Strafford

Presenting a live 90-minute webinar with interactive Q&A

Tender Offers and the New Streamlined Process for Deal Structuring

Navigating DGCL 251(h) and Timing Issues for Back-End Mergers

THURSDAY, JULY 11, 2013

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Nicholas O'Keefe, Senior Counsel, **Crowell & Moring**, San Francisco

A. Thompson Bayliss, Partner, **Abrams & Bayliss**, Wilmington, Del.

Atif Azher, Senior Associate, **Simpson Thacher & Bartlett**, Palo Alto, Calif.

The audio portion of the conference may be accessed via the telephone or by using your computer's speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact **Customer Service at 1-800-926-7926 ext. 10**.

Tips for Optimal Quality

Sound Quality

If you are listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory and you are listening via your computer speakers, you may listen via the phone: dial **1-866-570-7602** and enter your PIN when prompted. Otherwise, please **send us a chat** or e-mail **sound@straffordpub.com** immediately so we can address the problem.

If you dialed in and have any difficulties during the call, press *0 for assistance.

Viewing Quality

To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.

Continuing Education Credits

FOR LIVE EVENT ONLY

For CLE purposes, please let us know how many people are listening at your location by completing each of the following steps:

- In the chat box, type (1) your **company name** and (2) the **number of attendees at your location**
- Click the SEND button beside the box

If you have purchased Strafford CLE processing services, you must confirm your participation by completing and submitting an Official Record of Attendance (CLE Form).

You may obtain your CLE form by going to the program page and selecting the appropriate form in the PROGRAM MATERIALS box at the top right corner.

If you'd like to purchase CLE credit processing, it is available for a fee. For additional information about CLE credit processing, go to our website or call us at 1-800-926-7926 ext. 35.

Program Materials

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the + sign next to "Conference Materials" in the middle of the left-hand column on your screen.
- Click on the tab labeled "Handouts" that appears, and there you will see a PDF of the slides for today's program.
- Double click on the PDF and a separate page will open.
- Print the slides by clicking on the printer icon.

Tender Offers and the New Streamlined Process for Deal Structuring

July 11, 2013

A. Thompson Bayliss
302-778-1033
Bayliss@AbramsBayliss.com

ABRAMS & BAYLISS LLP

Nicholas O'Keefe
415.365.7230
nokeefe@crowell.com

crowell moring

Atif Azher
(650) 251-5033
aazher@stblaw.com

SIMPSON THACHER & BARTLETT LLP

Two-Step Tender Offer Timing Issues

Two Step Structure Timing Issues – Comparison with One Step

- One step structure
  - Merger must be submitted to target's board for adoption of merger agreement
  - Given need to file preliminary and definitive proxy statements with SEC and to address any SEC comments prior to soliciting vote of target stockholders, pre-closing period is typically around 3 months (assuming no delays for regulatory approvals or other pre-closing actions)
- Two step structure
  - Tender offer can be commenced upon initial filing of offering documentation with the SEC
  - If a 90% tender is obtained, tender offer and back-end merger can close 4 – 6 weeks quicker than merger (assuming no delays for regulatory approvals or other pre-closing actions)
  - Issues arise in connection with failure to obtain 90% tender required for short form merger, especially for deals involving debt financing

Two Step Structure Timing Issues
- Debt Financing Considerations

- One step structure
  - Debt financing sources provide funding at closing
  - Debt financing sources have access to all of the target’s assets and cash flows at closing
- Two step structure
  - Debt financing sources typically provide funding at closing of second-step merger
  - Debt financing sources have access to all of the target’s assets and cash flows <u>only</u> at closing of second-step merger
  - How does acquiror pay for shares in first-step tender offer?
    - Debt financing sources could issue a “margin loan” which is challenging
    - **Ensure nearly simultaneous completion of first step tender offer and second step merger**

