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KIRKLANDPEN
Private Equity Newsletter

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

PENpoints

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.

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Effect on Going-Private Transactions

The need to promptly update a 13D not only affects a more-than-five-percent stockholder (either individually or when viewed in conjunction with group members) contemplating leading a take-private (including a private equity sponsor with a "toe-hold" 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. Signing a customary confidentiality agreement, particularly one with a standstill, 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 steps the potential acquirers take may impact amendment obligations of these existing 13D filers, leading to premature disclosure of the approach. It is therefore important for a sponsor pursuing a take-private transaction 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 the deal. 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.[1]

A sponsor considering taking a less-than-five-percent "toe-hold" 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 sponsor 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.

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1 A private equity sponsor who is a registered investment adviser should be mindful that the SEC will have access to all of its emails in connection with an examination.

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

Daniel E. Wolf
http://www.kirkland.com/dwolf
+1 212-446-4884

Norbert B. Knapke II
http://www.kirkland.com/nknapke
+1 312-862-3350

PENbriefs

Crossing State Lines Again – Appraisal Rights Outside of Delaware

While appraisal rights have become a more prominent issue for Delaware corporations, not every target is incorporated in Delaware. In our recent *M&A Update* we discuss appraisal provisions in other other states and compare them to the corresponding Delaware rules.

Municipal Debt Investors May Be on Uneven Footing in Chapter 9

Political and other considerations may cause investors in municipal securities to face a greater risk of recovery than certain other creditors in a municipal bankruptcy. To learn more, see our recent *Alert*.

PENnotes

2015 Private Equity & Venture Capital Conference
Chicago, Illinois
April 15, 2015

The Kellogg School of Management is proud to present its annual Private Equity and Venture Capital Conference. This year's conference will explore the challenges of building value at both the fund and portfolio company level. Kirkland partners Meg Gibson and John O'Neil will speak at the conference. Click here for more information.

35th Annual Ray Garrett Jr. Corporate and Securities Law Institute
Chicago, Illinois
April 30 - May 1, 2015

The Ray Garrett Jr. Corporate and Securities Law Institute is the pre-eminent securities law conference in the Midwest. It is the only Midwest conference that brings together senior officials from the U.S. Securities and Exchange Commission and leading securities practitioners. Kirkland partners Robert Hayward, Scott Falk, and Keith Crow are members of the Executive Committee. Robert Hayward will also chair a session on Cybersecurity and Data Breach. Click here for more information.

PLI Delaware Law Developments 2015: What All Business Lawyers Need to Know
New York, New York
June 4, 2015

Delaware law continues to play a critical role in U.S. corporate and securities law, particularly in today's challenging business environment. This unique annual program focuses on the important Delaware corporate law developments over the past year and the practical impact on your corporate or legal practice. The very top Delaware corporate law experts from the Delaware judiciary, leading law firms and corporations, and academia will examine the latest case law and practical trends and share their real-world experiences, insights and advice on the issues of greatest concern to the corporate/securities legal community. Kirkland partner Yosef Riemer will speak at the event. Click here for more information.

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Kirkland & Ellis' nearly 400 private equity attorneys have handled leveraged buyouts, growth equity transactions, recapitalizations, going-private transactions and the formation of private equity, venture capital and hedge funds on behalf of more than 400 private equity firms around the world.

Kirkland has been widely recognized for its preeminent private equity practice. The Firm was named "Private Equity Group of the Year" in 2012, 2013 and 2014 by *Law360* and was commended as being the most active private equity law firm of the last decade in *The PitchBook Decade Report*. Kirkland & Ellis was named "Law Firm of the Year" in Mergers and Acquisitions Law by U.S. News Media Group and Best Lawyers in their 2014 "Best Law Firms" rankings. The Firm was named "Best M&A Firm" at *World Finance*'s 2014 Legal Awards, "North American Law Firm of the Year: Fund Formation" and "North American Law Firm of the Year: Transactions" at Private Equity International's 2014 Private Equity International Awards and "Private Equity Deal of the Year" at the 2014 IFLR Americas Awards.

In 2012, 2013 and 2014, Chambers and Partners ranked Kirkland as a Tier 1 law firm for Investment Funds in the United States, United Kingdom, Asia-Pacific and globally. The Firm was ranked as the #1 law firm for both Global and U.S. Buyouts by deal volume in Mergermarket's *League Tables of Legal Advisors to Global M&A for Full Year 2011, 2012, 2013* and *2014*, and has consistently received top rankings among law firms in Private Equity by The Legal 500, the Practical Law Company and IFLR, among others.

The Lawyer magazine has recognized Kirkland as one of its "Transatlantic Elite" every year since 2008, having noted that the Firm is "leading the transatlantic market for the provision of top-end transactional services ... on the basis of a stellar client base, regular roles on top deals, market-leading finances and the cream of the legal market talent."

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EDITORS
Jack S. Levin, P.C.
Margaret A. Gibson, P.C.
Norbert B. Knapke II

SUBSCRIPTIONS
To subscribe to *KirklandPEN*, please email
kirklandpen@kirkland.com
+1 (312) 862-3356