Recent Trends in Delaware Chancery Court Appraisal Rights Cases

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There are many U.S. federal and state laws that are designed to protect the rights of company shareholders—particularly noncontrolling shareholders (i.e., shareholders that otherwise lack significant influence over company decisions). Dissenting shareholder appraisal rights statutes provide protection to company shareholders in certain cases. These statutes can be developed and enforced both federally and state-by-state, and are typically designed to protect noncontrolling shareholders' financial interests in the case of a company change of control transaction. In recent years, the Delaware Court of Chancery (the "Delaware Chancery Court") has decided several shareholder appraisal rights cases. In these decisions, certain trends have developed in terms of how the Delaware Chancery Court has ruled on this often-controversial area of corporate law. This discussion provides an overview of some of the more recent trends in valuation-focused appraisal rights opinions that have been decided by the Delaware Chancery Court.

Introduction

For many years, Delaware has been a popular state of incorporation for American companies. Given the preponderance of corporations incorporated in Delaware, the state's corporate case matter legal decisions are often closely followed and studied by academics and professionals alike.

While there have been countless trials that have made their way through the Delaware Court of Chancery ("the Delaware Chancery Court"), recently some of the most widely followed cases have involved dissenting shareholder appraisal rights cases (also sometimes referred to as dissenters' rights cases).

In Delaware, Title 8, Section 262 provides shareholders certain protections. For example, Title 8, Section 262 of the Delaware Code ("Section 262") states that "any stockholder of a corporation of this State who holds shares of stock on the making of a demand . . . with respect to such shares, who continuously holds such shares through the effective date of the merger or consolidation . . . and who has neither voted in favor of the merger or consolidation nor consented thereto in writing . . . shall be entitled to an appraisal by the Court of Chancery of the fair value of the stockholder's shares. . . ."[1]

It is not uncommon for noncontrolling shareholders to effectively be forced to sell their shares of a company at a determined price upon the closing of a merger, sale, or other company change of control transaction. Section 262 is designed to protect those noncontrolling shareholders who, while forced to sell their shares, are not content with the financial consideration that is being paid to them in exchange for those shares.

In effect, Section 262 offers noncontrolling shareholders that are unhappy with the financial terms of a merger or a sale of a company to petition the Delaware Chancery Court in an effort to receive what they perceive to be the actual fair value of

their shares. These lawsuits are often referred to as appraisal rights cases.

Over the years, the Delaware Chancery Court has opined on numerous appraisal rights cases. In fact, the Delaware Chancery Court often sees several appraisal rights cases come to trial in any given year (which does not even consider that many more cases have likely settled or otherwise never reached trial).

In recent years, given that many appraisal rights cases have been tried in Delaware, certain trends have emerged regarding how the Delaware Chancery Court views certain recurring issues involved in those types of cases.

In particular, five noticeable trends have emerged in Delaware appraisal rights cases during the past several years:

1. The Delaware Chancery Court has recognized synergies that may be present—and need to be subtracted from fair value—in deal prices.
2. In determining fair value, the Delaware Chancery Court tends to give the most consideration to the deal price (assuming the selling process is fair and robust). Absent a fair and robust process, the Delaware Chancery Court has also considered the discounted cash flow valuation method.
3. The Delaware Chancery Court may be getting a little weary of appraisal arbitrage strategies involving investors effectively "buying into" litigation just before a transaction.
4. The Delaware Chancery Court has concluded on fair value compensation that is less than the deal price. Shareholders perfecting their appraisal rights should be aware that they may end up with less than other shareholders that accepted the deal price.
5. The Delaware Chancery Court is comfortable mixing and matching valuation analyses in order to come up with fair value. That is, typically the Delaware Chancery Court does not pick a single methodology, or a single expert, to agree with. And, the Delaware Chancery Court often reaches a decision based on multiple valuation-related analyses conclusions to arrive at fair value.

Fair Value and Deal Price Synergies

Section 262 states that if petitioners (i.e., noncontrolling shareholders subject to a merger or consolidation) are able to perfect their appraisal rights, then they are entitled to receive the fair value of their shares. Of course, the fair value (for statutory shareholder rights) standard of value is a standard that is often evolving and is generally influenced by past judicial decisions.

