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Delaware Court of Chancery Holds that Minority Stockholders Did Not Waive Appraisal Rights in a Merger Where the Company Failed to Properly Exercise Drag-Along Rights

In *Halpin v. Riverstone National, Inc.*, a controlling stockholder caused the company to complete a merger, but did so without exercising drag-along rights that would have compelled the minority stockholders to vote in favor of the merger and thereby waive their statutory rights to judicial appraisal. After receiving notification of the merger, the minority stockholders filed an action for statutory appraisal of their shares, and in response the company sought an order requiring the minority stockholders to vote in favor of the merger so that the company could avail itself of the benefits of the drag-along rights. The Delaware Court of Chancery held that because the company failed to properly exercise its drag-along rights in advance of the merger, the minority stockholders were not required to vote in favor of the merger and thus could pursue their appraisal rights.

In *Halpin*, the minority stockholders entered into a stockholders agreement with the company that provided the company with drag-along rights in a change-of-control transaction, including the right to compel the minority stockholders to vote in favor of certain change-of-control transactions. After the minority stockholders initiated unrelated litigation associated with alleged breach of fiduciary duties against the company, the company informed them that it had completed a cash-out merger with the consent of the majority stockholder and was exercising its drag-along rights provided for in the stockholders agreement to require the minority stockholders to approve the merger agreement by executing and delivering a written consent within 10 days. The letter noted that although the minority stockholders could be entitled to exercise their appraisal rights under the Delaware General Corporation Law, such rights would be relinquished by executing the written consent and that if the minority stockholders did not exercise the written consent, they would then be in breach of the stockholders agreement.

After receiving the letter from the company, the minority stockholders dropped their prior litigation and filed an action for judicial appraisal of their shares in the Court of Chancery. The company brought counterclaims seeking specific performance of the drag-along, which would cause the minority stockholders to execute the written consent and accept the merger consideration, thereby relinquishing their appraisal rights. On cross motions for summary judgment, the court held:

- *The company was not entitled to an order compelling the minority stockholders to vote in favor of the merger and accept the merger consideration because it failed to properly exercise the drag-along right – The drag-along right provided that the minority stockholders would, upon advance notice, tender into or vote in favor of a merger that had been proposed, not a merger that had been completed. The court stated that: “[T]he literal language of the Drag-Along does not include the power to require the Minority Stockholders to consent to a transaction that has already taken place.”*

- *Although a properly exercised drag-along would have caused the minority stockholders to lose their statutory appraisal rights, the drag-along did not contain an explicit waiver of such rights and thus did not entitle the Company to a judgment preventing the exercise of that right* – The company argued that the only purpose of the drag-along rights was to waive the minority stockholders' statutory appraisal rights. The court rejected this argument, holding that "because the Company would have gotten result X had it exercised its rights does not mean the Company is entitled to result X when it failed to exercise those rights." The minority stockholders, thus, were entitled to pursue their action for statutory appraisal of their shares.

Of note, the court declined to address the question of whether common stockholders, unlike preferred stockholders, of Delaware corporations can ex ante waive the right to seek statutory appraisal by contract as a matter of law. The court assumed that even if a stockholder may waive its appraisal rights, in this instance they had not done so. We view this case as a helpful reminder that companies and stockholders alike should review and consider exercising, as appropriate, their pre-negotiated drag-along rights, which may facilitate change-in-control transactions and avoid the type of litigation that occurred in *Halpin*.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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