Opinion | Matt Levine, Columnist

Of Course Sculptor Got Sued

Also a bankruptcy judge, EQT private IPOs and analyst names.

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By **Matt Levine**

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Sculptor

The basic situation at Sculptor Capital Management Inc. is this. In July, Sculptor, a publicly traded asset management firm, signed a deal to sell itself to Rithm Capital Corp. for $11.15 per share. Then, in August, a group of hedge fund managers led by Boaz Weinstein and including Bill Ackman, Marc Lasry and Jeff Yass offered to buy Sculptor for $12.25 per share instead.

Sculptor's board rejected Weinstein's offer, worrying that it was too conditional. Weinstein didn't have fully committed financing, and his deal (like Rithm's) required the consent of Sculptor's investor clients: Weinstein's proposed deal would allow him to walk away if fewer than 50.1% of Sculptor's hedge fund clients, or fewer than 80% of its real estate and collateralized loan obligation clients, consented to him taking over. (Rithm's deal required 85% consents.) Rithm planned to keep Sculptor's current chief executive officer and chief investment officer, Jimmy Levin, whom Sculptor's clients presumably like. Weinstein would presumably put himself in charge of Sculptor, and the board worried that this would scare clients away, the deal would not get the required consents, and Weinstein would walk away, leaving Sculptor with nothing.

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Sculptor's board said this – the $12.25 Weinstein deal was too risky, so it would stick with the $11.15 Rithm deal – and Weinstein's consortium responded, over the last few months, by (1) firming up their financing, so that now they have a bid backed by fully committed financing, (2) removing most of the client-consent conditions, so that now they have a bid that is not contingent on hedge fund client consents at all [1] and (3) raising their bid to $12.76, with a possibility of $13 if Sculptor engaged with them.

The result was:

- Weinstein's bid ($12.76 or so) was higher than the Rithm deal ($11.15).
- Weinstein's bid was much less risky than Sculptor originally argued. The financing is locked up, and the client-consent risk is lower: Even if all of Sculptor's hedge fund clients say no to Weinstein, the deal will still close and Sculptor's shareholders will still get their $12.76.
- *Rithm's* deal was now *riskier*: Rithm should have no problem getting financing or client consents (indeed, it seems to have already gotten the 85% consents it needs), but its deal (like any deal) is contingent on a vote of Sculptor's shareholders. And the shareholders would prefer to get $12.76 rather than $11.15. Sculptor's stock has traded above $11.15 since Weinstein's bid became public; it has been above $12 since Oct. 2. Sculptor's shareholders do not want the $11.15 Rithm deal – they think the stock is worth more than that – and so they are unlikely to vote for it. They could vote down the Rithm deal and hope that Weinstein will still be there, at $13 or $12.76 or even $12.25. The stock price suggests they would do that.

Sculptor really does not want to sell to Weinstein, though, so last week it cut a new deal with Rithm. The new deal raised the price to $12.00 per share, still below Weinstein's offer. In return, Sculptor … didn't *get rid* of the

shareholder vote (you can't do that), but it did a lot to lock up the shareholder vote:

- Roughly 26% of the voting shares are owned by Jimmy Levin and other current Sculptor executives, who have signed voting agreements committing them to support the Rithm deal. (Another 15.8% of the vote is owned by Dan Och, Sculptor's estranged founder, and Robert Shafir, another former Sculptor CEO, both of whom have come out against the Rithm deal and would presumably vote no.)
- A few years ago, Sculptor sold some warrants on its stock to Delaware Life Insurance Co. As part of the new merger deal, Rithm bought those warrants, giving it another roughly 6.5% of the voting stock. (The price it paid for those warrants comes to roughly $6.35 per warrant, and they have an exercise price of $7.95 per share, meaning that Rithm is paying roughly $14.30 per share for these extra votes – versus the $12 per share it is offering to public shareholders.) So between the warrants and the voting agreements, Rithm has about one-third of the shares committed to vote in favor of the deal: not the majority it needs, but closer.
- The original Rithm deal required not only a vote of all shareholders, but a second vote of all *outside* shareholders, excluding Levin and other current executives (and Och and other estranged former executives). The voting agreements would not have helped there. And the outside shareholders, the ones who have been buying and selling the stock at above $12, presumably want more money and would be hard to persuade to vote for Rithm. The new deal just gets rid of that second vote: Now the deal can close without the approval of a majority of outside shareholders.
- The new deal also raises Rithm's breakup fee: Now, if Sculptor does end up selling to someone else, Rithm gets $20.3 million, instead of the previous $16.6 million breakup fee.

