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**U.S. PRIVATIZATIONS**

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# FOREWORD

Many companies listed on U.S. stock exchanges with operations in China and Hong Kong have recently conducted “going private” transactions that take them off the U.S. exchanges and out of the U.S. public markets. Some of these companies remain private, while others have contemplated relisting on other exchanges, such as on the Hong Kong Stock Exchange. Other companies are considering, or may benefit from, such transactions, which reduce public scrutiny of the companies’ operations and help companies save money on compliance costs, though at the price of a less liquid stock. Going private transactions themselves are highly scrutinized by regulators and other shareholders, and are often the subject of litigation, and thus require careful planning.

*The MoFo Guide to U.S. Privatizations* (“Guide”) provides an overview of going private transactions and:

- explores various ways that a public company can go private;
- outlines potential advantages and disadvantages of going private;
- examines key legal obligations related to a going private transaction, including the fiduciary duties of directors and, to some extent, controlling or other large shareholders and required public disclosures; and
- outlines potential procedural safeguards and other ways of managing the process that may help lower the cost of such transactions.

The Guide is focused on companies doing business in China and Hong Kong, and so addresses issues typically faced in going private transactions by the kinds of companies used to engage in those activities. Accordingly, the Guide reviews the rules of several jurisdictions under which many of these companies are organized, including the rules of the Cayman Islands and the British Virgin Islands, as well as those of Delaware. It also reviews U.S. federal securities rules and the implications of having shareholders largely residing outside of the United States.

While we have tried to make the Guide as informative as possible, please kindly note that it is only an overview of the major legal, regulatory and practical issues involved in the U.S. privatization process as of November 5, 2012 and therefore should not be relied upon as legal advice in any jurisdiction. Because of the generality of the Guide, the information provided herein may not be applicable to all situations and should not be acted upon without specific legal advice based on particular situations.

We hope that you enjoy the Guide and find it readable, helpful and useful. Please do not hesitate to contact any of the members of our corporate team listed on the next page if you have any questions or comments.

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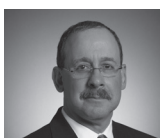


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## SECTION 1

# WHAT IS A “GOING PRIVATE” TRANSACTION?

“Going private” is sometimes used in a general business sense to refer to any deal in which a publicly traded company ceases to be publicly traded, such as when the company is acquired by a third party and becomes a wholly owned subsidiary of the third party, and as such, is taken out of the public securities market. In a more legal sense, however, particularly for purposes of the U.S. federal securities rules, “going private” has a narrower meaning and refers to a subset of such transactions in which a person who controls or otherwise is an affiliate of a publicly traded company acquires the remaining shares of the company.

### WHAT IS “CONTROL”?

For these purposes, “control” does not require actual majority holdings or absolute control, but rather only the power to direct or cause the direction of the management of the company. Control can be held or exercised through share holdings, contract or otherwise, and is determined by reference to the specific circumstances of a company.

### WHO IS AN “AFFILIATE”?

“Affiliate” means a person who, directly or indirectly, controls, is controlled by, or is under common control with, the company. These terms thus typically may cover all directors, executive officers and larger shareholders of a company.

Going private transactions often are effected with additional investment by private equity firms and debt provided by banks or other sources, in what are known as leveraged or management buyouts. Going private transactions may take many different forms; however, they are most typically conducted through one of the following:

#### Cash-out Merger

All outstanding shares of the company, other than shares held by the buyer or buying group, are converted into cash, following majority or other approval of the shareholders.

#### Cash Tender Offer

The acquirer purchases the outstanding shares directly from other shareholders, usually followed by a “squeeze-out” merger of any shareholders who did not accept the tender offer (sometimes referred to as a “two-step” approach).

#### Reverse Stock Split

Persons with smaller holdings who otherwise would receive fractional shares are given cash in lieu of the fractional shares, so that the company ends up with fewer shareholders.

#### Offshore Companies

For a company incorporated in the Cayman Islands (“Cayman”) or the British Virgin Islands (“BVI”), a scheme of arrangement, a squeeze-out transaction or a statutory merger.

Companies sometimes seek certain of the advantages of a going private transaction by taking steps to reduce the number of their shareholders so that they can remove themselves from the U.S. stock exchange and the related disclosure requirements, in what are known as “going dark” transactions. Such companies still may need to contend with any remaining shareholders, however, so they are not in the same position as a company that has “gone private.”



## SECTION 2

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# OVERVIEW OF THE LEGAL SCHEMES

In connection with going private transactions, companies must comply with a variety of laws, including principally (i) the law of their jurisdiction of incorporation, whether inside the United States or elsewhere, and (ii) U.S. federal securities laws, such as the U.S. Securities Exchange Act of 1934 (the “U.S. Exchange Act”). U.S. federal securities rules distinguish between companies organized under the laws of one of the U.S. states and certain companies organized under the law of jurisdictions outside the United States that are listed or traded in the United States but are largely held and operated outside the United States. Of course, other laws also may apply, such as regulatory issues related to the business of the company.

## A. U.S. DOMESTIC ISSUERS

### STATE LAW

U.S. states impose fiduciary duties on directors of companies organized in their states. While the duties imposed by different states have much in common, they still can vary materially in specific contexts. State law also imposes certain procedural requirements, such as the vote of the shareholders required to approve a merger, and the mechanics for holding a shareholder vote, or the process required for a tender offer and a squeeze-out merger. This Guide focuses on the law of the state of Delaware, since more public corporations are incorporated in Delaware than in any other state, and Delaware has developed an extensive body of case law that other states often look to for guidance and as a reference, if not for authority.

### U.S. SECURITIES LAWS

U.S. securities laws with respect to going private transactions focus primarily on disclosure, with the specific requirements determined by the structure of the particular transaction. The U.S. Securities and Exchange Commission (the “U.S. SEC”) tends to look closely at going private transactions, viewing them as one-sided and potentially giving the acquirer an unfair advantage in terms of, among other things, access to information about the company compared to the public shareholders or other potential acquirers. The U.S. SEC also is concerned that the acquirer might have undue influence over other directors and corporate insiders who may have been put in place by the acquirer or may otherwise have close relationships with the acquirer. The U.S. SEC thus typically does an extensive review of filings made in connection with these transactions.

In addition, a shareholder who owns more than 5% of the stock of a U.S. public company will be subject to U.S. federal securities disclosure obligations, including the requirement to disclose its intent with respect to its holdings and to amend any such disclosures to reflect any changes in its intent. This requirement sometimes requires announcements by potential acquirers of proposals for a going private transaction even before they are agreed upon with the company.

## B. NON-U.S. ISSUERS

### LOCAL LAW

As with the laws of the U.S. states, the laws of the jurisdiction in which a company is organized outside the United States frequently impose fiduciary duties on corporate insiders. Such laws also determine the available



structures and required procedures for going private transactions. This Guide focuses on Cayman and BVI law because many of the U.S.-listed companies with operations in Hong Kong and China are incorporated in, or have subsidiaries in, one of these two jurisdictions.

In general, the laws of Cayman and the laws of BVI related to going private transactions are largely similar. Companies incorporated in Cayman or BVI have conducted going private transactions through a scheme of arrangement, which is a court-supervised process in which a supermajority approval of the affected shareholders is required, or through squeeze-out transactions or statutory mergers.

## U.S. SECURITIES LAWS – FOREIGN PRIVATE ISSUERS

A company organized outside the United States, but traded on a U.S. stock exchange, will be subject to U.S. securities laws. However, the U.S. securities laws have some provisions for companies that have fewer contacts with U.S. residents. More specifically, these accommodations are made available to “foreign private issuers.”

### WHO IS A “FOREIGN PRIVATE ISSUER”?

A company is treated as a “foreign private issuer” if it is organized outside the United States and has one of the following:

- 50% or less of its outstanding voting securities held of record by U.S. residents
- more than 50% of its outstanding voting securities held of record by U.S. residents but does not have any one of the following:
  - (1) a majority of its executive officers or directors are United States citizens or residents,
  - (2) more than 50% of its assets are located in the United States, or
  - (3) its business is administered principally in the United States

See Rule 3b-4 of the U.S. Exchange Act.

