Shareholder Approval of Small Private Acquisitions: Has Omnicare Been Rendered a Farce?

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Perceived Delaware requirements for stockholder solicitation to approve an acquisition agreement have become increasingly opaque due to first the 2003 Omnicare decision and then the subsequent erosion thereof. The result is the casting of a cloud of both uncertainty and inefficiency, the twin root evils of effective corporate jurisprudence.

In Omnicare Inc. vs. NCS Healthcare Inc., 818 A.2d 914 (Del. 2003), the Supreme Court of Delaware invalidated a merger agreement where an insolvent company had been given 24 hours by a potential acquirer to agree to (1) no fiduciary out (the ability by a target company to terminate the agreement, subject to a break-up fee, in the event a third company offers a superior proposal for the target company) and (2) requiring voting agreements from two stockholders, who also represented one half the board, which had the effect of contractually guaranteeing the required stockholder vote prior to the company actually submitting the deal for approval to the stockholders as a whole.

Prior to Omnicare, private company acquisitions were relatively straightforward affairs. Provided that a transaction’s value fell below the threshold requiring a Hart-Scott-Rodino (HSR) antitrust notification filing (currently around US$66 million), and that consents from customers or suppliers could be acquired prior to signing, often a buyer could insist on a simultaneous signing and closing whereby stockholder consents were delivered concurrent with execution of the merger agreement. In venture capital backed companies, with a concentration of share ownership in a select few VC firms and perhaps a founder or two, smaller stockholders were routinely ignored in the initial pre-execution solicitation, though they retained the dissenters’ rights accorded them by statute. While this may seem procedurally high-handed, it did nothing to substantively change the outcome of any merger vote.

A simultaneous sign/close was beneficial, however, in that it allowed certain verbose, contentious provisions to be omitted from a merger agreement—for instance, interim operating covenants for the target company between signing and closing, a termination section, fiduciary outs and break-up fees. Omitting such provisions increased deal certainty and reduced transactional (that is, lawyer) costs. Even when HSR filings or contractual consents were necessary, the immediate delivery of stockholder approval at signing eliminated the buyer’s fear of a deal break-up from topping interference.

The decision in Omnicare limited the ability to lock up a deal prior to its submission to stockholders following execution of an agreement. For public company transactions, it meant that voting agreements could no longer make a deal a forgone conclusion. And, indeed, it meant the same for private company transactions—but with the added wrinkle that a period between signing and closing became mandatory, not optional. Thus came the advent of interim operating covenants and termination provisions in private company agreements, even where no HSR filing or contractual consents were required.

Following Omnicare, some counsel in smaller transactions quite conveniently chose to ignore the decision—and in such deals many continue to do so. Some cannot be bothered to worry about the purportedly hypothetical risk of merger contract judicial invalidation; others stake their claim by asserting that the specific facts of Omnicare are not analogous to a concurrent sign/close situation.

The oracles of the Delaware Bar, however, have generally taken a dim view of both perspectives. The risk of stockholder litigation in a closely held private company may be remote, but many are concerned about even the faint chance that a cranky shareholder might turn up in a Delaware court to upset a merger. And while the facts of Omnicare are extreme (an insolvent corporation backed into a financial pickle) the underlying holdings are pretty clear-cut—at least on their own. Further, if a law firm is asked to give a legal opinion on enforceability of a merger contract that does not comply with the basic tenets of Omnicare, ignoring the case is a difficult proposition.

From a public policy standpoint, the roots of Omnicare may well be grounded in laudable goals. In Omnicare, the target company (NCS Healthcare) was jammed. It was given less than 24 hours to deliver a stockholder vote for deal that threw a lifeline of value to an enterprise precariously perched on the precipice of financial apocalypse. One could reasonably posit that stockholders should have a fair period of time in which to review a detailed solicitation statement. The majority opinion in Omnicare noted there is an inherent balance under Delaware law between the board and the stockholders. Restoring some period of reasonable review would seem equitable in allowing stockholders to offset the specter of unfettered board edicts. Public companies already in reality enjoyed such benefits as federal securities laws have long mandated that a proxy statement for a publicly-traded company must be in the mail no
later than 20 business days prior to a stockholder vote, giving stockholders a whopping month to mull over a deal’s merits.

