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# DELAWARE COURT OF CHANCERY NARROWS ENFORCEABILITY OF *CON ED* PROVISION

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The Delaware Court of Chancery recently narrowed the enforceability of a "*Con Ed*" provision allowing a target company to seek lost stockholder premium as damages resulting from an acquiror's breach in a failed merger. In *Crispo v. Musk et al.*, Chancellor Kathaleen St. J. McCormick denied a stockholder-plaintiff's petition for a mootness fee related to the efforts of Twitter (now known as "X") to force Elon Musk to close their merger.[1] The Court held that Twitter stockholder Luigi Crispo lacked standing to seek lost premium damages from Musk under "two objectively reasonable interpretations" of the merger agreement's provision that includes the lost share premium as available target company damages (the "Lost-Premium Provision"). Specifically, the Court held that the Lost-Premium Provision was unenforceable by stockholders because (a) the merger agreement did not clearly confer third-party beneficiary status on stockholders to seek such lost premium damages directly, or (b) the stockholder's "implicit" limited rights to seek such damages under the Lost-Premium Provision had not vested when the complaint was filed because, at that time, Twitter was pursuing a claim for specific performance. In the course of determining the viability of the stockholder's claim, the Court also held that a Lost-Premium Provision that defines lost-premium damages as exclusive to the target (a "damages-definition approach") is unenforceable under Delaware law.

The first interpretation is reflective of the Court's conclusion that a damages-definition approach to *Con Ed* provisions is an unen-

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due diligence. The board proved itself willing to vigorously debate assumptions and oppose the conflicted director's wishes.

- Similarly, when Oracle purchased a company co-founded by Oracle's founder, former CEO and largest shareholder, and on whose board he served, the court rejected a challenge to the deal. There the special committee implemented "rules of recusal" that prohibited the founder from discussing the transaction with anyone but the special committee, required employees who were involved in assessing the transaction to be informed of the recusal, and forbade officers and other employees from participating in the negotiation process absent the special committee's direction.[1]

- In contrast to the *Mindbody* situation, the court in *Oracle* praised the special committee's willingness to let the deal die if it was not in the company's best interests.

### *Helpful Independent Financial Advisors*

- The courts in the *Tesla*, *Oracle* and *Columbia Pipeline* cases praised the boards or special committees for selecting top-tier financial advisors without longstanding relationships or conflicts with their companies or counterparties.

- In the *Tesla* case, the court positively noted that, during due diligence, the company's banker investigated the seller's financial state, had discussions with the seller's financial advisor, adjusted the focus of its work as concerns arose, reran analyses as needed, and kept the board apprised of new developments. The court also noted that, in response to information discovered during due diligence, the board lowered the offer price.

- In the *Mindbody* decision, the court applauded the company's banker for sharing its knowledge about the buyer, including its modus operandi and associated risks, but said that the company's CEO ignored that information.

## In Sum

In sum, Delaware courts have long held that a deal process does not have to be perfect and there is no one-size-fits-all blueprint. The facts and circumstances of each deal process will be considered and any one of the potentially problematic issues described above alone may not be enough to doom the process. But these cases should help directors understand what circumstances may taint a deal process and, on the other hand, what guardrails they may want to consider to protect the integrity of a deal process.

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**ENDNOTES:**

[1]Skadden advised Oracle's special committee.

# APPRAISAL RIGHTS IN CROSS-BORDER PUBLIC M&A: CANADA IS NOT QUITE DELAWARE

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## Overview: Partly Familiar, and Partly Foreign

How do appraisal rights in public cross-border M&A transactions into Canada compare with appraisal rights under Delaware law?

 

The 2023 ABA Canadian Public Target M&A Deal Point Points Study, together with an August 2023 Canadian court decision, provide timely and illustrative points of comparison on two key transactional issues.

First, while appraisal rights closing conditions are uncommon in U.S. public M&A transactions,[1] they are a near-omnipresent feature of Canadian public M&A. This raises several strategic considerations for a U.S. buyer eyeing a Canadian public target.

Second, while Delaware and Canadian courts have been trending in the same direction in favouring deal price over other valuation methodologies in deciding fair value in appraisal proceedings, the "one true rule" in Canada remains that the court will account for all relevant factors. This highlights the importance of the sales process conducted in determining the deference the court will give to deal price. It also highlights that target directors in Canada are not subject to exactly the same duties as target directors under Delaware law when overseeing the sale of the company.

