Weil, Gotshal & Manges
2023 Going Private Study

Introduction

Welcome to the 17th survey of U.S. sponsor-backed going private transactions prepared by Weil, Gotshal & Manges LLP. We first published this survey back in 2007, and, as was the case then, we are in a very dynamic and fluid market. This survey analyzes certain key transaction terms and trends (or expected future trends) of going private transactions signed in 2023 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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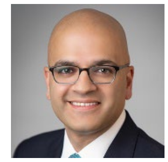

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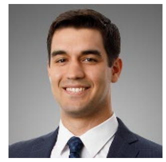

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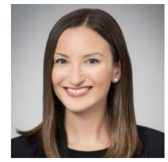


Research Methodology

We surveyed 31 U.S. sponsor-backed going private transactions signed between January 1, 2023 and December 31, 2023 with an equity value of at least $100 million. The 31 surveyed transactions involved the following U.S. target companies:

alteryx
ARCONIC
ATLAS
Avantax®
AVID
CHASE Corporation
CHICO'S FAS, INC.
CIRCOR
Consolidated communications
Crystal Clean
cvent
Duck Creek Technologies
EngageSmart
FIESTA RESTAURANT GROUP, INC.
FOCUS FINANCIAL PARTNERS
HERSHA HOTELS AND RESORTS
Midwest Holding
MOMENTIVE
new relic
nextgen healthcare
PARATEK
qualtrics XM
Quotient
radius global infrastructure
Rover
sumo logic
Syneos Health
TabulaRasa HealthCare
THORNE
Univar Solutions
Veritiv

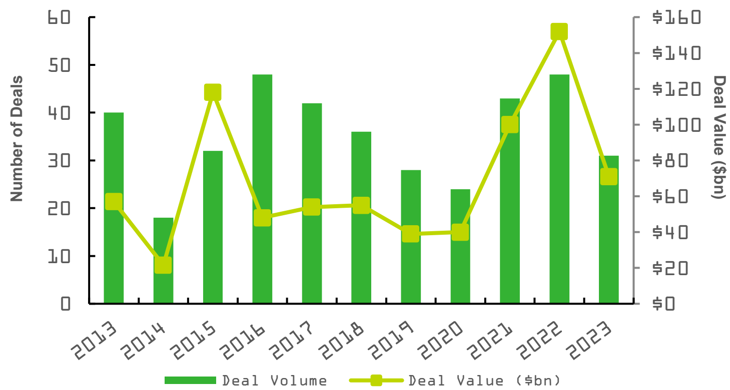
All dollar amounts and percentages referenced in this survey are approximate amounts and percentages. Unless otherwise noted, such amounts and percentages are based on the 31 surveyed transactions listed above.

GENERAL MARKET OBSERVATIONS

Going Private Activity. 2023 was the slowest full-year period for M&A deal making since 2013, as has been widely reported in the press. Consistent with that trend, **U.S. sponsor-backed going private transactions were down materially from 2022 (both in terms of deal volume and deal value), as deal volume was down 26% and aggregate deal value decreased by 50%.**

That said, going private transactions fared better than other M&A activity by sponsors, and, according to Pitchbook, going private transactions comprised half of the year's 10 largest private equity deals. Even in what was the most challenging M&A market in recent years, sponsors continued to set their sights on public company targets perceived to be attractive and/or undervalued.

Going Private Activity (Total Annual)

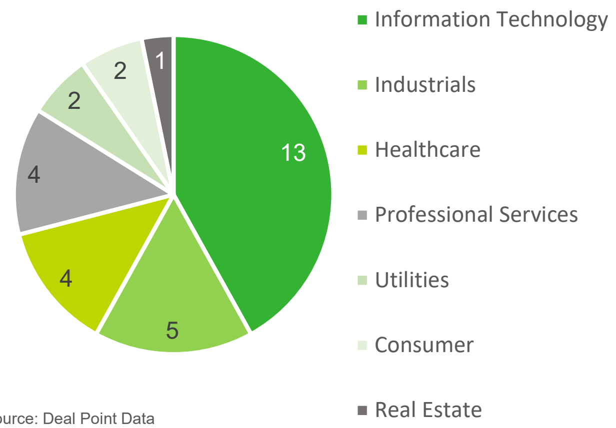


Source: Deal Point Data
Note: Deal value based on target equity value

Similar to the 2022 going private market, there was a concentration of transactions in the technology / software industry, with 42% of all deals surveyed in 2023 involving technology/software targets. In particular, sponsors demonstrated interest in software companies focused on artifical intelligence and machine learning.

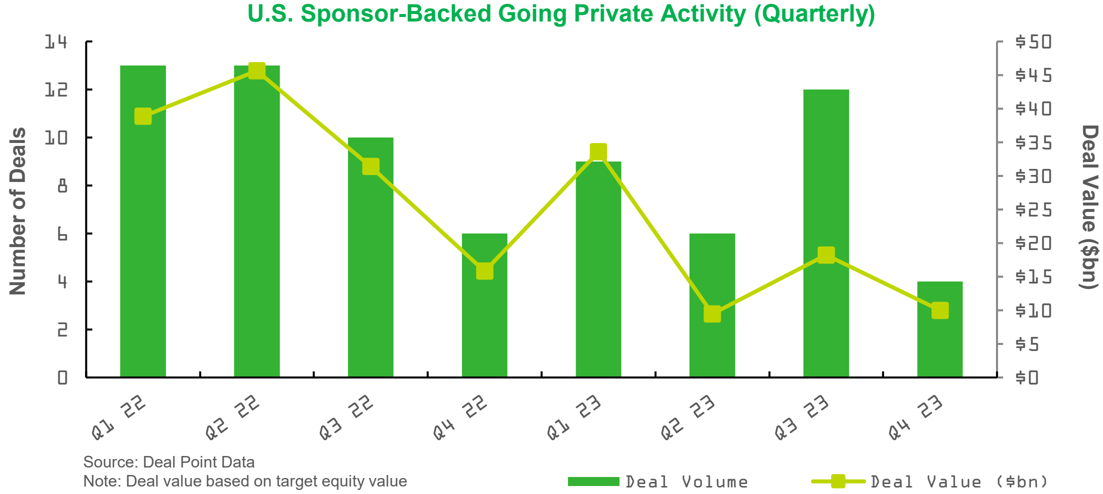
In terms of when the deals were signed, as shown in the chart below, U.S. sponsor-backed going private activity throughout 2023 was relatively stable across quarters – with 29%, 19%, 39% and 13% of deals occuring in Q1, Q2, Q3 and Q4, respectively, and roughly half (52%) of these transactions ocurring in the latter half of 2023. It is notable, however, that going private transactions were down materially in Q4, which corresponded to the run-up in public company valuations. It will be interesting to see how going private transactions are allocated across 2024 given the pending election cycle (we speculate that Q4 of 2024 may also be a depressed quarter for deal making).

