INSIGHTS

THE CORPORATE & SECURITIES LAW ADVISOR

ASPEN PUBLISHERS

Volume 26 Number 3, March 2012

MERGERS AND AQUISITIONS

Delaying Judgment Day: How to Defer Stockholder Votes in Contested M&A Transactions

In connection with an M&A transaction, public companies sometimes find it desirable to delay a previously scheduled stockholders meeting. Adjournment is the most traditional method, but a recess or postponement may be appropriate. In any event, a review of the company's charter and bylaws, applicable state or foreign law, the federal securities laws and the agreements governing the transaction must be analyzed.

by Lois Herzeca and Eduardo Gallardo

Public companies that are seeking stockholder approval of a contested business combination transaction have sometimes found it desirable to delay a previously scheduled meeting of stockholders. The company may wish to provide stockholders with additional time to consider new information (such as a new or revised acquisition proposal), may need additional time to solicit proxies, or may not have a quorum.

Adjournment is the most traditional, and most accepted, method to delay a stockholder vote. In an adjournment, the meeting is convened without taking a stockholder vote, but then reconvened at a later time and date. However, a stockholder meeting also can be postponed or recessed. In a postponement, the previously scheduled stockholder meeting is not convened, but is delayed to a subsequent time and date. In a recess, the stockholder meeting is convened, and then "recessed" without taking a stockholder vote and continued at a later time and date.

The determination of whether a company can delay its previously scheduled stockholder vote, and the best method of doing so, requires a rigorous analysis of the company's charter and bylaws, applicable state or foreign law, the federal securities laws, and the agreements governing the transaction.

Reviewing Organizational Documents

As an initial matter, both the charter and bylaws of the company should be reviewed to determine if, and to the extent that, they address the ability of the board of directors, or the chair of the meeting, to delay a stockholders meeting. Ideally, the bylaws should empower the board of directors, without a vote of the stockholders, to (1) postpone, reschedule, or cancel any previously scheduled annual meeting of stockholders and (2) postpone, reschedule, or cancel any previously scheduled special meeting of the stockholders called by the board of directors or management (but not by the stockholders). Further, the bylaws

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should provide that the chair of any stockholders meeting has the right to convene, recess and/or adjourn the meeting.

It also is important to determine whether a delay in a previously scheduled meeting could have the effect of re-opening the advance notice window under the company's bylaws, thus allowing a dissident stockholder to nominate directors, or bring other proposals to a vote at the meeting, when it might have been prevented from doing so absent such delay. For example, in December 2011, the Delaware Chancery Court sided with a dissident stockholder of China-Cast Education Corporation, who argued that the company's decision to postpone its 2011 annual meeting of stockholders had effectively re-opened the advance notice window under the company's bylaws, allowing him to nominate three individuals to the company's six-member board.[1]

Analyzing State Law

Even if a company's organizational documents empower the board of directors and/or the chair of a stockholder meeting to delay the stockholder vote, state law (or in the case of a foreign corporation, foreign law) may govern the manner in which such power may be used.

Under Delaware law, for example, if a Delaware court determines that a meeting was delayed as a defensive tactic or to interfere with the stockholders' right to vote, the court will place the burden on the company seeking the delay to demonstrate that the delay was appropriate, regardless of the authority granted under the company's bylaws. In *State of Wisconsin Investment Board v. Peerless Systems Corp.*, the company's bylaws provided that any meeting of the stockholders could be adjourned by the chairman of the meeting.[2] In reviewing the factual record, the Delaware Court of Chancery found that the primary purpose of the adjournment may have been to frustrate or interfere with stockholder franchise, thereby subjecting the decision to the "compelling justification" standard.[3] Though the defendant argued that "the adjournment was lawfully consistent with its bylaws and was made without objection from any shareholder present at the [a]nnual [m]eeting," the court concluded that such an argument "ignores the clear rule that inequitable action does not become permissible simply because it is legally possible."[4] Upon a rehearing, the court reiterated that while it did not intend to "entirely foreclose the ability of a Delaware corporation to reschedule or adjourn a shareholders meeting," the court stated that "[w]here a decision to adjourn is made due to an improper purpose, that decision may be challenged as a breach of fiduciary duty."[5]

When the court determines that the board's primary purpose was not to frustrate voter franchise, but the delay in the stockholder vote was nonetheless used as a defensive tactic, the court will still review the board's decision with the "enhanced scrutiny" applicable to other takeover defense tactics under an *Unocal* standard.[6] In *Kidsco Inc. v. Dinsmore*, The Learning Company (TLC) reached a negotiated merger agreement with Broderbund Software, Inc. (Broderbund), but a hostile tender offer was later commenced by Softkey International Inc. Broderbund eventually presented an improved offer and, in order to allow more time to consider the improved offer, TLC's board postponed its stockholder meeting from November 9 to December 11.[7] The court, in determining that the measure was appropriate, applied the *Unocal* standard, requiring that the board's action be "reasonable." It must "demonstrate that it had reasonable grounds to believe that a danger to corporate policy and effectiveness existed," and "proportional," in that the response was "neither preclusive nor coercive" and fell "within a range of reasonable responses to the threat posed."[8]

