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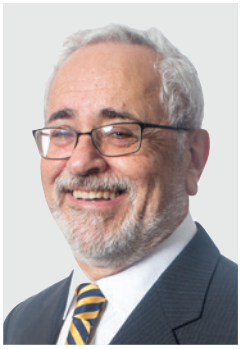


Cleary's Victor Lewkow

A Sleepy Topic

The Return of Appraisal Rights

Victor Lewkow of Cleary Gottlieb opened the panel on appraisal rights by saying this has been "the sleepiest topic for some time." He said that in the 15 years that he has been attending the Tulane Corporate Law Institute he could not remember the experts "ever more than mentioning it in passing." No longer.

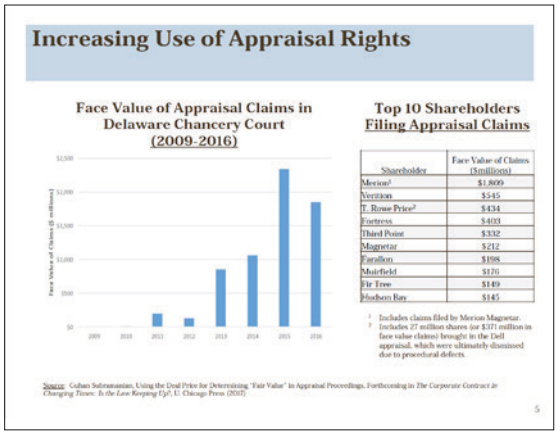
The panel included moderator Mr. Lewkow; The Honorable Andre G. Bouchard, the chancellor of the Court of Chancery; Ballad Spahr's David J. Margules; Skadden's Robert S. Saunders; and Simpson Thacher's Eric M. Swedenburg.

What are Appraisal Rights?

DGCL Section 262 provides holders of unlisted stock not held by more than 2000 holders of record with the right to demand a judicial appraisal of the "fair value" of their stock. In general, holders of listed stock (or stock held by more than 2000 holders of record) also have appraisal rights if they are required to accept as merger consideration anything other than (i) stock of the surviving company, (ii) listed stock of any other corporation or (iii) cash in lieu of fractional shares. This right is subject to *de minimis* exception adopted in 2016.

In general, to exercise appraisal rights a stockholder must: deliver a written demand prior to the vote; not have voted in favor of the merger; continuously hold the stock through closing; perfect appraisal rights after closing. A stockholder need not have owned the shares as of the deal announcement or even as of the record date for the vote.

Stockholder will receive the appraised fair value in cash together with interest at a rate of five percent over the Fed discount rate (compounded quarterly) from merger closing until paid—subject to the company's prepayment rights instituted in a 2016 statutory amendment. (See Emerging Issues, page 15.)



Statutory Underpinning

"[T]he Court shall determine the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with interest, if any, to be paid upon the amount determined to be the fair value. In determining such fair value, the Court shall take into account all relevant factors."

8 Del. C. Section 262 (h).

Putting it in Context

"[T]he standard 'Delaware block' or weighted average method of valuation, formerly employed in appraisal and other stock valuation cases, shall no longer exclu-

Appraisal Rights ➔

Appraisal Rights

continued

sively control such proceedings. We believe that a more liberal approach must include proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court, subject only to our interpretation of 8 De. C. Section 262(h), *infra. See also* D.R.E. 702-05. This will obviate the very structured and mechanistic procedure that has heretofore governed such matters."

Weinberger v. UOP, 457 A.2d, 701, 712-713 (Del. 1983).

Broad Mandate, Critically Applied

"Our Supreme Court has clarified that, in appraisal actions, this Court must not begin its analysis with a presumption that a particular valuation method is appropriate, but must instead examine all relevant methodologies and factors, consistent with the appraisal statute."

Merion Capital LP v. BMC Software, Inc., C.A. No. 8900-VCG, 2015 Del. Ch. LEXIS 268, at *2 (Del. Ch. Oct. 21, 2015) (citing *Global GT LP v. Golden Telecom, Inc.*, 11 A.3d 214, 217-18 (Del. 2010).

