Delaware Court Endorses Share Tracing in Order to Deny Appraisal Claims in Dell Merger

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After a string of Delaware decisions that have been widely interpreted as rejecting a share-tracing requirement in appraisal proceedings involving public companies, the Delaware Court of Chancery recently denied petitioners' appraisal claims on the grounds that evidence showed the petitioners' shares were voted in favor of the merger. The court's May 11 decision in *In re: Appraisal of Dell Inc.*, C.A. No. 9322-VCL is one of a number of recent developments that may help curtail the growth of the appraisal arbitrage industry.

Absence of Share Tracing Under DGCL Section 262 and Transkaryotic

Delaware's appraisal statute, Section 262 of the Delaware General Corporation Law (DGCL), obligates a stockholder seeking appraisal to show that (1) the record holder of the shares for which appraisal is sought (Record Holder Requirement) held the shares on the date it made the demand for appraisal, (2) continuously held the shares through the effective date of the merger, (3) has otherwise complied with DGCL Section 262(d) concerning the form and timeliness of the appraisal demand, and (4) has not voted in favor of the merger with respect to those shares. A problem arises regarding shares held in street name, where the record holder is Cede & Co. (Cede), the nominee for the Depository Trust Company (DTC). In a line of cases starting with *In re Appraisal of Transkaryotic Therapies, Inc.*, 2007 WL 1378345 (Del. Ch. May 2, 2007),[1] the Delaware courts have refused to require holders in street name to trace their shares and show how Cede actually voted those shares. Instead, the *Transkaryotic* court merely required a showing that the number of shares held by Cede that were voted against the merger, abstained or not voted, equaled or exceeded the number of shares that were the subject of Cede's appraisal petition. The *Transkaryotic* court viewed a share tracing requirement as involving an inquiry into actions of the beneficial holders, which were irrelevant under the appraisal statute, the focus of which was on record holders. Subsequent decisions affirmed this view. The judicial eschewal of any tracing requirement, which enables appraisal petitions to be made with respect to shares that are acquired after the record date for the merger, has been a boon to the appraisal arbitrage industry.

Evidence of How Cede & Co. Voted in In re: Appraisal of Dell

In re: Appraisal of Dell involved an appraisal claim by 14 mutual funds sponsored by T. Rowe Price with respect to Dell's going private transaction in 2013. The T. Rowe petitioners held their shares in street name through State Street Bank & Trust Company, as DTC participant, and voted them through a complicated arrangement involving State Street, State Street's outsourced voting service

[1] See an article discussing those decisions.

provider, Broadridge Financial Solutions, and T. Rowe's outsourced voting service provider, Institutional Shareholder Services (ISS). Although T. Rowe intended to vote against the merger, its shares were inadvertently voted in favor of the merger due to a failure to override default voting instructions that were built into its voting policies.

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Several pieces of evidence showed how Cede voted T. Rowe's shares. The votes were traceable as a result of a unique internal control number that Broadridge ascribes for each position held by a Broadridge client. The votes for eight of the T. Rowe petitioners were also evidenced by their Forms N-PX, which, as mutual funds, were required to be filed with the SEC. Email traffic between T. Rowe and ISS, and T. Rowe and State Street, in connection with T. Rowe's internal investigation when it became aware of the possible error after the merger, provided further evidence that T. Rowe's shares were voted in favor of the merger.

Reconciliation of Transkaryotic and In re Appraisal of Dell

In *In re: Appraisal of Dell*, Vice Chancellor Laster noted that the inquiry in *Transkaryotic* and the decisions on which the *Transkaryotic* court relied addressed whether a defendant corporation had the right to require that the record holder petitioner in those cases prove that it was duly authorized by the beneficial owner of the stock to seek appraisal. That requirement was rejected on the basis that the Record Holder Requirement of the appraisal statute dictates that it is the record holder's actions that determine perfection of the appraisal right, not those of the beneficial owner. That holding, according to Vice Chancellor Laster, was not controversial. After the *Transkaryotic* court concluded that only actions of Cede, as record holder, were relevant, it then restricted its analysis to the documents used at the stockholder meeting that showed how Cede voted. According to Vice Chancellor Laster, neither the parties nor the court in *Transkaryotic* appeared to have considered other evidence of how Cede actually voted. Vice Chancellor Laster noted a policy concern in *Transkaryotic* and its progeny (dubbed by Vice Chancellor Laster as the "Appraisal Arbitrage Decisions") that requiring an appraisal petitioner to satisfy a share tracing burden risked cutting off appraisal rights for stockholders holding in street name.

