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BLOG

Going Private Post-DeSPAC—Strategies and Considerations

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For the past several years, many private companies looking to “go public” utilized special purpose acquisition companies (SPACs) instead of traditional IPOs as an alternate route to the public markets. SPACs sometimes can be used to take private companies public without the costs and burdens associated with traditional IPOs (the process is often called a deSPAC). However, as newly public companies face rigorous public company disclosure obligations, onerous compliance requirements, and market volatility, some deSPAC companies may consider taking the company private again through a “going-private” transaction.

DeSPAC companies considering a going-private deal will need to consider a range of factors to determine if a return to the private market is the right choice, including: (1) the structure of the transaction; (2) navigation of fiduciary duties; and (3) disclosure obligations.

STRUCTURE

Public companies typically go private through a negotiated merger (sometimes called a “one-step” merger) or a tender or exchange offer, followed by a back-end merger (a “two-step” merger).

One-Step Merger

In a one-step merger, the party seeking to take the deSPAC company private negotiates a merger agreement with a special committee of the company’s board of directors (or the disinterested and independent members of the board). The company’s stockholders vote on the merger proposal after the preparation (and potential Securities and Exchange Commission (SEC) review) of a proxy statement detailing the transaction.

Two-Step Merger

Two-step mergers include (i) a direct tender offer to public shareholders and (ii) a back-end merger to complete the transaction without a shareholder vote promptly following consummation of the tender offer. The two-step structure offers speed and deal certainty, as the company can commence stockholder solicitation activity prior to SEC review (if any) and no shareholder vote is required.

DeSPAC companies should understand the strategic advantages and disadvantages that come with each structure. While the two-step structure might be faster, tender offers are subject to Rule 14d-10 under the Securities Exchange Act of 1934 (the Exchange Act), known as the "best price rule," whereby the "consideration paid to any security holder for securities tendered in the tender offer is the highest consideration paid to any other security holder for securities tendered in the tender offer."[1] If the transaction requires "rollover" of management securities, the securities can be seen as additional consideration, triggering the "best price rule." The flexibility in negotiating consideration and the time frame associated with the deal should be considered by deSPAC companies when deciding how to structure a take-private deal.

SHOULD MY COMPANY USE A ONE-STEP OR TWO-STEP MERGER?	
ONE-STEP MERGER	**TWO-STEP MERGER**
Advantages	
• If the deSPAC company is considering management equity rollovers, the "best price rule" will not be implicated in a one-step merger. • If regulatory issues are implicated, the acquiror can still solicit shareholder approval while waiting for regulatory approval—which can make a one-step merger faster than a two-step merger facing similar regulatory issues.	• The tender offer and back-end merger might result in a faster transaction (perhaps as quickly as 20 days from mailing to acquisition). • Once the acquiror holds a majority (or the necessary percentage required to control the entity), the likelihood of closing is all but guaranteed.
Disadvantages	
• The deSPAC company will need to file a proxy statement and solicit votes for an eventual shareholder meeting, which can mean more time and expense. • Increased likelihood of SEC review and scrutiny.	• If the deSPAC company seeks to "roll over" management equity, the acquiror might trigger the "best price rule." • Can be subject to delays if there are regulatory issues.

FIDUCIARY DUTIES

Going-private transactions often face lawsuits challenging the transactions on claims of breach of fiduciary duty, especially when the transaction is initiated by a controlling stockholder. When challenged, a Delaware court will apply the "entire fairness" standard of review, requiring the company board of directors to demonstrate that the deal was fairly priced and effected through a fair course of dealing. A company can implement procedural safeguards to prevent the application of the “entire fairness” standard by ensuring that the transaction was approved by: (1) a special committee, comprised of independent and disinterested directors who negotiate and recommend terms to the board; and (2) a majority of unaffiliated public stockholders in a fully informed vote. With these procedural safeguards in place, a Delaware court will instead analyze the conflict under the “business judgment rule,” placing the burden of proof on the plaintiff as opposed to the company. The burden-shifting to the plaintiff in a fiduciary duty action can help prevent challenges for breach of fiduciary duty for deSPAC companies looking for a return to the private markets.

DISCLOSURE OBLIGATIONS

Although many now-public companies might look to go private to avoid public disclosure obligations, the act of taking a company private carries its own broad disclosure requirements. The SEC promulgated Rule 13e-3 under the Exchange Act to provide unaffiliated stockholders with access to information regarding going-private transactions. Rule 13e-3 is triggered when the acquiror, or any member of the acquiror group, is an affiliate of the company (a common occurrence for deSPAC companies). Rule 13e-3 disclosure is extensive and requires documentation of all stages of the transaction. Companies planning for a going-private transaction should take particular care to initiate discussions and negotiations with the understanding that such documents and negotiations might eventually be publicly disclosed.

Additionally, controlling stockholders will need to be sensitive to Section 13(d) of the Exchange Act, which requires persons or groups that acquire beneficial ownership of more than 5% of a class of equity securities to file beneficial ownership reports (see our recent blog post regarding updates to Schedule 13D reporting requirements). Acquirors will need to disclose any acquisition of company stock with the intent to control or effect a going-private transaction.

NAVIGATING THE PATH TO GOING PRIVATE

The legal issues that deSPAC companies face on the path to taking the company private will be unique to each company’s specific circumstances: (1) timeline, (2) financing and available capital, and (3) strategic goals will dictate which structure or path a company should take. To make the right choice, consider reaching out to Winston’s capital markets specialists for advice on strategic considerations in a going-private transaction.

Capital Markets & Securities Law Watch will continue to monitor developments in this area and will provide our readers with updates.

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[1] 17 C.F.R. § 240.14d-10(a)(2).
4 Min Read

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