

2019

## Appraisal Confusion: The Intended and Unintended Consequences of Delaware's Nascent Pristine Deal Process Standard

Alex Peña

Brian JM Quinn

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# APPRAISAL CONFUSION: THE INTENDED AND UNINTENDED CONSEQUENCES OF DELAWARE’S NASCENT PRISTINE DEAL PROCESS STANDARD

ALEX PEÑA\* & BRIAN JM QUINN\*\*

*In a merger, shareholders who believe the consideration being offered is too low have a statutory right to seek fair value for their shares through a judicial process called appraisal. In recent years, there has been an explosion in the number of appraisal actions leading some to argue that the remedy was being abused. In this Article, we argue that a recent line of cases by the Delaware Supreme Court that places heavy reliance on merger price as part of the judicial determination of fair value in appraisal proceedings is misguided and may lead to unintended consequences. Rather than rely on merger price in the determinations of fair value for publicly traded companies, courts should either eliminate the appraisal remedy for publicly traded corporations altogether or look to the unaffected stock market price of merger targets.*

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\* Associate, Morgan, Lewis & Bockius LLP. The views expressed herein are those of the author and do not necessarily reflect the views of Morgan, Lewis & Bockius LLP.

\*\* Associate Professor of Law, Boston College Law School.

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## I. INTRODUCTION

In a merger, shareholders who believe the consideration being offered is too low have a statutory right to seek fair value for their shares through a judicial process called appraisal. In recent years, there has been an explosion in the number of appraisal actions leading some to argue that the remedy was being abused. In this Article, we argue that a recent line of cases by the Delaware Supreme Court that places heavy reliance on merger price as part of the judicial determination of fair value in appraisal proceedings is misguided and may lead to unintended consequences. Rather than rely on merger price in the determinations of fair value for publicly traded companies, courts should either look to the unaffected stock market price of merger targets or eliminate the appraisal remedy for publicly traded corporations altogether.

Until recently, appraisal litigation had largely been a backwater of corporate practice and jurisprudence with most shareholders opting to accept merger consideration rather than expend resources and time to pursue appraisal petitions. However, by the 2010's, this changed. In a series of papers, Professors Korsmo and Myers identified a significant increase in appraisal litigation, observing that the value of appraisal claims rose tenfold between 2004 and 2013.<sup>1</sup> They attribute much of this growth to the participation of financial arbitrageurs in appraisal litigation. The increased attention from financial arbitrageurs in what was previously a litigation afterthought gave rise to critiques that “appraisal arbs” and professional investors were abusing a legal remedy that was not meant for them.<sup>2</sup>

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1. Charles R. Korsmo & Minor Myers, *The Structure of Stockholder Litigation: When Do the Merits Matter?*, 75 OHIO ST. L.J. 829, 829 (2014) [hereinafter Korsmo & Myers, *Merits*]; Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 WASH. U. L. REV. 1551, 1553 (2015) [hereinafter Korsmo & Myers, *Appraisal Arbitrage*]; Charles R. Korsmo & Minor Myers, *Interest in Appraisal*, 42 J. CORP. L. 109, 111 (2016) [hereinafter Korsmo & Myers, *Interest*]; Charles Korsmo & Minor Myers, *Reforming Modern Appraisal Litigation*, 41 DEL. J. CORP. L. 279, 282 (2017) [hereinafter Korsmo & Myers, *Reforming*].

2. Matthew D. Cain, Jill Fisch, Steven Davidoff Solomon, & Randall S. Thomas, *The Shifting Tides of Merger Litigation*, 71 VAND. L. REV. 603, 604 (2018) [hereinafter *Shifting Tides*]; see, e.g., Trevor S. Norwitz, *Delaware Legislature Should Act to Curb Appraisal Arbitrage Abuses*, CLS BLUE SKY BLOG (Feb. 10, 2015), <http://clsbluesky.law.columbia.edu/2015/02/10/delaware-legislature-should-act-to-curb-appraisal-arbitrage-abuses/> [https://perma.cc/SGW5-WTTP].

This rapid increase in appraisal litigation did not arise in a vacuum. Rather, appraisal arbitrage is one of but a number of strategies that litigants have used over the past two decades to extract rent from transactions. By the 2010s, 96% of publicly announced mergers were the subject of litigation.<sup>3</sup> Clearly, it was not the case that directors uniformly violated standards of conduct and law such that they were worthy targets of litigation. Rather, the prevalence of litigation in connection with announced merger transactions is more likely a function of rent-seeking behavior by litigants.<sup>4</sup>

In response, courts in Delaware adopted a series of doctrinal innovations to stem the tide of this trend. These doctrinal innovations took form over a series of decisions, including *In re Trulia, Inc. Stockholder Litigation*,<sup>5</sup> *Kahn v. M & F Worldwide Corp.*,<sup>6</sup> and *Corwin v. KKR Financial Holdings LLC*,<sup>7</sup> that had the cumulative effect of deterring low-quality, transaction-related fiduciary litigation by reducing the economic value of settlement for such claims. With respect to appraisal litigation, courts moved to address a perception that professional investors were abusing the appraisal remedy. Through a series of cases at Chancery (*In re Appraisal of Ancestry.com, Inc.*<sup>8</sup>) and in the Delaware Supreme Court (*Golden Telecom, Inc. v. Global GT LP*,<sup>9</sup> *DFC Global Corporation v. Muirfield Value Partners*,<sup>10</sup> and *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd*<sup>11</sup>), courts began to minimize the economic

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3. Matthew D. Cain & Steven Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465, 484–86 (2015) [hereinafter *Great Game*]; Matthew D. Cain & Steven Davidoff Solomon, *Takeover Litigation in 2015*, 3 (Jan. 14, 2016) (unpublished manuscript) (on file with authors) [hereinafter *Takeover Litigation 2015*], <https://ssrn.com/abstract=2715890> [<https://perma.cc/7JDN-ZGE5>]; Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133, 135 (2004); Matthew D. Cain & Steven M. Davidoff, *Takeover Litigation in 2012*, 1–2 (Feb. 1, 2013) (unpublished manuscript) (on file with authors) [hereinafter *Takeover Litigation 2012*], <http://ssrn.com/abstract=2216727> [<https://perma.cc/23LV-EK78>] (finding that almost 92% of all transactions with a value greater than \$100 million experienced litigation in 2012).

4. The problem of rent-seeking behavior in the context of shareholder litigation is well-known. *See, e.g.*, John C. Coffee, Jr., *The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation*, L. CONTEMP. PROBS., Summer 1985, at 9.

5. 129 A.3d 884 (Del. Ch. 2016).

6. 88 A.3d 635 (Del. 2014).

7. 125 A.3d 304 (Del. 2015).

8. No. 8173-VCG, 2015 WL 399726 (Del. Ch. Jan. 30, 2015).

9. 11 A.3d 214, 217–18 (Del. 2010).

10. 172 A.3d 346 (Del. 2017).

11. 177 A.3d 1 (Del. 2017).

incentives to bring appraisal actions by leaning more heavily on the role of merger price in the judicial determination of fair value where there is a pristine deal process.<sup>12</sup>

The court justified its reliance on merger price in fair value determinations by pointing to the efficiency of markets and the Efficient Capital Market Hypothesis (ECMH), rationalizing that if a merger has been exposed to the forces of the market and no second bidder has offered a topping bid, such a price must be fair for purposes of an appraisal.<sup>13</sup> The court's reliance on the ECMH in the context of appraisal valuation has generated a good deal of academic discussion.<sup>14</sup> This paper adds to that discussion in the following ways. First, merger price as an indicator of fair value is contrary to appraisal's statutory mandate that fair value *not* include any element of value arising from the merger. Second, to the extent merger price becomes the default starting point for fair value determinations, the court's reliance on pristine deal process will transform an appraisal proceeding into something akin to fiduciary duty litigation (something we call "quasi-fiduciary litigation"), thus opening up a new, wholly-unexpected avenue for litigants. Finally, we observe that the court's explicit reliance on the ECMH is at odds with many of the policy-related justifications for director authority that have undergirded the court's fiduciary litigation over the years.

If one takes seriously Section 262(h)'s statutory charge that an appraisal valuation must exclude "any element[s] of value arising from the . . . merger," then reliance on merger price, particularly in the context of a played-out auction, necessarily exceeds the statutory limitations placed on such valuations.<sup>15</sup> Basic bargaining theory holds that in a bilateral negotiation over price, merger price represents a simple division of the buyer's economic surplus

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12. *Id.* at 21–22. A judge seeking to determine fair value in a merger must now first look to merger price as a primary, though not presumptive, determinant of fair value. If a judge wishes to deviate from merger price, he or she must first justify that decision.

13. *Id.* at 24–25.

14. *See, e.g.*, Albert H. Choi & Eric Talley, *Appraising the "Merger Price" Appraisal Rule*, 34 J. L. ECON. & ORG. 543, 543 (2018); Charles Korsmo & Minor Myers, *The Flawed Corporate Finance of Dell and DFC Global*, 68 EMORY L.J. 221, 259–69 (2018); Audra Boone, Brian Broughman & Antonio J. Macias, *Merger Negotiations in the Shadow of Judicial Appraisal* 10–12 (Ind. Legal Studies, Research Paper No. 381, 2018), <https://ssrn.com/abstract=3039040> [<https://perma.cc/5DWG-UHEG>]; Jonathan Macey & Joshua Mitts, *Asking the Right Question: The Statutory Right of Appraisal and Efficient Markets* 3, 5 (European Corp. Governance Inst., Working Paper No. 428/2018, 2018), <https://ssrn.com/abstract=3279838> [<https://perma.cc/PP3V-DPLH>].

15. DEL. CODE ANN. tit. 8, § 262(h) (2019).

associated with the transaction. In a fully played out auction, buyers must exchange economic surplus associated with the transaction for an increased probability of winning the auction. That is to say, the merger price that results from a bilateral negotiation or an auction must, necessarily, include elements of value arising from the merger. Consequently, a court's reliance on merger price for an indication of statutory fair value runs afoul of statutory limitations placed on valuation.

Increasing reliance on merger price by courts simultaneously does both too much and too little. A merger price standard threatens to reduce the statutory appraisal remedy for public companies to a nullity or, perhaps worse, transform it into a new class of litigation, quasi-fiduciary litigation.<sup>16</sup> Although some may perceive the increase in use of the appraisal remedy as abuse, it is hard to imagine that a legislature would write a remedy into statute and then simultaneously not wish for stockholders to access the remedy. Where dissenting shareholders nevertheless pursue appraisal, the effect of the court's new standard is to transform appraisal litigation into quasi-fiduciary litigation. This new quasi-fiduciary litigation threatens to create backdoor bright-line rules that are otherwise inconsistent with more than three decades of corporate takeover jurisprudence. In order to ensure the court applies merger price, boards have an incentive to pursue merger transactions in prescribed manner, checking certain boxes along the way to comport with appraisal's new quasi-fiduciary requirements. This may ultimately be a desirable result for corporate governance, but it will be unintended and will run contrary to decades of the court's jurisprudence.

Finally, the Delaware Supreme Court's recent reliance on the ECMH is odd, or at least at odds with past precedent. In the context of fiduciary duty litigation, the court has, for the better part of three decades, taken the general position that the ECMH did not control and that it was, in fact, sufficiently imperfect as to justify protection of board decisions (see e.g., the poison pill cases).<sup>17</sup> Where

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16. Term quasi-fiduciary litigation is new, but the idea of using appraisal to police fiduciary lapses is not. See Daniel R. Fischel, *The Appraisal Remedy in Corporate Law*, 1983 AM. B. FOUND. RES. J. 875, 879, 901–02 (1983) (suggesting that the appraisal discourages opportunistic behavior by parties); Hideki Kanda & Saul Levmore, *The Appraisal Remedy and the Goals of Corporate Law*, 32 UCLA L. REV. 429, 434 (1985).

17. Much of this argument played out by proxy in a series of articles in the 1980s by Prof. Ronald Gilson, Attorney Martin Lipton, and Prof. Lucien Bebchuk, with the professors taking the position that boards should remain neutral in the face of takeover offers, and thus subject the corporation to the machinations of the efficient capital market, while Mr. Lipton took the position that markets are not efficient and only boards are in the best position to evaluate takeover offers and should thus be

for years stockholders have argued that boards must be required to take certain actions in response to market prices and signals, courts have uniformly demurred. Rather, courts have given credence to board arguments that boards, rather than shareholders or markets, are in the best position to determine what actions are in the best interests of the corporation.<sup>18</sup> In pursuit of eliminating what the court may believe are abusive appraisal claims, recent cases appear to throw away much of the court's previous reticence, permitting markets to dictate what is fair value to boards of directors. By going this route, the court may have unintentionally created new avenues of attack for litigants.