2023 Going Private Targets by Industry



Source: Deal Point Data

U.S. Sponsor-Backed Going Private Activity (Quarterly)

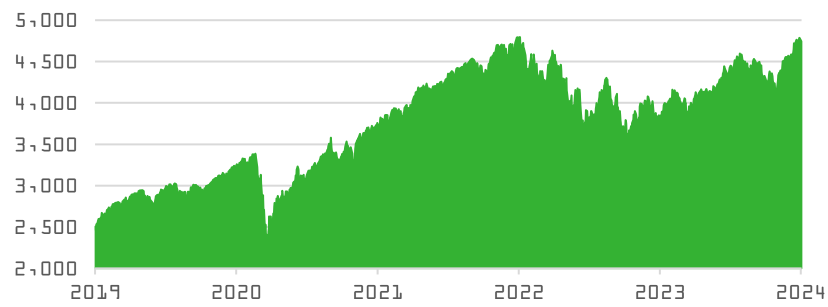


Source: Deal Point Data
Note: Deal value based on target equity value

So why did sponsors continue to focus on taking public company targets private in 2023, even though the overall M&A deal market was stagnant (and down from prior years)? We note the following:

- **Stock Prices Ebb and Flow.** Other than the aforementioned run-up in stock prices to end the year, in 2023 we saw a stock market that was generally range-bound, holding steady above the lows of 2022 but below the highs of 2021. As a result, private equity sponsors encountered more palatable valuations and acquisition opportunities of public targets, in stark contrast to private targets (where we continued to see large deltas between sponsor sell-side and buy-side valuations).

S&P 500 (2019 to Present)



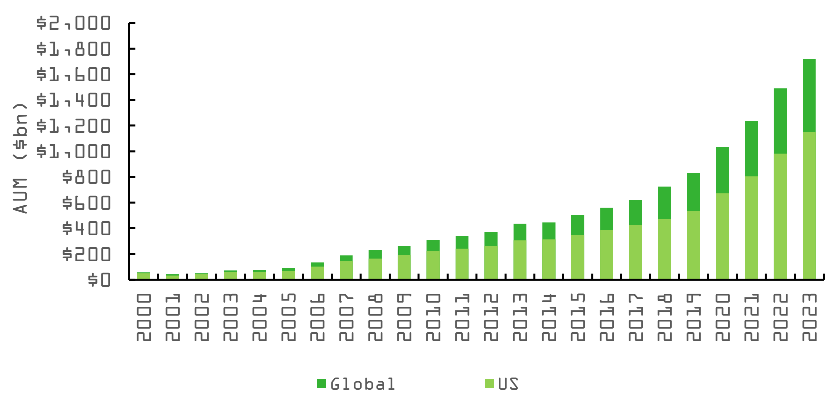
Source: Yahoo Finance

- **Public Company Boards Are Being Realistic**. Relatedly, and similar to what we began to witness in 2022, public company boards of directors appeared to have had realistic notions of their companies' stock prices – many of them were not holding onto historic (and likely inflated) highs. In contrast to the private M&A market, in 2023 public company boards were receptive to acquisition offers from sponsors at a premium to *current* prices (rather than *record* prices).

- **Reduced Competition.** Competition from corporate strategic buyers – which typically compete with sponsors on M&A transactions – remained down in 2023 (though we have seen an uptick in acquisitions by strategic buyers—i.e., not private equity sponsors—over the last few weeks).

Debt Financing Markets. Debt was available to finance going private transactions on favorable terms in 2023, which was a very welcome and encouraging development. However, lower leverage multiples driven by the interest rate environment likely played a role in the broader slowdown in M&A activity.

Private Credit Assets Under Management



Source: Preqin
Note: 2023 data as of June 2023

The syndicated and high yield debt markets reopened in 2023, as banks largely offloaded the hung commitments that burdened activity in 2022. After a moribund end to 2022, the syndicated market rebounded in the first half of 2023, allowing sponsors to finance going private transactions (like the Arconic, Cvent and Qualtrics transactions), with debt packages that would have been difficult to arrange only months before. Conditions continued to improve over the course of the year, with many deals (including financings for the take-private of Syneos and GTCR's acquisition of Worldpay) pricing inside the indicative range.

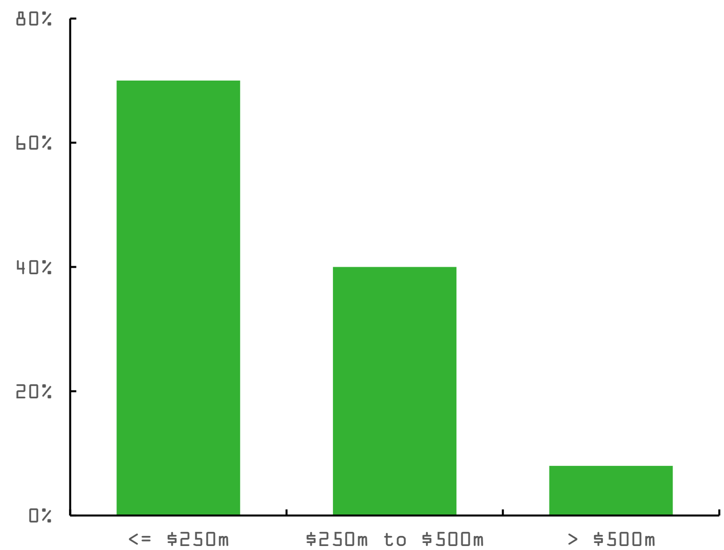
The rebirth of the leveraged loan market did not stunt the growth of direct lending, which, according to Institutional Investor, has grown nearly 25% per year over the last 20 years and nearly tripled in size since 2015. As a result, a segment of the financing universe that was once seen as a backwater home to lenders of last resort is now comparable in size to the previously dominant syndicated loan market. Over the last 18 months, a number of deals included private credit financing packages in excess of $2 billion, including Thoma Bravo's acquisition of Coupa, the acquisition of Zendesk by Hellman & Friedman and Permira and the acquisition by Advent and Warburg Pincus of Baxter's contract manufacturing unit. While the syndicated market reasserted itself in 2023 as an attractive solution for larger transactions, the $5.3 billion loan package that Blue Owl, HPS and Oak Hill led for Finastra, a Vistra Equity portfolio company – the largest on record in the US – showed that direct lenders are now able to finance all but the largest transactions.