Delaware courts have provided some guidance as to what factors will be considered to determine whether the board acted appropriately in determining whether to delay a stockholder

meeting. For example, the Delaware Court of Chancery has stated that it will find that a board acted in accordance with its fiduciary duties if, for example, "well-motivated, independent directors" postpone a stockholder meeting to vote on a merger, when they:

- believe that the merger is in the best interests of the stockholders;
- know that if the meeting proceeds the stockholders will vote down the merger;
- reasonably fear that in the wake of the merger's rejection, the acquiror will walk away from the deal and the corporation's stock price will plummet;
- want more time to communicate with and provide information to the stockholders before the stockholders vote on the merger and risk the irrevocable loss of the pending offer; and
- reschedule the meeting within a reasonable time period and do not preclude or coerce the stockholders from freely deciding to reject the merger.[9]

Delaware courts also have found that there was not a breach of fiduciary duty where the adjournment of a meeting was considered a "defensive measure intended to enable the … board to present the [board-sponsored] transaction to its shareholders in an environment that would provide the board a reasonable time to explore and develop other options if the [board-sponsored] deal were rejected."[10]

Federal Securities Law Requirements

Rule 14a-4 under the Exchange Act grants a company the ability to solicit proxies conferring discretionary authority to management to vote on matters "incident to the conduct of the meeting." However, the SEC generally considers the use of an adjournment at a stockholder meeting to require the previous disclosure in the proxy statement of the company's plans to seek an adjournment if needed to solicit additional proxies. The SEC also requires that companies give stockholders the ability to specifically vote on any such adjournment proposal on the proxy card. In fact, Delaware courts have noted the "general practice of the SEC that encourages issuers to seek stockholder pre-approval for an adjournment."[11]

If new material information is presented to stockholders immediately prior to the stockholder meeting, the company may be required to allow stockholders additional time to consider the proposal in light of such new information. If a definitive proxy statement previously mailed to stockholders has become materially misleading prior to the date of the meeting due to a subsequent event, such as an amendment to the terms of the merger agreement, the proxy statement must be amended or supplemented to correct any materially misleading statement or omission. Proxy materials must then be filed with the SEC and disseminated to stockholders with enough time prior to the meeting to allow the stockholders adequate time to digest the new information.

While there is no specifically required number of days that a meeting should be delayed to give stockholders time to consider new material information, 5 to 10 business days generally is regarded as common practice. A helpful benchmark is the tender offer rules which require an extension of the offer for an additional 10 business days for changes in the price or amount of securities sought and 5 business days for other material changes in the offer.[12] Additionally, when Delaware courts have enjoined stockholder meetings and mandated that further information be disclosed to stockholders, they have enjoined the meeting for a similar period.[13]

In the case of *In re Anderson, Clayton Shareholders' Litigation*,[14] a competing bid was presented three days prior to the target company's stockholder meeting, which the target board did not postpone. The court stated that directors have

> no duty to delay an otherwise appropriate transaction just because at the last minute a possible alternative arises that might, if it could be arranged, be more beneficial to

> the corporation or its shareholders [than] the transaction with which the company has been proceeding. But the board does have a duty, at least when the transaction is as significant as one that requires a shareholder vote, to explore and evaluate alternatives.[15]

The court also determined that a three-day period would likely be considered an insufficient period of time for stockholders to consider the offer, but cited to analogous cases involving material disclosures wherein 7 to 11 days was considered appropriate.[16] However, if the competing proposal is so materially deficient that it would not be considered material to the stockholder's analysis of the proposed transaction, a delay of the stockholder vote would not be necessary.[17]

Further, if the terms of a stock transaction are modified after the registration statement on Form S-4 becomes effective, the registrant may need to file a post-effective amendment to the Form S-4 or a prospectus supplement in order to maintain its accuracy. Item 512 of Regulation S-K provides that any securities registered pursuant to Rule 415 (which includes all registrations statements filed on Form S-4), must include an undertaking to file a post-effective amendment to the registration statement to:

> reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement.

The SEC has defined "fundamental" in this context as "major" and "substantial" changes that include, for instance, any change in the business or operations of the company that would necessitate a restatement of the financial statements.[18]

If the new information is considered material, but does not rise to the level of a "fundamental change," the company may file a prospectus supplement under Rule 424(b) instead of a post-effective amendment. Under Section 8(c) of the Securities Act, if a registration statement is amended after its effective date, the amended statement does not become effective until formally determined by the SEC. In contrast, a supplement filed under Rule 424(b) would not be subject to formal SEC clearance before it is declared effective, which will expedite the company's ability to disseminate it to stockholders.

