This report presents highlights from panel discussions held in New York (Dec 2014), Miami (Jan 2014), London and Zurich (Mar 2014) hosted by the Institutional Investor Educational Foundation (IIEF) on the topic of

Appraisal as an M&A Investment Strategy

Panelists

Each panel included four of the following distinguished experts:

- **Kevin Dages, CPA,** Senior Vice President at Compass Lexecon and court-certified expert in matters relating to accounting, valuation and M&A disputes.
- **Jay Eisenhofer**, Managing Director at Grant & Eisenhofer P.A., counsel in more multi-hundred million dollar cases than any other securities litigator. He has served as litigation counsel to many public and private institutional investors .
- **Stuart Grant**, Managing Director at Grant & Eisenhofer P.A., internationally recognized for his extensive knowledge in the areas of Delaware corporate law, including fiduciary responsibility, securities and investments, private equity and fixed income, appraisal remedies and valuation.
- **Geoffrey Jarvis,** Director at Grant & Eisenhofer P.A., widely recognized for his work in Delaware corporate law, appraisal remedies, and litigation related to protecting and promoting the rights of institutional shareholders.
- **S.P. Kothari,** Deputy Dean at the MIT Sloan School of Management and former Global Head of Equity Research for Barclays Global Investors.
- **Nick Matthews,** Senior Member of Kinetic Partners' Forensic and Corporate recovery practice, focusing exclusively on clients in the investment management sector, including hedge fund and traditional asset managers, investment banks, insurers and regulators.
- **Geoffrey Stern,** Managing Member of Muirfield Value Partners, an asset management firm dedicated to Appraisal Rights investing. Mr. Stern spent 20 years at Donaldson Lufkin & Jenrette, where he was a partner in the Mergers and Acquisitions group.

Discussion Topics

- What is an appraisal action, and what are the best appraisal cases?
- What is the appraisal action process and timeline?
- What is the investment opportunity?
- What are the parameters in a valuation? What is the role of expert testimony?
- What are the risks for investors?
- What happens if the appraisal gets appealed?
- What is the risk of multiple appraisals occurring on the same case?
- Do voting rights make a difference?
- Can appraisal claims be transferred or sold?
- What is the landscape outside of Delaware—in the U.S. and Europe?
- How is the investment process structured, and what are the performance fees?

"An appraisal action is similar to the U.S. Constitution guarantee that the government cannot take your property without just compensation."
- Stuart Grant

Introduction and background: What is an Appraisal Action?

Stuart Grant: An appraisal action is similar to the U.S. Constitution guarantee that the government can't take your property without just compensation. Your real estate can be taken by eminent domain to build a road, but you're entitled to a hearing and fair compensation for that property. Appraisal is the same thing in the corporate context. If the shareholder majority votes for a merger, you can be forced to give up your shares, but you are guaranteed just compensation, i.e. fair value.

Jay Eisenhofer: Appraisal is a proceeding to determine the value of minority stockholders' interest in a corporation when there is a cash transaction; it's a remedy for minority shareholders who are losing their interest in the corporation. Appraisal as an investment opportunity arises from the fact that the appraisal statute in Delaware says that minority shareholders are entitled to the fair value of their shares as of the date the transaction closes.

The term "fair value" is significant because fair value can be very different from market value as interpreted by the Delaware courts.

The difference between market value and fair value is what makes appraisal an attractive option for investors.

Stuart Grant: The appraisal proceeding determines in state court, usually Delaware, what your stock was worth when they took it away from you. The timing is critical; it's the value of the stock at the time the deal closes, not when the merger is announced – with no consideration of any synergies from the merger. An appraisal action is a legal proceeding, except that you don't have to prove any wrongdoing. The fight is exclusively over the stock's value.

Appraisal actions have been around for a very, very long time, but only recently been seen as an investment strategy.

Jay Eisenhofer: What made appraisal an especially attractive investment vehicle was the Delaware Court's ruling that you can buy into an appraisal action even if you buy your shares after the record date for the transaction. That means that the record date could pass, shareholders could vote on the transaction, and you could still buy your shares and decide to exercise your appraisal rights. You do have to vote against the deal in order to exercise your appraisal rights, but as long as a sufficient number of shares are voted against the deal, you are protected.

