APPRAISAL RIGHTS: A UNITES STATES OF AMERICA AND EUROPEAN UNION STUDY

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Abstract

Executive Summary

Appraisal rights are a protection mechanism, in the form of legal action, for shareholders partaking in takeover proceedings, in order for them to get what is deemed as a fair value of their shares in most cases. They have gained significant prominence over the previous years, involving important mergers and even attracting media attention. Nonetheless, the distribution of such actions is not even among the two sides of the Atlantic. In the United States of America their popularity is growing day by day, with appraisal rights even used as a form of shareholder activism by wealthy hedge funds, whereas in Europe, this institution just started to make its appearance.

The present paper deals with the general theme of appraisal rights, by first analyzing the notion and explaining their most common uses. Subsequently, it presents the overview of the American regime, focusing on the relevant provisions incorporated in the Delaware General Corporation Law, as well as on the way these rights are employed by the hedge funds. Next in line comes the European Union regime, with the fragmented provisions appearing in certain secondary legislations and the absence of a harmonized "landscape" among the Member States. Last, but not least, the conclusion deals with the differences concerning appraisal rights between the afore-mentioned regions, attributing those disparities mainly to the distinct stages of the formers' evolution among them. While they are at a mature level in the United States of America, the same thing cannot be said for their situation in Europe.

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1. GENERAL REMARKS

Appraisal rights actions are, nowadays, in the vanguard of any buyout proceeding[1]. Whenever such corporate transactions take place, the shareholders have, among others[2], the option to invoke their appraisal rights in order to obtain a fairer value of their shares, corresponding to a higher price that needs to be paid to them[3]. It is a remedy that, in general, protects the shareholders from the undervaluing of their share of ownership in a company. It protects them both in positive way, by providing an actionable claim, and in a more abstract one, acting as a determent of underpaying for the buyers[4].

Despite their rising popularity, especially in the United States of America (USA), appraisal rights actions are sometimes avoided by categories of shareholders, particularly the smaller ones, due to their costly procedure and the possibility for the court to actually

1 The value of appraisal claims in 2013 was $1.5billion, a tenfold increase from 2004, and more than 15% of takeover transactions in 2013 were subject to such claims. This is according to C. Korsmo and M. Myers, The Law & Economics of Merger Litigation: Do the Merits Matter in Shareholder Appraisal, draft pending availability of its revision, with results published in S. Davidoff, A New Form of Shareholder Activism Gains Momentum, New York Times (March 4, 2014).

2 Such as the blocking of the transaction altogether due to breach of fiduciary duties: Revlon v. MacAndrews & Forbes Holdings, 506 A.2d 173 (Del. 1986) and The Mony Group Shareholder Litigation, 2004 WL 769817 (Del. Ch. 2004).

3 M. Barry, J. Eisenhofer, Shareholder Activism Handbook, 2012 Supplement (Aspen Publishers, 2012), 11-3.

4 S. Davidoff, Ibid.

award them with less money than those included in the proposed takeover bid[5]. There are also concerns of transaction delays and increased legal risks, which are associated with the general availability of dissenting shareholders' remedies[6]. Nonetheless, they are still less expensive than full litigation, and, certainly, less time-consuming[7], as there is no wrongdoing involved[8], but just a business and economics analysis[9]. As a considerable sum is required for the procedure, hedge funds usually "monopolize" the commencement of such actions[10].

2. THE USA REGIME

Appraisal remedies are mostly found in the provisions of USA state-laws. Since the beginning of the 20th century, the State of Delaware attracted the majority of the American public companies, which chose it as the place of their incorporation[11], thus, making the appraisal statute included in the Delaware General Corporation Law (DGCL) the most relevant one for our case. Outside Delaware, the most commonly applicable legislation is the Model Business Corporation Act, but due to length constraints, we are going to focus solely on the Delaware regime, which, apart from its widespread popularity, also boasts a quite elaborate case law[12].