The accommodations for foreign private issuers include:

- U.S. federal proxy rules do not apply to foreign private issuers, who instead must follow the rules of their local jurisdictions.
- U.S. federal tender offer rules apply to tender offers for equity securities of foreign private issuers, but provide some relief depending on the proportion of shares held outside the U.S.:
  - *The Tier I exemption:* Provides broad relief from U.S. tender offer disclosure requirements when no more than 10% of the class of subject securities are held by U.S. holders.
  - *The Tier II exemption:* Provides more limited relief from U.S. regulation when no more than 40% of the class of subject securities are held by U.S. holders. The Tier II exemption is designed to allow bidders in cross-border transactions to comply with certain home country procedural requirements instead of U.S. regulations.<sup>1</sup>

1. Rule 3a12-3(b) of the U.S. Exchange Act.

## SECTION 3

# WHY DO COMPANIES GO PRIVATE?

## A. POTENTIAL ADVANTAGES AND DISADVANTAGES OF GOING PRIVATE

POTENTIAL ADVANTAGES	POTENTIAL DISADVANTAGES
<p>Because a going private transaction results in a company no longer being subject to the periodic filing requirements of the U.S. SEC,<sup>2</sup> going private can result in a significant reduction in legal and accounting costs and the elimination of internal costs related to U.S. SEC compliance, including senior management time spent on compliance.</p> <p>Other possible advantages include:</p> <ul style="list-style-type: none"><li>• realizing the full value of a company when the public market does not adequately value the company and enhancing the company's ability to pursue outside financing based on cash flow, revenue projections and cash balance rather than on a possibly undervalued stock price;</li><li>• allowing management to focus on long-term goals and objectives, rather than short-term management of market expectations;</li><li>• removal of the company's operations from public scrutiny and minimization of the need to disclose sensitive information that competitors can utilize;</li><li>• increased knowledge of, and control over, the company's shareholder base, and reduction in the cost of servicing the remaining, smaller shareholder group;</li><li>• additional corporate governance flexibility; and</li><li>• providing shareholders who are not part of the acquisition group with an opportunity to maximize the value of their stock in a depressed market.</li></ul>	<p>There are certain disadvantages to going private. Most important, there will no longer be a public market for a company's stock, which will:</p> <ul style="list-style-type: none"><li>• reduce liquidity for the remaining shareholders, if any;</li><li>• limit the company's ability to access capital markets to raise money;</li><li>• impact the company's ability to make acquisitions utilizing its stock as currency; and</li><li>• reduce the attractiveness of stock-based incentive plans to employees.</li></ul>

2. This assumes that the company also "goes dark," as discussed more fully in Section 11 of this Guide, "Going Dark – Delisting and Deregistration."

## B. WHY DO U.S.-LISTED CHINESE COMPANIES GO PRIVATE?

There were more than 60 Chinese companies listed on U.S. exchanges from 2008 to 2011, including a number of smaller Chinese companies formed by “reverse mergers” (see below). However, due to a number of high-profile cases, U.S. investors have raised concerns about the accounting and corporate governance standards of U.S.-listed Chinese companies, and many U.S. investors have lost confidence in such companies. Although allegations of fraud from short-seller firms and investigations by the U.S. SEC were generally targeted at Chinese companies listed through reverse mergers, the valuations of other U.S.-listed Chinese companies have also been adversely affected. As a result, there has been a trend since the end of 2011 for U.S.-listed Chinese companies to go private.

### REVERSE MERGERS

#### What is a reverse merger?

In a reverse merger, a private company merges with a public U.S. shell company, and the formerly private company becomes listed on a U.S. exchange, such as the New York Stock Exchange (“NYSE”) or the NASDAQ Stock Market (“NASDAQ”), without having to fulfill the stringent disclosure requirements of an initial public offering (“IPO”) in the United States while still facilitating its access to the capital markets.

Typically, the shareholders of the private company exchange their shares for a large majority of the shares of the public shell company. Although the public shell company survives the merger, the private company’s shareholders gain a controlling interest in the voting power and outstanding shares of stock of the public shell company. Also, the private company’s management typically takes over the board of directors and management of the public shell company. The assets and business operations of the post-merger surviving public company are primarily, if not solely, those of the former private company.

#### Why pursue a reverse merger?

A reverse merger often is perceived to be a quicker and cheaper method of “going public” than an IPO. The legal and accounting fees associated with a reverse merger tend to be lower than for an IPO. In addition, while the public shell company is required to report the reverse merger on a Form 8-K filing with the U.S. SEC, there are no registration requirements under the U.S. Securities Act of 1933, as amended (the “U.S. Securities Act”), as there would be for an IPO. In addition, being public may give a company increased value in the eyes of potential acquirers.

Because many U.S.-listed Chinese companies have controlling shareholders (such as a founder), the going private transactions can effectively be accomplished by the controlling shareholders acquiring all of the shares of the listed company from the public minority shareholders, who receive cash in exchange for their shares. In addition, many U.S.-listed Chinese companies are in businesses that have stable cash flows and strong balance sheets, which may help them to attract private equity investors to finance the going private transactions.

After going private, some of these companies aim to re-list in Hong Kong, where the valuation of Chinese companies tends to be higher and analyst research coverage is seen as being more positive toward Chinese companies. However, for Chinese companies that went private due to accounting or corporate governance problems, the stigma associated with such problems may pose a challenge with respect to a subsequent listing because stock exchanges and regulators often require issuers to disclose their history and may, in some cases, have suitability requirements that are difficult for such companies to fulfill. For a more detailed analysis of the

## SECTION 3 > WHY DO COMPANIES GO PRIVATE?

initial public offering process in Hong Kong, please see *The MoFo Guide to Hong Kong IPOs*, which can be found at our China Capital Markets website ([www.mofo.com/hk-capital-markets](http://www.mofo.com/hk-capital-markets)).

### C. CANDIDATES FOR A GOING PRIVATE TRANSACTION

While there is no model blueprint of public companies that are good candidates for going private, most candidates generally have, among others, the following characteristics:

<b>Management Team</b>	A strong management team that is able to run and create a more efficient company with the same cash-generating ability
<b>Market Capitalization</b>	Small- and mid-sized market capitalization, because the shares of such smaller companies are more likely to be undervalued
<b>Insider Ownership</b>	Significant insider ownership so that fewer shares need to be acquired
<b>Cash Flows</b>	Stable cash flows, a strong balance sheet with a low amount of outstanding debt and an established customer base, particularly if external financing is desired

### D. TRANSACTION COSTS

Companies contemplating going private transactions also need to consider the cost of the going private process. In addition to paying traditional transaction expenses, the shareholder or affiliate group seeking to acquire the remaining equity interest in a company will have to prepare and file applicable disclosures, and hire counsel to assist in that regard. The acquirer will also have to pay fees to accountants and financial advisors, financing fees for the transaction and printing and other costs. In addition, note that:

- litigation should be anticipated, if not expected, especially if the transaction value is significant, which can entail significant defense costs even if the litigation is won;
- courts (particularly in Delaware) employ a heightened level of judicial review in going private transactions; and
- as noted above, the U.S. SEC carefully reviews going private transactions.

## SECTION 4

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# WAYS OF GOING PRIVATE FOR U.S. DOMESTIC ISSUERS

There are several ways that a shareholder or affiliate group may acquire a public company in a going private transaction. State law generally dictates permissible corporate structures, but the company's organizational documents, contracts and other features also may constrain choices.

Generally, going private transactions require significant financing. Such financing may be in the form of debt secured by the assets of the company. The transaction may also be financed by selling common or preferred stock to private equity firms looking to invest in the resulting private company.

### A. TENDER OFFERS

One approach is to pursue a tender offer, either with or without the prior approval of the company's board of directors. In a tender offer, the acquirer makes an offer directly to the other shareholders to buy their shares. Pursuant to U.S. federal securities rules, the offer must be open for at least 20 business days, though delays in satisfying other conditions (such as the need for antitrust or other regulatory approval) might prevent the closing of the offer after only that minimum period.

Following the tender offer, if the acquirer holds at least 90% of the outstanding shares, including shares acquired in, as well as all shares the acquirer owned prior to, the tender offer, the acquirer may be able to complete the going private transaction by a short-form merger without a vote of the company's remaining minority shareholders. Even if the acquirer does not acquire 90% of the shares in the tender offer, it generally can cause a long-form merger to eliminate remaining shareholders, though a formal shareholder vote may be required that takes additional time and requires further proxy filings.

In a negotiated tender offer, it has become common for the company to grant the acquirer a "top-up" option to purchase additional shares from the company so that the acquirer reaches the 90% threshold and thus can effect a short-form merger, without a company shareholder vote, even if the acquirer does not reach the 90% threshold in the tender offer alone. The top-up option is included in the merger agreement, with a per share purchase price equal to the tender offer price, and is exercisable by the acquirer only after all other conditions to the tender offer have been satisfied and the tender offer has been completed, and only if the acquirer then holds at least a majority of the company's outstanding shares, so that it could control the outcome of any shareholder vote and any requirement to hold a shareholder vote would be a mere formality.

## LIMITATIONS OF TOP-UP OPTIONS

The use of top-up options is subject to the following limitations:

- there must be a sufficient reserve of the company's authorized but unissued stock in place to cover the option; and
- a company is required under NASDAQ or NYSE rules to obtain stockholder approval when issuing an amount of shares equal to 20% or more of its outstanding stock.

