BLANKROME

Corporate Litigation

MAY 2018 • NO. 1

Appraisal, Quasi-Appraisal, and Indemnification—Are Deals at Risk?

Both litigators and deal lawyers should take notice of stockholders' increasing attempts to obtain quasi-appraisal remedies. Given the potential impact of stockholders' arguments that quasi-appraisal can replace otherwise waived appraisal rights, but against directors for which indemnity may be required, counsel for both buyers and sellers need to account for these changing tides in Delaware corporate law.

Delaware litigators and deal lawyers around the globe are keen on accounting for the risk of dissenting stockholders exercising appraisal rights when negotiating and structuring a corporate transaction. Recently, however, Delaware corporate law trends may suggest that stockholders are attempting to obtain quasi-appraisal remedies more frequently, often arguing that such a remedy can be a class-wide substitute for foregone appraisal rights. As Delaware courts continue to grapple with the amorphous remedy that is quasi-appraisal and its interplay with directors' indemnification rights, corporate counsel need to be mindful of the best means to account for this expanding stockholder strategy and attempt to mitigate its risk in the transaction documents.

For appraisals, buyers have long understood that stockholders who perfect appraisal rights under 8 Del. Code Section 262 can obtain "fair value" for their shares as of the merger date instead of the merger consideration. See *Verition Partners Master Fund v. Aruba Networks,* 2018 WL 922139, at *1 (Del. Ch. Feb. 15, 2018) (objective of appraisal is not to ensure highest possible bid, but to evaluate "whether the dissenters got fair value and were not exploited"). In short, a filed appraisal claim addresses one thing, namely, the value of the dissenting stockholder's stock. And, it is well established that in determining "fair value," the Court of Chancery must do so exclusive of any element of value or synergies arising from the merger. The court reviews the entire pre-merger company as a stand-alone entity and assesses its value as such. All relevant factors are considered, and the statute requires consideration of proof of value by any techniques or methods which are generally considered acceptable in the industry. Of course, this means a battle of the experts, Corp & Commercial Practice in DE Court of Chancery 8.10[d][1]. While an efficient market check is generally a reliable assessment of fair value (more so than a paid expert's opinion), the Delaware Supreme

Court recently reiterated that it would not accept the invitation to create a presumption in favor of "fair value" at the deal price, see *Dell v. Magnetar Global Event Driven Master Fund,* 177 A.3d 1, 21–22, 23 (Del. 2017). That said, the Dell court held that when a robust and efficient sales process is involved (i.e., market efficiency, fair play, low barriers to entry, outreach to all local buyers, and the opportunity for any topping bidder), the deal price deserves heavy weight in the appraisal analysis.

While the amount involved can be high, appraisal actions are typically limited to a small percentage of stockholders. Only stockholders who timely perfected their appraisal rights are permitted to obtain an award of "fair value" instead of the merger price (and of course, "fair value" could be less than the merger price—a risk many stockholders are unwilling to take). If "fair value" is determined by the court to be higher than the merger price, the buyer is responsible to make those additional payments to the dissenting stockholders. As such, the statutory threshold for the perfection of appraisal rights can provide a buyer with a level of risk predictability in a transaction.

But, what about when, for whatever reason, stockholders do not timely perfect appraisal rights under Section 262? Can such stockholders use the concept of quasi-appraisal as a substitute for appraisal? In such a quasi-appraisal claim, a stockholder can bring a claim (likely dressed up as a breach of fiduciary duty claim, i.e., not enough information provided to allow one to make a decision on the exercise of appraisal rights) without the need to exercise appraisal rights under the statute. Because quasi-appraisal is rooted in fiduciary duty actions, directors/former directors are typically the target of such actions and may be on the hook for any difference in the merger price and the determined "fair value." Quasi-appraisal actions are often pursued as class actions on behalf of most of the stockholders, meaning directors may face crushing personal liability if the court were to find liability and award quasi-appraisal damages.