Two Step Structure Timing Issues
- Debt Financing Considerations *(cont.)*

- One step structure
  - Proxy mailing ensures at least 30 day notice of shareholder meeting
  - Allows acquiror and debt financing sources to time marketing of debt to coincide with closing
- Two step structure
  - Most target shareholders tender shares on the last two trading days prior to expiration of tender offer
    - Late tenders create uncertainty as to whether tender offer conditions will be satisfied on expiration date
    - If conditions not satisfied at expiration, one or more extensions typically required by merger agreement
    - If conditions satisfied at expiration, merger agreement may provide acquiror with right to extend in order to market financing (but stockholders can withdraw tendered shares during extension period)

Two Step Structure Timing Issues - Debt Financing Considerations *(cont.)*

- Timing issues much more pronounced for bond financing as compared to bank financing in a two step structure
  - Significantly more problematic to stop marketing of bond financing and attempt to restart later
  - Closing of bond financing typically may not occur less than 3 trading days after signing of purchase agreement (but may provide for longer period)
  - Given tendency of stockholders to tender late, risk that bond purchase agreement signed but tender offer conditions not satisfied by bond closing date
- Risks regarding relative timing of bond and tender offer closings largely can be addressed by providing for potential funding of bond financing proceeds into escrow
  - Requires acquiror to fund into escrow the negative spread on the full interest for the escrow period (plus redemption premium, if any)

Two Step Structure Timing Issues
- Debt Financing Considerations *(cont.)*

- Tension between "marketing period" for debt and primary benefit of tender offer structure (speed)
  - Emphasis on speed in tender offer structure puts greater pressure on PE sponsor and debt financing sources to be prepared to complete marketing of debt financing quickly (and, if high yield financing is unsuccessful, to use bridge financing to complete transaction)
  - Potentially shorter sign-to-close period in tender offer structure also results in fewer available "windows" to market debt financing
  - Need for current financials in debt marketing materials can reduce or eliminate speed advantage of tender offer structure if financials will become stale during the 1-2 month period after signing
  - Customary "blackout" periods (e.g., late August, Christmas) also can negatively impact speed of two step structure

Two Step Structure Timing Issues
- Debt Financing Considerations *(cont.)*

- Timing difference between expiration of tender offer and completion of closing
  - Tender offers typically expire at 11:59 p.m. Eastern time and tender offer rules require public announcement of any extension to occur no later than 9:00 a.m. Eastern on day after expiration
  - Closing of debt financings typically begin around open of business Eastern time
  - Timing difference between acceptance of tender offer and completion of short form merger and receipt of debt financing creates small window of risk to the extent short form merger and debt financing closing have not been completed by 9:00 a.m. Eastern on the day after tender offer expiration
  - Acquiror becomes obligated to purchase shares but does not yet have debt proceeds
  - Risk should be low, particularly if tender offer includes debt funding condition

Two Step Structure Timing Issues
- Impact of Federal Margin Rules on Debt Financing

- Lenders may only provide loans ≤ 50% of the value of any margin stock (includes publicly traded securities, such as a target company's stock) pledged to secure the loan
- Margin rules create potential problems for acquiror if loan used to complete tender offer in two step structure and target company remains public after loan made
- Solutions to margin rule limitation
  - Limit loans used to complete first step tender offer to ≤ 50% of value of shares acquired/pledged (Note: other assets of target company may not be pledged until completion of second step merger)
  - Use unsecured tender offer facility without pledge of shares (potentially expensive financing)
  - **Ensure nearly simultaneous completion of first step tender offer and second step merger**
    - Use high minimum tender condition and "top up" option to help acquiror obtain 90% of target company's outstanding shares

How the Market Has Attempted to Address the Issues

The Market's Solutions
- Top-Up Options

- Option granted to acquirer that permits the acquirer to purchase from the issuer, after completion of the tender offer, a number of shares that, together with shares purchased in tender offer, permit short form merger (90% of outstanding shares in Delaware)
- Top-Up Options are included in almost all tender offers involving public targets. See, e.g. *Olson v. ev3, Inc.*, C.A. No. 5583-VCL (Del. Ch. 2011); 2012 Strategic Buyer/Public Target Mergers & Acquisitions Deal Points Study
- Main purpose: to avoid delays associated with long form merger when result of stockholder vote is guaranteed, given that acquirer already holds sufficient votes to approve the long form merger
  - short form merger can be accomplished promptly after the tender offer. A long form merger would require several weeks in order to satisfy formalities such as filing preliminary proxy statement, obtaining SEC clearance, noticing and holding stockholder meeting
- Limited by amount of authorized but unissued shares under charter
  - If target has 100 shares outstanding and 80 are purchased in tender offer (80%), an additional 100 shares must be issued under the top-up option in order for the acquirer to have 90% ownership:
- ((80+100)/200) = 180/200 = 90%

