

# How Institutional Investors Are Letting Billions Slip Through Their Fingers in Delaware Appraisal Actions

By Michael Lange, Esq. and Brian Shea, Esq.

Report

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## INTRODUCTION

On May 31, 2016, the Delaware Chancery Court issued its opinion in the *Dell* appraisal case, valuing the company's common stock at 28% more than the \$13.75 paid to shareholders on October 29, 2013.<sup>1</sup> In other words, Michael Dell and his management team underpaid investors by about \$6 billion in the deal. Despite the magnitude of Dell's underpayment, the company is only paying \$37 million more to dissenters as a result of the Court decision.<sup>2</sup> Why? Most investors, having failed to timely exercise their appraisal rights *before* the vote on the deal, are now ineligible for payments and have consequently left \$5.96 billion on the table.<sup>3</sup> The *Dell* case is not an anomaly. As discussed in detail below, appraisal actions frequently award comparable premiums, and investor participation is similarly small.<sup>4</sup>

Institutional investors have become savvy about filing proof of claim forms in securities class action settlements, but they continue to let billions slip through their fingers by under-utilizing Delaware's appraisal process. This raises concerns about whether investors are fully satisfying their fiduciary duties in this area.<sup>5</sup>

This article provides an overview of Delaware appraisal law and recent trends that have created opportunities for institutional investors with significant holdings to more fully and efficiently utilize this remedy *without filing suit or prosecuting appraisal petitions themselves*. We offer insights for fiduciaries into the mechanics of this quasi-passive recovery opportunity, and then make suggestions on identifying, monitoring, and evaluating appraisal situations so they don't miss out on future premiums.

## APPRAISAL RIGHTS

Appraisal rights exist in mergers and consolidations involving some degree of cash (rather than stock) consideration. Not less than 20 days before the vote on a given deal, investors must be notified if appraisal rights are available.<sup>6</sup>

Under section 262 of the Delaware General Corporation Law, if you believe the value of your shares exceeds the amount being offered, you can exercise your right to have their worth determined and awarded by a judge from the Chancery Court. These suits differ from securities class actions and other shareholder matters in that they don't involve claims of wrongdoing – they concern your right as a shareholder to an objective valuation of your investment. There is no class or

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<sup>1</sup> In re Appraisal of Dell Inc., C.A. No. 9322-VCL at 1 (Del. Ch., May 31, 2016).

<sup>2</sup> Matt Levine, *T. Rowe Price Voted for the Dell Buyout By Accident*, BLOOMBERG (May 13, 2016).

<sup>3</sup> "Few of the Dell investors are eligible for compensation due to the intricacies of the law in Delaware, where the suit was filed." Sarah Krause, *T. Rowe Price Pays Up for Botched Vote*, WALL ST. J (June 6, 2016), note 1.

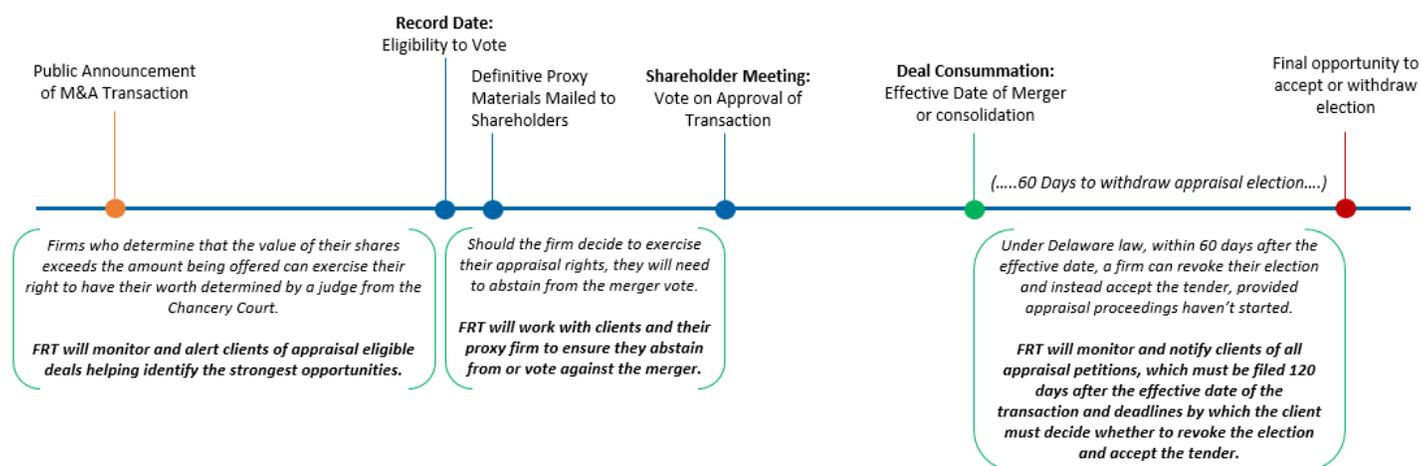
<sup>4</sup> Appraisal rights have gained increased attention in recent weeks following T. Rowe Price's decision to voluntarily pay \$194 million to its mutual fund investors after it failed to properly exercise its appraisal rights in *Dell* due to an administrative error. T. Rowe's payment is more than 5 times what Dell must pay following the Court's valuation decision.

