Crossing State Lines — Cautionary Tender Offer Tales

Dealmakers are finding that unique, and often quirky, provisions of state law in certain jurisdictions mean that caution and creativity are required to implement the tender offer structure for targets incorporated in those states.

With the increasing popularity of tender offers continuing unabated, dealmakers have quickly developed a comfort zone around structure and terms for Delaware targets. They are finding, however, that unique, and often quirky, provisions of state law in other jurisdictions mean that caution and creativity are required to implement the tender offer structure for targets incorporated in other states. These adjustments span the obvious (e.g., using a two-thirds minimum condition in states where that is the merger vote threshold) to the much more obscure. Below is a brief selection of examples of these issues that we have seen in recent deals:

California

- Section 1101(e) of the California Corporations Code seems to present an insurmountable obstacle to completing a back-end long-form cash merger following completion of a tender offer. While the statute does allow for cash consideration in a short-form merger if the acquirer reaches the 90% ownership level in the tender offer, it mandates that common stock rather than cash be the consideration to the minority shareholders in a long-form squeeze-out merger in the event that following the tender (presumably including any exercise of a top-up option) the acquirer owns between 50 and 90 percent of the target. Putting aside the obvious solution of using a 90% minimum condition that will likely be objectionable from a business standpoint, one alternative is to provide the acquirer an option to cut-back its tender offer such that it only acquires 49.9% of the target's shares in the event it would otherwise find itself stuck in the 50-to-90% zone. By doing so, the acquirer would avoid the restriction on cash-out mergers while at the same time practically assuring itself that it will be able to complete the back-end cash-out merger, albeit as a long-form merger that requires a 50% shareholder vote. See recent Microsemi/Actel transaction.

Washington

- Under Section 23B.11.040 of the Washington corporate statute, a short-form merger used at the back end of a tender offer may only be completed as a "forward" merger where the target company merges itself into the newly-formed acquisition vehicle, with the acquisition vehicle as the surviving company. Under other state statutes, there is an option to use a "reverse" merger structure where the target company survives. The use of a forward merger as compared to a traditional reverse merger raises a number of significant concerns including a potential corporate-level tax on completion of the merger and implications under anti-assignment provisions that may be triggered (especially under certain Federal principles applicable to intellectual property). Assuming that the alternative of only using a long-form merger, which even in Washington may be completed as a reverse merger, is not appealing for timing reasons, careful attention needs to be paid during due diligence to consider assignment issues that may be triggered and to structure the back-end merger in a manner that addresses the tax concerns. See recent Bristol-Myers/ZymoGenetics transaction.

Missouri

- Under Section 351.165 of the Missouri corporations law, a note may not be used to pay for shares of a Missouri company. This restriction means that cash will be the required consideration for the exercise of a top-up option. As such, instead of using the typical note that is immediately cancelled to pay for top-up shares, a buyer exercising the option may find itself needing cash financing (albeit very short term) that may, as a result of the dilutive math that applies to top-up option exercises, far exceed the amount required to complete the acquisition of the outstanding shares from target shareholders. See recent ABB/Baldor transaction.

- Under an obscure state regulation, the Missouri Takeover Bid Disclosure Act, a buyer may be required to file with the state commissioner of securities a special registration statement relating to a cash tender offer. While there may be questions as to the constitutionality of this regulation and the regulation itself includes important definitions that cross-reference other statutes that have been rescinded, it still may be prudent to file this short registration statement at the commencement of a tender offer. Thankfully, most if not all of the disclosure requirements can be satisfied by cross-referencing disclosure in the SEC tender offer documents.

- The Missouri control share acquisition statute (Section 351.407) limits voting rights for shares held by an acquiring person who crosses the 50% ownership threshold unless such rights are reinstated by vote of the minority shareholders. If applicable, this provision would preclude for practical purposes the use of a tender offer. Happily, the Missouri statute allows a company to opt out of these provisions under a board-adopted by-law. As such, a buyer must ensure that such an opt-out by-law is adopted by the board of the target prior to approving the merger agreement.

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At the early stages of deciding whether to use a two-step tender offer rather than a one-step merger and of structuring any such offer, dealmakers should pay careful attention to both company-specific issues (e.g., unusual charter or by-law terms) and state-specific provisions that may impact the advisability and terms of a tender offer. Given the dearth of tender offers until the recent resurgence, even local counsel is often unfamiliar with some of these obscure state law requirements. As shown above, a mistaken assumption that the "Delaware form" works for targets incorporated in other states can have unfortunate consequences.

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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