Waiver of Appraisal Rights Upheld by Split Delaware Supreme Court

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In *Manti Holdings, LLC v. Authentix Acquisition Co., Inc.*, the Delaware Supreme Court affirmed the Court of Chancery's decision to enforce a waiver of appraisal rights included in a stockholders agreement executed by "sophisticated parties" who owned 100% of the company.[1]

This 4-1 decision reinforces Delaware's longstanding public policy favoring private ordering, but has resulted in speculation (including from the strong dissent in the case) about what rights under the Delaware General Corporation Law (DGCL) are truly non-waivable. Delaware corporations, investors and practitioners should pay close attention to *Manti*'s guidance on contractual waiver of statutory rights.

Background

In connection with a 2008 transaction, Authentix Acquisition Company, Inc. (Authentix) entered a stockholders agreement with all holders of its shares (Stockholders Agreement), which provided that the common stockholders would "refrain from the exercise of appraisal rights with respect to [a board and controller approved] transaction" (Refrain Obligation).

In 2017, a third-party acquired Authentix. Under the merger agreement, the petitioners' stock was canceled and converted into a right to receive merger consideration, which, for common stock, was little to no compensation. The petitioner-stockholders sent timely appraisal demands to Authentix, which reminded the stockholders of the Refrain Obligation and requested withdrawal of the demands. The petitioners refused and filed an appraisal petition in the Court of Chancery.

The Court of Chancery granted summary judgment for Authentix and, in a case of first impression, held that Authentix stockholders waived their appraisal rights by consenting to the Stockholders Agreement and that such appraisal waiver was valid under Delaware law.

The Majority Opinion

On appeal, petitioners argued that (i) they did not waive their appraisal rights in connection with the 2017 merger, and (ii) even if they did, Delaware law prohibited enforcement of the Refrain Obligation.

Contractual arguments

In rejecting petitioners' contractual arguments, the Delaware Supreme Court held that, by signing the Stockholders Agreement, petitioners agreed to a clear and unambiguous waiver of their appraisal rights under the facts presented.

Among other reasons, petitioners argued that they were entitled to pursue their appraisal claims after consummation of the sale of Authentix because the Stockholders Agreement automatically terminated all obligations, including the Refrain Obligation, upon such a sale. Petitioners also argued that the use of the word "refrain" rather than "waive" in

[1] — A.3d —, 2021 WL 4165159 (Del. Sept. 13, 2021).

the Refrain Obligation demonstrated that petitioners did not agree to permanently relinquish their appraisal rights.

The majority found that petitioners' reading of the Stockholders Agreement was "commercially unreasonable" because stockholders could "only 'commence an appraisal proceeding'" after the sale of Authentix closed and the "clear purpose of the Refrain Obligation" was to prevent stockholders from "obtain[ing] a judicial appraisal *after* a Company Sale had closed."

The majority also refused to credit petitioners' attempt to distinguish between an agreement to "refrain" from exercising appraisal rights and an agreement to "waive" those rights, even though both terms were used in various provisions of the Stockholders Agreement. Specifically, the majority concluded that, while the Refrain Obligation used the word "refrain" rather than "waive" with respect to appraisal rights, that was because the Authentix stockholders did not agree under the Stockholders Agreement to completely "relinquish their appraisal rights" in all potential scenarios. Instead, those stockholders "agreed 'to keep [themselves] from' exercising their appraisal rights" if certain conditions were satisfied. The majority held that the sale of Authentix satisfied those conditions.

Policy argument

The majority also held the Refrain Obligation enforceable as a matter of Delaware law and public policy. While the majority noted that "there are certain fundamental features of a corporation that are essential to that entity's identity and cannot be waived," it reiterated that the DGCL is a "broad and enabling statute" that allows for freedom of contract, including the waiver of "mandatory rights," and that "the individual right of a stockholder to seek judicial appraisal is not among those fundamental features that cannot be waived."

In support of its holding, the majority observed that certain provisions of the DGCL contain express prohibitions against waiver but the appraisal statute does not contain similar language. The majority also noted that the waiver conferred a benefit to the corporation and its stockholders by making Authentix a more attractive acquisition candidate. Thus, while stating that "there are contexts where an *ex ante* waiver of appraisal rights would be unenforceable for public policy reasons," the majority held that "sophisticated and informed stockholders, who were represented by counsel and had bargaining power," could preemptively relinquish their appraisal rights for "valuable consideration," and held that such waiver did not contravene Delaware public policy.[2]

The Dissenting Opinion

In a lengthy dissent, one member of the court expressed the view that appraisal rights are one of the DGCL's mandatory provisions and should not be waivable. In addition, the dissent stated that even if such a waiver were permitted, there was none here under the plain language of the Stockholders Agreement – or, at the very least, the language was ambiguous and should be construed in favor of the petitioners.

Like the majority, the dissent stressed the presence of "sophisticated parties." Where sophisticated parties used both the term "waive" and "refrain" in the Stockholders Agreement, the dissent argued that the court should recognize the distinct "narrower" meaning of refrain and Authentix should have negotiated for a "savings clause"

[2] The majority also distinguished the Refrain Obligation from stock restrictions that must be included in a company's charter under Section 151(a). The majority held that the Stockholders Agreement imposed "personal obligations" on the stockholders, not "encumbrances on property rights that run with the stock." The Court emphasized that Authentix only attempted to enforce the Refrain Obligation against sophisticated and informed stockholders, who, represented by counsel, possessed bargaining power. The Court, however, expressed skepticism that such an agreement could bind successors.

continuing the Refrain Obligation beyond termination of the Stockholders Agreement. Further, the dissent expressed concern about the uncertainty the majority decision creates regarding the waivability of other so-called "mandatory" rights under the DGCL.

The dissent viewed the waiver of mandatory rights under the DGCL as an issue best determined by the Delaware legislature, not the Delaware courts, and said that, if such a waiver were to be permitted, it should be enshrined in a company's certificate of incorporation, not a stockholders agreement or a bylaw.

Noting that waiver provisions such as those in the Stockholders Agreement are common in start-up companies, the dissent questioned whether the majority was creating two classes of Delaware corporations: one (typically smaller, closely held corporations) with sophisticated stockholders who can waive mandatory rights and a second (typically larger, publicly traded corporations) that cannot enforce such a waiver against its stockholders.

Takeaways

- This case highlights the importance of careful drafting in stockholders agreements. The *Manti* majority held that the use of the term "refrain" in the Stockholder Agreement's Refrain Obligation provision unambiguously waived appraisal rights under the facts presented, but with another statutory right or slightly different language, the majority might have reached a different conclusion. Moreover, the dissent argued that the language was ambiguous as to whether the parties in *Manti* contracted for "refrain" to mean "waive."

- *Manti* does not provide a list of which DGCL sections the majority viewed as non-waivable "fundamental features of the corporate entity's identity." Thus, the full scope of permissible waivers of "mandatory rights," and the appropriate vehicle for such waivers, remains an open question.

- The majority's repeated emphasis on the presence of "sophisticated stockholders" and bargained-for restrictions may limit the scope of future attempts to enforce a waiver of the appraisal or other "mandatory" rights in different circumstances.

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