Increasing judicial reliance on merger price as indicator of fair value raises the question: What is left of appraisal? Indeed, not much. It may be time to simply eliminate the appraisal remedy altogether for publicly traded corporations. A statutory fix of this type is not radical and is in accord with previous amendments to the appraisal statute over the years.<sup>19</sup> Alternatively, the courts may, consistent with the present statute, focus determinations of fair value on the unaffected stock price of public corporations without regard to

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permitted to defend against unwanted offers. See, e.g., Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 891 (1981); Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 130–31 (1979) [hereinafter Lipton, *Takeover Bids in the Target's Boardroom*]; Lucian A. Bebchuk, Comment, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028, 1050 (1982). Other well-known proponents of the academic view that boards should defer to determinations of the market include Judge Easterbrook and Prof. Fischel. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1161 (1981) [hereinafter Easterbrook & Fischel, *The Proper Role*]; Frank H. Easterbrook & Daniel R. Fischel, *Takeover Bids, Defensive Tactics, and Shareholders' Welfare*, 36 BUS. LAW. 1733, 1749–50 (1981) [hereinafter Easterbrook & Fischel, *Takeover Bids, Defensive Tactics, and Shareholders' Welfare*].

18. In *Paramount Commc'ns, Inc. v. Time, Inc.*, the Delaware Supreme Court made it clear that the Chancery Court's moves towards board neutrality in the face of a tender offer was a step in the wrong direction. 571 A.2d 1140, 1152 (Del. 1989) ("In subsequent cases, the Court of Chancery has suggested that an all-cash, all-shares offer, falling within a range of values that a shareholder might reasonably prefer, cannot constitute a legally recognized 'threat' to shareholder interests sufficient to withstand a *Unocal* analysis."); *Air Prods. & Chemicals, Inc. v. Airgas, Inc.*, 16 A.3d 48, 95–101 (Del. Ch. 2011) (summarizing the thinking of the academic view and the Delaware Supreme Court's view that it is incorrect).

19. Wei Jiang, Tao Li, Danqing Mei, & Randall Thomas, *Appraisal: Shareholder Remedy or Litigation Arbitrage?* 699–701, 703 (J.L. & Econ., Working Paper No. 16–11, 2016), <https://ssrn.com/abstract=2766776> [<https://perma.cc/33ZW-5WW4>]; see, e.g., Kanda & Levmore, *supra* note 16, at 432.

merger price. This is not only feasible, but it would be also truer to the purpose of the appraisal statute.

This Article proceeds in the following manner. Part II surveys the recent flood of transaction-related litigation, including appraisal actions and the response by the courts seeking to reduce incentives tied to bringing perceived rent-seeking litigation. Part III reviews the appraisal process and its purpose. Understanding the purpose of appraisal as a remedy is important as one decides the best path to reducing incentives to perceived abuse of the mechanism. Part IV examines the courts use of merger price in determining the statutory fair value of dissenting shareholders' stock as a way of reducing the incentive for shareholders to bring, what the courts perceive to be, abusive appraisal claims. Part V evaluates a number of challenges that accompany the court's reliance on merger price for fair value determinations. Part VI proposes changes to the appraisal regime to remedy the deficiencies in the current structure and return the appraisal remedy to its more modest goals. Part VII summarizes and concludes.

## II. TRANSACTION-RELATED LITIGATION DURING THE 2000S

Until relatively recently, appraisal, like judicial dissolution or receivership, was a little-used remedy, largely vestigial, but available to shareholders in extreme circumstances who believed the consideration offered them in a merger was unfair. Professor Eisenberg once observed that appraisal was a remedy of "desperation."<sup>20</sup> Another respected legal commentator added to a growing chorus, "It is common knowledge that appraisal rights are largely on the way out."<sup>21</sup> Indeed, during the 1968 amendments to the Delaware corporate law, serious consideration was given to eliminating the appraisal remedy altogether.<sup>22</sup> It is thus unsurprising that appraisal litigation has largely been a backwater of corporate practice and jurisprudence.

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20. Melvin Aron Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CALIF. L. REV. 1, 85 (1969).

21. Ernest L. Folk, III, *Corporation Law Developments—1969*, 56 VA. L. REV. 755, 795 (1970).

22. Henry M. Canby, *Delaware's New Corporation Law*, 39 PA. B. ASS'N Q. 380, 387 (1968) ("Some members of the committee were inclined to eliminate the appraisal remedy altogether . . ."); Joel Seligman, *Reappraising the Appraisal Remedy*, 52 GEO. WASH. L. REV. 829, 829 (1984) ("Between 1972 and 1981 there were 16,479 completed mergers involving United States concerns. . . . Yet, during this period only twenty or so reported state court decisions involved an appraisal valuation.").



However, in a series of papers from 2014 to 2017, Professors Korsmo and Myers identified a significant increase in appraisal litigation brought by institutional investors, so called appraisal arbitrageurs.<sup>23</sup> They tie the increase in the incidence of appraisal actions, in part, to a 2007 decision, *In re Appraisal of Transkaryotic Therapies, Inc.*,<sup>24</sup> in which the court had to reconcile the complexities of record versus beneficial ownership of shares.<sup>25</sup> At the time, Chancellor Chandler anticipated the effect of his decision but felt constrained by appraisal's statutory mandate.<sup>26</sup> The effect of *Transkaryotic* was to greenlight arbitrageurs buying stock in announced transactions when the pricing of the merger suggested an appraisal action might be a financially viable strategy.<sup>27</sup> Professors Korsmo and Myers found that between 2004 and 2011, approximately 4.5% of merger transactions attracted an appraisal petition.<sup>28</sup> However, from 2011 to 2014, more than 13% of eligible merger transactions attracted appraisal petitions.<sup>29</sup> Not surprisingly, the rapid increase in appraisal litigation generated a good deal of criticism by the Delaware and New York

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23. See Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 1, at 1552; Korsmo & Myers, *Interest*, *supra* note 1, at 111; Korsmo & Myers, *Merits*, *supra* note 1, at 829; Korsmo & Myers, *Reforming*, *supra* note 1, at 314.

24. No. Civ.A. 1554-CC, 2007 WL 1378345, at \*3 (Del. Ch. May 2, 2007).

25. *Id.* (“The question presented in this case can be stated thusly: Must a beneficial shareholder, who purchased shares *after* the record date but before the merger vote, prove, by documentation, that each newly acquired share (i.e., after the record date) is a share not voted in favor of the merger by the *previous* beneficial shareholder?”).

26. Chancellor Chandler observed:

Respondents raise one policy concern that deserves mentioning. They argue that this decision will “pervert the goals of the appraisal statute by allowing it to be used as an investment tool for arbitrageurs as opposed to a statutory safety net for objecting stockholders.” That is, the result I reach here may, argue respondents, encourage appraisal litigation initiated by arbitrageurs who buy into appraisal suits by free-riding on [the petitioner’s] votes on behalf of other beneficial holders—a disfavored outcome. To the extent that this concern has validity, relief more properly lies with the Legislature. Section 262, as currently drafted, dictates the conclusion reached here. Only the record holder possesses and may perfect appraisal rights. The statute simply does not allow consideration of the beneficial owner in this context. The Legislature, not this Court, possesses the power to modify [section] 262 to avoid the evil, if it is an evil, that purportedly concerns respondents.

*Id.* at \*5 (footnotes omitted).

27. Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 1, at 1553–54.

28. Korsmo & Myers, *Reforming*, *supra* note 1, at 289.

29. *Id.*

M&A Bar that arbitrageurs were abusing the appraisal remedy.<sup>30</sup> In response to these criticisms, the Delaware legislature amended the appraisal statute to include various provisions in an attempt to reduce incentives for litigants to bring appraisal actions.<sup>31</sup>

Appraisal arbitrage and the increase in appraisal litigation did not arise in a vacuum. A series of other papers identified a rising flood of transaction-related litigation during the past two decades, of which appraisal petitions were only a small fraction.<sup>32</sup> By 2016, more than 90% of all announced merger transactions over \$100 million were accompanied by litigation without regard to the underlying merits of the proposed merger.<sup>33</sup> The rise of this litigation industrial complex in the past twenty-five years had much more to do with the economic incentives for litigants to bring litigation for its settlement value than it did with bringing litigation on behalf of stockholders harmed by self-serving boards.<sup>34</sup>

With the onslaught of shareholder litigation came the inevitable backlash. In the wake of a flood of federal securities litigation in the 1990s, the backlash came in the form of federal legislation, like the Private Securities Litigation Reform Act of 1995 (PSLRA) and the Securities Litigation Uniform Standards Act of 1998 (SLUSA), among others.<sup>35</sup> These federal reactions to shareholder

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30. See, e.g., Wei Jiang, *Reforming the Delaware Law to Address Appraisal Arbitrage*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 12, 2016), <https://corpgov.law.harvard.edu/2016/05/12/reforming-the-delaware-law-to-address-appraisal-arbitrage/> [https://perma.cc/5S9W-TJ9X].

31. These 2016 amendments included a *de minimus* requirement for appraisal petitions as well as the ability to prepay uncontested portions of the appraisal consideration in order to reduce interest liability. The *de minimus* requirement turned out to be ineffectual as appraisal petitions by professional investors easily exceeded the statute's requirements. See DEL. CODE ANN. tit. 8, § 262 (2019).

32. Thompson & Thomas, *supra* note 3, at 135, 170; *Takeover Litigation 2012*, *supra* note 3, at 1–2; *Takeover Litigation 2015*, *supra* note 3, at 3; *Great Game*, *supra* note 3, at 484–86.

33. *Takeover Litigation 2012*, *supra* note 3, at 1–2 (finding that almost 92% of all transactions with a value greater than \$100 million experienced litigation in 2012); *Takeover Litigation 2015*, *supra* note 3, at 3 (finding that 94.9% of all transactions with a value greater than \$100 million experienced litigation in 2014).

34. The economic incentives that give rise to the abuse of shareholder class action litigation are well known. See, e.g., Coffee, *supra* note 3, at 14–15.

35. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104–67, 109 Stat. 737 (codified in scattered sections of 15 U.S.C.); Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105–353, 112 Stat. 3227 (codified in scattered sections of 15 U.S.C.).

litigation had the unintended effect of pushing these cases into state courts in large numbers.<sup>36</sup>

As the volume of transaction-related litigation ramped up, state courts, particularly Delaware, stepped in to reduce the high-powered incentives associated with this litigation and push it out of the courtrooms.<sup>37</sup> Through the late 1990s and 2000s litigants brought “good faith” claims. In a typical good faith claim, litigants attempted to argue that directors’ failure to get the highest price reasonably available in a sale transaction amount to a violation of their duties under *Revlon* and its progeny.<sup>38</sup> Plaintiffs usually alleged that unconflicted directors’ actions fell so far short of their obligations under *Revlon* as to constitute a violation of their duty of good faith.<sup>39</sup> A successful good faith claim could, by the alchemy of motion pleading, convert what was otherwise an exculpable duty of care claim into a non-exculpable good faith claim (i.e., money for nothing). In *Lyondell v. Ryan*, the Delaware Supreme Court ruled that *Revlon* did not require directors to take any specific actions in order to comport with its requirements, thus effectively putting an end to good faith claims of this type.<sup>40</sup>

Following the end of the wave of good faith litigation, litigants’ strategies shifted to disclosure claims and disclosure settlements. In typical disclosure litigation, plaintiffs allege directors failed to disclose material information prior to a stockholder vote to approve a merger. Litigants and directors then agree to

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36. *Sciabacucchi v. Salzberg*, C.A. No. 2017-0931-JTL, 2018 WL 6719718, at \*4 n.21 (Del. Ch. Dec. 19, 2018) (citing *In re Lord Abbett Mutual Funds Fee Litig.*, 553 F.3d 248, 250 (3d Cir. 2009); *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006)).

37. One effect of Delaware’s attempts to filter out low-quality claims was that litigants continued to bring these claims, but outside of Delaware. See John Armour, Bernard Black & Brian Cheffins, *Is Delaware Losing Its Cases?*, 9 J. EMPIRICAL LEGAL STUD. 605, 605, 607 (2012). In response, firms began to adopt exclusive forum provisions in an effort to corral low-quality cases into a jurisdiction that could efficiently manage their disposal. See Brian JM Quinn, *Shareholder Lawsuits, Status Quo Bias, and Adoption of the Exclusive Forum Provision*, 45 U.C. DAVIS L. REV. 137, 141 (2011); Verity Winship, *Contracting Around Securities Litigation: Some Thoughts on the Scope of Litigation Bylaws*, 68 SMU L. REV. 913, 914–15 (2015).

38. See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 179–80 (Del. 1986); see, e.g., *In re Cyan, Inc. Stockholders Litig.*, C.A. No. 11027-CB, 2017 WL 1956955, at \*7 (Del. Ch. May 11, 2017).