Most investors who pursue appraisals as an investment strategy buy after the record date and before the vote in order to be able to vote their shares against the deal.

"In Delaware, you can bring an appraisal action in a cash merger, but not in a stock for stock transaction. In a mixed stock-cash situation, if there is a mandatory stock component, you generally can bring in an appraisal action."
- Geoffrey Jarvis

What is the appraisal action process and timeline?

Geoffrey Jarvis: In the U.S., an appraisal action can be brought in two places: in Delaware under a Delaware statute, and in most of the rest of the U.S. under the Model Business Corporation Act. The vast majority of appraisals are brought in Delaware for two reasons:

1) Most of the Fortune 500 and about half of American public companies are located there.
2) The Delaware Chancery bench really understands appraisals and the valuation of businesses. In the rest of the legal world, you may get a judge who has no idea what discounted cash flow is and the outcome will be much more random.

Historically, in order to bring an appraisal action you had to:

1) Own shares on the record date;
2) Vote "no" with the shares that you owned or instruct your record holder to vote "no" or abstain from voting on the merger;
3) File a paper with the company prior to the actual vote; and
4) File a petition for appraisal.

The 2010 *Transkaryotic* appraisal action decision, which said that you don't have to own shares on the record date, allows activist investors to come into the process much closer to the actual vote, thereby reducing deal risk.

Geoffrey Jarvis: Once you've gotten your letter in and the deal closes, you have an automatic 60 days to change your mind and take the deal price. If you decide to proceed, you have 120 days after the deal closes to file an appraisal petition beginning litigation.

If the case is not settled and the litigation continues, there is no need to prove any wrongdoing or breach of fiduciary duty

The documents obtained in discovery are all related to the value of the company. You hire experts to look at the elements they've used to determine cost of capital. You look at what they consider to be their long term growth prospects, and look for projections that were not put into the proxy.

Because management is not stupid, they're going to put together projections that demonstrate that the price is in the middle of the fairness range, not the more optimistic projections they may have put together previously for debt restructuring. The expert we hire to do this analysis is usually a finance professor at a major university, and these experts can be quite expensive. This expert will present his/her analysis to the court, and there's no need to demonstrate that anyone did anything wrong.

"Appraisal proceedings in Delaware don't take very long; they're much faster than typical commercial litigation. And most of the cases settle without going to trial." - Jay Eisenhofer

As a practical matter, we do like to show that this is an interested transaction and that the deal price has issues

Anything that shows the deal price to be unfair will get the judge to look vigorously at what the experts have to say. Once the company sees how many shares have sought appraisal, they can put a price tag on what it will cost them to resolve the entire situation. This is often when settlement discussions begin. Sometimes you have to pursue the litigation process all the way through to a court decision. For G&E, this generally takes 12 and 15 months; an outlier might take 18 months. The reported premiums in appraisal cases that go to trial are very substantial, but these are a fraction of the overall cases because most settle out of court.

There's a 60-day time period during which you can take the deal price if you change your mind after you petition for appraisal

Jay Eisenhofer: Even if you are forced to go through the entire proceeding and go to trial, an investor is able to get their return in a relatively short timeframe. There's a 60-day time period during which you can take the deal price if you change your mind after you petition for appraisal. Once the 60 days passes, whoever has filed the petition for appraisal is then on record. Once the company is aware of the universe of appraisal petitioners, they often want a quick resolution.

What makes an attractive appraisal investment?

Jay Eisenhofer: For an investor, the most attractive type of appraisal case is one where a majority controlling stockholder is buying out the minority. In that circumstance, the majority shareholder usually has some inside knowledge about what the corporation's prospects are. Clearly, they are not taking the company private because they want to be charitable; they're doing it because they believe there is additional unrealized value in those shares that they will capture. Historically, the premiums in this type of appraisal case have been very significant.

A less attractive situation is one where a strategic buyer is combining his assets with the assets of the acquired company and whatever premium they are paying is in part or in whole based upon synergies that are going to be achieved in the deal. This is not an attractive appraisal case, because fair value is determined to be at the time of the closing of the transaction, not taking into account any synergies going forward.

