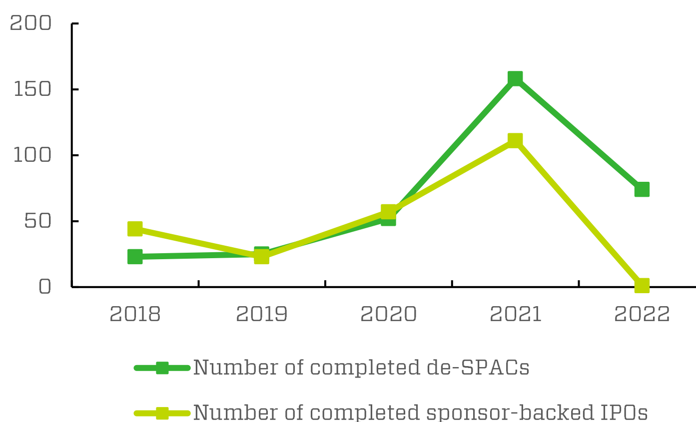


This heightened focus continued into 2022. As such, many practitioners expected to see more terminated or repriced deals where such covenants were breached (or alleged to have been breached). Yet only one of the surveyed transactions featured a change in the consideration payable to the target's stockholders after the signing of the merger agreement.

This was the Thoma Bravo-Anaplan transaction, where, pursuant to an amendment to the merger agreement, the parties agreed to an approximately 3.4% reduction in the cash consideration payable to Anaplan's stockholders from $66 per share to $63.75 per share. The reduction in purchase price stemmed from an alleged breach by Anaplan of the interim operating covenants related to the issuance of equity securities (which issuance resulted in an increased purchase price payable by Thoma Bravo). In this transaction, Anaplan concluded (according to public statements) that the threat of a long and drawn out litigation process resulting in a delayed closing would be harmful to its stockholders, which when coupled with a deterioration in the broader financial markets, made it unlikely that Anaplan would receive a price from an alternative bidder comparable to $66 per share. These factors motivated Anaplan to agree to a reduction in purchase price. In consideration for agreeing to a reduction in the purchase price, Anaplan negotiated for revised terms to the agreement that increased certainty that a closing would occur. These terms included, among other things, (a) a waiver by Thoma Bravo of any alleged violation of the agreement prior to the date of the agreement amendment, whether known or unknown, (b) an approximately 70% increase in the termination fee payable by Thoma Bravo if it failed to timely close the transaction following approval by Anaplan's stockholders (from $586,245,000 to $1,000,000,000), (c) a limitation of the closing condition related to Anaplan's compliance with its covenants to apply only to Anaplan's willful breach of its covenants occurring after the date of the agreement amendment and which were material to the transaction, taken as a whole, (d) a limitation of the closing condition regarding the absence of a material adverse effect on Anaplan so that such condition only applied to events occurring following the date of the agreement amendment and (e) a waiver of the closing condition relating to the bring down of Anaplan's representations and warranties.

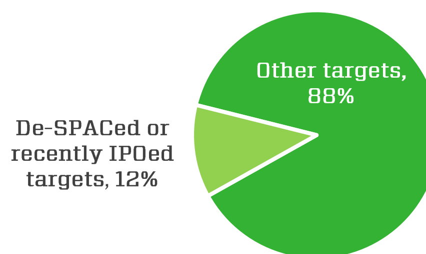
So far, the fallout from Anaplan has been muted. While we have seen first drafts of purchase agreements that include a tighter bring down of covenants, we saw an alternative formulation akin to the Anaplan amended language make it into the final agreement in only one other deal.

DE-SPAC TRANSACTIONS AND IPOS



It has been an incredibly volatile few years for de-SPAC transactions and IPOs. Although there was a decline of de-SPAC transactions in 2022, there was an avalanche of de-SPAC transactions in 2020 and 2021 (as the chart to the right reflects). In addition, there were a number of sponsor-backed IPOs during that period (as also shown in the chart to the right).

Given the challenging economic climate, many of these newly public companies saw their stock prices take a significant hit over the course of 2022. At the same time, these newly public companies found themselves navigating nuanced public company disclosure obligations, quarterly reporting and the scrutiny that goes along with them. And so a trend emerging in 2022 that we expect to continue in 2023 is that many of these companies have reversed course and agreed to be taken private (again).



In fact, 12% (5 of 42) of the surveyed transactions involved either a de-SPAC target or a target that went public within the past two years.[3]

Going privates involving public companies that fall in these categories – recently IPOed or recently de-SPACed – raise some interesting questions, primarily stemming from the concentrated stockholder base that they ordinarily retain from their days as a private company, particularly where they were sponsor-backed.

