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Familiar Features in Pennsylvania's New Entity Transactions Landscape

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Comprehensive amendments to the Pennsylvania Business Corporation Law ("PBCL") go into effect on July 1, 2015. The amendments repeal many substantive provisions of the PBCL in respect of corporate mergers. These provisions, and the equivalent provisions in the statutes governing Pennsylvania partnerships, limited liability companies and other entities, are being replaced with a consolidated set of procedures in the new Entity Transactions Law ("ETL") that are based on the Model Entity Transactions Act.¹ The purpose of this Note is to highlight certain features of the amended PBCL and the ETL that will be of interest to M&A practitioners whose clients engage in transactions with Pennsylvania entities and to serve as a reminder that, despite the comprehensive model amendments, Pennsylvania corporate law retains a unique set of takeover related provisions that must be factored into M&A transaction planning.²

Corporate Mergers under Pennsylvania Law

An outline of the merger procedure for Pennsylvania corporations is attached as Annex A. The ETL must be read in conjunction with the PBCL.³ As a general matter, the basic corporate merger framework provided by the PBCL remains

¹ The amendments are being effected through Pennsylvania Act 172 which establishes the ETL as a new chapter 3 of Title 15 of the Pennsylvania Consolidated Statutes and makes conforming amendments to the PBCL and the Pennsylvania Associations Code ("Code"). For a good summary and helpful introduction to the new law, see "A New Era of Simplified M&A in Pennsylvania" by Perry S. Patterson, Thomas M. Thompson and Adam G. Wicks in Law 360, December 4, 2014.

² This Note focuses on corporate mergers since acquisitions of most public companies and many private companies are accomplished through this structure. In addition, for historical reasons many of the unique features of Pennsylvania law emerged in a legislative response to issues that confronted public companies in the 1980's. However, the focus of this Note should not obscure that the value and benefits of the ETL derive in large part from the fact that the statute consolidates and simplifies a set of procedures across different forms of business association and contains provisions to accomplish five fundamental kinds of transactions (mergers, conversions, interest exchanges, divisions and domestications).

³ See, for example, Committee Comment to Section 321 (Approval by Business Corporation) which states that this section "is not a comprehensive statement of the procedures that must be followed to approve a plan. The provisions of the Business Corporation Law and the organic rules of the business corporation will apply as appropriate with respect to issues not dealt with in this section, such as how far in advance of a meeting notice must be given, quorum requirements for meetings, action by consent without a meeting, etc."

unchanged by the new law. The ETL incorporates existing concepts and procedures from the PBCL using a new vernacular and is designed to work consistently with merger procedures for other forms of business association.

Relationship to Antitakeover Law

It is well known that Pennsylvania law contains extremely protective antitakeover provisions for public companies.⁴ These provisions are not affected by the ETL. Section 313 affirms the continuing validity of the antitakeover provisions of Chapter 25 of the PBCL (Registered Corporations)⁵ and expressly provides that a transaction under the new law “may not impair any right or obligation that a person has under, and may not make applicable to the corporation” any of the antitakeover provisions unless the manner in which the transaction was approved would itself have satisfied the vote required to change the application of the statute.

Fiduciary Duties of Directors

Subchapter B of Chapter 17 of the PBCL permits a board of directors to consider the interests of constituencies other than the company’s shareholders when evaluating the best interests of the corporation, including in connection with a proposed change of control. Specifically, under Section 1715, a board may in the exercise of its fiduciary duties consider the effects of any action on shareholders, employees, suppliers and customers and is not required to consider any corporate interest or interests of any particular group as a controlling or dominant factor.⁶ The ETL does not change these principles which apply to privately-held as well as public companies. Section 313 expressly provides that no transaction may change the standard of care applicable to the board of directors under Subchapter B of Chapter 17 (relating to fiduciary duties).

⁴ The statute uses the term “registered corporation” which is defined as a Pennsylvania corporation that has a class of shares entitled to vote in the election of directors that is registered under the Securities Exchange Act of 1934 or that is subject to the reporting obligations imposed by section 15(d) of that Act by reason of having filed a registration statement which has become effective under the Securities Act of 1933 relating to shares entitled to vote in the election of directors.

⁵ The antitakeover provisions include, among others, a “put right” for shareholders at “fair value” to any person acquiring shares with at least 20% of the company’s voting power and a five-year merger moratorium on business combinations between a company and an “interested shareholder,” unless the acquisition of the shares that made a person an interested shareholder or the business combination was pre-approved by the company’s board. A registered corporation may opt out of the antitakeover provisions by appropriate amendments to its articles of incorporation.

