Schedule 13D Amendments in Take-Private Transactions: Three Considerations

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Over the past several years, private equity sponsors have increasingly pursued take-private transactions, driven by a combination of factors including ongoing market volatility, perceived undervaluation of certain public companies relative to their long-term prospects and the rise of private debt financing to facilitate these deals.

At the same time, the Securities and Exchange Commission (the "SEC") has continued its focus on Schedule 13D amendments made by private equity sponsors in connection with take-private transactions. Failure to timely amend a Schedule 13D can result in cease-and-desist proceedings or enforcement actions, which could lead to civil monetary penalties and cause reputational damage. Alternatively (or sometimes, in addition), the SEC may issue a comment letter questioning the timing and contents of a private equity sponsor's Schedule 13D in connection with the take-private transaction. Such back and forth with the SEC can, among other things, have the effect of delaying the completion of a transaction by delaying the target's stockholder meeting to approve the transaction.

Below, we provide an overview of the rules related to Schedule 13D and discuss three considerations related to Schedule 13D amendments that should be top-of-mind when considering a take-private transaction.

Overview

Section 13(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the rules promulgated thereunder require any person or entity that acquires "beneficial ownership" of more than 5% of a class of voting equity securities listed on a national securities exchange to file a statement of beneficial ownership on Schedule 13D or, in certain circumstances, on Schedule 13G.[1] A person or entity is considered to have

[1] A person or entity that beneficially owns more than 5% of a class of listed voting equity securities may be eligible to file a "short-form" Schedule 13G under certain circumstances, including if such person beneficially owned its securities prior to the issuer's listing or if the person acquired the securities without the purpose or effect of changing or influencing control of the issuer. While not discussed in this article, a take-private transaction may preclude a person from filing on Schedule 13G in lieu of Schedule 13D.

"beneficial ownership" of a security if such person or entity has, directly or indirectly, voting or investment power over such security, or the right to acquire voting or investment power within 60 days. The term "person" includes any group of persons that agrees to act together for the purpose of acquiring, holding, voting or disposing of such securities.

Schedule 13D requires detailed disclosure of information relating to the reporting person and the securities it beneficially owns. For example, Item 4 of Schedule 13D requires the reporting person to state the purpose or purposes of the acquisition of securities, including a discussion of any plans or proposals of the reporting persons that could reasonably result in specified transactions, including (i) changes in the issuer's board of directors or management, (ii) the acquisition or disposition of securities of the issuer, (iii) causing a class of securities of the issuer to be delisted or deregistered, (iv) the sale or transfer of a material amount of assets of the issuer or (v) engaging in extraordinary corporate transactions, such as a merger, reorganization or liquidation. Following the initial filing of a Schedule 13D, any subsequent material change in the information reported on the Schedule 13D, including any information reported in Item 4, requires an amendment to be filed within two business days of such material change.

Consideration 1: Changes in Investment Purpose, Plans and Proposals

In the context of take-private transactions, the requirement to amend a Schedule 13D will be triggered by a material change to the reporting person's investment purpose under Item 4 of Schedule 13D, to disclose the reporting person's plan or proposal to engage in the potential transaction. Often, disclosure of such change in investment purpose will put pressure on the transaction process and may drive up the company's stock price prior to the execution of definitive transaction documentation, particularly if the potential take-private transaction is mentioned in the amendment. Uncertainty regarding how definite a plan or proposal must be before a disclosure obligation is triggered has led to numerous comments from the SEC questioning the timing of filing Schedule 13D amendments (which are often based on comparing the Schedule 13D filings against the "Background of the Merger" disclosure in the issuer's proxy statement related to the stockholder meeting to approve the transaction), and has also resulted in several enforcement actions against the persons who have failed to make timely filings. However, it may be possible to defer forming the requisite material change in investment purpose, delaying the requirement to amend a Schedule 13D, if carefully managed.

SEC comment letters and enforcement actions provide helpful guideposts when considering when a Schedule 13D amendment should be made in connection with a

take-private transaction. Examples of actions taken by Schedule 13D reporting persons that the SEC has stated triggered a duty to amend Item 4 include:

- working with lawyers and other shareholders to submit a proposal to the issuer's board;
- deciding on a specific transaction structure;
- securing waivers from other shareholders to assist in an eventual transaction;
- discussing a third-party valuation report with officers and directors of the issuer;
- receiving information about issuer board meetings discussing matters relevant to the transaction;
- drafting an offer letter to the issuer with a "placeholder" offer price per share and providing such draft to outside counsel for review; and
- submitting an offer letter to the issuer.

While the above actions provide helpful guidelines, disclosure decisions are always context-specific, and no single factor should be considered definitive. Instead, the reporting person should consider the actions it has taken as a whole, together with what it has previously disclosed, when determining the appropriate time to amend its Schedule 13D.

Consideration 2: Group Formation

In addition to the private equity sponsor, a take-private transaction may involve other shareholders of the issuer (including management of the issuer). Such involvement often takes the form of voting and support or rollover agreements, whereby such other shareholders agree to vote in favor of the take-private transaction in exchange for equity interests in the surviving private company. When engaging in discussions with other persons in connection with a potential take-private transaction, it is important to remember that a Section 13 "group" may be formed with such other persons due to any arrangements or agreements that arise from such discussions. When two or more persons agree to act together for the purpose of acquiring, holding, voting or disposing of securities of an issuer, such agreement will form a group amongst such persons.

When a Section 13 group is formed, the group is deemed to have acquired beneficial ownership of all applicable securities of the issuer beneficially owned by any member of the group, as of the date of formation of the group. As a result, the group becomes subject to the reporting requirements of Section 13(d), even if the persons comprising the group individually do not beneficially own more than 5% of the applicable securities of the issuer. Additionally, group members with an existing Schedule 13D will be required to file an amendment disclosing the formation of the group.

Accordingly, when discussing a potential take-private transaction with other shareholders of the issuer, private equity sponsors should remember that formation of a Section 13 group will trigger prompt disclosure. As with Item 4 disclosure, as noted above, it may be possible to defer forming a group, delaying the requirement to file or amend a Schedule 13D, if carefully managed.

Consideration 3: Arrangements with Respect to Securities of the Issuer

In addition to Item 4 disclosure related to investment purpose, private equity sponsors should also keep in mind other Schedule 13D line-item disclosure triggers, particularly Items 6 and 7. Item 6 of Schedule 13D requires a description of any contracts, arrangements, understandings or relationships between the reporting person and any other person with respect to the securities of the issuer, including if such securities are used as reference securities. Item 7 of Schedule 13D requires, among other things, copies of any written agreements relating to the arrangements disclosed in Item 6 to be filed as exhibits. Importantly, while Item 7 only requires written agreements to be filed as exhibits, Item 6 is not limited to written agreements; descriptions of oral arrangements also must be disclosed. Examples of arrangements which may need to be disclosed include, but are not limited to, offer letters, lock-up agreements, voting and support agreements, and rollover agreements.

As a result, private equity sponsors considering take-private transactions should remember that making material arrangements with respect to the issuer's securities will trigger a Schedule 13D amendment.

Conclusion

Given the SEC's focus in recent years on the timing and contents of Schedule 13D amendments in relation to take-private transactions, it is important for private equity sponsors to keep these considerations in mind, remain coordinated with their counsel and ensure any required amendments are made in a timely manner.

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