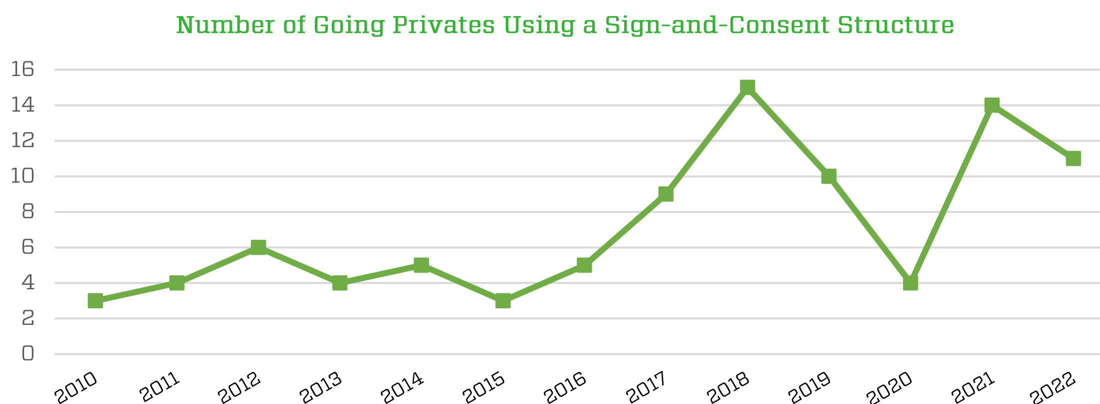
One is an issue that is specific to recent de-SPACs. Given that the stockholders in a public company resulting from a de-SPAC typically (though not always) hold warrants issued at the SPAC IPO, sponsors (and targets) need to consider how any such outstanding warrants will be treated in a going private transaction. In each of the two transactions involving a de-SPACed target where target stockholders held outstanding warrants (GI Partner's acquisition of GTY Technology and Patient Square Capital's acquisition of SOC Telemed), the outstanding warrants became exercisable for merger consideration. This is probably the right result, but we could in the future see sponsors take a harder look at how these warrants – in particular those held by the SPAC sponsor – are treated given the nuances related to their vesting (and the circumstances in which they were granted).

[3] Those transactions include: (i) EQT's acquisition of Billtrust; (ii) GI Partner's acquisition of GTY Technology; (iii) Patient Square Capital's acquisition of SOC Telemed; (iv) Altaris Capital Partner's pending acquisition of Trean Insurance; and (v) BDT Capital's pending acquisition of Weber.

DE-SPAC TRANSACTIONS AND IPOS (CONTINUED)

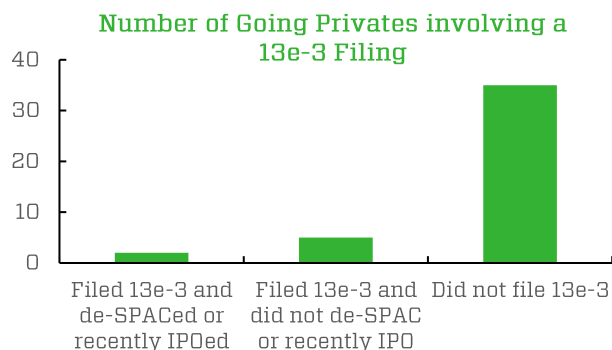
Another issue that may come up in these deals is consequent to recently IPOed or de-SPACed companies having a more concentrated stockholder base. This concentration may allow a sponsor on the buy-side to increase deal certainty by using a sign-and-consent structure for obtaining stockholder approval. While there are some interesting nuances from a Delaware law perspective, the sign-and-consent structure generally allows a target to obtain stockholder approval through a written consent that is effective immediately following signing. This has the effect of locking up the deal.

As the chart below demonstrates, the use of sign-and-consent structures (in all going privates, not just sponsor-backed) has fluctuated over time, though has generally been more commonly used in the past five years (with the exception of 2020).



Source: Deal Point Data

A final issue that we note which one is more likely to see in going privates involving recently IPOed and de-SPACed targets is the potential for a 13e-3 filing (which also stems from having a more concentrated stockholder base). Along those lines, 13e-3 filings were made (or required to be made per the terms of the merger agreement) in 40% (2 of 5) of the surveyed transactions involving either a de-SPACed target or recently IPOed target. Each of those transactions (BDT Capital's pending acquisition of Weber and Altaris Capital Partner's pending acquisition of Trean Insurance) involved a recently IPOed target (August 2021 and July 2020, respectively) and an acquirer who owned a significant stake of the target at the time of entry into the going private transaction (48% and 47%, respectively).

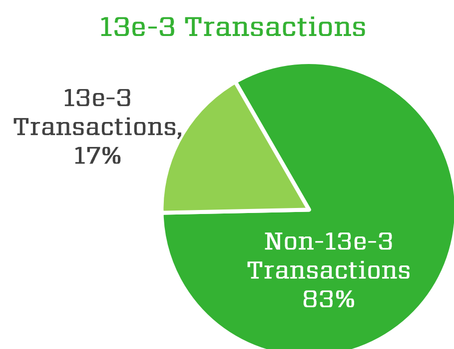


RULE 13E-3 TRANSACTIONS

Taking a step back, acquisitions of public companies involving "affiliates" of the target can trigger enhanced disclosure requirements under SEC Rule 13e-3. Rule 13e-3, and the resulting disclosure requirements, are triggered when an acquisition of a publicly-traded company involves the purchase of equity securities by the target's "affiliates" and the acquisition has a reasonable likelihood of causing any of the target's equity securities to become eligible for termination of registration or be delisted.

