Delaware Law Weekly

July 22, 2009 • Volume 12, Number 29 $10.00 An incisivemedia publication

Burden Eased for Shareholders Seeking Remedy After Merger

By Elizabeth Bennett
Of the DLW

Minority shareholders who do not receive proper disclosure before a short-form merger are entitled to a quasi-appraisal remedy without having to opt in to a class, according to the Delaware Supreme Court in a ruling earlier this month.

The form an appraisal-type remedy should take in the circumstance of disclosure violations by a controlling shareholder was, the justices said, an issue of first impression in *Berger v. Pubco Corp.*, handed down July 9.

With this ruling, shareholders cashed out in a short-form merger now automatically become members of a class for the purposes of seeking a fair valuation in the event of such violations.

Justice Jack B. Jacobs wrote the opinion, which reversed a May 2008 decision from the Court of Chancery and remanded the matter for proceedings consistent with its opinion. The case was heard by the court en banc.

Presumably, the lower court will schedule a trial to determine the fair value of the shares.

The Chancery Court decision, written by Chancellor William B. Chandler, required the minority shareholders to opt-in to a class seeking a fair-value assessment. It also required them to escrow a portion of their merger proceeds pending the valuation.

These requirements led Barbara Berger, the plaintiff below, to appeal.

During oral arguments, Ronald A. Brown Jr. of Prickett Jones & Elliott in Wilmington, counsel for Berger, said that the remedy described by the trial court was "almost punitive" toward the would-be members of the class.

The Chancery Court found that one of the defendants, Robert H. Kanner, the president, sole director and controlling shareholder of Pubco Corp., committed disclosure violations in connection with a short form merger completed in 2007. This finding was not disputed on appeal.

Pursuant to 8 Delaware Code Section 253, short-form mergers do not require a shareholder vote and can only happen when one stockholder owns 90 percent or more of the shares, according to court documents. The section also says that minority shareholders have the right to seek appraisal.

Kanner did not provide enough information as to how he had arrived at the merger price of $20 per share, the Chancery Court opinion said. In addition, he had attached an out-of-date version of the appraisal statute to the notice he sent to the minority shareholders.

Under the 2001 Supreme Court case *Glassman v. Unocal Exploration Corp.*,

Burden *continues on page 4*

Delaware Law Becomes a Model for Recently Adopted Uniform Trust Act

By Elizabeth Bennett
Of the DLW

Members of the Uniform Law Commission from all 50 states voted to approve the Uniform Statutory Trust Entity Act on July 15, thereby creating a consistent law that can be adopted in all jurisdictions to govern the use of statutory trusts, a fast-growing form of commercial enterprise.

Nowhere has it grown faster than in Delaware, so it is not surprising that the "drafting committee was influenced primarily by the Delaware Statutory Trust Act," as it says in the USTEA's prefatory note.

The ULC, formerly known as the National Conference of Commissioners on Uniform State Laws, wrapped up six years of work with the vote last week. It formed the USTEA drafting committee in 2003.

Robert H. Sitkoff, a Harvard Law School professor and the reporter for the drafting committee, said the ULC began this work because an investigation had discovered a lot of confusion surrounding trusts, "coupled with the undeniable reality that they were used often for asset securitizations and mutual funds. The absence of law coupled with extraordinary commercial importance met the threshold to appoint a drafting committee."

Delaware was something of a pioneer in the area, having passed its own Statutory Trust Act in 1988. Since then, it has seen more trust formations by far than any other state.

According to the 2008 annual report from the Division of Corporations, released early this month, 3,868 statutory trusts

Trust Act *continues on page 4*

IN THIS ISSUE

Burden

Continued from page 1

shareholders are entitled to receive all the information material to their decision about whether to seek an appraisal. How the controlling shareholder arrived at a price qualified as material information, the Chancery Court said.

Pubco also had about $96 million in cash and liquid assets on hand, the Chancery Court opinion noted, and Berger wanted Pubco to explain why it was sitting on it and what it planned to do with this money. Berger's counsel noted during oral arguments that if these assets were taken into account, the merger price would be more like $36 per share.

The Chancery Court ruled that a "quasi-appraisal" was a suitable remedy because "in a short form merger, rescissory remedies (i.e., rescission or rescissory damages) are unavailable for disclosure violations, because under Section 253 a short-form merger becomes effective before any disclosures to the minority stockholders are made," as explained in the Supreme Court opinion.

Adopting a quote from its own 2004 decision in *Gilliland v. Motorola*, the Chancery Court said, "'This quasi-appraisal action should be structured to replicate a modicum of the risk that would inhere if this were an actual appraisal action, i.e., the risk that the Court will appraise [Pubco] at less than [$20] per share and the dissenting stockholders will receive less than the merger consideration.'"

The Chancery Court therefore ruled that shareholders had to opt-in to the valuation and escrow part of their mergers proceeds if they did.

The Supreme Court disagreed, stating that "considerations of utility and fairness" impelled it to overturn the opt-in and escrow requirements, and that the minority shareholders should not have to shoulder any kind of burden stemming from the disclosure violations.

During oral arguments there was some discussion of the standard of review. Brown, counsel for Berger, said the standard was de novo because when the trial court found that the case was governed by *Gilliland*, it was applying legal principles.

The court asked whether it was true that the Chancery Court could exercise its discretion to do whatever it needed to do "to arrive at a fair result."

Brown said no, because going forward the opt-in and escrow form of quasi appraisal will become the rule, "and it's wrong."

Allen M. Terrell Jr. of Richards Layton & Finger in Wilmington, counsel for the appellees, contended that the trial court had to use its discretion, "particularly since quasi-appraisal is somewhat of a nebulous term."