39. See *Revlon*, 506 A.2d at 179–80.

40. *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 243 (Del. 2009) (“But . . . there are no legally prescribed steps that directors must follow to satisfy their *Revlon* duties. Thus, the directors’ failure to take any specific steps during the sale process could not have demonstrated a conscious disregard of their duties.”).

settle the claim with the directors making additional disclosures to the proxy statement and attorney fees in exchange for a global release of claims from the plaintiff class. Because settlement hearings are not adversarial in nature, these “disclosure-only” settlements were regularly approved by the courts. So efficient was this litigation/settlement strategy in generating fees for plaintiffs’ counsel that at its highest, 96% of all public company merger transactions were accompanied by litigation.<sup>41</sup> In 2016, Chancellor Bouchard of the Delaware Chancery Court refused to approve a proposed settlement in front of the court as well as future proposed settlements unless the disclosures secured by the settlement were “plainly material,” thus reducing the value of disclosure only litigation considerably.<sup>42</sup> *Trulia*, thus, marked the end of disclosure-only litigation strategies.<sup>43</sup>

With *Trulia* cutting off disclosure-only settlements, litigants developed other strategies to pursue transaction-related claims.<sup>44</sup> For example, some plaintiffs pursued *Revlon* claims as post-closing damages actions rather than pre-closing claims seeking injunctive relief.<sup>45</sup> Since courts proved reluctant to provide injunctive relief or approve settlements, litigants hoped that imperfections in the deal process might result in the court applying enhanced scrutiny to deals, leading to provable damages post-closing on a *Revlon* or quasi-appraisal theory.<sup>46</sup> In *Corwin v. KKR Financial Holdings LLC*, however, the Supreme Court of Delaware applied principles of common law stockholder

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41. *Shifting Tides*, *supra* note 2, at 608; *Great Game*, *supra* note 32, at 485.

42. *In re Trulia, Inc. Stockholder Litig.*, 129 A.3d 884, 898–99, 907 (Del. Ch. 2016).

43. *Trulia* has been adopted by other state courts where litigants had been bringing such claims. *See, e.g.*, *Griffith v. Quality Distrib. Inc.*, No. 2D17-3160, 2018 Fla. App. LEXIS 9879, at \*18–19 (Fla. Dist. Ct. App. July 13, 2018); *Bushansky v. Phoenix Cos.*, No. X08FSTCV156027891S, 2017 Conn. Super. LEXIS 370, at \*16 (Conn. Super. Ct. Feb. 23, 2017); *In re Krispy Kreme Doughnuts, Inc. Stockholder Litig.*, No. 16-CVS-3669, 2018 NCBC LEXIS 61, at \*18–19 (N.C. Super. Ct. June 20, 2018).

44. These strategies include bringing disclosure-only claims in federal court as settlements of Section 14(a) proxy disclosure claims. *See, e.g.*, *In re Walgreen Co. Stockholder Litig.*, 832 F.3d 718, 721 (7th Cir. 2016); *Shifting Tides*, *supra* note 2, at 605.

45. Disclosure claims are direct claims. Consequently, unlike derivative claims, they survive closing.

46. A “quasi-appraisal” is a post-closing class action in which plaintiffs make the argument that due to disclosure deficiencies by the board, the plaintiffs did not seek an appraisal. Consequently, the entire class of shareholders should be entitled to a remedy of the same type that would have been available to them had the board made adequate disclosure and all the shareholders in the class had sought an appraisal. *In re Orchard Enters., Inc. Stockholder Litig.*, 88 A.3d 1, 42–48 (Del. Ch. 2014).

ratification to such claims.<sup>47</sup> Where directors are not conflicted and fully-informed, uncoerced stockholders have approved the merger, courts would grant the board's decision to enter into the transaction the deferential presumption of business judgment.<sup>48</sup> *Corwin* largely shut the door to most post-closing damages and quasi-appraisal claims.<sup>49</sup>

A series of doctrinal inconsistencies with respect to pleading burdens in the context of controller freeze-out transactions, created yet another avenue for plaintiffs to bring claims for little more than their settlement value. Then-Vice Chancellor Strine observed in *Cox Communications* that the incentives worked so nicely that almost any controller freeze-out merger would be guaranteed litigation no matter how scrupulous the controller was in structuring the transaction.<sup>50</sup> Indeed, almost every controller freeze-out transaction was accompanied by litigation.<sup>51</sup> The doctrinal inconsistencies were mostly remedied in *Kahn v. M & F Worldwide Corp.*, thus reducing high-powered incentives to bring litigation on announcement of freeze-out mergers.<sup>52</sup>

Across the board, over the past decade or so, courts have been pushing back against a seeming tidal wave of litigation, much of which was, at least in the view of the courts, of low quality. To be clear, all of these doctrinal openings that litigants sought to exploit were creations of the court itself. As the courts closed off access to one litigation strategy, litigants moved to another.<sup>53</sup>

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47. 125 A.3d 304, 309–11 (Del. 2015).

48. *Id.*

49. *In re Cyan, Inc. Stockholders Litig.*, C.A. No. 11027-CB, 2017 WL 1956955, at \*7 (Del. Ch. May 11, 2017) (involving a quasi-appraisal action alleging a variety of disclosure problems.); see also Ignacio E. Salceda, *Clarity on the "Quasi Appraisal" Remedy and Post-Closing Claims*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 31, 2017), <https://corpgov.law.harvard.edu/2017/05/31/clarity-on-the-quasi-appraisal-remedy-and-post-closing-claims> [<https://perma.cc/4S7S-XY9A>].

50. *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 605 (Del. Ch. 2005) (finding because the burden of proof in controlling shareholder freezeout transactions shifted from defendants to plaintiffs to prove that the transaction was not entirely fair, the pleading burdens effectively guaranteed that every transaction would attract litigation that could not easily be dismissed no matter how pristine the defendant board's process or motives).

51. *Id.* at 631–32.

52. 88 A.3d 635, 644 (Del. 2014).

53. Professors Davidoff and Thomas argue correctly that a misalignment of takeover doctrine is responsible for incentives for professional litigants to bring claims during the post-hostile takeover era. Steven Davidoff Solomon & Randall S. Thomas, *The Rise and Fall of Delaware's Takeover Standards*, in *THE CORPORATE CONTRACT IN CHANGING TIMES: IS THE LAW KEEPING UP?* 29, 29–30 (Steven Davidoff Solomon & Randall Stuart Thomas eds., 2019).

Appraisal arbitration is yet another litigation strategy. Shareholder ownership recordkeeping is generally antiquated. When put under pressure by relatively large numbers of appraisal petitions, the problems associated with shareholder recordkeeping were exposed.<sup>54</sup> Appraisal arbitration takes advantage of a statutory loophole that permits a dissident to purchase shares and seek an appraisal *after* a deal is announced and even *after* the record date for the merger is set.<sup>55</sup> This loophole permits financial investors to scan merger announcements and where their analysis suggests the announced merger is underpriced to accumulate a significant block of stock and then seek an appraisal. The rapid increase in appraisal actions identified by Professors Korsmo and Myers can be attributed to this arbitration strategy.<sup>56</sup> The additional burden on the Chancery Court associated with the rapid rise in these petitions exposed some of the structural weaknesses in the appraisal remedy. When the number of petitions were few and the amounts at stake relatively small, litigants could accept judicial fair value determinations that might occasionally appear arbitrary. However, with the arrival of large financial investors engaging in arbitration strategies, the cost of judicial mistake became more pronounced. All of this combined to create at least the perception that appraisal arbitrageurs were abusing the remedy.<sup>57</sup>

Not surprisingly, the courts moved to close off the financial incentives that gave rise to the appraisal arbitration strategy. With respect to appraisal, the doctrinal battlefield the court found itself fighting on was “fair value.” By giving greater importance to the merger price, the Delaware Supreme Court has sought to reduce incentives for professional litigants to bring these actions. While seemingly effective, these moves by the court bring with them complexities that confuse doctrinal development more than necessary.

### III. THE APPRAISAL REMEDY AND ITS PURPOSE

Modern appraisal is a statutory creature.<sup>58</sup> Until 1899, a merger of any corporation required the unanimous consent of all stockholders. Under the

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54. *In re Appraisal of Dell Inc.*, 143 A.3d 20, 36 (Del. Ch. 2016).

55. *Id.*

56. Korsmo & Myers, *Merits*, *supra* note 1, at 889 (finding that appraisal arbitration claims tend to be brought against lower priced transactions).

57. *See, e.g.*, Norwitz, *supra* note 2.

58. For brief histories of the appraisal statute, see Kanda & Levmore, *supra* note 16, at 446–51 and Irving J. Levy, *Rights of Dissenting Shareholders to Appraisal and Payment*, 15 CORNELL L. Q. 420, 420–22 (1930), among others.

common law approach to mergers, a single shareholder could hold up a transaction and prevent a merger from going forward.<sup>59</sup> With the recognition that merger activity is on balance socially beneficial, corporate laws were amended to be more liberal with respect to their approval thresholds.<sup>60</sup> First, super-majorities, and then simple majorities became the norm.<sup>61</sup> As stock was mostly the consideration of choice, when a shareholder dissented from a merger, the objection, at least in part, could be to the fact that the merger would leave the stockholder as a continuing stockholder in a vastly different entity

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59. Barry M. Wertheimer, *The Purpose of the Shareholders' Appraisal Remedy*, 65 TENN. L. REV. 661, 666 (1998); 2 VICTOR MORAWETZ, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS 908–09 (2d ed. 1886) (“A corporation cannot consolidate with another company, even pursuant to legislative authority, except with the consent of all its shareholders.”).

60. *Chicago Corp. v. Munds*, 172 A. 452, 455 (Del Ch. 1934). The court in *Chicago Corp.* summarized the history of appraisal thusly:

What is the purpose of provisions of statutes which provide for the appraisal of the stock of a person who objects to the merger of his corporation with another? At common law it was in the power of any single stockholder to prevent a merger. When the idea became generally accepted that, in the interest of adjusting corporate mechanisms to the requirements of business and commercial growth, mergers should be permitted in spite of the opposition of minorities, statutes were enacted in state after state which took from the individual stockholder the right theretofore existing to defeat the welding of his corporation with another. In compensation for the lost right a provision was written into the modern statutes giving the dissenting stockholder the option completely to retire from the enterprise and receive the value of his stock in money. Most of the statutes provide that what the unwilling stockholder who refuses to accept an interest in the consolidated enterprise shall be paid is the “value” of his stock. . . .

When a stockholder buys stock it is to be supposed that he buys into a corporation as a going concern. He does not buy on the theory that he is about to participate in a contemplated liquidation of the corporation’s assets. He buys an aliquot share of a business, and he probably takes into account, or should at least take into account, not alone its present asset condition and earning power but as well its future prospects as a continuing enterprise. When a merger proposal is put through with which he chooses to dissociate himself, he is forced out of his investment and compelled to abandon his association with a business of which he was a past owner. As to him, the going concern is done. Others have decreed its cessation against his will. What he has been deprived of is his proportional share of an active enterprise which but for the compulsion of others he could continue to be associated with in the indefinite future. What he is deprived of is what he should be paid for.

61. Folk, III, *supra* note 21, at 790 (“Prior to 1969, the Delaware statute required approval by ‘two-thirds of the total number of the outstanding shares of the capital stock.’”). For an example of modern merger approval requirements, see DEL. CODE ANN. tit. 8, § 251(c) (2019).

with different management and goals than the entity in which the shareholder initially invested.<sup>62</sup>

In such situations, absent a blocking right, the dissenting shareholder should have the right to receive the fair value of their shares in the merged entity in cash so that they might be liberated from the now acquired corporation.<sup>63</sup> In exchange for giving up the power to block an unwanted merger, revised corporate law statutes provided dissenting shareholders with the right to cash out their position from the merged entity.<sup>64</sup> The purpose of the appraisal right, then, was to provide liquidity to dissident shareholders who found themselves involuntarily shareholders of a successor corporation.<sup>65</sup>

The appraisal statute has never been sacrosanct. The statute, as originally conceived, has evolved over time, having been amended twenty-nine times since the last major revision of the Delaware General Corporation Law in 1967.<sup>66</sup> Indeed in the early 1970's, the Delaware legislature was said to be on the cusp of eliminating appraisal as a remedy altogether.<sup>67</sup>

The “market out exception” to the appraisal statute, the bane of corporate law students everywhere, was similarly the subject of a good deal of revision. In 1967, the Delaware legislature adopted an exception that withdrew appraisal rights from dissenting shareholders in publicly-traded corporations on the theory that dissenting shareholders in publicly traded companies could simply sell their shares into the market if they were unhappy with the consideration offered in a merger.<sup>68</sup> Subsequent amendments to the market out exception

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62. The shift to other forms of consideration is a relatively recent phenomenon. For example, in *Sterling v. Mayflower Hotel Corp.*, the court characterized a merger in the following way: “Speaking generally, a merger effects an exchange of shares of stock in a going concern for shares in another going concern.” 93 A.2d 107, 113 (Del. 1952).

63. Wertheimer, *supra* note 59, at 661; MORAWETZ, *supra* note 59, at 909.

64. MELVIN A. EISENBERG, *THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS* 77–78 (1976) (concluding that the appraisal right arose out of a need to reconcile tensions between the majority shareholders’ rights “to make drastic changes in the enterprise to meet new conditions as they arise, with the need to protect the minority against being involuntarily dragged along into a drastically restructured enterprise in which it has no confidence”).

65. Wertheimer, *supra* note 59, at 662.

66. DEL. CODE ANN. tit. 8, § 262(c) (2019).

67. Folk, III, *supra* note 21, at 795 (observing that “[i]t is common knowledge that appraisal rights are largely on the way out”).