Additionally, transactions that do not involve a buyer who is an affiliate may still be subject to Rule 13e-3 if the issuer's management is determined to be engaged in the transaction (and thus essentially be "on both sides" of the transaction), whether pursuant to a significant rollover, significant new compensation or incentive equity grants or other significant benefits.

Application of Rule 13e-3 to a going private transaction entails a need for the parties to file a Schedule 13E-3 and comply with certain additional disclosure requirements. These requirements address such items as pricing history, past transactions involving the buyer and the issuer, recent history of any acquisition negotiations with unaffiliated third parties, the buyer making an affirmative statement regarding the fairness of the transaction as well as a disclosure of any third-party appraisals, reports and opinions materially related to the transaction.



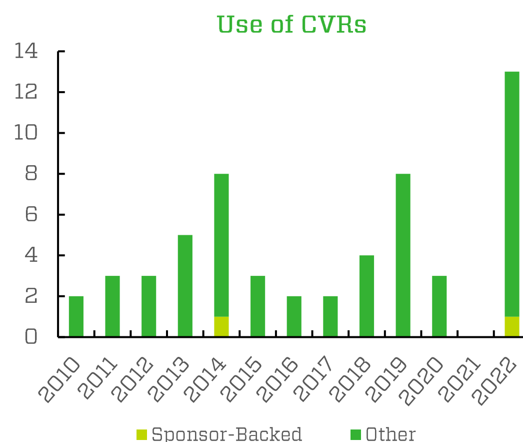
As shown in the chart to the left, 17% (7 of 42) of the surveyed transactions were Rule 13e-3 transactions, all of which involved affiliated, existing stockholders of the target as the acquirer and which held a significant stake prior to acquiring the target.[4] It will be interesting to see if an uptick in transactions involving recently IPOed or de-SPACed targets leads to an increase in 13e-3 transactions in 2023.

[4] These transactions were: TPG's acquisition of Convey Health Solutions; Clayton, Dubilier & Rice's acquisition of Cornerstone Building Brands; Clayton, Dubilier & Rice's acquisition of Covetrus; Searchlight's acquisition of Hemisphere Media Group; Vista Equity Partner's acquisition of KnowBe4; Ataris Capital Partner's pending acquisition of Trean Insurance; and BDT Capital Partner's pending acquisition of Weber.

CONSIDERATION TYPE; CVRs

As noted throughout this survey, 2022 was dominated by financing market dislocation and significant valuation gaps resulting from compressed EBITDA multiples and unpredictable post-pandemic financial results, which resulted in the private market in an uptick in earn-outs. While there is no perfect analog to earn-outs in public company M&A transactions, contingent value rights ("CVRs") have a lot of the features of an earn-out and allow buyers and sellers (in this case public company stockholders) to bridge valuation gaps. As the name implies, CVRs are a form of contingent consideration, similar to an earn-out, payable by an acquirer following the closing of a transaction upon the satisfaction of certain conditions or the happening of certain events. CVRs are typically used to address value uncertainty and resulting valuation gaps between the acquirer and the target company.

CVRs have sometimes been employed in strategic public company health care deals, but have not figured prominently in going privates. While the use of CVRs in public company deals (not limited to going privates) has fluctuated over the past decade or so, 2022 was a high watermark in the use of CVRs. As the chart to the right shows, there were 13 public company deals in 2022 that involved CVRs (though only one of those transactions involved a sponsor-backed going private), which followed a year in which there were none.

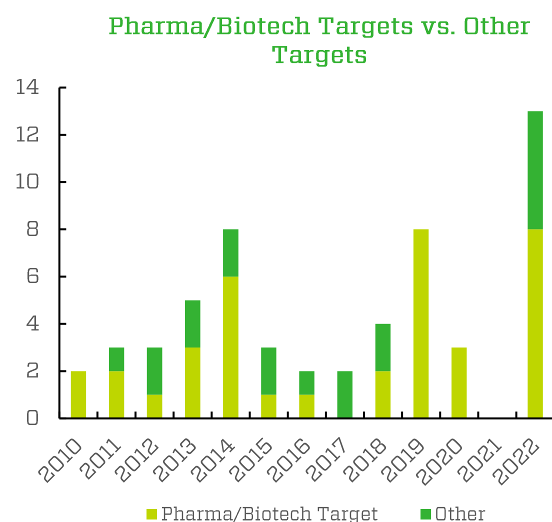


Source: Deal Point Data

The dearth of CVRs in sponsor-backed going privates generally reflects the types of companies that private equity firms are interested in, which rarely involve pharmaceutical or biotechnology assets where developmental drugs are key to the value proposition (which drives the use of CVRs in many cases). However, there was one sponsor-backed going private in 2022 that did employ CVRs – Patient Square Capital's and Gurnet Point Capital's acquisition of Radius Health, a biopharma company.

