

July 21, 2009 | Posted By

DELAWARE SUPREME COURT HOLDS THAT MINORITY STOCKHOLDERS IN A SHORT FORM MERGER ARE ENTITLED TO "QUASI-APPRAISAL" REMEDY WHEN MATERIAL FACTS ARE NOT DISCLOSED

In [*Berger v. Pubco Corporation*](#), Case No. 509, 2009 WL 1976529 (Del. July 9, 2009), the Delaware Supreme Court held that minority stockholders are entitled to a "quasi-appraisal" remedy to recover the difference between the fair value of their shares and the merger price. The Court also held that these stockholders did not have to opt-in to the appraisal proceedings or to escrow proceeds received from the merger. The decision in *Berger* resolves an important question, previously unclear under Delaware law, regarding the nature and scope of the remedies available to minority stockholders who allege misconduct by directors in connection with short form mergers.

The case arose out of a going private transaction involving Pubco Corporation, a Delaware Corporation. Robert T. Kanner, Pubco's 90% stockholder, decided that he wanted to have 100% ownership of the company. Kanner formed a wholly-owned subsidiary, transferred his shares to the subsidiary and effected a short form merger under 8 *Del. C.* § 253. As a result of the merger, Pubco's minority stockholders were cashed out for \$20 per share, including plaintiff Barbara Berger.

Prior to the merger, Pubco sent a written notice to its stockholders indicating that Kanner was intending to effect a short form merger and that the stockholders were being cashed out. This notice included a very short description of the company, and nothing about the company's plans, prospects or operations. The notice lumped all of Pubco's financial statements together and gave no information about how Kanner arrived at the value of \$20 per share. An outdated version of the Delaware appraisal statute was also included with the notice. After the notice was sent to the stockholders, Berger initiated a class action lawsuit on behalf of all minority stockholders regardless of whether or not they demanded appraisal, to recover the difference between \$20 and the fair market value of the shares based on Pubco's violation of its duty to provide stockholders with material information.

The Court of Chancery determined that there had indeed been disclosure violations and that Berger and the other minority stockholders were entitled to a quasi-appraisal remedy. First, the court held that Pubco violated its disclosure requirements by including an outdated version of the appraisal statute and by not providing any rationale for setting the cash out price at \$20 per share. Second, the Court of Chancery held that the minority stockholders are entitled to a quasi-appraisal remedy if: (1) Pubco makes additional disclosures, (2) minority stockholders choose to opt into the action, (3) the appraisal is structured so that

stockholders escrow a portion of the merger consideration and (4) the shares are valued as of the date of the merger.

The plaintiffs appealed the opt-in and escrow requirements of the decision to the Delaware Supreme Court. On appeal, the Supreme Court held that a minority stockholder does not have to opt-in to the appraisal action or escrow a portion of the merger proceeds in order to be entitled to the quasi-appraisal remedy.

The Delaware Supreme Court considered four different alternatives for granting a minority stockholder a remedy where the controlling stockholder omits material facts in a short form merger. After considering the four alternatives, the court concluded that

The optimal alternative would be the remedy that best effectuates the policies underlying the short form merger statute, the appraisal statute, and the *Glassman [v. Unocal Exploration Corporation, 777 A.2d 242 (Del. 2001)]* decision, taking into account consideration of practicality of implementation and fairness to the litigants.

One alternative, which was not advanced by any of the parties but nonetheless considered by the Court, was to duplicate the precise sequence of events and requirements of the appraisal statute. In this alternative, stockholders would have to make a formal demand for appraisal and remit all their stock certificates and merger consideration to the corporation. The stockholders would receive this money back, plus or minus the difference between the merger value and the fair value of the stock, only if the corporation could not reach a settlement with the stockholders and the dissenting stockholders commenced a formal action. The court reasoned that this alternative would put an unfair burden on dissenting minority stockholders and therefore rejected it.

The second alternative the court considered was no remedial appraisal proceeding at all. This alternative was not advocated by either side either. Instead of an appraisal remedy, minority stockholders would be able to bring a class action for a breach of fiduciary duty and the failure to disclose material information would be determined under entire fairness review. This remedy would be based on long form merger remedies. The court found that this alternative would expressly go against the stated desires of the Court in *Glassman* to enable a minority stockholder to make an informed decision whether or not to seek appraisal and to limit the available remedies to appraisal.

The court also considered and rejected the Court of Chancery's alternative, which was to require the minority stockholders to opt-in to the appraisal action and escrow a portion of the merger consideration they

received. This form of quasi-appraisal was based on *Gilliland v. Motorola, Inc.*, 859 A.2d 80 (Del. Ch. 2004). The court in *Gilliland* formulated this quasi-appraisal remedy to mimic the statutory appraisal requirements yet eliminate the requirement that the minority stockholders return all of the proceeds to the corporation when making an appraisal demand. The Court held that the opt-in requirement in the Chancery Court's decision was a burden on the stockholders yet applied no less burden on the corporation than would an appraisal remedy that did not have such a requirement. The Supreme Court also held that the minority stockholders' escrow requirement was not necessary. The Court held that there is no law requiring the court to design a remedy based on the statutory remedy. However, in the long form merger statute context stockholders are entitled to retain their profits while pursuing a class action appraisal remedy. The Court reasoned that nothing justified forcing the minority stockholders to forfeit the merger profits in this context when allowed in the long form merger context.

The Supreme Court, based on consideration of utility and fairness, adopted the alternative suggested by the plaintiff that granted quasi-appraisal rights to the minority stockholders without any opt-in or escrow requirements. This alternative was similar to the one adopted by the Court of Chancery in *Nebel v. Southwest Bancorp., Inc.*, 1995 WL 405750 (Del. Ch. July 5, 1995). First, the Court reasoned that the opt-in requirement put an unnecessary burden on the defendant while relieving the corporation of no burden at all. Second, the Court saw no reason to require the stockholders to escrow their profits and therefore risk losing the consideration they received absent a legal requirement. Furthermore, controlling stockholders should be strictly bound by disclosure and should not be relieved of that duty by a minority stockholder's failure to abide by some technicality. This result was both the most practical to implement and the most fair to all parties involved.

This case is significant because it clears up a legal ambiguity under Delaware law related to short form mergers. Remedies for minority stockholders who were cashed out in a short form merger after insufficient disclosure had been previously unclear under Delaware law, as *Nebel* and *Gilliland* were somewhat contradictory.

Berger also has implications for companies engaging in short form mergers in Delaware. Under *Berger* parent corporations and controlling stockholders are advised to take extra precaution to ensure that their disclosures meet all statutory requirements. Statutory appraisal rights under Delaware law require that the minority stockholder would forsake its right to the merger consideration as part of its election of its appraisal remedy. However, the "quasi-appraisal" remedy in *Berger* allows minority stockholders in a short form merger who can plead misconduct to retain their merger consideration and pursue an action for additional consideration under an appraisal.

For further information, please contact [John Stigi](#) at (213)617-5589.