68. *Id.*; 56 Del. Laws, c. 50, § 262(k) (1967–68):

This section shall not apply to the shares of any class of stock which, at the record date fixed to determine the stockholders entitled to receive notice of and to vote at the meeting of stockholders at which the agreement of merger or consolidation



restored appraisal rights to shareholders in publicly traded corporations where something other than stock of the acquiring corporation or another publicly traded corporation was the consideration (e.g., cash).<sup>69</sup>

Under earlier forms of appraisal, the value of a dissenter's shares were determined not by a judge but by an independent appraiser.<sup>70</sup> The sole function of a court in an appraisal proceeding was to select an appraiser and then ensure the dissident shareholder received their pro-rata share of the corporation's value.<sup>71</sup> Modern appraisal statutes have moved away from appointing appraisers and now leave the work of determining fair value of the dissident's shares in the hands of law-trained judges rather than professional appraisers, though it is not at all clear that law-trained judges have any sort of comparative advantage at valuation.<sup>72</sup>

Through these amendments, the modern appraisal statute has moved significantly away from appraisal's original purposes of providing dissenting stockholders liquidity (e.g., cash for their shares rather than stock of the acquirer). Indeed, the modern market out exception appears to turn appraisal

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is to be acted on, were either (1) registered on a national securities exchange, or (2) held of record by not less than 2,000 stockholders, unless the certificate of incorporation of the corporation issuing such stock shall otherwise provide; nor shall this section apply to any of the shares of stock of the constituent corporation surviving a merger if the merger did not require for its approval the vote of the stockholders of the surviving corporation, as provided in subsection (f) of section 251 of this title. This subsection shall not be applicable to stockholders of a corporation whose stock in a constituent corporation was not converted by the merger or consolidation solely into stock of the corporation resulting from or surviving a merger pursuant to sections 251 or 252 of this title.

*Id.* (emphasis omitted).

69. 57 Del. Laws, c. 148, §§ 27–29 (1969–70).

70. 63 Del. Laws, c. 25, § 14 (1981–82).

71. 56 Del. Laws, c. 50, § 262(c) (1967–68).

72. DEL. CODE ANN. tit. 8, § 262(h) (2019). In moving the power to determine value to the judge, the legislature justified it in the following manner:

At present, the statute requires the court to appoint an appraiser who is charged with the obligation of determining the fair or intrinsic value of the stock which is being appraised. Then, if either party disagrees with the appraiser's findings, the party has the right to have his exceptions heard in the Court of Chancery. Experience has shown this two-step procedure to be wasteful of time and money. Thus, proposed modifications to [section] 262(e) through [section] 262(g) provide for the streamlining of the appraisal process by the elimination of the appraiser. The action will now be heard by the Court of Chancery in the first instance.

H.B. 916, 128th Gen. Assemb., 2d Sess. (Del. 1976).

on its head. Pursuant to the market out exception, stockholders receiving publicly traded stock or stock of the surviving corporation as consideration have no appraisal rights.<sup>73</sup> In modern appraisal statutes, a stockholder receiving unlisted shares of the surviving entity would not have access to an appraisal remedy. Illiquid stock consideration is precisely the kind of consideration that gave rise to the need for an appraisal remedy. That stockholders receiving such stock must be forced to hold it or, in the absence of liquid markets, sell it at a discount raises serious questions about the remedy's ongoing purpose.

On the other hand, stockholders receiving private third-company stock or cash consideration get appraisal rights.<sup>74</sup> Cash, of course, is the most liquid of all assets. The availability of appraisal rights for cash transactions appears at odds with appraisal's initial purpose—to provide liquidity to shareholders forced to accept stock of an acquirer against their will as part of a merger.

Rather than liberate shareholders from an unwanted, illiquid shareholding position resulting from a merger, with its focus on providing fair value for cash transactions, the modern appraisal statute seeks to provide deterrence against minority oppression where a board might require minority stockholders to accept an amount of consideration that is too low.<sup>75</sup> This goal is especially clear when one observes that dissenting shareholders in Section 253 short form mergers have access to the appraisal remedy without regard to the form of consideration or whether the corporation is public or private.<sup>76</sup> The market out exception is not applicable to a short form merger. In a short form merger, minority shareholders can be cashed out by a controlling shareholder who owns more than 90% of the outstanding stock without a vote and without prior notice. A Section 253 short form merger is inherently unfair to minority shareholders, and minority shareholders are susceptible to opportunistic behavior by a controller.<sup>77</sup> The universal availability of the appraisal remedy for shareholders in Section 253 has the effect of providing shareholders a legal remedy against opportunism by the majority.

Providing a counterweight to minority oppression is, of course, a laudable goal. However, this goal calls into question the efficacy of the market out exception. Minority shareholders can be forced to accept less than fair value

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73. DEL. CODE ANN. tit. 8, § 262(b)(2) (2019).

74. In a reverse triangular merger, where consideration is stock of a privately held parent, stockholders of the disappearing corporation will have appraisal rights. *Id.*

75. Fischel, *supra* note 16, at 879 (suggesting that the appraisal discourages opportunistic behavior by parties).

76. DEL. CODE ANN. tit. 8, § 253(d) (2019).

77. *Glassman v. Unocal Expl. Corp.*, 777 A.2d 242, 247–48 (Del. 2001).

for their shares without regard to the form of the consideration offered. The retort that an unhappy shareholder receiving publicly traded stock in the acquirer can simply sell her shares into the market rather than accept what they might perceive as an unfair price for the shares seems like weak tea when stockholders are potentially receiving private company shares in the surviving entity.

To the extent modern appraisal statutes suffered from doctrinal or practical infirmities, they mostly went unnoticed for many years. The remedy was little used with a version of the “Wall Street Rule” governing shareholder behavior for the most part.<sup>78</sup> Given the relative paucity of appraisal petitions and the generally low stakes of the claims involved, whatever the doctrinal or practical weaknesses of the appraisal remedy there were could be overcome on a case by case basis.<sup>79</sup> However, when the number of appraisal claims rocketed in the past decade, particularly among publicly traded merger targets, the frailties of the system became evident.

#### *A. Appraisal’s Statutory Fair Value Requirement*

Under title 8, section 262 of the Delaware General Corporation Law (Section 262), stockholders of a constituent corporation dissenting from a merger who perfect their rights are entitled to receive judicial appraisal of their stock.<sup>80</sup> For shareholders who have perfected their rights, the Court of Chancery is required to independently determine the “fair value” of the shares by considering all relevant factors, excluding “any element of value arising from the accomplishment or expectation of the merger.”<sup>81</sup>

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78. Louis Lowenstein, *Beating the Wall Street Rule with a Stick and a Carrot*, 7 ANN. REV. BANKING L. 251, 251 (1988) (“The Wall Street Rule, which has been immutable for as long as any of us can remember, dictates that shareholders not take an active role in corporate affairs. Love’em or leave’em.”).

79. Prof. Seligman reported that between 1972 and 1981, there were 16,479 completed mergers in the United States and that there were only “twenty or so” reported appraisal opinions (approximately 0.1%). Seligman, *supra* note 22, at 829.

80. Perfecting one’s appraisal rights requires the shareholder, in a merger where the shareholder is receives consideration other than publicly traded stock, to comport with a number of procedural requirements, including making a demand on the board, not voting in favor of the merger or accepting consideration, and then holding their shares through the effective date of the merger. DEL. CODE ANN. tit. 8, § 262 (2019).

81. DEL. CODE ANN. tit. 8, § 262(h) (2019); *In the Matter of the Appraisal of Shell Oil Co.*, 607 A.2d 1213, 1218 (Del. 1992).

Fair value, under section 262(h), is a term of art.<sup>82</sup> Despite its inclusion in the original 1899 appraisal statute,<sup>83</sup> the meaning of “value” remained an issue for the court until the seminal *Tri-Continental Corp. v. Battye* decision.<sup>84</sup> There, the court established that “[t]he basic concept of value under the appraisal statute is that the stockholder is entitled to be paid for that which has been taken from him [as of the merger date], viz., his proportionate interest in a going concern.”<sup>85</sup> In establishing value of the dissenter’s shares, courts have traditionally approached this exercise by evaluating the corporation as an “operating entity,”<sup>86</sup> rather than through the lens of a sale to a third party acquirer.<sup>87</sup> The policy behind this general rule of paying shareholders their pro-rata share of a going concern is consistent with appraisal’s goal of protecting against minority oppression.<sup>88</sup> In that sense, most appraisal decisions premise

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82. Lawrence A. Hamermesh & Michael L. Wachter, *The Fair Value of Cornfields in Delaware Appraisal Law*, 31 J. CORP. L. 119, 124 (2005).

83. See 21 Del. Laws c. 273, § 56 (1899); *Gonsalves v. Straight Arrow Publishers, Inc.*, 701 A.2d 357, 360 (Del. 1997) (citing that the statutory appraisal remedy was created in 1899). It should also be noted that the 1899 statute did not include the term “fair value”; rather, it made mention of “value.” 21 Del. Laws c. 273, § 56 (1899).

84. 74 A.2d 71, 72 (Del. 1950). The fact that no court had been asked to resolve the question of “value” for 50 years following passage of the act suggests that for at least the first 50 years of the appraisal statute’s existence, the goal of the provision was more liquidity than protection against minority oppression.

85. *Id.* When assessing the going concern of the company or operating entity, courts also consider its “market position and future prospects.” See *Finkelstein v. Liberty Digital, Inc.*, No. Civ.A. 19598, 2005 WL 1074364, at \*12 (Del. Ch. Apr. 25, 2005).

86. See, e.g., *Paskill Corp. v. Alcoma Corp.*, 747 A.2d 549, 554 (Del. 2000); *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1144 (Del. 1989); *Huff Fund Inv. P’ship v. CKx, Inc.*, C.A. No. 6844-VCG, 2014 WL 2042797, at \*2 (Del. Ch. May 19, 2014).

87. See *Merion Capital L.P. v. Lender Processing Servs.*, C.A. No. 9320-VCL, 2016 WL 7324170, at \*13 (Del. Ch. Dec. 16, 2016). Consistent with the going concern approach, appraisal valuations do not apply minority discounts to dissenting shares. See Richard A. Booth, *Minority Discounts and Control Premiums in Appraisal Proceedings*, 57 BUS. LAW. 127, 131 (2001) (explaining that “the term minority discount as properly understood refers to a discount from the price that would be set for non-control shares in an active market simply because they are minority shares and have no power to influence the governance of the corporation and may therefore be exposed to the possibility of looting”).

88. See *M.G. Bancorporation, Inc. v. Le Beau*, 737 A.2d 513, 525 (Del. 1999). The *Finkelstein* court put it best:

The idea that stockholders should share pro rata to their ownership in the firm’s going concern value is designed, or so it seems, to protect against exploitation by insiders with the power to time mergers. In the real world, if a firm is worth \$100, has 100 shares, and one stockholder owns 51 shares, and 49 other people each own one share, the 51 shares, as a bloc, could be worth \$70 and the remaining

their valuation analysis on the “notion that the stockholder is entitled to be paid for that which has been taken from him.”<sup>89</sup>

Before the 1983 decision in *Weinberger v. UOP, Inc.*,<sup>90</sup> Delaware courts exclusively measured the going concern value using the “Delaware Block Method.”<sup>91</sup> The Delaware Block Method was a judicially created valuation method that had no basis in finance theory.<sup>92</sup> In the Delaware Block Method, the court was first required to calculate the value of the corporation using three different approaches: the asset value, the market price of stock, and an earnings valuation.<sup>93</sup> Next, each valuation was assigned a percentage weight based on “each approach’s significance to the nature of the subject corporation’s business.”<sup>94</sup> Ultimately, the fair value of the dissenting stock was determined by adding together the apportioned weight of all three valuations.<sup>95</sup>

*Weinberger* retired the Delaware Block Method as the exclusive method of appraisal valuation.<sup>96</sup> Under *Weinberger*’s liberalized approach, a valuation technique was valid if it was “generally considered acceptable in the financial community.”<sup>97</sup> Such methods included the discounted cash flow (DCF) analysis,<sup>98</sup> the comparable companies approach, the comparable transactions

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shares worth \$30. But, in the world of appraisal, the 49 shares are worth \$49.

*Finkelstein*, 2005 WL 1074364, at \*12 n.24.

89. *Dell, Inc. v. Magnetar Global Event Driven Master Fund*, 177 A.3d 1, 19 (Del. 2017) (internal quotations omitted). See also *Merion Capital*, 2016 WL 7324170, at \*12–13. The reader should note that *Tri-Continental* referred to this principle as “true or intrinsic value.” See *Tri-Continental Corp.*, 74 A.2d at 72.

90. 457 A.2d 701, 712 (Del. 1983).

91. See *Hamermesh & Wachter*, *supra* note 82, at 124 n.26 (providing footnote for seven cases between 1950 and 1988 that measured fair value, in whole or in part, using the Delaware Block Method).

92. *Weinberger*, 457 A.2d at 712.

