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"Dual Track" Acquisition Structure Remains Useful to Strategic Acquirors Even After DGCL §251(h)

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In the wake of the adoption of Section 251(h) of the Delaware General Corporation Law, numerous commentators have suggested that the "dual track" acquisition structure is no longer needed for deals with targets that are Delaware corporations. We are of the view that, to the contrary, the dual track structure is still a useful tool in the M&A toolbox for strategic acquirors in Delaware deals, and it can even be combined with Section 251(h) in a transaction.

In a dual track structure, the parties will initially utilize a two-step deal to effect an acquisition, with the first step being a tender offer, and the second step being a merger to squeeze out non-tendering stockholders. However, in the event the tender offer does not close (in many cases due to the failure of a high minimum tender condition that, when combined with shares issued pursuant to a "top up option," would require ownership of at least 90% of the target shares to permit a short-form merger to occur after the closing of the tender offer), the parties will terminate the tender offer and fall back to effecting the acquisition as a one-step deal consisting of a long-form merger. The principal aim of the original dual track structure was to avoid the acquiror becoming a majority owner of a publicly traded subsidiary after the closing of the first-step tender offer and before the closing of the second-step merger. Under a dual track structure, during the pendency of the tender offer, the target prepares and files a preliminary proxy statement to mitigate any timing delay should the transaction fall back to a one-step deal utilizing a long-form merger.

Delaware enacted Section 251(h) to eliminate the need to comply with the short-form merger statute (with a threshold of 90% ownership) in certain circumstances. Section 251(h) provides that if an acquiror purchases through the tender offer a sufficient percentage (typically a majority) of the outstanding shares of the target necessary to deliver the requisite stockholder approval in a merger vote, then the acquiror may consummate the second-step merger without stockholder approval even though the percentage of shares purchased in the tender offer is less than the 90% short-form merger threshold. This means that the ubiquitous top-up option used in two-step deals is, in many cases in Delaware deals, no longer needed, and that the delay of a long-form merger (if the short-form threshold is not achieved in the tender offer) can be avoided. In effect, the acquiror can close the transaction as if it were a short-form merger so long as the acquiror purchases in the tender offer the requisite percentage of shares to deliver the stockholder approval in a long-form merger.

Since Section 251(h) became effective, numerous commentators have prophesized the death of the dual track structure in Delaware deals. The reasoning is that Section 251(h) effectively lowered the “minimum tender” threshold to effectuate a short-form merger from 90% of the target’s shares to a majority of the target’s shares (or such higher threshold as set forth in the target’s governing documents). This in turn eliminates the concern of the acquiror having to abandon the tender offer if the 90% threshold was not reached and falling back to a long-form merger so as to avoid becoming a majority owner of a publicly traded subsidiary until the close of the second-step merger. That theory, however, may be too simplistic in its analysis, depending on the deal.

The dual track structure remains a valuable option in deals undertaken by strategic acquirors where there may be a potentially long interim period between signing and closing, typically due to regulatory approvals. In these deals, the timing advantage of a tender offer is lost because the acquiror cannot close the tender offer and purchase shares tendered until all regulatory approvals have been obtained. That is an important limitation—in deals with a long interim period, the tender-offer structure actually backfires against the acquiror because a Delaware target’s “fiduciary out” is not extinguished until the acquiror closes the tender offer and purchases the tendered shares. Section 251(h) does not eliminate this problem for the acquiror—the target’s fiduciary out continues until shares are purchased in the tender offer. By contrast, with a long-form merger, once the target’s stockholders approve the merger (generally, two to four months after signing), a Delaware target’s fiduciary out is extinguished.

One example of a situation where the dual track structure would be preferable over Section 251(h) alone would be a deal where there is a meaningful likelihood that a “second request” under the HSR Act may be issued by the DOJ or the FTC. Assume that the second request would result in the interim period between signing and closing being six months, a reasonable period of time to address a second request. Even if a majority of the target's shares are tendered by the 20th business day after the tender offer was commenced, the acquiror could not close the offer and purchase the target shares, and the target's fiduciary out would continue until the second request was substantially complied with at the end of the sixth month. As a result, the acquiror is vulnerable to six months of topping bid risk. Section 251(h) does not change that outcome.

However, if the transaction described above utilized a dual track structure instead, that same topping bid risk is minimized. After the parties received that second request from the DOJ or FTC, the parties could abandon the tender offer and revert to the long-form merger. This would enable the merger vote to be held within two to four months after signing, the target's fiduciary out would be extinguished upon receipt of stockholder approval, and the acquiror would not be susceptible to topping bid risk after that time. Accordingly, the dual track structure significantly shortens the period of topping bid risk. Georgia-Pacific's recent acquisition of Buckeye Technologies utilized a dual track structure with this very issue in mind. When the parties to that transaction received a second request, the tender offer was abandoned, and the transaction proceeded with a long-form merger. Section 251(h) would not provide similar protection.

Of course, the best of all worlds approach for a strategic acquiror in a Delaware deal would be to utilize a dual track structure that also incorporates Section 251(h). If the closing of the tender offer was not delayed due to regulatory or other reasons, then the second-step merger would be completed via Section 251(h); if there was a delay, then the deal would fall back to the one-step structure using a long-form merger.

Even after the enactment of Section 251(h), the dual track structure is still a valuable mechanism to mitigate a strategic acquiror's exposure to topping bid risk during the pendency of a lengthy regulatory approval process, and therefore increases deal certainty for a strategic acquiror.
