Streamlining Two-Step Mergers With Proposed Amendment to DGCL

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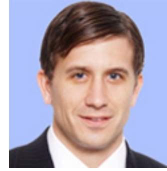
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Recent proposed amendments to the Delaware General Corporation Law contain an important addition to Section 251, which governs mergers between Delaware corporations, that would effectively allow the parties to dispense with the need for a back-end stockholder vote on a merger in certain cases where the buyer has acquired a sufficient number of shares in a front-end tender offer. If approved by the Delaware Legislature and signed into law, this amendment, which would appear as Section 251(h), would become effective August 1. If enacted, this amendment would help to streamline two-step transactions, effectively eliminating the delay between the closing of the tender offer and the consummation of the merger that would otherwise result from the need to hold a stockholders' meeting to vote on the adoption of the merger.

THE PROPOSED AMENDMENT

Currently, under Section 251 of the DGCL, a long-form merger must be approved by the target corporation's board of directors and must then be adopted by the requisite vote of its stockholders. In a typical two-step merger, the acquirer commences a tender offer to purchase a minimum number of shares (generally a majority of the outstanding common stock) and, if the tender offer is successful, completes a back-end merger, acquiring the remaining shares at the same price offered in the front-end tender. Although the stockholder vote to approve the merger in this context is usually a foregone conclusion, given that the acquirer, upon completion of the tender, owns the requisite voting power to adopt the merger agreement, under the current statute the merger cannot proceed under existing Section 251 without that vote. Since many public company charters prohibit action by written consent of stockholders, the practical effect is that acquirers seeking to consummate a back-end merger under Section 251 must call and hold a meeting of stockholders to secure the vote.

The Delaware courts have recognized this practical reality, noting that in the public company context, the stockholder vote "can take two to three months and cost tens of thousands of dollars," as noted in *Olson v. ev3*, C.A. No. 5583-VCL (Del. Ch. Feb. 21, 2011). In an effort to minimize this delay, transaction planners, in recent years, have used an alternative structure — the so-called "top-up option" — to complete the back-end merger in a more timely manner. Sections 253 and 267 of the DGCL are the key statutory components of the top-up option. Those sections generally permit a stockholder owning 90 percent or more of each class of a corporation's voting stock to consummate a short-form merger without any action by the board of directors of the target corporation and without a vote of the target's stockholders. A top-up option is intended to enable the acquirer to reach this threshold by providing that, if the acquirer purchases at least a majority of the target's outstanding voting stock in the tender offer but falls short of the 90 percent threshold, the acquirer may exercise an option to purchase a sufficient number of the target corporation's

authorized but unissued shares necessary to reach the 90 percent threshold and effect the back-end merger under Section 253 or Section 267.

Initially, top-up options were challenged on various technical and equitable grounds, including as evidence of the board of directors' interference with the stockholder franchise. But the Delaware courts have consistently upheld the basic structure of these provisions, reasoning that "once an acquirer ha[s] sufficient shares to approve a long-form merger pursuant to Section 251 [i.e., more than 50 percent], the top-up option could not interfere with voting rights because the acquirer could effect the merger regardless." Furthermore, the Delaware courts have noted that the top-up option is desirable because it "get[s] the money into the hands of the remaining stockholders faster." As a result, use of the top-up option has "become ubiquitous in two-step acquisitions," appearing in "more than 93 percent of two-step deals during 2007, 100 percent of two-step deals during 2008, and more than 91 percent of two-step deals during 2009," according to *In re Cogent Shareholder Litigation*, 7 A.3d 487, 505 (Del. Ch. 2010).

The top-up option, though, has its limitations and is not available in every circumstance. Whether a top-up option may be used is largely a function of the number of authorized but unissued shares of the target's stock. If the target has only a limited number of authorized but unissued shares available, the top-up option may be all but useless. Even where the target has a relatively large number of shares available, the number that must be issued upon exercise of the top-up option to adequately move the needle is often massive. It is only in rare circumstances that an acquirer obtaining a bare majority of the outstanding shares in the front-end tender offer would be in a position to exercise the top-up option to consummate the merger under Section 253 or Section 267.

The proposed amendment to Section 251 would permit parties that "opt in" to Section 251(h) to bypass the back-end stockholder vote requirement if the target corporation's shares are listed on a national securities exchange or held of record by more than 2,000 holders immediately prior to the execution of the merger agreement. Under the proposed amendment, a merger may be consummated without a stockholder vote for a corporation described above if: (1) the merger agreement, which must be entered into on or after August 1, expressly provides that the merger shall be governed by Section 251(h) and shall be effected as soon as practicable following the consummation of the front-end tender or exchange offer; (2) a corporation consummates a tender or exchange offer for any and all of the outstanding stock of the target corporation that, absent Section 251(h), would be entitled to vote on the adoption or rejection of the merger; (3) following the consummation of any such offer, the acquirer owns at least the percentage of the stock (and each class or series thereof) of the target corporation that, absent Section 251(h), would be required to adopt the merger agreement under the DGCL and under the target corporation's certificate of incorporation; (4) at the time the target corporation's board of directors approves the merger agreement, no party to the merger agreement is an "interested stockholder," as defined in Section 203(c) of the DGCL; (5) the corporation consummating the tender or exchange offer merges with or into the target corporation pursuant to the merger agreement; and (6) the outstanding shares of each class or series of the target corporation's stock not canceled in the merger are converted in the merger into the same amount and kind of consideration paid for shares of such class or series of stock upon consummation of the offer. Notably, the proposed legislation would also amend Section 252 of the DGCL, which deals with mergers between Delaware corporations and non-Delaware corporations, to provide for the application of Section 251(h) in

that context, and it would amend Section 262 of the DGCL, which deals with appraisal rights, to provide that such rights will be available in mergers effected pursuant to Subsection 251(h), unless all of the stock of the target corporation is owned by the acquirer immediately prior to the merger.

CONSIDERATIONS FOR PRACTITIONERS AND NEGOTIATING PARTIES

If Section 251(h) is enacted, corporations and their advisers, on both the buy and sell side, will have many factors to consider as they determine whether to demand or resist, as the case may be, opting into Section 251(h). While Section 251(h) provides a superior alternative (from a consummation standpoint) to the top-up option, and may enable the buyer to deliver merger consideration to the target's stockholders in a faster timeframe, target corporations may, depending on the nature of the sales process, wish to proceed with a customary long-form transaction.

It is also important to note that, as stated in the synopsis to the proposed legislation, "Subsection [h] does not change the fiduciary duties of directors in connection with such mergers or the level of judicial scrutiny that will apply to the decision to enter into such a merger agreement, each of which will be determined based on the common law of fiduciary duty, including the duty of loyalty." Finally, although the issues are outside the scope of this article, corporations and their counsel should be advised that Section 251(h) raises a number of highly technical issues in any circumstance involving an interested stockholder, and its use may be restricted in those circumstances.

In sum, the proposed Section 251(h) amendment provides a practical technical solution, consistent with the Delaware courts' previous statements on the effect of an acquirer's acquisition of a controlling stake in a front-end tender offer, that can streamline the merger process. Although it may make the two-step process more efficient, Section 251(h) will not change the standard of review applied to such transactions.

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