93. See *Hamermesh & Wachter*, *supra* note 82, at 124.

94. See *Paskill Corp. v. Alcoma Corp.*, 747 A.2d 549, 555 (Del. 2000).

95. *Id.*

96. See *DFC Global Corp. v. Muirfield Value Partners*, 172 A.3d 346, 366 (Del. 2017).

97. See *Kahn v. Household Acquisition Corp.*, 591 A.2d 166, 174 (Del. 1991).

98. The DCF method determines the present value of a company by measuring its projected future cash flows. The following is a more detailed description by the Delaware Court of Chancery:

The DCF model entails three basic components: an estimation of net cash flows that the firm will generate and when, over some period; a terminal or residual value equal to the future value, as of the end of the projection period, of the firm’s cash flows beyond the projection period; and finally a cost of capital with which to discount to a present value both the projected net cash flows and the estimated terminal or residual value.

approach, valuation based on net asset value, and valuation based on a combination of these techniques.<sup>99</sup> Historically, the DCF analysis was the most frequently featured method of valuation because it was regarded as “the approach that merits the greatest confidence within the financial community.”<sup>100</sup>

Unlike other kinds of shareholder litigation, in an appraisal action, both parties must bear “the burden of proving their respective valuation positions by a preponderance of evidence.”<sup>101</sup> The trial court, as finder of fact, reserves the right to cast its own determination of value when expert testimony is found to be unreliable or at odds.<sup>102</sup> This unique procedural aspect of appraisal gives rise to what has become known as the “battle of experts.” In *Kahn v. Household Acquisition Corp.*, the Delaware Supreme Court made the first reference to the “battle of experts” in its appraisal jurisprudence.<sup>103</sup> There, the court tasked itself with reviewing a complex independent valuation by the Chancery Court.<sup>104</sup> Noting that each expert’s valuation technique was subject to criticism, the court upheld the Chancery Court’s analysis of all relevant factors, citing that it was entitled to “draw its own conclusions from the evidence.”<sup>105</sup> This holding is an example of the court taking matters into its own hands when it believes that the

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Barry M. Wertheimer, *The Shareholders’ Appraisal Remedy and How Courts Determine Fair Value*, 47 DUKE L.J. 613, 628 (1998).

99. *Id.* at 628–29; Timothy W. Gregg & Rebecca L. Butcher, *The Latest Significant Delaware Appraisal Decisions and Potential Effects on Appraisal Litigation*, BUS. L. TODAY, Oct. 2015, at 1, 1–2.

100. *Cede & Co. v. JRC Acquisition Corp.*, No. Civ.A. 18648-NC, 2004 WL 286963, at \*2 (Del. Ch. Feb. 10, 2004) (internal quotation omitted).

101. *See M.G. Bancorporation, Inc. v. Le Beau*, 737 A.2d 513, 520 (Del. 1999).

102. *See Cede & Co.*, 2004 WL 286963, at \*2 (noting that the court must use its own independent judgment if neither party satisfied its burden of proof); *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1146 (Del. 1989) (noting that the “independent valuation approach [is] consistent with the Court of Chancery’s expanded role as the trier of fact in appraisal proceedings,” when an expert’s methodology lacks a “reliable factual premise”); *Gilbert v. MPM Enters.*, 709 A.2d 663, 667 (Del. Ch. 1997) (footnote omitted) (holding that “[s]ince neither party is entitled to any preference or presumption in this proceeding, the underlying assumptions that drive these valuations must be tested equally to ensure all that relevant facts were properly and reasonably considered”).

103. 591 A.2d 166, 175 (Del. 1991).

104. The Chancery Court tested an adjusted asset-based valuation by (1) concluding that the price/earnings and DCF approach were inapplicable due to the company’s volatile strike history and lack of comparable companies, (2) fixing asset value as the foundation for fair value due to the companies particular industry, and (3) adjusting assets “to reflect the realities of . . . [a] third party sale.” *Id.*

105. *Id.*

reliability of the expert appraisal process is in question. The court in *Kahn* confirmed its standard for future appellate review holding that it would not disturb the lower court's valuation decision if it was the "product of a logical and orderly deductive process."<sup>106</sup>

A year later, the Delaware Supreme Court would have another opportunity to opine on the increasing lack of reliable valuation outputs from the battle of the experts. In *Shell*, the court reflected upon the recurring "clash of contrary, and often antagonistic, expert opinions on value."<sup>107</sup> The court had harsh words for battles of experts, stating that such presentations handicap the Court of Chancery's analysis because they are limited to widely divergent partisan views.<sup>108</sup> The court suggested that the Chancery Court might consider returning to the practice of appointing their own valuation experts where it was determined that more objective evidence was required.<sup>109</sup>

Ten years after *Weinberger*, Delaware courts appeared to be forging their own judicially created valuation methodologies far more than they were selecting an expert's model in toto, thus embracing a rather dubious version of a valuation's art than its science.<sup>110</sup> In *M.G. Bancorporation*, the court reminded practitioners and future courts that the "ultimate selection of a valuation framework is within the Court of Chancery's discretion."<sup>111</sup> Whenever the Chancery Court fashions its own valuation framework,<sup>112</sup> *M.G. Bancorporation* instructs that it be (1) plausibly corroborated by "whatever reliable" evidence on the record, and (2) the result of an orderly and logical

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106. *Id.* Upon a Westlaw search of all the Delaware Supreme Court cases before *Kahn*, it appears that the first appraisal decision to use "orderly and logical deductive process" was *Alabama By-Products Corp. v. Neal*, 588 A.2d 255, 259 (Del. 1991). Given that this case was decided in the previous year, *Kahn's* reference to its language appears to have validated the appraisal abuse of discretion standard moving forward.

107. *In the Matter of the Appraisal of Shell Oil Co.*, 607 A.2d 1213, 1222 (Del. 1992).

108. *Id.*

109. *Id.*

110. *Id.* at 1221.

111. *M.G. Bancorporation, Inc. v. Le Beau*, 737 A.2d 513, 524 (Del. 1999) (the petitioner offered more than one valuation model).

112. It is worth noting that value determination does not need to be "completely separate and apart from the valuations performed by the parties' expert[s]" to be considered the court's own valuation methodology, as was the case here. *See id.* at 526. Therefore, so long as the court does not adopt an expert's valuation model, in toto, any other methodology used is generally considered to be part of the court's own judicially-created valuation calculation (e.g., part of the valuation could be calculated by "adapting or blending the factual assumptions [or framework] of the parties' experts"). *See id.* at 524, 526.

deductive process.<sup>113</sup> The frameworks adopted by courts since then can best be characterized as a modified Delaware Block Method. Courts will take a variety of commonly used valuation methodologies and then generate a valuation using a weighted average of the various methodologies. In *Orchard Enterprises*, then-Chancellor Strine observed that such an approach was anything but orderly and logical:

As a law-trained judge who has to come up with a valuation deploying the learning of the field of corporate finance, I choose to deploy one accepted method as well as I am able, given the record before me and my own abilities. Even if one were to conclude that there are multiple ways to come up with a discount rate, that does not mean that one should use them all at one time and then blend them together. Marc Vetri, Mario Batali, and Lidia Bastianich all make a mean marinara sauce. Is the best way to serve a good meal to your guest to cook up each chef's recipe and then pour them into a single huge pot? Or is it to make the hard choice among the recipes and follow the chosen one as faithfully as a home cook can? This home cook will follow the one recipe approach and use the recipe endorsed by Brealey, Myers and Allen and the mainstream of corporate finance theory taught in our leading academic institutions . . . .<sup>114</sup>

Post-*Weinberger* courts remained vexed by valuation. Although courts began to rely on discounted cash flows as one valuation model, they also continued to employ other valuation models, often relying on weighted average approaches amongst the various models in order to generate a value that reflected an amalgamation of each of these different models. As a consequence, judicial valuations, no matter how well backed by expert opinions, continued to lack rigor and were often no more than guesswork.

#### IV. COURTS PUSH BACK AGAINST ARBITRAGE

When the amount of appraisal litigation was limited, the creaky jurisprudential scaffolding that grew up around the appraisal statute, including the sometimes-dubious valuation methodologies, was sufficient for the purpose.

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113. *Id.* at 525; *see also* In the Matter of the Appraisal of Shell Oil Co., 607 A.2d 1213, 1219 (Del. 1992); Booth, *supra* note 87, at 131.

114. *In re* Appraisal of the Orchard Enters., Inc., C.A. No. 5713-CS, 2012 WL 2923305, at \*18 (Del. Ch. July 18, 2012).



However, with the pressure of more litigation as documented by Korsmo and Myers, the shortcomings of the appraisal infrastructure became apparent.<sup>115</sup> In reaction to the dramatic increase in appraisal litigation, the courts have been engaged in an effort to reduce incentives for shareholders to bring these appraisal actions. As discussed above, the battlefield upon which these recent appraisal wars have been fought has been “fair value.”

In a series of recent cases, Delaware courts have attempted to reduce incentives for litigants to treat appraisal as a judicial option by putting a thumb on the fair value lever. In *Golden Telecom, DFC*, and then *Dell v. Magnetar*, the Delaware Supreme Court, though stopping short of adopting a presumption in favor of merger price, made it clear that judges should lean heavily on merger price when determining fair value in an appraisal. Where a judge decides not to rely on merger price, the court has placed an obligation on the trial court to justify her decision to rely on other factors to determine fair value. While the court may hope the effect of leaning on merger price is to reduce the option value of appraisal, the court’s reliance on merger price and pristine deal process though short of a presumption may ultimately prove misguided.

In *Golden Telecom*, the Chancery Court conceded that an “arms-length merger price resulting from an effective market check is entitled to great weight in an appraisal,” but refused to extend such rule to the case at hand given the lack of reliability attributed to the sale process.<sup>116</sup> First, it considered the market’s scrutiny of the acquired company (Golden Telecom) following the announcement of its merger with VimpelCom.<sup>117</sup> Second, the court rebuffed the respondent’s contention that the deal price in the case before it was the result of transparent and effective sale process.<sup>118</sup> Third, the court distinguished the

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115. See Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 1, at 1551.

116. *Global GT LP v. Golden Telecom, Inc.*, 993 A.2d 497, 507–08 (Del. Ch. 2010).

117. See *id.* at 505–06 (highlighting the unusual rise in VimpelCom’s stock price following the merger announcement, Golden Telecom’s downgrading in rating by Morgan Stanley, Renaissance Capital’s quasi-financial opinion indicating that the acquired company’s low debt made it inherently more valuable in the telecommunications world, and evidence from a number of other market analysts who believed Golden Telecom was not receiving a good deal via the merger price).

118. See *id.* at 508–10 (criticizing the market check by pointing to (1) the Special Committee’s sole focus on securing the best deal possible from VimpelCom alone, (2) the inherent conflict posited by Golden Telecom’s two largest stockholders and their significant stake in VimpelCom’s stock and board of directors, (3) that conflict’s impact on potentially discouraging third-party bidders, and (4) a lack of public guarantee from the two conflicted stockholders that they would support a topping bid over that of VimpelCom).

case before it from *Union Illinois*<sup>119</sup> and *Highfields Capital*,<sup>120</sup> where the deal price, in both those scenarios, “resulted from a competitive and fair auction, which followed a more-than-adequate sales process and involved broad dissemination of confidential information to a large number of prospective buyers.”<sup>121</sup> Finally, and perhaps most importantly, the court suggested that the circumstances surrounding the merger process made the transaction more like one proposed by a controlling stockholder, than by an arm’s length dealer.<sup>122</sup> So, while the court declined to adopt merger price as presumptive of fair value in *Golden Telecom*, it laid out the conditions under which it might nevertheless accept merger price as an indicator of fair value.

In the years following the *Golden Telecom* decisions, Delaware opinions supporting merger price as the indicator of fair value saw a notable increase.<sup>123</sup> In each of these subsequent cases, where other metrics of valuation were either unreliable or not available but where the board was able to demonstrate that the deal process was pristine, the court relied exclusively on merger price to determine fair value.<sup>124</sup> In *Huff Fund Investment Partnership v. CKx, Inc.*,<sup>125</sup> the court found deal price to be the most reliable valuation method. In doing so, the court outlined what it believed is required for a pristine deal process. In

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119. *Id.* at 507–08; *Union Ill. 1995 Inv. L.P. v. Union Fin. Grp.*, 847 A.2d 340, 358 (Del. Ch. 2004).

120. *Golden Telecom*, 993 A.2d at 508 n.64; *Highfields Capital, Ltd. v. AXA Fin., Inc.*, 939 A.2d 34, 58–59 (Del. Ch. 2007).

121. *See Golden Telecom*, 993 A.2d at 507–08 (quoting *Union Ill. 1995 Inv. L.P.*, 847 A.2d at 357–58) (distinguishing *Union Illinois* in its “deal price” section and cites *Highfields Capital* as a corresponding footnote).

122. *Id.*

123. *See Merion Capital L.P. v. Lender Processing Servs.*, C.A. No. 9320-VCL, 2016 WL 7324170, at \*30 (Del. Ch. Dec. 16, 2016) (noting that a “series of decisions” following *Golden Telecom II* have considered the deal price valuation methodology).

124. The 2016 Chancery Decision in *Merion Capital* stated the following:

In five decisions since *Golden Telecom II*, the Court of Chancery has given exclusive weight to the deal price, particularly where other evidence of fair value was unreliable or weak. In five other decisions since *Golden Telecom II*, the court has declined to give exclusive weight to the deal price in situations where the respondent failed to overcome the *petitioner’s attacks on the sale process* and thus did not prove that it was a *reliable indicator of fair value*.

*See id.* (emphasis added). The reader should note that two of the post-2010 cases that did not rely entirely on deal price were the Chancery Court decisions leading up to both *DFC Global Corp v. Muirfield Value Partners*, 172 A.3d 346 (Del. 2017) and *Dell, Inc. v. Magnetar Global Event Driven Master Fund*, 177 A.3d 1 (Del. 2017).

