DELAWARE BUSINESS COURT INSIDER

May 7, 2014 An ALM Website

Proposed DGCL Amendments to Address Uncertainty

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The Delaware State Bar Association has proposed legislation that, if adopted, would amend the Delaware General Corporation Law in a number of significant ways. Among other things, the proposed legislation would amend the recently enacted Section 251(h), which facilitates the use of short-form mergers in certain two-step acquisitions, to eliminate the prohibition on the use of Section 251(h) by an "interested stockholder" and to clarify the provisions of Section 251(h) to address certain questions that have arisen in the months since its adoption. The proposed legislation also would clarify that director and stockholder action by written consent having a future effective time may be executed prior to becoming a director or stockholder and may be held in escrow (or similar arrangement), so long as the person executing such consent is a director or stockholder when the consent becomes effective.

Short-Form Mergers

Enacted in 2013, Section 251(h) provides an effective mechanism to consummate promptly a short-form merger without the need for stockholder approval in certain circumstances if the acquirer owns sufficient shares following a first-step tender or exchange offer to ensure that a merger would be approved if a meeting of the stockholders of the target corporation were held. Section 251(h) has been well received as a meaningful improvement over the previous requirement that the acquirer must hold 90 percent of each class of the target's outstanding voting stock to effect a short-form merger. In the first six months after Section 251(h) became effective, 22 two-step acquisitions were consummated by utilizing Section 251(h), according to Graziella Babb's FactSet Mergers Research Spotlight from March.

Perhaps due to the widespread acceptance of Section 251(h), several questions of interpretation have arisen in the months since it became effective, most notably: (1) whether and how the prohibition on the reliance on Section 251(h) when a party to the merger agreement is an "interested stockholder" limits the use of tender and support agreements and rollover agreements in Section 251(h) transactions; and (2) what it means for the acquirer to "own" such percentage of the target's stock following the tender or exchange offer that would be required to approve a merger by way of a long-form merger.

Interested Stockholders

In order to obtain some degree of confidence that a two-step acquisition will succeed, acquirers often enter into tender and support agreements with significant stockholders prior to commencing the offer, whereby such stockholders agree to tender their shares and otherwise support a two-step acquisition. However, Section 251(h)(4) currently prohibits from utilizing Section 251(h) any party who is an "interested stockholder" (as defined in Section 203 of the DGCL) of the target at the time the target's board of directors approves the merger agreement. Because the definition of interested stockholder in Section 203(c) includes any person who "has the right to acquire" 15 percent or more of the target's voting stock pursuant to any "agreement, arrangement or understanding," many practitioners doubted whether acquirers may utilize Section 251(h) if they enter into tender and support agreements with stockholders relating to more than 15 percent of the target's outstanding voting stock.

Similarly, acquirers often permit the target's management to enter into rollover agreements, agreeing to exchange their shares of stock in the target for equity in the acquirer, rather than tendering into the offer. As with tender and support agreements, many practitioners have questioned whether the acquirer's right to acquire management shares pursuant to rollover agreements in respect of more than 15 percent of the target's outstanding voting stock would preclude an acquirer from utilizing Section 251(h).

Both of these examples illustrate how the broad definition of interested stockholder could preclude an acquirer from utilizing Section 251(h), even if it did not own a single share of the target's stock prior to commencing the offer. They also serve to demonstrate how the prohibition on the use of Section 251(h) by those falling within such broad definition has limited the effectiveness of Section 251(h), as tender and support agreements, as well as rollover agreements, are common tools used to help achieve a successful result in two-step transactions. Accordingly, the proposed amendments would eliminate the prohibition on interested stockholders, and thereby remove the uncertainty regarding the permissibility of tender and support agreements and rollover agreements in a Section 251(h) transaction.

