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Delaware Legislature Acts to Limit Appraisal Rights

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On June 8th the Delaware Senate passed, and the Governor is expected to promptly sign, legislation amending appraisal rights in two ways under DGCL Section 262. The amendments will apply to merger agreements entered into on or after August 1, 2016. These amendments come after years of proliferating appraisal claims brought in high profile merger matters. See our previous Client Alert—*The Short, Unhappy Life of the Recent Appraisal Trend*. Many such claims have been brought by hedge funds as a form of "appraisal arbitrage" and certain aspects of the new legislation specifically aim to make such arbitrage less attractive. The legislation is a step in the right direction, and may curb or provide avenues to curb or lessen the cost of certain appraisal litigation. However, the new legislation is limited in its scope and does not include certain fundamental changes to the appraisal statute urged by takeover practitioners to limit abusive "appraisal arbitrage"—restricting appraisal rights of shareholders who acquire their shares after the record date for a merger vote or, possibly, after the announcement of a merger transaction.

The first amendment adds a new threshold ownership requirement before a shareholder may seek appraisal. The new statute provides that, for shares listed on a national securities exchange, the Court ***must dismiss*** an appraisal proceeding brought by shareholders unless (1) the total number of shares owned by all shareholders entitled to appraisal rights exceeds 1% of the outstanding shares of the class or series eligible for such appraisal, or (2) the value of merger consideration for the total number of shares seeking appraisal exceeds $1 million, or (3) the proposed transaction is structured as a short-form merger.

This amendment may curb what can often be substantial litigation costs and expenses related to appraisal claims outside the short-form merger context brought by dissenting shareholders or groups holding smaller stakes, and may at least partially address issues related to misuse of the appraisal discovery process in aid of class action or other post-closing shareholder litigation. An obvious limitation with this first piece of the amendments, however, is that it may not address potentially abusive appraisal litigation brought by large, well-funded hedge funds and other speculators.

The second amendment provides corporations that are subject to appraisal claims a prepayment option which would stop the accrual of statutory interest on shares seeking appraisal (5% plus the Federal Reserve discount rate, compounded quarterly). The new amendment allows a corporation to prepay any or all of the amount it may owe to a shareholder seeking appraisal, and interest will cease accruing on the portion so prepaid.

Given the length of some appraisal litigation proceedings coupled with the substantial interest rate awarded, the ability for an appraisal defendant to cut off the accrual of interest is not insignificant, and may be an option warranting consideration. By providing this prepayment right as a way of limiting interest exposure, rather than simply reducing the statutory interest rate, this second piece of the amendments will give rise to a tactical decision for appraisal defendants. Prepayment may reduce one of the key disincentives to seeking appraisal—namely, shareholders loss of use of capital until the proceeding is resolved—so impact on other settlement alternatives may need to be considered. Also, since appraisal decisions can result, and have in the past resulted, in an award of less than the merger consideration, prepayment of the full amount of merger consideration in order to stop all interest from accruing may not always be a desired course of action for corporations since the statute does not provide any ability to recover in the event the court determines that the fair value for appraisal purposes is less than the merger consideration. However, the statute affords the appraisal defendant the discretion to make the prepayment in the amount of its choosing, offering the opportunity to mitigate interest rate for an amount that may be more, less, or equal to the original merger consideration.

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