This was, I think, a pretty odd move: Sculptor's board was so opposed to taking the Weinstein deal that it took a lower deal from Rithm, and made it harder for its shareholders to reject that deal. There are two possible explanations:

- Sculptor's board is so worried that a deal with Weinstein would tank the company, and that the company tanking would give Weinstein an excuse to get out of the deal, that it had to stick with Rithm *and take the choice out of shareholders' hands*. The risk was too great that shareholders would be seduced by Weinstein's higher number and would vote down the Rithm deal, and then the company would collapse and shareholders would get nothing. The board is protecting shareholders from themselves, by giving them a deal they don't want but that is nonetheless best for them.
- Sculptor's board is friendly with Jimmy Levin, they've paid him a lot, they want him to keep his job, and so they are fighting to keep a deal that is best for him even though it is worse for shareholders.

The first explanation was, I think, plausible at the beginning, but it has become less plausible each time Weinstein has removed a condition from his bid. "There is no way that Boaz Weinstein will get 50% of Sculptor's hedge fund clients to work with him instead of Jimmy Levin" makes some sense, but his deal is no longer contingent on *any* of the hedge fund clients agreeing to stick with him. (It remains contingent on the real estate and CLO clients consenting, though, as well as presumably on some amount of general "Jimmy Levin doesn't sabotage the business on his way out the door" conditions.) Sculptor has continued making the same complaints about Weinstein's bid, even as the bid itself has changed in answer to those complaints.

In fact, when Sculptor *started* the process of selling itself, Sculptor's own board announced that it would sell itself to the highest bidder, subject to an 80% client consent threshold and without any requirement that the bidder retain any of the current staff. [2] It understood that, as a matter of fiduciary duties to shareholders, it couldn't try to preserve Levin's job, and it understood that, as a matter of how asset-management deals are done, the buyer would expect to get client consents. Now that Weinstein wants to buy Sculptor at the highest price, subject to a lower client consent threshold and without retaining Jimmy Levin, Sculptor says "no obviously that's impossible." But that's what Sculptor itself proposed!

All of this does *kind of* suggest that there might be something to the second explanation?

Anyway, Sculptor has scheduled its shareholder meeting for Nov. 16, hoping to get a majority and close the Rithm deal soon afterward. Weinstein has a standstill agreement that prevents him from making a public bid or tender offer, but it expires in December, so Sculptor is trying to get the Rithm deal done before then.

The traditional next step here is for the jilted party – Weinstein – to go to Delaware Chancery Court, lay out all of this stuff, say "this is not what the board is supposed to do," and try to get the court to block the Rithm deal. Weinstein has not done that, for whatever reason (possibly the standstill?).

But somebody has! It is tough for Sculptor that they have an estranged founder who takes a keen interest in all of this:

> Dan Och and a group of former executives of Sculptor Capital Management Inc. sued the hedge fund and proposed acquirer Rithm Capital Corp., saying the $676 million deal would shortchange investors in favor of protecting Sculptor Chief Executive Officer Jimmy Levin's job.
>
> Och, who left New York-based Sculptor in 2019, said Tuesday in a statement that he wants a Delaware judge to halt the buyout until a rival group led by Saba Capital Management's Boaz Weinstein is able to present its higher bid to shareholders. Weinstein's group, which includes billionaires Jeff Yass, Marc Lasry and Bill Ackman, has offered to pay $13 a share for Sculptor, which last week accepted Rithm's $12 bid.
>
> Sculptor directors backing Levin have made it clear that "they favor only one result – the preservation of management's jobs and compensation, at the expense of shareholder value," Och said. The suit was filed in Delaware Chancery Court.