⁶ The constituency statute distinguishes Pennsylvania law from the Delaware approach that imposes Revlon duties on the board to obtain the best price for the stockholders in a sale of the corporation.

“Black Hat – White Hat” Treatment of Shareholders

Section 329 of the ETL permits a merging corporation to treat shareholders holding shares of the same class or series in a materially different manner.⁷ Specifically, a plan of merger may contain a provision that classifies the holders of a class or series of shares into different groups “by reference to any facts or circumstances that are not manifestly unreasonable” and that provides for mandatory treatment of the shares that are held by one group “in a manner that differs materially from the treatment” accorded shareholders in another group. The plan must describe the type and extent of the special treatment authorized.

Under Section 329(a), a “black hat-white hat” treatment plan must be approved by a majority of the votes cast by the holders of any class or series of shares any of the shares of which are classified into groups, whether or not they would otherwise be entitled to vote on the plan. Alternatively, in lieu of the shareholder vote, such a plan may be authorized if a court of competent jurisdiction determines that the special treatment is undertaken in good faith, after reasonable deliberation and is in the best interest of the corporation.

In addition, subsection (b) of Section 329 provides that, unless the board determines to permit the members of the affected group to exercise dissenters rights, each group of holders who are to receive the same special treatment under the plan are entitled to vote as a special class whether or not they are entitled to voting rights under the articles of incorporation or bylaws.

The Committee Comments to Section 329 provide a good example of how the statutory provision may be implemented in practice:

Where, for example, holders of shares of a class or series are allotted a new fixed rate preferred interest unless they are employees, in which case they may elect to receive instead an earn-out (variable face amount) security, there will be two groups within the meaning of subsection (b): (1) the employee holders and (2) all other holders of the class or series. Subsection (b) will be applicable separately to each group, and the [board of directors] could, for example, provide for a separate vote by group (1) (thus depriving them of dissenters rights) and no separate vote for group (2) (thus according them dissenters rights).

⁷ Section 329 essentially tracks Section 1906 of the PBCL that became effective in October 1989.

The simplicity of the example belies the potential for abuse of the reclassification power for more questionable purposes. Limits on the corporation's ability to classify shareholders into groups are imposed by Section 329 which requires that the classification be determined "by reference to any facts or circumstances that are not manifestly unreasonable" as well as by the board's general fiduciary duty when taking action to act in the best interests of the corporation. However, it is not difficult to imagine circumstances in which the constituency law discussed above could be invoked to justify disparate treatment that may, in the view of the affected group at least, result in fundamental unfairness to one group of shareholders.

Force the Vote

The ETL contains a provision that permits Pennsylvania corporations to agree to a "force the vote" provision in a merger agreement.⁸ Specifically, Section 320 permits the board of directors to agree to submit a plan of merger to its shareholders whether or not it determines, at any time after approving the plan, that the plan is no longer advisable and recommends that the shareholders reject or vote against it. The Committee Comment to Section 320 clarifies that the initial approval of a plan by a board of directors is sufficient to satisfy the board approval requirement and that approval does not have to be refreshed at the time of approval of the plan by the shareholders.

Voting Requirements and Short Form Merger

Under Section 1924(a) of the PBCL, approval of a plan of merger requires the affirmative vote of a majority of the votes cast by all shareholders entitled to vote on the proposal. However, no shareholder vote of a Pennsylvania corporation is required to approve a merger if another corporation owns 80% or more of the shares of each class of its shares. Both these sections are being repealed but the same voting and ownership thresholds are retained by Sections 321(c) and 321(d)(ii) of the ETL. Section 330 of the ETL, however, is a new provision that, unless otherwise provided in the company's articles of incorporation or bylaws, dispenses with the need for board approval of a merger if the transaction is approved by the unanimous vote or consent of the company's shareholders.

⁸ "Force the vote" is a relatively recent concept in Pennsylvania merger practice. The new law is based on the provision contained in current Section 1908 of the PBCL which became effective in September 2013.

