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Corporate Governance Group Client Alert: Amendments Proposed to the Delaware General Corporation Law, Including an Amendment to Streamline Back-End Mergers

The Council of the Corporation Law Section of the Delaware State Bar Association recently proposed several key amendments to the Delaware General Corporation Law ("DGCL") that if adopted would, among other things, (i) streamline back-end corporate mergers, effectively eliminating the need for "top up" options, and (ii) create a mechanism by which corporations could ratify corporate actions once considered "void" and incapable of ratification under Delaware law. If adopted, the proposed amendment relating to back-end mergers would become effective on August 1, 2013, while the proposed ratification amendments would become effective on April 1, 2014. We will provide additional updates as the proposals move forward toward enactment.

PROPOSED NEW SECTION 251(H) – STREAMLINING BACK-END MERGERS

As currently proposed, new Section 251(h) of the DGCL would significantly alter the structuring of two-step mergers. Two-step merger agreements involve the acquirer conducting a first-step tender offer followed by a back-end merger to acquire any additional remaining target shares not purchased in the tender offer. Under existing DGCL provisions, if an acquirer purchases 90% of a target's outstanding shares in its first-step tender offer, the acquirer is permitted to "squeeze-out" the remaining target stockholders via a short form merger under Section 253 of the DGCL (which merger does not require a stockholder meeting or vote or any filings with the Securities and Exchange Commission). If an acquirer, however, consummates its first-step tender offer (which typically is conditioned on at least a majority of target's shares being acquired) but fails to reach the 90% threshold, the acquirer typically must proceed with a back-end merger that entails filing with the Securities and Exchange Commission and mailing to target stockholders a proxy or information statement as well as commencing a stockholders' meeting to approve such merger. All of these actions are required despite the fact that the acquirer, as a result of its first-step tender offer, likely owns a

sufficient number of target shares to adopt and approve the merger agreement by itself. Accordingly, given the relative speed and efficiencies of "squeeze-out" mergers under Section 253 of the DGCL, merger agreements customarily contain "top up" provisions that grant the acquirer, once the acquirer has crossed a minimum ownership threshold in the target as a result of its first-step tender offer, the right to purchase such number of additional shares from the target to increase the acquirer's ownership percentage to the 90% threshold required to complete a short-form merger under Section 253 of the DGCL.

New Section 251(h) of the DGCL would streamline back-end mergers by eliminating the 90% threshold requirement for short-form mergers and instead simply require that acquirers wishing to squeeze-out target stockholders in the back-end merger own at least the percentage of target stock required to adopt the merger agreement pursuant to Delaware law and the target's certificate of incorporation. Accordingly, assuming this proposed lower voting threshold can be obtained by an acquirer in its first-step tender offer, an acquirer under new Section 251(h) would be permitted to effectuate a short-form merger and "squeeze-out" any remaining target stockholders without ever having to be subject to (i) the process and timing delays associated with non-short-form, back-end mergers and (ii) the complexities of implementing and utilizing a "top up" option provision (including avoiding situations in which a target corporation may not be able to issue a sufficient number of shares to adequately "top up" an acquirer without stockholder approval). As a result, new Section 251(h) could effectively eliminate the need for "top up" provisions in two-step merger agreements.

In order to utilize new Section 251(h) of the DGCL, the following requirements would need to be satisfied:

- the merger agreement must expressly provide that the back-end merger will be governed by Section 251(h) of the DGCL and will be consummated as soon as practicable following the completion of the initial tender offer;
- the acquirer must consummate the tender offer for all target[1] shares entitled to vote on the proposed transaction on the terms provided in the merger agreement;
- following the consummation of the tender offer, the acquirer must own at least the percentage of target stock required to adopt the merger agreement pursuant to Delaware law and the target's certificate of incorporation;

1 New Section 251(h) of the DGCL would only apply to "public corporations" – *i.e.*, corporations whose stock is listed on a national securities exchange or held of record by more than 2,000 holders.