<sup>5</sup> See James D. Cox & Randall S. Thomas, *Letting Billions Slip Through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions to Participate in Securities Class Action Settlements*, 58 STAN. L. REV. 411 (2005) (citing In re Caremark Int'l Deriv. Litig., 698 A.2d 959 (Del. Ch. 1996)).

<sup>6</sup> Del. Code tit. 8, § 262(d).

lead plaintiff, and unlike securities cases, both sides in an appraisal action bear an equal burden to show fair value by a preponderance of evidence, a determination ultimately made by the court. This levels the playing field.

Appraisal petitions are *representative* actions brought on behalf of all investors perfecting appraisal, meaning only one dissenting shareholder needs to file a petition and prosecute the appraisal case on behalf of others. The petition must be filed in the Chancery Court within 120 days after the effective date of the transaction. Within 20 days of filing, the corporation must file an accompanying list of stockholders who have demanded appraisal and not previously settled.<sup>7</sup> If the petitioner obtains a negotiated or judicially determined valuation, that result is available to all others who have perfected their rights.



Appraisal litigation focuses on share value and involves “battles of the experts.” Discovery is focused on valuation issues, matters related to how the deal was negotiated and/or shopped, and on occasion, the standing of investors seeking appraisal.

With a number of large funds specializing in appraisal arbitrage – buying large amounts of shares after transaction announcements to seek premiums through appraisal – institutional investors who made prior investments and own significant numbers of shares as of the Record Dates can take advantage of these arbitrage efforts *without having to file and prosecute the appraisal petitions themselves*. As the Chancery Court recently noted in *Plasmanet*, non-appearing investors who exercised appraisal and negotiated settlements could have filed petitions but were not required to do so: “[T]here need be only one appraisal petition – filed by the surviving corporation or by a former stockholder – to commence an appraisal proceeding and thereby entitle all former stockholders with perfected appraisal rights to receive what the Court determines to be the ‘fair value’ of the corporation’s stock.”<sup>8</sup>

As that Court further noted, appraisal matters resemble class actions in that “all members of the class enjoy the fruits of the class representative’s labor.”<sup>9</sup> But there is a critical difference: investors seeking appraisal must affirmatively *opt in*

<sup>7</sup> § 262(e)-(f).

<sup>8</sup> *Mannix v. Plasmanet, Inc.*, C.A. No. 10502-CB at 5 (Del. Ch. July 21, 2015) (Bouchard, C.).

<sup>9</sup> *Id.* at 6.

by perfecting their rights before the deal vote. This was the problem in *Dell* – most shareholders failed to opt in *before* that vote, forfeiting their eligibility to later benefit from the Court’s valuation.

### APPRAISAL OPPORTUNITIES

From January 2015 to date, there have been more than 160 deals eligible for appraisal. Only a fraction of appraisal eligible deals – about 15% – result in filed appraisal petitions. The filing of a petition initiates the process for seeking objective determinations of share value by the Court.<sup>10</sup> On average, appraisal cases take about two years to resolve. Actual times vary widely depending on each company’s willingness to settle and, if litigated, the extent of any improprieties that arose in the course of shopping the company. *Dell* was one of the few matters pursued to judgment; many settle before or within a reasonable time after the petition is filed. Last year in the *Albertsons* case, for example, a group of investors settled for a 26% premium (\$127 million in total) within 6 months of the deal closing.<sup>11</sup> Others continued the litigation.

