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Cash/Stock Election Mergers: Recent Noteworthy Delaware Decisions

In certain merger transactions, the merger agreement provides the stockholders of the target corporation with the ability to elect the form of consideration (*e.g.*, stock, cash, or a mix of stock and cash) that each stockholder would prefer to receive in exchange for the conversion of their shares in the merger. Such merger transactions take a variety of forms and may provide, among other things, for caps on the amount of one or more forms of the merger consideration that may be elected, resulting in the *pro rata* allocation of merger consideration to certain holders if one form of the merger consideration is over- or under-subscribed. In some cases, the merger agreement does not limit the amount of either form of consideration that may be distributed, and thus the stockholders are entitled to receive their preferred form of merger consideration in full, regardless of the election choices made by other stockholders. In all events, however, merger agreements in such transactions necessarily provide for a default form of consideration payable to stockholders who fail to return their election forms indicating their merger consideration preference.

Merger transactions providing stockholders with the right to elect the form of their consideration raise certain unique issues under Delaware law, including issues with respect to the mechanics of the election process and appraisal rights. Two recent decisions of the Delaware courts provide guidance to M&A practitioners in this context. In *Amirsaleh v. Board of Trade of the City of New York, Inc.,*[1] the Delaware Supreme Court considered the merging corporations' refusal to accept an election form delivered after both the initial election deadline and a subsequent acceptance period, concluding that the late election form must be accepted because the merging corporations had not provided sufficient notice of a retraction of the contractual waiver of the initial election deadline. In *Krieger v. Wesco Financial Corporation*,[2] the Delaware Court of Chancery considered whether a cash/stock election merger triggered appraisal rights under Delaware law. The Court concluded that no appraisal rights were triggered where the merger agreement provided stockholders of a public target corporation with the uncapped right to elect consideration in the form of publicly listed securities, even though stockholders who did not make an election would receive cash in the merger by default. Each of those decisions is discussed below.

1 27 A.3d 522 (Del. 2011).

2 2011 WL 4916910 (Del. Ch. Oct. 13, 2011).

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Michael A. Pittenger and **Michael K. Reilly** are partners in the Wilmington, Delaware law firm of Potter Anderson & Corroon LLP.
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1313 North Market Street

P.O. Box 951

Wilmington, DE 19899-0951

(302) 984-6000

www.potteranderson.com

Retraction of Election Deadline Waiver

In *Amirsaleh v. Board of Trade of the City of New York, Inc.*, the Delaware Supreme Court, in an *en banc* opinion, reversed the Court of Chancery's post-trial decision and remanded, finding that a party to a merger agreement failed to provide the reasonable notice that was required to retract a waiver of a deadline for the delivery of merger consideration election forms.

The transaction at issue in *Amirsaleh* involved the acquisition of the Board of Trade of the City of New York, Inc. ("NYBOT") by Intercontinental Exchange, Inc. ("ICE" and, collectively with NYBOT, "Defendants"). The Agreement and Plan of Merger (the "Merger Agreement") provided that NYBOT would be merged with and into a wholly owned subsidiary of ICE (the "Merger"). Pursuant to the Merger Agreement, each NYBOT membership interest would be converted into either newly issued shares of ICE stock or cash, or a combination of stock and cash. The Merger Agreement provided that each NYBOT member could elect the form of consideration (*e.g.*, stock, cash, or a mix of stock and cash) that the member preferred to receive by submitting an election form (the "Election Form") by a specified date (the "Election Deadline"). The Merger Agreement capped the total amounts of cash and stock that ICE would pay in connection with the Merger and provided for *pro rata* allocation if either consideration was over-subscribed. If a member failed to submit the Election Form specifying the consideration the member wished to receive by the Election Deadline, the member would automatically receive the undersubscribed form of consideration. Any NYBOT member who wished to retain rights to trade on the NYBOT exchange after the Merger was required to own a certain number of shares of ICE stock and pledge the shares in accordance with a membership and pledge agreement. Members wishing to retain trading rights were, therefore, likely to choose at least an adequate amount of stock consideration for pledging purposes in connection with the merger.

Approximately two months after ICE filed the Merger Agreement with the Securities and Exchange Commission, the Defendants filed a definitive joint proxy statement and prospectus (the "Proxy") with the SEC and mailed copies to all NYBOT members. The Proxy notified the NYBOT members that the Election Form with notice of the exact Election Deadline date would follow in a subsequent mailing. The Election Forms were mailed to NYBOT members on December 19, 2006. Plaintiff Mahyar Amirsaleh ("Amirsaleh"), who owned two membership interests in NYBOT, each of which carried the right to trade on NYBOT's exchange, alleged that he did not receive a copy of the Election Form mailed on that date. The Election Forms provided that the Election Deadline was January 5, 2007.