Generally, for every 1% that the tender offer falls short of the 90% mark, a top-up option will require the company to issue an additional number of shares equivalent to 10% of its then-outstanding stock. In light of these considerations, as a practical matter, a purchaser should acquire at least 88% of the outstanding shares in a tender offer in order to successfully use a top-up option to effect a short-form merger.

The acquirer can pursue the tender offer either “unilaterally,” without first negotiating an agreement with the company, or by first negotiating an agreement with the company. The acquirer must first review state antitakeover rules, which may make it difficult for an acquirer that acquires more than a nominal percentage of the company's shares without the prior consent of the company's board (and, under some states' laws, even with the prior consent of the company's board) to take significant actions with respect to the company after the acquisition without additional shareholder approval or the passage of some amount of time.

Use of a tender offer structure in some circumstances also may help the acquirer to remain subject to a lesser standard of judicial review, as described in Section 8 of this Guide, “U.S. State Law: Fiduciary Duties.”

Pursuant to U.S. federal securities rules, the company must file a Schedule 14D-9 to state its position with respect to the tender offer within 10 business days after the tender offer commences.

## B. MERGERS

An acquirer in a going private transaction may acquire the company's stock through a merger. The merger occurs pursuant to statutory procedures, which require, among other things, an agreement between the acquirer and the company and the approval by vote of the shareholders. U.S. state law generally determines the minimum solicitation period, such as 20 days in the case of a Delaware corporation.

If approved, all shares of the company are converted, including shares held by persons who did not approve the merger, subject in some cases to statutory appraisal rights.

## C. REVERSE STOCK SPLIT

A company may also use a reverse stock split to reduce the number of shareholders of record to below the U.S. SEC's trigger threshold, allowing the company to suspend its U.S. SEC filing requirements. In a reverse stock split, the company issues one new share in exchange for a specified number of old shares. Completion of a reverse stock split involves cash payments for unaffiliated holders in lieu of fractional shares. For example, if a company declares a reverse stock split of 300 to 1, then a holder of 200 shares would be entitled only to a cash payment for the resulting fractional share and would no longer hold any shares of the company.

Because the charter of the company must be amended, a reverse stock split generally requires approval by holders of a majority of the company's outstanding stock.

## D. TIMING CONSIDERATIONS

The time required for a going private transaction depends in large part on the time required both for the acquirer and the company to reach agreement and for regulatory review, both of which can be difficult to predict with precision.

With respect to regulatory review, the U.S. SEC often has extensive comments on the solicitation or offer documents, and resolving those comments may take more than the otherwise applicable minimum time periods. For a going private transaction by a domestic issuer that is structured as a one-step merger, the U.S. SEC must complete its review and approve the solicitation materials before the company can solicit its shareholders. On the other hand, in a going private transaction structured as a tender offer, the U.S. SEC reviews the offer materials after the offer has commenced, so the parties do not have to wait for completion of U.S. SEC review before commencing the offer, although the acquirer cannot close the offer until the U.S. SEC finishes its review. Since the U.S. SEC reviews tender offer materials during the pendency of the offer, rather than before the company can even begin its solicitation, the tender offer process often can be quicker than the merger process, unless other conditions delay the acquisition.

See Section 7 of this Guide, "U.S. Securities Law Requirements," and the Appendix to this Guide, "Illustrative Timelines for a Going Private Transaction."



## SECTION 5

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# WAYS OF GOING PRIVATE FOR FOREIGN PRIVATE ISSUERS

A Cayman or BVI company can conduct going private transactions through a court-approved scheme of arrangement, a squeeze-out or a statutory merger.

### A. SCHEMES OF ARRANGEMENT

A scheme of arrangement is a court-supervised procedure that can be used to effect a transfer of shares in a company in exchange for money, property, shares, debt obligations or other securities of another company and is used to ensure that all of the shareholders of the company are bound by the terms of the transaction.

Under a scheme of arrangement, the board of directors typically first approves the terms of the scheme if it considers the scheme is in the best interests of the company.

The board then applies to the court to convene the necessary shareholders meeting or meetings to approve the scheme of arrangement. The scheme must then be approved by a majority in number representing at least 75% in value of the members or each class of members attending and voting at the meeting(s) convened by the court.

Once the necessary shareholder approval has been obtained, the company must then apply to the court for its final sanction of the scheme.

### B. SQUEEZE-OUT

A bid for a target company will ordinarily be in the form of an offer for all of the shares in that company. One of the key issues for the acquirer is how to deal with a dissenting minority of shareholders.

Under the Cayman Companies Law, a squeeze-out transaction enables the shareholder or acquirer of 90% or more of the shares of a Cayman company to effectively force the remaining shareholders to sell their shares to that majority shareholder or acquirer. In order to effect a squeeze-out, there must be a scheme or contract in place for the transfer of shares in a Cayman company to another company. A squeeze-out transaction under Cayman laws typically proceeds as follows:

- Within four months of the acquirer making the offer, the offer must be approved by not less than 90% in value of the shares that are the subject of the offer.
- Within two months of the expiration of the four-month offer period, the acquirer can give notice to the dissenting shareholders that the acquirer wishes to acquire their shares.
- Each dissenting shareholder then has one month from the date of the acquirer's notice to apply to the court for any appropriate orders affecting the proposed sale of the shares.
- On the expiration of one month from the date of the notice from the acquirer, if no application to the court is made by any dissenting shareholders, the acquirer can send to the company a copy of its notice to the dissenting shareholders whose shares are to be acquired by the acquirer and pay the purchase consideration to the company.

Following the payment of the consideration, the company must register the acquirer as the holder of the shares. Under BVI laws, there is no equivalent statutory waiting period and the requirement is simply that a written offer should be made to a dissenting member within seven days of the 90% majority instructing the company to commence the squeeze-out.

A squeeze-out generally provides the acquirer with control of the company more quickly than other transaction structures (assuming that the acquirer can quickly acquire 90% of the shares in the company) and ensures minimum business disruption. It is also a flexible method as there is no requirement to achieve any particular level of corporate acceptances before closing the offer. If a shareholder has less than the requisite 90% majority of shares required to effect a squeeze-out, but has, acquires or controls the requisite majority of shares specified below, then a merger may be used to effectively take out minority shareholders.

### C. STATUTORY MERGERS

Another way for Cayman or BVI companies to conduct going private transactions is through statutory mergers. In order to implement a statutory merger, each of the following steps must be taken<sup>3</sup>:

- The directors of each constituent company must approve a plan of merger, which includes certain specific information regarding each constituent company and the terms of the merger.
- For a Cayman company, the plan of merger must be approved by a special resolution of members of each constituent company and such other authorization, if any, as may be specified in the constituent company's articles of association.
- For a BVI company, the plan must be authorized by each constituent company by a simple majority of each class of shareholders authorized to vote on the merger unless a higher threshold is stipulated in the company's memorandum or articles of association.

Subject to certain limitations, a shareholder of a constituent Cayman or BVI company who dissents from a merger is entitled to be paid the fair value of his shares. A shareholder who intends to exercise his appraisal right must provide the constituent company with a written objection to the merger before the other shareholders vote on the merger.

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3. Cayman and BVI also have a concept of a consolidation, where all the constituent companies are consolidated into a new consolidated company. Contrast this with a merger, where one of the existing constituent companies becomes the surviving company (which is the more common approach). The considerations and processes are also slightly different depending upon whether there are foreign constituent companies, and also whether the surviving company/consolidated company is a BVI/Cayman company or a foreign company.

## **SPECIAL RESOLUTIONS FOR CAYMAN COMPANIES**

The Companies Law of the Cayman Islands defines a resolution as a special resolution when:

- it has been passed by a majority of at least two-thirds of such members as, being entitled to do so, vote in person or, where proxies are allowed, by proxy at a general meeting of which notice specifying the intention to propose the resolution as a special resolution has been duly given, except that a company may in its articles of association specify that the required majority shall be a number greater than two-thirds, and may additionally so provide that any such majority (being not less than two-thirds) may differ as between matters required to be approved by a special resolution; or
- if so authorized by its articles of association, it has been approved in writing by all of the members entitled to vote at a general meeting of the company in one or more instruments each signed by one or more of the members aforesaid, and the effective date of the special resolution so adopted shall be the date on which the instrument or the last of such instruments, if more than one, is executed.

## **D. TIMING CONSIDERATIONS**

For Cayman and BVI companies, a going private transaction that is structured as a statutory merger generally has a timing advantage over a transaction that is structured as a scheme of arrangement because the former does not require court approval. See the Appendix to this Guide, “Illustrative Timelines for a Going Private Transaction.”

