DUAL-TRACK TRANSACTIONS
MAXIMISING THE OPTIONS

Claire Coppel, Harsha Kumar, James Roe, Hannah Valintine and Elizabeth Wall of Allen & Overy LLP explain the advantages of, and issues involved in, dual-track transactions, where preparations for an initial public offering and a private M&A sale take place concurrently.

Traditionally, a dual-track transaction means a process in which the owners and management of a business run in parallel both an initial public offering (IPO) and a private merger and acquisition (M&A) sale process, usually by way of auction. The main driver for running the two exit strategies in parallel is to achieve the best outcome, most commonly to maximise the value of the exit or fundraising, as the IPO can represent an additional bidder in an auction sale, generating additional competition for the asset.

A dual-track transaction is also a hedge in the sense that there may be appetite for private M&A at a time when the equity markets are not conducive to an attractive valuation, or there is simply too much volatility in the markets to allow confidence in the deal execution. Conversely, if equity markets are buoyant at a time when debt is expensive, corporate and private equity buyers may not be offering ambitious valuations in an auction process. Dual-track transactions also exist in other areas (*see box "Twin-track restructuring process"*).

At the time of writing, the market is challenging both for private M&A, due to the cost of debt, and for IPOs, as the geopolitical and macroeconomic uncertainty is undermining market confidence despite the FTSE 100 having recovered to pre-COVID-19 pandemic capitalisation levels. As new sale processes begin, driven by the maturity of closed-end funds or the demand for returns by public company shareholders, it will therefore be interesting to see whether sellers find the hedge of a dual-track process appealing, and whether they become prevalent as the markets pick up.

This article looks at the legal and practical efficiencies and challenges that are inherent in running a private sale and an IPO in tandem. In-depth knowledge of these opportunities and challenges is crucial to a good outcome; in particular, being able to anticipate how to optimise the timetable and processes to achieve efficiencies will promote a successful exit. It is worth a seller understanding the dynamics and what may be coming down the track, or tracks, before embarking on such a process.

WHO CONTROLS THE EXIT

One of the first issues to consider when structuring a dual-track transaction and designing the project management around it is who controls the exit. For a business that is wholly owned, this is straightforward. But for a company with several institutional

Twin-track restructuring process

Dual-tracking is relevant not only to exit strategies but also to distressed scenarios, where companies and shareholders conduct negotiations both with potential new investors on the one hand, and formal restructuring processes on the other.

These processes are designed to establish a formal restructuring, including both consensual and non-consensual arrangements, as a fall-back or plan B in the event either that a solvent exit cannot be delivered or new money, whether debt or equity, cannot be raised in sufficient time before the directors conclude that they need to proceed with a formal restructuring transaction in order to maximise the likelihood of the business surviving.

There are interesting parallels between the co-ordination of an initial public offering and M&A dual-track transaction and a restructuring and sale or new money dual-track transaction, both relating to process issues around confidentiality and leveraging efficiencies, in particular for the preparation of marketing materials, and also in respect of tactics around using key milestones to maximise value.

Key points of difference relate, in a technical sense, to the analysis of directors' duties, as well as, from a practical perspective, to the timing pressure in a distressed environment (*see feature article "Directors' duties on insolvency: navigating the twilight zone", www.practicallaw.com/w-013-6147*). What is more, in a restructuring context, the breadth of stakeholders involved, from syndicated debt providers to trade creditors, can result in increased project management challenges.

shareholders and potentially management shareholders, the shareholders' agreement (SHA) and the articles of association will need to be reviewed to determine which person or persons can initiate and ultimately conclude an M&A sale or an IPO.

Where there are multiple shareholders, particularly where there has been new investment or share sales over the life of the SHA, the exit mechanics in the SHA may need to be updated in order to implement appropriate governance of the sale or IPO. If the share register is fragmented, it may be unwieldy for numerous shareholders to have rights of consent across all decisions on areas from administrative issues, such as the appointment of advisers and cost-sharing, and process issues relating to timetable and launching marketing initiatives, through to the most material and substantive issues around valuation and allocation of proceeds. It is common therefore to draft side letters or exit conduct agreements to supplement the SHA and clarify these areas.