Recent Delaware Chancery Court decisions may provide relevant information regarding the determination of fair value, particularly in the context of an appraisal rights dispute.

The 2016 case styled *In re Appraisal of Dell Inc.* ("Dell") was a closely followed case involving appraisal rights. That case received attention throughout the valuation profession. The opinion, issued by Vice Chancellor Laster, drew upon case law precedent involving issues of fair value and contemplated what the fair value standard of value means to the Delaware Chancery Court.[2]

Vice Chancellor Laster decided that the final merger consideration is a relevant factor, but stated that "it is not the best evidence of the Company's fair value."[3]

Similarly, Vice Chancellor Laster concluded that, while it was a factor, "market price data is neither conclusively determinative of nor presumptively equivalent to fair value."[4]

A particular issue with using the deal price as evidence of fair value is the "recognized problem that an arms' length deal price often includes synergies."[5]

The 2017 reversal of the *DFC Global Corporation* ("DFC") case similarly discussed the importance of considering acquisition synergies that may be included in deal prices.[6]

While the opinion by Chief Justice Strine was favorable regarding the robust marketing process involved in the sale of DFC, it similarly discussed the difficulties in determining what portion of the deal price represents the fair value of the company as a stand-alone, going-concern entity, and what portion may represent post-merger synergies.

The value associated with post-merger synergies would not otherwise exist in the premerger company as a going concern on a stand-alone basis. Accordingly, it is understood that, because merger transactions may incorporate synergies into the deal price, that deal price may not represent the company's fair value as it is often interpreted by the Delaware Chancery Court.

More recently, the 2018 case styled *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.* ("Verition"), referenced that "The Dell and DFC decisions recognize that a deal price may include synergies, and they endorse deriving an indication of fair value by deducting synergies from the deal price."[7]

The *Verition* decision ultimately excluded discounted cash flow estimates of fair value and considered both "Aruba's unaffected market price of $17.13 per share and my deal-price-less-synergies figure of approximately $18.20 per share."[8]

However, the only indication of fair value relied on in the original *Verition* decision ended up being the unaffected market price of the company. Vice Chancellor Laster recognized that "my deal-price-less-synergies figure is likely tainted by human error. Estimating synergies requires exercises of human judgement. . . ."[9]

Accordingly, while the original *Verition* decision similarly recognizes the importance of excluding synergies in estimating fair value, it also recognizes the difficulty in doing so. Importantly, the original Verition decision was ultimately reversed and remanded on appeal. In its opinion, the Supreme Court of Delaware determined that the Delaware Chancery Court should have relied on deal-price-less-synergies, rather than the unaffected market price. The Supreme Court of Delaware ultimately determined that the fair value of the subject shares was $19.10 per share, which was determined based on a deal-price-less-synergies methodology.[10]

The takeaway from those recent cases regarding deal price considerations is that, even if the transaction involved a robust and fair marketing and bidding process, that final deal price still may not be a true representation of the target company's fair value.

That is largely due to the presence of synergistic value or synergistic premiums that may be included as a portion of the deal price consideration. Because synergies would not be available to a company on a premerger stand-alone basis, courts often understand that those synergies should not be included in determining the target company's fair value.

However, as discussed in the next section, despite the Delaware Chancery Court's relatively consistent acknowledgement that deal prices may contain synergies, that has not stopped many court opinions from relying on an unadjusted deal price as evidence of fair value.

Discounted Cash Flow Method, Deal Price, and Other Valuation Methods

As discussed in the section above, the Delaware Chancery Court often does not take a one-size-fits-all approach in determining the most appropriate methodology to apply in estimating a target company's fair value in appraisal rights cases.

For instance, despite ultimately determining that a discounted cash flow method was the best estimate of fair value, the original *Dell* opinion states that "in at least five decisions, the Court of Chancery has found the deal price to be the most reliable indicator of the company's fair value, particularly when other evidence of fair value was weak."[11]

Exhibit 1 presents a list of several recent appraisal-rights-related Delaware Chancery Court opinions and the valuation methods applied by the court to determine fair value.

