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Corporate Governance Group
Client Alert

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DELAWARE COURT DENIES APPRAISAL RIGHTS TO STOCKHOLDERS IN CASH ELECTION MERGER

Statutory appraisal rights not available to stockholders who fail to make timely election and are therefore required to accept cash

In *Krieger v. Wesco Financial Corp.*,[1] the Delaware Court of Chancery recently ruled that public company stockholders who are given a choice of electing cash or stock in a merger, but are required to accept cash if they fail to make a timely election, are *not* entitled to assert appraisal rights under § 262 of the Delaware General Corporation Law (the "DGCL").

Background

Wesco Financial Corporation, which operates in the insurance, furniture rental and steel service center businesses, was indirectly 80.1%-owned by Berkshire Hathaway Inc. The remainder of Wesco's shares were publicly traded on NYSE Amex.

In February 2011, Berkshire Hathaway agreed to acquire the publicly held minority shares in a merger transaction. Under the terms of the merger agreement, Wesco's minority stockholders were given the option to elect to exchange their Wesco shares for either (i) cash at a price of $385 per share, (ii) "an equivalent value in publicly traded shares of Berkshire Class B common stock" or (iii) a combination of the foregoing. Election forms were due two days prior to the special meeting held to consider the merger. Stockholders who failed to make a timely election were required to accept cash for their shares. The merger proxy statement sent to Wesco minority stockholders disclosed that they would not be entitled to appraisal rights under DGCL § 262.

On February 8, 2011, the day after the merger announcement, Joel Krieger, the owner of 10 Wesco shares, brought suit against Wesco in the Delaware Court

[1] 2011 WL 4840686 (Del.Ch. 2011).

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of Chancery and moved for a preliminary injunction on the ground that (i) Wesco stockholders were denied appraisal rights and (ii) "the disclosures regarding appraisal rights in the proxy statement were false and misleading." The Court refused to enjoin the merger, and the parties cross-moved for partial summary judgment on the availability of statutory appraisal rights.

Subsequently, prior to the special meeting, holders of 539,613 Wesco shares elected to receive cash, holders of 624,921 Wesco shares elected to receive Berkshire Hathaway stock and holders of 232,356 Wesco shares failed to make an election. The merger was approved at the special meeting. No Wesco stockholder demanded an appraisal.

The Court's Analysis

The Court began its analysis by explaining the structure of the appraisal rights statute. DGCL § 262(b) provides that appraisal rights "shall be available for the shares of any class or series of stock of a constituent corporation in a merger or consolidation to be effected pursuant to" various enumerated sections of the DGCL, including the section governing the Wesco merger. DGCL § 262(b)(1) contains a "market-out" exception which provides that appraisal rights are not available "for the shares of any class or series of stock, which stock … were … listed on a national securities exchange …."

DGCL § 262(b)(2), however, contains an "exception to the exception," which restores appraisal rights to a class or series of stock otherwise covered by the "market-out exception" if its holders are required to accept anything in the merger other than "shares of stock … listed on a national securities exchange" and/or "[c]ash in lieu of fractional shares …." Krieger argued that Wesco stockholders were entitled to appraisal rights by virtue of this "exception to the exception" because stockholders who failed to make a timely election were required to accept cash.

In response to this argument, the Court pointed out that "holders of … Wesco common stock were not 'required' to accept any type of consideration that would restore appraisal rights under the 'exception to the exception.'" Rather, they were given three options, two of which included stock of Berkshire Hathaway listed on a national securities exchange. Moreover, Berkshire Hathaway placed no cap on the number of shares it would issue in the merger so, if they so elected, the minority stockholders could elect to receive 100% of the merger consideration in publicly traded Berkshire Hathaway stock.

Krieger, however, focused on the individual Wesco stockholders who failed to make an election and thus, by default, received cash for their shares. Krieger argued that "this 'select group of Wesco shareholders' is being 'required' to accept cash and should receive appraisal rights." The Court rejected this approach, explaining that "the transactional triggering of appraisal rights does not turn on the elections of individual stockholders," but "rather depends on … the type of consideration that the merger requires the holders of the class or series of stock to receive …." The Court saw nothing in the merger agreement that could be construed to support a conclusion that any Wesco stockholder was "required" to accept cash.[2]

Krieger also complained that the proxy statement equivocated over the availability of appraisal rights. The Court disagreed, stating that "[t]he proxy statement accurately disclosed Wesco's correct belief that

[2] To drive his point home, Vice Chancellor Laster quoted Jean Paul Satre: "[W]hat is impossible is not to choose. I can always choose, but I must also realize that if I decide not to choose, that still constitutes a choice."

appraisal rights were not available. When disclosure is required about an unsettled question of law, a disclosure document can express the filer's view." In this instance, "[t]he defendants had strong statutory bases for concluding that appraisal rights were not available, but recognized the absence of specific decisional law on point." In the Court's opinion, the inclusion of this view did not render the proxy statement disclosures inaccurate or incomplete.

Conclusion

While the decision of the Court of Chancery in *Krieger v. Wesco Financial Corp.* is not particularly surprising, it does plug a potential loophole in DGCL § 262. As such, the decision will certainly be of comfort to dealmakers and their legal counsel.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Corporate Governance Group, whose names and contact information are provided below.

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