

SECURITIES LITIGATION

DELAWARE CHANCERY COURT REJECTS MERGER PRICE AS MEASURE OF FAIR VALUE IN APPRAISAL RIGHTS CASES: PROFESSIONAL INVESTORS' RECOVERY IS NOT LIMITED TO MERGER PRICE

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As demonstrated by Carl Icahn's recent announcement in connection with the acquisition of Dell Inc., professional investors are increasingly exercising appraisal rights to achieve a fair price for their stock in a merger.

Accordingly, it is worth noting that the Delaware Chancery Court has now clearly *rejected* any presumptive weight attached to the merger price as evidence of the fair value of the company's shares. Under Delaware law, a company's shareholders of record are entitled to demand that a court appraise the value of their shares in lieu of accepting the merger price. Once a stockholder validly exercises its appraisal rights, the Delaware court must determine the fair value of the shares as of the merger date and award that amount to the stockholder. At least one analysis of reported appraisal decisions shows a median increase of 82.1% over the merger price.

The Role of Merger Price in Assessing Fair Value

Acquirers defending appraisal rights cases have repeatedly urged courts to accept the premise that in an arm's-length transaction, the merger consideration offered in the transaction and accepted by the board is a reasonable proxy for the stock's fair value. Since the merger price typically includes a premium above the existing market trading price for the stock, and the merger price was the result of a robust auction process or other arm's-length transaction that was blessed

by a "fair value" opinion, it is argued that it reflects "fair value." However, Delaware law has been reluctant to embrace that self-serving view.

In recent years, the Delaware courts have repeatedly declined to accept the merger price as a measure of fair value. Thus, in *Golden Telecom, Inc. v. Global GT LP*, the Delaware Supreme Court expressed its skepticism about simply deferring to merger price:

Section 262(h) unambiguously calls upon the Court of Chancery to perform an independent valuation of "fair value" at the time of a transaction. ... Requiring the Court of Chancery to defer—conclusively or presumptively—to the merger price, even in the face of a pristine, unchallenged transactional process, would contravene the unambiguous language of the statute and the reasoned holdings of our precedent. ... Therefore, we reject [respondent's] contention that the Vice Chancellor erred by insufficiently deferring to the merger price, and we reject its call to establish a rule requiring the Court of Chancery to defer to the merger price in any appraisal proceeding.

Golden Telecom, 11 A.3d 214, 217-28 (Del. 2010)

Consistent with *Golden Telecom*, last year Chancellor Strine refused to give *any* weight to merger price, remaining unmoved by the "rhetorical hay" that the acquirer made out of its search for other buyers. Concluding

that "this is an appraisal action, not a fiduciary duty case, and although I have little reason to doubt" that no buyer was willing to pay the target \$25 million for the preferred stock and an attractive price for the common stock, "an appraisal must be focused on [respondent's] going concern value." *In re Orchard Enters., Inc.*, 2012 WL 2923305, at *5 (Del Ch. July 18, 2012).

The Delaware Chancery Court Now Explicitly Disregards Merger Price

More recently, in *Merion Capital, L.P. v. 3M Cogent, Inc.*, __ A.2d __ (Del. Ch. July 8, 2013), Vice Chancellor Parsons soundly rejected the acquirer's suggestion that the merger price be taken as evidence of the fair value of stockholders' shares. In doing so, the Chancery Court relied on *Golden Telecom* and *Orchard*, and observed that the acquirer's case cites supporting its insistence on the merger price all pre-dated *Golden Telecom*. In *Cogent*, the acquirer did not use the merger price in presenting its proposed value to the court for the litigation (\$10.50/share), but instead advanced the price determined by its experts' analysis (\$10.12). Moreover, the company did not attempt to adjust the merger price to remove the "speculative elements of value" arising from the synergistic expectation of the merger. Accordingly, the Chancery Court put a nail in the coffin for any presumptive value being attached to the merger price: "In other words, Respondent asks this Court to rely on

a merger price that it has not relied on itself and that is not adjusted to produce the going concern value of Cogent. Those deficiencies render the merger price largely irrelevant to this case.”

Delaware courts had already largely disregarded the merger price in determining value in appraisal rights cases. Thus, in the vast majority of all Delaware appraisal rights cases conducted since the seminal 1983 case in this area, the court adopted a going concern valuation in excess—often far in excess—of the merger price. See *Doft & Co. v. Travelocity.com Inc.*, 2004 WL 1152338 (Del. Ch.) (appraisal share price: \$32.76; merger share price: \$28.00); *Lane v. Cancer Treatment Ctrs. of Am., Inc.*, 2004 WL 1752847 (Del. Ch.) (appraisal share price: \$1,345.00; merger share price: \$260.00); *Prescott*, 2004 WL 2059515 (appraisal share price: \$32.35; merger share price: \$9.31); *MedPointe*, 2004 WL 2093967 (appraisal share price: \$24.45; merger share price: \$20.44); *Dobler v. Montgomery Cellular Holding Co.*, 2004 WL 2271592 (Del. Ch.) (appraisal share price: \$19,621.74; merger share price \$8,102.23), *rev'd on other grounds*, 880 A.2d 206 (Del. 2005); *Gholl*, 2004 WL 2847865 (appraisal share price: \$1.64; merger share price: \$1.06); *In re U.S. Cellular Operating Co.*, 2005 WL 43994 (Del. Ch.) (appraisal share prices: \$54.00 and \$30.13 for Janesville and Sheboygan shareholders, respectively; merger share prices: \$43.85 and \$21.45); *Kessler*, 898 A.2d 290 (appraisal share

price: \$33,232.26; merger share price: \$16,228.55); *In re PNB Holding Co. S'holders Litig.*, 2006 WL 2403999 (Del. Ch.) (appraisal share price: \$52.34; merger share price: \$41.00); *Crescent/Mach I P'Ship, L.P. v. Turner*, 2007 WL 2801387 (Del. Ch.) (appraisal share price: \$32.31; merger share price: \$25.00).

In sum, the *Cogent* case neatly summarized what had been the operative reality in the Delaware courts for years: in adjudicating appraisal rights, merger price is no proxy for fair value. The courts will start with a clean slate and undertake their own searching analysis for how to assess the stock's worth. Whatever the acquirer paid is largely irrelevant to that inquiry.

Professional investors who believe their stock is more valuable than the merger price being offered should consider exercising their right to an appraisal. At the very least, exercising appraisal rights gives the investor an additional sixty-day period to either continue seeking appraisal or accept the merger consideration.

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