Appraisal can be applied in many industries

IP intensive companies are obviously more risky but they're also potentially much more rewarding, because unrealized intellectual property can be worth enormous sums of money.

"In addition to situations where majority shareholders are taking up minority shareholders, private equity transactions can also present an attractive investment opportunity." - Geoffrey Stern

The investment opportunity

Jay Eisenhofer: As a result of the legal developments in this area, appraisal has recently become very popular in the Delaware courts. Ten years ago, it was very rare to see appraisal action filed in Delaware. Today, appraisal cases make up around 15% of all the cases pending in the Delaware Court of Chancery.

Another attractive aspect of appraisal proceedings in Delaware is that you earn interest on your money – Fed Funds plus 5% – for the entire time that your case is pending

In today's environment, that's an attractive amount to be earning on your money. A number of funds are now applying appraisal as an investment strategy.

Geoffrey Stern: Our fund, Muirfield Value Partners, invests in appraisal rights opportunities on a deal by deal basis. We think it's an attractive, low-risk strategy with a limited downside. If you pick the right transactions, you have a very high likelihood of recovering a meaningful premium over your purchase price.

In addition to situations where majority shareholders are buying out minority shareholders, private equity transactions, where the management team is working with a private equity firm to take the company private, can also present an attractive investment opportunity. The climate for those transactions is favorable today because the financial markets are wide open. Financing is very cheap and private equity firms have lots of capital to put to work.

Our firm is expecting 3-7 actionable deals every year; we'll cherry pick that group and invest in 2-4 deals per year. This space has been under the radar for a number of years, partly because settlements are private and there's little public data about it.

There has certainly been an increasing amount of capital put forward in the past year, in part due to the visibility of the Dell case. Last year there was approximately $1 billion invested in some of the major appraisal rights cases. Last year, there were approximately 12 deals involving billion dollar-plus companies where appraisal rights were taken.

Jay Eisenhofer: There were 12 different appraisal cases filed last year in Delaware, and I believe there were 30-35 different funds that filed cases. Over the last 20-30 years, there have been hundreds of cases, with 10-15 in any given year.

Geoffrey Stern: It does depend a lot on what's going on in the markets. When credit is good and people are likely to do LBOs and go private, you are going to have a bigger universe. In '08, '09 and '10 there were fewer of these deals around.

" The opportunity for investors lies is finding companies that are bought at the very low end of the fair value range, where a strong argument can be made that they are really worth a lot more." Geoffrey Stern

Geoffrey Stern: The most well worn path for managers to get rich is to take a company private, and Wall Street is geared towards facilitating that.

Most of the companies we invest in are management LBOs where the management team is working with a private equity team to buy a public company and take it private at the lowest cost per share. There are over 75 private equity firms with over $2 billion of unspent committed capital, so we expect to see a fair number of deals like this in the near future.

If a private equity buyer is lined up with management, increasingly we see a board of directors willing to approve a deal that hasn't been extensively auctioned

There are lots of overlooked companies in any market that often trade at cheap prices. These companies are attractive to private equity buyers but not to strategic buyers. If a private equity buyer is lined up with management, increasingly we see a board of directors willing to approve a deal that hasn't been extensively auctioned.

In some situations, the intrinsic value of the company may be much higher than the deal price; the insiders have a real conflict between their obligations to the stock holders and their economic interest to get the lowest price possible.

The opportunity for investors lies is finding companies that are bought at the very low end of the fair value range, where a strong argument can be made that they are really worth a lot more. Institutional investors are often seen as passive people who scream about deals being unfair, yet many would rather roll over and put their money elsewhere than go for appraisal rights. But we believe there is a sea change. For the first time, we're seeing some large investors apply for dissenters' rights and go for appraisal rights.

The case that's gotten the most press recently is Dell, a $25 billion going-private transaction

Stuart Grant: There are some complicated cases out there, and Dell is a good example. Michael Dell will claim that Dell is a box maker with a declining market share in a declining industry. Our job is to prove that Dell is a company in transition to cloud computing, with unbelievable growth rates in the cloud side of the business.

What are the evaluation parameters?

Professor S. P. Kothari: I do fair bit of valuation analysis as a professor and as an expert witness. People generally rely on the traded stock price, and with a large company we often assume that the market is efficient for that security. But in an appraisal action, your valuation assumes that the takeover deal won't go through.