With regard to individual members of an executive or management team, the extent to which they participate in the various decisions will depend on the preferred exit route as well as on factors such as:

- Whether they hold shares.
- How they are currently incentivised.
- How critical they are or are likely to be perceived to be in relation to business performance after the exit.
- How likely they are to be part of the management team and how they will be incentivised following the exit.
- Whether the institutional sellers are able to access key information on the business without their involvement.

Other early-stage considerations include how to incentivise relevant executives and other members of management in order to ensure, at a practical level, that they co-operate fully in the process with a view to promoting the best exit outcome possible, as well as how wide the so-called "confidentiality net" for the transaction is cast.

CONFIDENTIALITY

In corporate finance transactions, there is often a tension in relation to information flows. On the one hand, there is merit in keeping the group of people who have access to the confidential information relating to a transaction very tight, either for regulatory reasons, whether associated with market abuse regulations or in order to avoid conditioning the market in the US, or so that the maximum amount of work can be carried out without the risk of a leak and ensuing public scrutiny that may undermine sale tactics. On the other hand, it can be desirable to disseminate information more widely both for market-testing purposes and in order to reach the most appropriate people across a business so that the information-gathering process for a data room is as efficient as possible.

On a dual-track transaction this tension is heightened. In terms of controlling information, the audience for marketing purposes is amplified: private auction participants and equity analysts and investors on an IPO represent different communities, and private M&A and IPOs require certain different advisory skills from the investment bank, and the legal, financial, tax and consulting advisers.

Further, a leak may be perceived to have a dramatic impact on deliverability: while dual-track transactions can be run in full view with the IPO lingering as a threat to a bidder or bidders on the private sale track, sometimes it may be the case that knowledge of the other track could be a distraction and lead to a lack of engagement. The authors once advised on a dual-track transaction where the advisers on the IPO were not informed that there was a parallel M&A process ongoing so as to minimise the risk of a leak and to ensure that all parties on the IPO track were focused on delivery.

On an IPO, there is also the need to avoid certain information flows that would affect the ability to market the offering into a particular jurisdiction and the risk that a leak of certain types of information, such as a profit forecast, may require greater disclosure in the offering document.

PR advisers are often brought in early in the process on dual-track transactions in order to help manage and respond to a leak. It is important not only to cater for different leak scenarios in the communications plan but also to think ahead to the direction in which a process may need to pivot in the event of a leak, depending on how critical confidentiality is deemed to be to either side of the track.

From a logistical perspective, areas that require careful project management by the seller's teams in order to maintain the desired level of confidentiality are file access,

Example high-level timetable

The table below sets out an example high-level timetable. There are a number of variables and so the approach to timetable can change, but the example gives an idea of a dual-track plan.

Phase	IPO track	M&A track
1	Structuring and preparation of marketing materials.	Structuring and preparation of marketing materials.
1.5		Pre-marketing: • Launch of teaser, high-level marketing materials. • Expressions of interest submitted by bidders.
2	Early-look presentations and feedback. Production of prospectus commences.	Auction round 1: • Launch of confidential information memorandum and management meetings. • Non-binding offers submitted by bidders.
3	Analyst presentations and analyst preparation of research. Investor deep dives.	Auction round 2: • Launch of virtual data room and any sell-side due diligence reports (for example, financial, commercial, tax or legal) and transaction documents review and negotiation. • Binding offers submitted by bidders.
4	Pilot fishing.	Auction round 3: final negotiation(s).
5 – Proceeding with chosen track	***(In the UK) Pre-intention to float (ITF) announcement and publication of registration statement (Financial Conduct Authority-approved document).***	***Signing of sale and purchase agreement.***
6	Steps to proceed with initial public offering (IPO): • ITF & research publication. • Pre-deal investor education. • Pricing and publication of prospectus. • Roadshow. • Bookbuilding. • Pricing.	Satisfaction of conditions precedent, such as competition, foreign direct investment, regulatory and any commercial or financing-related conditions.
7	Steps to complete IPO: • Admission. • Conditional trading. • Settlement.	Closing.

data room access and email and calendar invite distribution lists. Implementing good organisation from the outset is fundamental to success.

THE DATA ROOM

The virtual data room for a private M&A transaction can look very different to the one for an IPO. However, in order to maximise efficiency on a dual-track transaction, both for time and cost purposes and to minimise disruption to management, the optimal approach is to ensure that there is as much overlap as possible in the data sets that are prepared for the two tracks and that the information required in a particular category is sought from the business only once. From a practical perspective, this means planning the contents of the data room and agreeing how those contents will be displayed in the data room as part of the overall project plan at the beginning of the process.