With the loan markets re-open, debt financing was once again available, but ongoing recessionary fears and concerns over interest coverage capabilities drove more conservative underwriting standards. Since loans are floating rate instruments, the rise in benchmark interest rates resulted in a near 500 basis point increase in interest costs when compared to the first quarter of 2022, with first lien debt, particularly in private credit deals, now often yielding in excess of 10% per year. As a result, lenders offered less leverage (according to Refinitiv LPC's Gold Sheets, total leverage for large corporate U.S. LBOs declined to 5.8x, the lowest level since 2011) and required more equity, rendering sponsors less able to pay high purchase price multiples for assets, contributing to the overall downturn in deal activity.

With two viable financing solutions (private credit and the broadly syndicated/high yield market) for most deals and a relatively small number of strategic and opportunistic transactions, competition among lenders was fierce, driving issuer favorable trends in interest rate margins (the spread applied on top of the benchmark rate) and documentary terms.

As we kick off 2024, all signs point to a continuation of the borrower-friendly environment that developed over the course of 2023. Companies have taken advantage of friendly syndicated market conditions at the beginning of the year to reprice their credit facilities. Direct lenders continue to lean forward in deploying the capital that they've raised with the benefit of strong tailwinds for the sector. **And if, as many commentators project, the Federal Reserve lowers interest rates during the course of the year, lenders may be comfortable with higher leverage levels, which could unlock the wave of deal activity that market participants have hoped for since early 2022.**

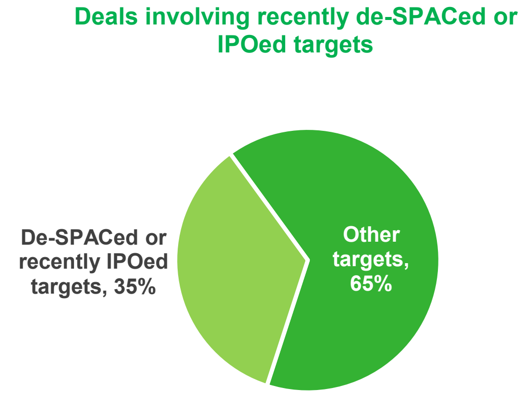
Percent of Private Credit Loans with Maintanance Covenants



Source: Moody's Investors Service
Note: Moody's analyzed a sample of 28 private credit loans made by business development company lenders issued between January 2022 through September 2023

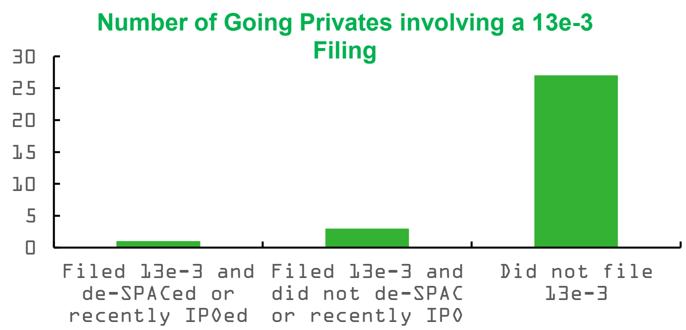
TRANSACTIONS INVOLVING RECENTLY DE-SPACED OR IPOED TARGETS

As predicted in last year's survey, **recently de-SPACed or recently IPOed targets were prime candidates for sponsor-backed going private transactions in 2023**. In fact, 35% of surveyed transactions involved either a de-SPACed target or a target that went public via a traditional IPO within the past three years – an increase from the surveyed transactions last year. This trend has many explanations, including that, in some cases, companies that went public in the height of the SPAC boom in 2021 may not have been fully prepared for the demands of being a public company or the challenges posed by rising interest rates and other market conditions impacting financial performance. Their concentrated stockholder base also oftentimes facilitated deal-making. In any event, we expect this trend to continue in 2024 (until supply for those companies starts to dry up, which could happen in the not-too-distant future given the frozen de-SPAC / IPO market over the last couple of years).



Source: Deal Point Data

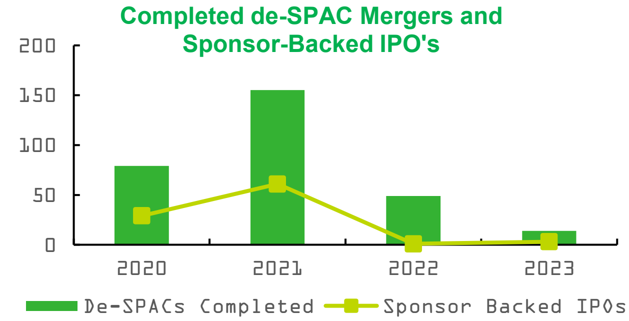
As we noted in last year's survey, going privates involving public company targets that fall in these categories – recently IPOed or recently de-SPACed – raise some interesting questions, primarily stemming from the concentrated stockholder base that they ordinarily retain from their days as a private company (and especially if they were sponsor-backed).



For example, one question raised by these transactions involving a recently de-SPACed or IPOed target is whether to use a sign-and-consent structure – stemming from the fact that these types of targets tend to have a more concentrated stockholder base. 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 increasing deal certainty (as the need for a stockholder vote is eliminated). That said, while we saw more deals in 2023 involving recently de-SPACed or IPOed targets, the use of sign-and-consent structures in 2023 largely remained the same as in the previous year (used in 6% of deals, as compared to 7% of surveyed sponsor-backed deals in 2022).

In addition, in last year's survey we discussed the possibility that more going private transactions would involve 13e-3 filings in 2023 - in part due to the concentrated stockholder base of recently IPOed or de-SPACed targets. However, only one of the surveyed transactions involving either a recently de-SPACed or IPOed target involved a 13e-3 filing. This transaction (Vista Equity Partners' pending acquisition of EngageSmart) involved a recently IPOed target (September 23, 2021), 54% of which was owned by General Atlantic (who was rolling a portion of its equity into the go-forward business). This would suggest that sponsors are working through company-led processes where communications with any large existing stockholders are limited, as opposed to sponsors having a separate dialogue with those large stockholders, which would potentially trigger not only 13e-3 filings but also could potentially increase litigation risk.

As noted above and as demonstrated in the adjoining table, given the significant decline in de-SPAC transactions and sponsor backed IPOs over the past two years, the supply of these target candidates for going private transactions should plateau in the near future (though we expect to see an uptick in sponsor backed IPOs in 2024).[1] We note also that the go-forward supply of de-SPAC targets looks particularly grim given recent SEC guidance regarding disclosure and related rules applicable to de-SPAC transactions.

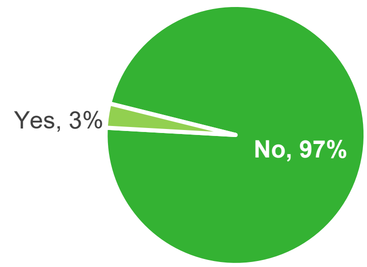


Source: Deal Point Data

[1] Completed de-SPAC deals and sponsor-backed IPOs reflected herein include only US-based targets and issuers, respectively. Includes SPACs that are headquartered in the United States but are incorporated in the Cayman Islands and the British Virgin Islands (otherwise, all SPACs are incorporated in the United States).

