

Latest Amendments to Delaware Law Revise Appraisal Rights

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August 17, 2016

Effective August 1, 2016, the appraisal rights of dissenting stockholders in mergers and certain other transactions under the Delaware General Corporation Law (DGCL) have been modified in two principal respects:

- a *de minimis* threshold for appraisal actions relating to publicly traded target corporations has been established; and
- a surviving corporation's prepayment to dissenting stockholders prior to a court's final determination on the appraisal proceeding will stop statutory interest from accruing on the amount so paid.

Designed to protect stockholders in certain merger and consolidation transactions from receiving inadequate consideration, Section 262 of the DGCL gives dissenting stockholders the right to receive the fair value of their shares, as determined in proceedings by the Delaware Court of Chancery. The recent amendments reflect concerns that appraisal rights have been increasingly used by certain sophisticated investors as part of an "appraisal arbitrage" strategy, whereby an investor will purchase shares of a corporation involved in a merger or consolidation transaction in order to exercise appraisal rights. The appraisal arbitrage strategy has been profitable for these investors because:

- corporations will often settle appraisal actions in order to avoid the nuisance costs of litigation; and
- Section 262 requires that the surviving corporation pay to the dissenting stockholder, in addition to the fair value of the shares, interest at a rate equal to the Federal Reserve discount rate plus 5% on such amount from the effective date of the merger or consolidation to the date of the judgment, representing a much higher rate of return than currently available in the marketplace.

The amendments to Section 262 reflect an effort to limit the use of appraisal rights for this kind of arbitrage.

First, Section 262(g) now eliminates appraisal rights for *de minimis* claims involving publicly traded corporations. Under the new Section 262(g), the Court of Chancery must dismiss and may not hear any appraisal proceeding concerning shares listed on a national securities exchange unless:

- the total number of shares entitled to appraisal exceeds 1% of the outstanding shares of the class or series eligible for appraisal;
- the value of the consideration provided in the merger or consolidation for such total number of shares entitled to appraisal exceeds \$1 million; or
- the merger was approved as a so-called "short form merger" under Section 253 or Section 267 of the DGCL.

Second, 262(h) now allows a surviving corporation to pay to the dissenting shareholders an amount in cash at any time before judgment is entered in the appraisal proceeding, thus stopping the accrual of interest on the amount so paid by the surviving corporation. Thereafter, interest will only accrue on the sum of (a) the difference, if any, between the amount so paid and the fair value of the shares as determined by the Court of Chancery, and (b) interest already accrued at the time of the payment.

The effects of these amendments on curtailing the recent rise in appraisal actions could be substantial. One recent study by Columbia Business School and Vanderbilt Law School projected that the *de minimis* amendment could cause the number of appraisal actions to drop by about one quarter. The study also estimated that prior to these amendments, the availability of the statutory interest rate triggered approximately 6.5% of additional appraisal filings among all eligible deals. By removing some of the financial incentives for investors to use appraisal rights as an investment strategy, instead of for the intended purpose of protecting shareholder rights to adequate consideration, Delaware has acted to reduce the incidence of appraisal proceedings undertaken for reasons outside of the primary public

policy.

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