Partial Written Consent of Shareholders in Lieu of Meeting

Under Section 1766(b) of the PBCL, action may be taken by written consent of less than all of the shareholders entitled to vote on a proposal if the bylaws expressly provide for such action. However, while written consents potentially afford the opportunity for Pennsylvania corporations to avoid the expense and delay of shareholder meetings, in the case of private companies much of the timing advantage is currently eroded by Section 1766(c) of the PBCL which provides that any action taken by partial written consent does not become effective until after at least ten days' notice of the action has been given to each shareholder entitled to vote but who did not consent in writing.⁹

Section 1766(c) is being amended to eliminate the ten days' prior notice requirement for all actions that are approved by partial written consent other than actions that approve a merger or other fundamental transaction. Except in these cases, actions approved by partial written consent may become effective immediately but notice must be given promptly to each shareholder entitled to vote that has not consented. Accordingly, while the amendments will expedite the process for securing many corporate approvals, for privately held companies it will still be necessary to incorporate in a merger transaction timeline the need to convene a shareholders' meeting or the ten days' notice period if it is contemplated that less than all shareholders entitled to vote on the merger will sign a written consent.

Contractual Dissenters Rights

Section 333 of the ETL incorporates without any substantive amendments the dissenters rights procedures of Subchapter D of Chapter 15 of the PBCL (Dissenters Rights). Existing law already permits a corporation to provide in its bylaws or by separate resolution for shareholders to exercise dissenters rights in a transaction to which they are not otherwise entitled. Section 317 of the ETL expands on this concept and provides that shareholders shall be entitled to contractual dissenters rights in connection with a merger to the extent provided in the company's articles of incorporation or bylaws or in the plan of merger, even though they would not otherwise be entitled to statutory dissenters rights.

⁹ In contrast, under Section 2524(b) of the PBCL, if a company's articles of incorporation permit, an action authorized by the shareholders of a registered corporation without a meeting by less than unanimous consent may become effective immediately upon its authorization, but prompt notice of the action shall be given to those shareholders entitled to vote who have not consented.

Tax Clearance

Where a Pennsylvania corporation is merged into a foreign entity that is not registered to do business in Pennsylvania, the parties must obtain tax clearance certificates from the Department of Revenue and the Department of Labor and Industry evidencing payment by the merged corporation of all Pennsylvania state taxes and include the certificates with the merger filing. Obtaining such certificates takes many months. A new provision has been added to Section 139 of the Code that exempts the parties from the requirement to obtain tax clearance certificates if the foreign entity that survives the merger registers to do business in Pennsylvania simultaneously with the delivery of the statement of merger.



For further information or if you have any questions concerning this topic or any other questions concerning Pennsylvania corporate law, please contact Paul De Rosa at (412) 297-4821 (pderosa@cohenlaw.com) or any of the following attorneys in our mergers and acquisitions practice.

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OUTLINE OF PENNSYLVANIA CORPORATION MERGER PROCEDURE

Statute / Section	Description
ETL §331	<u>Merger Authorized</u> “Mergers” are defined and authorized.
ETL §332	<u>Plan of Merger</u> A Pennsylvania corporation may become a party to a merger by approving a plan of merger. This section prescribes the information and terms that must be included in the plan of merger.
PBCL Chapter 17 Subchapter B	<u>Fiduciary Duty</u> This subchapter describes the fiduciary relationship of directors to the corporation and articulates factors that directors may take into account in their decision-making as well as presumptions that apply when their conduct is evaluated.
PBCL §§2501-2588	<u>Registered Corporations</u> These sections contain antitakeover provisions applicable to Pennsylvania registered corporations that have not opted out of the statutory protections.
ETL §329	<u>Special Treatment of Shareholders</u> This section authorizes and sets forth the procedure for approving disparate (“black hat-white hat”) treatment of groups of shareholders in a plan of merger.
ETL §321 and §333	<u>Approval of Plan of Merger</u> These sections cover the manner in which the plan of merger must be approved by the corporation, including the proposal of the plan of merger by the board of directors, the notice of a shareholders meeting, the shareholder vote required to adopt the plan of merger, the circumstances under which shareholder adoption of the plan of merger is not required, the conditions for holding company mergers and the availability of dissenters rights.

PBCL Chapter 17
Subchapters A and E

Notice and Meetings Generally and Shareholders

These subchapters contain rules in respect of the manner of notice, time, place and notice requirements for a meeting called to adopt a plan of merger, quorum, the voting rights of shareholders generally, determining shareholders of record, voting lists and taking action by written consent in lieu of meeting.

ETL §334

Amendment or Abandonment of Plan of Merger

This section sets forth the requirements for amending and/or abandoning the plan of merger.

ETL §335

Statement of Merger

This section prescribes the terms that must be included in the statement of merger that is filed with the Pennsylvania Department of State and when the merger becomes effective.

ETL §336

Effects of Merger

This section describes the effects of the merger on the parties to the merger.

PBCL §§1571-1580

Dissenters Rights

These sections set forth for the procedure for the exercise of dissenters rights by eligible shareholders.