REPRICED TRANSACTIONS

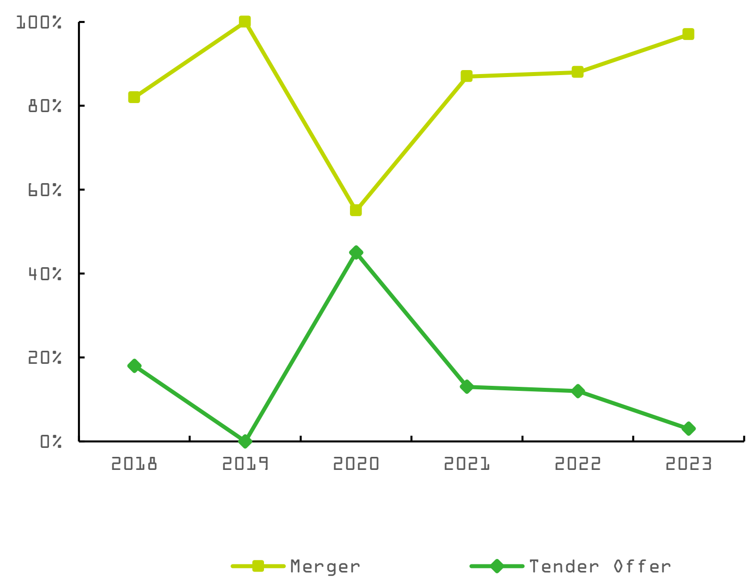
Change in purchase price after signing of merger agreement



The only repriced deal in this year's survey was the KKR-CIRCOR transaction, where, pursuant to an amendment to the merger agreement, the parties agreed to increase the cash consideration payable to CIRCOR's stockholders from $49 per share to $51 per share, then ultimately to $56 per share plus a ticking fee, if the merger was not consummated within a specific time period. The increase in purchase price stemmed from a competing acquisition proposal from another potential buyer to acquire CIRCOR for $52.65 per share, followed by an improved bid of $57 per share in cash. Consistent with its fiduciary responsibilities and in consultation with outside legal and financial advisors, CIRCOR's board of directors unanimously concluded that the transaction certainty associated with amending the original deal with KKR more than offset the slightly higher price contemplated by the competing offer. **This repriced deal is to be distinguished from the repriced deals from the past few years that involved parties agreeing to lower prices. While crystal-ball gazing is difficult on this front, if "animal spirits" really do reappear the way some have speculated it would, we could see more post-signing bidding wars.**

TRANSACTION STRUCTURE

Merger vs. Tender Offer



Sponsors continue to favor the use of the one-step merger structure (i.e., a pure merger) over the two-step tender offer / back-end merger structure (i.e., a tender offer for at least a majority of the outstanding shares followed by a squeeze-out merger) in going private transactions. In fact, only one of the surveyed transactions (L Catterton's acquisition of Thorne HealthTech) utilized the tender offer structure, which reflects the lowest frequency in the use of the tender offer structure in the past few years other than 2019 (when none of the surveyed deals used a tender offer). As shown in the chart to the right, the recent decline in the use of the tender offer structure is in line with the downward trend witnessed prior to 2020 (when the use of tender offers spiked).

As we've previously noted, from a sponsor's perspective, the tender offer structure remains a less attractive option compared to a one-step merger, despite some of the advantages of a tender offer (including the faster timeline for transaction completion). This is especially the case when debt financing is involved—given the need to use debt financing in most public company acquisitions by sponsors, the tender offer structure present challenges due to, among other things, the need to purchase the shares tendered in the tender offer prior to, in many cases, 100% ownership of the target.

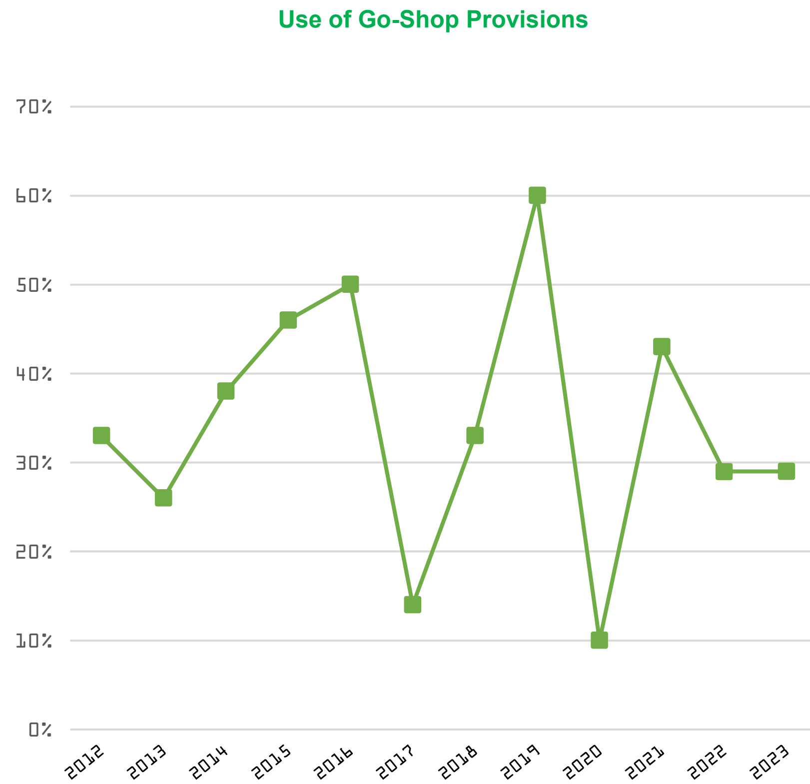
We anticipate sponsors will continue to disfavor the tender offer structure going forward, especially for larger transactions that require debt financing.

GO-SHOP PROVISIONS

While the use of go-shop provisions in going private transactions has generally fluctuated over time, in 2023 we saw the use of go-shops hold steady (following a sharp decline in 2022).

As the chart below shows, the use of go-shop provisions in sponsor-backed going private transactions steadily increased at a moderate pace from 2012 through 2016. Between 2016 and 2022, the use of go-shops flucuated significantly (between 10% and 60% of sponsor-backed going private transactions) – settling at 29% in both 2022 and 2023. This variability reflects the fact-specific nature of whether a target company will insist upon the inclusion of a go-shop provision, which generally will be driven by the extent to which the company has engaged in a pre-signing market check.

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 20-45 days, with a mean and median of 32 and 30 days, respectively) 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, following compliance with certain matching rights, is generally 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 is typically about 50% of the target's termination fee that would be payable to the initial acquirer under other termination scenarios.

