SEWARD & KISSEL LLP

SHAREHOLDER ACTIVISM BULLET REPORT

July 2016

- ***Delaware Court of Chancery Departs From Precedent to Determine Fair Value in Dell Appraisal Action.*** On May 31, 2016, Vice Chancellor J. Travis Laster of the Delaware Court of Chancery issued an opinion in *In re: Appraisal of Dell Inc.*, determining that the fair value of Dell Inc.'s common stock in a management-led buyout by Michael Dell and Silver Lake Partners was approximately 28% higher than the per share transaction price approved by shareholders of the company.

The ruling is a departure from several recent appraisal decisions by the Court of Chancery in that it did not give significant weight to the transaction price in the determination of fair value. While recognizing transaction price as a relevant factor in determining fair value, the court found certain other factors to be more persuasive in determining fair value. For instance, the opinion noted that the use of a leveraged buyout pricing model in determining the transaction price had the effect of undervaluing the company. It also found that there was a significant gap between the market price of the company and its intrinsic value because of a focus by investors on the short term that led to an undervaluation of the stock.

The decision does not necessarily indicate a rejection of transaction value as a relevant factor, and in some cases the most reliable factor, in determining fair value in appraisal actions in Delaware. Vice Chancellor Laster distinguished the Dell case from other decisions by the Court of Chancery that determined transaction price to be the most reliable indicator of fair value in arm's length third-party mergers. But the Dell transaction was a management-led buyout, and Vice Chancellor Laster held that this merited consideration of factors beyond the transaction price. The court ultimately used a discounted cash flow analysis to compute "fair value" using elements from the opinions of the experts presented by the two sides.

As a result, the Dell case may serve to encourage appraisal actions primarily with respect to management-led buyouts, where circumstances similar to the Dell case may exist that would result in fair valuation determinations that depart from the transaction price.

- ***Court Rejects Shareholder Activist's Proposed Slate for Board of Directors.*** On May 20, 2016, the U.S. District Court for the Northern District of Texas, interpreting Maryland law, granted Ashford Hospitality Prime, Inc. a preliminary injunction against Sessa Capital (Master), LP, ending Sessa's proxy contest for positions on the Ashford board of directors. The court deemed Sessa's slate of directors ineligible for election in Ashford's 2016 annual meeting and enjoined Sessa, or any person acting on its behalf, from submitting Sessa's candidates or soliciting proxy votes for those candidates. This order stems from months of litigation between Ashford and Sessa.

Ashford is a publically traded REIT based in Dallas and organized under the laws of Maryland. The dispute initially arose after Sessa informed Ashford of its intention to nominate five candidates to replace incumbent directors on Ashford's seven-member board.

Under Ashford's bylaws, a stockholder submitting director candidates for election must provide an indication of what its plans are if its campaign is successful. Sessa submitted its proposed slate of directors on time, but did not disclose the directors' future intentions for Ashford. Sessa claimed that the directors had no plans for Ashford if Sessa gained control of the board and refused to provide substantive answers to questions about the directors' plans. Ashford rejected the proposed slate of directors, arguing that the directors' nominations were incomplete. During discovery, Ashford uncovered multiple correspondences among Sessa's management that revealed discussions about bylaw amendments, the sale of Ashford, and other "gameplan" options. The court found that the Maryland business judgment rule protects the decision by the Ashford board to reject the proposed candidates because Sessa's plans had not been disclosed.

This ruling is significant because it is the first time a court has invalidated an activist shareholder's slate for failure to comply with the substantive disclosure provisions of a company's advance notice bylaws under Maryland law. Commentators have noted that the decision strengthens Maryland's pro-board stance. The decision also provides for a broad interpretation of Maryland's business judgment rule.

The United States Court of Appeals for the Fifth Circuit has since decided to hear Sessa's appeal of the court's decision, with oral arguments beginning the week of August 1, 2016.

- ***Amendments to Delaware Law Will Restrict Shareholder Appraisal Rights.*** The Delaware Legislature has approved, and the Governor has signed, legislation recommended by the Corporation Law Section of the Delaware State Bar Association to amend the General Corporation Law of the State of Delaware. Among the amendments, which will become effective on August 1, 2016, are changes affecting shareholder appraisal actions by (i) barring appraisal claims that do not meet certain "*de minimis*" thresholds and (ii) allowing companies to prepay shareholders at an earlier stage of the appraisal proceeding to limit the amount of statutory interest owed at the conclusion of the

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proceeding. The amendments will apply to merger agreements entered into on or after August 1, 2016. Appraisal rights will still be available only if the merger price is paid to shareholders in cash.