"Although this Court frequently defers to a transaction price that was the product of an arm's-length process and a robust bidding environment, that price is reliable only when the market conditions leading to the transaction are conducive to achieving a fair price. Similarly, a discounted cash flow model is only as reliable as the financial projections used in it and its other underlying assumptions. The transaction here was negotiated and consummated during a period of significant company turmoil and regulatory uncertainty, calling into question the reliability of the transaction price as well as management's financial projections. Thus, neither of these proposed metrics to value DFC stands out as being inherently more reliable than the other."

In re Appraisal of DFC Global Corp., C.A. No. 10107-CB, 2016 Del. Ch. LEXIS 103, at *2 (Del. Ch. July 8, 2016).

Discounted Cash Flow Analysis

"The DCF method is frequently used in [Chancery Court] and, I, like many others, prefer to give it great, and sometimes even exclusive, weight when it may be responsibly."

Andaloro v. PFPC Worldwide, Inc., C.A. No. 20336 Del. Ch. LEXIS 125, at *35 (Del. Ch. Aug. 19, 2005) (Chancellor Strine).

"Although I believe my DCF analysis to rely on the most appropriate inputs, and thus to provide the best DCF valuation based on the information available to me, I nevertheless am reluctant to defer to that valuation in this appraisal. My DCF valuation is a product of a set of management projections, projections that in one sense may be particularly reliable due to BMC's subscription-based business. Nevertheless, the Respondent's expert, pertinently, demonstrated that the projections were historically problematic, in a way that could distort value. The record does not suggest a reliable method to adjust to these projections."

Merion Capital LP v. BMC Software, Inc., C.A. No. 8900-VCG, 2015 Del. Ch. LEXIS 268, at *65 (Del. Ch. Oct. 21, 2015).

Emerging Issues: Role of Deal Price

"Requiring the Court of Chancery to defer—conclusively or presumptively—to the merger price, even in the face of a pristine, unchallenged transactional process, would contravene the unambiguous languages of the statute and the reasoned holdings of our precedent. It would inappropriately shift the responsibility to determine 'fair value' from the court to the private parties . . . .Therefore, we reject . . . [the] call to establish a rule required the Court of Chancery to defer to the merger price in any appraisal proceeding."

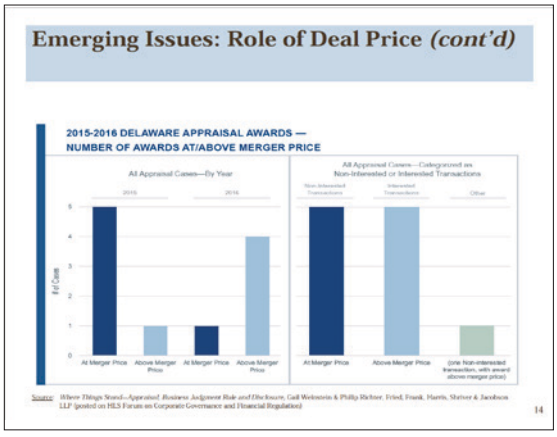
Golden Telecom, Inc. v. Glob. GT LP, 11 A.3d 214, 217-18 (Del. 2010).

"What is the fair value of an asset? For a simple asset—a piece of real property, for instance—it is the market value. If a trustee were to sell property held in trust, such a sale could be challenged by the beneficiary on a number of grounds. It would be odd, however, if the sale were an arms-length, disinterested transaction after an adequate market canvas and auction, yet the challenge was that the price received did not represent "fair" value. It would be odder still if the beneficiary presented as evidence of this proposition a post-sale appraisal, relying on speculative future income from the property not currently being realized, and stating that, notwithstanding the sales price, the true value was more than twice that received; and if the trustee's rebuttal involve a second post-facto appraisal indicating that the sales price was higher than the fair value of the parcel. In such a case the appraisals would be viewed by this Court, not as some Platonic ideal of "true

value," but as estimates—educated guesses—as to what price could be achieved by exposing the property to the market. A law-trained judge would have scant grounds to substitute his own appraisal for those of the real estate valuation experts, and would have no reason to second-guess the market price absent demonstration of self-dealing or a flawed sales process."

Huff Fund Inv. P'ship v. Ckx, Inc., C.A. No. 6844-VCG, 2013 Del. Ch. LEXIS 262, at *1-2 (Del Ch. Oct. 31, 2013).