## SECTION 6

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# ADDITIONAL CONSIDERATIONS FOR CONTROLLING SHAREHOLDERS

Going private transactions are often conducted by an existing controlling shareholder. These transactions are seen as inherently self-dealing transactions:

- on one hand, the controlling shareholder is the acquirer, and should be across the table from the company and the other shareholders; and
- on the other hand, the controlling shareholder may have substantial nonpublic information regarding the company and, through its power to elect or appoint directors and the power to vote its shares, the power to control the approval of the proposed transaction and the company's pursuit of its other alternatives, as well as to influence the management making decisions on behalf of the company.

The controlling shareholder also may owe fiduciary duties to the minority shareholders, whose shares would be acquired in the proposed transaction.

Due to such inherent conflicts of interest, U.S. courts generally apply a stringent standard of review (the so-called "entire fairness standard," as described below) to going private transactions by controlling stockholders. However, some courts may give the controlling shareholder the benefit of a more lenient standard of review (the "business judgment rule") in some circumstances if the transaction is both negotiated and approved on behalf of the company by a special committee and subject to and approved by a majority of the minority shareholders. See Section 8 of this Guide, "U.S. State Law: Fiduciary Duties," and Section 10 of this Guide, "Procedural Safeguards."

For these purposes, courts may find that a shareholder holds "control" over a company either because it holds a majority of the voting power of the company or, through shareholdings, board or executive positions or other means, can exercise control over the company.

## SECTION 7

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# U.S. SECURITIES LAW REQUIREMENTS

## A. GENERAL REQUIREMENTS

A going private transaction is subject to U.S. SEC disclosure and filing requirements, depending on the structure of the transaction, similar to other public company mergers and acquisitions.

### TENDER OFFERS

For transactions structured as tender offers, the acquirer must file a tender offer statement on Schedule TO (see below). In addition, the company must file a Schedule 14D-9 indicating its recommendation with respect to the tender offer within 10 business days after the tender offer commences.

### LONG-FORM MERGER

For a transaction structured as a long-form merger, the company must solicit approval of its shareholders through a proxy statement that complies with Regulation 14A and Schedule 14A under the U.S. Exchange Act, and file it with the U.S. SEC (note that proxy rules do not apply to foreign private issuers). If proxies are not solicited for the transaction, an information statement that complies with Regulation 14C and Schedule 14C must be prepared and filed. In particular, both schedules require the disclosure of the direct or indirect interests of the company's directors in the matters to be acted upon.

### REVERSE STOCK SPLIT

A transaction structured as a reverse stock split will usually require the company to obtain shareholder approval of an amendment to the company's charter documents. Therefore, a proxy statement, together with a shareholder meeting, is required.

State law imposes fiduciary duties on company directors and officers to ensure that all "material facts" are disclosed to shareholders. See Section 8 of this Guide, "U.S. State Law: Fiduciary Duties."

### WHAT IS SCHEDULE TO?

Under the U.S. Exchange Act, parties who will own more than five percent of a company's securities after making a tender offer for securities registered under the U.S. Exchange Act must file a Schedule TO with the U.S. SEC. Schedule TO requires disclosure of the following information:

- (i) material terms of offer;
- (ii) information regarding the company and subject securities;
- (iii) identity, background and business of the acquirer;
- (iv) prior negotiations and transactions between the acquirer and the company;
- (v) purposes of the transaction and any plans for material changes in the company;
- (vi) sources and amount of funds, including financing arrangements;
- (vii) the acquirer's ownership of securities of the company and any transaction in subject securities during past 60 days; and
- (viii) if material, financial statements of the acquirer.

## B. ADDITIONAL REQUIREMENTS UNDER RULE 13E-3

### APPLICABILITY OF RULE 13E-3

Rule 13e-3 imposes additional disclosure requirements on going private transactions. More specifically, Rule 13e-3 applies when:

- the transaction is:
  - a purchase of any equity security by the company or an “affiliate” of the company (see below);
  - a tender offer for any equity security by the company or an affiliate of the company; or
  - a proxy or consent solicitation (or distribution of an information statement) by the company or an affiliate of the company in connection with a merger or similar corporate reorganization, an asset sale or a reverse stock split involving a repurchase of fractional interests;
- the transaction is “engaged in” by the company or an affiliate of the company (see below); and
- the transaction has a “reasonable likelihood or a purpose” of causing any class of public equity securities of the company to be either eligible for termination from registration or reporting obligations under the U.S. Exchange Act or removed from listing on a national securities exchange.

### DETERMINING WHO IS AN AFFILIATE

Whether a person is an “affiliate” of the company for the purpose of a going private transaction is a fact-based question, that requires careful consideration. The following are the applicable rules, as well as factors that the U.S. SEC and courts may consider, for determining “affiliate” status:

#### Rule 13e-3(a)-(1)

Rule 13e-3(a)-(1) defines an “affiliate” of an issuer as “a person that directly or indirectly through one or more intermediaries controls, is controlled by or is under common control with such issuer.”

#### Rule 12b-2

Rule 12b-2 defines “control” as “the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise.”

#### Case Law and U.S. SEC Interpretations

The U.S. SEC and courts may consider the following factors in determining whether a person is in control of a company:

- whether the company and the person have common board members, officers or stockholders;
- whether the person is a member of the company’s board committees (e.g., compensation committee, audit committee, etc.) that have significant influence over the decisions of the company;
- whether the person has any contractual relationships with the company; and
- the nature of past, current and future relationships between the person and the company.

In addition, the U.S. SEC focuses on the power to exercise control and not merely whether that power has actually been exercised in determining whether a person is affiliated with a company.

Thus, Rule 13e-3 applies to a typical transaction in which existing shareholders or the management of a company, alone or together with a private equity sponsor, offers to purchase the other shares of the company, by merger, tender offer or other means, since following the acquisition the company will be owned by the controlling shareholder or insiders and will not be publicly listed or registered.

However, Rule 13e-3 does not apply to the second step in a two-step tender offer/merger, as long as the consideration in the second step is the same as in the first, and transactions in which the purchase price is paid in with rights similar to that in the company, rather than in cash or other kinds of securities.

### **DETERMINING WHETHER A TRANSACTION IS “ENGAGED IN” BY THE COMPANY OR AN AFFILIATE OF THE COMPANY**

Whether a company or an affiliate of the company will be deemed to be “engaged in” a going private transaction for the purpose of Schedule 13E-3 depends on the facts and circumstances of the transaction. The U.S. SEC has indicated that a company or its affiliates may be considered to be “engaged in” a going private transaction in a wide range of circumstances, including the following:

- the company recommends that its stockholders accept a tender offer by its affiliates, even if the company has not entered into a merger agreement with the affiliate; or
- senior management of the company (who are generally considered to be “affiliates”) will receive material benefits from the transaction that will not be received by the public stockholders (e.g., receiving significant amount of the company’s outstanding equity securities or occupying seats on the board).

### **DISCLOSURE OBLIGATIONS AND DOCUMENTATION REQUIRED UNDER RULE 13E-3**

Rule 13e-3 requires disclosure of information relating to:

- the post-transaction plans of the acquirer for the company and its business;
- the source and amount of the funds used in the transaction;
- the purposes and effects of the transaction, as well as any alternatives to accomplish the stated purposes and effects;
- a statement by the acquirer that it believes the transaction is fair to the minority shareholders and any factors supporting that belief;
- reports, opinions and appraisals by financial and legal advisors; and
- pro forma data regarding the effect of the transaction.

Schedule 13E-3 disclosure can be burdensome. Because Rule 13e-3 was designed to protect minority shareholders, the disclosure regarding the fairness of a going private transaction is likely to receive close scrutiny from the U.S. SEC. Among other things, the U.S. SEC will review disclosures relating to valuation, fairness of the transaction price, transaction background and history and the independence of directors and any independent committee recommending or approving the transaction. Shareholders and plaintiffs’ attorneys also will scrutinize the disclosures and may bring claims to stop the transaction or to change the transaction terms.

Foreign private issuers conducting going private transactions also are generally required to prepare Schedule 13E-3 filings, except for tender offers that fall within the Tier I exemption.



## C. OTHER POTENTIAL DISCLOSURE ISSUES FOR ACQUIRERS AND COMPANIES

### TIMING OF DISCLOSURES

Disclosure of the transaction is required as soon as the transaction commences, and the U.S. SEC often takes a broad view as to when this has occurred. Transactions in the company's stock by members of the acquiring group that occur as much as two years prior to the public announcement of the transaction could be viewed as the beginning of a series of transactions that are the first steps in going private.

### SCHEDULE 13D

If a group of senior executives has agreed in principle among themselves to make a proposal to acquire a public company, even if not in writing, there is a significant risk that the group has triggered filing requirements.

