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Are Appraisal Cases Coming Back?

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Recently, several stock appraisal cases have turned out well for those stockholders persistent enough to see their claims through a trial. Does this mean that more stockholders will demand that the Delaware Court of Chancery ask that court to determine the value of their shares when they are cashed out in the merger? While it is too early to tell, there are several good reasons to believe that more appraisal cases will be filed.

Before reviewing the recent decisions, however, it is useful to recall why there generally have been so few appraisal cases filed compared to the hundreds of mergers that cashed out stockholders against their will. First, appraisal actions need seriously motivated plaintiffs. Unlike a traditional class action, each stockholder whose stock is to be appraised must actually demand appraisal. You cannot simply go along with the other stockholders as part of a class led by a class representative who may have been solicited by a plaintiffs law firm. At least to date, the plaintiffs bar has not shown much interest in motivating stockholders to join together by individually asking for their appraisal rights.

Second, appraisal actions may be too expensive. A typical stock appraisal trial is a battle of experts with the Court of Chancery left to pick among their testimony to strike the fair value determination required by Delaware law. Experts cost real money if they are any good.

Third, appraisal actions are somewhat risky. The court is not required to accept the merger price as a floor for value. Instead, in a few instances, the Court of Chancery has decided that the fair value of a company's stock is actually less than the amount offered to the stockholders in the merger. Those stockholders who thus came up short still had to pay the lawyers, after waiting for the verdict.

Yet while all three factors still exist to dampen the enthusiasm of any stockholder who feels the merger price is too low, the recent decisions show there is opportunity in an appraisal case. Perhaps that opportunity is just the result of some low merger values set during the Great Recession. After all, the Delaware Supreme Court has definitively decided that the stock market price is not a guide to determining a stock's fair value in an appraisal case. Thus, while it may be possible to cash out stockholders willing to accept a modest premium to a depressed market price, the stockholders may see the opportunity to do better in an appraisal proceeding.

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There are other reasons to see that opportunity apart from a depressed market price. First, appraisal actions are becoming more predictable. The reasoning process the Court of Chancery will use is now clearly set out in several recent opinions. Generally, a discounted cash flow method is now utilized, although other valuation methodologies are permitted. The DCF approach with its fixed criteria to set value permits a better estimate of the possible outcome than may have been possible in the past. Hence, a risk-gain assessment is easier to do.

Second, appraisal actions need not be all that expensive to litigate. The actual trials tend to be short, often three days or less. The pretrial discovery process that is so costly in other cases is fairly limited in appraisal cases. After all, the stockholder-petitioner will rarely be subject to any discovery demands beyond his or her expert's deposition. The company to be valued will, of course, still need to be subject to plaintiff's discovery, but even then the discovery may be limited. Management's financial projections are the most important information for a plaintiff to obtain. But that discovery does not require extensive and expensive depositions.

Of course, expert testimony is usually expensive. A plaintiff's appraisal case is only as good as his or her expert's testimony. Moreover, that testimony is often very technical with financial analysis using complicated equations to determine unfamiliar concepts used in a valuation analysis, such as "weighted average cost of capital" and many others. This is not a field for the novice. Experienced counsel, particularly one familiar with the applicable valuation decisions, is essential.

In just the last few weeks, two appraisal decisions show that there is money to be made when the litigation is done well. Thus, in *Towerview LLC v. Cox Radio*, C.A. 4809-VCP (June 28, 2013), and in *Merion Capital LP v. 3M Cogent*, C.A. 6247-VCP (July 8, 2013), stockholders recovered significant amounts in appraisal cases.

These decisions illuminate several basic principles of Delaware appraisal law that apply in all such proceedings. First, the court wants an expert's conclusion to be well-grounded in generally recognized financial treatises. An expert who cannot name the treatise that supports his or her approach is to be avoided. Second, the expert's conclusions have to be supported by a detailed explanation of why he or she reached that conclusion. Views based on "my experience" are not worth much. Third, familiarity with the industry involved is essential. For example, a DCF analysis involves future growth projections. If your expert does not know how the relevant industry is likely to do in the future, his or her projections for the specific business entity to be valued is not worth much.

Finally, an appraisal action should be worth at least $1 million to be worth pursuing. If your consulting expert does not think that the increase in price that will result, multiplied by the number of shares to be appraised, is not worth at least that much, forget it. But if he or she is confident the recovery will exceed that $1 million minimum, seriously consider appraisal.