According to the DGCL provisions, shareholders that have an objection concerning a cash offer regarding their shares, may opt to dissent and seek a higher price through litigation[13]. This dissent, shown by some shareholders, gave appraisal rights their alternative name: dissent rights. There are two ways for perfecting appraisal rights according to the relevant section of the DGCL; the shareholders shall either vote against or abstain from voting on the buyout[14]. Additionally, they shall also refuse to accept the merger consideration paid to the other shareholders at closing[15]. The demand of the shareholder to exercise his appraisal rights shall be received by the time of the vote on the

5 M. de la Merced, Icahn Gives Up Fight Over Dell Appraisal Rights, in The New York Times (October 4, 2013), J. Velasco, The Fundamental Rights of the Shareholder, UC Davis Law Review, Vol. 40 (2006), 423.
6 P. Mantysaari, The Law of Corporate Finance: General Principles and EU Law (Springer, 2010), 394.
7 For a contradictory view consult: T. Kirchner, Merger Arbitrage: How to Profit from Event-Driven Arbitrage (Wiley, 2009), 250.
8 Cede & Co. v. Technicolor, 542 A.2d 1182 (Del. Supr. 1988).
9 M. Barry, J. Eisenhofer, Ibid.
10 S. Davidoff, Ibid.
11 Delaware Division of Corporations, 2012 Annual Report: http://corp.delaware.gov/pdfs/2012CorpAR.pdf Accessed on April 5, 2014.
12 M. Barry, J. Eisenhofer, Ibid, 11-4.
13 Section 262 of the DGCL.
14 G. Geis, An Appraisal Puzzle, Northwestern University Law Review, Vol. 105, No. 4 (2011), 1637.
15 D. Katz, Shareholder Activism in the M&A Context, in The Harvard Law School Forum on Corporate Governance and Financial Regulation (March 27, 2014).

merger[16]. The statute even allows the exercise of such rights even if the shareholder bought shares having previous knowledge of the proposed merger[17].

After the conclusion of the merger, the dissenting shareholders have the absolute right to an appraisal[18], by filling a suit in the Delaware courts, requesting the assessment of the shares' value as of the merger closing date. This right shall be exercised within 120 days from the merger's closing. The stockholder can, within a 60 day period from the merger, withdraw the afore-mentioned demand and accept the initial terms of the offer. The cause for the enactment of appraisal rights was the shift in view that happened in the 1930s, which allowed for the continuation of a buyout proceeding even if there is a minority opposing it, eliminating the right of any shareholder to block the merger[19]. The payment of the fair value of their shares, whose reliable indicator might be their merger price, after all[20], is done in cash, provided that the shareholders have complied with the above-mentioned statutory provisions[21].

As said *supra*, hedge funds tend to appertain for the most part in the appraisal rights actions. Since they are concentrations of big capital, they can venture into this risky and expensive procedure[22]. The main gain behind these actions is the return on investment, as there is an interest of 5,7% paid on the money invested in the shares under dispute, in particular, if the claimants expect to get the merger price at least. It could also be viewed as a good place for the hedge funds to "park" cash[23]. For them, appraisal rights are some sort a new form of business, outside the conventional ones[24]. Therefore today, we observe appraisal arbitrage as a means of shareholder activism[25].

Companies should be more careful in future cases of buyouts; undervaluing the price they are willing to pay per share might lead them having potential liability problems, due to actions brought up by shareholders regarding their appraisal rights. The latter

