The Triumph of Private Ordering Since *Manti Holdings*

Delaware's courts and legislature have steadily expanded the ability of companies and stockholders to shape governance on their own terms, raising questions about flexibility and investor protection.

BY DOUG RAYMOND

As we celebrate the 50th anniversary of *Directors & Boards*, we will take a look back at articles written for the 45th anniversary of the publication, revisiting them to see how corporate governance has evolved in the last five years. In this edition, we explore "Advance Waivers of Dissenters' Rights," a piece originally written by Doug Raymond and Todd Schlitz.

Five years ago, the Legal Brief column addressed what at that time was a novel question under Delaware corporate law: Could stockholders agree, ahead of time, to give up their right to demand that a court authorize payment to them of the "fair value" of their shares if the company went through a merger at a price that these stockholders deemed inadequate. This right, known as "appraisal rights" or "dissenters' rights," allows stockholders to demand to be paid what they believe their shares are truly worth, instead of just accepting the price offered by the company in a merger. The possibility that minority stockholders may assert these claims inevitably creates risks for buyers, as it raises the possibility of expensive post-closing litigation and increasing the aggregate purchase price. For this reason, it was not unusual for companies to require minority investors to waive appraisal rights as a condition of investing. However, at the time, it was unclear whether Delaware law allowed this kind of waiver, especially since the Delaware General Corporation Law (DGCL) has many protections for stockholders that, at the time, were widely seen as mandatory.

That question was decided in the affirmative by the Delaware Supreme Court in the case of *Manti Holdings LLC et al v. Authentix Acquisition Company Inc.* (*Manti Holdings*), which turned out to be a harbinger of things to come. *Manti Holdings* addressed whether the DGCL prohibits Delaware corporations from enforcing advance waivers by stockholders of appraisal rights. The court agreed that, in many areas, the DGCL sets forth mandatory provisions intended to protect the interests of common stockholders, which cannot be modified or waived. However, after extensive analysis, the court ultimately concluded that the 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." In reaching its decision, the court noted,

"The DGCL is a broad enabling act that allows for immense freedom for businesses to adopt the most appropriate terms for the organization, finance and governance of their enterprise."

The fundamental issue this decision revisited was the balance between those rules that the owners can set within their own discretion, even if inconsistent with otherwise applicable provisions of the DGCL, and those rules that apply to all Delaware corporations regardless of the desires of the owners. In *Manti Holdings*, the Delaware Supreme Court concluded that, at least in the case of "sophisticated and informed stockholders," their ability to waive their right to assert appraisal rights falls on the "private ordering" side of the equation, despite no real indication in the language of the statute that this right could be waived long in advance of any transaction triggering them.

In the five years since *Manti Holdings* was decided, this balance has been repeatedly revisited against a backdrop of challenges to the long-standing primacy of Delaware as the jurisdiction of choice for corporate formation. Following some controversy and confusion, it is now fairly clear that, at present, this balance has been moved to further permit "businesses to adopt the most appropriate terms for the organization, finance and governance of their enterprise," apparently regardless of the sophistication of investors. Over this same period, Texas and Nevada have become significantly more visible as hospitable venues for corporations, particularly for corporations that sought to protect controlling or significant stockholders from challenges to transactions with the controlled entity. Most notably, Tesla announced it would reincorporate from Delaware to Texas shortly after the Chancery Court concluded that a $55 billion compensation package to its CEO, Elon Musk, was not valid because it had not been properly approved by the Tesla board in compliance with Delaware requirements for approving transactions with controlling stockholders, and that this fatally infected the stockholder approval of the pay package. Coinbase, Dropbox, Roblox, Tripadvisor and others also left Delaware. The publicity around these exits focused attention on whether Delaware had become inhospitable to business, particularly businesses with a controlling or significant stockholder.

Then, just weeks after the decision invalidating the Tesla CEO compensation package, the Chancery Court struck down several provisions in a long-standing stockholder agreement that gave a controlling stockholder the right to approve or at least veto a wide range of corporate actions. This had been challenged as an impermissible abrogation by the board of its obligation under Delaware law that the corporation be managed "by or under the direction of a board of directors, except as may be otherwise provided . . . in its certificate of incorporation." In the words of the Chancery Court in *W. Palm Beach Firefighters' Pension Fund v. Moelis & Co.*, the extensive approval rights granted in the case to its controlling

stockholder encompassed "…virtually everything the board can do" and diminished the board's role to merely an "advisory body" with the controller "running the show."

The *Moelis* decision caused consternation among some corporate lawyers who had implemented similar structures for other companies, even though, as the court pointed out, a roughly equivalent result could have been obtained by including such provisions in the corporation's certificate of incorporation (but which, unlike the stockholders' agreement, would have been publicly available and would require stockholder approval to adopt to modify). The issues raised by these cases boiled over into the general press, where the usually arcane topic of corporate governance gave rise to articles about whether the Delaware courts had become too unpredictable and hostile to business interests. The controlling stockholder appealed his loss to the Delaware Supreme Court. However, before the court could act, the Delaware legislature, urged on by business interests and the state's corporate bar, swung into action and adopted new legislation to reverse the result in *Moelis* and allow for these sorts of delegations to validly be included in stockholder agreements. At the same time, the legislation provided new safe harbors for transactions between controlling stockholders and the corporation that might have supported upholding the challenged compensation in the Tesla case. In addition, it also adopted a bright-line arithmetic test for identifying when a controlling stockholder exists — control of least 33⅓ percent of the voting power of the corporation's issued and outstanding shares plus managerial authority equivalent to a majority owner. This undercut case law that had developed investigating the messier and more subtle social and financial relationships between a large stockholder and the board that can influence behavior.

These and other changes to the DGCL that were adopted at the same time occurred against the backdrop of controversy over the public policy implications for Delaware in its rush to overturn the *Moelis* decision even before the Delaware Supreme Court had been given the chance to weigh in, but also over whether these changes were tilting the balance too far in favor of letting the owners, and especially significant stockholders, write their own deal with minimal judicial oversight. The speed at which the legislature moved was possibly influenced by the roughly 25-to-30% share of the Delaware state budget that is funded by corporate franchise taxes and fees and the publicity accompanying the high-profile relocations of some very visible corporations from Delaware to other jurisdictions.

Moreover, as it turns out, when the Delaware Supreme Court finally had the chance to address the *Moelis* decision on delegation by the board through a stockholder agreement, it overturned the Chancery Court on a fairly narrow ground (specifically, that the plaintiffs had waited too long to complain about the long-standing stockholder agreements) and upheld the agreement. (In a quirk of the new amendments, they did not apply to pending cases, so, although the *Moelis* case was the match that set off the firestorm, the amendments did not apply to it.)

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So, five years after *Manti Holdings*, the balance in favor of private ordering has moved considerably. *Manti Holdings* marked the beginning of a broader movement toward private ordering, giving corporations, boards and stockholders more freedom to structure their internal affairs and governance with reduced risk of judicial interference. Subsequent legal controversies, high-profile corporate departures and rapid legislative responses, especially following the *Moelis* decision, underscored Delaware's commitment to maintaining its status as a premier venue for corporate formation by adapting its laws to meet the evolving business needs of its corporate constituencies. The broader public policy implications of these shifts — whether they favor business interests too heavily at the expense of minority stockholder protections — remain unresolved and will likely continue to be a subject of scrutiny and debate in the years ahead. ■

***Doug Raymond** is a partner at Faegre Drinker Biddle & Reath LLP (www.faegredrinker.com). He can be reached at douglas.raymond@faegredrinker.com.*