*Omnicare*, however, has been muddied by subsequent erosion. Nothing in either that decision or in Delaware law prescribes an actual bright-line time period for stockholder review of the terms of a proposed merger. In practice, many deals now involve execution of the merger agreement followed by an immediate “solicitation” that constitutes an e-mail from the target’s counsel to stockholders, followed by the seemingly magical submission of stockholder consents from large stockholders representing the required vote. Such consents in reality often are sought in hushed tones by the target’s counsel prior to the execution of the merger agreement and held by such counsel in mythical escrow, pending signing. This process perfects the triumph of form over substance.

It therefore was inevitable that some clever lawyer would impose a post-signing deadline for a stockholder vote. Such a deadline was included in a merger agreement that became the subject of a 2008 Delaware Chancery case, *Miami v. WCI Steel, Inc.*, C.A. No. 3833-VCL (Del. Ch. June 27, 2008), in which a 24-hour deadline to return consents was included in the merger contract; the failure to meet such condition gave the buyer a right to terminate. Upholding this condition, Vice Chancellor Stephen Lamb reaffirmed that Delaware law does not require “any particular period of time between a board’s authorization of a merger agreement and the necessary stockholder vote.” *WCI Steel* thus would appear to substantially undermine *Omnicare’s* applicability to private company mergers.

Indeed, following *WCI Steel*, many smaller private company agreements now contain a 24-hour (or shorter) deadline, whereby the buyer can terminate the agreement if the stockholder vote has not been received. The result is farcical. Frantically prepared solicitation statements are transmitted in a post-signing e-mail flurry, only to be promptly superseded by prepared consents, freshly released from “escrow” and pouring in. However, lawyers must still negotiate pre-closing operating covenants, and termination provisions all of which are an arguably superfluous chore if no HSR or contractual consents are needed for closing; the provisions themselves remain operative only during the briefly open window between signing of the merger agreement and the return of stockholder approvals just hours later. One could hypothetically assert that *WCI Steel* allows for a return to the old days of near-simultaneous signing/closing, but it is not clear that it does. And lack of clarity causes customarily risk-averse lawyers to assume that the worst (a court action to invalidate) can still occur. For a transaction of modest size, this imposes both needless angst and an indirect tax (of lawyer’s fees) on stockholders of both sides of the transaction.

The unadorned beauty of Delaware as the jurisdiction of choice for American corporate law is its large body of rulings on the subject, its subjectivity opportunity for judicial review, its customer-service oriented filing process (the utility of which is not to be underestimated) and the (usual) clarity of its judicial guidance. A few larger technology darlings have recently conducted long-awaited IPOs which have garnered much publicity. However, such deals are numerically dwarfed by the volume of pre-public acquisitions. Well established, large technology companies rely on Silicon Valley and its various geographic siblings as incubators for ideas that are enshrined in an ever-changing constellation of startups. The ability to efficiently and quickly acquire such idea-based entrepreneurial gems strips away development cost. And even startups (and their VC backers) rely on the ability to quickly combine such very entities in order to re-jigger organizations, tweak development and evolve ideas.

Accordingly, Delaware, whether through one of its august judiciary or legislative bodies, would do well to proactively address the present conundrum. If Delaware decides, through statute or a bright-line Supreme Court holding, to require a minimum period of time for stockholder review, then so be it—but a public policy determination of such import needs real teeth. One would think a period of 72 hours reasonable to digest and discuss the contents of a thorough solicitation statement (which Delaware also ought to consider mandating be written in “plain English”). In larger transactions with publicly traded buyers, even though there likely would be a required HSR filing, 72 hours would seem a reasonable period, since such buyers may need to file the terms or actual agreement on a Form 8-K with the Securities and Exchange Commission. Such a filing publicizes the commercial terms of the deal, thereby essentially inviting topping offers, permissible absent stockholder approval ending a fiduciary out period, which such buyers are understandably loathe to do. What we do not need is the current, de facto standard, in all its ambiguity and ridiculous brevity.

On the other hand, if Delaware decides that no prescribed period is necessary, and the power of stockholders to withhold their vote (or signature on a consent) is sufficient leverage in the balance of the board and the stockholders with which Delaware should not further interfere, so be it. Such a clarification would allow the charmingly simplistic simultaneous sign/close model to re-emerge.

With either approach, however, at least transactional lawyers in small private deals could abandon their perennial head-scratching question: “But what about *Omnicare*?”