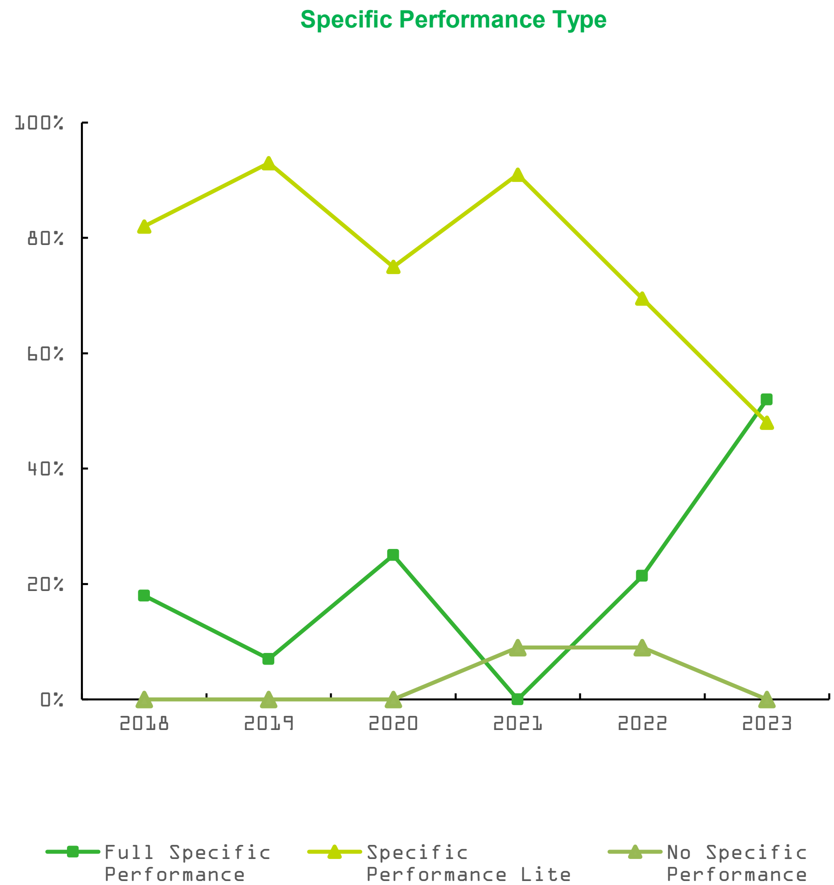


Nonetheless, and as noted in last year's survey, **there generally has not been consistent use of go-shop provisions across sponsor-backed going private transactions (and we expect that to continue).** Given that in the going private context a target will generally have a fiduciary out termination right (which permits 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), go-shop provisions are not always necessary from a Delaware law perspective. We surmise that some targets may just have a stronger preference for the additional bells and whistles that a go-shop period may provide.

REMEDIES

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 in going private transactions that we have historically tracked in this survey.

Notably, **for the first time in the past decade, the "specific performance lite" construct was surpassed in frequency by the "full specific performance" construct as the preferred market remedy to address an acquirer's financing failure and a target's closing risk in sponsor-backed going private transactions.** As a reminder, specific performance lite (whereby the target can only force a deal to close if the acquirer's debt financing is available and otherwise must rely upon a reverse termination fee) was first introduced after the financial crisis and was steadily adopted over the years.



As shown in the chart to the right, the use of "specific performance lite" continued to decrease in 2023 to 48% of the surveyed transactions (a 31% decrease from 2022 and a 47% aggregate decrease from 2021).

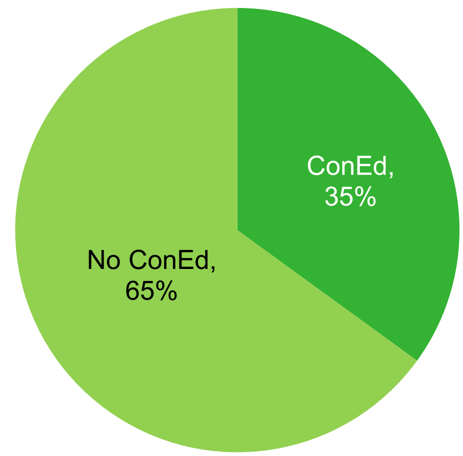
Relatedly, the use of "full specific performance" (whereby the target can force the closing upon satisfaction or waiver of the applicable closing conditions, regardless of whether an acquirer's debt financing is available) surpassed the "specific performance lite" construct as the preferred remedy in 2023, rising to 52% of the surveyed transactions (as compared to 21% of the surveyed transactions in 2022, 0% of surveyed transactions in 2021 and 25% of the surveyed transactions in 2020). Yet, not all of these transactions were fully equity financed – in fact, almost half of these transactions contemplated debt financing. This is interesting, since historically full specific performance has been used in transactions that are fully equity financed.

These trends are not surprising, given the challenging debt financing market of 2022 that continued into 2023. Target company boards are of course always focused on financing risk, but this concern was heightened given those challenges. Full specific performance with a full equity backstopped deal simply provides those boards more deal certainty. Relatedly, slightly less of the surveyed transactions used debt financing in 2023 as compared to 2022 (71% versus 76%, respectively). As a result, the "specific performance lite" construct would have only been applicable to a lower percentage of transactions in 2023 as compared to 2022.

While we think sponsors will continue to agree to full specific performance even in debt-financed deals (thereby bearing full closing risk of obtaining debt financing), it will be interesting to see if specific performance lite makes a comeback in 2024. We would predict that, as deals get bigger (which we suspect will happen in 2024), it will be more difficult for even large-cap sponsors to fully underwrite deals with equity.

***ConEd* Language**. Ever since the Second Circuit's decision in *Consolidated Edison, Inc. v. Northeast Utilities, 426 F.3d 524 (2d Cir. 2005)* ("*ConEd*"), which held that a target company's stockholders were not entitled to any lost merger consideration premium as a result of an acquirer's wrongful termination of a merger agreement, target companies in merger transactions (which, as noted above, almost all going privates are) have sought to address the Court's decision in *ConEd* by (i) defining damages to include the lost stockholder merger consideration premium and/or (ii) providing target stockholders with third party beneficiary rights (or third-party beneficiary rights enforceable solely by the target company), and such protective language has been referred to as "*ConEd language*".

