Top 10 Considerations When Selling Your Company to a PE Firm

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For a board of directors of a public company, perhaps no decision is as important (and litigious) as the sale of the company in a change-of-control transaction. The good news is that Delaware courts have a long history of being deferential to directors, and that while heightened "Revlon" duties (that is, the duty to obtain for shareholders the highest value reasonably attainable) may apply, courts recognize that "there is no single blueprint" for selling your company.

But therein lies the rub. There is no one-size-fits-all approach that necessarily works. And when the buyer is a private equity (PE) firm, additional issues may arise. What matters most is good process, exercise of good judgment, making an informed decision and maintaining a good record of that. Below are ten important considerations to keep in mind—they won't prevent your company (or you, in your capacity as a director) from being sued (over 93% of deals over $100 million result in litigation, so you should expect to get sued), but they will help you in your exercise of your fiduciary duties and your ability to demonstrate the same to a Delaware court.

1. Retain Highly Qualified Advisors. Delaware courts understand that a board needs to rely, in certain situations, on the professional judgment of experienced outside advisors. This should go without saying, but for such an important decision as a potential sale of the company, the board should engage financial and legal advisors that are sufficiently qualified for these types of transactions. The company's pre-existing advisors may fit that bill or the board may need to look elsewhere.

2. There Are No Shortcuts to Good Process. A board must act in an informed manner and be sufficiently involved in the sales process. It is important for the record to show that the board met periodically throughout the process, was appropriately advised by outside advisors and exercised informed judgment on the important decisions when it mattered. Prior to commencing a sales process, let your financial advisor take the time to inform (or update) you as to their view of the value of the company and its shares. Similarly, let your outside counsel advise (or remind) you as to your fiduciary obligations (particularly in connection with a sales process and potential change-of-control transaction). This will help get things started on the right foot—process- and record-wise.

3. Be Mindful of Conflicts of Interests. It does not matter how careful you are in your sales process, if your banker, lead director or chief executive officer has an undisclosed material conflict of interest with the winning bidder that is discovered by the plaintiff's law firm after the fact. You should inquire about potential conflicts of interest, and your counsel should guide you on how to vet these conflicts early on in the sales process and help you navigate them if they arise (e.g., staple financing).

4. Management Participation is Critical, but Oversight is Needed. Most likely, you cannot sell your company without active participation by senior management. However, their interaction with potential bidders runs the risk of them acting in their own interests or the bidders' interest (to curry favor). You will want to (i) instruct your management team as to how to properly interact with the bidders during the sales process and (ii) direct your financial and/or legal advisor(s) to chaperone the management presentations to make sure that discussions with bidders are consistent with the foregoing.

5. Make Sure Management Keeps an Eye on the Business. A sales process is going to distract management. They cannot be in two places at once, and responding to bidders' needs can be time-consuming. However, management must continue to execute the board-approved business plan (except as otherwise directed by the board), because getting to a signing, let alone a closing, of a sale transaction takes time, and by no means is a certainty. And, it helps, when negotiating with bidders, that remaining as a stand-alone company is a viable option.

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6. Your Largest Stockholder is Important But Cannot Dictate Terms. While the objectives of the company's largest stockholder may be in line with the best interests of the company's stockholders generally, the board must make decisions for the benefit of the stockholders taken as a whole. In certain situations, particularly where the largest stockholder (e.g., a PE fund) is pressing for a sale due to its own liquidity issues, that may mean the board refusing to conduct a sales process or, if such a process has been commenced, refusing to accept the highest offer on the table (because the board has determined, after consultation with its financial advisors, that the highest offer on the table still does not adequately value the company).

7. When Going "Open-Kimono," Be Clean About it. Target boards are best served (by their management and advisors) having prior warning about any key issues that bidders are likely to raise, so that they can make the business decision to be upfront about such issues. If a bidder submits a bid without having been informed as to a material issue, you can bet they are going to seek a haircut to that bid once they find out about the negative diligence information. Disclosing negative information in the diligence process is an art and not a science, and if it is likely to materially affect a bidder's valuation of the company, the board (or a committee or lead director) should be involved in deciding when and how to disclose it.

8. Be Careful About Leaks. Deciding whether to run a sales process, or conducting one, generates confidential, potentially price-sensitive information. The board must be particularly careful about leaks. Not only could they give rise to insider trading, but they could derail or unnecessarily complicate the sales process and distract employees from doing their jobs.

9. Maintain a Good Record. Not only should the board strive for good process, the board and its advisors need to develop a good record of such process. That objective can be undermined by casual emails and incomplete notes of meetings or conversations. Directors should not assume that private emails or personal notes will remain confidential. In fact, they are often subject to discovery in merger-related litigation and can be taken out of context by plaintiff's lawyers, undermining the appearance of good process. Treat each document you create (including drafts), even if it is marked internal or confidential, as if it will be read by a plaintiff's lawyer. Make sure that each document accurately and clearly reflects the events that took place.

10. Know Your Buyer. The spectrum of potential bidders may include PE firms and strategic buyers. Not only do these bidders present different risks in terms of sharing competitive information (including antitrust risk in certain cases), they can and often do present different risk of deal certainty. Strategics are much more likely to agree to target-friendly terms: they likely won't need a financing condition (or "back-door" financing condition) and can agree to a full specific performance remedy (where they are required to close so long as the closing conditions are satisfied), as compared to a PE firm that at least is going to demand a limited specific performance condition (so that it doesn’t have to close if it can't get its debt financing) and that it only be obligated to pay a reverse termination fee in the event of a financing failure or willful breach. On the other hand, the PE bidder may present little or no antitrust risk and may be able to sign and close the transaction much faster than the strategic (for a number of reasons). What's important from the board's perspective is understanding these differences at a high level and appreciating that, in certain situations, all bids may not be equal. Depending on the facts, the board may reasonably determine that the $95 bid from a PE firm is better than the $100 bid from a strategic, or vice versa.

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