"It helps to demonstrate that there was some conflict of interest, because that provides a rationale for why the deal price was lower than the fair value."
- Professor Kothari

In the case of Dell, the analysis is that if Dell remains a public corporation, it would be operated somewhat differently – and therefore the valuation would be different. The claim is that a bit of self dealing is going on, even though in court of law you are not trying to establish any wrongdoing.

The valuation expert's job is to establish and explain to the judge what the price would have been if the company had not gone private

To determine fair value, we use standard techniques, including discounted cash flow. In discounted cash flow, we consider two elements: what are the projected cash flows and what is the appropriate discount rate? There's more latitude in projected cash flows.

The task of the expert is to come across as reasonable, not as an advocate of the party that hired us, because the other side is going to produce an expert as well. It helps to demonstrate that there was some conflict of interest, because that provides a rationale for why the deal price was lower than the fair value.

So while there's no burden to establish wrongdoing, demonstrating that some conflict of interest, self-interest, or agency issue influenced the deal price is helpful in establishing a higher fair value.

Geoffrey Stern: It's helpful but not essential. For example in Dell, between the date the deal was announced in January and the date it closed in October, Dell's primary competitor's stock (HP) went up 90%. You don't need to have conflicts; market forces can impact fair value.

Nick Matthews: I'm not a lawyer and I'm not an American, so I bring a different angle to this process. I'm a forensic accountant working for Kinetic Partners, a firm of advisors for the investment space. We're not so much involved in the financial due diligence analyzing DCF or comparative price models; we look at the nonfinancial side of things.

We're looking to use the company's own projections to establish a higher value than the deal price.

Jay Eisenhofer: In our appraisal cases, we would use somebody like Nick to test the reasonableness of the company's projections. We're looking to use the company's own projections to establish a higher value than the deal price. In a management or majority shareholder led buyout, the company's internal projections will almost always support a higher price than the deal price.

Geoffrey Stern: More aggressive projections are often used when companies seek bank financing, and when setting executive compensation levels.

"DCF (discounted cash flow analysis) was used for valuation in the majority of cases since 2004. But today, sometimes the court will accept DCF, and sometimes not." - Kevin Dages

What is the role of expert testimony?

Kevin Dages: The judges in appraisal actions have to sign their name to an opinion assigning value per share, and they are not by training or by nature appraisers. Professor Kothari and I have to present evidence and a balanced analysis, and convince the court that our rational is reasonable. The final decision will be dependent on the facts and the discovery within the particular case. DCF was used for valuation in the majority of cases since 2004. But today, sometimes the court will accept DCF, and sometimes not. In the most recent CKx and American Idol cases, they could not get comfortable with the forecast and decided not to take DCF. Another issue is how much to rely on management forecasts in calculating DCF. I have been in the situation of extending a one-year management forecast to five years in my DCF; the court accepted that as a reasonable projection.

I can't assure you that the valuation will always be based on DCF and the management forecast.

The opposite happened in Vitalink. The management forecast used in valuation incorporated products and elements of value that the standalone company would not have had access to. The court rejected that forecast and accepted three other scenarios instead. So I can't assure you that the valuation will always be based on DCF and the management forecast. I also can't assure you of a premium value if you litigate.

The Technicolor case, which took 21 years, was a huge anomaly, and the interest far dwarfed the actual reward in that case. But the Technicolor case did demonstrate what the relevant elements are in determining fair value. Is it the value of the company that would exist post merger, or the value of the company that exists on the day of the close, and how do you determine that? Professor Kothari said the value is exclusive of any value or synergies arising from the expectation or accomplishment of the merger. But it has to take into account the state of the business and the expectations of the business as of the appraisal date.

The premiums have ranged up to the 400% range, but not all are positives. Across the last 28 cases, 21 have had premiums ranging from 4% to 417%, with 28% the median. The rest were awards ranging from -4% to -19% below the deal price, except for one case where the company was approaching bankruptcy. In that case the value was zero.

In the last 28 cases going back to 2004, 75% have yielded significant premiums or premiums to the deal price. But a number of recent cases have resulted in no premium to the deal price and certain earlier ones had negative premiums.

