

KIRKLAND M&A UPDATE

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Keeping It Private – Tough Disclosure Issues in Take-Private Transactions

Recent SEC settlements illustrate the need for careful consideration of the need to update ownership disclosures to reflect material changes when pursuing a going-private transaction.

One of the tougher issues buyers face when engaging in preliminary discussions regarding a potential going-private transaction is whether and when an amendment to required SEC stock ownership disclosures needs to be filed as steps are taken to advance the transaction. Recent settlements between the SEC and officers, directors and major shareholders for failure to update their stock ownership disclosures to reflect material changes — including steps to take a company private — illustrate the importance of careful consideration of these issues when pursuing a going-private transaction.

Regulatory Framework

U.S. securities laws and regulations require any person or group who has acquired beneficial ownership of more than five percent of the stock of a public company to file with the SEC a Schedule 13D identifying (1) the beneficial owners, (2) the purpose of the acquisition, including any plan to affect the issuer's board of directors or to cause an extraordinary corporate transaction, such as a going-private transaction, and (3) the interests of each beneficial owner, including those acting as a group. (Note that acquisition of a greater than five percent block by a passive investor and by certain institutional investors is usually reported on a "short-form" Schedule 13G.) Generally, two or more people who have agreed to act together for the purpose of acquiring, holding, voting or disposing of stock are deemed to be a group. The stock holdings of the entire group are then aggregated on Schedule 13D and each group member is deemed to beneficially own that aggregate number of shares.

A stockholder with a 13D on file must "promptly" amend it whenever there is a "material" change or development affecting the prior disclosures. A one percent or larger change in ownership is *per se* material, but there is no bright-line test to determine whether and when a filer must update qualitative disclosures regarding plans for its investment. For example, a 13D must be updated once a filer "formulates" a plan to engage in an extraordinary transaction (e.g., a proxy fight or a take-private), but the SEC takes the position that an amendment may be required even before a plan is formulated if there is a "material change" in the facts set forth in the original filing. The SEC has indicated that it does not believe that "stale" or "boilerplate" language included in many 13Ds stating the filer "reserves" its right to consider and pursue various future extraordinary transactions is sufficient to cover material steps taken towards a specific transaction. If these steps are taken, an amendment may be required, with or without the boilerplate.

As noted in the [SEC's press release](#) announcing the recent settlements, the parties took what the SEC viewed as "significant steps" towards a going-private transaction that, when viewed together, resulted in a material change from previous disclosures in existing 13Ds. These "significant steps" included seeking waivers from the target's preferred shareholders, determining the transaction structure, assisting the target with shareholder vote projections, informing target management of the deal plan, and forming a consortium for a going-private transaction.

While there is no bright-line test for determining which actions may require a 13D amendment, the SEC's recent enforcement actions indicate that it is keeping a close eye on this issue. While the financial penalties in these cases were small (which could be a result of this being a "broken windows" warning to the market), the reputational and other risks with violations of 13D obligations can be steep.

Effect on Going-Private Transactions

The need to update promptly a 13D not only affects a more-than-five-percent stockholder contemplating leading a take-private (including a potential acquirer who may have taken a greater-than-five-percent “toehold” position in a prospective target), but it can also affect 13Ds on file for significant stockholders and/or management who are asked to participate in, support or roll-over a portion of their target investment into the transaction. The act of signing a customary confidentiality agreement, particularly one with a stand-still, may require consideration of whether public disclosure is required under a 13D amendment.

Even potential acquirers, including financial buyers, who do not own any shares in a target need to be sensitive to these requirements if and when they approach a target with shareholders who are 13D filers, because the steps the potential acquirer take may impact the amendment obligations of these existing 13D filers, leading to premature disclosure of the approach. It is therefore important for a potential

acquirer to account for the risk of creating a 13D disclosure obligation for anyone connected to the target at each step of and in each communication relating to a take-private transaction. For example, in one of the recent 13D cases, emails, not formal communications, among the parties provided the factual basis for the SEC’s charges.

A potential acquirer considering taking a less-than-five-percent “toehold” position in a target should also evaluate how a 13D filing (together with its amendment requirements) might limit its ability to approach other stockholders on a confidential basis when pursuing a potential take-private. As with 13D amendments, there is no bright-line rule as to when a group has been formed, so a potential acquirer holding even less than five percent of a target’s stock who reaches out to other stockholders could unwittingly trigger a 13D filing obligation as part of a group that in the aggregate exceeds the five percent threshold, or later face a hindsight challenge from the SEC as to whether or when a group had been formed.

If you have any questions about the matters addressed in this *M&A Update*, please contact the following Kirkland authors or your regular Kirkland contact.

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