JONES DAY

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COMMENTARY

PROPOSED AMENDMENT TO SECTION 251 OF THE DGCL: RENDERING TOP-UP OPTIONS OBSOLETE AND INCREASING THE APPEAL OF TENDER OFFERS

The Delaware State Bar Association recently proposed an amendment to the Delaware General Corporation Law ("DGCL") that would increase the appeal of utilizing a tender offer structure by eliminating the need to obtain stockholder approval for a long-form second-step merger following a public tender offer. Tender offers have important advantages over one-step mergers, including a shorter time frame between signing and closing and more focused SEC review of disclosure materials. If this amendment is approved by the Delaware legislature, as expected, it would, effective as of August 1, 2013, further increase the certainty of closing tender offers in a timely manner and help to solidify the tender offer as the acquisition structure of choice for acquirers, including financial sponsors.

BACKGROUND

A "two-step" transaction begins with the tender or exchange offer, subject to a minimum condition that the acquirer obtain more than 50 percent of the outstanding voting stock of the target, followed by a "back-end" merger that squeezes out the remaining target stockholders if 90 percent of the target's outstanding shares are tendered. However, if the 90 percent threshold is not achieved in the tender offer, the acquirer would need to complete the second step via a traditional long-form merger requiring SEC-compliant proxy statements and a stockholder vote. The proposed amendment would permit an acquirer to complete a two-step transaction without obtaining a stockholder vote as long as the acquirer were able to purchase a majority of the outstanding stock in the tender offer (or, if applicable, such higher percentage as may be specified in the target's charter).

THE REQUIREMENTS OF SECTION 251(h)

Under proposed Section 251(h) (which would apply only to publicly traded targets and other widely held companies), a stockholder vote would not be required to complete a two-step merger if certain conditions are satisfied, including the following:

- The merger agreement states that the merger is governed by Section 251(h) and requires that the acquirer complete the merger as soon as practicable following the offer;

- The acquirer consummates an offer for all of the target's outstanding voting stock;

- Following the offer, the acquirer owns enough target shares to adopt the merger agreement;

- At the time the target'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) of the target; and

- The acquirer merges with the target pursuant to the merger agreement, with the target's remaining outstanding shares converted into the same consideration paid to stockholders in the offer.

THE IMPLICATIONS OF SECTION 251(h)

If the minimum condition in an offer is satisfied, the outcome of the stockholder vote in favor of a long-form merger is essentially guaranteed because the acquirer will own a sufficient number of the target's shares to approve the merger. However, the long-form merger adds significant time and expense. In recent years, acquirers have frequently used a "top-up" option to avoid a long-form merger following a tender offer in which the 90 percent short-form merger threshold is not met. If the acquirer does not obtain tenders of 90 percent of the target shares, the top-up option enables the target to issue shares to the acquirer to permit it to reach the 90 percent threshold. However, the top-up option is not always viable because the target may not have sufficient authorized and unissued capital stock to allow the acquirer to reach the 90 percent threshold, which, given the math, typically requires the target to have significant excess authorized and unissued stock unless the number of shares tendered is very close to 90 percent. Proposed Section 251(h) would essentially eliminate the need for long-form mergers after a successful tender offer and thereby render top-up options obsolete.

In some instances, margin rules have made financing an acquisition through a tender offer difficult unless the merger closes simultaneously with the tender offer. Given the disparity between the 90 percent statutory short-form threshold and the typical majority minimum tender condition, this could never be certain under the current regime. The enactment of Section 251(h) would solve this problem and, as a result, should increase the utilization by private equity firms of tender offers as an acquisition structure.

CONCLUSION

The enactment of proposed Section 251(h) could provide significant benefits to acquirers looking to make acquisitions of Delaware corporations in a cost-efficient and timely manner. The use of tender offers for targets dropped off dramatically beginning in the 1990s due to a number of questionable judicial interpretations of the application of the "best price" rule to typical management payments in takeovers,[1] but the SEC remedied that in 2006 with its amendments to Rule 14d-10. Since then, tender offers have increasingly become the transaction structure of choice for acquisitions.[2] The proposed Section 251(h) should facilitate the continuation of this trend.

Dealmakers, of course, will need to consider how this latest development will affect practice. In this regard, we note that acquirers (including financial sponsors) who rely on transaction financing may have to tweak their financing commitments to accommodate the shortened time frame as they will not want to appear to be disadvantaged in auction processes compared to potential acquirers who do not need traditional transaction financing.

1 *See Gerber v. Computer Assocs. Int'l Inc.*, 303 F.3d 126 (2nd Cir. 2002).

2 Amendments to the Tender Offer Best-Price Rules, Exchange Act Release No. 34-54684 (Nov. 1, 2006).

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

Robert A. Profusek
New York
+1.212.326.3800
raprofusek@jonesday.com

Andrew M. Levine
New York
+1.212.326.8319
amlevine@jonesday.com

Benjamin M. Grossman
New York
+1.212.326.3760
bgrossman@jonesday.com

Adam S. Namoury
New York
+1.212.326.3747
anamoury@jonesday.com