What happens in such circumstances? Not to be overlooked, many corporate charters or by-laws have indemnification provisions which require indemnification of directors, meaning that a buyer (having acquired the seller) may well be responsible for the quasi-appraisal claim, even without an appraisal action. As such, it might be possible that a quasi-appraisal/breach of fiduciary duty action pursued as a class action on behalf of all (or most) of the stockholders could expand specifically to swallow the appraisal remedy created by statute. After decades of expansion, courts now face the question of what limitations, if any, to apply to quasi-appraisal. See, e.g., transcript of oral argument at 15, *In re Cyan, C.A.* No. 11027-CB (Del. Ch. June 14, 2016).

At play are also issues relating to Director exculpatory provisions. A Section 102(b)(7) exculpatory charter provision (which many corporate entities use) eliminates a director's personal liability arising from breaches of the duty of care, see *Kahn v. Stern, 2*017 WL 3701611, at *8 (Del. Ch. Aug. 28, 2017), *aff'd,* 2018 WL 1341719 (Del. Mar. 15, 2018). A director's personal liability, however, cannot be exculpated if the director acted in bad faith or was disloyal to the company or its stockholders. In other words, Delaware law requires that *Revlon* duties remain applicable notwithstanding an exculpatory charter provision, even though directors may only be held liable for a non-exculpated breach of those duties. Thus, whether a director faces personal liability under quasi-appraisal would depend on whether the director allegedly acted in bad faith or was otherwise disloyal. If the court finds no bad faith or disloyalty, a Section 102(b)(7) exculpatory provision should help to protect a buyer from any quasi-appraisal damages.

Director indemnity agreements are typically designed to favor indemnity of the directors to the fullest extent allowed under Delaware law. As the Delaware Supreme Court has explained, the purpose of indemnification is to encourage men and women to "serve as corporate directors, secure in the knowledge that expenses incurred by them in upholding their honesty and integrity as directors would be borne by the corporation they serve." See *Stifel Financial v. Cochran,* 809 A.2d 555, 561 (Del. 2002). Such indemnity agreements often become an obligation of the buyer. See 8 Del. Code Section 145(h).

However, a corporation (buyer or seller) cannot indemnify directors for bad faith/loyalty breaches. See *Hermelin v. K-V Pharmaceutical,* 54 A.3d 1093, 1094-95

BLANKROME

(Del. Ch. 2012) ("[T]he statute prohibits a corporation from indemnifying a corporate official who was not successful in the underlying proceeding and has acted, essentially, in bad faith…. Prohibiting the indemnification of unsuccessful 'bad actors' also relieves stockholders of the costs of faithless behavior and provides corporate officials with an appropriate incentive to avoid such acts to begin with.") (emphasis in original); see also *Waltuch v. Conticommodity Services,* 88 F.3d 87, 95 (2d Cir. 1996) (invalidating indemnification provision indemnifying bad faith actions because it was "inconsistent with [Section] 145(a) and thus exceeds the scope of a Delaware corporation's power to indemnify").

As such, as quasi-appraisal claims continue to increase, the predictability that comes with the timely perfection of appraisal rights may be lost. Buyers may need to consider more than just the number of dissenting stockholders, and more specifically, also consider if a class of all (or most) of the stockholders would or could pursue a quasi-appraisal claim against the seller's former directors for which the buyer might have indemnity responsibility.

This intersection of quasi-appraisal remedies and directors' indemnification rights could put a buyer potentially at odds with a seller's former directors, and highlight further unanticipated deal risks. Navigating these changing tides in Delaware corporate law is of critical importance, particularly for buyers, and these considerations should receive appropriate attention in the early stages of the deal negotiations.

For additional information, please contact:

Larry R. Wood Jr.
215.569.5659 | lwood@blankrome.com

Adam V. Orlacchio
302.425.6431 | orlacchio@blankrome.com

Craig N. Haring
302.425.6426 | charing@blankrome.com

Reprinted with permission from the May 30, 2018, edition of *Delaware Business Court Insider* © 2018 ALM Media Properties, LLC. All rights reserved. Further duplication without permission is prohibited. For information, contact 877-257-3382, reprints@alm.com or visit www.almreprints.com.

©2018 BLANK ROME LLP. All rights reserved. Please contact Blank Rome for permission to reprint. Notice: The purpose of this update is to identify select developments that may be of interest to readers. The information contained herein is abridged and summarized from various sources, the accuracy and completeness of which cannot be assured. This update should not be construed as legal advice or opinion, and is not a substitute for the advice of counsel.