While Exhibit 1 is not an all-inclusive list of appraisal rights cases to go through the Delaware Chancery Court in recent years, it provides a good sample indicating certain trends regarding the valuation methods relied on by the court in those cases.

As evidenced in Exhibit 1, the two valuation methods that seem to get the most consideration in the Delaware Chancery Court are:

1. the discounted cash flow method and
2. the so-called "deal price" method (or otherwise, the deal price less post-merger synergies).

The discounted cash flow method is a generally accepted business valuation method that is applied in many valuation analyses. It is based on the fundamental financial principle that the value of a business is equal to the present value of its future cash flow.

While the discounted cash flow method relies on many inputs and assumptions, it has appeal to the Delaware Chancery Court. This may be because of its theoretical soundness and the ability for the court to determine what it believes to be the most reliable inputs to incorporate into a discounted cash flow analysis.

The so-called "deal price" method is generally considered to be the price the selling company shareholders received as a result of the merger or acquisition is representative of the target company's fair value.

As discussed above, the Delaware Chancery Court often relies on the deal price, but then subtract the value of certain perceived post-merger synergies that may be included in the unadjusted deal price.

Either way, the Delaware Chancery Court has demonstrated that, as long as the company's sale process was fair, thorough, and robust, it will often rely on the deal price as the indication of fair value.

However, in situations where the Delaware Chancery Court finds that the sale process was not

Exhibit 1
Delaware Court of Chancery Appraisal Rights Decisions
Methods Used by the Court to Determine Fair Value

Year	Case/Opinion	Methods Relied on by the Court
2015	*In Re Appraisal of Ancestry.com, Inc.*	Deal Price, DCF
2015	*Longpath Capital, LLC v. Ramtron International Corporation*	Deal Price (less synergies)
2015	*Merion Capital L.P. v. BMC Software, Inc.*	Deal Price
2016	*John Douglas Dunmire v. Farmers & Merchants Bancorp of Western Pennsylvania, Inc.*	DCF
2016	*In Re Appraisal of Dell Inc.*	DCF
2016	*In Re Appraisal of DFC Global Corp.*	DCF, Comparable Companies, Deal Price
2016	*Merion Capital L.P. v. Lender Processing Services, Inc.*	Deal Price
2016	*In Re ISN Software Corp.*	DCF
2017	*ACP Master, Ltd. v. Sprint Corporation v. Clearwire Corporation*	DCF
2017	*In Re Appraisal of Petsmart, Inc.*	Deal Price
2018	*In Re Appraisal of AOL Inc.*	DCF
2018	*Veriton Partners Master Fund Ltd v. Aruba Networks Inc.*	Unaffected Market Price
2018	*In Re Appraisal of Solera Holdings, Inc.*	Deal Price (less synergies)
2019	*In Re Appraisal of Stillwater Mining Company*	Deal Price
2019	*In Re Appraisal of Columbia Pipeline Group, Inc.*	Deal Price
2019	*Kendall Hoyd v. Trussway Holdings, LLC*	DCF
2019	*In Re Appraisal of Jarden Corporation*	DCF, Deal Price (less synergies)
2020	*In Re Appraisal of Panera Bread Company*	Deal Price (less synergies)
2020	*Manichaean Capital, LLC v. SourceHOV Holdings*	DCF

DCF = Discounted cash flow
Sources: Opinions published in the above-referenced Delaware Court of Chancery cases.

robust, for one reason or another, the court tends to rely on a discounted cash flow method analysis conclusion.

Of particular note, as indicated in Exhibit 1, it appears that the Delaware Chancery Court's preference is generally for deal price fair value indications, however, the discounted cash flow method has been considered in many judicial decisions. For a time in 2016 and 2017, it was more typical for the Delaware Chancery Court to discard the deal price and rely solely on discounted cash flow method analysis.

However, that "trend" may simply be a coincidence as those particular cases likely involved certain issues that the Delaware Chancery Court found within the target company's sale process.

Trends in Appraisal Arbitrage

Section 262 of the Delaware Code offers appraisal rights to all shareholders who hold the stock (1) on the date of a making of demand through (2) the effective date of the merger or consolidation. That is, a shareholder need not be a long-term owner of company shares to be able to petition for appraisal rights.