Ownership of Shares

Section 251(h) currently provides that a second-step merger may be completed without stockholder approval if the requirements of Section 251(h) are met, including the requirement that, after the tender or exchange offer, the acquirer owns at least such percentage of the target's voting stock that would be required to approve the merger under the DGCL and the target's certificate of incorporation. Many practitioners have questioned whether evidence of record ownership is required to demonstrate that the acquirer owns the required shares (and have experienced difficulty in obtaining evidence of transfer of record ownership immediately at the closing), or whether delivery of notice of acceptance of shares tendered into the offer would suffice. Given the importance of closing the merger immediately following the tender offer (in light of lenders' requirement that the target be held 100 percent by the acquirer to support liens on the target's assets), the proposed amendments would clarify that the short-form merger may be consummated following delivery of notice of acceptance of shares tendered into the offer. Specifically, the merger may be consummated once the total of the shares "irrevocably accepted for purchase or exchange" pursuant to the offer and received by the depository prior to the expiration of the offer plus all shares otherwise owned by the acquirer equals such percentage of the target's stock that would be required to approve the merger under the DGCL and the target's certificate of incorporation. Shares are received by the depository when stock certificates have been physically received or, for uncertificated shares, when such shares are transferred into the depository's account, or an agent's message has been received by the depository. Accordingly, shares tendered by guaranteed delivery would not be counted unless and until they were actually received by the depository.

Other Amendments

The proposed amendments also would revise Section 251(h) by clarifying that a merger agreement may either permit or require that the merger be effected under Section 251(h) (to address those situations where its applicability is uncertain at the time the merger agreement is entered into); a merger is "consummated" for purposes of Section 251(h) when the acquirer irrevocably accepts for purchase or exchange the shares tendered into the offer; and the tender or exchange offer may exclude treasury stock and shares of the target that are owned by the acquirer, its subsidiaries and parent entity.

Actions by Written Consent

The proposed amendments to the DGCL address another practical issue faced in connection with acquisitions where the acquirer intends to replace the board members of the target (or a subsidiary of the target) at closing. Such people who are not yet directors, but are expected to become directors at the closing, often must approve financing arrangements and other actions to be taken upon the closing. However, written consents often must be executed immediately before the closing because, for example, without financing, the closing cannot occur.

Although current law provides that a stockholder's written consent may be executed by a person who is not a stockholder at the time of execution so long as such person becomes a stockholder by the applicable record date, there is authority for the proposition that a director's written consent is invalid unless the person executing such consent is a director at the time of execution, as in *U.S. Bank National Association v. Verizon Communications*, 10-CV-1842-G (N.D. Tex. Aug. 8, 2012), and *AGR Halifax Fund v. Fiscina*, 743 A.2d 1188 (Del. Ch. 1999). The proposed amendments to Sections 141(f) and 228(c) are intended to clarify that a person may consent to corporate action with a future effective time, and such consent may be held in escrow until such person becomes a director or stockholder.

The proposed amendment to Section 141(f) would clarify that a person (whether or not then a director) may execute a consent, and such consent may be placed in escrow (or similar arrangement), to become effective at a later time (including a time determined upon the happening of an event), so long as (1) the escrow period does not exceed 60 days; (2) the person is a director at the time the consent becomes effective; and (3) the consent is not revoked prior to its effectiveness. Any consent executed in accordance with the foregoing would be revocable prior to it becoming effective.

The proposed amendment to Section 228(c) contains the same requirements, though it would not affect the requirement that the consent bear the actual date of signature and, unlike the proposed amendment to Section 141(f), does not expressly state that the person signing such consent would need not be a stockholder when the consent is signed, since current law provides that a person executing a written consent need not be a stockholder at the time of execution, but only on the applicable record date.

Practical Solutions

The proposed amendments described above, along with the other proposed amendments to the DGCL, if adopted by the legislature, would become effective Aug. 1, except the amendments to Section 251(h) would apply only to merger agreements entered into on or after Aug. 1. These amendments reflect the continued focus in the state of Delaware on updating the DGCL to keep it state-of-the-art and address any practical concerns as they arise.

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