Academic literature indicates that appraisal awards typically equal or exceed tenders.<sup>12</sup> While past matters may be poor predictors of future outcomes given the unique facts of each case, below are 15 suits (besides *Dell*) between 2010 and 2015 that resulted in Court awarded valuations.<sup>13</sup> Where available, the additional returns from statutory interest (discussed below) are noted.

- *In re Dole Food Co.* (Aug. 2015) 20% premium
- *In re Safeway Inc.* (July 2015), 26% premium
- *Owen v. Canon* (June 2015), 60% premium plus 17.6% more from interest
- *Laidler v. Hesco* (May 2014), 75.5% premium plus 21.5% more from interest
- *In re Orchard Enterprises* (Sept. 2013), 127.8% premium plus 36.1% more from interest
- *Merion v. 3M Cogent* (July 20, 2013), 8.5% premium plus 14.3% more from interest
- *Towerview v. Cox Radio* (June 2013), 19.8% premium plus 26.9% more from interest
- *IQ v. Am. Commercial Lines* (Mar. 2013), 15.6% premium plus 13.7% more from interest
- *Global v. Golden Telecom* (Apr. 2010), 19.5% premium plus 14.7% more from interest
- *In re Sunbelt Beverage* (Feb. 2010), 148.8% premium plus 213.8% more from interest

Four other matters resulted in zero premiums but returned 10.5% to 13.7% with the added interest. Only one case resulted in a negative premium, which was largely offset by statutory interest.

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<sup>10</sup> Appraisal cases are distinct from the more prevalent and much maligned “disclosure suits” brought in an estimated 90% of proposed transactions. These often settle quickly for modest extra disclosures and fee awards to plaintiffs’ counsel.

<sup>11</sup> See Liza Hoffman, *Safeway to Pay Hedge Funds \$44 a Share to Settle Buyout Suits*, WALL ST. J. (June 2, 2015).

<sup>12</sup> See, e.g., Kobi Kastiel, Co-Editor, *Why Delaware Appraisal Awards Exceed the Merger Price*, Harvard L. Sch. Forum on Corporate Governance and Fin. Regulation (Sept. 23, 2014).

<sup>13</sup> Source Fried Frank, *A Study of Recent Delaware Appraisal Decisions: Part 1*, LAW360 (July 28, 2015).

Given the volume of appraisal-eligible matters each year and the potential for significant negotiated or court awarded premiums, there's ample reason for fiduciaries to monitor, evaluate and participate in appropriate cases.

### PERFECTING YOUR APPRAISAL RIGHTS

To perfect appraisal, before the vote, you or your proxy firm must deliver to the corporation a written demand for appraisal of your shares.<sup>14</sup> You must also instruct your proxy firm to abstain or vote against the deal.<sup>15</sup> This demand is different from filing an appraisal petition, which must be done by at least one dissenter who has exercised appraisal and within 120 days after the effective date of the transaction.<sup>16</sup>

To benefit you must also continue to hold your shares through the resolution of the suit. Under section 262(h), you are entitled to "interest from the effective date of the merger through the date of payment of the judgment [which] shall be compounded quarterly and shall accrue at 5% over the Federal Reserve discount rate." Interest applies even if the court awards a zero premium (*i.e.*, determines fair value equals the tender). However, the impact of interest on total recoveries will likely change very soon.<sup>17</sup>

Exercising appraisal rights creates the *option* but not the obligation to pursue them later. Under Delaware law, within 60 days after the effective date of the merger, you can revoke your election and instead accept the tender, provided appraisal proceedings haven't started. (With company consent, you can revoke after this 60 day period.) This limited withdrawal right gives you a *window of time* to monitor the appraisal situation before making a final decision.

If your preference is to piggyback on the efforts of arbitragers or others rather than filing your own petition, there are several additional factors to consider:

- (1) Who will file the initial petition? If a petition is not filed within 60 days after the effective date, you will need to either do it yourself or cancel your appraisal election and accept the tender to avoid receiving nothing.
- (2) Will you need to hire counsel? If another investor files the petition, you may or may not be able to work through their lawyers. If you work with another law firm, you or someone else from the group may need to file a petition.

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<sup>14</sup> Del. Code tit. 8 § 262(d).

<sup>15</sup> § 262(a).

<sup>16</sup> § 262(e).

<sup>17</sup> On June 8, 2016, the Delaware Senate passed HB 371, which seeks to eliminate smaller appraisal suits, namely those where less than 1% of eligible shares elect appraisal and/or the merger consideration for dissenters is \$1 million or less. Also, to avoid paying as much statutory interest, defendants will be able to make cash payments to investors exercising appraisal in amounts they choose any time before settlement, limiting statutory interest to the remaining amount. These changes will be effective for transactions entered into on or after August 1, 2016.