The Market's Solutions
- Burger King Structure

- Dual track approach, first tried in 2010 in 3G Capital's acquisition of Burger King.
- Involves filing of preliminary proxy statement contemporaneously with, or shortly after, commencement of tender offer.
- If tender offer + top up option will not result in ownership of sufficient shares to permit short-form merger, the tender offer is terminated and the structure is switched to a long-form merger
  - The minimum tender condition is set high enough so that if it is satisfied, exercise of the top-up option will result in ownership of sufficient shares to permit short-form merger
- The definitive proxy statement is not filed until after the tender offer has been terminated because the SEC may view it as a Rule 14e-5 violation
  - Rule 14e-5 under the Securities Exchange Act prohibits purchases of the target's securities outside the tender offer
- In almost all deals using the dual track approach, sufficient shares are tendered to enable completion of the tender offer route, and the definitive proxy statement is never filed.
- In one 2011 dual track deal, the tender offer was completed for 49.9% ownership, the definitive proxy statement was filed a few days later and the merger was completed 2 weeks after closing of the tender offer.

The Market's Solutions
- Burger King Structure: Pros & Cons

- Pros:
  - Permits parties to try to achieve speed of tender offer, but if insufficient shares are tendered, parties can switch to long-form merger and achieve almost the same timing they would have achieved had they pursued long-form merger at the outset
  - Thus avoids financing issues associated with partial ownership of target where short-form merger cannot be completed promptly after tender offer, e.g. lack of access to target assets for security interests, applicability of margin rules to target share pledge
- Cons:
  - Added cost, given that documentation for both tender offer and merger are prepared, so less suitable for smaller deals on a tighter budget
  - If minimum tender condition not likely to be reached, parties better off with single track long-form merger
  - Single track merger preferable for deals where a long closing period is anticipated
  - The interplay between the timing on the offering and the timing of the debt financing may result in the debt financing having to close into escrow if the structure is flipped to a long-form merger.
  - Litigation over top up options (may be untested in jurisdictions outside Delaware)

The Market's Solutions
- Other Alternatives

- Joint Tender Offers
  - Target tenders for a portion of its shares and acquirer tenders for the remaining portion
- Target Financing
  - loan of a portion of the purchase price by the target company to the acquirer
  - loan amount can be cash on hand or proceeds from indebtedness incurred by target
- Bridge financing
- Equity only tender offers

Litigation Over Top Up Options

Top Up Option Litigation
- Stockholder Voting Rights Claims

- **<u>8 *Del. C.* Section 251: Merger or consolidation of domestic corporations</u>**

Requires adoption by the holders of "a majority of the outstanding stock entitled to vote"

***<u>NECA-IBEW v. Prima Energy Corp.</u>*<u>, C.A. No. 522-N (June 30, 2004) (Transcript)</u>**

- On a motion to expedite, Vice Chancellor Lamb rejected the stockholder plaintiffs' argument that a top up option "emasculated" stockholders' Section 251 voting rights and therefore constituted a breach of fiduciary duty under *Blasius*.

- The Court held that the top up option wasn't "taking away anything" where the acquirer's majority control ensured that a long form merger would be a fait accompli.

***<u>In re Cogent, Inc. S'holder Litigation</u>*<u>, 7 A.3d 487 (Del. Ch. Oct. 5, 2010)</u>**

- On a motion for preliminary injunction, Vice Chancellor Parsons rejected the stockholder plaintiffs' allegation that a top up option would disenfranchise stockholders by permitting 3M to take control of Cogent without first acquiring a majority of Cogent's stock in the first step tender offer.