There are several reasons why the data rooms for private sales and IPOs look different:

- Private M&A due diligence is, subject to the nature of the asset, the bidders and the point below on financial information, typically much wider in scope than IPO due diligence because both the market and also securities laws and regulations relevant to capital markets transactions dictate a higher materiality threshold in IPOs.

- The disclosure on an IPO is more standardised because the organisations conducting the due diligence are primarily:

  - the underwriters;
  - for a London Stock Exchange Main Market IPO, the sponsor or, for an AIM float, the nominated adviser (nomad);
  - lawyers; and
  - reporting accountants.

In contrast to financial sponsors and trade buyers on a private deal, those underwriters, sponsors and nomads have defined legal and regulatory obligations as well as defined internal policies. In addition, a large part of the underwriter's due diligence on an IPO is conducted through management Q&A sessions and the drafting of marketing materials.

- Prospectuses contain customary historical financial information disclosure, management commentary on historical trading, trends and capital structure (the operating and financial review), confirmation of sufficiency of working capital, financial (and, increasingly, non-financial) guidance and, occasionally, profit forecasts. There are detailed rules, conventions and practices that support the production of this information and the checking of its reliability. That comfort includes the process that supports the preparation of the company's business plan and model, accounting comfort letters and assurance, chief financial officer's certificates and, where appropriate, the verification process undertaken by the lawyers, which essentially serves as a depositary of the evidence supporting the relevant financial information.

- Because the parties conducting due diligence are bankers and other advisers, the competition law concerns around disclosing information to trade buyers and certain financial sponsors are not typically relevant and confidentiality is not generally as sensitive. Although it is worth noting that, when selling to financial sponsors, the commercial sensitivity of sharing information may be diminished depending on the other investments that those firms hold. However, data protection advice should still be sought.

In terms of look-back periods, the approach taken across the two tracks is not materially different. The general look-back period for data room disclosure on an IPO is typically extended to the three most recent completed financial years, including a bring-down period up to the date of the offering document. This can be shortened for certain types of information and extended for others; for example, it may be five years for compliance matters. On a private sale, the look-back tends to be three years too, although that does not typically carry across to the look-back periods for representations and warranties, which can be significantly shorter, except for tax and certain other compliance areas.

The dual-track transaction tactics will inform the most appropriate logistics for the data room. How to structure the data room, including whether there should be two different data rooms or one data room with different security access settings, will depend on who from the seller's side, advisory teams and investor community needs access (for the purpose of both uploading and reviewing information) and what information is intended to be released to whom and at what point.

TIMETABLE

Ideally, the two sides of the dual-track transaction will be choreographed so that equivalent decisions are scheduled to coincide. The timetable does, of course, have to be tailored on a case-by-case basis and the financial advisers may recommend that one process runs ahead of the other in order to capitalise on a particular window in the markets or because a bidder is positioned to pre-empt the private auction. However, the goal on a dual-track process is usually to maintain momentum behind both sides of the track with a view to synchronising the key milestones so that the green light to proceed with either a sale or an IPO is as informed as possible.

In practice, this typically means targeting the hard launch of an IPO (in the UK, this is the pre-intention to float (ITF) announcement and publication of the registration statement) and the signing of the sale and purchase agreement (or other private investment or joint venture agreement) on the same date.

Aside from designing the timetable to leverage efficiency and negotiating power across both tracks, the company's financial calendar is an important factor. Depending on where the IPO is going to be marketed, there will be dates on which quarterly, half-year and year-end financial information required for the prospectus or other offering document will go stale. Other timetable factors, in addition to those mentioned above, will include prevailing financial performance, track record of management, the extent to which there is seasonal influence in the company's business or the sector more widely, and any impending regulatory reform. With the target timetable on a traditional dual-track, there is a significant amount of work that must be done in parallel on both sides of the track before deciding which route to pursue (*see box "Example high-level timetable"*). On the IPO track, all of the marketing materials, including the prospectus, have to be ready or substantively final at the point of a pre-ITF announcement, and on the M&A track, the terms and conditions of the sale have to be fully settled. Of course, this has a cost implication should one side fail, which has to be balanced with the timing and tactical implications of running the processes sequentially or with one running in advance of the other.