Here is Och's complaint, which makes these and other points. On the client consents [3] :

> When it came to Rithm, the Special Committee accepted a client-consent condition that would allow Rithm to walk away if merely 15% of the clients of Sculptor's hedge fund objected to the deal. Yet when it came to the Consortium, the Special Committee effectively required the Consortium to be bound to purchase the Company even in the extraordinary scenario that all employees and clients fled the Company, leaving it an empty shell. …
>
> Incredibly, while maintaining that the client-consent condition in the Consortium's proposal imposed unacceptable deal risk, the Special Committee refused to conduct reasonable due diligence to determine whether a significant number of clients would, in fact, oppose the Consortium's offer. Initially, the Special Committee relied solely upon the opinion of Sculptor management that clients would not consent to a deal that did not preserve their role.
>
> When pressed publicly, the Special Committee retained a consultant to evaluate the views of the Company's clients, but the Special Committee refused to allow the consultant to speak with the clients (even though the clients are obviously aware of the publicly announced sale process).

On the vote:

> There is little doubt the Merger would have failed the Disinterested Vote. Sculptor's stock is now trading above the deal price (closing at $12.27 on October 16, 2023), demonstrating that public stockholders still believe that the Company is worth more than what Rithm is offering and should be able to obtain it. …
>
> It is apparent that the Company and Rithm waived the standstill, eliminated the Disinterested Vote, and increased the break-up fee for the sole purpose of pushing through the Merger against the interests of the stockholders as a whole. An unconflicted Board of Directors would never have agreed to such measures.

Here is Sculptor's statement:

> The Special Committee's role is to recommend the transaction that it believes is in the best interest of stockholders, based on price and certainty of closing. Contrary to Dan Och's assertions in the baseless lawsuit filed today that he too seeks to act in the best interest of stockholders, his ongoing campaign against the company, including his conduct throughout the Special Committee's process, has cost stockholders significant value. His complaint is replete with materially misleading statements, and Sculptor intends to vigorously defend itself."

I suppose we will see in court. There's a hearing for Nov. 9 or 10, about a week before the vote on the Rithm deal, and a judge either will or won't let that vote go forward.

Speaking of courts

Presumably Boaz Weinstein and Dan Och called up their lawyers and said "this seems unfair, is Sculptor allowed to do this?" And presumably the lawyers did not say to them "well, Section 420 of the Delaware General Corporation Law sets out the factors that a board of directors is allowed to consider in rejecting a merger proposal at a higher price, and it says that in the case of a client-consent condition the board needs to" etc. There is no Section 420 of the Delaware General Corporation Law. The stuff that the board is allowed to do is not *really* written down anywhere in clear and comprehensive form.

Presumably the basic thrust of the advice that Och's lawyers gave him was something like: "I think that a Delaware Court of Chancery judge, in looking at these facts, would be offended, and would think they're unfair, and might enjoin the deal." Or: "I think that a Delaware judge would think this is fine, but I'm not sure, so we could take a shot." Or even: "Of the seven Court of Chancery judges in Delaware, three would find this offensive and four would think it's fine, so let's see." Some of this advice would be based on what the lawyers know of the current judges, and some of it would be based on reading previous Delaware opinions for clues on how Delaware judges would treat this case. But the essential question here really is, "will a Delaware judge find this situation fair," because lawsuits about breaches of fiduciary duty really are about "equity," about the judge's somewhat

subjective (though informed by precedent) views of fairness. ("The Court has subject matter jurisdiction over this action because it brings equitable claims and seeks equitable relief," says Och's complaint.) And there are seven relevant Delaware judges, [4] and they are knowable humans with track records, and the question of what is legal in US mergers and acquisitions to some extent boils down to asking how it will strike those people. This is called "legal realism."

