Smoothing Out Your Back-End (Merger)

Dealmakers are employing a variety of creative techniques to reduce, and sometimes eliminate, the incremental time and expense burden associated with the often-overlooked second-step merger that follows a tender offer.

Tender offers are commonly referred to as "two-step" transactions as a successful tender offer satisfying the minimum condition (i.e., the first step) is followed by a "back-end" merger which squeezes out the inevitable remaining target shareholders. Ideally, the buyer will reach 90% ownership following the tender (or the equivalent threshold in jurisdictions other than Delaware) and will be able to complete the second-step as a "short-form" merger immediately following the closing of the tender offer without the requirement to seek target shareholder approval. However, if the short-form threshold is not achieved in the tender offer, the second step must be completed as a "long-form" merger with the preparation, review and mailing of an SEC-compliant proxy statement followed by a shareholder meeting. While the outcome of the vote is assured because the buyer will, after completion of the tender offer, own sufficient target shares to dictate the result, a long-form merger adds meaningful incremental time and expense to reach 100% ownership (usually a prerequisite to commencing full integration as well as the ability to use the target's assets as security for the buyer's financing package). In fact, while the pathway to majority control is faster using a tender offer compared to a one-step merger, some buyers will question the timetable benefits of a two-step approach if the road to 100% ownership is longer as a result of the sequential nature of the tender offer and the long-form back-end merger processes.

Over the last few years, the top-up option has been employed to reduce the instances where a long-form merger is required by having the target company grant the buyer an option to purchase, upon successful completion of the tender offer at or above the minimum condition level (usually 50%), a number of newly issued shares of the target (assuming sufficient shares are authorized and unissued) such that in aggregate the buyer will own at least 90% of the target's shares, thereby permitting a short-form merger. A further refinement of the top-up option, the so-called "Burger King structure", has been employed in a growing number of private equity (Bain/Gymboree, Golden Gate/CPK) as well as certain strategic acquisitions (Raytheon/Applied Signal) utilizing a tender offer structure, where it was imperative to achieve 100% ownership virtually simultaneously with the closing of the tender because of financing constraints. Under this approach, the minimum condition to the front-end tender offer is set at the percentage that, when added to the maximum available top-up option, will ensure that the buyer will cross the 90% short-form threshold; if the tender fails to meet that higher minimum condition (often much higher than 50%), the parties abandon the tender offer and proceed with a one-step merger using a proxy statement that is prepared and filed while the tender offer is pending. However, absent use of the Burger King structure, which is sometimes viewed as less than ideal given the resulting requirement that the minimum tender condition often be well in excess of 50%, the effectiveness of the top-up option is limited in cases where there are insufficient authorized but unissued shares to allow the exercise of the option to carry the buyer from the ownership level achieved in the tender offer to the target 90% level.

Another idea worth exploring is use of an action by written consent of shareholders as an alternative to a long-form merger where the top-up option is insufficient to allow the buyer to cross 90%. Action by written consent entails delivery of a written resolution approving an action by holders of the same number of shares that would have been required to vote to approve the matter at a shareholder meeting. Assuming a combination of applicable state law and the company's organizational documents allows shareholders to act by less than unanimous written consent (in Delaware, such action is permitted unless prohibited by the charter), the buyer, as owner of a majority of the target shares following the tender offer, can deliver that consent immediately and thereby avoid the need for a post-tender proxy statement and shareholder meeting. Unlike the Burger King structure that allows virtually simultaneous closing of the tender offer, top-up option and short-form merger,

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this written consent approach likely requires a delay between the tender and closing of the merger under the SEC rules that require an information statement be sent to the other shareholders following a stockholder action by written consent at least 20 calendar days before the effectiveness of the action, here the merger, that is the subject of the consent. See Section 7.01(b) of the recent BHP/Petrohawk merger agreement. A similar creative structure that may merit further consideration is coupling the front-end tender offer with a consent solicitation for target shareholder approval to increase the number of authorized shares to a number sufficient to underpin a top-up option that enables the buyer to reach the short-form threshold.

Dealmakers are employing a variety of creative techniques to reduce, and sometimes eliminate, the incremental time and expense burden associated with the often-overlooked second-step merger that follows a tender offer. As seen in the largely unsuccessful plaintiffs' suits in Delaware challenging top-up options, courts seem inclined to accommodate these approaches as they merely represent an acceleration of a foregone conclusion, benefitting both the buyer and the target's remaining shareholders by hastening the now inevitable exchange of 100% control for a fixed amount of cash. With the increasing employment of these innovative structures, we expect that tender offers will continue their unabated growth as the structure of choice in cash acquisitions.

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As a coda to our recent M&A Update about state-specific provisions applicable to tender offers for targets incorporated in those jurisdictions and apropos the topic of this M&A Update, the Tennessee corporate statute appears to mandate a one month waiting period between the achievement of 90% ownership and the closing of the short-form merger, reducing some of the benefits of a two-step structure and of achieving the short-form threshold. See recent Pfizer/King transaction.

If you have any questions about the matters addressed in this *M&A Update*, please contact the following Kirkland authors or your regular Kirkland contact.

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