In Radius Health, in addition to the cash consideration payable by the acquirer at closing, each CVR holder will be entitled to receive the applicable payment amount ($1.00 per CVR) upon the achievement of the requisite milestone (based on net sales of a developmental drug reaching a specified amount within a specified period of time).

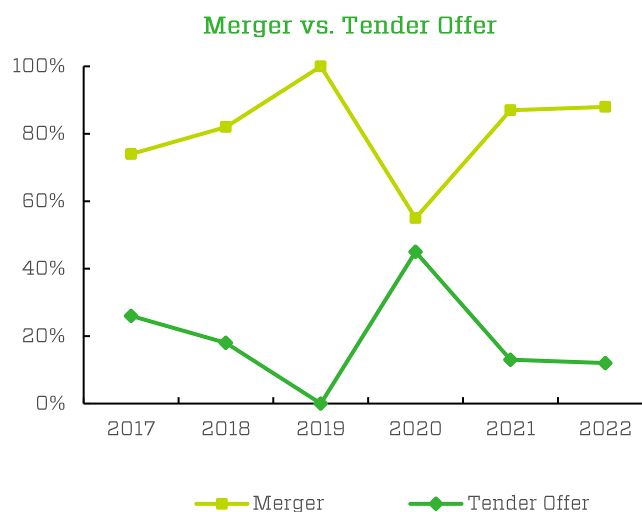
While the use of CVRs in the Radius Health transaction was driven by the nature of the target company's business and revenue streams, we have spoken to private equity clients who have thought through their use more broadly in other public company situations and would not be surprised to see an uptick in the use of CVRs by sponsors in the coming years.



Source: Deal Point Data

TRANSACTION STRUCTURE

Acquisitions of public companies – including those by sponsors – are generally structured as either a one-step (i.e. a pure merger) or a two-step transaction (i.e. a tender offer for at least a majority of the outstanding shares followed by a squeeze-out merger). Each structure presents sponsors and targets with distinctive advantages and challenges.



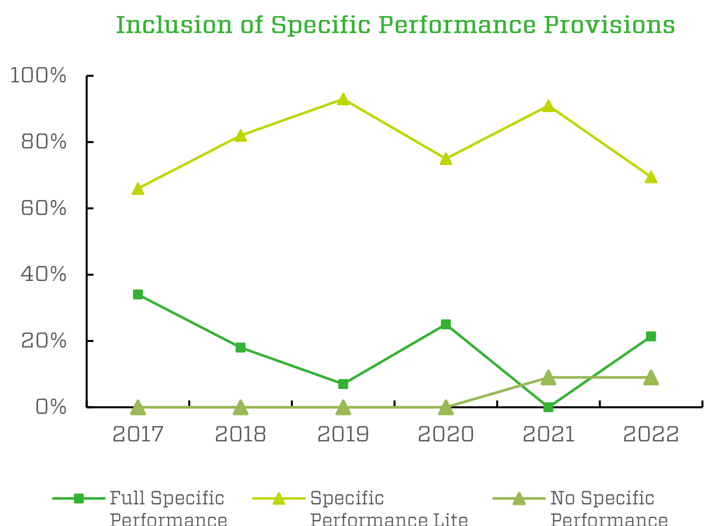
Acquisitions structured as a two-step transaction may generally be completed on a faster timeline, as the first-step tender offer can be launched promptly following signing and must remain outstanding only for a minimum of 20 business days. Furthermore, tender offers can be launched and materials distributed to stockholders prior to SEC review, as any SEC review is typically completed during the pendency of the initial 20 business day offer period. In all cash transactions with relatively little regulatory risk, two-step structures may be preferred. However, given the need (or desire) to use debt financing in most public company acquisitions by sponsors, two-step structures present challenges due to, among other things, the need to purchase the shares tendered in the tender offer prior to, in many cases, obtaining 100% ownership of the target (and the impact of doing so on the ability to obtain debt financing). While it is certainly possible to structure a take private as a tender offer where debt financing is involved, depending upon the jurisdiction these mechanics can create sufficient headaches such that the benefits of the tender offer will be outweighed by the costs. Accordingly, a one-step structure is typically better suited to accommodate a sponsor-backed acquisition, and as set out below is by far the more popular method of effecting transactions.

The use of two-step tender offers in 2022 in sponsor-backed going privates decreased slightly as compared to 2021, and, with the exception of 2020, remains closer to the use of two-step tender offers in other recent years. Sponsors utilized the two-step tender offer / back-end merger structure in only 12% (5 of 42) of the surveyed transactions in 2022, some of which contemplated the funding of the entire purchase price with equity financing of the sponsor. This is not surprising due to the challenging debt financing markets (as discussed above). If the financing markets continue to be challenged, we could see an increase in two-step tender offer structures – particularly in lower valuation acquisitions – as sponsors may seek to obtain the benefit of the promptness in completing the transaction by using all equity financing, and then financing the transaction post-closing with debt once financing markets open up.

