APRIL | 2025

Planning for the Exit

Quick Takes

U.S. and global sponsor-related deal values were generally flat throughout 2024, but saw some growth in the first quarter of 2025. March saw the largest total values in the last 12-month period, despite the number of U.S. and global sponsor-related deals reaching a low point during that time. It remains to be seen whether these trends will continue into the second quarter given the current market uncertainty.

In this issue of the *Private Equity Digest*, we discuss key strategies and legal considerations for sponsors in planning an exit from a controlling stake, which can be crucial for value enhancement and preserving optionality in choppy markets.

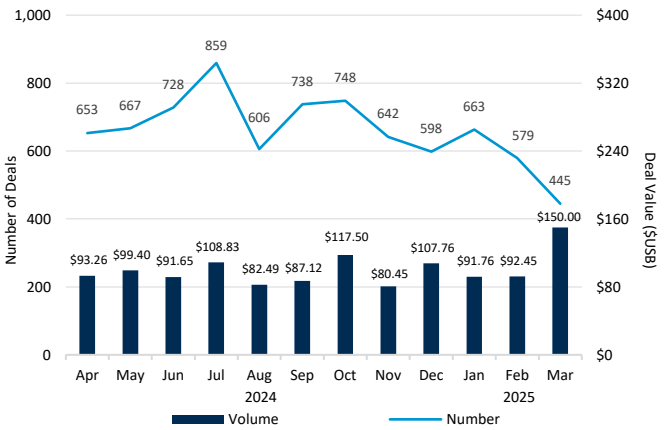
Amidst market uncertainties and a competitive private equity environment, effective advance planning can be key to value enhancement, achieving targeted returns to investors and a successful exit from a controlling private equity investment. This pursuit is complicated by legal obligations, regulatory compliance and the balancing of various stakeholders' interests. In this article, we explore key strategies and legal considerations that underpin planning for an exit of a controlling stake.

Starting at the Beginning

A successful exit requires planning, even before investment. Ongoing market volatility emphasizes the need for private equity sponsors to structure the initial investment to provide for optionality among various exit paths, including through an IPO, sale or secondary transaction, which sponsors can pursue individually or in parallel. Sponsors should seek to ensure that they can leverage several exit strategies, easily change course from one strategy to another, and block strategies that may not maximize the value of the portfolio company or allow for appropriate returns to investors. Such flexibility should be captured by or negotiated into the governing documents of the portfolio company at the outset of the investment.

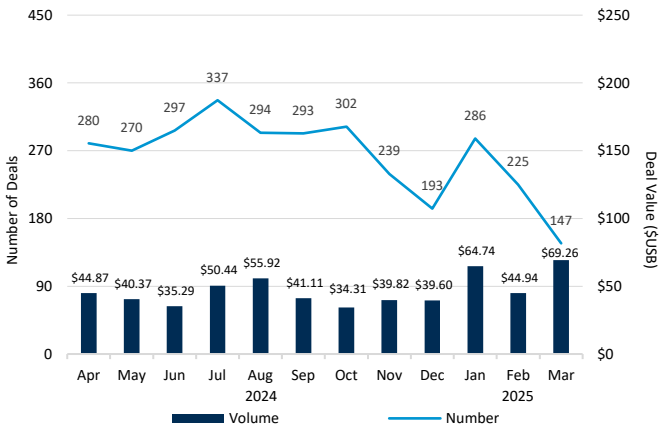
Documentation. Private equity sponsors should consider how key provisions in a portfolio company's organizational documents and shareholder agreements will facilitate the exit. These terms include drag-along and tag-along rights, sponsor rights of first refusal if a third party offers to acquire the portfolio company, registration rights (including piggyback rights giving the sponsor the right to participate in a public offering of the company's securities) and requirements for the portfolio company to cooperate with the sponsor in connection with an IPO.

Global Sponsor-Related M&A Activity



Source: Dealogic[1]

U.S. Sponsor-Related M&A Activity



Source: Dealogic[1]

Corporate governance. Governance rights play a critical role from the first stages of planning. Sponsors should consider carefully the implications of giving non-controlling stockholders veto or consent rights over the manner and timing of an exit, as well as the need for coordination with the board and/or committees on the exit process. Sponsors can employ varying governance strategies, including through the use of stockholders' agreements relating to corporate governance, a tool that was reinforced by 2024 amendments to the Delaware General Corporation Law (DGCL).[2] However, despite having statutory authority, sponsors should always consider the applicability of fiduciary duties and whether their governance arrangements would survive equitable review by Delaware or other applicable courts.