In particular, Section 13(d) of the U.S. Exchange Act requires any person who accumulates beneficial ownership of more than 5% of any equity securities registered under Section 12 of the U.S. Exchange Act to file a Schedule 13D, essentially disclosing the purchase as well as any intentions the party may have to influence the company via its percentage ownership. In addition, if any material changes occur in the facts disclosed in a Schedule 13D (including 1% acquisition or disposition of the beneficial ownership), the Schedule 13D must be promptly amended.

Thus, if a controlling shareholder (or other beneficial owner of more than 5% of a class of equity securities) proposes a going private transaction and has filed a Schedule 13D previously without disclosing its intent to participate in a going private transaction, an amendment to its Schedule 13D may be required to disclose such change in intent. Such amendment must be filed promptly after the filer forms its intent to enter into the going private transaction, not merely on execution of formal documents or commencement of a tender offer. Therefore, the acquirer in a going private transaction should carefully consider the timing for filing an amendment to its Schedule 13D in order to avoid premature disclosure while ensuring that such amendment will be made before approaching the company board of directors for the potential transaction.

### OTHER DISCLOSURE ISSUES

Other issues related to public disclosure of the transaction include the following:

- public announcement of the transaction may put the company in play and result in third parties making bids at a higher price;
- the U.S. SEC takes a broad view as to who is required to make filings, and equity sponsors, members of management, subsidiaries and other parties may be required to make filings; and
- nearly all materials relating to a fairness opinion rendered in connection with the transaction will be subject to disclosure, including handouts, drafts and discussion materials.

## SECTION 8

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# U.S. STATE LAW: FIDUCIARY DUTIES

Directors, acting in their capacities as such, generally owe fiduciary duties to the company and its shareholders, pursuant to the law of the company's state of incorporation. These duties apply to the directors' actions in connection with a going private transaction.

## A. GENERAL DUTIES

### DUTY OF LOYALTY

Perhaps the most important duty from a litigation perspective, the duty of loyalty, requires directors to act in good faith and in a manner believed to be in the best interests of the company and its shareholders. Directors must not engage in "self-dealing," which involves a material interest that is different from, or in conflict with, those of other shareholders, or act in the interests of anyone other than the company and its shareholders.

The determination of a director's independence with respect to a particular proposal must be made by reference to the proposal and the overall context. This notion of independence is different from the "independence" required by NASDAQ and other exchanges, which tends to relate to the company and not to third parties, such as potential buyers. A director's independence may need to be confirmed as a deal progresses, if the director's participation changes or if the potential counterparties change.

In companies with large or controlling shareholders, other shareholders often claim that the large or controlling shareholder has interests in the company or in a transaction involving the company that are not shared equally by all shareholders, and that some or all of the directors of the company either share some interests with the controlling stockholder or are otherwise beholden to the controlling shareholder and so are likely to act in whole or in part in the interest of the controlling shareholder when acting as directors.

### DUTY OF CARE

Under the duty of care, directors must act on an informed basis after due consideration of relevant materials and proper deliberation. Directors generally can rely on reports and advice of appropriate advisors but must do so in good faith and should not substitute their advisors' judgments for their own.

### DUTY OF GOOD FAITH

Although actually a part of the duty of loyalty, courts often look separately to see whether directors have acted in good faith. This duty may be violated when directors disregard their responsibilities as directors, or know they are making material decisions without adequate information and deliberation. The threshold for finding a violation of this duty is high, but so is the penalty, since the exculpation otherwise available to directors is not available for violations of the duty of good faith.

### DUTY OF DISCLOSURE

A board of directors asking for shareholder action (whether through a vote or the acceptance of a tender offer) must disclose fully and fairly all material facts within its control regarding the matter. The Delaware courts have adopted the general U.S. federal securities law definition of "materiality" and consider a fact to be material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.

This duty applies to going private deals as well. In fact, much of the litigation surrounding public company transactions ultimately is resolved through disclosures.

## B. REVLON DUTIES

In *Revlon v. MacAndrews & Forbes Holdings*,<sup>4</sup> the Delaware Supreme Court held that when a board of directors proposes to sell a company for cash or engage in a change-of-control transaction, the board should act as an “auctioneer” to secure the best value for the shareholders reasonably available. Courts have emphasized that there is no “single blueprint” for compliance with *Revlon* duties, and that instead boards must act reasonably under the circumstances, taking into account the context of the situation. Accordingly, it is important for the board to take proactive market checks or other deliberate means of confirming market value to ensure the appropriate value for shareholders and reduce litigation risks.

For this and other reasons, boards often feel compelled to “shop” the company after receiving an offer from an insider to see if a higher offer might be available. This may not be practical if the initial offer is made by a very large shareholder who refuses to consider other deals, since other buyers are unlikely to be interested in trying to acquire a company with a reluctant or hostile large shareholder, and courts have acknowledged the practical limits on this ability. However, a large shareholder who makes an acquisition proposal to a company should be prepared for the board to try to find other buyers.

## C. STANDARDS OF REVIEW

### BUSINESS JUDGMENT RULE

The actions of the directors of a company generally are protected by the so-called “business judgment rule,” which presumes that the directors acted in good faith, in an informed manner and in the honest belief that the actions taken were in the best interests of the company. With this, courts avoid second-guessing directors’ decisions or looking into the substance of directors’ decisions, unless a shareholder can rebut the presumption or raise doubts about whether the directors fulfilled their fiduciary duties or one of the few exceptions (such as that for transactions with controlling shareholders, discussed below) applies.

### ENTIRE FAIRNESS

When reviewing a transaction between a company and its controlling stockholder, or that otherwise involves an inherent conflict of interest or a breach by directors of their fiduciary duties, Delaware courts may apply an enhanced level of scrutiny called the “entire fairness” standard, subject to some potential exceptions as described below.

To meet the “entire fairness” standard, the acquirer has the burden of proving two basic elements: “fair dealing” and “fair price.”

- “Fair dealing” refers to the process by which the transaction was approved, by examining factors such as the timing of the transaction, how it was initiated, structured and negotiated and how director and shareholder approvals were obtained and whether the disclosure was adequate.
- “Fair price” involves an economic and financial analysis of the value received by the shareholders in exchange for their shares.

4. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 179 (Del. 1986).

Although the acquirer generally has the burden of proving the procedural and substantive fairness of a going private transaction, the Delaware courts held in *Kahn v. Lynch Communication Systems*<sup>5</sup> that the burden would shift to the plaintiff shareholders in an entire fairness review if the transaction was either (i) negotiated and recommended by an active and informed special committee or (ii) approved by a majority of the minority shareholders.

## APPLICATION TO GOING PRIVATE TRANSACTIONS

Historically, going private transactions have been subject to the entire fairness review, at least when the transaction involved a controlling shareholder or there was a question as to whether the directors had fulfilled their fiduciary duties. However, some lower courts in Delaware have said that there may be ways for the parties to qualify for the more deferential business judgment rule if a going private transaction follows certain processes.

### *The “Pure Resources” Standard for Unilateral Tender Offers*

Some Delaware courts have held that acquisitions by controlling shareholders may be able to be reviewed under the business judgment standard if the transaction is structured as a noncoercive tender offer followed by a short-form merger. According to these courts, a tender offer by a controlling shareholder is considered to be “noncoercive” if each of the following is satisfied:

- the offer is irrevocably conditioned on the tender of a majority of the shares held by the minority shareholders;
- the controlling shareholder has committed to effect a short-form merger at the same price if over 90% of the shares are obtained in the tender offer;
- the controlling shareholder has made no retributive threats; and
- the independent directors are given sufficient time and discretion to react to the tender offer, by hiring their own advisors, providing a recommendation to the noncontrolling shareholders and disclosing adequate information to the noncontrolled shareholders to allow them to make an informed decision.<sup>6</sup>

### *The “CNX” Unified Standard for Tender Offers and Mergers*

In *CNX Gas Corporation*,<sup>7</sup> another Delaware court proposed a “unified” standard of review, applicable to both tender offers and mergers, where the business judgment rule applies to a going private transaction involving a controlling shareholder if the transaction is both:

- (i) negotiated and approved by a special committee of independent, disinterested directors; and
- (ii) irrevocably conditioned on an affirmative vote of a majority of the minority shareholders (or on the tender of a majority of the shares held by the minority shareholders in the case of a tender offer).

Thus, under the *CNX* standard, the special committee must not only be empowered to review the transaction but also must agree with and recommend it.

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5. *Kahn v. Lynch Communication Systems, Inc.*, 638 A.2d 1110 (1994).

6. *In re Pure Resources Inc. Shareholders Litigation*, C.A. No. 19876 (Del. Ch. Oct. 7, 2002).

