Eight Key Differences: Public vs. Private Company Acquisitions in the US

WINSTON & STRAWN LLP

Transaction Advisors
January 2017

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With the Dow Jones Industrial Average setting 17 record high closings since the 2016 election and the Federal Reserve unanimously approving its second rate increase in a decade, the U.S. economy is showing signs of heating up. The market for M&A deals in 2016 has also rebounded from 2015 with 35 public company take-private transactions having been announced in 2016, as compared to 30 deals the prior year.[1] Deal conditions continue to remain extremely favorable: both buyers and sellers have improved confidence in the economy, interest rates remain low, and both strategic and private equity buyers have historically high levels of cash reserves and equity commitments, respectively. Private equity funds and strategic buyers are seeking more and different ways to deploy capital.

With at least 85% of closed take private deals announced in 2015 or 2016 and valued over $100 million resulting in litigation,[2] what should a first-time buyer of a public company know about the "take-private" sales process in order to best position its bid and to minimize the risks and costs (in terms of both money and time) of the almost inevitable shareholder challenge? This article will highlight eight key differences buyers should be aware of between a public company take-private transaction and a private company sale – with additional considerations for private equity funds that may have considerable experience buying private companies, but less familiarity with the public company sales process.

1. More Extensive Market Check.

Many buyers, particularly private equity fund buyers, seek "proprietary deals" by forming a relationship over a period of time with a potential target company, its owners and management before ultimately making an offer to buy that company. One of the objectives of this approach is to afford no opportunity for other potential buyers to make a competing bid. In the current deal environment, however, almost all transactions (public and private) are "shopped" in one form or another. The boards of directors of public and private corporations have a fiduciary duty to make sure the price at which a company is sold is fair and in the best interest of the company's shareholders.[3] This legal requirement, together with the threat of shareholder litigation, means that a public company sale will always include some form of "market check."[4]

That market check may take place at the front end of the deal process as part of initial bidding before a definitive agreement is signed – which is also common in a private company sale. Or, the market check may take place after a buyer has been identified and a definitive agreement is signed – which is rare in private company sales, but commonly seen in the form of a "go shop" period in public deals.[5]

With the potential for a post-signing "go shop" period, together with the board's ability to consider superior proposals (discussed below), a buyer of a public company is unable to obtain the same broad exclusivity protection that is customary in connection with a definitive sales agreement relating to a private company. Buyers should

1 S&P Capital IQ.
2 S&P Capital IQ; Courthouse News Service; Bloomberg Law; publicly-available court dockets.
3 *See e.g. In re Comverge, Inc.*, No. CV 7368-VCP, 2014 WL 6686570, at *9 (Del. Ch. Nov. 25, 2014) (in connection with a sale of a company, "the board must perform its fiduciary duties in the service of a specific objective: maximizing the sale price of the enterprise").
4 *See, e.g., C & J Energy Servs., Inc. v. City of Miami Gen. Employees'*, 107 A.3d 1049, 1067–68 (Del. 2014) ("[A] board [is] permit[ed] … to pursue the transaction it reasonably views as most valuable to stockholders, so long as the transaction is subject to an effective market check under circumstances in which any bidder interested in paying more has a reasonable opportunity to do so. Such a market check does not have to involve an active solicitation, so long as interested bidders have a fair opportunity to present a higher-value alternative, and the board has the flexibility to eschew the original transaction and accept the higher-value deal.").
5 *See In re Plains Expl. & Prod. Co. Stockholder Litig.*, No. CIV.A. 8090-VCN, 2013 WL 1909124, at *6 (Del. Ch. May 9, 2013) ("[S]o long as a company has not agreed to onerous deal protection devices that would unduly impede a competing bid, a post-agreement market check can be an effective way to ensure that a company obtains the best price reasonably available.").

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not be deterred, however. In practice, "go-shop" provisions rarely generate topping bids for public companies, which has prompted some courts and commentators to question whether "go shops" are truly effective at generating post-signing competition.[6] Deal protection devices (discussed below), such as contractual termination (or "break-up") fees – typically around 2-3% of the proposed deal value – are, of course, another deterrent to topping bids.