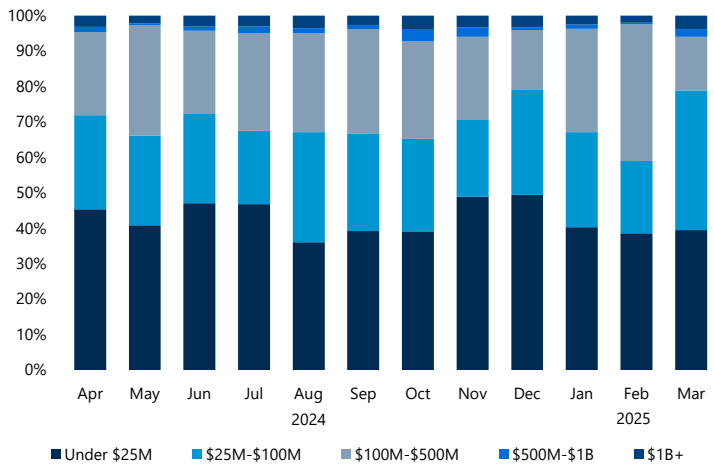
Working Through the Middle

Detailed consideration and evaluation of multiple exit paths is vital for a successful exit. A sponsor's evaluation of single-track versus multi-track processes and assessment of fund-level transactions, such as continuation funds,[3] lays the groundwork for a well-informed plan.

Timing and liquidity considerations. Sponsors should be aware that each exit strategy will come with its own set of timing and liquidity considerations. The timing and ability of sponsors to use key exit strategies like a private sale or an IPO is subject to market conditions, the size and nature of the transaction, required regulatory and compliance hurdles, and stakeholder alignment, among other company and/or deal-specific considerations. A private sale often offers a sponsor the opportunity for a full exit on a faster timeline than an IPO due to the relatively lower compliance and disclosure hurdles (subject to required regulatory approvals in connection with the sale). Unlike a private sale, a full exit via an IPO may be extended well beyond the IPO itself as sponsors may be subject to lock-ups or other restrictions that delay a sponsor in selling out of its position in the public company. Secondary transactions, such as continuation funds, may offer sponsors the opportunity for a full or partial exit as an alternative to traditional private sales or IPOs. Ultimately, the exit strategy a sponsor chooses should align with market conditions and the sponsor's desired investment horizon and return on investment.

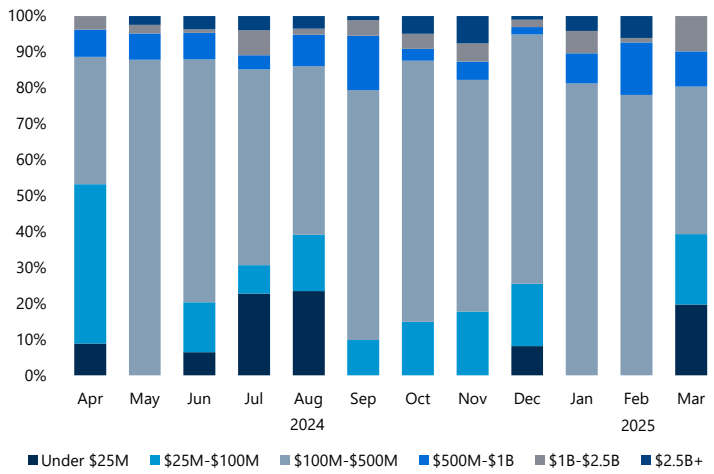
Applicable law considerations. Private equity sponsors should be mindful of Delaware and other state law considerations, particularly regarding controlling stockholder status and fiduciary duties owed to minority stockholders. In the Delaware corporate context, once deemed to be a controller, a stockholder owes fiduciary duties to minority stockholders in certain contexts. Recent amendments to the DGCL[4] have clarified that controller status for transactional purposes attaches at an

U.S. Sponsor-Backed M&A by Size



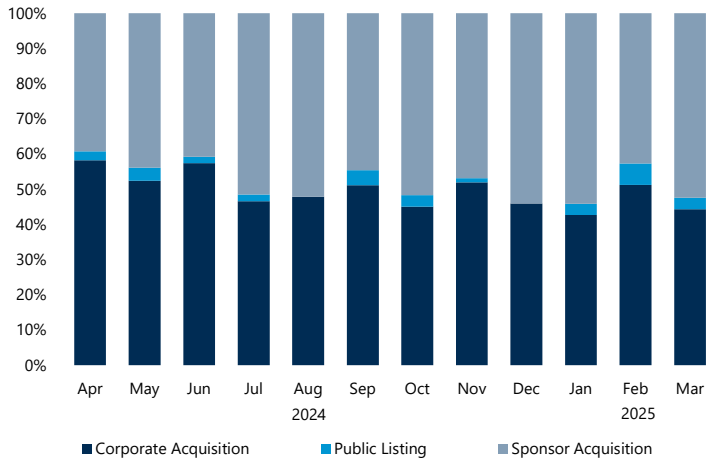
Source: PitchBook Data, Inc.[5]

U.S. Sponsor-Backed Exits by Size



Source: PitchBook Data, Inc.[5]

U.S. Sponsor-Backed Exits by Type



Source: PitchBook Data, Inc.[5]

ownership threshold of one-third of a corporation's voting power if the stockholder also exercises managerial authority over the corporation. In addition, the amendments clarify that two or more stockholders can constitute a control group owing fiduciary duties if they collectively constitute a controlling stockholder by virtue of an agreement, arrangement or understanding between or among them.