This is true to a sort of surprisingly large degree in American law, and particularly mergers-and-acquisition law, which is very much based in equity. It is similarly true of *bankruptcy* law, which also involves quite a lot of equitable, is-this-fair questions. For instance, we talk from time to time about various sorts of distressed-debt shenanigans that have the basic shape of stripping some value, in a distressed company, away from some creditors to hand it to other creditors. "Is that allowed," the losing creditors will ask, and the answer will to some extent depend on the words in the contract but will also depend on whether the bankruptcy judge hearing the case finds it offensive.

And, while there are lots of bankruptcy judges in the US, big corporate bankruptcies tend to end up with only a few of them. And for the last few years, practically speaking, the question "is this sort of distressed-debt shenanigan allowed" could often be reduced to "will Bankruptcy Judge David R. Jones of the Southern District of Texas find this offensive?" He hears a lot of the cases.

I am not a close observer of bankruptcy, but I have written about Judge Jones a few times around here. One time, it was about a fairly technical issue in the Serta Simmons Bedding LLC deal, whether some loans had been swapped in an "open market purchase"; he ruled that they had, saying "I sit with these matters every single day" and "this is very easy for me." That struck me as about right: The guy does a lot of bankruptcies, and he knows what those words mean to the market; his sense of fairness matched up with what the people doing these deals probably think.

Another time, we discussed some very odd rulings about short selling, and my view was, uh, he does not sit with *these* matters every day and it shows.

The point is that, for good and bad, the law of US corporate bankruptcy kind of boils down to David R. Jones's deeply informed but also somewhat idiosyncratic personal views about what's fair and what isn't.

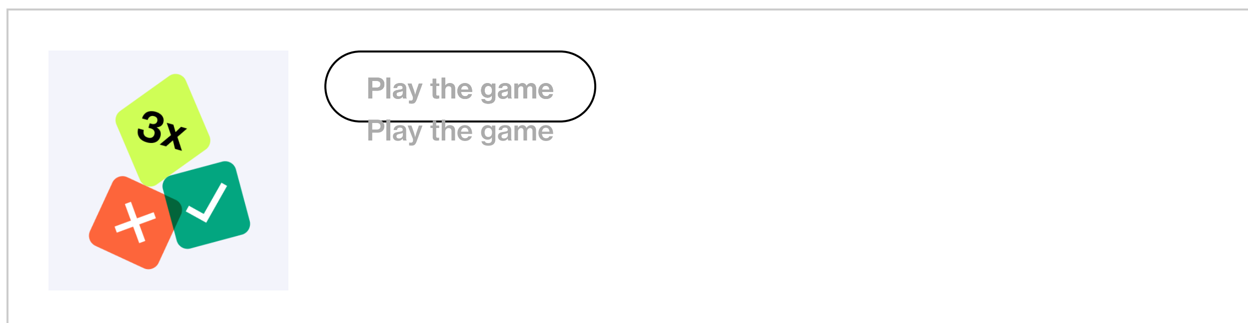
Also though he was secretly living with a bankruptcy lawyer while ruling on those cases [5] and oops oops oops:

> There are few bankruptcy courts in America busier than the one in Houston. The top judge there, David R. Jones, has handled more than 1,000 corporate insolvencies in his time on the bench and routinely oversees the nastiest debt fights that come out of Wall Street.
>
> So when Jones resigned on Monday following revelations that he has dated and lived with a top Houston bankruptcy lawyer since 2017, it rocked the insolvency world. Beyond the shock felt by those who have come to know him as a towering figure in restructuring, the move has cast a pall over cases he was overseeing – like that of Platinum Equity-backed Incora – and ones he ruled on in the past. …
>
> "This is a nightmare for the bankruptcy bench there," said Nancy Rapoport, a law professor at the University of Nevada, Las Vegas. "At best, the judges are divvying up all those cases now. At worst, there are going to be more inquiries."
>
> Jones came under fire for failing to disclose that his girlfriend, Elizabeth Freeman, was a high-ranking bankruptcy attorney at a prominent Texas law firm with frequent business before his court. He approved fees in dozens of cases for her firm, Jackson Walker, which she left in late 2022. His resignation ended a formal judicial inquiry into the matter.
>
> But the fallout has only just begun. The court is working to redistribute cases and come up with a plan until it can appoint a replacement, which it hopes to do quickly, according to Chief US District Judge Randy Crane. Not only did Judge Jones oversee around 1,100 corporate bankruptcies, but he also presided over 3,000 cases for individuals – what amounts to a Herculean case load.