After the Election Deadline, the Defendants learned that some NYBOT members had not submitted Election Forms. On January 17, 2007, five days after the Merger closed and after receiving a number of late Election Forms from NYBOT members, the Defendants decided to accept the late Election Forms received to date and to reach out to the remaining NYBOT members who had not submitted forms in attempts to prompt them to do so. Through these actions, ICE intended to accommodate as many late Election Forms as possible, but there was a limited period of time available to process the forms and calculate, allocate, and process the merger consideration because the Merger Agreement contractually obligated ICE to distribute the merger consideration within ten business days of the Merger's closing.

NYBOT Member Services immediately attempted to contact by telephone every NYBOT member who had not yet submitted Election Forms. On January 17 and again on the following morning, Member Services called and left messages for Amirsaleh. After Amirsaleh's executive assistant returned the calls, Member Services sent an extra copy of the Election Form to Amirsaleh by email, which stated that, although Member Services could not guarantee acceptance of the late form, Amirsaleh needed to fax a copy of the attached Election Form "[i]n the attempt to save [his] Memberships."[3] Late that same evening or the following morning, Defendants determined they could no longer accept late elections because further delaying finalization of the allocation and distribution process would unduly risk jeopardizing the contractual deadline for distributing merger consideration.

In the afternoon of the next day, Amirsaleh faxed his Election Form electing to receive 100% stock for his NYBOT membership interests. Amirsaleh's submission was deemed untimely. Because the stock component of the merger consideration was over-subscribed, Amirsaleh did not receive any shares of ICE stock for his membership interests. Amirsaleh declined to purchase shares in the market for purposes of pledging them and, consequently failed to pledge the requisite number of ICE shares and lost his NYBOT trading rights.

Amirsaleh commenced an action, seeking an order requiring the Defendants to honor his stock election and reinstate his trading rights. The Court of Chancery issued three memorandum opinions. In those opinions, the Court (i) dismissed Amirsaleh's claims that the Defendants breached the Merger Agreement by not mailing an Election Form to him and allowed only that he pursue a claim for breach of the implied covenant of good faith and fair dealing in connection with Defendants' failure to accept his Election Form despite their limited acceptance of late elections, (ii) denied Amirsaleh's motion for summary judgment on an implied covenant of good faith and fair dealing claim, and (iii) after trial, concluded that the Defendants made a good faith attempt to accommodate all NYBOT members who had not submitted Election Forms by the Election Deadline, thereby fully discharging their implied contractual duties under the Merger Agreement.

Reviewing the Court of Chancery's conclusions of law *de novo*, the Supreme Court determined the case was best decided based on the waiver doctrine, which the parties had not addressed at trial or on appeal, and not on the grounds of the implied covenant of good faith and fair dealing. The Court addressed the three elements necessary to invoke the waiver doctrine: "(1) that there is a requirement or condition capable of being waived, (2) that the waiving party knows of that requirement or condition, and (3) that the waiving party intends to waive that requirement or condition."[4] The Court held that each of those elements was satisfied and thus the Defendants waived the initial Election Deadline.

After determining that the Defendants waived the Election Deadline, the Court concluded that the Defendants did not validly retract the waiver before Amirsaleh submitted his election form. Prior to the time that a non-waiving party suffers prejudice or materially changes its position, a waiving party may retract the waiver by giving reasonable notice to the non-waiving party.[5] The Court determined that the Defendants failed to provide reasonable notice sufficient to retract the waiver. According to the Court, NYBOT Member Services' warning that it could not guarantee that Amirsaleh's Election Form would be accepted did not retract

3 27 A.3d at 526.

4 *Id.* at 530.

5 Importantly, the Court stated that a waiving party typically may not retract a waiver if the non-waiving party has suffered prejudice or has relied on the waiver to his detriment. *Id.*

the waiver because the Defendants did not give Amirsaleh, or any other NYBOT member, reasonable notice of a new election deadline. The Court also found that Amirsaleh suffered the prejudice of losing his trading rights as a result of the manner in which Defendants determined to accept late elections, to contact members who had not submitted elections, and to cut off the acceptance of late elections. The Court held that, because the waiver retraction was invalid as a matter of law, Amirsaleh submitted his Election Form on time and the Defendants must honor it.