Deal Price Adopted	Deal Price Rejected
Merion Capital, L.P. v. Lender Processing Services, C.A. No. 9320-VCL (Dec. 16, 2016)	*Dunmire v. Farmers & Merchants Bancorp of W. Penn., Inc.*, C.A. No. 10589-CB (Nov. 10, 2016)
In re Appraisal of DFC Global Corp., Consol. C.A. No. 10107-CB (July 8, revised Sept. 21, 2016)* (adopted in part)	*In re ISN Software Corp. Appraisal Litig.*, C.A. No. 8388-VCG (Aug. 11, 2016)**
Merion Capital, LP v. BMC Software, Inc., C.A. No. 8900-VCG (Oct. 21, 2015)*	*In re: Appraisal of Dell Inc.*, C.A. No. 9322-VCL (May 31, 2016)*
Longpath Capital, LLC v. Ramtron Int'l Corp., C.A. No. 8094-VCP (June 30, 2015)	*In re Dole Food Co., Inc. Stockholder Litig.*, Consol. C.A. No. 8703-VCL, 9079-VCL (Aug. 27, 2015)
Merlin Partners LP v. AutoInfo, Inc., C.A. No. 8509-VCN (Apr. 30, 2015)*	*Owen v. Cannon* [Energy Services Group], C.A. No. 8860-CB (June 17, 2015)**
In re Appraisal of Ancestry.com Inc., C.A. No. 8173-VCG (Jan. 30, 2015)*	* financial buyer ** deal price not considered



"Depending on the facts of the case, a variety of factors may undermine the potential persuasiveness of the deal price as evidence of fair value."

- "For one, in a public company merger, the need for a stockholder vote, regulatory approvals, and other time-intensive steps may generate a substantial delay between the signing date and the close date."
- "Writing as a Vice Chancellor, Chief Justice Strine observed that even for purposes of determining the value of individual shares, where the stock market is typically thick and liquid, the proponents of the efficient capital markets hypothesis no longer make the strong-form claim that the market price actually determines fundamental value; at most they make the semi-strong claim that market prices reflect all available information and are efficient at incorporating new information. The M&A market has fewer buyers and one seller, and the dissemination of critical, non-public due diligence information is limited to participants who sign confidentiality agreements. . . . It is perhaps more erroneous to claim that the thinner M&A market generates a price consistent with fundamental efficiency, when the same claim is no longer made for the thicker markets in individual shares."

In re Appraisal of Dell Inc., C.A. No. 9322-VCL, 2016 Del. Ch. LEXIS 81, at *70-77 (Del. Ch. May 31, 2016).

In *Dunmire*, the Court "place[d] no weight on the Merger price as an indicator of fair value" because the Merger was not the product of an auction, the record did not "inspire confidence" that the negotiations of the Special Committee were truly arm's-length, and the transaction was not conditioned on obtaining the approval of a majority of the minority stockholders of F&M."

Dunmire v. Farmers & Merchs. Bancorp of W. Pa., C.A. No. 10589-CB, 2016 Del. Ch. LEXIS 167, at *19-22 (Del. Ch. Nov. 10, 2016).

Emerging Issues: Appraisal Standard v. Fiduciary Standard

"Because the standards differ, it is entirely possible that the decisions made during a sale process could fall within *Revlon*'s range of reasonableness, and yet the process still could generate a price that was not persuasive evidence of fair value in an appraisal. Put differently, even if a transaction passes fiduciary muster, an appraisal proceeding could result in a fair value award."

In re Appraisal of Dell Inc., C.A. No 9322-VCL, 2016 Del. Ch. LEXIS 81, *70-77 (Del. Ch. May 31, 2016).

Emerging Issues: Synergies

"The Company argued belatedly that the court should make a finding regarding the value of the combinatorial synergies and deduct some portion of that value from the deal price to generate fair value. That is a viable method. . . . Having taken these positions, it was too late for the Company to argue in its post-trial briefs that

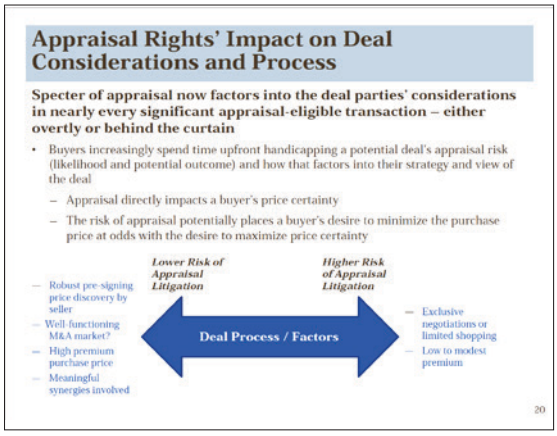
Appraisal Rights ➔

Appraisal Rights

continued

the court should deduct synergies."