For the past few years, the correct answer to many technical legal questions about the structuring of multibillion-dollar distressed debt deals would have begun with "David R. Jones in Houston has a secret girlfriend at Jackson Walker." The law is weird.

Private markets are the new public markets

One theory is that public markets are deeper and more liquid than private markets. If your stock is publicly listed, then anyone can buy it: mutual funds, hedge funds, individual retail investors, everyone. Also they can trade it: If they change their mind about owning the stock, they can sell it to someone else. This liquidity should make them willing to pay more for the stock. And the fact that you can sell it to *anyone* means that you can probably get a higher price. There are more possible bidders, more competition for the shares, so they should get a higher price. This is the traditional theory. Companies would tend to start small and then, when they got big, they'd usually go public, because they figured that their shares would be worth more in the public markets.



Play the game

Another theory is that, at this point, "private" investors – the ones who can and do buy shares in private companies, the big institutional investors and family offices and so forth – are so big and important that you don't lose much by being private instead of public; a few retail investors are not really going to increase the demand for your stock. And, meanwhile, the private investors will *pay more for private stock than for public stock*. Why? I find this a bit mysterious. A few possible answers:

1. This is a mistake? Private investors are somehow more hype-prone than cynical public investors, or they are so used to thinking of private companies as "small startups that offer a 100x return" that they forget that this model does not describe late-stage private investments in

multibillion-dollar companies. And the mistake persists due to market structure and the lack of short selling: A public company's stock price balances the views of buyers and sellers, including short sellers who doubt its value; a private company's stock only trades when the company wants it to.

2. Private investors are actually willing to *pay for illiquidity:* Being able to sell your stock at all times is not, as conventional theory has it, good. It is *bad*. If you can sell, you will do so sub-optimally and will lose money. Private markets discipline you, forcing you to hold for the long term, and so increase your returns. (Cliff Asness has argued a version of this theory.)
3. The public markets reduce the *actual value* of companies, due to compliance costs, or the impact of activists and short sellers, or a short-term focus on quarterly results, or whatever. This is a popular theory among CEOs. On this theory, investors should pay more for private-company stock than for public-company stock, because the private companies will systematically outperform.

None of these theories seems all that compelling to me. But here's this:

> Nordic private equity fund manager EQT Group is drawing up plans to hold private stock sales for its portfolio companies because public markets have proven unreliable to exit investments.
>
> EQT chief executive Christian Sinding said private auctions among its 1,100 limited partners could provide a novel way for its backers to monetise their illiquid holdings without the need to sell shares in initial public offerings.
>
> The preliminary plans have been driven by what Sinding described as "dysfunction" in the IPO markets, he told the Financial Times.
>
> The comments come as the volumes of new offerings in Europe have slumped to their lowest level since the 2008 financial crisis and private equity firms have a harder time selling down their stakes in portfolio companies. …

> In EQT's plans, the firm would hire an investment bank to build a book of interested buyers and sellers of a single private investment, much like the process of hiring underwriters for a traditional IPO.
>
> The underwriter would lead negotiations on pricing, but instead of soliciting investment from public market investors like hedge funds, mutual funds and other large institutional investors, they would focus on EQT's existing investors. The private transaction would give investors in the private company the ability to sell shares, or simply hold them. Others would get the chance to buy.

So it's like an IPO, except that instead of marketing the shares to everyone, you market them only to existing clients of EQT? Why would that get a better price?

Elsewhere:

> CVC Capital Partners is preparing to kick off its initial public offering, undaunted by the recent equity market jitters, people with knowledge of the matter said.
>
> The European private equity firm is discussing plans to unveil its intention to float in Amsterdam as soon as the coming days, according to the people. It hasn't yet set an exact timeline and the announcement could spill into next week, the people said, asking not to be identified because the information is private.

A different theory.