- The Court took comfort in the reality that, as a mathematical matter, 3M would need to acquire approximately 59% of the stock held by unaffiliated stockholders to achieve 90% ownership following exercise of the top up option.

Top Up Option Litigation
- Statutory Validity Claims Under DGCL §§152, 153 & 157

- **<u>8 *Del. C.* Section 152: Issuance of stock; lawful consideration; fully paid stock</u>**

  [T]he board of directors may authorize capital stock to be issued for consideration consisting of cash, any tangible or intangible property or any benefit to the corporation, or any combination thereof. In the absence of actual fraud in the transaction, the judgment of the directors as to the value of such consideration shall be conclusive.…

- **<u>8 *Del. C.* Section 153: Consideration for stock</u>**

  (a) [S]hares of stock with par value may be issued for such consideration, having a value not less than the par value thereof, as determined from time to time by the board of directors, or by the stockholders if the certificate of incorporation so provides….

Top Up Option Litigation
- Statutory Validity Claims Under DGCL §§152, 153 & 157 *(cont.)*

- **8 *Del. C.* Section 157: Rights and options respecting stock**

  (a) Subject to any provisions in the certificate of incorporation, every corporation may create and issue, whether or not in connection with the issue and sale of any shares of stock or other securities of the corporation, rights or options entitling the holders thereof to acquire from the corporation any shares of its capital stock of any class or classes, such rights or options to be evidenced by or in such instrument or instruments as shall be approved by the board of directors.

  (b) The terms upon which, including the time or times which may be limited or unlimited in duration, at or within which, and the consideration (including a formula by which such consideration may be determined) for which any such shares may be acquired from the corporation upon the exercise of any such right or option, shall be such as shall be stated in the certificate of incorporation, or in a resolution adopted by the board of directors providing for the creation and issue of such rights or options, and, in every case, shall be set forth or incorporated by reference in the instrument or instruments evidencing such rights or options. In the absence of actual fraud in the transaction, the judgment of the directors as to the consideration for the issuance of such rights or options and the sufficiency thereof shall be conclusive.

Top Up Option Litigation
- Statutory Validity Claims Under DGCL §§152, 153 & 157 *(cont.)*

***Olson v. EV3, Inc.*, 2011 WL 704409 (Del. Ch. Feb. 21, 2011)**

Stockholder plaintiffs challenged a merger agreement between ev3 and Covidien that included a top up option that permitted Covidien (the acquirer) to pay for top up shares either with cash or with a promissory note on terms set by Covidien, so long as these terms were " reasonably satisfactory" to ev3.

– After Vice Chancellor Laster granted the plaintiffs' motion to expedite, the litigation settled.

– Among other things, the defendants agreed to amend the merger agreement to:

  - Specify the material terms of the promissory note; and
  - Require the par value of the top up shares be paid in cash.

– Vice Chancellor Laster granted a $1.1 million fee award to plaintiffs, holding that the top up option as originally structured was likely invalid under Sections 152, 153 and 157

– Court stated that the amendments had "defus[ed] a potential corporate landmine" by preventing the possibility that the merger could be subsequently voided.

Top Up Option Litigation
- Statutory Validity Claims Under DGCL §§152, 153 & 157 *(cont.)*

***In re Cogent, Inc. S'holder Litig.*, 7 A.3d 487 (Del. Ch. Oct. 5, 2010):**

Stockholder plaintiffs challenged a merger agreement between Cogent and 3M pursuant to which Cogent granted 3M an option to acquire up to 139 million shares at the tender offer price for either cash or a promissory note payable in one year.

Merger agreement specified the material terms of the promissory note and the value of the consideration to be paid for the top up shares upon exercise of the option.

- On a motion for preliminary injunction, Vice Chancellor Parsons rejected the stockholder plaintiffs' allegation that the Cogent board had violated Sections 152, 153 and 157 of the DGCL by failing to determine the consideration for the issuance of stock and to control and implement all aspects of the creation and issuance of a stock option

- Court held that the defendants had proffered credible evidence that the board understood the "general nature" of the top up option's mechanics and had made an informed business judgment in granting the top up option.