IPO READINESS

In the UK at least, it has always been the case that there is enhanced scrutiny of a company's systems and controls, focused on financial information and financial reporting, in the process of an IPO. This is primarily because of how a listed company will need to operate and its obligations as a listed company. This focus is then reinforced by the sponsor and nomad obligations. These obligations tend to drive the nature of the process and the comfort delivered, such as commentary reports and comfort letters.

Additional preparatory work is required on an IPO, not only to allow the company to comply with the Listing Rules and Disclosure Guidance and Transparency Rules once it is listed, but also to enable the company to comply with governance and sustainability codes, investor expectations, and enhanced company law financial and non-financial reporting that applies to companies that are traded.

However, increased regulation relating to financial crime means that there is likely to be more focus on the M&A track as part of due diligence than in the past.

Trends around investor demand, as well as heightened legal and regulatory disclosure and other compliance requirements, have meant that sustainability or environmental, social and governance (ESG) matters have become part of an IPO process. This adds another workstream to the project plan for IPO readiness.

That is not to say that sustainability due diligence is not relevant as part of an M&A

process or that investors in the M&A sphere do not have sustainability criteria. However, ESG credentials will be at the fore as part of marketing an IPO and to the extent that the company needs to improve its performance on sustainability, there will need to be a plan to achieve the desired profile before IPO marketing commences. There is more flexibility on an M&A sale for a buyer to drive improved sustainability after the acquisition.

ESG consultants have therefore risen in prominence on IPOs and will review the company's purpose, culture, operations, reporting lines, policies and procedures in order to determine its environmental and social impact, as well as compliance with relevant governance standards (*see feature article "Sustainability in supply chains: due diligence in focus", www.practicallaw.com/w-035-5415*).

On the topic of governance, one specific workstream relevant to an IPO as opposed to a private sale is bringing in new independent non-executive directors (INEDs). The scope of that exercise will be determined by the extent to which the company intends to be compliant with market practice or specific governance standards, such as the UK Corporate Governance Code. An interesting dynamic here is the point at which the company chooses to bring in proposed new INEDs and the level of transparency given to the relevant individuals in relation to the M&A track and the related costs.

For completeness, the other important code that is relevant on an IPO in the UK market, but is not usually applicable to the M&A track, is the Takeover Code (the Code). Relevant parts of the Code on an IPO typically include:

- The mandatory bid regime; for example, in respect of over-allotment and share lending for the purpose of stabilisation.

- The provisions on acting in concert. If there are multiple shareholders in a private company before the IPO, they will usually ask the Takeover Panel to confirm that they will not be deemed to be acting in concert following the IPO.

It will also be important to brief the relevant directors in advance of the impact of the Code following IPO, so that they are not caught off-guard by a bid approach.

Limits on liability in underwriting agreements

In underwriting agreements, liability for the various parties giving representations and warranties is typically limited as follows:

- For directors, the comfort is typically limited by reference to their knowledge, having made certain enquiries, and the financial limit on liability will be set by reference to remuneration.

- For selling shareholders, liability is capped at a percentage of their net sell-down proceeds.

- There is usually only one overall cap on a director or selling shareholder's liability. There will not usually be a de minimis, threshold or basket limitation, unlike in a sale and purchase agreement.

- The company's liability will not be capped. In fact, the company will provide the underwriters and sponsor with wide indemnification protection relating to the marketing process and any loss that the banks might suffer in connection with it.

- The time limits on liability for representations, warranties and indemnities given by selling shareholders and directors relating to the business, the marketing materials and the shares being sold will often be similar to the time limits on liability for business warranties in a private sale because the focus is on issues being flushed out through the next audit cycle. Although certain warranty and indenmity policies will provide synthetic protection by extending time limits in certain areas.

DEAL DELIVERABILITY

Valuation and market conditions will always be central to the success of either track; however, the increasing regulatory intervention at a global level, in particular in the merger control and foreign ownership spheres, is not only a factor that will inform the likely gap between signing and closing but should also inform the marketing strategy on both sides of the track (*see feature article "National Security and Investment Act 2021: taming the M&A dragon", www.practicallaw.com/w-032-2847*). Identifying the target investors on the IPO track and the target bidders on the M&A track will help to refine the overall exit strategy.

On the M&A track, direct and indirect share ownership thresholds may trigger approvals from:

- Sector regulators (notably financial services and aviation).

- Competition regulators, such as the Federal Trade Commission in respect of Hart-Scott-Rodino filings in the US or the Competition and Markets Authority in the UK.