In the rare instance where a topping bid does materialize after signing, the original buyer may be forced to increase its offer price or risk having the target company's stockholders vote down the original deal in favor of the new proposal. This situation recently arose in connection with the sale of Dell Inc. to its founder, Michael Dell, and the investment firm Silver Lake (together, "the Buyout Group"). Following the signing and announcement of a definitive merger agreement with the Buyout Group, both Carl Icahn (through Icahn Enterprises) and Blackstone Management Partners LLC ("Blackstone") submitted higher bids for Dell.[7] Though Blackstone subsequently withdrew its bid, Icahn did not.[8] To avoid the risk of Dell's shareholders voting its deal down, the Buyout Group increased its offer price by 23 cents per share, representing a 2% bump in the overall merger consideration.[9] The merger agreement was amended accordingly, and Dell's shareholders voted to approve the revised transaction.[10]

2. Faster Paced Pre-Signing Process.

Deal participants – in the private and public company contexts alike – are concerned about leaks, and, accordingly, generally sign confidentiality agreements early in the transaction process. Even so, leaks can and do occur, and they can be particularly problematic for public company deals. Leaks and rumors can derail a public company transaction in a number of ways, including through the pre-signing run up in the target company's stock price in response to a deal rumor that may exhaust any premium the buyer may have been willing to pay.[11] To minimize such risks, a public company pre-signing process (due diligence and negotiations) will often proceed more quickly than a private company sales process. This faster pace has the potential of favoring private equity fund buyers who are often better able (with streamlined bidding, due diligence and internal approval processes) to move more quickly than many strategic buyers.

3. Less Likely to Team with Management at the Outset.

Many buyers, particularly private equity fund buyers, seek to team with management before transaction documents are signed. Partnering with management can include offering employment agreements and equity incentive plans to senior management before any buyer is chosen, extending management an opportunity to make a personal investment in the continuing business and strategizing with management on the best way for the buyer to win the deal and run the company going forward.

In order to minimize the risk of shareholder challenges based on perceived conflicts of interest in this regard, target management in the public company context are often excluded from negotiations relating to the potential transaction – leaving the process solely to independent directors on the target board – and/or the negotiation of the specific terms of their continuing employment and possible investment in the surviving entity frequently await the signing of definitive deal documents.[12] The latter approach may be viewed as impracticable by many private equity buyers, who seek from the outset to lock in strong management teams with aligned incentives to run the day-to-day business.

One possibility for addressing this concern is for target management to put forward a "pre-cleared" set of employment and investment terms that they are prepared to accept from all potential buyers. A variation on this theme was seen in connection with the recent sale of American Surgical Holdings, Inc. ("American Surgical") to

6 *See In re Appraisal of Dell Inc.*, No. CV 9322-VCL, 2016 WL 3186538, at *36-37 n.35 (Del. Ch. May 31, 2016); Brian JM Quinn, *Omnicare: Coercion and the New Unocal Standard*, 38 J. Corp. L. 835, 844 (2013); *see also* Steven Davidoff Solomon, *Flawed Bidding Process Leaves Dell at a Loss*, N.Y. Times (Apr. 23, 2013) at 2 (citing FactSet MergerMetrics and showing that "[s]ince 2004, there have been 196 transactions with go-shops .... [i]n only 6.6 percent of these did another bidder compete during the go-shop period").

7 *Id.* at *37.

8 *Id.*

9 *Id.*

10 *Id.*

11 *See, e.g., Global GT LP v. Golden Tele., Inc.*, 993 A.2d 497, 509 (Del. Ch. 2012) ("VimpelCom's stock rose substantially from $22.31 per share at the time that rumors about the proposed merger were leaked ... to $41.98 ... the day that the Merger Agreement was announced, although the overall market remained relatively stable.").

12 *See, e.g., In re Barnes & Noble S'holder Deriv. Litig.*, C.A. No. 4813-CS (Del. Ch. March 27, 2012) (target CEO excluded from negotiations in order to avoid conflicts of interest).

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an affiliate of Great Point Partners I, LP ("Great Point"). In that deal, executives of American Surgical – the public company target – instructed the company's financial advisor and lead independent director early on in the process that "were there to be a merger [with any of the bidders], they would be open to rolling over a portion, between 20–30%, of their American Surgical stock into equity in the surviving entity," in connection with "a sufficient employment package with the surviving entity," which "was framed as a no less than 70% up front condition."[13]Because the American Surgical executives in question nevertheless subsequently became involved in negotiations both with respect to the deal with Great Point and their own corresponding employment and rollover agreements, the pre-cleared employment and investment terms they outlined did not have the desired curative effect in that case.[14] In other contexts, they likely would.