Overall, U.S. counsel will find that appraisal rights in cross-border public M&A into Canada are both partly familiar and partly foreign.

## Appraisal Rights in Canada in Brief

Similar to Delaware, appraisal rights in Canada are a statutory or court-appointed right available to shareholders who object to certain fundamental corporate changes. Specifically, they enable dissenting shareholders to compel the corporation to buy their shares at "fair value."[2]

Canada's different corporate statutes (*i.e.*, federal, provincial and territorial) are not identical in respect of appraisal rights. However, generally speaking, dissent and appraisal rights are a live issue in most Canadian public M&A transactions either because they are imposed by statute (*e.g.*, in an amalgamation, including as part of a second stage, squeeze out during a takeover bid, or in a sale of substantially all of the business or assets) or because they are incorporated into a plan of arrangement, a court-supervised process where appraisal rights will be an important part of the indicia of fairness the court will consider in approving the transaction. In addition, and as discussed further below, most Canadian public M&A deals will involve an appraisal rights closing condition (*i.e.*, a condition in favour of the buyer requiring appraisal rights not be exercised by shareholders representing more than a specified percentage of the target's shares).

## Appraisal Rights Closing Conditions in Canadian Public M&A

The great majority of Canadian public M&A transactions include an appraisal rights closing condition. Specifically, in the most recent ABA Canadian Public M&A Deal Points Study, released earlier this year, 87% of deals with all-cash consideration included an appraisal rights closing condition. In the case of both part-cash/part-stock deals and all-stock deals, 100% of deals included an appraisal rights closing condition.[3]

Similarly notable is that the approval thresholds applicable to appraisal rights closing conditions in Canadian public M&A are both highly concentrated and generally slanted in favour of the buyer. The most common threshold (*i.e.,* the bar below which the percentage of shareholders exercising appraisal rights must remain for the appraisal rights closing condition to be met) is 5%, found in 59% of deals with the condition. The next most common threshold is 10%, appearing in 30% of deals with the condition. Therefore, in total, almost 90% of appraisal rights closing conditions featured either a 5% threshold or a 10% threshold.[4]

The principal takeaways here are threefold. First, not only are buyers of Canadian public targets extremely successful in securing an appraisal rights closing condition, they are also highly successful in obtaining the relatively low threshold of 5% (*i.e.*, in 59% of deals). Second, and notwithstanding the foregoing, it is highly unusual for a buyer to secure a threshold lower than 5%, this occurring in only a single deal within the ABA sample.[5] Third, given that 89% of deals with appraisal rights closing conditions feature thresholds of either 5% or 10%, as well as the fact that only a single deal featured a threshold below 5%, it appears that appraisal rights closing conditions are often simply accepted as a matter of course rather than subject to circumstance-specific scrutiny and negotiation. Appraisal rights closing conditions in Canadian public M&A therefore appear to exemplify the potential for "what's market" to sometimes trump what's truly at issue.

Against this backdrop, several strategic considerations emerge for the U.S. buyer of a Canadian public target.

Perhaps most importantly, what threshold is warranted or otherwise prudent in the circumstances? Although the ABA Study evidences that in most cases the parties will settle on either a 5% or 10% threshold, the key question for the U.S. buyer is what degree of dissent is within the buyer's tolerance, and why or why not. For example, is the approval of one or more significant shareholders critical to the buyer's desire to proceed with the deal? Or, given that dissenting shareholders exercising appraisal rights must be paid out in cash, in a part-cash/part-stock deal or in an all-stock deal, what amount of cash payment for appraisal purposes is acceptable? If the buyer is willing to entertain a higher threshold requested by the target (*i.e.*, higher than 5% or 10%), this could serve as a valuable bargaining chip. On the other hand, should the U.S. buyer seek a threshold lower than 5%, it should be prepared to justify this demand and/or to accept concessions elsewhere. Overall, just because Canadian market practice evidences somewhat of a "knee-jerk" tendency to include the closing condition and land on a threshold of either 5% or 10%, it does not exclude the opportunity for more strategic or creative deal-making.