SPECIFIC PERFORMANCE

A target company's ability to force a closing (i.e., a target's right to specific performance) is not unique to going private transactions, but is a key deal term of going private transactions that we have historically tracked in this survey. And it has been a particularly hot topic given the dramatic resolution of the Twitter take private.

Despite a significant retreat from the peaks of 2019 and 2021, the "specific performance lite" construct (sometimes referred to as conditional specific performance) continues to be the predominant market remedy with respect to addressing an acquirer's financing failure and target's closing risk in sponsor-backed going private transactions.



While still present in a vast majority of the surveyed transactions, the use of "specific performance lite" (whereby the target has the limited right to force the closing if all of the acquirer's conditions to closing are satisfied (or waived) and acquirer's debt financing is available and ready to be funded) decreased as compared to recent prior years (70% of the surveyed transactions in 2022, as compared to the 91% of the surveyed transactions in 2021, 75% of the surveyed transactions in 2020 and 93% of the surveyed transactions in 2019). This is not surprising, given the challenging debt financing market of 2022, which led to more fully equity-backstopped transactions (and the dip in 2020 was no doubt attributable to the challenging financing markets at the outset of the pandemic).

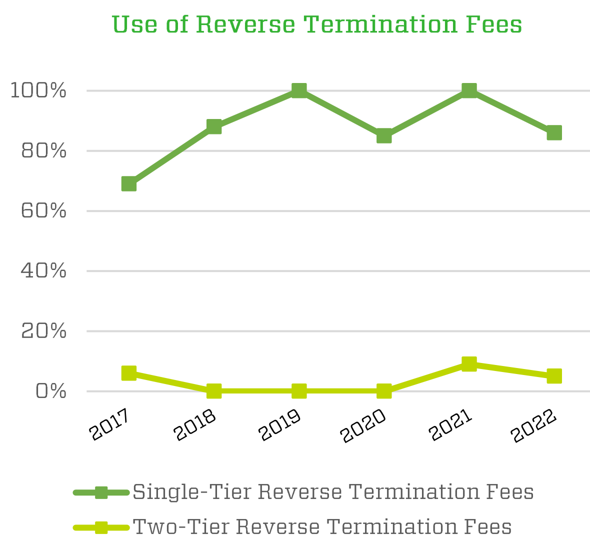
Relatedly, the full specific performance construct (whereby the target can force the closing upon satisfaction or waiver of the applicable closing conditions, regardless of whether an acquirer's debt financing is available) made a return in 2022, rising to 21% (9 of 42) of the surveyed transactions (as compared to the 0% of surveyed transactions in 2021, and 25% of the surveyed transactions in 2020). All except two of these transactions were fully equity financed (two of the transactions contemplated debt financing).

It is important to keep in mind that while specific performance lite now dominates acquisition agreements for leveraged buyouts, this concept did not even really exist when we did our first survey in 2007 (and, in fact, many deals at that time still had financing outs). Similar to other terms we examine here such as go-shop provisions, this speaks both to the impermanence of the most material legal provisions in acquisition agreements and also how quickly private equity deal professionals can coalesce around new concepts that make sense.

TERMINATION FEES

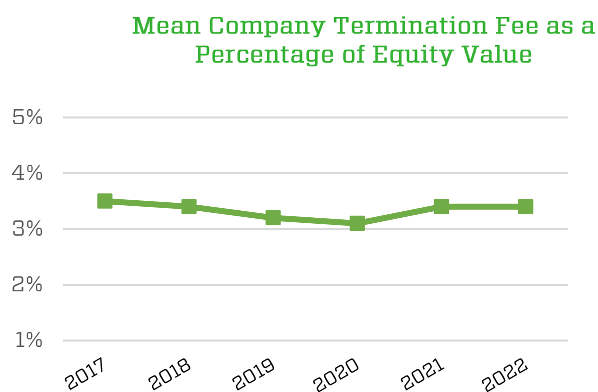
Of all the questions that we get from clients on acquisition agreements, some of the most common relate to termination fees (both reverse termination fees, payable by the sponsor, and regular termination fees, payable by the company). Of note:

- <u>Reverse Termination Fees</u>. The mean fee amount of reverse termination fees as a percentage of equity value slightly increased (in 2022, it was 7.5% of equity value of the target compared to 7.2% in 2021). The mean reverse termination fee in 2022 as a percentage of enterprise value was 5%. We note that 5% is on the lower end of the market in private company deals, which we would attribute to the fact that take privates tend to involve larger target companies. We also note that practitioners look at reverse termination fees based upon both equity and enterprise value, but find that people increasingly refer to enterprise value.