4. No Concurrent Signing and Closing; Increased Financing Risk.

Any gap between signing and closing obviously provides for added deal risk. And the longer the gap, of course, the greater the risk. Accordingly, many private company deals are now "concurrent sign and close" transactions – i.e., definitive deal documents are signed, the transaction is closed, and the purchase price is wired on the same day. This approach has the benefit of guaranteeing that any deal that is ultimately signed up is also closed (and, therefore, doesn't leave the buyer or seller with any reputational or actual damages from a busted deal). And, in the current seller-favorable deal environment, where the failure to obtain sufficient acquisition financing (a "financing out") is not considered a "market" closing condition for a buyer, the buyer in a concurrent signing and closing will always have its financing in place (otherwise, it would not have signed the deal).

Public company deals, on the other hand, will always have a gap between signing and closing, during which (i) the buyer will either conduct a tender offer for the target company's stock (in a "two-step" transaction with a tender offer followed by a back-end merger), or (ii) the target company will seek the vote of its shareholders (in a "one-step" merger transaction). The two-step tender offer transaction can typically be completed more quickly (about a month) than the one-step shareholder vote transaction (possibly several months due to the preparation and filing of a proxy statement with the Securities and Exchange Commission that is subject to review and comment). Either way, this gap period can result in added risk based on unforeseen circumstances and other factors.

While the financing markets remain robust, a private equity buyer of a public company (or a strategic buyer without sufficient cash on hand) should obtain multiple "tight" financing commitments from its funding sources, as well as back-up plans, should those financing commitments fail. As an alternative financing source, a private equity fund may seek to fund with additional equity drawn from its limited partners (and refinance that equity later), draw on the fund's own line of credit or directly or indirectly seek additional equity through co-investors.

5. No Purchase Price Adjustments; Unique Pricing Formulations Rare.

With the exception of a "stock-for-stock" merger with a strategic buyer (which is unavailable to a private equity buyer), public company deals often provide for all cash consideration to be paid to the target shareholders in full at, or shortly following, the closing. Escrows, holdbacks, earn-outs, working capital adjustments, other purchase price adjustments and unique pricing formulations, all of which are fairly customary in private company deals, are rare in public company transactions. That said, a market has developed in a limited number of public deals (particularly in the biotechnology and pharmaceutical industries) where additional consideration may be paid to target company shareholders in the future if certain milestones are met (via a "contingent value right"). For example, when Lundbeck A/S recently purchased Chelesea Therapeutics International Ltd., a developmental biopharmaceutical company, Chelsea's shareholders received not only received a specified amount in cash per share, but also contingent value rights based on the company's post-sale ability to hit certain sales targets.[15]

The bottom line is that, with limited built-in pricing adjustments and other protections, and with limited

13 *See Frank v. Elgamal*, No. CIV.A 6120-VCN, 2014 WL 957550, at *4 (Del. Ch. Mar. 10, 2014).
14 *See id.* at *15, 30.
15 *See In re Chelsea Therapeutics Int'l Ltd. Stockholders Litig.*, No. CV 9640-VCG, 2016 WL 3044721, at *3 (Del. Ch. May 20, 2016).

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recourse against the seller's erstwhile public shareholders (as further discussed below), the buyer's front-end due diligence of a public company is of paramount importance.

6. Different Contract Terms and Focus of Negotiations.

In private company transactions, contractual non-disclosure and confidentiality obligations provide the deal participants with greater flexibility in negotiations, paving the way for deal creativity and the possibility of crafting unique contract terms. The material terms of public company transactions, by contrast, will ultimately become public, and, as a result, those deal terms are much more market driven with less opportunity for variation among deals, particularly within the same industry.

Further, in private company transactions, the buyer has the ability, post-closing, to sue the sellers for breaches of representations and warranties. As such, a significant focus of the contractual negotiations in a private deal is on the seller's representations and warranties and the agreement's related indemnification and damages provisions. Once a public company transaction has closed, by contrast, the buyer has no ability to sue the seller's shareholders for breaches of representations and warranties. Rather, the focus of negotiations in the context of a public company transaction is generally on closing conditions. A seller will naturally seek to limit the closing conditions to a very short list of items over which it either has control or otherwise has comfort will be met. Due to the pressure to include standardized market terms, a buyer of a public company generally has limited ability to inject unique closing conditions that it feels might be appropriate for the transaction (e.g., a tailored material adverse effect definition, financial thresholds that must be met, or third-party (non-governmental) consent requirements).