- at the time the target's board approves the merger agreement, no other party to the agreement may be an "interested stockholder" under Section 203(c) of the DGCL; and
- the acquirer must consummate the back-end merger pursuant to the terms of the merger agreement and pay the same amount and kind of cash, property, rights or securities to the "squeezed-out" stockholders as offered in the initial tender offer.[2]

PROPOSED SECTIONS 204 AND 205 OF THE DGCL – RATIFICATION OF DEFECTIVE CORPORATE ACTS

In the recent past, Delaware courts have held that certain types of defective corporate actions – typically those involving impermissible share issuances or improper changes to a corporation's capital structure – were "void" and essentially incapable of *ex post facto* ratification.[3] Proposed Sections 204 and 205 of the DGCL, however, seek to provide an avenue around this case law and grant Delaware corporations a means by which to ratify and approve past actions previously considered entirely "void" under Delaware law.

If a corporation were to follow the mechanics set forth in proposed Section 204 of the DGCL, it would be able to properly ratify nearly any "defective corporate act."[4] The term "defective corporate act" is defined to include an over-issuance of corporate stock, a defective election or appointment of directors or any other past act or transaction within the corporation's power that was not properly authorized under Delaware law or the corporation's governing documents.

If adopted, the requirements to achieve "self-help" ratification under the proposed amendments to Section 204 of the DGCL would broadly include:

- Board adoption of a resolution approving the ratification and detailing the defective corporate act to be ratified (*e.g.*, including a description of any "putative stock" issued pursuant to the defective corporate act);

2 It is also proposed that conforming changes reflecting new Section 251(h) of the DGCL be made to Section 252 of the DGCL (merger of a Delaware corporation with a non-Delaware corporation) and Section 262 of the DGCL (appraisal rights).

3 *See, e.g., STAAR Surgicial Co. v. Waggoner*, 588 A.2d 1130 (Del. 1991); *Blades v. Wisehart*, 2010 WL 4638603 (Del. Ch. 2010).

4 Although proposed Section 204 of the DGCL is a proposed means to seek ratification of corporate acts, other methods of ratification (*e.g.*, curative stockholder votes) are not intended to be preempted or made invalid by the proposed amendments.

- Stockholder approval of the board resolution approving the ratification, unless a stockholder vote was not required in connection with the initial defective corporate act and is also not required at the time of the related ratification. In connection with any such stockholder vote, notice must be given not only to current holders of a corporation's valid stock and "putative stock", but also to all holders of such stock as of the time of the defective corporate act;

- If the ratified defective corporate act required a filing under Section 103 of the DGCL, the filing of a "certificate of validation" with the Delaware Secretary of State setting forth details of the defective corporate act and providing a record of the corporation's ratification process under proposed Section 204 of the DGCL; and

- The provision of notice of adoption of such "self-help" ratification to current holders of a corporation's valid stock and "putative stock" and all holders of such stock as of the time of the defective corporate act.

In addition to the high-level requirements set forth above, the text of proposed Section 204 of the DGCL contains numerous restrictions on what constitutes proper quorum and how to obtain the requisite board and stockholder approvals. Several of these restrictions base the appropriate quorum and approval thresholds on the corporation's own requirements in place at the time the defective corporate act was adopted. Consequently, as applied, the specific, nuanced mechanics of new Section 204's "self-help" ratification would vary on a case-by-case basis.

As a complement to proposed Section 204 of the DGCL, proposed new Section 205 of the DGCL would grant the Delaware Court of Chancery jurisdiction to, among other things, determine the validity of "self-help" ratification pursuant to proposed Section 204 of the DGCL, modify or waive any of the procedures contained in proposed Section 204 of the DGCL and independently determine the validity and effectiveness of any corporate act not capable of ratification pursuant to proposed Section 204 of the DGCL.

CORPORATE GOVERNANCE GROUP

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