Top Up Option Litigation
- Appraisal Dilution Claims Under DGCL §262

- **<u>8 *Del. C.* Section 262: Appraisal Rights</u>**

  When applicable, entitles dissenting stockholders to a judicial determination of the "fair value" of their stock as of the effective date of the merger.

  "Fair value" determination is highly sensitive to changes in the target's capital structure.

<u>*In re Gateway S'holders Litig.*, C.A. No. 3219-N (Del. Ch. Sept. 14, 2007) (Transcript)</u>

Stockholder plaintiffs argued (among other things) that the inclusion of a top up option in a merger agreement coerced stockholders to tender into the first step tender offer because of the risk that the issuance of a significant number of top up shares for less than fair value would dilute the remaining stockholders' proportionate interest in the corporation and negatively impact any "fair value" determination in a subsequent appraisal action.

- Without commenting directly upon this theory, Vice Chancellor Noble granted the plaintiffs' motion to expedite.
- The case subsequently settled for consideration including an agreement by the surviving corporation not to assert in any appraisal action that the number of shares for purposes of calculating fair value should include the top up shares. No stockholders sought appraisal following consummation of the merger.

Top Up Option Litigation
- Appraisal Dilution Claims Under DGCL §262 *(cont.)*

***In re Cogent, Inc. S'holder Litigation*, 7 A.3d 487 (Del. Ch. Oct. 5, 2010):**

On a motion for a preliminary injunction, Vice Chancellor Parsons rejected the stockholder plaintiffs' claim that the possible issuance of up to 139 million top up shares for "questionable value" could devalue subsequent appraisal claims.

- The Court noted that the merger agreement contained a provision providing that the fair value of any appraisal shares shall be determined without regard to any top up shares or the promissory note issued as consideration for the top up shares.

- The Court noted that although there was a question about whether Section 262 permitted parties to define the conditions under which appraisal could proceed, there was a "strong argument" that parties could stipulate to certain conditions in an appraisal matter.

Top Up Option Litigation
- Appraisal Dilution Claims Under DGCL §262 *(cont.)*

***In re Protection One, Inc. S'holders Litig.*, C.A. No. 5468-VCS (Del. Ch. Oct. 6, 2010) (Transcript)**

Then-Vice Chancellor Strine declined to award a fee to plaintiffs' lawyers for obtaining a merger agreement amendment providing that top up shares and any payment for them would be excluded from consideration in a subsequent appraisal action.

- The Court stated that in his "wildest dreams" he could not imagine reducing the value of an award to an appraisal petitioner because of a top up option

- "I would put on a lot of padding if I issued a ruling nailing an appraisal petitioner over a top-up option, because the ball would bounce off Dover so quickly, that opinion, and could come back and hit me. I would want to be well padded, because that impact would be dangerous to my person."

Top Up Option Litigation
- Appraisal Dilution Claims Under DGCL §262 *(cont.)*

***Olson v. EV3, Inc.*, 2011 WL 704409 (Del. Ch. Feb. 21, 2011)**

Vice Chancellor Laster awarded fee of $100,000 to plaintiffs' attorneys for obtaining an amendment to a merger agreement providing that any top up shares and any payment for them would be excluded from consideration in a subsequent appraisal action.

- Noted that the benefit obtained was "ephemeral at best"
- Conceded that Delaware courts had not yet conclusively decided the question
- Held that the theory of appraisal dilution was a "clever legal theory without real-world heft" that "founders" on the plain language of Section 262, which calls for the exclusion of "any elements of value arising from the accomplishment or expectation of the merger."