- Foreign direct investment regulators, such as the Committee on Foreign Investment into the US.

Certain governance rights for minority investors that are agreed as part of the sale process may also trigger approvals, even if the voting rights that are acquired do not cross the relevant thresholds.

On the IPO track, these approval thresholds may also be relevant in respect of cornerstone investors that are acquiring shares or in respect of existing owners of the business selling down. For example, on an IPO of an airline company, it is necessary to observe nationality requirements in certain jurisdictions in order to preserve landing and operating rights. In that sector, this is a key factor that will inform the global co-ordinators' or bookrunners' approach to marketing as well as the exit parameters for existing shareholders.

Certain ownership thresholds may require only notification, rather than approval, but the investment banks will often want to outline the regulatory regime in the early stage marketing materials on both sides of the track. The banks on the IPO track will

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also want to agree a plan on investor "know your client" (KYC) anti-money laundering requirements at an early stage and, in the current geopolitical environment with a complex sanctions matrix, KYC is increasingly involved (*see News brief "Russian sanctions: responding to a complex situation", www.practicallaw.com/w-035-3181*).

CONTRACTUAL COMFORT

Representations, warranties and indemnities will be provided by the owners in relation to the business on both tracks but there are key differences in the liability regime in terms of who provides the comfort, to whom, the scope of the comfort and the limitations on liability.

On the M&A track, the starting point is that the selling shareholders or the shareholders rolling into a new structure (whether institutional or management), or both, will provide contractual protection regarding the target business to the buyer or new investors. However, it is standard for private equity sellers, and increasingly common for corporate and individual sellers, to look to minimise their liability on exit by offering title and capacity warranties only with all other warranties subject to a £1 liability cap and provided solely to enable the buyer to take out warranty and indemnity (W&I) insurance to provide recourse in respect of those warranties (though W&I insurance may not be an appropriate solution in all circumstances).

On an IPO, the company and the executive directors are all usually required to provide representations and warranties to the underwriters and the sponsor or nomad in the underwriting agreement, as well as to the banks and the company (respectively) in representation letters. These cover both the target business and the adequacy and accuracy of disclosure in the marketing materials, with the comfort being repeated at various milestones, including at pricing, until completion of the IPO process.

The scope of representations, warranties and indemnities for selling shareholders, depending on the level of their involvement in the business, is often limited to title, capacity, solvency and information relating to them in the marketing materials, with the liability of non-executive directors (NEDs) limited to the marketing materials, including the forward-looking and belief statements set out in those materials (*see box "Limits on liability in underwriting agreements"*).

On an M&A process, it is rare to provide protection in relation to the marketing materials. But on a dual-track process, there is often a debate as to whether protection should be offered in relation to advanced drafts of marketing materials where those have undergone verification on the IPO track.

ROLE OF THE BOARD

On a private M&A sale, the centre of gravity for decision-making sits with the shareholders. Any NEDs are likely to be nominated by the shareholders and so, on a change of ownership, the NEDs will almost certainly resign with effect from completion. As described above, unless the directors hold shares or are acquiring shares as members of management in the business in the future, they are unlikely to be offering protection through representations, warranties or indemnities.

The board, as a unit, is therefore a less important stakeholder, other than in matters relating to pre-sale restructurings or other pre-completion corporate actions. In this regard, the board needs to be cognisant of director duties (*see feature article "Intra-group reorganisations: directors' duties in times of stress", www.practicallaw.com/w-028-3705*).

On an IPO, however, the directors are key stakeholders for two reasons:

- Having an appropriate board in place in terms of balance and expertise is key from an investor perspective so investors will look to them as guardians of the business in the future.

- The directors need to stand behind the package of representations, warranties and indemnities outlined above. It will be important as part of the board education process for the company and advisers to spend time with the directors focusing on forward-looking statements that are proposed to be included in the marketing materials, whether on the industry or specific to the company's prospects, and to ensure that the directors are comfortable that there is a reasonable basis on which those statements are being made.

Given the responsibility regime for marketing materials on an IPO, thought must be given to the timing of director appointments and resignations. Any directors intending to resign at the time of the IPO are unlikely to want to take responsibility and liability for the registration document or prospectus. For appointments, the UK regime requires that prospective directors take responsibility for certain marketing documents, and so the early education of those directors is key.

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