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Business Alert

Delaware Corporation Law Amended to Eliminate Need for Stockholder Approval of Back-End Merger following Successful Tender Offer

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Recent amendments to the Delaware General Corporation Law (DGCL) include a new subsection that will, in many cases, eliminate the need to obtain stockholder approval of a back-end merger following a successful tender offer, where the back-end merger was not otherwise able to be effected as a "short-form" merger under the DGCL. New subsection 251(h), which is effective today, August 1, 2013, permits a merger agreement to include a provision eliminating the requirement of a target stockholder vote to approve a back-end merger if the buyer obtains voting control of the target in the tender offer. The new provision increases the appeal of the tender offer structure for negotiated mergers and may render outdated the so-called "top-up" option as well as the "dual-track" structure.

Tender Offer as Transaction Structure for Negotiated Public Company Acquisitions

Cash buyers have increasingly used tender offers, followed by back-end merger, as the preferred transaction structure for negotiated acquisitions of public company targets, due to the potential timing advantage afforded by a tender offer over a traditional long-form merger. If a buyer holds at least 90% of the target company's shares after a successful tender offer, the back-end merger can be consummated immediately following the tender offer without a vote of the target company's stockholders, by effecting a short-form merger under Section 253 of the DGCL. However, if the buyer holds less than 90% of the target company's shares after the tender offer, the target company must hold a stockholders' meeting to approve the back-end merger, even though stockholder approval is a certainty (as a result of the buyer having achieved voting control of the target via the tender offer). The time associated with preparing and filing proxy materials for the back-end merger with the Securities and Exchange Commission (SEC) after the tender offer may actually cause the transaction to take longer to complete than if the buyer had pursued a traditional long-form merger from the outset.

What are "Top-Up" Options and the "Dual-Track" Structure?

The "top-up" option is a mechanism designed to help buyers using the tender offer structure reach the 90% ownership threshold necessary for a short-form merger, and thereby avoid the timing issue otherwise associated with a back-end merger following a successful tender offer that falls short of achieving 90% ownership. The top-up option, which has been approved by Delaware courts, is a stock option granted to the buyer by the target company allowing the buyer to purchase sufficient newly issued shares of the target to reach this 90% threshold. The vast majority of negotiated public target cash deals announced in the last few years that were structured as tender offers included a top-up option. However, top-up options are subject to practical limitations that hamper the frequency with which they can be exercised to be eligible for a short-form merger.

More recently, M&A practitioners have also begun using the "dual-track" structure, in which the buyer commences a tender offer while simultaneously filing preliminary proxy materials with the SEC for a traditional long-form merger, in case the tender offer and top-up option fall short of achieving 90% ownership of the target company. Like the top-up option, the dual-track structure has practical drawbacks, including the expense of preparing proxy materials that ultimately may not be used if the tender offer results in the buyer being able to effect a short-form back-end merger.

How will 251(h) Work?

Under 251(h), which applies to target companies that are Delaware corporations whose shares are listed on a national securities exchange or are held by more than 2,000 record holders, the parties to a negotiated merger agreement providing for a tender offer can eliminate the need for a target stockholder vote to approve the back-end merger if the following conditions are satisfied:

- The merger agreement states that the merger is governed by 251(h) and requires the buyer to complete the merger as soon as practicable following the tender offer;
- The buyer completes a tender offer for all of the target company's outstanding voting stock;
- Following the closing of the offer, the buyer owns at least the percentage of the target company's stock that would otherwise be required to adopt the merger agreement and approve the back-end merger (i.e., a majority, unless a higher threshold is required by the target's organizational documents);
- At the time the target company's board of directors approves the merger agreement, no party to the merger agreement is an "interested stockholder" of the target, as defined in subsection 203(c) of the DGCL;
- The buyer entity that completed the offer merges with the target pursuant to the merger agreement; and
- The target company's remaining outstanding shares are converted in the back-end merger into the same consideration paid to stockholders in the offer.

There may be disadvantages associated with acquisitions structured under 251(h) compared to a tender offer followed by short-form merger, based on the remedies available to target stockholders (beyond appraisal rights, there are very limited fiduciary remedies available to stockholders in a short-form merger under Section 253, while 251(h) affords stockholders the much broader set of fiduciary remedies traditionally available in long-form mergers). However, parties to a negotiated acquisition of a public target that elect to use 251(h) will increase the likelihood of completing their transaction in a timely and efficient manner.

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