Related considerations include whether the U.S. buyer might be prepared to proceed with the acquisition notwithstanding that the appraisal rights condition has not been satisfied, *i.e.,* by waiving the condition. Also, although targets in Canadian public M&A are rarely successful in excluding appraisal rights closing conditions, the ABA Study identifies incremental target success on this front based on results from 2013 to 2022 in all-cash deals.[6] A U.S. buyer should therefore anticipate likely target arguments against inclusion of the condition, which can include giving leverage to minority shareholders and/or attracting shareholder activists.

## Sales Processes and Directors' Duties in Canadian Public M&A

As U.S. deal counsel will be aware, in three decisions over 2017 to 2019 the Delaware Supreme Court moved away from a discounted cash flow ("DCF") approach and toward a deal price approach when determining fair value in appraisal proceedings.[7] Notably, Canadian courts have been trending in a similar direction, with the most recent endorsement of deal price over a DCF analysis coming in *Baffinland*,[8] decided in August 2023. In particular, the court exhibited a clear preference for objective, market evidence in the form of the negotiated deal price over theoretical valuations based on a DCF analysis. In so doing the court also followed recent Canadian appellate precedent toward a similar end.[9]

That said, it is critical to appreciate that, as recognized in *Baffiinland*, in Canada the "one true rule" in appraisal proceedings remains that the court will "consider all the evidence that might be helpful," as well as "the particular factors in the particular case," to "exercise the best judgment that can be brought to bear on all the evidence and all the factors."[10] Appraisal by a Canadian court therefore remains highly discretionary and unamenable to a set or fixed formula.[11]

This "one true rule" of appraisal actions in Canada highlights several key considerations for the U.S.

buyer of a Canadian public target, two of which we focus on here.[12] First, the importance of the sales process in determining the deference a court will give to the deal price. Second, that target directors in Canada are not subject to exactly the same duties as target directors under Delaware law when overseeing the sale of the company.

Regarding the importance of sales process, Canadian courts have trended toward preferring deal price over theoretical valuations. The transaction price will typically serve as the starting point for appraisal as Canadian courts have determined that appraisal rights are neither intended to result in a bonus to dissenting shareholders nor should they incorporate a minority discount when determining fair value. However, from there the court will weigh whether the broader circumstances tend to reinforce or undermine the deal price as indicia of fair value. This may be by comparing deal price against a DCF analysis or net asset value analysis. Much more likely, however, the court will gauge the robustness of the sales process conducted. The more extensive and procedurally sound the target's engagement with potential buyers, the greater the likelihood deal price will be held to represent fair value. Conversely, the thinner the target's market check, the greater the risk the court could set fair value higher than deal price.

In *Baffinland*, for example, the court noted that, in additional to the ultimately successful joint bidders, the target's financial advisor had contacted over 40 other potential buyers, that such solicitations had occurred over a two-year period, that the acquisition opportunity was otherwise well-known, and that, notwithstanding the foregoing, no higher offers were made. In *Carlock*, the court noted that the deal price represented a sizeable premium to the pre-announcement (*i.e.*, unaffected) stock price, that the target's institutional investors (whom the court presumed were experts at assessing value) voted in favor of the transaction, and that the target's original suitor chose not to increase its bid. In *Deer Creek*,[13] the court was willing to overlook a limited confidential marketing process and strong deal protection terms given the target's experienced board and advisors, coupled with a robust negotiation process that led to a superior proposal that was ultimately matched by the successful bidder. The aggregate result was that, in each case, the court found deal price to be a strong indicator of fair value.

Regarding directors' duties in Canadian public M&A, two key points are warranted. First, Delaware's *Revlon* line of cases requiring the maximization of shareholder value in certain circumstances has been considered but not adopted by Canadian courts.[14] Among other things, this has meant that in Canada, strictly speaking, a target board is not required to run an auction to obtain fair value for the target's shares. Second, and for a variety of reasons, litigation arising from public M&A transactions is considerably less frequent in Canada than in the United States. Among other things, this means that Canadian boards are somewhat less accustomed to having their sales processes scrutinized by courts.

