

Court: Certificate of Incorporation Doesn't Grant Preferred Stockholders Liquidation Preference

By **Aric H. Wu**

The recent decision in *In re Appraisal of GoodCents Holdings*, C.A. No. 11723-VCMR (Del. Ch. June 17), illustrates that courts are reluctant to imply preferred stockholder rights that are not clearly set forth in the documents containing the preferred stock terms. In *GoodCents*, Vice Chancellor Tamika Montgomery-Reeves held that a disputed provision in a company's certificate of incorporation granted preferred stockholders the right to a class vote, but not the right to a liquidation preference in lieu of a class vote, in the event of a merger.

Background

In July 2015, GoodCents entered into a merger transaction. Because the merger consideration was less than the liquidation preference GoodCents believed its preferred stockholders were entitled to in the event of a merger, the preferred stockholders received all of the merger proceeds and the common stockholders, the two founders of GoodCents' predecessor entities, received no consideration. In November 2015, the two former common stockholders brought an appraisal action, arguing that, for

purposes of the appraisal, the holders of common stock and preferred stock should be treated pro rata, with the preferred stock entitled to consideration on an as-converted-to-common basis. The parties subsequently cross-moved for partial summary judgment on the proper allocation of the fair value of GoodCents among common and preferred stockholders.

Under Article V, Section B.2b of GoodCents' amended and restated certificate of incorporation, "except in a transaction governed by Section B.6," the preferred stockholders of GoodCents cannot be paid a dividend unless the common stockholders receive an equal dividend per share on an as-converted basis.

Sections B.6.a and B.6.b set forth a liquidation preference in the event of a "liquidation, dissolution or winding up of the corporation." Section B.6.c provides: "Without the affirmative vote of the holders of a majority of the series 1 cumulative convertible preferred stock, the corporation shall not ... effect any merger or consolidation ... unless the agreement or plan of merger ... shall provide that the consideration payable to the stockholders



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of the corporation ... or consideration payable to the corporation ... shall be distributed to the holders of capital stock of the corporation in accordance with Sections B.6.a and B.6.b above.

The petitioners argued that, whereas Sections B.6.a and B.6.b provide for a liquidation preference in the event of a liquidation, dissolution, or winding up, Section B.6.c is limited to providing a voting right in the event of a merger. By contrast, GoodCents argued that the "unless" clause of Section B.6.c provides for a liquidation preference when effecting a merger without the affirmative vote

of the preferred stockholders and thus dispenses with the vote requirement when a merger agreement provides, like the merger agreement entered in July 2015 effectively provided, that merger proceeds “shall be distributed to the holders of capital stock of the corporation in accordance with Sections B.6.a and B.6.b.”

The Chancery Court’s Ruling

The Chancery Court held that, based on its unambiguous text, Section B.6.c “grants the preferred stockholders a voting right but not a right to the liquidation preference in the event of a merger.” Montgomery-Reeves explained that, rather than trigger a liquidation preference, the “unless” clause of Section B.6.c “simply means that the preferred stockholders’ right to block a merger by withholding their affirmative vote falls away if the terms of the merger agreement ‘shall provide that the consideration payable to the stockholders of the corporation ... or consideration payable to the corporation ... shall be distributed to the holders of capital stock of the corporation in accordance with [the preferred stockholders’ liquidation preference].’” Montgomery-Reeves further observed that the language in Section B.6.a that “expressly requires payment of the preferred stockholders’ liquidation preference before any payment is made to junior stock in the case of a GoodCents liquidation, dissolution, or winding up” was “noticeably absent from Section B.6.c”

The Chancery Court also relied on *In re Appraisal of Ford Holdings Preferred Stock*, 698 A.2d 973 (Del. Ch. 1997), in which then-Chancellor William T. Allen held that a charter provision with substantially similar language to Section B.6.c of GoodCents’ certification of incorporation did not waive the statutory appraisal rights of certain preferred stockholders. Noting that statutory rights “should ordinarily be waived only by clear affirmative words or actions,” the Chancery Court in *Ford* held that the language in the “unless” clause of the charter provision was “too frail a base upon which to rest the claim that there has been a contractual relinquishment of appraisal rights under Section 262.” Although *Ford* did not address “whether the preferred stockholders were entitled to at least their liquidation preference—the issue [in *GoodCents*],” Montgomery-Reeves nonetheless found *Ford* to be persuasive because it involved “nearly identical language” and “the court held that the language [of the charter provision] was merely a voting provision.”

On July 6, the Chancery Court denied GoodCents’ request for interlocutory appeal.

Conclusion

Twenty years ago in *Ford*, the Chancery Court explained that any modification or waiver of preferred stockholder statutory rights must be “clearly set forth” in the documents containing the preferred stock

terms. In *GoodCents*, the respondent-company argued that a certificate of incorporation provision with substantially similar language to the charter provision at issue in *Ford* provided the company’s preferred stockholders with an affirmative right to a liquidation preference in the event of a merger without a preferred stockholder vote. In the company’s view, the commercially reasonable interpretation of the provision is that “either the preferred stockholders must receive the liquidation preference or a majority of them must vote to approve a merger in which they forego the liquidation preference.” The Chancery Court’s holding to the contrary in *GoodCents* illustrates that courts are also reluctant to imply preferred stockholder rights that are not clearly set forth in the documents containing the preferred stock terms.

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