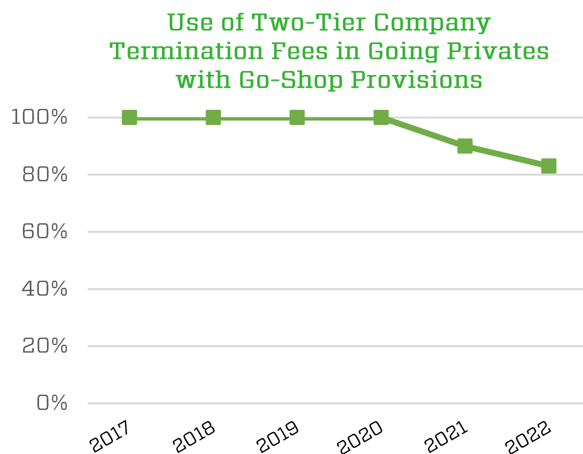
  In a decrease from last year, only 5% of the surveyed transactions included a two-tier reverse termination fee (compared to 9% in 2021). A two-tier reverse termination fee is typically structured so that a lower fee is payable by the sponsor under certain circumstances (usually in the event of a financing failure), and a higher fee is payable by the sponsor in all other situations in which the sponsor fails to close the transaction (i.e. willful breach or refusal to close). Tying this back to the comment on the previous page, it is interesting that two-tier termination fees have stuck around at all: at one time following the financial crisis it seemed like it was a trend that would pick up momentum and become a regular feature of leveraged buyouts, but it never really caught on.

- <u>Company Termination Fees</u>. The mean company termination fee as a percentage of equity value was 3.4% (which is the same as it was in 2021 and is generally consistent with the past five years). The mean fee amount as a percentage of enterprise value accordingly held consistent at 2.4%. This consistency makes sense as the size of the company termination fee is largely informed by Delaware law (too high a fee would be deemed coercive by the courts).



TERMINATION FEES (CONTINUED)

In 7% (3 of 42) of the surveyed transactions, the company termination fee was set at exactly 50% of the reverse termination fee payable by the sponsor (and on average, the company termination fee was set at 49% of the reverse termination fee payable by the sponsor). This is interesting as at one time these fees were generally the same, but that changed following the financial crisis.

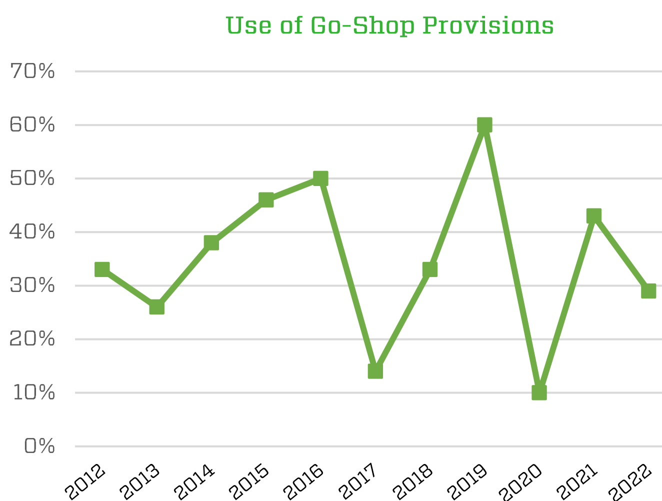


Transactions with go-shop provisions generally have a two-tiered company termination fee. In fact, all except two of the surveyed transactions that contained go-shop provisions (discussed on the next page) included a two-tier company termination fee, which represents a slight deviation from recent prior years (except 2021) where all of the surveyed transactions that contained go-shop provisions included such a termination fee. A two-tier company termination fee is typically structured so that a lower fee is payable by the target in the event the target accepts a superior offer from an interloper during the go-shop period, and a higher fee is payable by the target following the expiration of the go-shop period and in all other situations in which the target fails to close the transaction (i.e. willful breach or refusal to close). The amount of the lower company termination fee in the surveyed transactions ranged from 30% to 75% of the higher company termination fee, with the mean being 45%.

- Target Termination Tail Fee. Company termination fees are always triggered where the company terminates the purchase agreement to accept a superior proposal or where the buyer terminates based upon a board's change of recommendation. In addition, and consistent with recent prior years, 100% of the surveyed transactions included a target termination tail fee of some sort. A target termination tail fee provision typically requires the target to pay the sponsor the target termination fee in the event the agreement is terminated under certain circumstances (e.g., failure to receive stockholder approval or termination due to the outside date being reached), an alternative proposal was made at or prior to such termination and the target subsequently enters into or consummates an alternative acquisition arrangement with a third party within an agreed-on tail period (typically 12 months) after termination of the agreement.

GO-SHOP PROVISIONS

The use of go-shop provisions has, interestingly, fluctuated significantly over time. In keeping with that trend, we saw a sharp decrease in the use of go-shops in 2022 relative to recent prior years (with the exception of 2020 and 2017, where the use of go-shop provisions dipped even more).



