Simpson Thacher

Memorandum

Delaware Chancery Court Confirms Stockholders May Petition for Appraisal without Showing Shares Were Not Voted in Favor of Merger by Previous Stockholders

January 9, 2015

Introduction

In a pair of memorandum opinions written by Vice Chancellor Glasscock and decided on January 5, 2015, the Court of Chancery of the State of Delaware, in *In Re Appraisal of Ancestry.com, Inc.* and *Merion Capital LP v. BMC Software, Inc.*, found that neither the beneficial owner nor the record owner of shares for which appraisal is sought under Section 262 of the General Corporation Law of the State of Delaware is required to show that the specific shares for which it seeks appraisal have not been voted in favor of the merger in question by previous stockholders. The findings follow the analysis applied in *In Re Appraisal of Transkaryotic Therapies, Inc.*, a 2007 case which preceded an amendment to Section 262(e) later that year permitting beneficial owners to petition for appraisal in their own name. The decisions support the practice known as "appraisal arbitrage" – a practice which has contributed to the more than tripling of incidents of appraisal petition filings in eligible deals over the past 10 years – for investors who buy stock in target companies following the record date for stockholder votes on mergers and highlight public policy considerations concerning the role of Delaware's appraisal statute in merger transactions.

Background

The *Ancestry.com* case arose from the December 2012 acquisition of Ancestry.com, Inc. by the private equity firm Permira Advisors. Following the record date for the vote of the stockholders of Ancestry.com to approve the merger but prior to the stockholder meeting, Merion Capital L.P., a hedge fund that engages in appraisal arbitrage as an investment strategy, acquired approximately 1.25 million shares of common stock of Ancestry.com. Merion then sought appraisal of those shares pursuant to Section 262 of the General Corporation Law of the State of Delaware. Subsection (a) of Section 262 entitles stockholders to "an appraisal by the Court of Chancery of the fair value of the stockholder's shares of stock" provided that certain procedures are complied with, including that the stockholder has "[not] voted in favor of the merger". For

purposes of subsection (a), a "stockholder" means a holder of record of stock in a corporation.

Most of Ancestry.com's shares, including those acquired by Merion, were held in fungible bulk by the record owner Cede & Co, a practice typical for publicly traded companies. As the owner of record, Cede notified Ancestry.com prior to the stockholder meeting that it was asserting appraisal rights with respect to the shares beneficially owned by Merion. Thereafter, Merion filed a petition for appraisal in its own name under Section 262(e). In 2007, Section 262(e) had been amended to permit such filings by beneficial owners. Before the amendment, only record holders were permitted to file such petitions.

The *BMC Software* case also involved the acquisition of shares by Merion subsequent to the record date for the stockholder vote on the merger. Like in *Ancestry.com*, the shares acquired by Merion were held of record by Cede but, unlike in *Ancestry.com*, the broker through which Merion acquired such shares would not, as a matter of policy, instruct Cede to make a written demand for appraisal on Merion's behalf before the taking of the stockholder vote on the merger. As a result, Merion had to make arrangements to become the holder of record of the shares it beneficially owned in order to make a written demand for appraisal as the record holder of shares in accordance with Section 262.

Delaware Chancery Court Analysis

In *Ancestry.com*, after observing that the appraisal remedy is a "creature of statute" and that the Court's role is to "ensure compliance with the statutory prerequisites," the Court reviewed the requirements for perfecting appraisal claims under Section 262. The Court noted that while the 2007 amendment to Section 262(e) had expressly amended that subsection to permit beneficial owners (in addition to record owners) to commence an appraisal proceeding, it had not similarly broadened the procedural requirements for eligibility provided in the other subsection of Section 262 – namely, that the record holder (i) holds the shares on the date it makes a demand for appraisal, (ii) continuously holds the shares through the effective date of the merger, (iii) delivers a written demand for appraisal to the corporation before the stockholder meeting to vote on the merger and (iv) has not voted in favor of the merger.