A shareholder could theoretically purchase shares shortly before a merger and, as long as the shareholder owns those shares through the close of the transaction, it is possible to attempt to claim appraisal rights. That concept has given rise to an entire class of investor strategy, often referred to as "appraisal arbitrage."

Appraisal arbitrage is a strategy in which investors purchase shares of a company that are soon expected to be part of a merger transaction. Following the close of that transaction, those new investors will attempt to perfect their appraisal rights in order to make a profit on their investment. The idea being that, investors (typically as part of a hedge fund strategy) will be able to make a quick, court-ordered profit if they are able to prove that the fair value of the acquired company is more than what was actually paid as part of the final deal consideration.

In general, appraisal arbitrage is an intuitive strategy—there is seemingly little downside risk (an uninformed investor may think that, at worst, they will largely break even because they will be entitled to receive their share of the deal proceeds regardless of the appraisal action) and a seemingly plentiful upside gain opportunity (if the investor is able to show through, for example, a discounted cash flow method analysis that the fair value of the company far exceeds the deal price).

However, in practice, there are some issues to be aware of in the context of appraisal arbitrage. The primary issues include the following:

1. The Delaware Chancery Court may be growing somewhat weary of the practice of "gaming" the Delaware Code to the benefit of opportunistic investors, rather than for the protection of the general public.
2. There is significantly more downside risk than may be identified at first glance.

This section focuses on the first issue; the following section discusses the second issue.

In general, corporate law is often designed to protect those who are not in control. That is why there are shareholder oppression statutes, corporate fraud statutes, and many others that are designed to protect shareholders in the event that those in control of a company manipulate their power to the detriment of noncontrolling shareholders.

Similarly, it could be argued that is why Section 262 of the Delaware Code exists—to protect noncontrolling shareholders who are forced to participate in a change of control transaction and sell their shares, despite having little say in the process or the ultimately negotiated deal price.

However, as is often the case, the underlying purpose of a corporate law statute may be muddled over time, as investors seek ways to use the law to their advantage. Appraisal arbitrage is, effectively, a statute-driven investment strategy.

Despite relatively sound theory behind employing the strategy, there are some observable trends in recent Delaware Chancery Court decisions that indicate it may be getting more difficult to effectively employ the arbitrage strategy.

There have been some recent decisions in which the Delaware Chancery Court opinion has appeared to indicate a certain appraisal arbitrage weariness from the court.

For instance, Vice Chancellor Glasscock wrote in 2015 regarding the *Merion Capital LP v. BMC Software, Inc.*, opinion, "This case presents what has become a common scenario in this Court: a robust marketing effort for a corporate entity results in an arm's length sale where the stockholders are cashed out, which sale is recommended by an independent board of directors and adopted by a substantial majority of the stockholders themselves. On the heels of the sale, dissenters (here, actually, arbitrageurs who bought, not into an ongoing concern, but instead into this lawsuit) seek statutory appraisal of their shares."[12]

The fact that Vice Chancellor Glasscock identifies the plaintiffs as "arbitrageurs" who "bought into the lawsuit" in the first sentence of the opinion seems to imply a certain skepticism with regard to the circumstances of the investors in that case. Not surprisingly, the opinion then proceeds to largely disregard the petitioners' methodologies and to state that the deal price was the best indication of fair value in that case.

It appears that the Delaware Chancery Court has been careful to refrain from advocating for, or against, appraisal arbitrageurs and to instead interpret the relevant law as written. For instance, the case styled *In Re Ancestry.com, Inc.*, similarly involved a transaction in which arbitrageurs purchased shares of Ancestry.com, Inc., shortly prior to its acquisition by a private equity firm.

In the opinion, Vice Chancellor Glasscock wrote, "If the General Assembly wishes to address the 'problems' caused by appraisal arbitrage, either substantive or with respect to the operation of Section 262, presumably it will do so, but the fact that, in Ancestry's reading, the statutory language is an imperfect representation of legislative intent does not give a judge license to rewrite clear statutory language; nothing Ancestry has pointed out makes operation of the statute impossible or leads to a result that is absurd."[13]

So while in certain cases it may be possible to read between the lines in order to get a sense for a court's proclivity with regard to appraisal arbitrage strategy, it largely remains an issue that is dependent on the facts and circumstances of each case.