7. *In re CNX Gas Corporation Stockholders Litigation*, C.A. No. 5377-VCL (Del. Ch. May 25, 2011).

While lower courts have suggested that going private transactions thus could be reviewed under the less stringent standard if the appropriate safeguards were put in place, note that the Delaware Supreme Court has not yet sanctioned the application of the lower standard to an acquisition by a controlling shareholder. Proponents of a going private transaction, as well as the other company directors, thus should be prepared to defend the transaction under the more stringent standard.

### *The Importance of an Effective Committee*

Recent cases have emphasized that to be eligible for the lower standard of review, the special committee must be truly engaged and effective. In *Southern Peru Copper Corporation*,<sup>8</sup> for example, the Delaware chancery court found that a special committee formed by a public company controlled by another company to review a proposal by the controlling company for the controlled company to purchase another company owned by the controlling company had not performed effectively. The case thus did not involve a going private transaction but did involve a transaction in which a controlling stockholder was on both sides of the deal and thus subject to entire fairness review.

The court found that the use of the special committee had not sufficed to shift the burden of persuasion back to the plaintiff shareholders who were challenging the transaction. Moreover, the court ultimately found that the purchase of the other company owned by the controlling company was not entirely fair to the controlled company and awarded the controlled company approximately US\$2 billion in damages against the controlling company and the directors of the controlled company appointed by the controlling company.

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8. *In re Southern Peru Copper Corporation Shareholder Derivative Litigation*, C.A. No. 961-CS (Del. Ch. Oct. 15, 2011).

## SECTION 9

# FIDUCIARY DUTIES FOR FOREIGN PRIVATE ISSUERS

English common law principles would be highly persuasive in Cayman and the BVI, and such principles indicate that a director's duties can be summarized as follows:

- a duty to act in what the directors bona fide consider to be the best interests of the company (and in this regard, it should be noted that the duty is owed to the company and not to associated companies, subsidiaries or holding companies; what is in the best interests of the group (if any) of companies to which the company belongs is not necessarily in the best interests of the company);
- in a takeover context, the directors have a duty to act in good faith when giving shareholders advice on whether to accept a takeover offer for their shares (the directors are not required to give such advice, but if they do, the advice should not be given for their own improper reasons);
- a duty to exercise their powers for the purposes for which they are conferred;
- a duty of trusteeship of the company's assets;
- a duty to avoid conflicts of interest and of duty;
- a duty to disclose personal interests in contracts involving the company;
- a duty not to make secret profits from the director's office; and
- a duty to act with skill and care.

In addition, in the BVI, directors owe the following statutory duties:

<b>Honesty and Good Faith</b>	A director in exercising his powers or performing his duties shall act honestly and in good faith and in what the director believes to be in the best interests of the company.
<b>Proper Purpose</b>	A director shall exercise his powers as a director for a proper purpose and shall not act, or agree to the company acting, in a manner that contravenes the BVI Business Companies Act or the memorandum or articles of the company.
<b>Care, Diligence and Skill</b>	A director, when exercising powers or performing duties as a director, shall exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances, taking into account, but without limitation: <ul style="list-style-type: none"><li>• the nature of the company;</li><li>• the nature of the decision; and</li><li>• the position of the director and the nature of the responsibilities undertaken by him.</li></ul>

<b>Disclosure of Personal Interests</b>	<p>A director shall, forthwith after becoming aware of the fact that he is interested in a transaction entered into or to be entered into by the company, disclose the interest to the board of the company. However, a director of a company is not required to disclose such interest if:</p> <ul style="list-style-type: none"><li>• the transaction or proposed transaction is between the director and the company; and</li><li>• the transaction or proposed transaction is or is to be entered into in the ordinary course of the company's business and on usual terms and conditions.</li></ul>
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Although there is no statute or case law in Cayman or the BVI analogous to the entire fairness standard under Delaware law that imposes a more stringent fiduciary duty on the board of directors, many practitioners believe that the board of a Cayman or BVI company may look to Delaware law for guidance on the actions that should be taken in order to avoid litigation risks in a going private transaction. In light of this, it has been common practice for a Cayman or BVI company to form a special committee consisting of independent directors to negotiate the terms of a going private transaction directly with the acquirer.



## SECTION 10

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# PROCEDURAL SAFEGUARDS

To mitigate litigation risks of a going private transaction initiated by a controlling shareholder, the acquirer and board of directors in the transaction may take certain procedural safeguards. The two most effective measures generally are to have the transaction approved by (1) a special committee consisting of independent and disinterested directors and (2) a fully informed majority of the minority shareholders. As discussed previously, in transactions subject to entire fairness review, the acquirer may shift the burden of proving the procedural and substantive fairness of the transaction to the plaintiff shareholders if one of these procedural safeguards is properly employed. In addition, in some courts, a transaction otherwise subject to entire fairness review may obtain the benefit of the business judgment standard of review (instead of the more stringent entire fairness standard of review) if both of these procedures are employed. See Section 8 of this Guide, “U.S. State Law: Fiduciary Duties.”

### A. SPECIAL COMMITTEE

It is now common practice for the board of directors in a going private transaction to appoint a special committee of independent and disinterested directors to evaluate and, if appropriate, negotiate the transaction. In order to obtain the benefit of shifting the burden of the entire fairness standard to the plaintiff shareholders, or otherwise to show that the use of the committee resulted in a fair process, particular consideration must be given to whether the special committee was truly independent and disinterested, fully informed and had the freedom to negotiate an arm’s-length transaction in the best interests of the shareholders.

Key considerations for a special committee include the following:

- All directors serving on the committee should be independent and disinterested in the transaction. Any relationships of the members with the acquirer should be reviewed, even if the members are not otherwise receiving any consideration other than that received by shareholders generally.
- The committee should have a clear mandate. In particular, the committee should be empowered with real bargaining power, including the power to say “no” to a particular transaction, and perhaps even the power to take steps to prevent the acquirer from proceeding without the approval of the committee.
- The committee should be allowed to obtain the resources it needs, including the ability to choose independent legal counsel, financial advisors and other advisors and access to management and otherwise to information about the business and potential acquirers.
- All members should be active in the process, participating in meetings and critically evaluating information and advice. Members can rely to some extent on their advisors and on management, but nonetheless should make their own judgments and decisions. Members should think creatively about the alternatives available to the company and not focus on just the acquirer’s proposal.
- As one part of its process, the committee will likely seek to obtain a fairness opinion from a qualified and independent financial advisor as to the fairness of the consideration to be paid to the shareholders in the transaction from a financial point of view. See subsection D, “Fairness Opinion,” below.

Note that in some cases, typically not involving a controlling stockholder and where a majority of the members of the board of directors are disinterested, the board may choose to act as a board, with the interested members of the board recusing themselves and not participating in deliberations and decisions, rather than forming a separate committee.

## B. APPROVAL OF THE “MAJORITY-OF-THE-MINORITY”

Another potential procedural safeguard for a going private transaction is to make the transaction subject to a nonwaivable requirement that the majority of the shares held by the minority shareholders are tendered or that the transaction is approved by a majority of the minority shareholders who are entitled to vote. The public shareholders must be provided with all relevant information regarding the transaction so that they can make an informed decision.

Note that use of a majority-of-the-minority condition also may make it easier for third parties, such as hedge funds or arbitrageurs, to purchase enough shares of the company’s stock, after the announcement of the transaction, to play a significant role in the shareholder vote or tender. The arbitrageurs and hedge funds then may contact the acquirer to try to negotiate for an even higher deal price or for other benefits. For smaller public companies, or companies with smaller floats, the amount of money required to effectively control a majority of the minority shareholder vote may be relatively small.

Note too that approval by an informed majority of minority shareholders does not by itself cure any defect in the underlying process or the price obtained, and the fairness of the underlying transaction is still subject to review by the courts.

## C. ADEQUATE DOCUMENTATION OF THE DECISION-MAKING PROCESS

The special committee should create an appropriate record of its work so that the committee gets credit for its actions. Minutes of special committee meetings relating to the going private transaction and a detailed and accurate record of the negotiations and decision-making process leading up to the approval of the transaction should be kept in order to help demonstrate the independence, diligence and deliberations of the special committee.

## D. FAIRNESS OPINION

Boards of directors (or special committees, if applicable) often request a “fairness” opinion from an independent financial advisor (generally an investment bank) to support their determinations with respect to the fairness of the price being paid in a going private transaction. The financial advisor should have appropriate experience and should be given adequate time and information to prepare its analyses. The board or committee should be aware of all material conflicts that the bank may have and consider whether those conflicts are fatal or can be addressed or accommodated in some way.

