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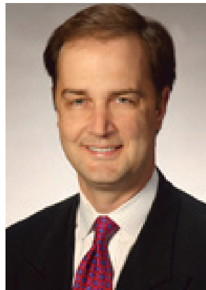
Acquisitions of Publicly Traded Corporations: A Cure for the Two-Step in Texas

By Whit Roberts and Nathan Crow of Locke Lord – (Aug. 9, 2016) – Delaware recently adopted amendments, effective August 1, 2016, to an oft-used statute that streamlines the acquisition of a Delaware public corporation ("Target") structured as a tender offer followed by a back-end merger. The statute eliminates the requirement of a stockholder vote for the merger if the number of shares tendered is sufficient to approve the merger under Delaware law and the Target's governing documents. The amendments clarify certain details and broaden the scope of what types of parties and tender offers qualify to use the statute.


Whit Roberts

Since its adoption, this statute has been welcomed by buyers, Targets and their stockholders, as well as the lawyers who work on these transactions.

The effectiveness of the Delaware amendments presents an opportunity to highlight the fact that Texas adopted a statute in its last legislative session that permits the same transaction structure and carries many of the same advantages ("New Texas Merger Statute").

To understand the New Texas Merger Statute, it is helpful to delve into the historic approach for acquisitions of public companies, the Delaware statute as initially adopted in 2013, and subsequent amendments to the Delaware statute in 2014 and 2016.

The Old Two-Step

Before the New Texas Merger Statute, there were generally two ways to structure an acquisition of a publicly traded Texas corporation. It could be structured as a long-form merger, which requires a vote of the Target's shareholders to approve the transaction.

Alternatively, parties wanting to avoid the expense and delay of a shareholder vote could structure the transaction as a two-step tender offer. In the first step, the buyer commences a tender offer, subject to a typical minimum condition that the buyer obtain more than 50% of the outstanding voting stock of the Target. This initial step is followed by a statutorily permitted short-form (or second-step) merger without a vote of the target shareholders if the buyer obtains the statutorily required minimum of 90% of the Target's shares in the tender offer.

Nathan Crow

Tender offers have important advantages over long-form mergers. They typically have a shorter time frame between signing and closing. They also have a more focused SEC review of disclosure materials.

But what if the buyer pursues a tender offer and obtains more than 50% — but less than 90% — of Target's shares? Buyers can use subsequent offering periods to attempt to acquire enough shares to reach the 90% threshold or, if negotiated into the merger agreement, take advantage of a "top-up" option under which the Target will issue additional shares to reach this threshold. This top-up option solution, however, depends on the Target having enough authorized and unissued shares to get the buyer to the 90% threshold.

If the 90% threshold is not achieved, the buyer must complete the acquisition by means of a traditional long-form merger. This structure involves filing a proxy statement and waiting >

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for a vote of the Target's shareholders to approve the transaction. At this point, the parties find themselves in the unattractive situation where (i) the buyer has acquired a majority of the Target's shares in the tender offer (which will be sufficient for the shareholder approval of the merger whenever the shareholder meeting can occur); (ii) additional time, expense and resources are required to complete an SEC compliant proxy statement and hold the shareholder meeting; (iii) the Target's shareholders must wait for this extended period to receive the merger proceeds; (iv) the remaining public shareholders complicate the ability of the buyer to refinance the Target's debt and access the Target's balance sheet; and (v) a new and delayed appraisal valuation point is triggered for dissenting shareholders.

To mitigate this result, some parties pursue "dual track" structures to anticipate the possibility of a required shareholder vote and reduce the delay when a first-step tender offer fails to reach the 90% share threshold. But the "dual track" approach adds complication and expense to the transaction.

Delaware: A Pioneering Approach

Initial Adoption.
In response to this unattractive situation, Delaware adopted Section 251(h) of the Delaware General Corporation Law ("DGCL"). Section 251(h) permits a buyer to effect a two-step merger without a vote of the Target's stockholders if, after consummation of a tender offer, it owns a sufficient percentage of the Target's shares necessary to approve the merger agreement under Delaware law and the Target's certificate of incorporation. As adopted in 2013, the requirements to use Section 251(h) included:

- The Target's shares are listed on a national securities exchange or held of record by more than 2,000 holders immediately prior to the signing of the merger agreement.
- The merger agreement expressly provides that the merger is governed by Section 251(h).
- The buyer is a corporation.
- The buyer consummates a tender or exchange offer for any and all of the Target's outstanding stock, under the terms of the merger agreement, that would otherwise have been entitled to vote on the adoption or rejection of the merger agreement.
- Following the consummation of the tender offer, the buyer owns at least the percentage of stock of Target that would be required to adopt the merger agreement under Delaware law and the Target's certificate of incorporation.
- No party to the merger agreement is an "interested stockholder" of the Target, as that term is defined in Section 203 of the DGCL.
- The buyer consummating the offer merges with or into the Target under the merger agreement.
- The Target's outstanding shares not canceled by the merger are converted through the merger into, or into the right to receive, the same amount and kind of cash, property, rights or securities paid for shares upon consummation of the offer.