125. C.A. No. 6844-VCG, 2013 WL 5878807, at \*13 (Del. Ch. Nov. 1, 2013).

order for merger price to be a reliable metric for valuation, the process by which the company “was marketed to potential buyers was [1] thorough, [2] effective, and [3] free from any spectre of self-interest or disloyalty.”<sup>126</sup> *In re Appraisal of Ancestry.com, Inc.*,<sup>127</sup> the Chancery Court added to this developing merger price standard by describing the robustness of the auction process as one “that is unlikely to have left significant stockholder value unaccounted for.”<sup>128</sup> The court characterized the sequence of events in the market test leading up to the transaction as “logical and as an open door to a range of people.”<sup>129</sup> After finding that the problematic inputs rendered the DCF and sales projection methods unreliable, the *Ancestry.com* court relied exclusively on the deal price methodology.<sup>130</sup> Similarly, in *Merion Capital LP v. BMC Software, Inc.*,<sup>131</sup> the court upheld the use of merger consideration again, finding that the “price generated by the market through a thorough and vigorous sales process [was] the best indication of fair value under the specific facts presented.”<sup>132</sup> There, the fluid market test was characterized as one “sufficiently structured to develop fair value.”<sup>133</sup> This description (and its connection to fair value) demonstrated the court’s growing level of comfort with the “merger price standard” as a credible indicator of fair value.

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126. *See id.* (dividing implicitly the “deal price” analysis into three buckets by holding that the process by which the company “was marketed to potential buyers was [1] thorough, [2] effective, and [3] free from any spectre of self-interest or disloyalty”).

127. No. 8173-VCG, 2015 WL 399726 (Del. Ch. Jan. 30, 2015).

128. *See id.* at \*16. In addition, the court in *Ancestry.com* also accounted for *Golden Telecom I*’s three “deal price” buckets, holding that the “sales process was reasonable, wide-ranging and . . . free from the taint of breaches of fiduciary duty.” *See id.*

129. *See id.* (internal quotations omitted). The court highlighted the following aspects of the five-month long auction process: (1) the acquired company’s financial investor sought potential financial sponsors and strategic buyers early on, (2) the financial investor held meetings with fourteen potential bidders resulting in seven non-binding bids, (3) the three highest bids were invited to engage in a complete due diligence assessment of the target company, (4) the company hired Goldman Sachs to support with alternative sale plans after no final bids resulted from the rocky due diligence process, and (5) after a final bid was eventually approved by the board, “no topping bid[s] emerged” during the two-month period following the announcement, despite there being a “fiduciary out” provision within the merger agreement. *Id.* at \*3–6.

130. *See id.* at \*23.

131. C.A. No. 8900-VCG, 2015 WL 6164771, at \*1 (Del. Ch. Oct. 21, 2015).

132. *Id.*

133. *Id.* at \*16. There, the transaction was “negotiated over multiple rounds of bidding among interested buyers.” *Id.* at \*18.

Where a defendant board could not demonstrate merger price was a credible indicator of fair value due to infirmities in the sales process, or the spectre of self-interest or disloyalty, a court is free to rely on other potentially more credible indicators of value, like discounted cash flows.<sup>134</sup> This point was proven in *In re Appraisal of Orchard Enterprises, Inc.*,<sup>135</sup> where the court did not award any weight to the deal price given its suspiciously similar characteristics to that of a transaction led by a controlling stockholder (i.e., it was a going private merger led by a large stockholder).<sup>136</sup> In *Merion Capital, L.P. v. 3M Cogent, Inc.*, the court refused to give any weight to the merger price because the respondent failed to rely on it itself, opting instead to rely on discounted cash flows that resulted in a valuation lower than merger price.<sup>137</sup> In *Merion Capital*, the Chancery Court noted that the reliability of the merger price as a valuation method is only as strong as the sale process and market environment it derived from.<sup>138</sup>

By 2017, Delaware's "fair value" jurisprudence as deployed by the Chancery Court had established a set of factors that were essential to a court's equitable determination that the deal price was the most reliable method of valuation. These factors generally broke down into three categories: (1) the effectiveness of the market check, (2) the purity of the sale process, and (3) the reliability of the merger price. Category one involved a review of elements such as the adequacy of disclosures,<sup>139</sup> the robustness and breadth with which

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134. *LongPath Capital, LLC v. Ramtron Int'l Corp.*, C.A. No. 8094-VCP, 2015 WL 4540443, at \*20–21 (Del. Ch. June 30, 2015) (awarding one-hundred percent valuation weight to deal price given the existence of a "competitive and fair auction," while also clarifying that "[a]ny impediments to a higher bid resulted from Ramtron's operative reality, not shortcomings of the [m]erger process").

135. C.A. No. 5713-CS, 2012 WL 2923305, at \*2 (Del. Ch. July 18, 2012).

136. *See id.* at \*5. While the court relied entirely on the DCF valuation method, it expressed doubt over the "quality of marketing . . . or the utility of the 'go shop' provision contained in the merger agreement, which could obviously have been affected by [the controlling stockholder's] voting power and expressed interest to acquire all of Orchard for itself." *Id.* *See also infra* notes 192–93, 204.

137. C.A. No. 6247–VCP, 2013 WL 3793896, at \*5 (Del. Ch. July 8, 2013).

138. *See Merion Capital L.P. v. Lender Processing Servs.*, C.A. No. 9320-VCL, 2016 WL 7324170, at \*16 (Del. Ch. Dec. 16, 2016) (explaining that a transaction "is informative of fair value only when it is the product of not only a fair sale process, but also of a well-functioning market") (quoting *In re Appraisal of DFC Glob. Corp.*, C.A. No. 10107-CB, 2016 WL 3753123, at \*21 (Del. Ch. July 8, 2016), *rev'd*, 172 A.3d 346 (Del. 2017)).

139. *See Kahn v. Household Acquisition Corp.*, C.A. No. 6293, 1983 WL 103279, at \*1 (Del. Ch. Apr. 26, 1983); *Union Ill. 1995 Inv. L.P. v. Union Fin. Grp.*, 847 A.2d 340, 343 (Del. Ch. 2004).

the market canvass and subsequent negotiations were conducted,<sup>140</sup> the reliance upon the advice of independent financial advisors,<sup>141</sup> the perpetual threat of competition spanning past the signing of the merger, and any other evidence tending to prove that the transaction price was forged in the crucible of objective market reality.<sup>142</sup>

Category two incorporated a search for “fiduciary [or] process irregularities,”<sup>143</sup> the involvement of controlling or large stockholders,<sup>144</sup> the conditioning of the transaction on the vote of the majority of disinterested stockholders,<sup>145</sup> and anything else indicating that the deal price resulted solely from arm’s length negotiations free from claims of collusion.<sup>146</sup>

Finally, category three emphasized the existence (or lack thereof) of any additional bids during the auction process that exceeded the eventual merger price,<sup>147</sup> valuations based on unaltered management projections that were facilitated before or as of the merger date,<sup>148</sup> market reactions to the acquiring company’s stock price following the leaking or announcement of the merger,<sup>149</sup>

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140. See *Van de Walle v. Unimation, Inc.*, C.A. No. 7046, 1991 WL 29303, at \*17 (Del. Ch. Mar. 7, 1991).

141. See *In the Matter of the Appraisal of Shell Oil Co.*, 607 A.2d 1213, 1220 (Del. 1992).

142. *Union Ill. 1995 Inv. L.P.*, 847 A.2d at 343.

143. *Merion Capital L.P. v. Lender Processing Servs.*, C.A. No. 9320-VCL, 2016 WL 7324170, at \*30 (Del. Ch. Dec. 16, 2016).

144. *Global GT LP v. Golden Telecom, Inc.*, 993 A.2d 497, 507–08 (Del. Ch. 2010); *Huff Fund Inv. P’ship v. CKx, Inc.*, C.A. No. 6844-VCG, 2013 WL 5878807, at \*13 (Del. Ch. Nov. 1, 2013).

145. See *Merion Capital*, 2016 WL 7324170, at \*32.

146. In *In re Appraisal of PetSmart*, the Chancery Court awarded full valuation weight to the merger price “[i]n the wake of a robust pre-signing auction among informed, motivated bidders, and in the absence of any evidence that market conditions impeded the auction.” C.A. No. 10782-VCS, 2017 WL 2303599, at \*40 (Del. Ch. May 26, 2017). The court attributed these circumstances to the result of a proper sales process and healthy performing market. *Id.* at \*31. Further, the court contrasted its rejection of the DCF valuation model (noting the dispositive existence of unreliable data inputs), with the near-perfect reliable indicator that was the transactional process. *Id.* at \*31–37. In a telling manner, this court listed the following factors as critical to achieving this near-perfect reliable valuation model: “[1] meaningful competition among multiple bidders during the pre-signing phase, [2] the availability of adequate and reliable information to participants in the auction, [3] the absence of any explicit or implicit collusion, and [4] the lack of a topping bid.” *Id.* at \*27 n.338 (internal quotations omitted) (quoting *Merion Capital*, 2016 WL 7324170, at \*16–26).

147. See *Global GT LP*, 993 A.2d at 507.

148. See *Cede & Co. v. JRC Acquisition Corp.*, No. C.A. 18648-NC, 2004 WL 286963, at \*2 (Del. Ch. Feb. 10, 2004).

149. See *Global GT LP*, 993 A.2d at 508–09.

and any “structural impediments” that may have prevented a counter bid.<sup>150</sup> After that, the court would corroborate the merger price with each party’s purported valuation model to ensure it fell within the range of “reasonable value” given the admissible evidence.<sup>151</sup> In sum, these three categories (and their corresponding factors) were the essential components in determining whether merger price was an indicator of fair value prior to *DFC*<sup>152</sup> and *Dell*.<sup>153</sup>

Delaware’s nascent pristine deal process standard was tested by the 2017 Delaware Supreme Court decision in *DFC Global Corporation v. Muirfield Value Partners, L.P.* There, the lower court’s decision to allocate one-third in fair value weight to each of the merger considerations, comparable companies, and DCF analyses rather than rely entirely on merger price was reversed and remanded in light of its “own findings about the robustness of the market check.”<sup>154</sup> In declining to establish a presumption in favor of merger price, the court held that a competitive market is the “most reliable evidence of value . . . so long as interested buyers are given a fair opportunity to price” the bid in question.<sup>155</sup> The court endorsed the “generally accepted view” by the financial community that a single market actor is normally no match for the collective value judgment born out of a robust auction process.<sup>156</sup> It did so, not by citing judicial precedent, but by citing numerous pieces of economic literature.<sup>157</sup> The logical consequence of such deference to merger price would be the weakening of the single-judgment DCF methodology as a credible valuation metric; the same methodology that the court had, up to this point, consistently held to be “the approach that merits the greatest confidence within the financial community.”<sup>158</sup> The court did not mince words on this front,

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150. See *Highfields Capital, Ltd. v. AXA Fin., Inc.*, 939 A.2d 34, 52–53, 59 (Del. Ch. 2007).

151. See *Union Ill. 1995 Inv. L.P. v. Union Fin. Grp.*, 847 A.2d 340, 357–59 (Del. Ch. 2004); *supra* notes 119–21 and accompany text; *infra* note 223 and accompanying text.

152. See *DFC Global Corp. v. Muirfield Value Partners*, 172 A.3d 346, 388 (Del. 2017).

153. See *Dell, Inc. v. Magnetar Global Event Driven Master Fund*, 177 A.3d 1, 23–24 (Del. 2017).

154. *DFC Global*, 172 A.3d at 388.

155. *Id.* at 367.

156. *Id.*

157. See *id.* at 367 nn.104–05. The citing of the economic literature demonstrated the court’s intent to communicate that this standard was backed by legitimate financial principles. Notably, it indicated that this was the first time the deal price had be awarded such weight as a “generally accepted” financial principle since the court did not cite to any case precedent.

158. *Cede & Co. v. JRC Acquisition Corp.*, No. Civ.A 18648-NC, 2004 WL 286963, at \*2 (Del. Ch. Feb. 10, 2004) (internal quotations omitted).

concluding that “[m]arket prices are typically viewed superior to . . . a single person’s discounted cash flow model.”<sup>159</sup> The court’s deference for merger prices created a de facto presumption of fair value when the deal price is the product of a pristine deal process: “Although there is no presumption in favor of the deal price,” a transaction resulting from “an open process, informed by robust public information, and easy access to deeper, non-public information, in which many parties with an incentive to make a profit had a chance to bid” may be dispositive of fair value.<sup>160</sup> This new soft merger price presumption renders valuation opinions offered by litigation experts moot unless such opinions attack the reliability of the deal process with credible evidence supported by the record.<sup>161</sup> There are now two broad approaches to successfully attacking a supposed arm’s length transaction’s deal price: first, identify any impediment or barrier to the transaction, and second, identify any aspect of the process that could fall into the category of self-dealing or conflict of interest.<sup>162</sup>

*Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.* presented the first formidable challenge to the durability and validity of the pristine deal process standard.<sup>163</sup> The transaction in *Dell* involved a management buyout (led by the famous Michael Dell) and the affiliates of a private equity firm.<sup>164</sup> As suggested earlier, conflicted merger transactions and the transactions involving single bidders raise red flags when evaluating the reliability of merger price for valuation purposes.<sup>165</sup> The Chancery Court’s decision recognized this point, indicating its concerns over several elements typically associated with private equity deals: the inadequacy of a market canvass; the disproportionate influence of deal protection measures, such as go-shops, on competing bidders; and the alleged prioritization of the internal rate-of-return valuation model (unique to leveraged buyouts) over the going concern value.<sup>166</sup>

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159. *DFC Global*, 172 A.3d at 369.