- (3) What happens if the matter settles? If you don't like the settlement terms proposed, you'll need another petitioner to prosecute the case on behalf of the remaining dissenters. You'll also need to be sure the remaining group has enough at stake to motivate counsel.<sup>18</sup>

Capable counsel can help you effectively navigate this process and obtain appraisal benefits without yourself filing a petition and prosecuting the litigation. Most Delaware attorneys will undertake appraisal cases on a fully contingent basis, advancing all costs. If the case is successful, the Court will decide the extent to which others benefiting from the appraisal litigation will share responsibility for the overall fees and costs associated with achieving the outcome.

### SUGGESTED BEST PRACTICES

With the above in mind, we suggest the following best practices for institutional investors:

- (1) Identify relevant appraisal eligible transactions: Implement a system to identify all appraisal eligible transactions affecting your portfolio, particularly those in which you have significant holdings as of the Record Dates. Establish a minimum investment amount for further consideration of appraisal activity, bearing in mind the new thresholds being enacted (see footnote 17).
- (2) Monitor matters likely headed for appraisal: Your portfolio managers will likely have strong views on which tender offers are inadequate. Pay particular attention to negative premium deals in which tenders are less than pre-announcement share prices. Appraisal petitions are more frequent in interested-director transactions and/or management-led buyouts where market checks and minority protections are less clear.
- (3) Be prepared to exercise your rights: Understand and have systems in place ready to instruct your proxy firm on voting and to notify the company about appraisal. Be sure communications are well documented and given as far in advance of the vote date as possible. Also, identify and rectify any standing issues beforehand, and be sure to keep your shares.
- (4) Monitor the Chancery Court docket: Decide whether your firm is willing to file an appraisal petition or would prefer to let other dissenters lead the charge. Between your exercise of appraisal and the 60 days after transaction consummation, monitor the Chancery Court docket to see if appraisal petitions are filed, and if so, by whom. Obtain the list of investors exercising appraisal (footnote 17). Identify law firms representing investors and if it makes sense, work through them or obtain your own counsel. Decide in advance what your fund will do if an appraisal petition is not filed. If you join a group, ensure someone else will serve as the petitioner if that's your preference and establish a mechanism for staying informed about the proceedings.
- (5) Monitor the appraisal litigation: If another investor negotiates a proposed resolution, you or your counsel will likely receive an offer to settle on the same terms. Remember that if you don't accept, you or someone else will need to continue the effort with enough at stake to motivate counsel. If the case results in a valuation decision be sure you have a system in place to know about it and obtain your recovery.

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<sup>18</sup> After a plaintiff files her appraisal petition, the company will file with the court a list of all investors that exercised appraisal. You'll appear on this list but your inclusion in the disclosure document does not make you a plaintiff or require you to take an active role in prosecuting the petition.

## ABOUT FINANCIAL RECOVERY TECHNOLOGIES

Financial Recovery Technologies (FRT) is a leading technology-based services firm that helps institutional investors identify eligibility, file claims and collect funds made available in securities class action settlements and litigations impacting global investors. Offering the most comprehensive range of services, we provide best-in-class eligibility analysis, disbursement auditing and client reporting:

- Claims Filing
- Litigation Monitoring
- Non-U.S. Group Settlements
- Direct Opt-Out and Appraisal Rights
- Antitrust
- Claims Purchasing

We deliver the highest level of accuracy, accountability and transparency available to a wide range of institutional investors including hedge funds, investment managers, custodians, public and private pension funds, and wealth managers. Financial Recovery Technologies is a Cross Country Group company ([www.crosscountrygroup.com](http://www.crosscountrygroup.com)). For more information, go to [www.frtservices.com](http://www.frtservices.com) or email [info@frtservices.com](mailto:info@frtservices.com).

## ABOUT FRT APPRAISAL RIGHTS

FRT Appraisal Rights is designed to help institutional investors monitor and identify appraisal-eligible M&A opportunities in today's growingly complex settlement and recovery market. FRT's team of professionals and proprietary network:

- Monitor merger and acquisition activity for appraisal-eligible opportunities
- Identify strategic opportunities that may recover premiums on undervalued shares
- Work with you to exercise appraisals to receive fair value
- Notify you of case developments throughout the entire appraisal process