Immediately upon adoption, Section 251(h) was popular as a means to structure acquisitions in which the target was a publicly traded Delaware corporation. In fact, only a small number of Delaware-governed tender offers since its effective date have not used this structure.

Amendments to the Delaware Statute.

The immediate and widespread use of Section 251(h) quickly highlighted matters needing clarification. A number of these matters were addressed in an amendment to Section 251(h) adopted in 2014 (the "2014 DGCL Amendments"). Also, in June 2016 House Bill 371 was signed >

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into law, further amending Section 251(h) (the "2016 DGCL Amendments"), which applies to merger agreements entered into on or after August 1, 2016. Together, these amendments were adopted to address the following issues:

- When is the tender offer consummated? When initially adopted, Section 251(h) did not define the term "consummate." Consequently, ambiguity existed regarding whether consummation of the tender offer occurs when the tendered shares are accepted for payment or upon acceptance and payment. The 2014 DGCL Amendment defined consummation as acceptance for payment. Thus, consummation occurs even though the buyer has yet to make payment.

This definition of "consummation" has significant practical benefits. It brings more potential buyers into the tender offer process since a buyer relying on debt financing does not need to overcome the difficulty of actually paying for the shares before it has access to the Target's underlying assets for collateral. This approach places bidders using debt financing on a more competitive footing with bidders that do not need financing in terms of available transaction structures.

- Meeting the threshold for shares "owned" upon consummation. As initially adopted in 2013, Section 251(h) was silent as to what shares are considered to be "owned" by the buyer. Also, Section 251(h), as initially adopted, did not permit a buyer to count shares held by its affiliates or any stockholders of Target that agree to rollover their shares of Target into ownership interests of buyer.

The 2014 DGCL Amendment clarified that following the consummation of the offer, the stock irrevocably accepted for purchase pursuant to such offer and received by the depository prior to the expiration of the offer, together with the stock otherwise owned by the buyer, must equal at least the percentage of stock of the Target that, absent Section 251(h), would be required to adopt the merger agreement under the DGCL and the Target's certificate of incorporation.

Together, the 2014 DGCL Amendment and the 2016 DGCL Amendment also clarified the meaning of "received" as it pertains to certificated and uncertificated shares, so that:

- certificated shares are deemed "received" upon physical receipt of a stock certificate accompanied by an executed letter of transmittal (thus excluding, for example, shares subject to notices of guaranteed delivery);
- uncertificated shares held of record by a clearing corporation as nominee are deemed "received" by transfer into the depository's account by means of an agent's message; and
- uncertificated shares not held by a clearing corporation as nominee are deemed "received" by physical receipt of an executed letter of transmittal by the depository.

The 2016 DGCL Amendment also broadens the scope of shares that count toward meeting the required ownership threshold. In addition to shares owned by the buyer, the following shares also are counted:

- shares of the Target held by any person (i) that owns, directly or indirectly, all of the outstanding stock of the buyer, or (ii) that is a direct or indirect wholly owned subsidiary of the buyer or any person referred to in clause (i) of this paragraph ("Affiliate-Owned Stock"); and
- any rollover stock, which consists of shares of stock of Target that are the subject of a written agreement requiring such shares to be transferred, contributed or delivered to the buyer or any of its affiliates in exchange for equity interests in such buyer or an affiliate of buyer ("Rollover Stock"). >

- Increasing the flexibility regarding what transactions may use Section 251(h).

- Use by "interested stockholders." The 2014 DGCL Amendment deleted the requirement that no party to the merger agreement could be an "interested stockholder" of the Target. This change also clarified that tender and support agreements and rollover agreements with stockholders can be used in connection with a transaction completed under Section 251(h).

- Optionality under Section 251(h). To resolve any doubt on whether parties have the flexibility to complete a merger with or without a shareholder vote, the 2014 DGCL Amendment clarified that parties may draft the merger agreement either to permit or to require the merger be governed by Section 251(h). Optionality may be useful under certain circumstances. For example, switching to a long-form merger can allow the board of directors of the Target to bring the transaction to a stockholder vote and close its fiduciary out. This may occur in a transaction that faces an unexpected and extended regulatory delay.

- Any class of stock of Target listed or widely held. The 2016 DGCL Amendment clarifies that parties may use Section 251(h) so long as the Target has any class or series of stock listed on a national securities exchange or held of record by more than 2,000 holders, even if it also has a class or series of shares that is not so listed or held.

- Separate offers for separate classes or series of stock of Target. The 2016 DGCL Amendment clarifies that parties may use Section 251(h) for transactions in which the offer is conditioned on the tender of a minimum number or percentage of shares of the stock or in which separate offers are made for separate classes or series of stock.