For a U.S. buyer considering acquiring a Canadian public target, the combined result of the foregoing is that the sales process conducted in Canada may not be as rigorous as the buyer is accustomed to.[15] This is not to suggest that Canadian boards take their fiduciary duties any less seriously than do their U.S. counterparts. Nor is this to suggest that a U.S. buyer should necessarily expect a sales process in Canada to be any less rigorous than at home. Rather, it is merely reflective of the fact that differences in applicable law will result in somewhat different market practice. For example, while "go shops" are included in 9% of U.S. public M&A deals, they only appear in 3% of Canadian public M&A deals.[16] Of course, the U.S. buyer will have limited to no input over the target's sales process and may actually prefer that there not be a robust sales process to avoid further competition for the target. Nonetheless, the point remains that the less rigorous the target's sales process, the greater the potential for the court to be persuaded that fair value might be in excess of deal price in the event that appraisal rights are exercised by dissenting shareholders. Among other things, this should be kept in mind by the U.S. buyer when assessing the buyer's range of acceptable appraisal rights closing condition thresholds.

## Summary Comments

The 2023 ABA Canadian Public Target M&A Deal Point Points Study and recent caselaw illustrate that appraisal rights in cross-border public M&A into Canada will be partly familiar and partly foreign to a U.S. buyer.

While, generally speaking, appraisal rights in Canada function similarly to appraisal rights under Delaware law, unlike in the U.S., appraisal rights closing conditions are a near-omnipresent feature of public M&A in Canada. This raises several strategic considerations for a U.S. buyer eyeing a Canadian public target, including regarding the applicable threshold. It also opens the door to different negotiation tactics and creative-dealmaking.

Lastly, the general availability of appraisal rights in Canadian public M&A highlights the importance of the sales process conducted in determining the likelihood that the court could set fair value higher than deal price. Here U.S. buyers should know that target directors in Canada are not subject to exactly the same duties as target directors under Delaware law when overseeing the sale of the company and that, among other things, this can impact the robustness of the sales process conducted.

## ENDNOTES:

[1]Appraisal rights closing conditions are not tracked in the ABA's U.S. Public Target M&A Deal Points Study.

[2]As in Delaware, corporate statutes in Canada do not define "fair value."

[3]American Bar Association, *2022 Canadian Public Target M&A Deal Points Study* (2023) at slide 45.

[4]The remaining 11% of deals included thresholds of 15% (3% of applicable deals) and 7.5% and 7% (each appearing in 2% of applicable deals).

[5]This deal featured a threshold of 2%.

[6]While 92% of all cash deals in the 2013 study included an appraisal rights closing condition, by 2022 this figure had dropped to 87%.

[7]See *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd*, 177 A.3d 1 (Del. 2017); *DFC Global Corporation v. Muirfield Value Partners, L.P.*, 172 A.3d 346 (Del. 2017); *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, 210 A.3d 128 (Del. 2019).

[8]*1843208 Ontario Inc. v. Baffinland Iron Mines Corp.*, [2023] O.J. No. 3859 [*Baffinland*].

[9]*See Carlock v. ExxonMobil Canada Holdings ULC*, 2020 YKCA 4 (CanLII) [*Carlock*].

[10]*Baffinland* at para. 21. See also para. 22 and *Carlock* at paras. 13 and 92.

[11]It should also be noted that, while appraisal caselaw across Canada's different common law jurisdictions has been fairly consistent, differences among the particular business corporations statute at issue (*i.e.*, federal, provincial or territorial) in an appraisal proceeding and those at issue in precedent could drive different results.

[12]For example, other indicia of fair value the court may consider in an appraisal proceeding include any valuation obtained by the target or its board in connection with the deal. This could include a formal valuation report prepared by a qualified and independent valuator as to the fair market value of the subject matter of the transaction which is required by Canadian securities law in specified circumstances. Subject to certain exemptions, such circumstances could include (1) insider bids, (2) related party transactions, (3) issuer bids, and (4) certain business combinations. In such a scenario, the further the deal price from the high end of the valuation range, then presumably the greater the potential for appraisal rights being exercised as well as the court awarding fair value in excess of the deal price.

[13]*Deer Creek Energy Limited v. Paulson & Co. Inc.*, 2008 ABQB 326 (CanLII), aff'd 2009 ABCA 280 (CanLII).

[14]*See*, for example, *BCE Inc. v. 1976 Debentureholders*, 2008 SCC 69 (CanLII) at paras. 85-88.

[15]Additional explanations are likely also at play, e.g., typical deal value: Canadian public M&A transactions are generally smaller in size than in the U.S. and with the result that a robust and costly sales process does not make financial sense.

[16]American Bar Association, *2022 Canadian Public Target M&A Deal Points Study* (2023) at slide 58.