160. *Id.* at 349.

161. *See* M.G. Bancorporation, Inc. v. Le Beau, 737 A.2d 513, 526 (Del. 1999) (discussing the bifurcated approach to the abuse of discretion standard when evaluating the Court of Chancery’s role as an independent appraiser).

162. *DFC Global*, 172 A.3d at 349.

163. *See* 177 A.3d 1, 21–22 (Del. 2017).

164. *Id.* at 5.

165. *See* Merion Capital L.P. v. Lender Processing Servs., C.A. No. 9320-VCL, 2016 WL 7324170, at \*30 (Del. Ch. Dec. 16, 2016); *Global GT LP v. Golden Telecom, Inc.*, 993 A.2d 497, 508–09 (Del. Ch. 2010).

166. *Dell*, 177 A.3d at 16.

The Supreme Court took heed of these concerns but ultimately dismissed them altogether.<sup>167</sup> Its primary area of disagreement with the trial court's decision was its decision to award zero weight to the merger price.<sup>168</sup> The court held that there were factors present in Dell's buyout that suggested the deal process was sufficiently pristine as to support merger price as the primary indicator of fair value.<sup>169</sup>

The Chancery Court refused to assign any citing the following reasons: (1) the existence of a "valuation gap" between the stock price and the target company's going concern value; (2) the lack of heavy involvement by strategic buyers throughout the process artificially kept the deal price below fair value; and (3) several characteristics associated with management buyout go-shops negatively impact the reliability of the deal price.<sup>170</sup>

The Delaware Supreme Court rejected the first under its application of the "efficient market hypothesis."<sup>171</sup> This financial theory teaches that a stock price forged by an efficient market is typically more reliable than that of a single analyst engaged in a battle of experts.<sup>172</sup> The factors associated with this test are: the existence of many unconflicted stockholders; the lack of a controlling stockholder; "highly active trading" (i.e., a public stock exchange); and the unimpeded dissemination of all publicly available information to the market.<sup>173</sup> Here, the court found no rational basis to ignore this financial theory given the trial court's failure to identify any of the four aforementioned factors.<sup>174</sup> Specifically, Dell was largely held by common stockholders, was covered by numerous market research analysts and market makers, and did not have a

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167. *Id.* at 19.

168. *Id.* at 5.

169. *Id.* at 5–6. The court indicated that it would normally defer to the trial court's findings if the valuation had a "reasonable basis in the record and in accepted financial principles relevant to determining the value of corporations." *Id.* By concluding otherwise, the court instructs the Chancery Court to recognize the existence of factors in this appraisal proceeding that generally contribute to a reliable merger price. This is clearly instructive for future practitioners on both sides of the appraisal action. The scrutiny was presumably higher under this analysis given the characteristics of an interested transaction (affecting process purity) and the disproportionate involvement of financial bidders (affecting both the market canvass and sale price).

170. *Id.* at 23–24.

171. *Id.* at 24.

172. *Id.*

173. *Id.* at 25.

174. *Id.* (noting that "[t]he record before us provides no rational, factual basis for such a 'valuation gap,' before going on to list each of the reasons why).



controlling stockholder (despite Mr. Dell's obvious influence as a founder).<sup>175</sup> Most importantly, the court provided future petitioners with certain elements that could be used to attack a deal price valuation.<sup>176</sup> One of the newest factors considered was the treatment of the target's confidential information by prospective bidders.<sup>177</sup> Taken together, the court's "efficient market hypothesis" addresses all three deal price buckets.

Next, the court dealt with the lack of strategic bidders involved in the sale process. Disagreeing with the Chancery Court, it expressed its confidence that financial buyers have just as much incentive to adequately measure fair value as strategic buyers do.<sup>178</sup> Here, the court gave weight to the consistent competition facilitated by Dell's financial advisors during the pre-canvass and post-signing phases as well as the stock market's treatment of Dell's prospects and profitability.<sup>179</sup> The analysis also hinted that an independent committee's success in repeatedly raising a financial sponsor's bid helps dissuade any notion that outside competition is necessary to generate fair value.<sup>180</sup> Further, the court endorsed the dynamics of the go-shop as "rais[ing] fewer structural barriers than the norm," and attributed this to the provision limiting the financial firm's compensation unless the go-shop was "as effective as possible."<sup>181</sup>

Thus, the fairness of the go-shop, the value placed by public markets, an extensive and cooperative due diligence process, the target company's willingness to facilitate competition, and the management's attempts to persuade the market that the company was more valuable than its stock price

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175. *Id.*

176. These elements include, but were not limited to: a track record of a company's stock reacting to news regarding its internal developments (implying that stock price at the time of the merger was an informed one); facts suggesting that relevant financial information did not make its way into the market; and facts suggesting that management intentionally persuaded common stockholders to be shortsighted in the company's investment prospects in order to orchestrate a future fire-sale transaction. *Id.* at 25–27.

177. *Id.* at 27 (noting that "[t]he record simply does not support the Court of Chancery's favoring of management's optimism over the public analysts' and investors' skepticism—especially in the face of management's track record of missing its own projections").

178. *Id.* at 27–28.

179. *Id.* at 28. Additionally, due to early leaks regarding Dell's interest in a potential strategic transaction, the lack of subsequent interest by strategic buyers during the pre-canvass was deemed to be a byproduct of their financial concerns rather than a lack of marketing by the independent committee. *Id.*

180. *Id.*

181. *Id.* at 29.

all constitute “objective indicia of the deal price’s reliability.”<sup>182</sup> The court found “no rational connection between a buyer’s status as a financial sponsor and the question of whether the deal price is a fair price.”<sup>183</sup>

Finally, the court explicitly made sure to distinguish the uniqueness of this case, noting that only “when the evidence of market efficiency, fair play, low barriers to entry, outreach to all logical buyers, and the chance for any topping bidder to have the support of [an influential stockholder’s] votes is so compelling” would a failure to assign the deal price any weight under these circumstances trigger an abuse of discretion.<sup>184</sup> These factors, when contrasted against a DCF analysis that undervalued Dell by \$23 billion (using over 1,100 inputs), are why the court believed there to be a tremendous discrepancy in reliability.<sup>185</sup> Ending on a policy note, the court emphasized that a contrary holding would deter the future embrace of the best practices adopted by the target company and Mr. Dell.<sup>186</sup>

Following *Golden Telecom*, *DFC*, and *Dell*, Delaware has adopted a “light touch” presumption with respect to merger price in the appraisal context. In each of these cases, the court made it clear that it favored valuations “forged in the crucible of objective market reality” over other approaches.<sup>187</sup> However, in each of the cases, the court specifically disclaimed a presumption that merger price is the correct measure for appraisal valuation.<sup>188</sup> Nevertheless, the court in *DFC* and *Dell* instructed lower courts that they look first to merger price. To the extent a finder of fact wishes to deviate from merger price, the trial court must justify that decision based on “reasoning that is consistent with the record and with relevant, accepted financial principles.”<sup>189</sup> So, while the current state

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182. *Id.* at 30–31.

183. *Id.* at 28 (internal quotation omitted).

184. *Id.* at 35.

185. *Id.* at 36.

186. *Id.* at 37–38 (concluding that “[i]f the reward for adopting many mechanisms designed to minimize conflict and ensure stockholders obtain the highest possible value is to risk the court adding a premium to the deal price based on a DCF analysis, then the incentives to adopt best practices will be greatly reduced”).

187. *Id.* at 23 n.108 (citing *Van de Walle v. Unimation, Inc.*, C.A. No. 7046, 1991 WL 29303, at \*17 (Del. Ch. Mar. 7, 1991)).

188. “In *DFC*, we again rejected an invitation to create a presumption in favor of the deal price. Even aside from the statutory command to consider all relevant factors, we doubted our ability to craft the precise preconditions for invoking such a presumption.” *Dell*, 177 A.3d at 21–22 (footnote omitted).

189. *Id.* at 44.

of fair value jurisprudence leaves the discretion to determine fair value in the hands of the trial court, it requires the court to rationalize a decision to move away from merger price; consequently, fair value involves a light-touch presumption in favor of merger price.

Since *DFC* and *Dell*, the court's light-touch presumption in favor of merger price has had its intended effect. The number of appraisal petitions in Delaware rose every year from 2009 until 2016 when there were seventy-six petitions filed.<sup>190</sup> In 2018, the number of petitions declined to just twenty-six.<sup>191</sup> Although the court was able, through its deference towards merger price in the determination of fair value, to reduce incentives for appraisal arbitrageurs to bring appraisal actions, the court may have gone too far.

## V. CHALLENGES TO THE DELAWARE RESPONSE

There are a number of challenges that arise with the Delaware Supreme Court's retreat to merger price and the pristine deal process standard in determining fair value of a dissenter's stock. These problems run afoul of Delaware precedent and Delaware's approach to the business judgment rule as well as the appraisal statute's statutory constraints. In addition, the pristine deal process standard raises the unwelcome prospect of unintended consequences with respect to board duties in the context of a merger or sale of control.

### A. Merger Price and Section 262(h)

If one takes seriously Section 262(h)'s charge that the "Court shall determine the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger," then reliance on deal price, particularly in the context of a played out auction, runs afoul of the statutory limitations placed on judicial fair value calculations.<sup>192</sup> The statutory prohibition against including elements of value arising out of the merger transaction is a reflection of the goals of appraisal. Appraisal provides dissenting shareholders liquidity or deterrence against opportunistic behavior by controllers by ensuring dissenters the ability to receive their pro rata share in the corporation as a going concern. To the extent the proposed merger creates

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190. CORNERSTONE RESEARCH, APPRAISAL LITIGATION IN DELAWARE: TRENDS IN PETITIONS AND OPINIONS 2006–2018 1 (2018), <https://www.cornerstone.com/publications/reports/appraisal-litigation-delaware-2006-2018> [<https://perma.cc/SB6Y-9N78>].

191. *Id.*

192. DEL. CODE ANN. tit. 8, § 262(h) (2019). Carney and Sharfman make a similar argument. William J. Carney & Keith Sharfman, *The Death of Appraisal Arbitrage: Ending Windfalls for Deal Dissenters*, 43 DEL. J. CORP. L. 61, 61 (2018).

an economic surplus, dissenting shareholders voluntarily forgo that surplus by virtue of their appraisal petition.

Basic bargaining theory suggests, merger price represents a division of the buyer's surplus associated with the transaction. That is to say, the merger price must, by definition, include elements of value arising from the merger. Consequently, reliance by courts on merger price for an indication of fair value runs contrary to statutory mandate.

In order to better understand how merger price must include elements of value arising from the acquisition, consider how a buyer understands her own bidding model. When a buyer makes a bid on a seller, the bid price will be a function of the expected value of the target corporation in the buyer's hands. Bidders can be expected to submit bids according to a decision rule that permits bids as long as the bid price does not exceed the expected value of the target. The difference between the bidder's expected value is the transaction surplus and the current value of the target corporation. The bidder's expected profit associated with the transaction is equal to the difference between the expected value of the target in the bidder's hands and the final bid price. The more of the transaction surplus the bidder is able to retain, the higher the bidder's expected profit associated with the transaction.<sup>193</sup>

Consequently, in a bilateral negotiation, bargaining over deal price represents a mere division of the transaction surplus between the buyer and the seller. Since the transaction surplus is the difference between a seller's minimum reservation price and a buyer's maximum reservation price, both parties will be better off doing the transaction regardless of the ultimate distribution of the surplus. The auction literature demonstrates that, in expectation, a seller in a bilateral negotiation will not do better than a fifty-fifty split of the transaction surplus.<sup>194</sup>

In an active auction for the target corporation where bidders do not know the expected values of other bidders, sellers can expect to receive even more of the transaction surplus. The key insight from the auction literature in economics

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193. Brian JM Quinn, *Bulletproof: Mandatory Rules for Deal Protection*, 32 J. CORP. L. 865, 877–81 (2007).