Several lessons may be drawn from the Delaware Supreme Court's decision in *Amirsaleh*:

- Contracting parties are now on notice that, under Delaware law, there is a requirement to provide reasonable notice for the retraction of any waiver of contractual rights (regardless of whether the issue arises in the merger context). Anytime that a contracting party is considering a waiver of a contractual right, such party should give thought to whether a retraction of the waiver would later be possible and/or potentially desired. If so, the waiving party should be prepared to make a proper retraction of the waiver by providing reasonable notice (if the non-waiving party has not yet suffered prejudice or materially changed it position following the waiver).

- The facts of *Amirsaleh* are unique given the trial court's findings (undisturbed on appeal) that the merging corporations had acted in good faith to keep the window for acceptance open as long as possible (rather than setting a specific deadline) so that as many as possible would have an opportunity to correct their earlier failure to submit a timely election form and thus prevent the loss of their trading privileges as members of NYBOT. While most cash/stock election mergers are not likely to involve situations in which the stockholders are also the corporation's customers, thus giving rise to the need for as many stockholders as possible to elect a particular form of merger consideration so that they can remain customers, it can still be assumed that many target corporations engaging in cash/stock election mergers will wish to facilitate an opportunity for as many stockholders as possible to make their election. Because a later decision to waive an original election deadline – even where made in good faith to accommodate stockholders who failed to meet the original deadline – may be fraught with peril and risk exposing the merging corporations to later monetary liability to any stockholder who still fails to make an election, corporations should waive election deadlines only in unusual circumstances and after careful deliberation and planning. Accordingly, target corporations wishing to facilitate elections by as many stockholders as possible should assume that a waiver or postponement of the election deadline will be unlikely and, instead, seek to ensure sufficient time between the date of the mailing of the election form and the predetermined election deadline. In addition, the target corporation should consider follow-up efforts that might be needed (if any) to ensure responsiveness to the original election deadline. Of course, the deadline timeframes and stockholder outreach efforts (if any) will depend largely on the unique facts and circumstances of each particular merger transaction (*e.g.*, the stockholder composition, business and practical factors relating to the time of closing the merger, etc.).

- If the merging corporations find themselves in the position of considering a waiver of an election deadline, they should do so only after careful consideration of the potential consequences and careful planning in connection with any extended acceptance period. In particular, it appears necessary that the corporations set and effectively communicate to all stockholders a specific new election deadline, even if accepting elections as long as feasible and determining the cut-off "in the moment" might facilitate providing more stockholders an opportunity to correct their earlier failure to make a timely election. Simply waiving the deadline and making calls and follow-up calls to stockholders on an individual basis to facilitate the delivery of the election forms for as long as possible (as NYBOT did) likely will not be enough. Rather, the target corporation should provide very clear and written notice of all aspects of the waiver and the new election deadline, even if that means appearing more rigid and less concerned about stockholder interests.

Appraisal Rights in Cash/Stock Election Mergers

In *Krieger v. Wesco Financial Corporation*, the Delaware Court of Chancery granted defendants' cross-motion for partial summary judgment, finding that the holders of Wesco Financial Corp. ("Wesco") common stock were not entitled to appraisal rights because they were not required pursuant to the terms of the merger agreement at issue to accept a form of merger consideration triggering appraisal rights under Section 262 of the General Corporation Law of the State of Delaware (the "DGCL").

At issue in the case was the consummation by Wesco of a forward triangular merger with its parent company Berkshire Hathaway Inc. ("Berkshire") and Montana Acquisitions, LLC, a Berkshire subsidiary. Before the merger, Berkshire indirectly owned 80.1% of Wesco's outstanding common stock.

Under the terms of the merger agreement, the minority stockholders of Wesco could elect to have their shares converted into the right to receive (i) $385 per share in cash, (ii) an equivalent value in publicly traded shares of Berkshire Class B common stock, or (iii) a combination of cash and publicly traded shares. The merger agreement specified that stockholders who failed to make an election would receive cash. Importantly, the number of stockholders who could elect to receive shares of Berkshire Class B common stock was not capped, subject to proration, or otherwise restricted.

In analyzing the parties' claims, the Court first determined that the common stock of Wesco fell within the "market-out" exception contained in Section 262(b)(1) of the DGCL by virtue of Wesco's listing on a national securities exchange. The Court then discussed the "exception to the exception" language contained in Section 262(b)(2) of the DGCL, which restores appraisal rights to stock otherwise covered by the market-out exception if holders are "required by the terms of an agreement of merger or consolidation" to accept certain types of consideration excluding, among other categories, shares of stock listed on a national securities exchange, cash in lieu of fractional shares, and any combination of shares of stock and cash in lieu of fractional shares.[6]

Noting that, under the terms of the merger agreement, holders of Wesco common stock were not "'required' to accept appraisal-triggering consideration,"[7] and reaffirming the ability of holders of Wesco common stock to elect to receive Berkshire Class B common stock if they so chose, the Court criticized plaintiff's focus on individual Wesco stockholders, stating as follows: "The General Corporation Law in fact makes appraisal rights available on a transactional and class-wide (or series-wide) basis. Stockholders can choose individually

6 8 *Del. C.* § 262(b)(2).

