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The Latest on Schedule 13D and Going Private Transactions

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In a going private transaction in which a Schedule 13D filer (generally, a non-passive holder of more than 5% of a publicly traded issuer's voting equity securities) is a participant, one of the first questions to arise is whether and when the filer's obligation to promptly update its "purpose" disclosure in Item 4 of its Schedule 13D is triggered. It is sometimes the case that filers will update that disclosure later than they should, or even as late as the time a deal is announced.

The Securities and Exchange Commission recently charged and settled with several directors, officers and major shareholders in connection with their participation in going private transactions. The gravamen of the SEC's actions was that these persons took "significant steps" towards the going private transaction in question without updating the relevant disclosures in their respective Schedule 13D. In particular, the SEC stated that "Stale, generic disclosures that simply reserve the right to engage in certain corporate transactions do not suffice when there are material changes to those plans, including actions to take a company private." Notably, part of the SEC's claims were based on emails and other communications by the participants which indicated that they had taken steps to effect the undisclosed take-private transaction, including determining the form of the transaction, obtaining waivers from certain shareholders and forming a consortium of participating shareholders. The SEC viewed these significant steps, when taken together, as causing a material change that required a prompt amendment to the filers' Schedule 13D.

Determining when to disclose a change in purpose, in the context of pursuing a going private transaction, is always something of a judgment call. The buyer group is understandably concerned about disclosures that occur too early in advance of discussions “crystalizing” on a deal, and the prospect of disclosing when, in fact, there may be no deal because the target company is opposed to a take private.

The SEC’s recent enforcement actions will impact the calculus on those determinations and, in particular, suggest that a more careful and cautious assessment by deal lawyers than usual, as well as additional planning and preparation, may be warranted. The SEC’s actions also raise the possibility that an amendment to the buyer’s Schedule 13D may need to occur earlier than previously thought, particularly if a waiver by the target under state antitakeover laws or an amendment by the target of its shareholder rights plan (or “poison pill”) is necessary in order to assemble the buyer group consortium or to otherwise facilitate the transaction.

It remains to be seen whether the SEC’s recent actions on Schedule 13D in the context of going private transactions are indicative of a larger trend by the SEC, or were focused on a select group whose actions were viewed as particularly egregious by the SEC. It is worth noting that the SEC has in the past taken strong enforcement actions against violators of Regulation 13D in the context of going private transactions. One such example is *SEC v. William A. Wilkerson* (October 27, 2003), where the SEC obtained a cease and desist order against the buyer group for violating Regulation 13D and Rule 13e-3 in a going private transaction, and which order compelled the buyer group to vote its shares for or against the transaction in the same proportion as the unaffiliated shareholders voted. This drastic remedy is illustrative of how far the SEC may be willing to go in response to alleged violators of Schedule 13D and Rule 13e-3.

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Going private transactions always are among the most difficult of M&A transactions to execute, even under the best of circumstances. The SEC’s recent enforcement actions reinforce the need for, and role of, experienced deal lawyers to navigate the complex disclosure issues that invariably arise in going private transactions.

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