Jay Eisenhofer: The key is to invest in the right cases. If you pick the right transactions, you have a very high likelihood of resolving the case for a meaningful premium over your purchase price.

"As you look at potential targets, you should question the degree of leverage, the environment and how well you're compensated for the lack of liquidity."
- Stuart Grant

Geoffrey Jarvis: The cases yielding a negative or no premium tend to be idiosyncratic situations. Perhaps someone on the inside was angry or didn't like the people who did the deal, and they litigated something they probably shouldn't have. A clear example was the case with the negative 100% premium Kevin referred to. It was an effectively bankrupt company worth virtually nothing. No one considering an investment strategy would go anywhere near that.

What are the risks for investors?

Jay Eisenhofer: The primary risk of going into an appraisal proceeding is that the deal will not close; buying in close to the vote significantly decreases that risk. The second is credit risk. When you do an appraisal, your public shares are cancelled and you become an unsecured creditor of the company during the appraisal proceeding. I am not aware of any case where a company defaulted on its obligations while an appraisal proceeding was pending. So although there is a theoretical credit risk, as a practical matter it's not been proven to be an issue.

The third risk is that the court determines that the fair value is less than the deal price, but if you chose your appraisal cases carefully that's not going to happen to you. There have only been a few appraisal cases in the past 30 years where courts have awarded less than the deal price.

Stuart Grant: Lack of liquidity is a concern for some investors. Once the deal closes and you seek appraisal, there's no longer a market for the shares, and you're in until you can resolve the case. As you look at potential targets, you should question the degree of leverage, the environment and how well you're compensated for the lack of liquidity.

Lack of deal flow is another concern. We have not had a huge flow of M&A deals recently, and a higher percentage of them have been strategic deals. You don't know what the opportunities are going to be in any given year because they really depend on deal flow.

Despite these drawbacks, the rewards are such that we are seeing money pouring into appraisal actions from hedge funds as well as from separate funds dedicated just to this strategy

Geoffrey Stern: Being an unsecured creditor is not the best place to be, but you are generally senior to other obligations of the company. We carefully monitor the situation, and can buy credit default swaps if we're concerned.

We mitigate the risk that the deal doesn't happen by selecting good targets and by buying the stock late in the process, on or after the record date. We can also hedge our position by buying put options on the securities.

"In most circumstances, it's simply going be a waste of the company's money to spend additional funds on legal fees by appealing the case."
- Jay Eisenhofer

Jay Eisenhofer: The cost of litigation is an investment risk. There is no minimum number of shares required to pursue appraisal, but the cost of an appraisal proceeding for a petitioner is the same whether you have 10 shares or 10 million shares. The key issue affecting how many shares you want to have when seeking appraisal is the expense of the proceeding, because it's heavily dependent upon corporate finance experts. You need a very good valuation expert on your side, and the really good ones are particularly expensive. If you're going to spend $500,000 or $1 million on a valuation expert, clearly the potential return has to justify that level of expense.

What happens if the appraisal gets appealed?

Jay Eisenhofer: If the company disputes the court's valuation, they can appeal. But in most appraisal cases, the determinations will be based upon factual questions and there's not much an appellate court will do to disturb that. So in most circumstances, it's simply going be a waste of the company's money to spend additional funds on legal fees by appealing the case.

Geoffrey Jarvis: An appeal is unlikely. A lot of times, the company has to put up an appeal bond to cover the award amount, and the interest rate (Fed Funds plus 5%) is running the whole time. Unless the company thinks they have a very good chance of winning, it's just not worth it.

Jay Eisenhofer: Many cases are settled with a privacy obligation. Companies do not want to be on record that a judge has ruled that the price is unfair, which indicates that something bad happened.

Kevin Dages: Whether a valuation is appealed depends on whether the original issues are fully explored in the initial proceeding.

If there is an appeal, it generally means you got a really good result

Stuart Grant: The appeal process is about a nine month process, and you're still collecting interest on the entire appraised value. Let's say the deal price is $20; with the quarterly compounding interest you're earning 6% interest. If the appraisal price is $30, you made a 50% premium plus interest on the $30 price. It's an added kicker.

