CLIENT UPDATE

DELAWARE PROPOSES TO ELIMINATE NEED FOR STOCKHOLDER VOTE IN MOST TWO-STEP DEALS

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Recently proposed amendments to the Delaware General Corporation Law (the "DGCL") could have significant benefits for acquirors conducting two-step acquisitions of Delaware corporations.

Two-step acquisitions commence with a tender or exchange offer, generally subject to a minimum condition that the bidder acquire more than 50% of the outstanding voting shares of the target, followed by a "back-end" merger to acquire the remainder of the shares. Unless the bidder owns at least 90% of the target voting stock following the offer (or pursuant to the exercise of a post-offer "top-up option"), the second-step merger requires a shareholder vote, which must be preceded by a proxy or information statement that complies with the applicable securities regulations. The new Delaware legislation, if adopted, would allow a bidder for a Delaware corporation to effect a second-step merger without obtaining a stockholder vote, even if the bidder owns less than 90% of the target's outstanding voting stock.

The proposed rule would apply if a bidder met certain conditions, including the following:

- The bidder cannot be an "interested stockholder" of the target as defined in Section 203(c) of the DGCL. This generally means that the bidder can't already own 15% or more of the target's stock.

- The merger agreement must expressly provide that the merger will be governed by the new rule and that the second-step merger will be effected as soon as practicable following the completion of a tender or exchange offer. Target directors approving the merger agreement will need to consider whether permitting the new rule to apply is consistent with their fiduciary duties.
- The bidder must complete a tender or exchange offer for any and all of the outstanding stock of the target on the terms set forth in the merger agreement. Upon completion of the offer, the bidder must own at least the number of target shares required to approve the merger – i.e., a majority of the outstanding shares, unless the target has increased the threshold in its certificate of incorporation.

By allowing a bidder to complete its acquisition of the target promptly upon closing of a tender or exchange offer, the proposed rule would eliminate the need for a "long-form" back-end merger, which can take several months to complete and require significant resources—even if the outcome is a foregone conclusion. In the past, to avoid the burdens of a long-form back-end merger, some parties have included "top-up options" in their acquisition agreements. Top-up options require the target to issue to the bidder additional shares following a tender or exchange offer to increase the bidder's ownership above the 90% threshold required under Delaware law to effect a "short-form" merger. However, there is a random aspect to the usefulness of top-up options: they depend on the number of shares authorized for issuance under the target's charter. For instance, a target with 100 million shares outstanding would have to issue 390 million new shares to the bidder to raise the bidder's ownership from 51% to 90%. The proposed rule would in most cases eliminate the need for top-up options.

The proposed rule may also ease the difficulty in acquiring a target company that lacks current audited financial statements, which must be included in the proxy or information statement required to be disseminated prior to the shareholder vote needed for a long-form back-end merger. Audited financial statements are not required in tender offer documents, although the disclosure needed to enable shareholders to decide whether to seek appraisal rights will depend on the facts and circumstances.

Financial sponsors may reap the greatest benefit from the proposed rule. To avoid complexity in financing arrangements and the application of the federal margin rules, sponsors acquiring public companies have generally shied away from tender offers, sacrificing the speed advantage that tender offers can provide. The obstacles tender offers pose for financial sponsors largely disappear if they can ensure that the back-end merger would close substantially concurrently with the closing of the tender offer. In the past, that

could happen only if the bidder ended up with at least 90% of the target's stock, which in many cases could not be guaranteed.

If adopted, the new legislation would become effective August 1, 2013.

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Please do not hesitate to contact us with any questions.

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