The Supreme Court came down on Brown's side, seemingly because the Chancery Court's decision had come in the form of summary judgment.

"[T]he appellant claims that the disputed remedy was erroneous as a matter of law, because the trial court erred 'in formulating or applying legal principles' and in granting summary judgment to the defendants. A claim of that kind is one that we review de novo," its opinion said.

After considering a number of potential remedies, the Supreme Court ruled that a quasi-appraisal with no opt-in requirement was the most equitable result.

Looking at it from the minority's standpoint, the opinion said, the opt-in requirement is potentially burdensome "because shareholders that fail either to opt in or to opt in within a prescribed time, forfeit the opportunity to seek an appraisal recovery. On the other hand, structuring the remedy as an 'opt out' class action avoids that risk of forfeiture, and thus benefits the minority shareholders."

Regarding the escrow requirement, the appellees argued that absent such a requirement, the minority shareholders "would have it both ways," the opinion said, keeping the merger proceeds while litigating to recover a higher amount at the same time.

The appellees described this as a "dual benefit" the shareholders would not have in an actual appraisal, the opinion said.

"It is true that the minority shareholders would enjoy that 'dual benefit.' But, does that make it inequitable from the fiduciary's standpoint? We think not," the opinion said. "No positive rule of law cited to us requires replicating the burdens imposed in an actual statutory appraisal." •

Trust Act

Continued from page 1

were formed in Delaware in 2006 and 4,449 were formed in 2007. In 2008, the number fell to 2,581, most likely because of the dire economy.

By way of comparison, in Connecticut, which adopted a trust law similar to Delaware's, there were 38 statutory trusts formed in 2008, according to reports from the secretary of state.

Now that there is a uniform law that can be easily adopted by many states, one might predict that statutory trusts would fan out across the country, taking some of that business away from Delaware, but Ellisa Opstbaum Habbart, a founding partner of The Delaware Counsel Group in Wilmington, does not think that will happen.

Habbart served as the American Bar Association's adviser to the drafting committee.

As the only Delaware practitioner on the drafting committee, she said she played an active role in the process.

"At my suggestion, we brought in people from the mutual fund industry," Habbart said, because the vast percentage of users of business trusts are mutual funds. Later, the committee invited input from the securitization industry.

"I think it is a plus for Delaware when an entire model act acknowledges in its own introductory notes that it took the Delaware act into account," she said.

In a more specific sense, Habbart said the USTEA confers a more widespread legitimacy on this form of enterprise.

"You want every jurisdiction to recognize what a statutory trust is," Habbart said.

For example, if a Delaware entity is going to do business in another jurisdiction, parties would want to be sure that the jurisdiction "recognizes the validity of this form of entity and presumably will respect the limited liability," Habbart said.

Sitkoff, while stressing that this topic will have to be researched and that his comment is pure conjecture, also thinks that if other states were to adopt the uniform act it would help Delaware more than it would hurt.

"Other states might have some indigenous trust business that currently has to go to Delaware. ... My best guess is the opposite effect would be bigger. People who otherwise would have been skittish about using a statute unique to Delaware would be comforted by a uniform version with the imprimatur of the ULC."

While Delaware's trust act may have been the primary model, the ULC also drew on its own uniform alternative entity

Trust Act *continues on page 6*

Trust Act

Continued from page 4

laws and corporate law, and there are significant differences between the Delaware Statutory Trust Act and the USTEA.

Justin L. Vigdor, chairman of the ULC drafting committee and a partner with Boylan Brown Code Vigdor & Wilson in Rochester, N.Y., said there are certain mandatory requirements in the USTEA.

"The Delaware law largely permits the drafters of the organization document total freedom of contract to provide whatever they want to provide. There are no absolute requirements," Vigdor explained. "Our act does have certain mandatory requirements. We say it has freedom of contract, but there are certain enumerated things that cannot be changed."

The uniform act prohibits donative trusts, for example. It also states that the certain duties on the part of the trustees cannot be entirely eliminated by the governing instrument.

"They can be tailored and they can be to some extent diluted, but not entirely eliminated," Vigdor said. "It still must retain certain fiduciary duties."

To illustrate, the USTEA states that a governing instrument may not "vary the standards of conduct for trustees ... but the governing instrument may prescribe the standards by which good faith, best interests of the statutory trust, and care that a person in a similar position would reasonably believe appropriate under similar circumstances are determined, if the standards are not manifestly unreasonable."

Sitkoff explained it this way: the uniform act contains provisions directing some questions that the Delaware act leaves open.

"The clearest example is the applicability of ordinary trust law," Sitkoff said. "Both acts provide that in case of silence by the statute and the governing instrument, ordinary trust law applies."

This law grew up in the context of personal asset trusts, however, so in some instances the ULC "went through the ordinary trust law canons and expressly overrode ordinary trust law rules and replaced them with more business appropriate rules," Sitkoff said. "In Delaware, that happens in the governing instrument."

Because the uniform law has to go everywhere, the drafting committee decided a few things needed to be crystal clear, he said.

Another difference between the Delaware act and the uniform act concerns series trusts, often used by mutual funds.

"We have a fuller treatment of series trusts," Sitkoff said. "That was pioneered by Delaware but the Delaware series provision is really quite spare. We spent an entire year developing a more comprehensive series provision. On that the uniform act is ahead of Delaware." •

News in Brief

Continued from page 2

available on the court's Web site. Also, a personal information form must accompany each petition for appointment of guardian.

New requirements also include that in any case that requires the guardian to execute a bond, the bond must be executed, notarized and e-filed within seven days of the entry of the final guardianship order. More changes in procedure are detailed in the order, which is available on the court's Web site. •