The recent amendments to the DGCL also clarify the acts and omissions for which controlling stockholders can be found to be liable, including breaches of the duty of loyalty, acts and omissions not in good faith, intentional misconduct or knowing violation of the law and transactions for which the controller derives an improper personal benefit. In the context of exit transactions, liquidity needs of a sponsor have been used as the basis for claims alleging breaches of these duties, although the standard of proof is high (as exemplified by cases like *Synthes*, *Narang*, *Infogroup* and *Manti*). By crafting a comprehensive process timeline, as well as anticipating procedural protections available to transactions where there are interested parties or controlling stockholders, sponsors can enhance the likelihood of a successful exit while minimizing litigation risk.

Work on the portfolio company's attractiveness. Sponsors can take steps in advance of an exit to make a portfolio company more attractive to the market, including, but not limited to, the following:

- Undergoing any necessary corporate restructurings;
- Identifying key person/executive management matters, including treatment of management equity in an exit and any post-exit retention arrangements;
- Assessing potential regulatory compliance issues (such as the Foreign Corrupt Practices Act[6] and data privacy/security regulations);
- Addressing potential regulatory hurdles (such as required antitrust approvals);
- Documenting ownership of intellectual property rights; and
- Securing appropriate insurance coverage if not already in place (such as state-of-the-art directors and officers (D&O), errors and omissions (E&O) and environmental insurance policies).

Maintain thorough records. Rigorous record-keeping is important to ensure a smooth exit. This involves enhancing financial reporting and internal controls, organizing key contracts (i.e., agreements that are material to the business, including customer, supplier and lease arrangements), and ensuring the completeness of board and stockholder records.

Mitigate potential legal issues. Anticipating and mitigating the impact of legal disputes that could raise questions from a potential buyer and ensuring the currency of government licenses or permits, especially those that may be impacted by a potential transaction, add layers of readiness for a seamless transition towards a successful exit.

Getting to the Finish Line

As the time for the exit nears, diligent preparation and strategic decision-making take center stage. Selecting the right legal and financial advisors, with careful consideration of potential conflicts, such as when using staple financing, sets up the foundations for a smooth exit process. Timing for finalizing the key processes mentioned above and assembling necessary documents and preparing for due diligence (including conducting internal due diligence) should also be determined at the outset, working backwards from the date of the desired exit.

Prepare for due diligence. Sponsors can prepare for due diligence by assembling documents that buyers are likely to ask for and identifying suitable data room technology and providers in anticipation of creating a virtual data room. Sponsors should expect comprehensive legal, tax and accounting due diligence, encompassing critical areas like key contracts (i.e., agreements that are material to the business, including customer, supplier and lease arrangements), affiliate transactions (i.e., related party transactions), intellectual property ownership, insurance policies, litigation overviews, compliance policies focusing on anti-bribery and anti-money laundering policies and procedures, government contracts and government or political relationships, financial, tax, executive compensation, benefits and data privacy/security. If the business is environmentally sensitive, sponsors should consider retaining an environmental consulting firm to preview environmental due diligence.

Get the financials ready. Sponsors should prepare the portfolio company's financial statements as needed depending on the anticipated exit path, particularly because transitioning to audited financial statements may require significant lead time depending on the portfolio company's financial audit history.

IPO-specific prep. There are significant structural differences between private and public companies that sponsors need to be aware of when considering an IPO. Strategic considerations for an IPO include building out public company disclosure, preparing compliant financial statements, establishing legal, investor relations and finance teams, and curating a board of directors with independent directors and committees that satisfy SEC and applicable stock exchange listing requirements. Further considerations include building a defensive structure and negotiating certain post-IPO rights such as registration rights, information rights and consent rights, in addition to formalizing and properly documenting the governance rights discussed above.

Transaction-related issues. Finally, in order to allow for a proactive plan of action, sponsors cannot ignore potential transaction issues such as contingent liabilities, third-party consents or rights of first refusal, rollovers and parties with power to block transactions.

Conclusion

Throughout the life of an investment, sponsors should actively consider how strategic initiatives involving the portfolio company affect the manner and timing of an exit. Sponsors should also understand how market conditions and legal and regulatory impediments may affect the availability of potential exit strategies and whether it may be appropriate to pursue multiple exit strategies simultaneously amidst market uncertainties.

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1 Sponsor categorization determined by Dealogic; as of April 10, 2025. Deal volume by dollar value is calculated from the subset of deals that include a disclosed deal value. Paul, Weiss has not reviewed data for accuracy.

2 See here for our alert on the 2024 DGCL amendments.

3 See here for our prior article discussing private equity liquidity strategies.

4 See here for our alert on the March 2025 DGCL amendments.

5 Data provided by PitchBook Data, Inc. as of April 1, 2025. PitchBook's current data methodology includes all announced or completed deals or exits. Sponsor and exit type categorizations determined by PitchBook. Paul, Weiss has not reviewed data for accuracy.

6 On February 10, 2025, President Trump issued an executive order requiring the Attorney General to review the policies and guidelines for investigations and enforcement actions under the Foreign Corrupt Practice Act for 180 days. During this time, all FCPA investigations and enforcement are to be suspended.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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