Laster's new test preserves the test set forth in the Appraisal Arbitrage Decisions, but turns it into an element that the appraisal petitioner has to show to establish its *prima facie* case. His new test introduces a means by which defendant corporations can rebut the appraisal petitioner's *prima facie* case

Vice Chancellor Laster noted that the Appraisal Arbitrage Decisions contained language that could be interpreted as precluding any sort of share tracing for shares held in street name. However, he stated that those decisions could be differentiated on the basis that, unlike in *In re: Appraisal of Dell*, there was no proof as to how Cede actually voted the appraisal shares. He stated that where there is such proof, it does not

necessarily follow that the parties cannot introduce it and the court cannot consider it. In setting forth a new test, Vice Chancellor Laster stated that under the Appraisal Arbitrage Decisions, appraisal petitioners holding in street name could establish a *prima facie* case:

> "by showing that there were sufficient shares at Cede that were not voted in favor of the merger to cover the appraisal class. This showing satisfies the petitioner's initial burden and enables the case to proceed. If there is no other evidence, then as in the Appraisal Arbitrage Decisions, the *prima facie* showing is dispositive. . . . The analysis, however, need not stop there. Once the appraisal petitioner has made out a *prima facie* case, the burden shifts to the corporation to show that Cede actually voted the shares for which the petitioner seeks appraisal in favor of the merger. The corporation can do this by pointing to documents that are publicly available, such as a Form N-PX. Or the corporation can introduce evidence from Broadridge, ISS, and other providers of voting services, such as internal control numbers and voting authentication records."

Laster's new test therefore preserves the test set forth in the Appraisal Arbitrage Decisions, but turns it into an element that the appraisal petitioner has to show to establish its *prima facie* case. His new test introduces a means by which defendant corporations can rebut the appraisal petitioner's *prima facie* case.

Implications for Practitioners

In re: Appraisal of Dell is a welcome, but in some sense unremarkable, retrenchment from the Appraisal Arbitrage Decisions. It would be an odd outcome, had the court decided that T. Rowe was entitled to appraisal notwithstanding the undisputed fact that T. Rowe had voted in favor of the Dell merger. The facts arose from a mistake in processing T. Rowe's votes as a result of T. Rowe's complicated voting procedures. How often will corporations defending appraisal actions in future public mergers be presented with such favorable facts? Appraisal arbitrage funds are likely to own far fewer shares than mutual funds, have much simpler voting procedures, and be more diligent in ensuring that shares are not erroneously voted in favor of a merger.

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If the decision does not have a big immediate impact, it could nonetheless prove very significant in the future. Given technology developments, it is likely that ownership and voting architectures will be adopted in the future that make it much easier for appraisal defendants to trace voting of shares held in street name. For example, Governor Jack Markell recently announced a state initiative to explore the use of blockchain technology, such as for "distributed ledger shares." Blockchain technology could serve as a very precise mechanism for tracking ownership and voting of shares. If that proves to be the case, in light of *In re: Appraisal of Dell*, blockchain technology evidence could become

the norm for appraisal cases relating to public company mergers.

The decision is also not the only recent set-back for appraisal arbitrage funds. As described later in this newsletter, DGCL Section 262 was recently amended to prohibit *de minimis* appraisal claims and, more importantly, to permit corporations to limit the accrual of interest on appraisal claims by making early payments to appraisal petitioners. It will be interesting to see whether these amendments, and the *In re: Appraisal of Dell* decision, end up representing a turning point for an industry that has been on the rise for more than a decade.

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