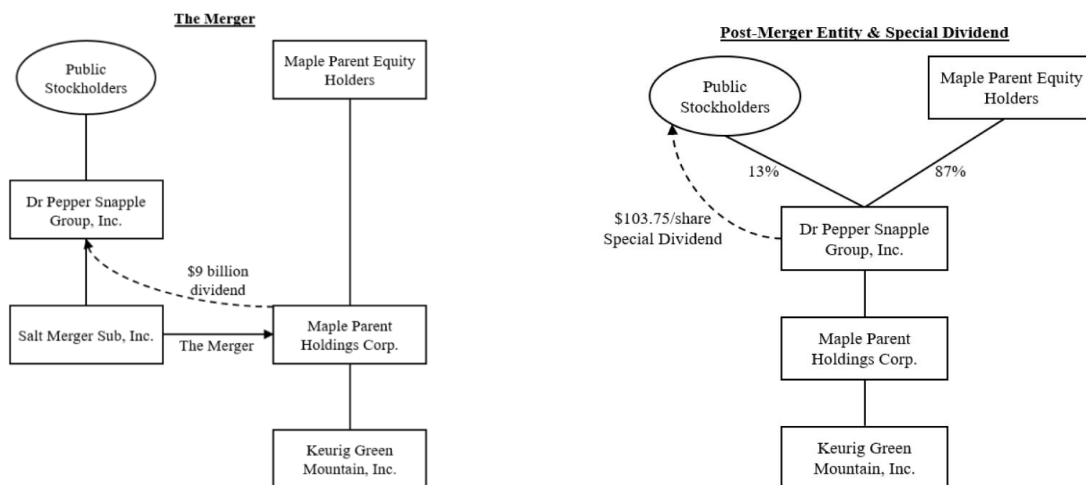


Delaware Chancery Court Applies Strict Statutory Construction to Reject Appraisal Rights Following Reverse Merger

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The ability of stockholders to seek and recover statutory appraisal of the value of their shares when dissenting from the consideration offered in a merger transaction has been restrained by recent amendments to the Delaware General Corporation Law (DGCL) and several Delaware court decisions. On June 1, 2018, the Delaware Court of Chancery again limited the availability of statutory appraisal rights in *City of North Miami Beach General Employees' Retirement Plan v. Dr. Pepper Snapple Group, Inc.* by applying a strict interpretation of section 262 of the DGCL to find that stockholders of Dr. Pepper Snapple Group, Inc. (Dr. Pepper) were not entitled to statutory appraisal following that company's combination with Keurig Green Mountain, Inc. (Keurig).

In the subject transaction, although Keurig would customarily be viewed as the acquiring entity (as the stockholders of Keurig's parent entity ended up controlling Dr. Pepper post-merger), the transaction was structured so that Keurig became an indirect wholly-owned subsidiary of Dr. Pepper through a reverse triangular merger in which a newly formed wholly-owned subsidiary of Dr. Pepper was merged into the parent company of Keurig. As a result of such structure, Dr. Pepper stockholders received a one-time cash dividend (funded by cash infusions to Dr. Pepper at the time of the merger, in part from third-party sources, but also including a dividend that it was receiving from Keurig's parent company as its direct subsidiary immediately following the merger) and retained their shares of Dr. Pepper, which post-merger accounted for only 13% of the equity of the combined company and the indirect owners of Keurig (the stockholders of its holding company parent) received shares of Dr. Pepper resulting in them holding the remaining 87% of the equity of Dr. Pepper. As such, the Dr. Pepper stockholders would customarily be considered as the sellers and Dr. Pepper as the "target," as the substance of the transaction was that they received the cash dividend in exchange for transfer of 87% ownership of Dr. Pepper. The court created the following diagrams to depict the transaction:



The structure did not require Dr. Pepper's stockholders to authorize the merger itself, but it did require approval of two proposals necessary to effectuate the transactions – namely the issuance of the Dr. Pepper stock to the stockholders of Keurig's parent as merger consideration and an amendment to the certificate of incorporation of Dr. Pepper to authorize sufficient shares to issue such stock. Plaintiffs in the case argued that the court should focus on "the structure and economic reality of the deal" and recognize that Dr. Pepper's stockholders were giving up 100% control of Dr. Pepper in exchange for cash and a 13% equity rollover in the post-merger entity. However, since the Dr. Pepper stockholders did not actually transfer their shares and Dr. Pepper itself was not a constituent corporation in the reverse triangular merger, the court held that Section 262 by its express terms does not provide appraisal rights for Dr. Pepper stockholders.

Company management and their advisors in a merger transaction should be guided by how the court addressed the deal structure in this case. As a threshold matter, appraisal is available in a merger or consolidation governed by Section 262 only for the stock of a "constituent corporation." The court held that where a merger subsidiary merely functions as an intermediary entity, solely formed to facilitate the merger, its "constituent corporation" status is not imputed to its parent corporation. The court relied in part on the language of Section 251(a) of the DGCL to determine that "constituent corporations" means solely the corporations actually being merged or consolidated. The court also referenced language in Section 262 (b)(i) of the DGCL which provides that no appraisal rights shall be available for any shares of stock of the constituent corporation surviving a merger if the merger did not require for its approval the vote of the stockholders of the surviving corporation. The court said that "logically for a constituent corporation to survive a merger, the constituent corporation must be an entity pre-existing the merger that was combined with another entity in the transaction.

This is significant because the use of a merger subsidiary to effectuate a transaction structured in this manner will prevent an action for statutory appraisal of the stock of the merger subsidiary's parent company (*i.e.*, the company acquired for all practical purposes under this transaction structure).

The court further held that Section 262 does not bestow appraisal rights upon stockholders simply upon a sale of control. First, Dr. Pepper stockholders were not entitled to appraisal rights because Dr. Pepper's stock is listed on a national security exchange. However, there is an exception which restores appraisal rights where the holders of stock are required to accept certain types of consideration in exchange for their stock. Dr. Pepper's stockholders were not technically accepting consideration in exchange for their stock. This is independently significant because when stockholders are not relinquishing their stock in the acquired company, but are merely receiving a dividend and having their ownership diluted by the issuance of additional shares as merger consideration, they cannot meet the standards for statutory appraisal – even if losing a control position.

The court noted that appraisal rights are entirely a creature of statute and found the plain meaning of Section 262 was clear and unambiguous. Further, the court would not disregard the form of the transaction as Section 262 references shares not voted in favor of the merger. Since the vote of Dr. Pepper's stockholders was not required to authorize the merger itself, they could not gloss over the actual words of the statute to "stitch together a new set of rules".

This decision offers up an additional approach for potential structuring of merger transactions to avoid statutory appraisal under Section 262.

If you have questions or would like additional information, please contact Marc Casarino (casarinom@whiteandwilliams.com; 302.467.4520), Lori Smith (smithl@whiteandwilliams.com; 212.714.3075) or another member of the Corporate and Securities Group.