When Fair Value Is less than the Deal Price

Perhaps more concerning to appraisal arbitrageurs is the growing incidence of cases in which the court determines that the fair value of a target company's shares is actually less than the per-share price implied by the final transaction consideration.

That is, it is not unheard of and, in fact, somewhat typical, for petitioners in an appraisal rights case to end up with a court order that grants them less for their shares than they otherwise would have received had they foregone their appraisal rights and participated in the transaction with the other selling shareholders.

That phenomenon is able to occur because Section 262 clearly states that the standard of value in appraisal rights cases is fair value, and it gives the Delaware Chancery Court exclusive authority to determine that fair value.

Accordingly, if the court determines that the deal price does not provide a reliable indication of

fair value for one reason or another, that effectively opens the gates to allow for any other methodology that the court finds to be more reliable. In that case, the fair value concluded by the court could be either more than or less than the actual transaction value.

For example, as previously discussed, the Delaware Chancery Court has often indicated that a deal price may include synergistic value. At the same time, the Delaware Chancery Court has often indicated that fair value should represent a standalone value—and should exclude post-merger synergies.

Accordingly, based on that logic, it stands to reason that an argument could be made for many transactions that a deal price overstates the actual fair value of the target company.

Not surprisingly, in all of the cases listed in Exhibit 1 in which the method relied upon was the deal price less synergies, the Delaware Chancery Court ultimately concluded a fair value that was less than the deal price consideration received by the selling shareholders.

In more extreme cases, the Delaware Chancery Court may find that fair value is not simply deal price less synergies, but rather something substantially less than the deal price.

For instance, in the original *Verition* decision, the Delaware Chancery Court ignored the deal price entirely and found that the unaffected market price before the announcement of the transaction was the best estimate of the company's fair value.

In that case, the fair value of $17.13 initially provided to the petitioners was significantly less than the $24.67 per share implied by the deal terms (and received by the other selling shareholders).[14]

When neither the deal price nor unaffected market price are determined to be reliable, the Delaware Chancery Court has often used a discounted cash flow method analysis to determine the fair value of the subject shares. Similarly, the discounted cash flow method may result in a value that is more than or less than the agreed upon deal price.

In another matter styled *ACP Master Ltd. v. Sprint Corporation v. Clearwire Corporation*,[15] the Delaware Chancery Court found that a discounted cash flow methodology that resulted in $2.13 per share for Clearwire stock was the best indication of fair value. In contrast, the agreed upon deal price in the subject acquisition was $5.00 per Clearwire share.

The court-ordered fair value to be paid as consideration to the petitioners in that case was less than half of what would have been received had they foregone their appraisal rights and participated in the transaction with the other selling shareholders.

Although this section focuses on some of the more interesting cases in which fair value was determined to be less than the deal price, there have similarly been many cases in which the Delaware Chancery Court determined the opposite.

In other words, in certain cases the Delaware Chancery Court decided that the deal price was significantly less than the fair value of the target company. Those are typically cases in which the court determines there were certain insufficiencies in the deal process.

For example, there may have been conflicts of interest that affected board members' judgement, or there may not have been ample market time to get the best possible bid for the company. In those instances, it is not uncommon for the Delaware Chancery Court to conclude a fair value for the company's shares that is greater than the indicated deal price.

But, it is clear that appraisal arbitrageurs cannot simply assume that their investment strategy is low risk or that a deal price represents the floor of the consideration they are entitled to.

If the Delaware Chancery Court determines that the deal process was sufficient and robust, it is often an uphill battle to convince a court that the fair value of the company is something substantially greater than what was paid as transaction consideration.

Court Decisions and Certain Analyses

There appears to be a trend in terms of the general procedures or steps the Delaware Chancery Court takes with regard to valuation issues in appraisal rights cases. In many cases the court will scrutinize the deal process and determine whether it was sufficient to provide a good indication of the fair value of the company.

If that is the case, the Delaware Chancery Court may rely heavily on the deal price (either adjusted or unadjusted) in determining fair value. However, if the deal price is determined to be unreliable, the court has then typically turned to discounted cash flow methods in recent appraisal rights cases.

