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Applicability of Proposed Amendment to Section 251 of the DGCL to Hostile Offers

The Delaware State Bar Association has recently proposed an amendment to the Delaware General Corporation Law (the “DCGL”) that would significantly modify the way acquisitions of Delaware public companies are effected by eliminating the need to obtain stockholder approval for a second-step merger in a two-step transaction (i.e., an acquisition structured as a tender offer followed by a back-end merger). While commentators have focused primarily on how the proposed amendment would change how friendly acquirers, and in particular private equity sponsors, use tender offers to acquire public companies in negotiated transactions, the proposed DGCL amendment would also provide similar timing and cost benefits to transactions that commence with an unsolicited tender offer, but end with a negotiated merger agreement.

The newly proposed Section 251(h) of the DGCL, which would apply only to targets with shares that 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, provides that certain conditions must be satisfied for a stockholder vote not to be required in connection with a second-step merger following consummation of a tender or exchange offer, including:

1. The merger agreement must expressly provide that the second step merger will be governed by Section 251(h) and that it will be effected as soon as practicable following the consummation of the tender or exchange offer;

2. The tender or exchange offer must be 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 agreement;

3. Following the consummation of the tender or exchange offer, the acquirer must own at least such percentage of the stock, and of 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 by the certificate of incorporation of the target corporation;

4. At the time the target corporation’s board of directors approves the merger agreement, no other party to the merger agreement is an “interested stockholder” (as defined in Section 203(c) of the DGCL) of the target corporation;

5. The acquirer consummating the tender or exchange offer must merge with or into the target corporation pursuant to the merger agreement;

6. The outstanding shares of each class or series of stock of the target corporation not to be cancelled in the merger are to be converted in the merger into, or into the right to receive, the same amount and kind of cash, property, rights or securities paid for shares of such class or series of stock of the target corporation in the tender or exchange offer; and

7. If the merger agreement is adopted without the vote of stockholders of the target corporation pursuant to Section 251(h), the secretary or assistant secretary of the surviving corporation must certify on the merger agreement that the agreement has been adopted pursuant to Section 251(h) and that the conditions specified above have been satisfied.

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The submission of Section 251(h) for adoption by the Delaware legislature resulted primarily from the Delaware State Bar Association's recognition of the significant costs and delays (e.g., preparation and filing of a merger proxy statement, conducting a special stockholders meeting, etc.) associated with requesting adoption of the merger agreement for a second-step merger when adoption is a *fait accompli* following consummation of the tender offer. If adopted, Section 251(h) would eliminate the need to obtain a shareholder vote or to use top-up options to reach the 90% ownership threshold required for a short-form merger, and would facilitate the financing of two-step transactions by ensuring that the second-step merger occurs immediately after consummation of the tender offer.

While Section 251(h) was primarily proposed to reduce delays and costs in friendly two-step transactions, a transaction that starts out as an unsolicited tender offer would not be disqualified from employing Section 251(h) if the parties ultimately negotiated a merger agreement—either because the target board agreed to sell to the hostile bidder or because the hostile bidder prevailed in a proxy contest and replaced the board with a new board that approved the merger agreement. This would enable a hostile bidder to potentially benefit from similar cost savings and timing efficiencies and facilitate the financing of hostile transactions. It should be noted, however, that in light of the condition described in clause 4 above, the hostile bidder would be required not to consummate the tender offer before entering into a merger agreement with the target corporation in order to avail itself of Section 251(h).