The Court applied the reasoning of *In Re Appraisal of Transkaryotic Therapies, Inc.*, a 2007 case with similar facts, and concluded that so long as Cede, as record owner, could show that the number of shares it did not vote in favor of the merger is at least as many as those for which it perfected appraisal on behalf of the petitioning beneficial owners, then the requirement that the stockholder not have voted in favor of the merger was satisfied. It was not relevant to the Court that Merion was not entitled to vote the shares it had acquired, as it had acquired them subsequent to the record date, or that Merion could not demonstrate that whoever had been entitled to cast votes in respect of those shares did not, in fact, vote in favor of the merger. The Court found "no indication that the Court's observation [in *Transkaryotic*] that 'the actions of beneficial holders are irrelevant in appraisal matters' is no longer accurate . . ." and that "[t]he plain language of [Section 262], including the 2007 amendment to Section 262(e), does not impose on beneficial owners any new burden in connection with affording them the opportunity to file petitions in their own names". Rather, it concluded beneficial owners could file petitions in their own name but would need to rely on the fact that

the record owner of the shares they beneficially owned would have available sufficient shares not voted in favor of the merger under the Court's analysis in *Transkaryotic*.

In *BMC Software*, where Merion had become the record owner of the shares with respect to which it sought appraisal prior to making its demand, the Court found similarly that Section 262 required only that the record holder, in this case Merion, demonstrate that it had not voted in favor of the merger and that there was no requirement that the record owner demonstrate that the shares were not voted in favor of the merger by any previous owner.

Conclusion

The *Ancestry.com* and *BMC Software* opinions are important decisions insofar as they support the practice of appraisal arbitrage under existing law and conclude that notwithstanding the amendments to the appraisal statute in 2007, investors who wish to seek appraisal may do so with respect to shares of merger targets purchased subsequent to the record date for determining eligibility for voting on the applicable merger, thus allowing appraisal arbitrageurs to deploy their capital later and for shorter periods of time. In light of the continued growth of appraisal arbitrage and modern practices for the ownership and transfer of securities of public companies, the policy concerns raised by the respondents in these cases is an issue that the Delaware legislature may well consider addressing in the future.

You can download a copy of the January 5th *Ancestry.com* opinion by clicking here and the *BMC Software* opinion by clicking here.

For further information about the opinion or related matters, please contact any of the members of our Mergers and Acquisitions or Litigation Practice, including those listed below.

William E. Curbow
+1-212-455-3160
wcurbow@stblaw.com

Peter E. Kazanoff
+1-212-455-3525
pkazanoff@stblaw.com

Alan M. Klein
+1-212-455-3188
aklein@stblaw.com

Joseph M. McLaughlin
+1-212-455-3242
jmclaughlin@stblaw.com

Lee A. Meyerson
+1-212-455-3675
lmeyerson@stblaw.com

Mario A. Ponce
+1-212-455-3442
mponce@stblaw.com

Robert E. Spatt
+1-212-455-2685
rspatt@stblaw.com

Eric M. Swedenburg
+1-212-455-2225
eswedenburg@stblaw.com

Ben P. Schaye
+1-212-455-7866
ben.schaye@stblaw.com

The contents of this publication are for informational purposes only. Neither this publication nor the lawyers who authored it are rendering legal or other professional advice or opinions on specific facts or matters, nor does the distribution of this publication to any person constitute the establishment of an attorney-client relationship. Simpson Thacher & Bartlett LLP assumes no liability in connection with the use of this publication. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all of our partners, as well as our recent memoranda, can be obtained from our website, www.simpsonthacher.com.

Simpson Thacher Worldwide

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
2 Houston Center
909 Fannin Street
Houston, TX 77010
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
1155 F Street, N.W.
Washington, D.C. 20004
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3919 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
West Tower, Mirae Asset Center 1
26 Eulji-ro 5-gil, Jung-gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000