16 M. Barry, J. Eisenhofer, Ibid, 11-5.
17 Salomon Bros. v. Interstate Bakeries, 576 A.2d 650 (Del. Ch. 1989).
18 Kaye v. Pantone, 395 A.2d 369, 37 (Del. Ch. 1978).
19 Chicago Corp. v. Munds, 172 A. 452, 455 (Del. Ch. 1934).
20 Huff Fund Investment Partnership v. Ckx, Inc., 6844-VCG (Del. Ch. 2013). See also: W. Savitt, D. Shapiro, Court Holds Merger Price is Reliable Indicator of Fair Value, in The Harvard Law School Forum on Corporate Governance and Financial Regulation (November 5, 2013) and The Growth of Appraisal Litigation in Delaware, WSGR Alert (November 2013).
21 S. Bainbridge, Mergers and Acquisitions (Foundation Press, 2003), 192-3.
22 D. Wolf, The Evolving Face of Deal Litigation, in The Harvard Law School Forum on Corporate Governance and Financial Regulation (March 27, 2014).
23 S. Davidoff, Ibid.
24 For an elaborate view on the issue consult: D. Berer, The Growth of Appraisal Litigation in Delaware, in The Harvard Law School Forum on Corporate Governance and Financial Regulation (December 5, 2013).
25 C. O'Brien, R. O'Halloran, M. Dockery, Activists at the Gate: The Continuing Evolution of Shareholder Activism in the US, in BoardMember.com (March 20, 2014), and Appraisal Arbitrage – A Rising Star in the Activist Playbook, in Cooley M&A Team News (March 2014).

could be the tool through which the former might ensure their prerogatives. On the other hand, the way these are being exploited by hedge funds, without, at least for the moment, the active participation of institutional or individual shareholders, could be a plausible argument invoked by companies to make appraisal rights harder to exercise in the future[26].

3. THE EU REGIME

The European Union (EU) appraisal rights "landscape" is less prominent – and extensive - compared to its counterpart on the other side of the Atlantic, mainly due to the fact that the EU does not dictate a uniformly applicable regime. Appraisal rights, although not mentioned as such, are implied in some relevant sources of EU legislation. Firstly, mention should be given to the Third Company Law Directive[27], which in Article 28 elaborates on the possibility of such rights existing in some Member States laws. The determination of the value can be made either by a court or by an administrative authority that is designated by the Member State for that purpose[28].

Secondly, the Council Regulation on the Statute for a European Company[29], and more specifically, article 25 therein, in particular its third paragraph, describes a procedure of judicial review quite similar to the one of the appraisal remedy in the US, leading us to conclude that the latter could exist in some Member States. In fact, the German European Company (SE[30]) Implementation Act explicitly cites that an appraisal right might be allowed in cases of the formation of a holding-SE and of a merger into a SE[31].

Last, but not least, the Directive on Cross-Border Mergers of Limited Liability Companies[32], allows, in the second paragraph of Article 4, for the adoption of measures ensuring the protection of minority shareholders, who opposed the cross-border merger. The third paragraph of Article 10 explicitly refers to a compensation procedure towards minority members. It is important to note, that all of the above-mentioned provisions do not require the Member States to enact laws including some sort of appraisal remedy.

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26 S. Davidoff, Ibid.

27 Third Council Directive concerning mergers of public limited liability companies, 78/855/EEC, OJ L 295 (20.10.1978), 36.

28 As amended by Directive 2009/109/EC of the European Parliament and of the Council, OJ L 259 (2.10.2009), 14.

29 Council Regulation (EC) No. 2157/2001, OJ L 294 (10.11.2001), 1.

30 As in Societas Europaea.

31 In Sections 7 and 9 of the SE-Ausfuhrungsgesetz. For more consult: J. Reichert, Experience with the SE in Germany, in Utrecht Law Review, Vol. 4, No. 1 (2008), 22-33.

32 Tenth Directive 2005/56/EC of the European Parliament and of the Council, OJ L 310 (5.11.2005), 1.

Instead, the reference of similar procedures, implies that Member States are free to adopt appraisal rights, as their American peers, taking into account the conditions enshrined in the relevant EU legislation[33].