In those instances, it is typical for financial experts on both sides to present competing discounted cash flow analyses. It is often up to the court to reconcile significant differences between multiple discounted cash flow analyses in order to arrive at fair value.

In many instances, the court scrutinizes the various discounted cash flow method analyses and

places weights on the indicated values (e.g., 50 percent weight on petitioners expert's discounted cash flow method indication of value and 50 percent weight on respondents expert's discounted cash flow method indication of value).

This was the case, for example, in the original Dell decision, in which Vice Chancellor Laster selected the two most reliable discounted cash flow models and placed equal weight on their indicated values to arrive at fair value.[16]

In other instances, when the court appears to be most comfortable relying on a discounted cash flow method analysis, it may pick and choose certain assumptions or pieces of a discounted cash flow method analysis from various experts and make adjustments.

For example, in the case styled *Manichaean Capital, LLC v. SourceHOV Holdings, Inc.*, the Delaware Chancery Court almost entirely accepted the petitioners' discounted cash flow indication of value.[17]

The Delaware Chancery Court only made one adjustment to the size premium that was applied in the petitioners' discounted cash flow model.

Because Section 262 gives the Delaware Chancery Court broad authority to determine fair value in appraisal rights cases, it is sometimes difficult to predict how a court will apply various methods to reach a conclusion.

As discussed above, there are cases in which a court may adopt various experts' discounted cash flow models and simply weight the value conclusions. In other cases, the Delaware Chancery Court may adopt certain aspects of an expert's discounted cash flow model but change certain assumptions as it sees fit.

Summary and Conclusion

Given the prevalence of corporations incorporated in Delaware, the Delaware Chancery Court sees several high-profile corporate-law-related cases each year. Appraisal rights cases often lead to some of the most controversial decisions. These Delaware Chancery Court judicial decisions often involve complex valuation issues.

Due to the many appraisal rights cases tried in the Delaware Chancery Court each year, it is possible to identify certain trends regarding how the Delaware Chancery Court may view certain recurring issues.

However, the ever-evolving nature of case law means that, despite some of the previously discussed trends and issues regarding Delaware appraisal rights cases, it is often difficult to precisely predict how a trial will evolve or how a court will rule on certain issues.

Perhaps the only certainty with regard to appraisal rights cases that reach the Delaware Chancery Court is that there will no doubt be interesting legal and valuation issues involved.

Notes:

1. The Delaware Code, Title 8, Section 262.
2. In Re Appraisal of Dell Inc., C.A. No. 9322-VCL, 2016 WL 3186538 (Del. Ch. May 31, 2016). For the purpose of this discussion we focus on the original decision in Dell, but we recognize in December of 2017, the Delaware Supreme Court remanded the Dell case back to Delaware Chancery Court on appeal. That appeal emphasized the deal price to be more relevant to fair value than the discounted cash flow method.
3. Id. at *22.
4. Id. at *23.
5. Id. at *25.
6. DFC Global Corporation v. Muirfield Value Partners, L.P., No., 518,2016, 2017 WL 3261190 (Del. Ch. Aug. 1, 2017).
7. Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., C.A. No. 11448-VCL, 2018 WL 922139 at *2 (Del. Ch. Feb. 15, 2018).
8. Id.
9. Id.
10. Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., 210 A.3d 128 (Del. 2019).
11. In Re Appraisal of Dell Inc. at *23.
12. Merion Capital LP v. BMC Software, Inc., C.A. No. 8900-VCG, 2015 WL 6164771 (Del. Ch. Oct. 21, 2015).
13. In Re Ancestry.com, Inc., C.A. No. 8173-VCG2015 WL 66825 at *8 (Del. Ch. Jan. 5, 2015).
14. Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., 2018 WL 922139.
15. ACP Master, Ltd. v. Sprint Corporation v. Clearwire Corporation, C.A. 8508-VCL, C.A. 9042-VCL, 2017 WL 3421142 (Del. Ch. July 21, 2017).
16. In Re Appraisal of Dell Inc.
17. Manichaean Capital, LLC v. SourceHOV Holdings, Inc., C.A. No. 2017-0673-JRS, 2020 WL 496606 (Del. Ch. Jan. 30, 2020).

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