

# Upshots of Del. Holding on Appraisal Rights Waivers in M&A

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In what represents a victory for private equity and venture capital investors, on Sept. 13, the Delaware Supreme Court issued a decision in *Manti Holdings LLC v. Authentix Acquisition Co.*, confirming the enforceability of appraisal waivers by private contract so long as the stockholders agreeing to the waiver are sophisticated, informed, represented by counsel and have at least some bargaining power.

The decision serves to further reinforce the long-standing trend of sophisticated investment firms using stockholders agreements to require common stockholders to support strategic transactions involving the corporation, including by waiving their appraisal rights under Delaware law.

## Background

The case arose from a merger between Authentix Acquisition Co. and a third-party acquirer. Prior to the merger, Authentix and its stockholders entered into a stockholders agreement, which provided for drag-along rights requiring 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% of Authentix stock.

The stockholders agreement also required the stockholders, including the plaintiffs, to refrain from exercising any appraisal rights in connection with such a sale. After the stockholders agreement was signed, a majority of Authentix stockholders resolved by written consent to sell Authentix to a third party.

Despite signing the stockholders agreement, certain nonconsenting stockholders sought to perfect their supposed appraisal rights and brought suit against Authentix, seeking statutory appraisal under Section 262 of the Delaware General Corporation Law. The [Delaware Chancery Court](#) dismissed the stockholders' petition. The stockholders appealed, and on Sept. 13, the Delaware Supreme Court affirmed.

Following the court's decision, the plaintiffs filed a motion for reargument, which was then denied. In a footnote, Justice Karen L. Valihura continued to emphasize that the appeal implicated important issues of Delaware public policy and that the matter deserved reconsideration.

Specifically, the court's Sept. 13 decision held that Section 262 of the Delaware General Corporation Law, or

DGCL, does not prohibit sophisticated and informed stockholders, who are represented by counsel and have bargaining power, from voluntarily agreeing to waive their appraisal rights in exchange for valuable consideration. It reasoned that:

- The DGCL is a broad enabling act that allows freedom for private ordering;
- Section 262 does not contain any language purporting to prevent stockholders from agreeing to an ex ante waiver of their appraisal rights; and
- Public policy does not prohibit sophisticated and informed stockholders from waiving their appraisal rights in exchange for valuable consideration.

The court grounded its holding in both statutory interpretation and Delaware case law. A plain reading of Section 262, the court stated, “does not prohibit stockholders from agreeing to waive their appraisal rights” even though appraisal rights are known as mandatory stockholder rights.

In course of its analysis, the court reasoned that Delaware’s state Legislature knows how to draft language prohibiting alteration of mandatory rights in the DGCL but had not done so in the case of Section 262.<sup>[1]</sup>

The court was also not troubled by the plaintiffs’ contention that enforcing a waiver of appraisal rights on a common stockholder in the context of the facts of the case would violate public policy, whether because of the dilution of the unique features of a Delaware corporation or otherwise. Rather, the court was satisfied that such a waiver would not violate public policy because:

- The stockholders agreement was not a contract of adhesion;
- The stockholders would be able to foresee the circumstances in which the waiver could be used against them, i.e., a merger in which they were provided unfair consideration; and
- The waiver did not affect a waiver of the plaintiff’s ability to participate in corporate governance or to police corporate misconduct.<sup>[2]</sup>

## Analysis

At the center of the parties’ arguments in *Manti* is a fundamental and well-known principle of Delaware corporations involving the interplay among the DGCL and the organizational documents. At the top of the hierarchy sits the DGCL, followed by the certificate of incorporation, then the bylaws and, finally, the stockholders agreement.

In this sense, the court’s holding in *Manti* confirms that a stockholders agreement can go even further than a corporate charter or bylaws.<sup>[3]</sup>

Practically, the court's holding provides sophisticated investors — such as private equity and venture capital investors — comfort that the dual approach of using appraisal waivers and drag-along rights to keep common stockholders in check is enforceable under Delaware law, at least as it relates to common stockholders who are represented by counsel. The court's opinion also frames contexts in which such a waiver might not be enforceable.

For instance, according to the court, a waiver might not be enforceable against:

- A retail investor who was not involved in the negotiation of the stockholders agreement;
- Outsiders who generally lack knowledge of the corporation's corporate governance dynamics; or
- Stockholders who did not consent to the waiver and who are only purportedly bound because of a midstream amendment to a stockholders agreement.

What's more, the court's holding also provides sophisticated investors with license to continue testing the waters as to the types of waivers that may be enforceable under Delaware law.

While the court's decision does not directly address the enforceability of other such waivers, the court was careful to note that there are some rights under the DGCL that are so fundamental that they cannot be waived such as "rights designed to police corporate misconduct or to preserve the ability of stockholders to participate in corporate governance."

We do not know at this point whether such other waivers, like those contained in the most recent versions of the model documents of the National Venture Capital Association,<sup>[4]</sup> are enforceable with that test in mind.

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[1] The Court pointed to (i) Section 115 of the DGCL, which prohibits corporate charters and bylaws from diverting internal corporate claims from the Delaware courts and (ii) Section 102(f) of the DGCL which generally prohibits fee-shifting charter provisions. The Court also noted in passing, however, that neither Section 115 nor Section 102(f) prohibit alteration through a stockholders agreement.

[2] Rather, according to the Court, the purpose of Section 262 of the DGCL is to pay dissenting stockholders fair value for their canceled shares in a merger. Although the Court identified academic sources that argued that appraisal rights at least indirectly involve the policing of corporate misconduct, the Court viewed such indirect policing as "ancillary" and not the core focus of Section 262.

[3] In her dissenting opinion, Justice Karen L. Valihura argued that appraisal rights waivers should only be permitted in the certificate of incorporation (assuming, for purposes of her analysis, that appraisal rights could be waived at all) and that the Court's decision effectively establishes a separate regime for private corporations

(which commonly utilize stockholders agreements) and publicly-traded corporations (which do not).

[4] In the course of her analysis, Justice Valihura highlighted the creeping scope of such waivers, noting that the NVCA's newest forms cover waivers of not just appraisal rights, but inspection rights under Section 220 of the DGCL and the right to bring post-closing claims for breach of fiduciary duties in the merger context.

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