Use of *ConEd* Langauge



In 2023, 35% of the surveyed transactions contained *ConEd* language. This data point is interesting, as the decision in *ConEd* was based on the Second Circuit's interpretation of New York law, and in 2023, for the first time since that 2005 decision, the Delaware Court of Chancery weighed in on the questions posed in the *ConEd* decision. In *Crispo v. Musk (Del. Ch. Oct. 31, 2023)* (*"Crispo"*), Chancellor McCormick commented, in ruling on a mootness fee, that a provision in a merger agreement designed to include the lost merger consideration premium as damages of a target company (prong (i) of the *ConEd* language mentioned above) cannot be validly enforced as the target company has no expectation to the lost merger consideration premium, only its stockholders do. With respect to the other approaches commonly utilized to address *ConEd*, the Chancellor noted that the idea that a target company could appoint itself as an agent for its stockholders without their consent to recover the lost merger consideration premium as a result of a wrongfully terminated merger agreement would also likely be found invalid, but did not dismiss the idea that third-party beneficiary rights could be given directly to a target's stockholders.[2]

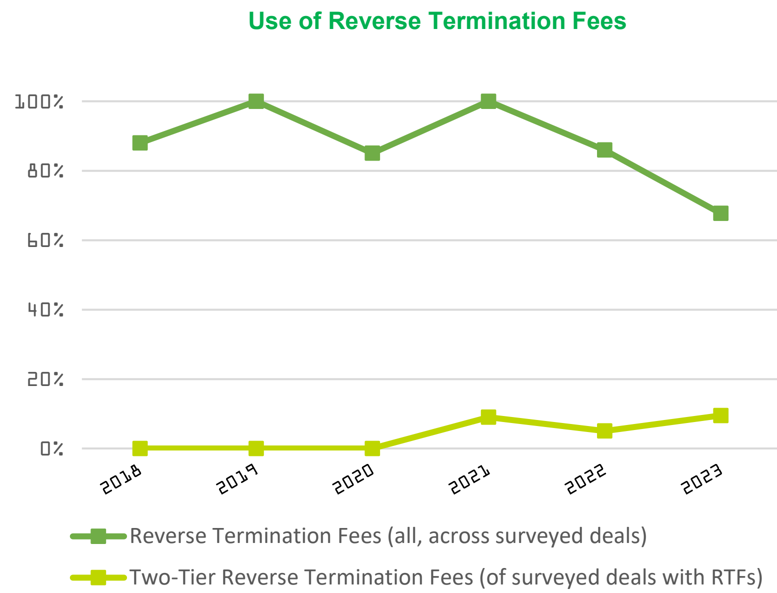
It remains to be seen what effect, if any, the Court of Chancery's comments in *Crispo* have on market practice with respect to use of the *ConEd* language. The two take-private transactions announced post-*Crispo* in 2023 included standard *ConEd* language with no modifications. Nevertheless, we expect that the *Crispo* decision will prompt discussion among practitioners (and potentially legislators) with respect to the use of *ConEd* language (or variations to such language) for deals signing post-*Crispo* and the ability of a target to recover a lost transaction premium as damages in busted deal litigation.

[2] Glenn West, *Surprise: Target Company May Not Be Entitled to Expectancy Damages Based Upon the Lost Premium for an Acquirer's Wrongful Failure to Close a Merger*, Weil's Global Private Equity Watch, November 14, 2023, https://privateequity.weil.com/glenn-west-musings/surprise-target-company-may-not-be-entitled-to-expectancy-damages-based-upon-the-lost-premium-for-an-acquirers-wrongful-failure-to-close-a-merger/

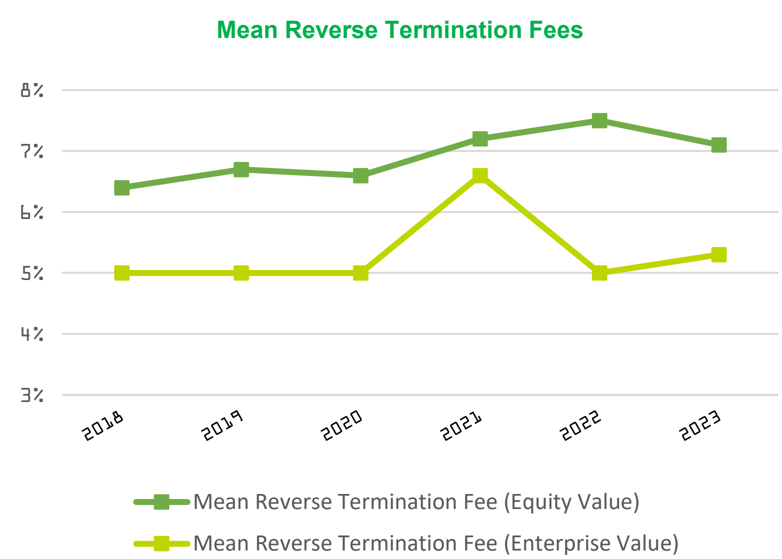
TERMINATION FEES

We continue to commonly receive from clients questions relating to termination fees (both reverse termination fees payable by sponsors and regular termination fees payable by target companies). Of note:

<u>**Reverse Termination Fees**</u>. **While reverse termination fees continue to be widely used in going private transactions, we've seen a decline in the use of reverse termination fees across surveyed transactions since 2021** (where 100% of the surveyed transactions included a reverse termination fee). Of the 2023 surveyed transactions, 68% contained a reverse termination fee. This decline in the use of reverse termination fees is primarily attributable to the decrease in the use of "specific performance lite" (discussed above), though it is interesting to note that 19% of the surveyed transactions had both full specific performance and a reverse termination fee (which gives target boards maximum optionality and which we have called "specific performance plus"). As noted above, we attribute this to the uncertain financing market that prevailed throughout much of 2023.

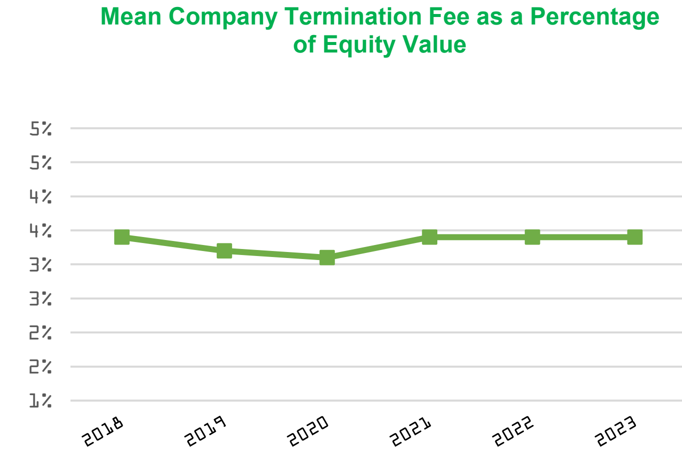


In an increase from 2022 (and more akin to 2021), 10% of the surveyed transactions that contained a reverse termination fee had a two-tier reverse termination fee (compared to 5% in 2022 and 9% in 2021). A two-tier reverse termination fee is typically structured so that a lower fee is payable by the 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. a willful breach or refusal to close). This increase in the use of two-tier reverse termination fees is again likely attributable to the choppy financing markets in 2023 and heightened concern from target boards that sponsors could use the reverse termination fee as an "option." In the deals with two-tier reverse termination fees, the amount of the lower reverse termination fee in the surveyed transactions ranged from 77% to 80% of the higher fee amount, with the mean being 79%.