Notice and Record Date

Under Delaware law, if a stockholder meeting is adjourned, and if the time and location of the reconvened meeting are announced at the time of adjournment, no additional notice to stockholders need be given unless (a) the adjournment is for greater than 30 days, or (b) a new record date is fixed subsequent to adjournment.[19] The record date used for the original meeting will apply to adjourned sessions unless changed by the board.[20]

Generally, adjourning a meeting will not necessitate a change in the record date for voting at the meeting. However, if the board wishes to do so, it may fix a new record date for determination of stockholders entitled to vote at the adjourned meeting.

Although no reported case law has addressed the issue, it is believed that in light of Sections 222(c) and 213(a) of the Delaware General Corporation Law (DGCL), a company may adjourn a meeting for successive periods of fewer than 30 days.[21] While more than one adjournment would likely be permissible, a company would probably not be able to continue to adjourn a meeting indefinitely—but the line is not clear. Additionally, as discussed above, a Delaware court may consider the adjournment of a meeting to constitute a breach of the board's fiduciary duty if the purpose appears to be to frustrate the stockholder vote.

In contrast to adjournment, the DGCL does not contain any express provisions concerning postponed meetings or the notice and record date requirements regarding such meetings.[22] Under Delaware law, the board has the authority to postpone or reschedule a stockholder meeting. After the date for a meeting of stockholders has been designated but before the meeting has been formally convened, the board of directors has the power to postpone it. However, if the postponement is challenged by a stockholder, the burden is upon those seeking the postponement to show that the postponement is in the best interests of the stockholders.[23] As discussed above, the Delaware courts have outlined factors that it will consider in determining whether a board acted in accordance with its fiduciary duties if it delays a stockholder meeting.

In contrast to an adjournment, however, the postponed meeting will likely be considered a new meeting under Delaware law. While the question of whether a postponed meeting must be treated as a new meeting for purposes of delivering notice to stockholders remains open, it is general practice to provide 20 days' notice to approve a merger transaction,[24] as required for the original special stockholder meeting under the DGCL. Generally, a postponement is treated as a new meeting date, triggering the requirements to mail a new notice and to allow 20 days to elapse before the meeting date. In contrast, there is no minimum period of time that has to elapse between the adjournment of a meeting and the time such adjourned meeting reconvenes.

Additionally, Section 213(a) of the DGCL provides that the record date for the stockholders meeting must be "not more than 60 nor less than 10" days prior to the date of the meeting. If, following the postponement, the new meeting date is more than 60 days after the original record date, the company will need to establish a new record date, requiring that new notice be mailed to stockholders, as discussed above. If the postponed meeting falls within this 60 day window, however, the company should not be required to establish a new record date. In contrast, if a company opens and adjourns a meeting, it will be able to preserve its original record date even if more than 60 days have passed between the record date and the date that the adjourned meeting is reconvened.

There does not appear to be clearly established law in Delaware surrounding the use of a recess to delay the conclusion of a stockholder meeting. However, it is a strategy that previously has been used as a means of delaying a meeting without the notice and record date requirements triggered by a postponement and also without first obtaining the stockholder vote necessary to adjourn the stockholder meeting. On November 17, 2010, Dynegy Inc. called a recess to delay a stockholder meeting when it was uncertain whether it had the authority under its bylaws to adjourn.[25] The company recessed the meeting for seven days in light of an improved offer, rather than calling for an adjournment. While no litigation appears to have resulted from this tactic, this may be due to the fact that the proposed transaction was not approved by the company's stockholders when the meeting was reconvened.[26] There is no Delaware caselaw discussing recess, and the boundaries between a recess and an adjournment are unclear. However, some practitioners believe that a recess is likely to be treated similarly to an adjournment with regard to notice and record date requirements. Adjournment will therefore likely be preferable to recess as there is a statutory basis for adjournment, and it is more likely to survive judicial scrutiny. However, if the board's authority to adjourn the meeting is at issue, the company could consider, if appropriate, using a recess.

Reviewing the Terms of the Transaction Agreement

Any determination to delay a previously scheduled stockholder meeting also must be reviewed in light of the specific contractual

provisions contained in the governing transaction agreement. In drafting transaction agreements in which the transaction is subject to stockholder approval, it is useful to provide a specific carve out which allows each company to postpone or adjourn its stockholder meeting for up to 20 or 30 days, for delineated reasons, including for the absence of a quorum and to allow reasonable time to solicit additional proxies.