GTT – "Gone to Texas"

In 2015, Texas adopted the approach for acquisitions of public Texas corporations by tender offer without a shareholder vote popularized in Section 251(h) of the DGCL. Section 21.459(c) of the Texas Business Organizations Code ("TBOC") permits a buyer to effect a second-step merger without a vote of the Target's shareholders if, after consummation of a tender offer, it owns a sufficient percentage of the shares of the Target as would be necessary to approve the merger agreement under Texas law and the Target's certificate of formation.

Like the Delaware statute, the Target must be a corporation whose shares are either listed on a national securities exchange or held of record by at least 2,000 shareholders. Under the New Texas Merger Statute, this requirement must be met immediately before the date Target's board of directors approves the plan of merger. Under Section 251(h) the relevant time is the signing of the merger agreement.

Also in contrast to the Delaware statute, in which the buyer must be a corporation, under the New Texas Merger Statute the buyer may be any type of organization. Like Section 251(h) following the 2014 DGCL Amendment, the New Texas Merger Statute has no limitation on its use by "interested shareholders."

The New Texas Merger Statute states that a plan of merger is not required to be approved by the shareholders of the corporation if:

Include express provisions. The Plan of Merger expressly permits or requires the merger to be effected under the New Texas Merger Statute and provides that any merger effected under this statute shall be effected as soon as practicable following the consummation of the tender offer. Note that the New Texas Merger Statute provides the flexibility to use a term in the merger agreement that would let the parties choose to effect – or not to effect – the merger under the statute's provisions. This approach echoes the flexibility added to the Delaware statute in the 2014 DGCL Amendment.

Consummate offer for all shares entitled to vote. The buyer consummates a tender for all of the outstanding shares of the Target >

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(excluding shares owned by buyer and certain affiliated parties) on the terms provided in the plan of merger that, absent the New Texas Merger Statute, would be entitled to vote on the approval of the plan of merger. Under the New Texas Merger Statute, the term "consummates" means irrevocably accepts for purchase, which (consistent with the Delaware statute, as amended in the 2014 DGCL Amendment) enables bidders requiring debt financing to pursue Targets on a more competitive basis with all-cash bidders, as explained above.

Meet threshold to approve merger. The shares that are received by the depository before the expiration of the offer and that are irrevocably accepted for purchase in the offer, together with the shares that are otherwise owned by the buyer, equal at least the percentage of the shares, and of each class or series of those shares, of the Target that otherwise would be required to approve the plan of merger under the TBOC and the Target's certificate of formation. Note that the New Texas Merger Statute does not allow a buyer to count Affiliate-Owned Stock or Rollover Stock toward the threshold. Under the New Texas Merger Statute, the term "received" means physical receipt of a certificate representing shares, in the case of certificated shares, and transfer into the depository's account or an agent's message being received by the depository, in the case of uncertificated shares.

Buyer merges with or into Target. The buyer merges with or into the Target pursuant to the plan of merger.

Shares not tendered are converted into the right to receive the same consideration. Each outstanding share of each class or series of the Target that is the subject of and not irrevocably accepted for purchase in the offer is to be converted or exchanged in the merger into, or into the right to receive, the same amount and kind of consideration as to be paid or delivered for shares of such class or series of the corporation irrevocably accepted for purchase in the offer.

It is important to note that the New Texas Merger Statute, like the Delaware statute, leaves room for a Target's certificate of formation to require shareholder approval of certain mergers following a tender offer. It also does not alter the fiduciary duties of directors that apply to merger transactions.

Conclusion, including Potential Next Steps along the Trail

When considering acquisitions or sales of publicly traded Texas corporations, buyers, Targets and their lawyers should remain aware of the advantages available under the New Texas Merger Statute, many of which can be seen by looking at Section 251(h) and its amendments.

Moving forward, Texas may want to consider amendments to broaden the use of the New Texas Merger Statute. For instance, an amendment could be adopted to count Affiliate-Owned Stock and Rollover Stock toward the requisite ownership threshold.

More boldly, the State of Texas could consider expanding the New Texas Merger Statute so that it is available for privately owned Targets. The ABA Corporate Laws Committee approved a provision in the 2016 Revision of the Model Business Corporation Act (the "MBCA") that reflects this approach (the "MBCA Intermediate Merger Provision"). This provision is contained in Section 11.04(j) of the Exposure Draft of the 2016 Revision of the Model Business Corporation Act. The official commentary to this provision explains that the shareholder action in selling in response to the offer provides the necessary consent for the transaction, in lieu of a shareholder vote, if the other conditions for the merger are met. This commentary further >

provides that the requirements for a merger under this provision, together with related provisions under the MBCA, are intended to ensure that shareholders are not disadvantaged by the absence of a vote, and that they receive the same protection in terms of timing, director duties, and appraisal rights that they would in a transaction approved by a shareholder vote. Given the protections that would be available to shareholders in the New Texas Merger Statute, the State of Texas could expand the scope of the New Texas Merger Statute to include Targets that are private Texas corporations.

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