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Delaware Court Permits Delay of Merger Vote but Proposes New Standard of Legal Review

When a merger vote appears headed for defeat, target companies frequently postpone the vote to give the parties more time to drum up majority shareholder support for the deal. Delaware courts historically have scrutinized but ultimately upheld such postponements against legal challenge. In a recent case, Vice-Chancellor Strine similarly upheld a target board's decision to postpone a merger vote, but in doing so proposed a revised standard of judicial review and raised the specter that, under different circumstances, delay of a merger vote might well be invalidated. Mercier v. Inter-Tel, Del. Ch. Aug. 14

Inter-Tel involved the 25-day postponement – in the face of near-certain defeat – of a shareholder vote on an all-cash offer from a third party acquiror. Delaware courts have applied a variety of legal standards when reviewing challenges to such postponements. Sometimes the legal test has been stated as whether the board has shown a "compelling justification" for its action; other times the deferential business judgment rule standard has been applied on the ground that the directors are supporting a merger after which they will cease to serve, thus negating any charge of entrenchment.

Finding both of these approaches lacking, V.C. Strine has, in Inter-Tel, proposed a "more tempered" alternative: whether the postponement served a "legitimate objective" and was "reasonable in relation" to that objective. Applying this test, the court found that Inter-Tel's directors were legitimately concerned that if the proposed merger (which the board believed to be the best interests of stockholders and to be a better alternative than a leveraged recap proposed by management) were rejected, the acquiror would walk away and Inter-Tel's share price would plummet. Under these circumstances, the Inter-Tel approach would allow the postponement, provided that (1) the board does nothing else that would "preclude" shareholder choice on the merger or otherwise "coerces" the vote; (2) the board can point to some genuine news that needs disseminating (in Inter-Tel, details about management's leveraged recap alternative), as opposed to just beating the bushes for more votes on the pre-existing informational basis; and (3) the postponement is relatively brief. The court also noted favorably that the Inter-Tel directors would not continue to serve after the merger and appeared to have no self-interest in the transaction, and he found unproblematic the setting of a new record date in conjunction with the postponement, which shifted votes into the hands of presumably pro-transaction arbitrageurs. Left unanswered is whether the delay would have been upheld if any of the key facts were different (for example, if there were no new news to disseminate, but the board reasonably believed that shareholder minds could yet be changed), but Inter-Tel strongly suggests that, under different facts, some delays would not pass this new doctrinal muster.

While the Inter-Tel formulation is doctrinally elegant, we believe that Delaware would be wiser, in this area, to apply a simpler, business judgment rule approach that would allow directors to postpone merger votes for a reasonable time provided they do not also take other steps to "disenfranchise" or "coerce" the vote. Where the directors have no personal interest in the outcome of the vote, there is no discernible reason to impose a complex, heightened legal test when it comes to judicial review, nor (as Inter-Tel does) to put the burden of persuasion on the board. This simpler approach is especially important in the current environment, where large institutional or activist shareholders sometimes play a complex tactical game in which they threaten to vote against a deal not because they genuinely hope to defeat it, but because they seek to elicit a small, final bump in price. In response to tactics of this type, courts should be more receptive rather than less to a board's judicious use of its prerogatives where such tactics could backfire and risk giving a buyer an option to walk. In short, operating in volatile capital markets such as we are experiencing today, and grappling with diverse shareholder base populated with sophisticated investors, boards should be trusted to exercise good-faith discretion in such scheduling matters without subjecting the decision to intense and hostile scrutiny from the courts.

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