I was asked if I had turned down cases. I will not take a case with a person who needs to sell in two or three months and expects the best returns. I need people who are prepared to go the long haul, who are doing this for the right reason because the numbers work. Investors need to understand that it's going to be an illiquid investment for 12 to 15 months, longer if there is an appeal. But if there is an appeal, it generally means you got a really good result.

"For those of you who dive, if you're swimming with a bunch of fish and all of a sudden there are no other fish around you, there may be a reason. It's nice to know that there are others who think the deal is undervalued." - Stuart Grant

What is the risk of multiple appraisals occurring on the same case?

Stuart Grant: Unlike a class action suit where somebody steps forward on behalf of everyone, if you don't petition for appraisal, you don't get it. And once everyone buys in, there is only one appraisal, so there's a negotiation around who is going to lead the pack. If there is one shareholder or group of shareholders who are substantially larger than the others, it will get to lead. If there are multiple shareholders or groups of shareholders with significant stakes, generally leadership will be shared.

Geoffrey Stern: As the plaintiff, we need to have enough money at stake to make it worthwhile - $30 million or more - because we pay our own legal and other costs of the case, including good experts. In a case like Dell, Michael is going to pay a premium to the small group people who go out for appraisal rights, but it's still a lot cheaper for him than increasing the price for everybody.

It's harder for an individual investor to have a large enough position to warrant appraisal

Stuart Grant: A benefit of the funds that focus on this strategy is that they have the capital to commit at least $30-50 million to make it economically worthwhile. It's harder for an individual investor to have a large enough position. There's another issue to consider. For those of you who dive, if you're swimming with a bunch of fish and all of a sudden there are no other fish around you, there may be a reason. It's nice to know that there are others who think the deal is undervalued.

Do voting rights make a difference?

Geoffrey Stern: In the Delaware statute, the valuation is irrespective of voting rights. So you are entitled to the fair value of your shares as a going concern without regard to being a minority shareholder.

Stuart Grant: I've probably done 30 appraisal cases, and the worst scenario took two years - a Georgian telecom company (the republic of Georgia, not the U.S. state). We settled during the appellate process for a 35% return over the two year period. The case was interesting because it involved both common and preferred stock. There are only appraisal rights where there is a cash, not a stock, deal.

Can appraisal rights claims be transferred or sold?

Stuart Grant: We have had people transfer claims, but most want to stay in it. Most of these appraisal proceedings do not drag out; I have settled many within 100 days. These may not have been huge hits, but an additional 10% in less than three months is not a bad return.

"Appraisal rights actions are outside the SEC's regulatory scope. The SEC regulates matters under federal law, and appraisal is a state law remedy."
- Jay Eisenhofer

What is the landscape in states other than Delaware?

Jay Eisenhofer: In the United States, just about every state recognizes appraisal as a remedy, but virtually all of the appraisal litigation to date have taken place in Delaware. Most states outside of Delaware follow what's called the Model Code, which allows you to get your money when the deal takes place, even if you seek appraisal. In Delaware, if you have decided to seek appraisal, you don't get your money when the deal closes; you simply become a creditor of the company.

The problem with pursuing appraisal in the other states is that the judges are totally unfamiliar with valuation or complex valuation matters, whereas in Delaware you will get judges with an in-depth understanding of valuation techniques and corporate law.

In the U.S. most of the investors who have pursued appraisal as an investment strategy have limited themselves to Delaware cases

Geoffrey Stern: You may ask, "What's the risk in a state with the Model Code if I know I'll get my money out when the deal closes?" The risk is the cost of the appraisal proceeding. You have to pay a finance expert and they're very expensive – $500k - $1m per case. You also need lawyers to handle the discovery, and it will be harder to find lawyers willing to take on the case on a contingent basis in a state with no track record of appraisal cases.

What is the landscape outside of the U.S.?

Jay Eisenhofer: Germany has an appraisal statute and they've had many appraisal proceedings during the last decade, particularly since they raised the interest rate awarded on judgments.

I believe they've raised it to the risk free rate plus 5%, similar to the rate awarded in Delaware. There are significant differences between the way appraisal works in Delaware and the way appraisal works in Germany and you should consult with a German lawyer.

Is the SEC involved in these cases?

