

Corporate Finance/M&A - USA

Ancestry.com price was fair, despite challenge from appraisal arbitrage investors

Contributed by **Ropes & Gray LLP**

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In a January 30 2015 Delaware Chancery Court decision, *In Re Appraisal of Ancestry.com, Inc.*⁽¹⁾ the court found that the price paid for the \$1.6 billion buy-out of Ancestry.com by private equity firm Permira Advisers LLC was fair.

In recent years, certain hedge funds have pursued an investment strategy known as 'appraisal arbitrage', pursuant to which they acquire stock of a public company after a merger is announced in the hope that the Delaware Chancery Court will determine that the fair value of such stock is actually higher than the merger price. Under Section 262 of the Delaware Code, dissenting stockholders which have perfected appraisal rights have the right to a judicial determination of the fair value of their stock based on the value of the acquired firm as a going concern. The returns associated with appraisal arbitrage can be substantial, including because the statutory interest rate for appraisal awards (which begins to accrue as of the merger's effective date) is the Federal Reserve discount rate plus 5%. For example, in 2012 Orchard Enterprise Inc was ordered to pay hedge funds that successfully exercised appraisal rights more than twice the per share merger price. However, appraisal arbitrage is not without its risks. In assessing fair value, the Delaware Chancery Court may also determine that the fair market value for shares of an acquired company is at or below the merger price.

The acquisition of Ancestry by Permira was announced on October 22 2012 at a price of \$32 per share, which represented a 41% premium above the trading price of Ancestry's stock. Ancestry subsequently received written demands for appraisal on behalf of hedge fund stockholders collectively holding approximately 1.4 million shares. On December 27 2012 Ancestry's stockholders approved the transaction, with 99% of the shares present and voting at the meeting voting in favour of the transaction.

Acknowledging that it found the approach taken by valuation experts on either side to be "less than fully persuasive", the court nevertheless determined that "fair value" was "best represented by the market price", noting that the discounted cash flow valuation came close to the market price and gave comfort that "no undetected factor skewed the sales process". The court allowed the petitioners to collect interest, limiting their potential losses.

Many see *In Re Appraisal of Ancestry.com, Inc* as a blow to the practice of appraisal arbitrage. There is language in the decision underscoring that the Delaware Chancery Court will look closely to the market in assessing fair value, barring exceptional circumstances (eg, a poorly run sale process). In a transaction resulting from an arm's-length process between independent parties where there are "no structural impediments" that might materially distort "objective market reality", the court is likely to give "substantial evidentiary weight to the merger price as an indicator of fair value".

In a separate ruling earlier in January 2015 against Ancestry, the Delaware Chancery Court confirmed that for purposes of determining legal standing it is the record holder, not the beneficial owner, who must not have voted the shares for which appraisal is being sought. Further, in the case of shares held in fungible bulk by a record owner, a record holder need only have at least as many shares not voted for in favour of a merger as those for which appraisal is being sought.

For further information on this topic please contact [Howard Glazer](#) at Ropes & Gray LLP's San Francisco office by telephone (+1 415 315 6300) or email (howard.glazer@ropesgray.com). Alternatively, contact [Christian J Westra](#) at Ropes & Gray LLP's Boston office by telephone (+1 617 951 7000) or email (christian.westra@ropesgray.com). The Ropes & Gray LLP website can be accessed at www.ropesgray.com.

Endnotes

(1) *In Re Appraisal of Ancestry.com, Inc*, CA No 8173-VCG (Del Ch January 30 2015).

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Authors

Howard Glazer



Christian J Westra



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