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Amendments to Delaware General Corporation Law to Facilitate Short-Form Mergers in Two-Step Transactions

On August 1, 2013, new Section 251(h) of the Delaware General Corporation Law (the DGCL) becomes effective, which will allow consummation of second-step mergers without stockholder approval following a tender or exchange offer in many circumstances.[1]

Issue Addressed by the Proposed Statute and Existing Solutions

Acquisitions often employ a two-step structure in which the acquiror first launches a tender or exchange offer for any and all outstanding shares. Upon the close of the tender or exchange offer, the acquiror then acquires any shares not tendered in the offer by way of a second-step merger to complete the acquisition.

Under Delaware law, a "short-form" merger pursuant to DGCL Section 253 does not require stockholder approval of the second-step merger, but can be used only if the acquiror owns at least 90 percent of the target's outstanding voting stock after the first-step tender or exchange offer. If the tender or exchange offer results in the acquiror owning less than 90 percent of the outstanding voting stock of the target, a "long-form" merger must be utilized, requiring the mailing of a proxy statement to target stockholders and holding a stockholder meeting to approve the merger.

However, whether a short-form or long-form merger is utilized, the second-step merger is a *fait accompli* if the acquiror owns enough shares after the tender or exchange offer to approve the merger as a long-form merger, which typically is a precondition to the closing of the first-step tender or exchange offer. Due to the expense and delay associated with preparing, filing and mailing a proxy statement and holding a stockholders meeting, a second-step, long-form merger often is an expensive formality for a corporation that is, after a successful first-step tender or exchange offer, controlled by a stockholder holding sufficient shares to approve a long-form merger.

Although regulatory and market-based remedies to this situation, such as subsequent offering periods, top-up options and dual-track structures, have been developed over time, the existing solutions have not proven to be effective to eliminate uncertainty as to whether a short-form merger may be utilized. Subsequent offering periods do not guarantee that the acquiror will reach the required 90 percent threshold. Top-up options are dependent on the target's authorized capitalization and cannot be utilized in all transactions. Dual-track processes may save time[2] compared to running consecutive processes for the first-step offer and second-step merger, but they avoid little, if any, of the expense of the long-form merger process and do not eliminate the uncertainty as to whether the stockholder meeting to approve the merger will be held contemporaneously with the closing of the tender or exchange offer.

1 H.B. 127, 147th Gen. Assembly, 79 Del. Laws, c. 72, § 6 (2013).

2 It is unclear whether the dual-track structure would permit the stockholders meeting to be held simultaneously with the closing of the tender or exchange offer. The ability to do so depends on the timing of SEC review of the proxy statement, if any.

Section 251(h): The New Solution

Section 251(h) remedies this situation by permitting merger agreements entered into after August 1, 2013, to contain a provision eliminating the need for a stockholder vote for a second-step merger following consummation of a tender or exchange offer if certain conditions are met.[3] Section 251(h) thus eliminates the need for subsequent offering periods, top-up options and dual-track structures. Section 251(h) is an "opt-in" statute; it is applicable only if the merger agreement includes a provision electing Section 251(h) to apply. Further, Section 251(h) may not be used if the target's certificate of incorporation expressly requires a stockholder vote to approve a merger, nor may it be used to circumvent a supermajority vote or separate class vote required by the target's certificate of incorporation.

Eligibility

To be eligible to use Section 251(h), the target corporation's shares must be listed on a national securities exchange or held of record by more than 2,000 stockholders immediately prior to the execution of the merger agreement. This requirement ensures that the tender or exchange offer will be subject to the informational and procedural requirements of the Williams Act. In addition, Section 251(h) permits only corporations to serve as the acquisition vehicle.

Transaction Requirements

If an acquiror and the target's board of directors desire to employ Section 251(h), the merger agreement must contain a provision expressly opting in to Section 251(h). This opt-in requirement permits the target's board to use the inclusion of a Section 251(h) provision as a negotiating tool with a potential merger partner, much in the same way targets' boards have used top-up options. Section 251(h) is not for use in hostile transactions — an agreed-upon merger agreement containing an opt-in provision must be approved by the target's board.

The merger agreement also must require the second-step merger to be effected as soon as practicable following the consummation of the first-step tender or exchange offer. This requirement addresses the statute's objective of making the merger consideration available to nontendering stockholders quickly once the tender or exchange offer closes.

Section 251(h) also requires the first-step tender or exchange offer to be for "any and all" of the target's outstanding stock that, absent Section 251(h), would be entitled to vote on the adoption or rejection of the merger agreement. The tender or exchange offer also must be made on the terms provided for in the merger agreement. In addition, the consideration paid to holders of outstanding shares in the second-step merger must be the same amount and kind as that paid in the front-end tender or exchange offer.

Third-Party Acquisitions

Section 251(h) is available for use in connection with third-party acquisitions only. No party to the merger agreement may be an interested stockholder (as defined in DGCL Section 203) at the time the merger agreement is approved by the target's board. This requirement prohibits the use of Section 251(h) in transactions considered more likely to involve conflicts (*e.g.*, going-private transactions). Although Section 251(h) incorporates the definition of "interested stockholder" from DGCL Section 203, it does not incorporate the exceptions to the business combination restrictions afforded by Section 203 to stockholders who receive board approval or who have exceeded the 15 percent ownership threshold for longer than three years. Accordingly, such interested stockholders cannot take advantage of Section 251(h).

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3 79 Del. Laws, c. 72, § 6.

Requisite Level of Support

In order to effect a second-step merger without a stockholder vote under Section 251(h), the shares obtained by the acquiror in the first-step tender or exchange offer must be sufficient to satisfy the voting requirements that would apply under the DGCL if Section 251(h) were not invoked. The shares obtained also must be sufficient to satisfy any high-vote provisions in the target's certificate of incorporation and any requirement for a separate class or series vote.

Fiduciary Duties

Although Section 251(h) offers an efficient way to effect second-step mergers, it 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.[4]

Appraisal Rights in Stock Transactions

Under DGCL Section 262, appraisal rights are generally not triggered by a merger in which the consideration is publicly traded stock. Section 262 also has been amended to provide that appraisal rights are available for all Section 251(h) mergers, including those involving publicly traded stock as consideration.

Conclusion

Section 251(h) provides a cost-effective procedure to consummate promptly a two-step acquisition whenever a corporate acquisition vehicle acquires sufficient shares in a first-step tender or exchange offer to ensure that a second-step long-form merger will be approved, while preserving the existing substantive and procedural protections afforded to a target's stockholders. The associated cost savings and ability to expedite receipt of the merger consideration by the target's nontendering stockholders enhance acquirors' ability to rely on a two-step transaction structure.

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4 *Id.*