### WHAT IS A “FAIRNESS OPINION”?

A fairness opinion is a professional evaluation provided by an outside financial advisor regarding the fairness of certain elements of a transaction, including the consideration to be paid and certain structural elements of the transaction. The fairness of the transaction is evaluated from a financial point of view as of a specific date and is generally based on certain limitations and assumptions. The financial advisor who prepared the fairness opinion is not recommending the transaction nor expressing a view that the consideration to be paid is optimal. Instead, the financial advisor is only expressing an opinion that the consideration being paid is within a range that is considered to be fair. Therefore, the board of a company should avoid over-reliance on a fairness opinion and should carefully consider whether alternative structures or alternative transaction partners are available on more favorable terms.

# GOING DARK – DELISTING AND DEREGISTRATION

## A. DIFFERENCE BETWEEN “GOING PRIVATE” AND “GOING DARK”

As we have discussed, “going private” refers to a transaction in which the acquirer, such as the controlling shareholder, acquires the outstanding shares of the company, for example, through a merger or some form of tender offer, resulting in the company having fewer than 300 record holders or the delisting from a public stock exchange or quotation system. However, in either of these situations, the company is still subject to U.S. SEC reporting requirements under the U.S. Exchange Act. The company must take another step and deregister its shares in order to suspend its periodic reporting obligations with the U.S. SEC.

When a company elects to “go dark,” without going completely private, it bypasses the first step and voluntarily delists and deregisters its shares without cashing out all of its shareholders. In both instances, the company is relieved of its U.S. SEC reporting requirements and compliance obligations with other securities rules and with the rules and regulations of the stock exchange on which the shares were listed.

## B. BECOMING A REPORTING COMPANY

A company initially may have become subject to U.S. SEC reporting requirements through its IPO, but in many cases, a company will gradually have accumulated obligations under Section 15(d) (companies that have filed a registration statement under the U.S. Securities Act), and either or both Section 12(g) (companies that have had more than 500 shareholders of record) and Section 12(b) (U.S.-listed companies), all of which need to be taken into account when the company is seeking to completely exit the reporting system. These U.S. Exchange Act rules apply to U.S. SEC reporting companies whether they are U.S. companies or foreign private issuers. Specifically, a foreign private issuer can become subject to the reporting requirements of the U.S. Exchange Act in three ways:

- (1) By listing a class of equity securities on a U.S. securities exchange, a foreign private issuer must register the class of equity securities with the U.S. SEC under Section 12(b) of the Exchange Act.
- (2) If within 120 days after the last day of its first fiscal year, in which the issuer had total assets that exceed US\$10 million and a class of equity securities held of record by either (i) 2,000 or more persons worldwide or (ii) 500 persons who are not accredited investors residing in the United States, it must register the class of equity securities with the U.S. SEC under Section 12(g) of the U.S. Exchange Act.<sup>9</sup>
- (3) If it files a registration statement under the U.S. Securities Act to sell securities, the foreign private issuer becomes subject to U.S. SEC reporting obligations pursuant to Section 15(d) of the U.S. Exchange Act.

The method of calculating record ownership for foreign private issuers differs from the method a U.S. company or a foreign company that is not a “foreign private issuer” is permitted to use in its determination of the number of record owners for purposes of Section 12(g) of the U.S. Exchange Act. These latter companies count only record owners and not beneficial owners holding securities in street name. In the case of a foreign private issuer, securities held of record by a broker, dealer, bank or nominee for the accounts of customers residing in

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9. The JOBS Act recently changed these thresholds for U.S. companies and foreign private issuers. Prior to the amendment, Section 12(g) had required issuers to register a class of equity securities with the U.S. SEC if, on the last day of the issuer’s fiscal year, such class of securities was held of record by 500 or more record holders and the issuer had total assets of more than US\$10 million.

the United States are counted as held in the United States by the number of separate accounts for which the securities are held. In addition, a foreign private issuer also must treat as owned of record by U.S. residents any shares reported as beneficially owned by a U.S. resident in a filing made under Section 13(d) of the U.S. Exchange Act or any comparable reporting provision of another country.<sup>10</sup>

## C. DEREGISTRATION PROCESS

The deregistration process involves several steps, and the rules can be complex and highly technical in their practical application.

### *Delisting and Deregistration under Section 12(b)*

For a typical IPO company that has a class of securities registered under Section 12(b) and is listed on a national securities exchange (e.g., NASDAQ or NYSE), Rule 12d2-2 and Form 25 initiate the delisting and deregistration process with respect to the company's current Section 12(b) registration. The first step is to delist the securities. Listed companies are entitled to delist their securities voluntarily and to deregister them under Section 12(b) of the U.S. Exchange Act by filing a Form 25 with the U.S. SEC. The company must give notice of its intention to file the Form 25 and issue a press release announcing that intention 10 days prior to filing the Form 25. The delisting will become effective 10 days after filing the Form 25. As of the effective date of the delisting, the company's duties to file U.S. SEC reports under Section 13(a) of the U.S. Exchange Act are suspended. However, the actual termination of registration under Section 12(b) does not occur until 90 days after effectiveness of the delisting. Delisting and deregistration under Section 12(b) are not the end of the process.

### *Deregistration under Section 12(g) and Suspension of Reporting Obligations under Section 15(d)*

Once delisted under Section 12(b), a company may still be subject to reporting obligations pursuant to Section 12(g) of the U.S. Exchange Act. To deregister under Section 12(g) and suspend its reporting obligations under Section 15(d), the issuer must file a Form 15. The Form 15 may be filed on (or after) the effective date of the delisting (i.e., 10 days after filing the Form 25). In order to deregister under Section 12(g), the Form 15 must certify that the company has less than 300 shareholders of record of the class of securities to be deregistered. The Section 15(d) suspension can occur either (i) automatically, if the class of securities is held by less than 300 record holders at the beginning of any fiscal year (other than a year in which the registration statement became effective) or (ii) at any time, by relying on Rule 12h-3's conditional suspension, if the class of securities is held by less than 300 record holders or less than either 2,000 record holders or 500 nonaccredited record holders and the issuer's assets do not exceed US\$10 million at the end of each of its last three fiscal years.<sup>11</sup>

A company's periodic reporting obligations (e.g., Forms 10-K, 20-F, 10-Q, 8-K and 6-K) under the U.S. Exchange Act will be suspended immediately upon its filing of Form 15, and deregistration under Section 12(g) becomes effective 90 days after. However, other U.S. Exchange Act filing obligations continue during the 90-day period following the filing of the Form 15, or Form 25 to deregister under Section 12(b). Foreign private issuers that were previously registered under Section 12(b) or 12(g) will continue to be subject to Section 13(d) and Section 13(e) requirements, including the going private rule in Rule 13e-3 during the 90-day period.

While a company can suspend its Section 15(d) obligations by filing a Form 15, it can never terminate its Section 15(d) reporting obligations. If at any time the company no longer satisfies the requirements under which its Section 15(d) obligations were suspended (if, for example, the company exceeds the limit on the number of record holders on the first day of any fiscal year after it files a Form 15), the reporting obligations come back to

10. Rule 12g3-2(a) of the U.S. Exchange Act.

11. The threshold has recently been amended by the JOBS Act.

life without any action by the company. For example, brokers and other institutions holding shares in street name may cease holding the shares in that capacity and cause the transfer agent to record the shares directly in the name of the beneficial owners for whom they hold the shares. In such a case, each beneficial owner will become a record holder, and the record holder count may exceed the limits. In order to avoid the need to reregister, companies that have “gone dark” should carefully monitor the number of record holders they have during each year and take steps (such as a reverse stock split or stock repurchase or tender) to ensure that they continue to have less than 300 record holders before the applicable test dates under Sections 12(g) and 15(d).

### *Deregistration for Foreign Private Issuers*

Some modifications to the deregistration process apply to foreign private issuers. A foreign private issuer may deregister a class of its securities under Section 12(g) of the U.S. Exchange Act if the class is held by (i) fewer than 300 U.S. residents or (ii) fewer than 500 U.S. residents for issuers with less than US\$10 million in assets, as of the end of its last completed fiscal year.<sup>12</sup>

The issuer must “look through” the record ownership of brokers, dealers, banks or nominees on a worldwide basis and count the number of separate accounts of customers residing in the United States for which the securities are held. If an issuer can satisfy all of the criteria, the issuer may exit the U.S. SEC reporting system. See subsection C, “Deregistration Process.” Similar to U.S. companies, typically the foreign private issuer may only suspend (not terminate) its U.S. SEC reporting obligations, forcing it to have to determine on a year-to-year basis whether it meets the U.S. SEC reporting exemption threshold, unless it can take advantage of an additional deregistration option provided to foreign private issuers discussed below.