Top Up Option Litigation
- Standard of Review Claims

***Olson v. EV3, Inc.*, 2011 WL 704409 (Del. Ch. Feb. 21, 2011)**

- Plaintiffs argued that a top up option impermissibly permitted acquirer to evade "entire fairness" review under Delaware common law:
  - Argued that acquirer became a controlling stockholder after acquiring a majority of the stock in the first step tender offer;
  - Reasoned that acquirer was therefore subject to fiduciary duties when completing second step of transaction;
  - Argued that second step transaction was subject to "entire fairness review" under *Kahn v. Lynch Communication Systems, Inc.* (Del. 1994)
    - Theory not yet directly addressed by Court of Chancery

Overview of DGCL §251(h)

DGCL §251(h)
- Legislative History

- Proposed By Corporation Law Council Of The Delaware State Bar Association On March 20, 2013
- Approved By Corporation Law Section Of Delaware State Bar Association On April 2, 2013
- Approved By The Executive Committee Of The Delaware State Bar Association
- Introduced In The Delaware House Of Representatives And Assigned To The House Judiciary Committee On May 9, 2013
- Reported Out Of The House Judiciary Committee On May 15, 2013
- Passed By The House Of Representatives (41-0) On June 4, 2013
- Assigned To The Senate Judiciary Committee On June 4, 2013
- Reported Out Of The Senate Judiciary Committee On June 12, 2013
- Passed By The Senate (21-0) On June 18, 2013
- Expected To Be Signed Into Law Before August 1, 2013
- If Signed Into Law, Section 251(h) Will Be Available For Transactions Entered Into On Or After August 1, 2013

DGCL §251(h)
- How Section 251(h) Operates

If adopted, Section 251(h) will eliminate the need to obtain a stockholder vote on a Section 251 merger, if:

– (h) The target is a Delaware corporation "whose shares are listed on a national securities exchange or held of record by more than 2,000 holders …" and the following conditions are met:

1) "[T]he agreement of merger … expressly provides that such merger shall be governed by [Section 251(h)] and shall be effected as soon as practicable following the consummation of [a qualifying tender or exchange offer];"

2) The acquiring corporation "consummates a tender or exchange offer for any and all of the outstanding stock of [the target] … that, absent [Section 251(h)] would be entitled to vote on the adoption or rejection of the agreement of merger;"

3) [F]ollowing the consummation of the [qualifying tender or exchange] offer, the [acquiring corporation] owns at least such percentage of the stock, and of each class or series thereof, of [the target] that, absent [Section 251(h)], would be required to adopt the agreement of merger [under Section 251] and by the certificate of incorporation [of the target ;"

DGCL §251(h)
- How Section 251(h) Operates *(cont.)*

4) "[A]t the time [the target's] board of directors approves the agreement of merger, no other party to such agreement is an "interested stockholder" (as defined in Section 203(c) [of the DGCL]);"

5) "[T]he [acquiring] corporation consummating the [qualifying tender or exchange] offer described in clause (2) of this subsection merges with or into [the target] corporation pursuant to [the] agreement [of merger]; and"

6) [T]he 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 such merger into, or into the right to receive, the same amount and kind of [consideration] paid [in the qualifying tender or exchange offer]."

DGCL §251(h)
- How Section 251(h) Operates *(cont.)*

– **Legislative Synopsis:**

"Section 6 amends § 251(h) to permit a merger agreement to include a provision eliminating the requirement of a stockholder vote to approve certain mergers if a statutorily defined minimum number of shares is tendered in a tender or exchange offer consummated by an arms'-length third-party acquiror."

"The subsection does not change the fiduciary duties of directors in connection with such mergers or the level of judicial scrutiny that will apply to the decision to enter into such a merger agreement, each of which will be determined based on the common law of fiduciary duty, including the duty of loyalty."

Interpretive Questions and Potential For Future Litigation

DGCL §251(h) Interpretive Questions

- Clause (3): "following the consummation of such offer, the consummating corporation owns at least such percentage of the stock, and of each class or series thereof, of such constituent corporation that, absent this subsection, would be required to adopt the agreement of merger by this chapter and by the certificate of incorporation"
  - Fair price provisions and other certificate provisions that require supermajority votes in some instances?
  - Inclusion of rollover stock in determining whether "the consummating corporation <u>owns</u>" the requisite percentage of stock?

