

M&A Update

Proposed Amendments to the Delaware Appraisal Statute

April 19, 2016

The Corporation Law Section of the Delaware State Bar Association recently approved proposed legislation to amend the General Corporation Law of the State of Delaware (the “DGCL”). Among the proposed changes are amendments that would mitigate some of the risks presented by stockholder appraisal actions by barring appraisal claims that do not meet certain minimum thresholds. In addition, the proposed legislation would allow companies to limit the amount of statutory interest payable to stockholders who seek appraisal by making discretionary payments to such stockholders prior to the final value determination by a court. If adopted by the Delaware General Assembly, these amendments would apply to merger agreements entered into on or after August 1, 2016.

Background

De Minimis Exclusion

Under the proposed rules, stockholders who otherwise would be entitled to appraisal rights in connection with a transaction will not be entitled to appraisal under the following circumstances:

- if the total number of shares for which appraisal is sought is less than or equal to 1% of the outstanding shares of the class or series eligible for appraisal; or
- if the value of the consideration (based on the deal price) for the total number of shares for which appraisal is sought is less than or equal to \$1 million.

These de minimis exclusions apply only to shares for which appraisal is sought that were previously listed on a national stock exchange and do not apply in connection with a short-form merger pursuant to Sections 253 or 267 of the DGCL.

Pre-Judgment Payments

The proposed legislation also permits a company to reduce the amount of interest that accrues during the appraisal process by making a cash payment to stockholders seeking appraisal in

advance of the court's final judgment determining the fair value of the stock. The amount of any such prepayment will be at the discretion of the company. Under the current regime, unless the court determines otherwise for good cause, interest will accrue on the ultimately appraised value of the shares from the effective date of the merger at a rate of 5% over the Federal Reserve discount rate, compounded quarterly.

If a prepayment is made by the company, interest will accrue only on the sum of (i) the difference between the amount paid and the fair value of the shares as determined by the court and (ii) interest accrued before the early payment, unless paid at that time. Any prepayment would be required to be made to all of the appraisal claimants, unless the company has a good faith basis for contesting a particular claimant's entitlement to appraisal.

Takeaways

The proposed rules are a response to the increased prevalence of appraisal actions being sought in connection with M&A transactions and the significant amounts of cash and resources that companies are required to expend in resolving these actions. The new legislation, if enacted, would impact future appraisal actions in the following ways:

1. Prepayment of Claims May Reduce the Attractiveness of Appraisal. Today, stockholders may seek appraisal with the comfort that, at a minimum, their return will include the payment of interest on the total value of the shares at a generous rate. Moreover, stockholders may be incentivized to prolong appraisal proceedings in order to increase the amount of interest payable upon final judgment. The proposed amendments will give companies the ability to reduce their exposure to interest payments by making pre-judgment payments to appraisal claimants and limit the company's interest payment obligations to apply only to amounts that are in dispute. Thus, if the proposed amendments are enacted, stockholders will be less incentivized to bring or prolong appraisal claims without a reasonable basis to do so.
2. The Proposed Amendments May Curtail Appraisal Arbitrage. The past few years have seen a significant increase in "appraisal arbitrage," an investment strategy in which hedge funds and other money managers acquire stock in companies that have entered into agreements to be sold, with a view toward seeking a higher valuation in an appraisal proceeding in front of the Delaware Chancery Court. Certain recent high profile instances where appraisal arbitrage was thrust into the spotlight include contentious appraisal proceedings arising out of the acquisitions of Dell, Ancestry.com and BMC Software, among others. Indeed, Delaware courts have criticized this practice in certain instances, noting in *Merion Capital v. BMC Software* that these investors "bought, not into an ongoing concern, but instead into this lawsuit." While these proposed amendments are not likely to curtail appraisal arbitrage in instances where there is a good faith dispute over

the fair value of a company's shares, they limit the attractiveness of this strategy by reducing the interest that arbitrageurs will receive upon final resolution of the proceeding and by requiring arbitrageurs to take larger stakes at the outset in order to meet the minimum thresholds.

3. The Proposed Amendments Will Eliminate Costly and Burdensome Appraisal Proceedings for De Minimis Claims. Appraisal proceedings are generally costly and burdensome to a buyer, often taking years to resolve and costing millions of dollars in defense and settlement costs. These demands on a buyer's time and resources are not proportionately decreased in the case of an appraisal claim involving a small number of shares relative to an appraisal claim involving a large number of shares. Thus, buyers often will find themselves expending significant resources in defending appraisal claims for de minimis amounts of shares. Further, buyers often agree to disproportionate settlements with stockholders holding minimal stakes in order to avoid expending these resources. The proposed legislation would mandate dismissal of appraisal claims unless the shares at issue are more than 1% of the outstanding shares of the class or series or represent a value (based on the deal price) of more than \$1 million, which will ensure that only appraisal claims for significant holdings are valid.

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If you have any questions, please contact any of the following attorneys or your Cadwalader contact:

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| William P. Mills | +1 212 504 6436 | william.mills@cwt.com |
| Joshua Apfelroth | +1 212 504 6391 | joshua.apfelroth@cwt.com |
| Mattan Erder | +1 212 504 6006 | mattan.erder@cwt.com |