Merion Capital L.P. v. Lender Processing Services, C.A. No. 9320-VCL, 2-16 Del. Ch. LEXIS 189, at *89-90 (Del. Ch. Dec. 16, 2016).



Appraisal Rights' Impact on Deal Considerations and Process

Seller's focus, meanwhile, continues to be centered on: maximizing price/value; maximizing deal certainty.

Satisfaction of fiduciary duties remains the primary driver of a seller's construction of the deal process. Satisfaction of fiduciary duties does not, however, eliminate the appraisal/price certainty risk facing a buyer. *Absent an appraisal condition*, appraisal is a post-closing risk that is borne by the buyer.

Putting it all together, how does appraisal risk impact the mating dance and deal documentation?

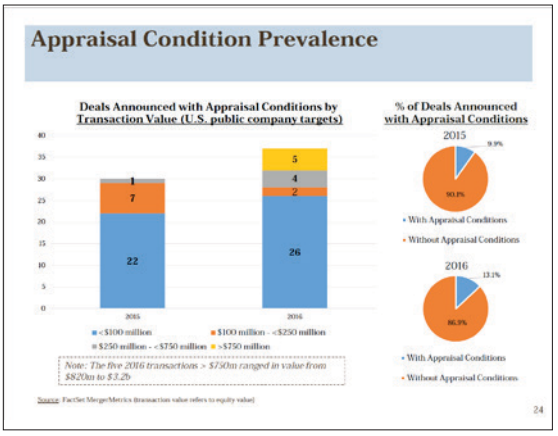
Appraisal Conditions—What's Old is New?

The perception of a heightened appraisal risk (and related buyer anxiety) is evidenced by the increased consideration by buyers of seeking an appraisal condition and some increase in the actual inclusion of such a condition.

Since adoption of DGCL Section 251(h), appraisal conditions have become possible in two-step deals. Traditional appraisal conditions have provided that: buyer need not close if initial appraisal notices given by holders of >X% of target's shares (typically 10-20%); condition measured as of proposed closing (not as of date of vote); buyer may waive the condition at or prior to closing; neither buyer nor target has termination right, until drop-dead date; no fee or expense reimbursement obligations triggered by failure of condition.

In deals with other closing conditions that remain unsatisfied post vote (*e.g.*, antitrust/regulatory, this formulation can create a limbo period between vote and drop-dead date—as stockholders may withdraw their appraisal claims at any time before closing. In the event of such a period: buyer remains obligated to continue to use agreed "efforts" to obtain approvals; target remains subject to ordinary course and other business covenants. To avoid a long limbo period, both parties may prefer a more tailored appraisal condition, which may include: buyer termination right if threshold remains exceeded for specified period after vote, with target being able to seek to obtain withdrawal of appraisal notices during that period; if appraisal cap still exceeded at end of such period and buyer doesn't waive condition within specified period, target has termination right for some period.

In a DGCL Section 251(h) tender offer, buyer may want to extend offer rather than make an immediate waiver decision, and target may want to require extension, in either case if the condition would be triggered. In negotiating appraisal cap percentage, parties should consider the implications of a major stockholder who may be likely to demand appraisal. In negotiating an appraisal cap, either party could seek expense reimbursement or a termination fee under specified circumstances.