### *Termination Option for Dual-listed Foreign Private Issuers*

If a foreign private issuer is also listed outside the United States, and the non-U.S. market (for example the Hong Kong Stock Exchange) is its primary trading market, the dual-listed foreign private issuer may be eligible to use U.S. Exchange Act Rule 12h-6 to exit the U.S. SEC reporting system, regardless of the company’s size or number of holders that are U.S. residents. Rule 12h-6 provides an option for permanent termination of U.S. SEC reporting obligations regarding a class of securities under either Section 12(g) or Section 15(d) of the U.S. Exchange Act. Several requirements must be met:

- the issuer must have been a U.S. Exchange Act reporting company for at least one year, have filed or submitted all U.S. Exchange Act reports required for this period and have filed at least one annual report pursuant to Section 13(a) of the U.S. Exchange Act;
- the issuer must not have made a registered offering in the United States for the past 12 months (with limited exceptions);
- the issuer must have maintained a non-U.S. listing, which is its primary trading market, that constituted at least 55% of trading in a recent 12-month period;
- (i) the average daily trading volume (“ADTV”) of the issuer’s shares in the United States must be no more than 5% of worldwide ADTV or (ii) the issuer must have had less than 300 holders of record (worldwide or U.S. residents) using a modified look through to beneficial owners;<sup>13</sup> and
- there is a 12-month further waiting period if the issuer did not meet the 5% ADTV test when it delisted.

The foreign private issuer must file a Form 15F, certifying to various elements of the rule requirements, to accomplish the deregistration.

<sup>12</sup> Rule 12g-4 and Rule 12h-3 of the U.S. Exchange Act.

<sup>13</sup> In lieu of on a worldwide basis, an issuer can limit the “look through” to brokers, banks and other nominees located in the United States, the issuer’s jurisdiction of incorporation and, if different, the jurisdiction of its primary trading market.

## SECTION 12

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# SPECIAL CONSIDERATIONS FOR FOREIGN PRIVATE ISSUERS – A RECAP

Throughout this Guide, we have highlighted special rules and considerations for foreign private issuers, including as they relate to:

- the laws of jurisdiction of foreign private issuers' incorporation, which may have alternative approaches (for example, a scheme of arrangement) to going private and different standards for fiduciary duties of directors and officers;
- certain cross-border transactions being exempt from the U.S. tender offer disclosure rules;
- the U.S. proxy materials rules not applying to foreign private issuers;
- differences in the method of calculating record ownership; and
- modifications in the rules that apply to foreign private issuers in the deregistration process when “going dark.”

Depending on the circumstances, these differences may result in lower litigation risk, lower costs, reduced U.S. SEC review and scrutiny and less time involved with some going private transactions by foreign private issuers.

Finally, while not the focus of this Guide, it is important to note that a going private transaction may also be subject to review by the Committee on Foreign Investment in the United States (“CFIUS”). CFIUS reviews transactions that involve U.S. companies or operations acquired by non-U.S. persons that may raise U.S. national security concerns, and it may take steps to revise, or even recommend that the U.S. president block, a certain transaction due to national security concerns. CFIUS review may apply even if there is a change in control from one foreign person to another foreign person. Furthermore, CFIUS may also review acquisitions by U.S. companies with foreign parents or significant foreign shareholders.

While a going private transaction requires a carefully considered process and is generally subject to a high degree of scrutiny, it can result in significant benefits, most notably reduced compliance, accounting and legal costs. Given the recent heightened scrutiny of U.S.-listed Chinese companies, going private transactions could be a highly attractive approach for these companies.

## APPENDIX

# ILLUSTRATIVE TIMELINES FOR A GOING PRIVATE TRANSACTION

The following timelines are intended to illustrate the potential processes and the amounts of time required. Actual times will, of course, vary, depending upon circumstances that sometimes are within, and sometimes are outside of, the parties' control. In practice, the parties in a going private transaction may encounter unforeseen issues, including litigation, which may delay the timing of the transaction.

### A. COMPARATIVE ILLUSTRATIVE TIMELINES FOR A ONE-STEP MERGER AND A TENDER OFFER FOLLOWED BY A SHORT-FORM MERGER

One-step Merger: Procedural Steps	
Day 1 to 5	<ul style="list-style-type: none"><li>• The acquirer submits a formal going private proposal at the company's board meeting;</li><li>• The board forms a special committee to consider the fairness of the going private transaction and authorizes the special committee to appoint independent counsel and advisors;</li><li>• The company issues press releases regarding the formation of the special committee and the retention of counsel and advisors; and</li><li>• The special committee requests all relevant information related to the going private proposal and the valuation of the company.</li></ul>
Day 6 to 20	<ul style="list-style-type: none"><li>• Financial advisor conducts financial due diligence and reports the preliminary valuation and transaction alternatives at the special committee meeting; and</li><li>• The special committee evaluates the going private proposal and decides whether to accept the proposal.</li></ul>
Day 21 to 25	<ul style="list-style-type: none"><li>• The special committee negotiates the price of the transaction and the terms of the merger agreement with the acquirer.</li></ul>
Day 26 to 30	<ul style="list-style-type: none"><li>• The financial advisor delivers its fairness opinion at the special committee meeting, and the special committee decides whether the terms of the proposal are fair;</li><li>• The special committee recommends the proposal to the board and the board approves the recommendation; and</li><li>• The parties execute the merger agreement and the company issues press releases regarding the execution of the merger agreement.</li></ul>
Day 31 to 45	<ul style="list-style-type: none"><li>• The company prepares and submits U.S. SEC filings (preliminary proxy statement (or information statement in the case of a foreign private issuer) and Schedule 13E-3).</li></ul>
Day 46 to 100	<ul style="list-style-type: none"><li>• U.S. SEC review process.</li></ul>
Day 101	<ul style="list-style-type: none"><li>• The board approves the calling of a special shareholders meeting to approve the transaction (generally 30 days' prior notice).</li></ul>



One-step Merger: Procedural Steps	
Day 145	<ul style="list-style-type: none"> <li>• Shareholders meet to approve the transaction.</li> </ul>
Day 146	<ul style="list-style-type: none"> <li>• Closing of the transaction and confirm delisting of the company post-closing.</li> </ul>

Tender Offer Followed by a Short-form Merger	
Day 1 to 25	<ul style="list-style-type: none"> <li>• The company and the acquirer negotiate the terms of a merger conditioned on the completion of a tender offer;</li> <li>• The board of directors (and the special committee, if applicable) approves the merger agreement and each of the company and acquirer issues a press release regarding the agreement on the terms of the merger and the expected tender offer; and</li> <li>• Drafting of the tender offer statement.</li> </ul>
Day 26	<ul style="list-style-type: none"> <li>• The tender offer commences;</li> <li>• Filing of Schedule TO containing the tender offer statement;</li> <li>• Filing of Schedule 14D-9 indicating the company's recommendation with respect to the tender offer (within 10 days after the tender offer commences);</li> <li>• Filing of Schedule 13E-3;</li> <li>• Placement of newspaper advertisement regarding the tender offer; and</li> <li>• Distribution of tender offer documents to shareholders.</li> </ul>
Day 21 to 25	<ul style="list-style-type: none"> <li>• The special committee negotiates the price of the transaction and the terms of the merger agreement with the acquirer.</li> </ul>
Day 26 to 30	<ul style="list-style-type: none"> <li>• The financial advisor delivers its fairness opinion at the special committee meeting, and the special committee decides whether the terms of the proposal are fair;</li> <li>• The special committee recommends the proposal to the board and the board approves the recommendation; and</li> <li>• The parties execute the merger agreement, and the company issues press releases regarding the execution of the merger agreement.</li> </ul>
Day 27 to 55	<ul style="list-style-type: none"> <li>• Tender offer remains open (note the exact amount of time that the tender offer remains open generally depends on how long the parties believe it will take to obtain tender from 90% of the shareholders, but the tender offer must remain open for at least 20 days); and</li> <li>• Filing of material changes (if any) to the tender offer on Schedule TO.</li> </ul>
Day 56	<ul style="list-style-type: none"> <li>• Closing of the tender offer;</li> <li>• Each of the company and acquirer issues a press release regarding the completion of the tender offer and the short-form merger;</li> <li>• Filing of Certificate of Merger with the state;</li> <li>• Filing of amendment to Schedule 13E-3 describing the results of the transaction; and</li> <li>• Filing of final amendment to Schedule TO.</li> </ul>

## B. ILLUSTRATIVE TIMELINE FOR A SCHEME OF ARRANGEMENT UNDER CAYMAN OR BVI LAW

Timing (from date of filing scheme document with the court)	Procedural Step
14 days	First court hearing for the convening of meetings of the company's members.
14-21 days	Posting of notice of meetings.
45-50 days	Class meetings held in accordance with the court's directions.
56-63 days	Second court hearing to sanction the scheme.
70-84 days	Filing of the court order with the Registrar.



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