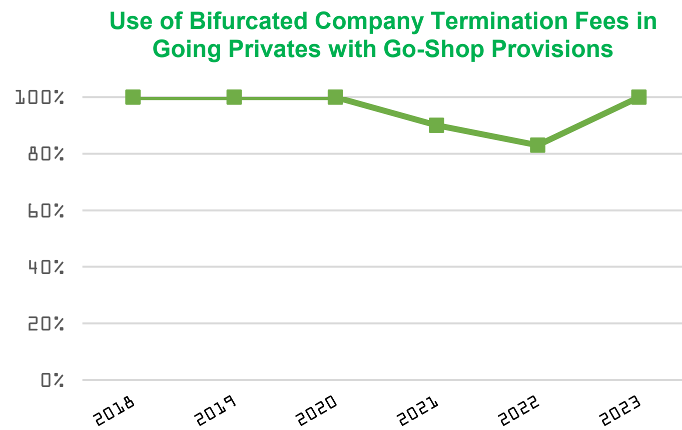


While the mean reverse termination fee amount as a percentage of equity value slightly decreased (in 2023, it was 7.1% compared to 7.5% in 2022), the mean reverse termination fee as a percentage of enterprise value slightly increased (in 2023, it was 5.3% compared to 5% in 2022). This difference in directions as between enterprise value and equity value is likely because target companies in 2023 had more debt and less cash available (and, accordingly, equity values were lower on a relative basis). The mean reverse termination fee of 5.3% of equity value is on the lower end of the market in private company deals, which we would attribute to the fact that going privates tend to involve larger target companies.

Company Termination Fees. As expected, 100% of the surveyed transactions contained company termination fees. Unsurprisingly, the mean fee as a percentage of equity value and enterprise value did not deviate significantly from prior years – in fact, the mean fee as a percentage of equity value was 3.4% (the same as the 2022 statistic) and as a percentage of enterprise value only slightly increased to 2.6% (from 2.4% in 2022), which, again, likely results from equity values being lower this year on a relative basis. This trend of overall consistency across years makes sense, as the size of the fee is largely informed by Delaware law (too high a fee may be deemed coercive and invalid by the courts).



All of the surveyed transactions that contained go-shop provisions (discussed above) included a termination fee structure where 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 (the regular target termination 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). This represents a return to what was seen in surveyed transactions prior to 2021 (in 2021 and 2022 we saw transactions that contained go-shop provisions but that did not contemplate a bifurcated termination fee structure).



Of the surveyed transactions that contained go-shop provisions, the amount of the lower company termination fee ranged from 46% to 56% of the higher company termination fee, with the mean being 51%. Given prior survey results, it appears the range is trending towards a mean of 50%.

Target Termination Tail Fee. Company termination fees are always triggered where the target company terminates the purchase agreement to accept a superior proposal or where the buyer terminates the purchase agreement 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 company 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. All but two of the surveyed transactions contained a termination tail period of 12 months (two of the surveyed transactions contained a termination tail period of 9 months).

TRANSACTIONS INVOLVING ACTUAL OR POTENTIAL CONFLICTS

In many cases, conflicts of interest – or perceived conflicts of interest – can arise in going private transactions, including where the buyer is an existing stockholder of the target company or has representation on the target board, or the sponsor of the target has relationships with the buyer or otherwise participates in the transaction. Conflicts may also arise in going private transactions in the context of equity rollovers, new compensation or incentive packages granted to existing directors or officers or in the event of disparate treatment of public stockholders.

In lawsuits challenging a going private transaction with actual or perceived conflicts, a Delaware court may apply the most exacting standard of judicial review (entire fairness) when the transaction involves a controlling stockholder or when the target board of directors does not consist of a majority of independent and disinterested directors. However, by employing certain procedural safeguards, the use of special committees or approval of the underlying transaction by a majority of unaffiliated stockholders, parties can shift the burden of proof to the plaintiff stockholders or, by utilizing both, can restore the business judgment rule, the lower standard of review applied by a Delaware court.

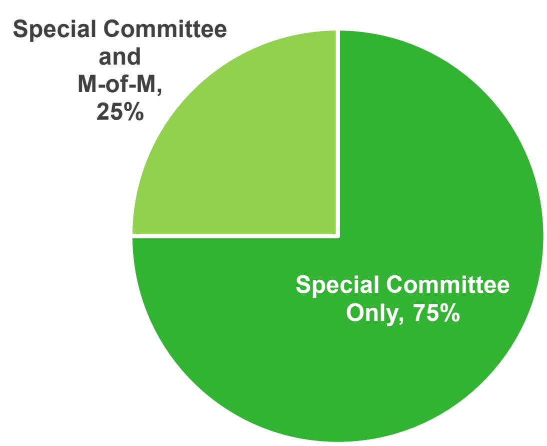
Mitigation of Conflicts – Special Committees and Majority-of-the-Minority Voting Standards. In some going private transactions that involve an actual or perceived conflict of interest, the board of the target company may appoint a special committee comprised solely of disinterested and independent directors to review, evaluate and negotiate a transaction on behalf of the board. A special committee that is properly constituted and mandated to negotiate a conflicted transaction with the assistance of independent legal and financial advisors can help ensure that the process approximates an arm's-length, third party negotiation. A special committee can also be useful if investors or others perceive that the target board, though consisting of a majority of nominally independent and disinterested directors, is dominated or unduly influenced by a controlling or significant stockholder.

Further, going private transaction parties may agree to also seek the approval of the transaction by a majority of the target's unaffiliated stockholders (also known as a "majority-of-the-minority" vote), in addition to approval by a majority of the target's stockholders (the statutory requirement under Delaware law).

Under Delaware law, the use of a special committee or a majority-of-the-minority vote can shift the burden of proving entire fairness to the plaintiff. In addition, the use of both a special committee and majority-of-the-minority vote construct has the potential of shifting the standard of review to the business judgment rule (the so-called "MFW" construct (discussed further below under *Going Private Litigation Landscape*). However, while approval of a majority-of-the-minority may increase certainty in the litigation context with respect to an entire fairness review, the inclusion of such a requirement also raises increased deal uncertainty and closing risk (given that receipt of such stockholder approval imposes an additional condition to closing and places that condition in the hands of the target's stockholders).

In this year's data set, 39% of the surveyed transactions featured the use of a special committee to negotiate the transaction on behalf of the target's board of directors, ostensibly to address a conflict or perceived conflict. Notably, the vast majority (75%) of these transactions featured solely the use of a special committee, with only 25% employing both the use of a special committee and a required majority-of-the-minority vote.[3] This bifurcation is consistent with our experience, as many sponsors and dealmakers are comfortable employing the use of a special committee to address potential conflict situations, but are hesitant to also subject a conflicted going private transaction to a majority-of-the-minority vote given the aforementioned heightened closing risk and deal uncertainty, even with the prospect of lowering the standard of review to the business judgment rule in any stockholder challenge to the transaction.