DGCL §251(h) Interpretive Questions *(cont.)*

- Clause (4): "at the time such constituent corporation's board of directors approves the agreement of merger, no other party to such agreement is an 'interested stockholder' (as defined in Section 203(c))"

- Section 203(c)'s "Interested Stockholder" Definition:

  [A]ny person (other than the corporation and any direct or indirect majority-owned subsidiary of the corporation) that (i) is the owner of 15% or more of the outstanding voting stock of the corporation, or (ii) is an affiliate or associate of the corporation and was the owner of 15% or more of the outstanding voting stock of the corporation at any time within the 3-year period immediately prior to the date on which it is sought to be determined whether such person is an interested stockholder, and the affiliates and associates of such person….

- Restriction is limited to "the time such constituent corporation's board of directors approves the agreement of merger"?

DGCL §251(h) Interpretive Questions *(cont.)*

- Section 203(c)'s "Interested Stockholder" Definition (continued):

  "Owner," including the terms "own" and "owned," when used with respect to any stock, means a person that individually or with or through any of its affiliates or associates:

  (i) Beneficially owns such stock, directly or indirectly; or

  (ii) Has (A) the right to acquire such stock (whether such right is exercisable immediately or only after the passage of time) pursuant to any agreement, arrangement or understanding, or upon the exercise of conversion rights, exchange rights, warrants or options, or otherwise… or (B) the right to vote such stock pursuant to any agreement, arrangement or understanding….

  (iii) Has any agreement, arrangement or understanding for the purpose of acquiring, holding, voting … or disposing of such stock with any other person that beneficially owns, or whose affiliates or associates beneficially own, directly or indirectly, such stock.

Likely Impact of DGCL §251(h) on Deals Involving Debt Financing

Likely Impact of DGCL §251(h) On Deals Involving Debt Financing

- Target companies' primary objectives often include:
  - **Price**
  - **Speed**
  - **Certainty**
- Two step structures have the advantage of **speed** over a one step structure
- Two step structures employed by acquirors using debt financing typically have greater **uncertainty** due to high tender offer acceptance conditions (necessary to effect a simultaneous completion of first step tender offer and second step merger)
- DGCL 251(h) addresses the issues surrounding **certainty** when using a two step structure
  - Allows an acquiror to complete a "second-step" merger without shareholder approval if an acquiror owns a *majority* of the outstanding target stock after a "first-step" tender offer

Likely Impact of DGCL §251(h) On Deals Involving Debt Financing *(cont.)*

- DGCL 251(h) would simplify the ability for acquirors, including those using debt financing, to effect tender offers by **eliminating** the need for:
  - High tender offer acceptance conditions;
  - Top-up options; and/or
  - Dual-track structures.
- As a result, because of the speed and certainty advantages that will be available by using a two step structure once DGCL 251(h) is effective, it is anticipated that target companies will increasingly seek to utilize two step structures in going-private transactions, particularly those involving debt financing.

Other Important Considerations Relating to Tender Offers

Other Important Considerations

- Tender offers may not be a suitable structure where there is expected to be a long closing period, e.g. in regulated industries, or because of antitrust issues
  - A long-form merger may be preferable in order to cut off target board's fiduciary out under the no shop
- New law does not impact targets incorporated outside Delaware
  - Top-up options and Burger King structure may still be suitable used in those jurisdictions
  - Note tender offer issues for California targets under 50/90 rule
- Long-form mergers may be preferable where target stockholders can act by written consent, in accordance with *In re Openlane, Inc. S'hlders Litig.*, C.A. No. 6849-VCN (Del. Ch. 2011)
- Acquirer has greater potential exposure to target stockholders in a tender offer given that acquirer is making offer directly to stockholders as opposed to merely being in privity with target company
  - In addition, the SEC frequently requires that the fund sign the tender offer documentation, as opposed to merely its newly formed purchaser entity

Other Important Considerations *(cont.)*

- A tender offer that is subject to a Schedule 13E-3 filing obligation is likely to take more time than one that is not. Consequently, some of the timing advantage of a tender offer compared to a merger will be lost.
- Given Rule 14e-5's prohibition of purchases outside the tender offer, equity rollover by management must generally be negotiated prior to signing merger agreement.
  - Given confidentiality concerns, rollover will therefore only be available to a small group.
  - Having an agreement or understanding in place regarding management rollover arrangements is one of the factors the SEC considers for purposes of determining whether a Schedule 13E-3 needs to be filed.