Jay Eisenhofer: Appraisal rights actions are outside the SEC's regulatory scope. The SEC regulates matters under federal law, and appraisal is a state law remedy. U.S. federal law generally governs disclosures and the remedies you might have if those disclosures are not adequate. State law governs issues of valuation and how transactions are structured.

"It's possible that as appraisal as an investment strategy becomes more and more popular, there may be people who want to make it less available as an investment strategy." - Jay Eisenhofer

Additional Audience Questions

Can a retail investor without the financial resources to cover the litigation costs ride on the coattails of a larger investor seeking appraisal rights?

Jay Eisenhofer: You might be able to, but you would be taking a significant risk. There's no guarantee that the larger investor will be willing to share the costs with you, nor that they won't settle the case out from under you and leave you alone to prosecute your own case. It's a risky thing for an individual investor to do if you're not prepared to pay the freight.

Can multiple investors pull together to share the legal and expert costs?

Jay Eisenhofer: Investors pulling together has become commonplace, often because they have a relationship with a law firm like us; they're increasingly filing these cases as groups because it makes economic sense. And we're seeing a lot of repeat filers - half a dozen funds are coming into these cases on a regular basis and working together to share expenses.

If you get started and discover it's not a great case, can you pull out and get the deal price?

Jay Eisenhofer: If you decide you made a mistake, once you pass the 60 day statutory window, you are not entitled to get the deal price. But as a practical matter, if you've chosen the cases properly, the company is going to be thrilled to give you the deal price; they'll be happy to have you drop the appraisal action.

What's the definition of a minority investor and is there a limit to what you can invest?

Jay Eisenhofer: There is no minimum or maximum number of shares that can seek appraisal, and by definition you're going to be a minority shareholder. If you are a majority shareholder, the deal will not go through if you aren't in favor of it.

What is the reputational risk to investors? Are appraisal actions seen as just part of the cost of taking a company private, or are they still seen as unusual?

Jay Eisenhofer: In terms of reputational risk, there really is none in the United States. It's just a valuation proceeding; you're not accusing anybody of doing anything wrong. You just have a disagreement over what the value of the shares should be.

Appraisal is a statutory process designed to protect minority shareholders. Of course it's possible that as appraisal as an investment strategy becomes more and more popular, there may be people who want to make it less available as an investment strategy. But at least for now it's a perfectly appropriate mechanism.

"As a practical matter, you don't want to be involved in appraisal cases where there is no self-interest to point to."
- Jay Eisenhofer

Additional Audience Questions

In discovery, what is actually discoverable? Would a spreadsheet prepared on his home computer by the CEO for his management team be discoverable? And is a projection like that allowed in the valuation process?

Jay Eisenhofer: You would certainly be entitled to obtain discovery of those CEO projections if you can get them.

You made it clear that the appraisal proceeding doesn't require proof of fraud or breach of fiduciary duty. But you indicated that the process benefits from the plaintiff demonstrating some potential bias or benefit to the management from using a particular set of projections. How does that figure into your legal strategy?

Jay Eisenhofer: You don't have to prove breach fiduciary duty or prove fraud, but it can color the judge's perception of the case if s/he feels that there was a motive to underpay the minority shareholders. In that case, the judge will be much more receptive to your valuation argument. On the other hand, if a judge sees a fully negotiated, fully shopped transaction involving a third party with no relationship to management or a controlling shareholder, the judge's natural inclination is to trust that the deal price is fair. As a practical matter, you don't want to be involved in appraisal cases where there is no self-interest to point to.

If the judge rules in favor of the appraisal filer, does the buyer have the right to walk away from the entire deal?

Jay Eisenhofer: No, the deal has already closed by the time that happens. In Delaware, only the persons who have sought appraisal obtain the benefits of the appraisal proceeding. The other shareholders have already gotten the deal price because the appraisal proceeding takes place post closing. Years ago, most transactions included a provision giving buyers an out if a certain percentage of the shareholders sought appraisal. That may come back as a greater percentage of shareholders seek appraisal.

An important difference between the procedure in Delaware and the procedure in Germany is that in Germany the appraisal proceeding applies to everyone. If you seek appraisal for your shares and the court in Germany awards you a premium, my understanding is that the premium then goes to everybody.