Analyst names

I dunno, here's a result in empirical finance:

> When two people coincidentally have something in common (such as a name or birthday), they tend to like each other more and are thus more likely to offer help and comply with requests. This dynamic can have important legal and ethical consequences whenever these incidental similarities give rise to unfair favoritism. In a large-scale, longitudinal

> natural experiment, covering nearly 200,000 annual earnings forecasts over more than 25 years, we show that when a CEO and a securities analyst happen to share a first name, the analyst's forecast is more accurate. We offer evidence that name matching improves forecast accuracy due to CEOs privately, selectively sharing important information with name-matched analysts. This effect holds above and beyond the effects of gender- and ethnicity-matching. Additionally, we show that this effect is especially pronounced among CEO-analyst pairs who share an especially uncommon first name. Our research thus demonstrates how incidental similarities can give way to special treatment.

That's from "Sharing Names and Sharing Information: Incidental Similarities between CEOS and Analysts Can Lead to Favoritism in Information Disclosure," by Omri Even-Tov, Kanyuan Huang, Brett Trueman, Jon Bogard and Noah Goldstein. One meta-analysis in empirical finance that I would like to read is, like:

1. What sorts of empirical finance questions are of interest to both quantitative investors and finance academics? (Obviously lots of them.)
2. What sorts of questions are only of interest to investors and are not addressed in the academic literature? (Presumably some of my readers know these, but won't tell me.)
3. What sorts of questions are only of interest to academics and not investors?

If you work at a hedge fund and your model overweights sell-side price targets from analysts whose names are similar to the names of the CEOs they cover, I would very much like to hear from you. I mean, if you've been tracking this for years, but also if you read this paper last month (or today!) and immediately started implementing it in your model. Is this the sort of paper that you read and think "ooh there's alpha here," or is it just the sort of paper that you read and think "ha, that's funny, that should be in Money Stuff"?

Obviously if you work at a hedge fund and you skip all the modeling and just *hire analysts with the same names as CEOs to get inside information* then I

really want to hear from you.

Things happen

J&J Weighs Third Bankruptcy to Resolve Tainted Baby Powder Suits. Bondholdings Become Less of a Burden at Bank of America and Other Big Banks. China Property Bonds Looked Cheap at 20 Cents on the Dollar. They Weren't. Choice Hotels Unveils $7.8 Billion Takeover Offer For Wyndham. Goldman Sachs, BNY Mellon Join Post-Earnings Bank Bond Spree. PwC succession twist followed debate on management style. Apollo, Goldman Eye Record €4.5 Billion Direct Loan for Adevinta. US fintech Plaid hires first chief financial officer on road to potential IPO. Wealthy Travelers Have Found an Even More Desirable Way to Fly Private. Park Slope Parents Is Old Enough to Order a Drink. "They want a cool, good-looking 30-year-old butler."

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1. It does require 70% of real estate clients and 80% of CLO clients to consent, but those seem to be pretty separate businesses where the management and strategy would not change very much under either Rithm or Weinstein. See page 89 of Sculptor's merger proxy for details on the consent conditions. View in article

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2. It told potential buyers that they "would not be required to retain any Company personnel following the closing of the potential transaction" (page 41 of the proxy), and it "propose[d] an 80% threshold" client consent condition (page 48). View in article

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3. I should say, they cite me here: "The Special Committee's dereliction of its diligence duties has not been lost on neutral observers, such as Matt Levine of Bloomberg, who opined on September 18, 2023: 'Surely the whole ballgame here is: (1) Figure out how many of your clients would leave if you agreed to sell to Boaz Weinstein. (2) Tell shareholders the answer. For some reason Sculptor won't do that!'" View in article

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4. That's not true, there's a Delaware Supreme Court that can, and sometimes does, reverse Chancery decisions. But you start with Chancery. View in article

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5. It is not clear to me how much this mattered for the cases: "The law firm instructed Freeman to stop working or billing on any case that had been assigned to Judge Jones," and "the firm in most cases served as local Texas counsel in collaboration with powerhouse law firm Kirkland & Ellis." It's not like she was making the arguments and he was agreeing with them. Still, obviously a bad look. View in article

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