7. Fiduciary Outs and Deal Termination.

As discussed above, many private deals involve a concurrent signing and closing, so there is no negotiation over the circumstances under which a deal can be terminated or the associated penalties or damages that will flow from any such termination. Similarly, in a private company deal, if a vote is required, it will be obtained immediately at signing of the definitive agreements so there is no risk of a failed vote.

Public company transactions operate differently; fairly customary market standards have developed that would allow for deal termination in a public company sale between signing and closing that are not typically found in private company deals. In a public company sale, the board of directors is provided with a "fiduciary out" that would allow it to terminate the proposed deal if a superior transaction comes along. The fiduciary out often comes with "buyer friendly" deal protection mechanisms,[16] and the terms that are typically negotiated include: (1) a definition of what constitutes a "superior" proposal that the board is permitted to consider; (2) what sort of opportunity must be provided to the existing buyer to match or beat the superior proposal; (3) what recommendations to shareholders the board must make regarding the existing deal and what is permitted to be said regarding the superior proposal; (4) whether a shareholder vote must still be held on the existing deal if a superior proposal has been received; (5) the circumstances under which the existing deal may be terminated in light of the foregoing; (6) whether a "breakup fee" (typically an agreed-upon small percentage of the overall transaction value) will be owed to the existing buyer if the target company terminates the transaction; and (7) the associated timing relating to all of the foregoing.

Other times, even when the public company seller is ready and willing to close on the transaction, the buyer is unable to do so based on a failure to obtain sufficient acquisition financing or necessary regulatory approvals. In this scenario, the buyer will typically be required to pay the target company a "reverse break-up fee," which is likewise now generally provided for in the definitive deal documents. For example, when the Halliburton-Baker Hughes transaction was recently thwarted due to regulatory antitrust issues, Halliburton was forced in May 2016 to pay Baker Hughes a $3.5 billion reverse break-up fee.[17]

16 *See e.g. In re Crimson Expl. Inc. S'holder Litig.*, No. CIV.A. 8541-VCP, 2014 WL 5449419, at *25 (Del. Ch. Oct. 24, 2014).

17 Kevin Allison, *Halliburton-Baker Hughes Breakup Is a Lesson in Hubris*, N.Y. Times (May 2, 2016), available at http://www.nytimes.com/2016/05/03/business/halliburton-baker-hughes-breakup-is-a-lesson-in-hubris.html.

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While the concept of a “reverse break-up fee” has also found its way into some private company deals, a “fiduciary out” remains extremely rare in the private company context.

8. Public Deal Terms.

As noted above, by contract, private company sale terms generally remain private. By law, the material terms of public company transactions (including the entire definitive purchase or merger contract) are, by contrast, publicly filed with the SEC and mailed to all target company shareholders (as part of any tender offer or shareholder vote). This level of required public disclosure can come as a surprise to many buyers, especially private equity fund buyers who are experienced in negotiating unique deal terms and keeping those terms private, particularly from competing private equity funds and prospective buyers and sellers. The public disclosure of transaction terms and details can also lead to some discomfort for deal participants. For example, in connection with the Tesla-SolarCity merger that was approved by Tesla shareholders in November 2016, the press reported extensively on the information contained in the company’s required SEC filings, including the inner workings and history of the transaction, as well as the fact that Elon Musk and his cousins were purchasing bonds in SolarCity before the transaction closed, a disclosure which was expected to lead to “unhappy shareholders.”[18]

Conclusion

As private equity funds and strategic buyers continue to seek out opportunities to invest their capital in this robust M&A market, they should be mindful of the significant differences that exist between a public company take-private transaction and a private company sale. Careful consideration of the eight key differences discussed in this article will position a buyer to avoid being caught behind the eight ball in any sales process.

About Winston & Strawn

Winston & Strawn’s private equity practice is one of the broadest and most active national middle-market practices in the U.S., providing strategic advice and legal counsel to middle-market private equity funds, hedge funds, family offices, real estate funds, alternative asset managers, portfolio companies, and institutional investors.

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18 David Welch & Dana Hull, *Musk Talked Merger with SolarCity CEO Before Sale of Stock*, Bloomberg (Aug. 31, 2016), available at https://www.bloomberg.com/news/articles/2016-08-31/musk-talked-merger-with-solarcity-ceo-before-tesla-stock-sale.

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