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Court addresses extraordinary dividend paid in connection with merger

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The Delaware Supreme Court recently addressed the effect an extraordinary dividend had on stockholders' appraisal rights in a merger. In the transaction, approximately 98.5% of the value paid to stockholders was structured as a dividend paid the day before closing, with the remaining value paid in the form of merger consideration.

The Supreme Court held that, for appraisal purposes, the "fair value" of the corporation's shares should be determined "as if the dividend had not been declared."

More importantly, the majority opinion reversed the lower court's dismissal of the plaintiffs' disclosure claim, finding that the complaint stated non-exculpated claims that stockholders were misled by the proxy statement about their appraisal rights.

Background

In re GGP, Inc. Stockholder Litigation involved Brookfield Property Partners LP's acquisition of GGP, Inc., a Delaware corporation operating as a REIT.[1] According to the plaintiffs, the merger consideration was structured to reduce the risk that stockholders would seek appraisal rights.

The Supreme Court held that, for appraisal purposes, the "fair value" of the corporation's shares should be determined "as if the dividend had not been declared."

This was allegedly done by structuring the transaction to consist of a $32.50 per share dividend (98.5% of the total transaction value) paid the day before closing and $0.312 per share paid as merger consideration upon the closing.

The plaintiffs argued that this was done to discourage stockholders from seeking appraisal because, among other things, stockholders would be concerned that the appraised value would be assessed on a post-dividend basis. Plaintiffs further alleged that the proxy statement was materially misleading on this point.

The Delaware Supreme Court first addressed the "threshold question" of whether using a pre-closing dividend improperly restricted or eliminated stockholders' statutory appraisal rights under Delaware law. It held that it did not.

The Supreme Court noted that, although typically a stockholder abandons its appraisal rights by accepting merger consideration, that general rule does not apply when stockholders "had no choice" on whether to accept the payment, as was the case with a pre-closing dividend. The Supreme Court then turned to the proper assessment of the "fair value" of the shares in an appraisal action.

The fact that the court upheld loyalty claims, indicating that insiders could be personally liable for proxy disclosures describing what effectively was a legal issue of first impression, is concerning.

It said "dividends that are conditioned on the consummation of a merger are treated as merger consideration under Delaware law, meaning that the fair value of an entity that declares a conditional dividend ... is appraised as if the dividend has not been declared."

The Supreme Court then addressed whether the plaintiffs stated non-exculpated disclosure claims against the insiders.

A majority of the justices held that the disclosures were "confusing and misleading" as to, among other things, (i) how the statutory appraised value would relate to the dividend (i.e., whether fair value was based on the corporation's value before or after the dividend) and (ii) how stockholders could satisfy the statutory de minimis appraisal condition, which requires that the value of the number of shares seeking appraisal must exceed $1 million (i.e., whether it would treat the value of the shares as $0.312 per share for such purpose).

The majority opinion concluded that "[i]t is reasonably conceivable, if not reasonably certain, that a [] stockholder who read the Proxy would have taken it at its word and concluded that appraisal rights were limited to the fair value of [the corporation] after payment of the Pre-Closing Dividend."

The majority opinion further held that the plaintiffs adequately alleged that the misleading disclosures were a breach of the duty of loyalty, which could give rise to personal liability by the directors and officers.

The majority said "it is reasonably conceivable that the Defendants settled on this structure and the related Proxy disclosure as another method of limiting [the buyer's] exposure to appraisal demands" and that the transaction structure "was designed and disclosed with the explicit aim of curtailing the statutory appraisal rights that were triggered."

The fact that the court upheld loyalty claims, indicating that insiders could be personally liable for proxy disclosures describing what effectively was a legal issue of first impression, is concerning, and two justices dissented. As a remedy, the court held that stockholders were entitled to opt into a class seeking quasi-appraisal damages.

Notes

[1] No. 202, 2021 (Del. July 19, 2022).

About the author

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