

Contractual Waivers of Appraisal Rights Declared Valid Under Delaware Law



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In a recent opinion (available at <https://courts.delaware.gov/Opinions/Download.aspx?id=279230>), the Delaware Court of Chancery, for the first time, held that contractual provisions in stockholder agreements barring common stockholders from exercising their statutory appraisal rights are enforceable as a matter of law, so long as the stockholders voluntarily signed the stockholder agreement in return for consideration, such as investment in the company. The decision, *Manti Holdings LLC v. Authentix Acquisition Co.*, C.A. No. 2017-0887-SG, holds that appraisal waivers do not violate section 151(a) of the Delaware General Corporation Law (DGCL) and, in so doing, brings additional certainty to private equity and venture capital investors whose investments include drag-along rights with appraisal waivers.

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Background and Analysis

In 2008, Authentix Acquisition Co. and its stockholders entered into a stockholder agreement to facilitate the investment of a group of investors, collectively referred to in the opinion as the Carlyle Group. The stockholder agreement provided for drag-along rights, which required the stockholders to consent to a sale of Authentix (whether by merger or stock sale) if such a sale was approved by the holders of at least 50 percent of Authentix stock. The stockholder agreement also required the stockholders, including the plaintiffs, to refrain from exercising any appraisal rights in connection with such a sale.

After the stockholder agreement was signed, a majority of Authentix stockholders resolved by written consent to sell Authentix to a third party. Despite the fact that they had signed the stockholder agreement, certain stockholders sought to perfect their supposed appraisal rights and brought suit against Authentix seeking statutory appraisal pursuant to section 262 of the DGCL. In seeking appraisal, the plaintiff stockholders argued that their appraisal rights were not waived.

First, the plaintiff stockholders made a number of textual arguments regarding the language of the drag-along provisions. For instance, because the drag-along provisions stated that the stockholders were to “refrain from exercising” their appraisal rights, as opposed to “waiving” those rights, the plaintiffs maintained that their appraisal rights did not extinguish. According to the plaintiffs, the provisions merely obligated them to delay the exercise of those rights until after closing. The court disagreed, finding that reading to be an unreasonable interpretation of the provision. Although the use of the word “waive” might have been clearer, the court ultimately held that the use of the term “refrain” unambiguously extinguished the stockholders’ appraisal rights.

Second, the plaintiff stockholders argued that the drag-along rights, if construed to include an appraisal waiver, were unenforceable because they violated section 151(a) of the DGCL. As a general rule, holders of common stock in a Delaware corporation are entitled to appraisal rights in accordance with section 262. Further, section 151(a) requires that limitations on classes of stock must be set out in, or derived from, the corporation’s certificate of incorporation. Thus, the plaintiffs argued that to be enforceable, a waiver of appraisal rights must appear in the certificate of incorporation pursuant to section 151(a), and that appraisal rights cannot be waived by contract, such as a stockholder agreement.

The court disagreed, finding that enforcement of the appraisal waiver in the stockholder agreement is “not the equivalent of imposing limitations on a class of stock.” It reasoned that the stockholder agreement “did not transform the [plaintiffs’] shares of stock into

a new restricted class.” Rather, “individual stockholders took on contractual responsibilities in return for consideration,” which included refraining from seeking appraisal. These contractual obligations, the court held, are enforceable and do not violate section 151(a).

Takeaway

Before the court issued its opinion on October 1, the question of whether drag-along rights with an appraisal waiver could be enforced to prevent common stockholders from seeking appraisal was an open question under Delaware law. Indeed, although the Court of Chancery previously held that prospective waivers of *preferred* stockholders’ appraisal rights (which are largely contractual) are enforceable, no prior Delaware decision addressed the question of whether *common* stockholders can prospectively waive, by contract, the right to seek statutory appraisal. The court’s decision answers that question in the affirmative and, in so doing, brings further certainty to private equity and venture capital investors whose investments include drag-along rights with appraisal waivers.

Another takeaway from the decision is that, even though there is now clear authority upholding drag-along rights with appraisal waivers, plaintiff stockholders will still seek to challenge the effectiveness of those waivers on interpretation and ambiguity grounds. Drag-along provisions with appraisal waivers should therefore be carefully drafted in order to achieve the desired effect of such provisions.