As the chart to the right shows, the use of go-shops steadily increased at a moderate pace from 2012 through 2016, after which there is no discernible pattern; between 2017 and 2022, go-shops have fluctuated between 10% of sponsor-backed going private transactions and 60% of sponsor-backed going private transactions, settling at 29% in 2022.

As the name implies, a "go-shop" provision allows a target to solicit superior bids from other potential acquirers for a predetermined window of time (which in the surveyed deals ranged from 1-60 days with the median being 30 days) following entry into a merger agreement with the initial acquirer. If the target and its advisors are successful in sourcing an alternative acquirer willing to pay a higher price than the price contemplated by the merger agreement (i.e., a "superior proposal" comes to fruition) prior to expiration of the go-shop period, the target is entitled to terminate the merger agreement to enter into an alternative merger agreement with the alternate acquirer (the "interloper") and pay a termination fee to the initial acquirer. As noted above, the termination fee payable in a scenario where the go-shop yields an alternate acquirer / merger is typically about 50% of the target's termination fee that would be payable to the initial acquirer under other termination scenarios.

Go-shop provisions provide the target with the opportunity to actively solicit bids, even after the initial merger agreement is signed. With a go-shop provision in the merger agreement, the target has the opportunity to actively shop (or continue to shop, depending on the nature and extent of the pre-signing market check), and in theory, the initial acquirer, knowing that the target will be out actively shopping itself post-signing, may be willing to pay a higher price up-front in order to make that marketing exercise more challenging.

So why hasn't there been more consistent use of go-shops, or at least a discernible pattern or trajectory? We surmise, as many practitioners do, that sponsors and targets question the need for a go-shop because a target will always have a "fiduciary out," permitting the target's board of directors to change its recommendation and terminate the initial merger agreement should a higher price come along prior to the stockholder vote. With the combination of public company reporting obligations (requiring targets to disclose that they're being acquired along with the merger agreement that memorializes the acquisition) and a 24/7/365 financial news cycle, reporting on any and every public company transaction in real time, does a target and its advisors really need the ability to proactively check the market?

GOING PRIVATE LITIGATION LANDSCAPE

Going private transactions, like all public M&A transactions, are highly likely to draw "strike suit" litigation or stockholder demands, whereby stockholders of the target allege that a transaction proxy contains misstatements or omissions in violation of the federal securities laws or state fiduciary law and seek additional disclosures in a transaction proxy before the stockholder vote. These complaints and demands are typically conceived of and funded by plaintiffs' attorneys on a contingency fee basis, and transaction parties often decide to make "mooting" disclosures in response to them to mitigate the risk of the stockholder plaintiff seeking an injunction that will interfere with the timing for a stockholder vote to approve the transaction and, potentially, the transaction closing timeline. Where such disclosures are made, any stockholder plaintiff will typically voluntarily dismiss her complaint as moot, and the stockholders' counsel (whether they filed a complaint or made a demand) will then seek a fee (post-closing) for the claimed benefit to stockholders from receiving the additional information. These fees are often negotiated, but could also be litigated if no agreement is reached.

Going private transactions also draw litigation on the merits by public stockholders of the target, alleging that the transaction is unfair, that the target's board of directors breached its fiduciary duties in agreeing to the going private transaction, and that the acquirer aided and abetted those alleged fiduciary breaches. These challenges, like the "strike suits" discussed above, are often driven by plaintiffs' attorneys.

Developments in Delaware law over the past several years have provided greater clarity for transaction planners seeking to minimize litigation risk and obtain more favorable standards of judicial review in any stockholder litigation arising out of going private transactions, depending upon whether or not the target has a controlling stockholder with unique interests in the transaction. These developments also have led to an increase in books and records inspection demands, under 8 *Del. C.* § 220, by stockholders and plaintiffs' counsel seeking to circumvent the more favorable standards of judicial review.

<u>No Controlling Stockholder</u>. If, prior to the going private transaction, the target did not have a controlling stockholder, and the transaction proxy provided target stockholders with all material information regarding their decision whether to vote in favor of the transaction, stockholder breach of fiduciary duty claims concerning the transaction are often subject to dismissal on a motion to dismiss. Under the "*Corwin*" doctrine, "the long-standing policy of [Delaware] law has been to avoid the uncertainties and costs of judicial second-guessing when the disinterested stockholders have had the free and informed chance to decide on the economic merits of a transaction for themselves."[5] As explained by the Delaware Supreme Court, "[w]hen the real parties in interest—the disinterested equity owners—can easily protect themselves at the ballot box by simply voting no, the utility of a litigation-intrusive standard of review promises more costs to stockholders in the form of litigation rents and inhibitions on risk-taking than it promises in terms of benefits to them."[6] Thus, transaction disclosures are often critical to the success of a pleading stage motion to dismiss, and transaction parties should ensure that the proxy contains robust and complete disclosure.