Under the *de minimis* thresholds, shareholders will be entitled to appraisal rights only if (i) the shareholder's total number of shares exceeds 1% of the outstanding shares eligible for appraisal, or (ii) the value of the consideration for such shares based on the merger price exceeds $1 million. The *de minimis* thresholds will only apply when the shares eligible for appraisal are listed on a national securities exchange immediately before the merger and will not apply to "short-form" mergers.

If a company opts to prepay appraisal claimants before the court's judgment, interest will no longer accrue at a statutorily-determined above-market rate from the effective date of the merger through the payment of the court-determined fair value. Instead, interest will accrue only upon the sum of (i) the difference between the amount paid to the claimants and the court-determined fair value, and (ii) any interest that accrued before the prepayment, unless paid at that time. A prepaying company will be required to prepay all appraisal claimants an amount in cash that the company determines to be appropriate, unless the company has a good faith basis for contesting a particular claimant's entitlement to appraisal.

The amendments are viewed as an attempt to provide a disincentive for appraisal actions in order to eliminate costly and burdensome appraisal proceedings for buyers. A recent study[1] (discussed in more detail below) found that the *de minimis* thresholds could potentially eliminate one-fourth of appraisal actions and that the interest prepayment option could reduce shareholders' incentives to bring or prolong appraisal proceedings.

However, it is unclear how the amendments will impact appraisal actions brought by large shareholders. The same study shows that over the last few years, appraisal cases have overwhelmingly been brought by hedge funds engaging in "appraisal arbitrage," in which funds acquire shares of a company just before a merger in order to exercise appraisal rights. The *de minimis* thresholds will not affect this trend because most hedge funds already meet the *de minimis* holding requirements. The prepayment option will provide the greater disincentive for arbitrageurs because they will receive reduced interest upon a final resolution. But prepayment could unintentionally motivate arbitrageurs who will no longer have to wait for the conclusion of a lengthy court proceeding to potentially redeploy awarded capital to their next appraisal case.

- **Study Provides Analysis of Delaware Appraisal Rights Amendment.** An April 2016 study[1] provides an empirical analysis of the potential effects of the amendments to appraisal rights in Delaware. The study is based on a sample of merger deals entered between 2000 and 2014 in which shareholders were entitled to exercise appraisal rights in Delaware. Out of the 1,566 appraisal eligible deals, 225 appraisal petitions were actually filed. Hedge fund petitioners accounted for 75.6% of the challenged deals and 73.8% of the total dollar value of appraised shares. These funds targeted deals with the appearance of a conflict of interest or unfair pricing, e.g., going private deals, minority squeezeout deals, tender offers, and low takeover premium deals. The top seven hedge funds accounted for over 50% of the dollar volume of the appraisal right petitions.

In addition, the study finds that there would have been at least 22.7% fewer deals with appraisal petitions filed if the proposed de minimis thresholds had been effective in 2015. However, the study predicts that the de minimis thresholds will have no impact on the number of cases going to trial, unless the threshold is closer to $5 million. Currently, a petitioner's holding value is the most powerful predictor of whether an appraisal action will go to trial. For cases in which the underlying amount invested was less than $1 million, the petitioners settled their cases 100% of the time. For cases in which the petitioners' holding value exceeded $10 million, 36.4% of the cases went to trial (leading to the inference that 63.6% of these cases settle).

The study also confirms that a significant number of appraisal petitions are motivated by the statutorily-determined above-the-market interest accrual on appraisal awards. Almost 45% of the petitions in the sample appear to have been driven by the certainty of earning interest at rates significantly above current market rates, since regardless of the outcome of the appraisal action the dissenting shareholder will receive interest on either the merger compensation or the appraisal value. In fact, the study finds that 60.5% of petitioners' profits in trial cases derived from interest accrual rather than higher valuation awarded by the court. Thus, many appraisal petitioners gain returns which are not derived from genuine disagreement with takeover valuation.

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[1] Wei Jiang et al., *Reforming the Delaware Appraisal Statute to Address Appraisal Arbitrage: Will It Be Successful?* (Columbia Bus. Sch. Research Paper No. 16-31; Vanderbilt Law & Econ. Research Paper No. 16-11, 2016), *available at* http://ssrn.com/abstract=2766776.

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