The appraisal right procedure inside the Member States is based on their respective company - and in some cases civil - law, as no valuation method is included in the EU legislative provisions. In Germany, for example, the Transformation of Companies Act provides shareholders with the right to adequate cash compensation[34]. Appraisal rights also exist in Dutch legislation, although with differences between a cross-border merger, and a merger creating a SE, which has resulted in a long debate discrimination-wise[35]. Estonian laws, on the other hand, do not include any appraisal remedies[36]. In general, appraisal rights are associated with exit rights, sell-outs and squeeze-outs in most of the EU Member States[37].

The fundamental freedoms are among the most respected principles of EU Law. Accordingly, Recital 3 of the Directive 2005/56/EC imposes certain limits to the introduction of special minority rights, appraisal rights being among them. Such measures shall not restrict the fundamental freedoms, in particular those of establishment and capital movement. In case of a restriction, this must be justifiable, in line with previous Court of Justice of the European Union jurisprudence, and take into consideration the general interest and the principle of proportionality[38]. This rationale is the norm when it comes to issues of EU corporate law, in particular with regard to securities regulation[39].

4. CONCLUSION

After having briefly reviewed the general outline of the appraisal rights schemes in the US and the EU, it is time to state our conclusion. In both jurisdictions this kind of rights and remedies seem to exist, albeit at a different extent in each. In the USA, appraisal rights

33 P. Mantysaari, Ibid, 251, 374.

34 In Sections 15(1), 29(1) and 34 of the Umwandlungsgesetz. Similar provisions are also included in the Aktiengesetz, according to P. Mantysaari, Ibid.

35 P. Vries, Exit Rights of Minority Shareholders in a Private Limited Company (Kluwer, 2010), Chapter 7, and in particular 408-411.

36 S. Papp, J. Kasevits, Estonia in C. Cogut, Mergers & Acquisitions in 52 jurisdictions worldwide (Getting The Deal Through, 2008), 95.

37 Such as Belgium, in Articlees 334-342 of the Wetboack van Vennootschappen and Italy, in Article 2473 Codice Civile. For more consult: D. Gerven, Common Legal Framework for Takeover Bids in Europe, Vol. 1 (Cambridge University Press, 2008), P. Vries, Ibid, 17, and J. Winter, Report of The High Level Group of Company Law Experts on Issues Related to Takeover Bids (January 10, 2002).

38 P. Vries, Ibid, 404.

39 An example of that could be the Golden Shares regime whereby the same procedure is followed. For more consult: P. Camara, The end of the Golden Age of Privatisations? The recent ECJ Decisions on Golden Shares, in European Business Organization Law Review, Vol. 3 (2002).

have gained momentum and represent a tactic used by minority shareholders in order to defend their prerogatives, or, in order to play the role of an activist shareholder, if used by well-heeled hedge funds[40]. EU minority shareholders do not seems to take advantage of these provisions, when they do exist. In general the relevant legislation is fragmented and this is the reason why appraisal rights are uncommon in this part of the world. This difference could be understood since they are seen as merely a remedy for those shareholders that are not going to survive the merger[41].

The USA state-laws, and in particular the DGCL, are more comprehensive, covering a variety of cases, and allowing the exercise of such rights in a plethora of circumstances, as explained *supra*. Even the exit regime is better thought-of in comparison to the EU, where minority shareholders face a series of enforcement obstacles[42]. Nonetheless, it is interesting to note that the DGCL statutes do not provide appraisal rights for charter amendments that might materially affect the rights of dissenting stockholders, contrary to some EU countries and the majority of the rest of the USA state-laws[43].

We could summarize our views by saying that while the EU is struggling to implement the basic notion of these rights, due to the absence of a harmonization requirement, the US is several steps ahead "of the game", now facing problems on how to restrain them, so that their use won't fall outside their *raison d'être*, as sometimes is the case when prosperous hedge funds are involved. Such problems imply a more advanced and mature regime that could act as the model for an upcoming EU one. The need for that would not rise soon, though, taking into consideration the simple fact that the hedge fund market in Europe, which has the power to push for further expansion of appraisal rights and remedies, is nowhere near the USA one in terms of performance and size[44].

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43 Ibid, 191.
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