Conclusion

Parties entering into business combination transactions generally expect that they will be able to schedule stockholder meetings to vote on the transaction and then hold the meeting as scheduled. It is useful, however, to plan in advance for unexpected developments. To the extent permissible under applicable law, both the company's bylaws and the transaction agreements should be drafted to provide the company with sufficient flexibility to delay a stockholder vote on the transaction should it be necessary or appropriate to do so. An actual determination to exercise such flexibility and delay a scheduled vote, however, must be made in light of the specific situation and applicable law.

Notes

1. *Sherwood, et al. v. Ngon, et al.*, C.A. No. 7106-VCP (Del. Ch. Dec. 20, 2011).
2. *State of Wis. Inv. Bd. v. Peerless Sys. Corp.*, 2000 Del. Ch. LEXIS 170, at *9-*10 (Del. Ch. 2000).
3. *Id.* at *27-*39.
4. *Id.* at *53.
5. *State of Wis. Inv. Bd. v. Peerless Sys. Corp.*, 2001 Del. Ch. LEXIS 1, at *5-*6 (Del. Ch. 2001).
6. *Unocal Corp. v. Mesa Petroleum Co.*, Del. Supr., 493 A.2d 946, 954-55 (1985); *see Kidsco Inc. v. Dinsmore,* 674 A.2d 483, 496 (Del. Ch. 1995).
7. *Kidsco,* 674 A.2d at 488.
8. *Id.* at 495 (citing *Unitrin, Inc. v. American Gen. Corp.*, Del. Supr., 651 A.2d 1361, 1372, 1384-86 (Del. 1995)).
9. *Mercier v. Inter-Tel (Delaware), Inc.*, 929 A.2d 786, 787-88 (Del. Ch. 2007).
10. *Kidsco*, 674 A.2d at 496.
11. *Mercier*, 929 A.2d at 792 (citing to comments that "the SEC has some 'unwritten policies' regarding shareholder voting on adjournment of meetings." Transcript, Roundtable Discussions Regarding the Federal Proxy Rules and State Corporation Law 239 (May 7, 2007) available at *http://www.sec.gov/spotlight/proxyprocess/proxy-transcript050707.pdf*).
12. *See* Rule 14e-1(b) (requiring that if there is a change in the percentage of the class of securities being sought in a tender offer, the offer must remain open for at least 10 business days following notice of the revision); Rule 14d-4(d)(2)(iii) (requiring, in a registered securities offering, that if the price or amount of securities is changed through a revised tender offer, a prospectus supplement must be disseminated and the offer must remain open for another 10 business days); *See also* Rule 14d-4(d)(2)(i) (requiring, in a registered securities offering, that the offer must remain open from the date that material changes to the tender offer materials are disseminated for 5 business days for a prospectus supplement containing a material change other than price or share levels).
13. *See In re Art Tech. Group. S'holder Litig.*, C.A. No. 5955-VCL (Del. Ch. Dec. 20, 2010) (discussing a case in which the meeting was enjoined for 5 days and opinion that 10 calendar days of notice is reasonable in light of the 20 day notice requirement for merger agreements); *Steinhardt v. Howard-Anderson*, C.A. No. 5878-VCL (Del. Ch. Jan. 24, 2011) (enjoining meeting for 10 business days).
14. *In re Anderson, Clayton S'holders Litig.*, 519 A. 2d 669 (Del. Ch. 1986).
15. *Id.* at 676.
16. *Id.* at 679; *See also In re Answers Corp. S'holders Litig.*, 2011 Del. Ch. LEXIS 59 (Del. Ch. 2011) at *4 n.3 (referring to the *Anderson* opinion and suggesting that given modern technology, 3 days' notice may be more appropriate than it was in 1986 but declining to decide on the issue).
17. *In re Answers*, 2011 Del. Ch. LEXIS 59 at *4.
18. 46 Fed. Reg. 42001 (Aug. 18, 1981), 1981 WL 119423 (F.R.).
19. Del. Code Ann. tit. 8, § 222(c) (2011).
20. *Id.* at § 213(a).
21. *See* 2-24 Del. Corp. Law and Practice § 24.03 (2010).
22. *Id.* § 24.05.
23. *Id.*
24. Del. Code Ann. tit. 8, § 251(c).
25. Steven M. Davidoff, *Dynegy's Unusual Approach to Delay a Vote*, N.Y. Times Dealbook (Nov. 18, 2010), *http://dealbook.nytimes.com/2010/11/18/dynegys-unusual-approach-to-delay-a-vote/.*
26. Jim Polson and Noah Buhayer, *Blackstone's Dynegy Bid Scrapped, Other Offers Sought*, BLOOMBERG (Nov. 23, 2010), *http://www.bloomberg.com/news/2010-11-23/dynegy-to-seek-bids-on-concern-blackstone-pact-faces-shareholder-rejection.html.*