

Daily Journal

www.dailyjournal.com

FRIDAY, DECEMBER 21, 2012

LITIGATION

Amending California's dissenters' rights statute

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On Sept. 23, Gov. Jerry Brown signed Assembly Bill 1680 into law. AB 1680 amends California's dissenters' rights statute by (i) eliminating dissenters rights for shareholders of California-incorporated public companies in transactions where those shareholders are to receive unrestricted, publicly traded stock of the acquiring company, (ii) clarifying how "fair market value" is to be determined in those transactions where dissent rights continue to be applicable, and (iii) making certain technical amendments to clarify the process to perfect dissenters rights in California.

Existing law.

Chapter 13 of the California Corporations Code generally provides dissent rights to shareholders of California corporations in merger, acquisition and certain other transactions, and, if such rights are perfected, requires corporations to purchase dissenting shareholder's shares for cash based on a statutorily determined fair market value. Historically, however, companies incorporated in California with securities listed on a national securities exchange have been exempt from the dissenters' rights statute *unless* shareholders owning an aggregate of 5 percent or more of the company perfect their dissenters' rights in a transaction — the so-called "5 percent exception." In the event that a sufficient number of shareholders dissent and the 5 percent exception is triggered, a California corporation is required to pay those shareholders fair market value for their shares.

California's 5 percent exception — unique among the 50 states — has vexed California public companies for years. Unlike companies incorporated in states, such as Delaware, that do not have similar exceptions, California public com-

panies being sold in stock-for-stock transactions where shareholders receive unrestricted, publicly traded shares have had to contend with the possibility that shareholders could exercise dissent rights. This has created significant deal tension where both acquirers and sellers are looking for certainty. In addition, for some acquirers, the idea of having to pay any cash to target shareholders in an otherwise all-stock transaction is untenable.

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As a consequence, acquirers of California public companies in stock-for-stock transactions have often sought to transfer the risk associated with the potential for dissenting shareholders to the California company being sold. Such acquirers, knowing that shareholders of California public companies have the statutory ability to dissent, have generally required that merger agreements include special termination rights or conditions to closing which allow the acquirer to terminate the transaction. Such a contractual arrangement has the effect of putting the transaction at risk if an excess number of shareholders dissent.

California's existing dissenters' rights statute also establishes that the fair market value of a dissenting share is to be determined the day *before* a transaction is first announced. For California public companies, this formulation, depending on when a transaction was first publicly announced, has the effect of potentially excluding the most recent closing price for the company's stock. If, for example, a transaction is first announced after the close of trading on a given day, the company must look to the *prior* day's stock closing price, i.e., the

fair market value of the stock a full trading day *before* the day the transaction was publicly announced.

The result is that if the share price of the acquirer's stock were to decline after announcement of the transaction to an amount that was less than the price per share of the California company's share price on the day *before* announcement, speculative shareholders could seek to exploit the situation by purchasing a sufficient number of shares to trigger dissent rights. This could have the effect of either preventing the transaction from closing or allowing dissenting shareholders to receive cash payments from the California public company at the expense of the majority of shareholders who approved the transaction and will continue to own shares of the surviving company.

In addition, California's dissenters' rights statute, as it currently exists, contains ambiguities as to what procedures shareholders of California public companies are to follow in perfecting their dissent rights. This ambiguity has led to a fair amount of confusion among California practitioners. However, despite this ambiguity, the legislative history for California's dissenters' rights makes clear that in order for shareholders of California public companies to perfect dissenters' rights, such shareholders are required to (i) vote against the proposed transaction and (ii) make written demand on the corporation for purchase of their shares at fair market value *no later than the date of the shareholders meeting* to vote on the proposed transaction.

Amendments to California's dissenters' rights statute.

AB 1680 was introduced by California Assemblyman Bob Wieckowski, approved by the Legislature, and signed into law by Gov. Brown to fix the problems associated with the 5 percent exception, the defini-

tion of "fair market value," and the ambiguities relating to the technical procedural issues.

The bill eliminates the 5 percent exception. Pursuant to the amendments, shareholders of public companies incorporated in California will no longer be entitled to dissent in stock-for-stock mergers where the shareholders are to receive unrestricted, registered shares of the acquirer. However, dissenters' rights will still be available to shareholders of California public companies in cash-out mergers or where the consideration paid by the acquirer includes restricted securities or other illiquid consideration.

The bill also establishes that fair market value is to be determined "as the day of, and immediately prior to," the first announcement of the transaction. In doing so, AB 1680 ensures that the most recent closing share price is used for determining the fair market value of dissenting shares.

Finally, AB 1680 amends California's dissenters' rights statute to clarify the ambiguities in the procedures by which shareholders of California public companies perfect dissenters' rights. Consistent with the legislative intent, AB 1680 amends California dissenters' rights statute to clarify that, in order to perfect dissenters' rights, shareholders of a California public company must (i) vote against the proposed transaction and (ii) make written demand on the corporation *no later than the date of the shareholders meeting* to vote on the transaction.



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