7 *Wesco*, 2011 WL 4916910, at *3.

whether to perfect or pursue their appraisal rights, but the underlying statutory availability of appraisal rights is not a function of individual choice."[8]

The Court also dismissed plaintiff's argument that Wesco stockholders who wanted to vote against the merger had no choice but to elect cash consideration since the election deadline preceded the special meeting called by Wesco. The Court explained that the merger agreement did not condition a stockholder's ability to elect one form of consideration over another on whether such stockholder voted for or against the merger. The Court also expressed skepticism with respect to plaintiff's contention that Wesco's stockholders were "coerced" into failing to make an election with respect to the form of merger consideration in light of language contained in Wesco's proxy statement indicating that Wesco "reserves the right to take the position that appraisal ... may not be exercised with respect to any shares as to which cash was elected or stock was received."[9] Characterizing the proxy disclosure as "erroneous," and noting that a misleading disclosure may, under certain circumstances, trigger the quasi–appraisal remedy analyzed in *Berger v. Pubco Corporation*,[10] the Court nonetheless found that since holders of Wesco common stock were not entitled to appraisal rights, the flawed proxy disclosure neither misled nor harmed Wesco's stockholders.[11]

Turning to plaintiff's argument that the proxy statement "equivocated" with respect to the availability of appraisal rights, the Court held that the proxy statement appropriately disclosed Wesco's view with respect to an unsettled question of law, as well as plaintiff's contrary view of the law once litigation proceedings commenced.[12] The Court concluded that disclosures contained in the proxy statement with respect to plaintiff and defendants' view of the availability of appraisal rights were therefore "accurate and complete."[13]

Several lessons may be drawn from the Delaware Court of Chancery's decision in *Wesco*:

- Practitioners should be mindful of the possible availability of Delaware appraisal rights in cash/stock election merger transactions. Appraisal rights might not be triggered in connection with a merger of a public target corporation, even where the stockholders receive, by default, cash in the merger, so long as the stockholders are not "required" to receive cash and can elect to receive publicly listed securities. In any cash/stock election merger, practitioners should evaluate whether appraisal rights could be triggered due to the presence of caps on the merger consideration and the consequent proration of consideration, such that even holders who elect stock consideration could be "required" to accept some cash.

- The Court found that the availability of appraisal rights is determined on a class-wide basis and not on an individual basis. The Court did not address, however, the application of that principle in disparate treatment mergers where certain holders receive cash in a merger, while other holders of the same class receive stock (or, perhaps more interestingly, where certain holders receive publicly listed securities, while other holders

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8 *Id.* at *4.

9 *Id.* at *5.

10 976 A.2d 132 (Del. 2009).

11 *Wesco*, 2011 WL 4916910, at *5.

12 *Id.*

13 *Id.*

of the same class receive non-publicly listed securities). Although such transactions are less common, the Court's conclusion both provides guidance and gives rise to uncertainty in such circumstances. Although each situation would need to be analyzed to determine the likelihood of triggering appraisal rights in any given situation, whether the holders receiving the form of consideration that would otherwise trigger appraisal rights have agreed to such treatment (and thus were not "required" to receive such consideration) could be relevant to determining whether appraisal rights are available.

- There was some confusion as to the availability of appraisal rights in *Wesco* given the arguably equivocal language in the proxy statement. Although the law may have been unclear at the time the proxy statement was drafted, thus creating the reason for the company's inability to provide more certain guidance on the availability of appraisal rights, practitioners should now be comfortable providing clear guidance on appraisal rights for transactions structured like the merger in *Wesco*.

- Practitioners sometimes find it necessary to draft disclosures taking positions on unsettled areas of the law. The Court's decision provides further comfort for practitioners finding themselves in that situation, as it confirms that it remains appropriate for proxy statement disclosures to describe the company's view on an unsettled area of the law so long as the disclosure is accurate and complete.

Conclusion

When structuring cash/stock election mergers, practitioners should be mindful of the reasoning of both *Amirsaleh* and *Wesco*. Although the relevant facts underlying a particular merger transaction will dictate the applicability of the holdings and reasoning of those cases in any particular circumstance, practitioners may now take guidance from these cases in connection with the fixing (and possible waiver) of election deadlines and as to the determination of whether appraisal rights apply to a particular cash/stock election merger transaction.