Geoffrey Stern: When I started my business in the early 80s, there was a standing provision that if more than 10% of the shareholders opted for appraisal rights it was grounds for the buyer to not consummate the merger. As the business evolved and merger contract terms tightened in the 90s and 2000s, this practice went away. I don't think it's going to come back anytime soon, and the top M&A attorneys I know agree.

"There are a small number of funds like ours that do this on dedicated basis, and there are some hedge funds that invest in appraisal actions opportunistically on a case by case basis." - Geoffrey Stern

How is the investment process structured?

Geoffrey Stern: We invest money on a deal by deal basis and our minimum investment is $1 million. It's a segregated investment. We buy stock in that one transaction, we hire G&E to pursue it for us, and when that settles, money comes back in and we distribute all the cash to investors. The strategy is available to non-U.S. investors. We have an offshore feeder fund, subject to the same tax implications that you have for other offshore funds.

Stuart Grant: There are a lot of different strategies. Geoff's fund gives you more options than most to invest or not in individual deals. Other funds ask you to commit funds for a fixed number of years and won't tell you the deals they're investing in. Still other funds put your money in other investments when they're not investing in appraisal actions.

What are the performance fees?

Geoffrey Stern: We charge one percent management fee and 20% of the net profits after all transaction costs, including legal and brokerage fees. By working with G&E on a contingency basis, we are buying insurance, protecting ourselves against the potentially very large cost of a fully litigated case with appeal. We expect that our investors will net in the high teens to low 20's over a series of cases.

Geoffrey Stern: We have a very large group of passive investors in the space. There are a small number of funds like ours that do this on dedicated basis, and there are some hedge funds that invest in appraisal actions opportunistically on a case by case basis. Carl Icahn has done this episodically over the years.

"There is a legal art and an investment art, but the bottom line is that this investment strategy is predicated upon management or shareholder self interest. You need to assume that people are acting in a self-interested way, and that they won't overpay for something. If you are careful and limit yourself to those cases, you can make a lot of money in this strategy." - Jay Eisenhofer

Learn More

The Appraisal Briefing workbook materials are available to IIEF members only on the IIEF website. They provide a comprehensive overview of the current use of Appraisal Rights actions.
See Page 17 for a list of the workbook contents.

Workbook Materials

The following workbook materials are available to IIEF members only on the IIEF website. They provide a comprehensive overview of the current use of Appraisal Rights actions.

- The Use of A Statutory Appraisal Proceeding as an Investment Strategy – *Grant & Eisenhofer P.A.*
- State Appraisal Statutes: An Underutilized Shareholder Remedy – *Geoffrey C. Jarvis, Grant & Eisenhofer P.A.*
- Statutory Appraisal in the Spotlight – *Grant & Eisenhofer P.A.*
- Appraisal Rights – Shareholder Activism Handbook – *Jay W. Eisenhofer and Michael J. Barry, Grant & Eisenhofer P.A.*
- An Appraisal of the Model Business Corporation Act's Appraisal Rights Provisions – *Mary Siegel, Washington College of Law*
- Unlocking Intrinsic Value Through Appraisal Rights – *Jeremy D. Anderson and José P. Sierra, Law360*
- The Growth of Appraisal Litigation in Delaware – *David J. Berger, Wilson Sonsini Goodrich & Rosati*
- Icahn Moving To Perfect Appraisal Rights Of Dell Shares; Urges Other Dell Stockholders To Act Now To Do The Same – *PR Newswire*
- Icahn's Latest Gamble at Dell: Appraisal Rights – *Michael J. de la Merced, The New York Times*
- Dell Value Dispute Spotlights Rise in Appraisal Arbitrage – *Miles Weiss, Bloomberg*
- Dell Appraisals Demanded by T. Rowe to Magnetar Capital – *Miles Weiss, Bloomberg*
- Dell Shareholders Like Their Appraisal Odds in $25B Buyout – *Liz Hoffman, Law360*
- Dole Food Deal Passes by Slim Margin as Hedge Funds Seek Appraisal – *Liz Hoffman, WSJ*
- Freeze-Out Transactions in Germany and The U.S.: A Comparative Analysis – *Christian A. Krebsa*