<u>Controlling Stockholder</u>. If, prior to a going private transaction, the target did have a controlling stockholder, a challenge to the going private transaction often will be subject to entire fairness review, which is the most stringent standard of review under Delaware law and requires the defendants to prove that the transaction was the product of "fair dealing" and resulted in a "fair price"

[5] *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 312-13 (Del. 2015).
[6] *Id.* at 313.

to the minority stockholders. Where entire fairness applies, a complaint is not subject to dismissal at the pleading stage. Transaction planners can potentially shift the standard of review, however, from entire fairness to business judgment—and thereby potentially obtain dismissal on a motion to dismiss—where, from the outset of the transaction negotiations, the transaction is conditioned "upon both the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care; and the uncoerced, informed vote of a majority of the minority stockholders."[7] The *M&F Worldwide* "standard . . . recognize[es] the utility to stockholders of replicating the two key protections that exist in a third-party merger: an independent negotiating agent whose work is subject to stockholder approval."[8] Thus, when considering a potential going private transaction with a target that has a true majority stockholder (greater than 50%) or a significant stockholder (less than 50%) that nevertheless may be characterized as a controlling stockholder, it is important to consider and discuss with counsel whether to implement the *M&F Worldwide* framework *before* there are any substantive price discussions or negotiations with the target.[9]

<u>Books and Records</u>. In an effort to allege that the stockholder vote on a going private transaction was not fully informed (which is relevant to both the *Corwin* and *M&F Worldwide* doctrines) and/or that any special committee was not properly functioning (which is relevant to the *M&F Worldwide* doctrine), stockholder plaintiffs have increasingly been making books and records demands under 8 *Del. C.* § 220. Section 220 provides stockholders with a right to inspect a corporation's books and records for a "proper purpose," including investigating potential mismanagement and wrongdoing in connection with a merger transaction. The Delaware Courts have interpreted the "proper purpose" standard to be a very low bar and, thus, a stockholder who seeks books and records in connection with a going private transaction will often be entitled, at a minimum, to the formal board minutes and materials concerning the transaction. Some books and records inspections also reach emails, and potentially even text or other chat communications, to the extent that the formal board records contain gaps or insufficient information to enable the stockholder to investigate her claims. It is therefore important, even as the buyer, to proactively consider and potentially discuss with the transaction target's counsel what record the target is creating in relation to the transaction. Detailed minutes and materials are a first line of defense in any stockholder litigation, and can often be considered on a motion to dismiss, which can foreclose a plaintiff from taking liberties in making allegations that misrepresent the documented factual record. Finally, buyers also should be cognizant that key deal and negotiating points will often be reflected in the record of any target board minutes where such issues are discussed, and that aggressive positions (or perceived aggressive positions) can sometimes be recorded in ways that might be exploited by stockholder plaintiffs in any transaction litigation. Thus, it is important to consider both intended and unintended consequences of all actions during the course of negotiating a transaction, particularly where a transaction is likely to draw stockholder litigation challenging the fairness of the deal.

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[7] *Kahn v. M&F Worldwide*, 88 A.3d 635 (Del. 2014).
[8] *Flood v. Synutra Int'l, Inc.*, 195 A.3d 754, 766-67 (Del. 2018).
[9] *Id.* at 763.

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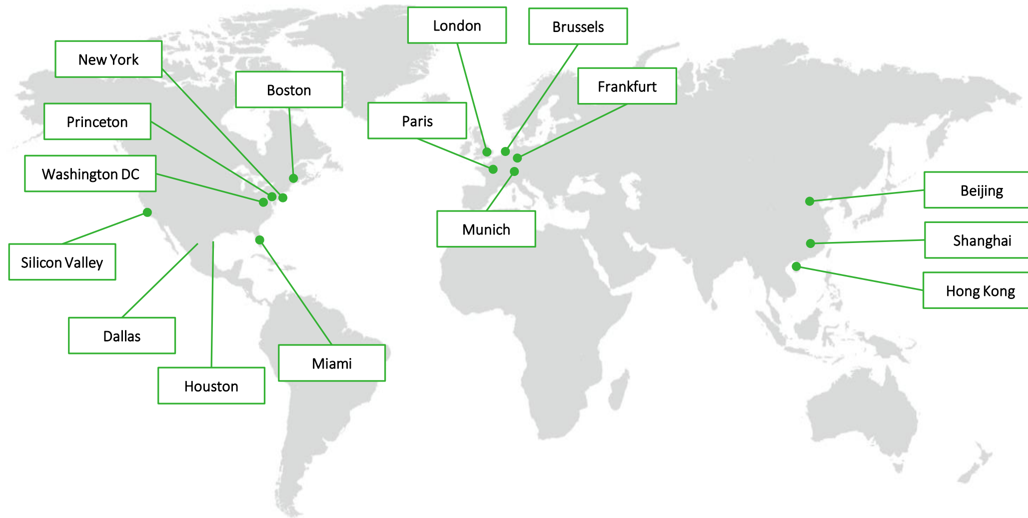

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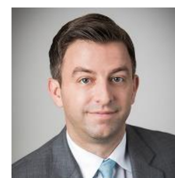

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