



Delaware Court Decisions on Appraisal Rights Highlight Need for Reform

Posted by Theodore Mirvis, Wachtell, Lipton, Rosen & Katz, on Wednesday January 21, 2015

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Recent developments in the once sleepy area of appraisal rights have woken folks up. It seems that deals are subjected to intense scrutiny even in non-*Revlon Revlon* cases, and then face the mill of appraisal where claim-buying has become virtually enshrined. Below is one suggestion for legislative reform.

Two recent decisions of the Delaware Court of Chancery highlight the troubling expansion of stockholder appraisal rights. Delaware's appraisal statute prohibits stockholders who vote in favor of a transaction from seeking appraisal for their shares. Notwithstanding this requirement, the Court of Chancery permitted claims to be pursued by a petitioner who purchased its shares after public announcement of the merger for the purpose of bringing an appraisal lawsuit and who was unable to show that the shares for which it sought appraisal had not been voted in favor of the deal. *In re Appraisal of Ancestry.com, Inc.*, C.A. No. 8173-VCG (Del. Ch. Jan. 5, 2015); *Merion Capital LP v. BMC Software, Inc.*, C.A. No. 8900-VCG (Del. Ch. Jan. 5, 2015). (Wachtell Lipton represents the respondent in the *Ancestry* case.)

Both decisions were based on what the court considered to be the "plain language" of the appraisal statute, read to require only that the record holder of the shares for which appraisal is sought had not voted those shares in favor of the merger. The court thus held that any stockholder who purchased shares after the record date for the stockholder vote on the merger could demand appraisal of all of its shares, without regard to how those shares may have been voted by the record-date holders. As respondents pointed out, under this interpretation, any

shares sold after the record date would be eligible for appraisal, including shares voted in favor of the merger, giving rise to the absurd result that appraisal could be sought for more shares than actually voted against the merger. Although the Court acknowledged this “theoretical concern,” it nevertheless permitted appraisal claims to proceed where the specific shares in question could well have been voted in favor of the merger by their predecessor owners, observing that any “concern” about this interpretation “may of course be addressed by the legislature.”

Neither opinion makes any claim that this result serves any legitimate policy objective. Nor did the court assert that its holdings were consistent with the view that the purpose of appraisal is to permit stockholders dissenting from a cash merger to obtain a judicial determination of the fair value of their shares. Rather, the court viewed the matter as resulting from “conflicts that arise when the alleged intent of the appraisal statute [*i.e.*, to provide a remedy for stockholders who dissented from a cash-out merger] collides with the realities of modern securities practice [*i.e.*, the widespread separation of beneficial and record ownership, with the record holder holding shares in fungible bulk].” The court relied on the 2007 *Transkaryotic* case, where then-Chancellor Chandler called for legislative action if appraisal rights were to be cabined to serve their intended purpose, stating:

[Respondents] argue that this decision will “pervert the goals of the appraisal statute by allowing it to be used as an investment tool for arbitrageurs as opposed to a statutory safety net for objecting stockholders.” That is, the result I reach here may ... encourage appraisal litigation initiated by arbitrageurs who buy into appraisal suits by free-riding on Cede’s votes on behalf of other beneficial holders—a disfavored outcome. To the extent that this concern has validity, relief more properly lies with the Legislature.

That observation has proved prescient. One of the petitioners in the recent cases, Merion, is a self-described “event-driven investment” fund founded in 2009 to buy shares of announced merger targets for the purpose of “creating and monetizing appraisal rights.” The fund’s promotional material observed that the “typical” worst case scenario is the deal price plus statutory interest at the Fed Discount Rate plus 5%. Billions of dollars are now committed to buy appraisal claims for investors who can scarcely be said to have “dissented,” as they did not even own the stock they ever had the right to vote.

The increased incidence and value of appraisal claims may force transaction planners to take that circumstance into account. Since acquirors may not be able to size the appraisal uncertainty, particularly in leveraged transactions, the opportunistic use of the appraisal process by claims-buyers may lead to the increased use of appraisal conditions in merger agreements, under which

an acquirer is not obligated to close if more than a specified percentage of the target's shares are sought to be appraised.

It is difficult to accept that the Delaware Legislature intended or desired any of these outcomes, none of which protect the fair-value rights of actual stockholders of Delaware companies. And the "heads I win, tails you lose" perspective of appraisal fund investors in this space suggests that the process has become misaligned with the purpose of the statute. Notably, the Delaware Supreme Court has not had occasion to weigh in on the proper interpretation and application of the Delaware appraisal in light of the "realities of modern securities practice."

The Delaware Legislature has already taken notice of the subject. Last June, the Legislature called for examination of the "the operation and administration of statutes and court rules governing the exercise of appraisal right" as well as the currently high interest rate to which fair value determinations are subject. Legislative proposals are expected to be considered shortly. In the absence of judicial correction, the sensible solution is to amend the statute to make express that appraisal rights are not available for shares purchased after public announcement of the terms of the merger, thereby confining the appraisal right to the purpose of protecting stockholders of Delaware corporations who dissent from a merger that is subject to appraisal rights.