2023 Conflicted Transactions

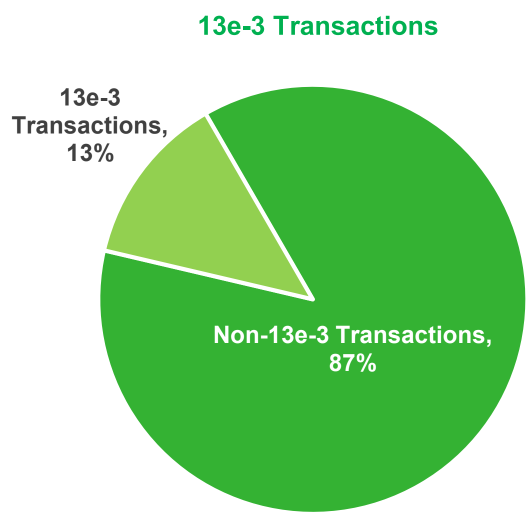


[3] Zero surveyed transactions featured the use of a majority-of-the-minority voting standard alone without the use of a special committee.

Rule 13e-3 Transactions. In addition to the considerations regarding actual or perceived conflicts of interest discussed above, going private transactions may be subject to enhanced disclosure requirements under SEC Rule 13e-3 if they involve “affiliates” of the target. Rule 13e-3 and the resulting disclosure requirements are most commonly triggered when an acquisition of a publicly traded company involves the purchase of equity securities by the target’s “affiliates” – for example, a buyer/sponsor who is an existing stockholder of the target. In addition, 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 present “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 enhanced 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.

13% of the surveyed transactions filed the additional disclosures required by Rule 13e-3. In each of those transactions, Rule 13e-3 was triggered because of the involvement of an “affiliate,” as defined in Rule 13e-3. In one transaction (Vista’s pending acquisition of Engagesmart, a recently IPOed target, discussed above), both a significant stockholder of the target who was rolling a portion of its equity, as well as the buyer (who entered into a support agreement with the significant stockholder) were deemed to be affiliates of the target. Rule 13e-3 “affiliates” in the other surveyed transactions included: a significant stockholder who was also the buyer (BCI and Searchlight’s pending acquisition of Consolidated Communications); the target’s CEO who rolled over his equity, as well as the buyer, who entered into support agreements with the CEO and other members of the target’s management (Gurnet Point Capital’s and Novo Holding’s acquisition of Paratek Pharmaceuticals); and a significant stockholder of the target that obtained a materially different benefit in the transaction from other public stockholders of the target (CD&R’s acquisition of Focus Financial Partners).



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. 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 transaction, and that the acquirer aided and abetted those alleged breaches.

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.

No Controlling Stockholder. 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."[4] 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."[5] 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.

Controlling Stockholder. If, prior to a going private transaction, the target did have a controlling stockholder, a challenge to the going private transaction will likely be subject to entire fairness review if the controlling stockholder is the one taking the target private or "the controller competes with the common stockholders for consideration" in the going private transaction.[6] Entire fairness 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" to the minority stockholders. Where entire fairness applies, a complaint is not subject to dismissal at the pleading stage. As noted above, 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 *MFW* "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 *MFW* framework *before* there are any substantive price discussions or negotiations with the target.[9]

Transaction planners must balance the potential litigation benefits that may be realized from implementing the *MFW* framework (i.e., a more favorable standard of review in a post-closing lawsuit) against the transaction costs, and potential uncertainties, of requiring approval of the proposed transaction by an independent committee and a minority stockholder vote. Transaction planners can (and many do) opt for deal certainty over litigation protections, recognizing that they will defend any challenge to the transaction under the entire fairness standard. Regardless of which path is chosen, however, it is important to work closely with counsel to ensure that a robust record is created to best position the proposed transaction to withstand even the most exacting judicial review.

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[4] *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 312-13 (Del. 2015).
[5] *Id.* at 313.
[6] *In re MultiPlan Corp. S'holders Litig.*, 268 A.3d 784, 809 (Del. Ch. 2022).
[7] *Kahn v. M&F Worldwide*, 88 A.3d 635 (Del. 2014) ("*MFW*").
[8] *Flood v. Synutra Int'l, Inc.*, 195 A.3d 754, 766-67 (Del. 2018).
[9] *Id.* at 763.

<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 *MFW* doctrines) and/or that any special committee was not properly functioning (which is relevant to the *MFW* 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.

<u>Potential 2024 Developments To Watch</u>. In late 2023, the Delaware Supreme Court requested supplemental briefing from the parties in the appeal of *In re Match Group, Inc. Deriv. Litig.*,[10] to consider the following issue: whether "[i]n a controlling stockholder transaction not involving a freeze-out merger," the business judgment rule (instead of entire fairness review) should apply if only one of the following procedural devices is employed as part of the transaction: "approval by (a) a board with an independent director majority; (b) a special committee of independent directors; or (c) a majority of the minority stockholder vote."[11] The Court explained that it decided to consider this issue (i) "in the interests of justice to provide certainty to boards and their advisors who look to Delaware law to manage their business affairs," and (ii) "to provide certainty to the Court of Chancery, which has continued to address *MFW* outside the context of controlling stockholder freeze out transactions in a manner that has evaded appellate review."[12] The decision will be important for transaction planners to watch, as it could provide further guidance concerning the *MFW* protections in going private transactions involving a controlling stockholder, as well as guidance for reclaiming the protections of the business judgment rule (as compared to entire fairness review) in other transactional settings involving controlling stockholders. Transaction planners should consider and discuss with counsel the implications of the potentially changing legal landscape for transactions involving a controlling stockholder.

[10] 2022 WL 3970159 (Del. Ch. Sept. 1, 2022).
[11] *In re Match Group, Inc. Deriv. Litig.*, No. 368, 2022, Order (Del. May 30, 2023).
[12] *Id.*

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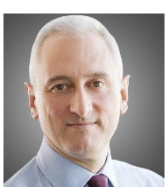
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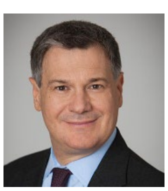
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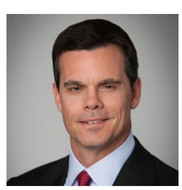
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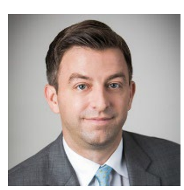
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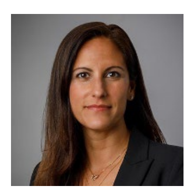
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