

## Delaware Court of Chancery Examines Relationship between Company's Drag-Along Right and Stockholder's Waiver of Right to Appraisal

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In *Halpin v. Riverstone National, Inc.*,<sup>1</sup> the Delaware Court of Chancery examined the language of a stockholders' agreement to determine whether Riverstone had properly exercised its contractual drag-along right and triggered a waiver by minority common stockholders of the statutory right to appraisal of their shares. The court held that the express language of the stockholders' agreement limited the exercise of the company's drag-along right to a vote in favor of a merger that had been proposed (i.e. was prospective only) but did not apply when minority stockholders were asked to consent to the merger after the fact once the merger had already taken place.

Riverstone and common stockholders owning 9% of the outstanding shares had entered into a stockholders' agreement in June 2009 which provided that:

If at any time the Company and/or any Transferring Stockholders propose to enter into any Change-in-Control Transaction, the Company may require the Minority Stockholders to vote in favor of such transaction where approval of the shareholders is required by law or otherwise sought by giving the Minority Stockholders notice thereof within the time prescribed by law and the Company's Certificate of Incorporation and By-Laws for giving notice of a meeting of shareholders called for the purpose of approving such transaction.

On May 29, 2014 the company's majority stockholder executed a written consent to authorize a merger with a third party. The company and the third party entered into the merger agreement on May 30, 2014 and the merger became effective on June 2, 2014 with each company share converted into a right to receive cash. It was not until June 9, 2014 that the company first gave notice to the minority stockholders in an information statement that the merger had taken place and attempting to invoke the drag-along right. The minority stockholders subsequently sought to exercise appraisal rights, after which two of the minority stockholders filed petitions for appraisal. The company counterclaimed for specific performance of the drag-along right.

The court stated that it did not need to decide whether the minority common stockholders could contractually waive their statutory appraisal rights *ex ante* i.e. in a stockholders' agreement in advance of knowing the merger consideration that would be set a later date. The court noted that Delaware courts have allowed preferred stockholders to contract out of their appraisal rights since their rights are contractual

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<sup>1</sup> C.A. No. 9796-VCG (Del. Ch. Feb. 26, 2015)

in nature. The rights of common stockholders, on the other hand, are governed by the Delaware General Corporation Law and the law of fiduciary relationships. The court did not need to answer this legal question, however, since it was able to resolve the case based on the contractual language contained in the stockholders' agreement.

Assuming that a common stockholder may waive its appraisal rights ex ante, the question was whether the minority common stockholders had waived their statutory rights by agreeing to take certain actions in connection with a change of control transaction, including voting in favor of a merger. Such a waiver is enforceable, the court said, only to the extent that it is clearly set forth in the parties' contract. In this case, the language of the contract unambiguously defined those acts as entirely prospective in nature, that is, the minority stockholders had agreed, upon advance notice, to vote in favor a merger that had been proposed but had not agreed, upon notice after the fact, to consent to a merger that had been consummated. Just because the company was entitled to a benefit if it had exercised the right does not mean it is entitled to the benefit when it has failed to exercise the right. Under a literal reading, the company cannot require the minority stockholders to consent to a merger that has already taken place.

There are three lessons to be taken from the case. First, the questions as to whether and how common stockholders may waive their statutory appraisal rights under Delaware law remain and are not answered by the court in this case. Second, (assuming that common stockholders can waive appraisal rights ex ante), it is important that companies follow the exact procedure contained in the contract when exercising the contractual rights. Third, it is advisable for companies to include an express waiver of the right of appraisal in the contract rather than (as did the stockholders' agreement in this case) merely including a provision that commits the minority stockholders to take certain actions that, if and when taken, would have the effect of waiving appraisal rights. The outcome of the case may have been different had the stockholders' agreement contained such a provision and may have forced the court to answer the questions raised above.



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