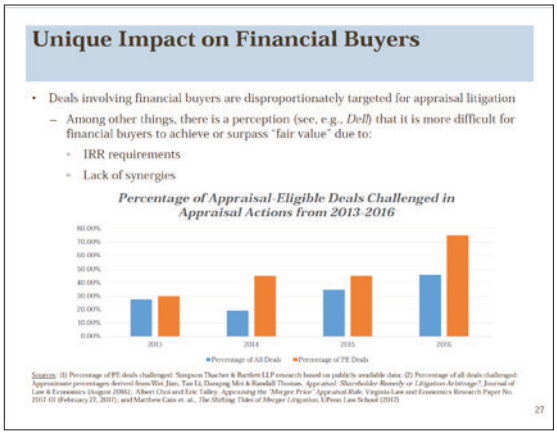


Other Deal Implications Related to Today's Appraisal Risk

The Exclusivity Discussion: Exclusive negotiations = less pre-signing price discovery = more perceived risk of drawing appraisal litigation and having it result in a valuation that is materially in excess of deal price. Despite increased risk of appraisal litigation (and the corollary of less

overall price certainty), a buyer may nonetheless pursue a strategy of seeking to engage in exclusive negotiations with the seller. In response, the seller may look to seek buyer's agreement to not demand an appraisal condition. Query as to practical enforceability?

Impact on Deal Protection Negotiations: The more robust the sale process, the more likely a court will defer, at least in part, to the merger price in appraisal litigation. Accordingly, the threat of appraisal could theoretically soften, somewhat, buyer deal-protection related demands. Similarly, the presence of an appraisal condition could incentivize the seller to demand a more robust market check (pre- and post-signing). Query whether use of a go-shop could help mitigate appraisal risk??



Unique Impact on Financial Buyers

Appraisal claims pose unique challenges for financial buyers. When the aggregate purchase price will not be known until post-closing:

- How does this impact financing commitments at signing?
- How to accurately model the investment?
- Issues with navigating capital calls?

Silver (or Grey?) lining: Financial buyer may be able to reduce capital invested at closing and until resolution of appraisal litigation.

- Can change the leverage profile immediately post-closing.
- Other advantages and disadvantages?

Appraisal Prepayment

In 2016, legislation was adopted in Delaware permitting the "prepayment" of appraisal demands in order to cut off claims for interest on the prepaid amounts. Statutory amendments also limited appraisal to cases involving a minimum aggregate share value of $1 million or 1 percent of the outstanding stock of the company.

Anecdotal indications regarding the use of the pre-funding option to limit the interest rate exposure (5 percent over the Federal Reserve discount rate) are a mixed bag. Some buyers have used the option. Other buyers, however, pass on the opportunity, weighing factors such as:

- Cost of capital associated with prepaying (particularly poignant concern of financial buyers)
- Whether depriving an appraisal petitioner of liquidity by not prepaying could reduce overall appraisal actions and/or offer a buyer leverage in settlement negotiations with appraisal petitioners.

When buyers are considering pre-funding, the key decision points become when to pre-fund and how much.

- Benefit of preserving some downside risk for petitioners.

Final Observations

Further Judicial Guidance: Deal world anxiously awaits Delaware Supreme Court decisions in *Dell* and *DFC Global*. Impact on other notable appraisal litigations pending in the Chancery Court (*e.g.*, *Petsmart*).

Possible Future Legislative Developments?

The following reforms have been proposed and/or discussed in various circles as a result of the appraisal arbitrage phenomenon:

Reduction of Statutory Interest Rate—Reduce the statutory pre-judgment interest rate paid on the amount awarded in any appraisal proceeding.

Shareholder Disqualification—Disqualification of shareholders from appraisal if they were not owners as of the record date, or perhaps even as of the date on which the merger was announced.

Potential appraisal-friendly reforms have been discussed as well, such as: eliminating the exception for stock-only deals; enhanced disclosure

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Appraisal Rights

continued

requirements to give shareholders additional information needed to conduct an independent valuation.

No indication that the appraisal trend will abate. The appraisal arbitrage community, by all accounts, have achieved attractive rates of return to date employing the strategy. Based on a study of appraisal petitions from 2000 to 2014, one study estimates that the average annualized net return on appraisal petitions (not including settlements) was approximately 25 percent, and it appears that appraisal arbitrage funds have subsequently continued to generate attractive returns.

Corwin and (if controllers use it) *MFW* and their progeny (and *Trulia*) may also increase the likelihood of appraisal litigation. Appraisal now one of the few avenues open to plaintiffs to seek post-closing remedies. Recent studies have suggested that the limitation on remedies in merger challenges has been correlated with an increase in appraisal claims. Although statutory reforms were recently adopted to reduce appraisal litigation, practitioners have not been surprised that they have not dissuaded the appraisal arbitrage community.

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