194. This is because the buyer's valuation of the seller is private information known only to the buyer, and there is no mechanism by which the buyer can credibly signal to the seller that its statements about valuation are more than mere puffery. Absent a credible commitment device that reveals information about the buyer's valuation of the seller, the exact division of transaction surplus in a bilateral negotiation is indeterminate. Paul Milgrom, *Auctions and Bidding: A Primer*, J. ECON. PERSP., Summer 1989, at 3, 19.

is that competition, or the threat of competition, in the form of an auction will lead to a deal price that transfers relatively more of the buyer's transaction surplus to the seller and that the price effect of one additional competitor in an auction is greater than the price effects attributable to effective bargaining.<sup>195</sup> The credible threat that the seller in the course of an auction will accept a higher bid from an auction competitor causes bidders to reveal private information about their valuations of the seller through higher bid prices.<sup>196</sup> This is so because bidders can only increase their probability of winning an auction where other bidders' valuations are private by transferring transaction surplus from buyer to seller.<sup>197</sup> "When given the choice between losing a potential transaction or giving up some of the expected transaction surplus, rational bidders are not indifferent. A rational bidder will exchange surplus for certainty up until the point where the bidder has no additional surplus available from pursuing a transaction."<sup>198</sup> Bidders in an auction therefore submit bids that transfer increasing amounts of transaction surplus to sellers in exchange for a higher probability of success in an auction. Consequently, the winning bidder in an auction is one with the highest valuation of the seller, and the winning bidder can be expected to have transferred its transaction surplus to the selling

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195. Bulow and Klemperer show that, subject to certain assumptions, a standard English auction with  $N + 1$  bidders will always yield higher expected revenue than a negotiation with only  $N$  bidders. Jeremy Bulow & Paul Klemperer, *Auctions Versus Negotiations*, 86 AM. ECON. REV. 180, 185–86 (1996) (noting an auction with  $N + 1$  bidders and no reserve price is more profitable than any standard mechanism with only  $N$  bidders). Bulow and Klemperer also show that an auction with  $N + 1$  bidders is superior to *any* mechanism involving only  $N$  bidders. *Id.* (same).

196. Because the seller does not know the buyer's private valuation of the seller, the seller's ability to bargain is limited. R. Preston McAfee & John McMillan, *Auctions and Bidding*, 25 J. ECON. LITERATURE 699, 704 (1987). The seller can, however, exploit competition among bidders, or potential bidders, to drive up the price closer to the buyer's reservation price. *Id.*

197. This assumes symmetric bidders, and on the one side a seller with no bargaining power running an English auction with no reserve price, and on the other side a seller with all the bargaining power, including the ability to make binding commitments, conducting a negotiation or an auction with  $N$  bidders, culminating with a final take-it-or-leave-it offer. See Bulow & Klemperer, *supra* note 195, at 187–88. Analytically, a bilateral negotiation is the same as an English auction but with only one bidder. *Id.* at 182 n.9.

198. Quinn, *supra* note 193, at 880.

shareholders.<sup>199</sup> This result is consistent with the observation that selling shareholders tend to do better than buyers in merger transactions.<sup>200</sup>

In the case of both an auction and a bilateral negotiation involving a non-controlled corporation and a third-party buyer, the price paid to selling shareholders in excess of the selling corporation's current value will always represent a transfer of at least some transaction surplus from buyer to seller.<sup>201</sup> In the case of a bilateral negotiation, the amount of surplus captured by the seller is indeterminate as this will be a function of parties' negotiating power. Where the deal is fully shopped and there is hard bargaining, then merger price can be expected to include more of the buyer's transaction surplus. In the case of an auction, the more efficient the auction the more likely larger amounts of transaction surplus will be transferred to selling shareholders through the merger price. Merger prices that result from a fully played-out auction may well represent the highest price reasonably available to shareholders.<sup>202</sup> Such prices are obviously "fair" to selling shareholders to the extent they are in excess of selling shareholders' reserve price. However, they also necessarily include "elements of value" attributable to the transaction and therefore are contrary to statutory limitations put upon fair value calculations by Section 262(h).

In *DFC*, the Delaware Supreme Court noted, correctly, that a fair price "means a price that is one that a reasonable seller, under all of the circumstances, would regard as within a range of fair value; one that such a seller could reasonably accept" and not necessarily the highest price reasonably available.<sup>203</sup> To this extent, a successful price negotiation between a buyer and

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199. Although a buyer can increase the amount of transaction surplus it retains by submitting a low-ball bid to the seller, the effect of a low-ball bid is to reduce the probability that a bidder in an auction will succeed. Milgrom, *supra* note 194, at 19.

200. Michael Firth, *Takeovers, Shareholder Returns, and the Theory of the Firm*, 94 Q. J. ECON. 235, 235 (1980) (Benefits of mergers accrue to acquired firms' shareholders and managers while losses are suffered by acquiring firms' shareholders); Ulrike Malmendier & Geoffrey Tate, *Who Makes Acquisitions? CEO Overconfidence and the Market's Reaction*, 89 J. FIN. ECON. 20, 21 (2008) (same).

201. John C. Coates, IV, "Fair Value" as an Avoidable Rule of Corporate Law: Minority Discounts in Conflict Transactions, 147 U. PA. L. REV. 1251, 1351-52 (1999).

202. *Revlon's* charge to the board in the case of a change of control is to seek out the highest price reasonably available. This, however, is not a requirement under the fair value provision of the Delaware Code. DEL. CODE ANN. tit. 8, § 262(h) (2019).

203. *DFC Global Corp. v. Muirfield Value Partners*, 172 A.3d 346, 370-71 (Del. 2017) (quoting *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134, 1143 (Del. Ch. 1994), *aff'd*, 663 A.2d 1156 (Del. 1995)).

a seller is constrained to a range of alternatives that represent the minimum acceptable to the seller and the maximum a buyer is willing to pay.<sup>204</sup> This range of possible prices represents a set of possible points of exchange above the seller's reservation price where the buyer would be willing to exchange transaction surplus (e.g., elements of value associated with the transaction) for control of the target. Although it might be appropriate to reference to the buyer's maximum willingness to pay in some valuation circumstances, in light of Section 262(h)'s statutory exclusion of elements of value arising from the merger, reference to the buyer's maximum willingness to pay is not appropriate.<sup>205</sup> When assessing fair value in the context of an appraisal, because the buyer's private value for the seller includes elements of value that derive from the management of the seller by the buyer, it is not a permissible inquiry for a court when determining the statutory fair value under section 262(h).<sup>206</sup> Consequently, when courts rely on merger price, they are looking through the wrong lens.

Given that merger price reflects the value of the target corporation in the hands of the buyer, it is not clear that merger price is at all relevant to the determination of fair value of the target corporation exclusive of any elements of value in connection with the merger as required under section 262(h). This is especially true in the context of a fully played-out auction where merger price reflects the maximum price a *buyer* is willing to pay, not the fair value of the corporation to the *seller* as a going concern.

Courts appear to intuitively understand this problem, sometimes explicitly.<sup>207</sup> Indeed, even the Delaware Supreme Court in *DFC* acknowledged

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204. This is known as the "zone of possible agreement" in the negotiation literature. James K. Sebenius, *Negotiation Analysis: A Characterization and Review*, 38 MGMT. SCI. 18, 20 (1992).

205. In *Dell*, the court makes reference to the buyer's willingness to pay by saying "in many circumstances a property interest is best valued by the amount a buyer will pay for it." *Dell, Inc. v. Magnetar Global Event Driven Master Fund*, 177 A.3d 1, 23 n.108 (Del. 2017) (citing *Applebaum v. Avaya, Inc.*, 812 A.2d 880, 889–90 (Del. 2002)). Of course, the circumstances cited by the court in *Applebaum* were very different from an appraisal under section 262(h). *Applebaum*, 812 A.2d at 889–90). *Applebaum* dealt with a valuation of fractional shares under section 155. *Id.* at 889–90. Valuations of fractional shares pursuant to section 155 are *not* subject to the same statutory limitations as valuations under section 262(h). *Compare id.* at 885–88, *with Dell*, 177 A.3d at 18–24.

206. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983) ("[S]peculative elements of value that may arise from the 'accomplishment or expectation' of the merger are excluded" from the fair value determination.).

207. *Union Ill. 1995 Inv. L.P. v. Union Fin. Grp.*, 847 A.2d 340, 356 (Del. Ch. 2004) (observing "that acquirers typically share a portion of synergies with sellers in sales transactions and that that

that merger prices include “synergies,” resulting in selling shareholders receiving some portion of transaction surplus.<sup>208</sup> At times, courts attempt to deal the problem of transaction surplus present in merger present by subtracting synergies or applying a “synergy discount” to the merger price.<sup>209</sup> A merger price minus synergies approach, while admirable, is more art than science. By anchoring the fair value determinations to merger price, the synergies discount approach will still necessarily include some elements of value associated with the transaction unless the court is able to precisely value the deal-related synergies, which it is unlikely to be able to do in anything more than a rudimentary fashion.

Although endorsed by the Delaware Supreme Court as recently as in *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*,<sup>210</sup> the deal price minus synergies is a blunt instrument that, because of its imprecision, unnecessarily runs afoul of Section 262(h)’s limits on fair value calculations.

### B. Appraisal as Quasi-Fiduciary Litigation

Relying on merger price and the pristine deal process standard for indicators of fair value may have the unintended consequence of transforming appraisal litigation into a new class of “quasi-fiduciary” litigation. The claims are quasi-fiduciary because they are synthetic. In this new quasi-fiduciary litigation, plaintiffs will attempt to boot-strap exculpable duty of care violations into effectively non-exculpable quasi-fiduciary claims by arguing a failure to carry out a pristine deal process should result in a higher valuation for purposes of appraisal valuation.

The idea of re-characterizing appraisal into something akin to fiduciary litigation is not new. In 1995, Professor Mary Siegel argued that in certain conflict transactions, appraisal should be available as a device to monitor

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portion is value that would be left wholly in the hands of the selling company’s stockholders, as a price that the buyer was willing to pay to capture the selling company and the rest of the synergies”).

208. *DFC Global*, 172 A.3d at 358. Nevertheless, the court ruled that absent a reasonable justification otherwise, merger price in this case is the best indicator of fair value. *See id.* at 370–71 (citing *Cinerama*, 663 A.2d at 1143).

209. *Union Ill. 1995 Inv. L.P.*, 847 A.2d at 353–54, 357–58 (holding that merger price, less expected synergies, was the “best indicator of value” where a merger resulted from a “competitive and fair auction, which followed a more-than-adequate sales process and involved the broad dissemination of confidential information to a large number of prospective buyers”); *see also* *Highfields Capital, Ltd. v. AXA Fin., Inc.*, 939 A.2d 34, 42 (Del. Ch. 2007) (merger price minus synergies).

210. 210 A.3d 128, 140–41 (Del. 2019).



actions of management.<sup>211</sup> The professor appears prescient, though perhaps not quite in the manner she may have predicted. Post-*DFC* appraisal has become a vehicle for shareholders in non-conflicted transactions to engage in fishing expeditions under the guise of these quasi-fiduciary appraisal claims.

The court's reliance on merger price where there is evidence that the deal process was pristine opens up appraisal to quasi-fiduciary claims in two ways. First, shareholders are able to use appraisal's discovery tools to feed affiliated fiduciary duty claims where discovery turns up evidence of otherwise unknown fiduciary breaches. Second, where discovery fails to turn up evidence of breaches, but merely turns up evidence of deal process deficiencies, dissenters will be able to use these deficiencies, deficiencies that would otherwise not generate fiduciary liabilities, to argue that deal price does not represent fair value and thus bias appraisal valuations upwards.

Quasi-appraisal claims effectively permit shareholders who opt-in the ability to engage in a private attorney general review of every transaction, even non-conflicted, arm's length transactions. From a litigant's perspective, the power of appraisal lies in its ability to provide shareholders who opt-in, discovery rights that would not be available in typical fact scenarios involving arguably only duty of care claims. Where discovery turns up evidence of actual violations of fiduciary duties by directors, dissenting shareholders can then hand off the results of their discovery to plaintiffs to bring post-closing fiduciary duty litigation seeking damages. In this use of the appraisal remedy, dissenting shareholders are ultimately indifferent to the standard used by courts to value the firm because their object is to engage in discovery in service of finding a possible post-closing fiduciary claim.<sup>212</sup> From a plaintiff's

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211. Mary Siegel, *Back to the Future: Appraisal Rights in the Twenty-First Century*, 32 HARV. J. ON LEGIS. 79, 79 (1995). Left unsaid is the rationale for why, in conflicted transactions, traditional opt-out fiduciary litigation is not the optimal result. Others have also suggested this role for appraisal. But the idea behind it is not. *See, e.g.*, Kanda & Levmore, *supra* note 16, at 433 (lauding appraisal's discovery power). As Vice Chancellor Laster observed in *Trados*, "Since *Cede & Co. v. Technicolor, Inc. (Technicolor I)*, 542 A.2d 1182 (Del. 1988), the consolidated breach of fiduciary duty action and appraisal proceeding has been a fixture of Delaware law." *See In re Trados S'holder Litig.*, 73 A.3d 17, 35 (Del. Ch. 2013).

212. For an example of this litigation strategy currently in play, see *In re Xura, Inc.*, Stockholder Litig., C.A. No. 12698-VCS, 2018 WL 6498677, at \*12 (Del. Ch. Dec. 10, 2018) and Complaint at 1–2, *Obsidian Management LLC v. Tartavull*, C.A. No. 2018-0232-JRS (Del. Ch. Apr. 4, 2018), 2018 WL 1709657.

perspective, gaining access to broad deal-related discovery via an appraisal action is an improvement to filing Section 220 books and records actions.<sup>213</sup>

Even where quasi-fiduciary claims do not turn up evidence of fiduciary shortcomings, they may still be valuable to plaintiffs. In the absence of evidence of violations of the duty of loyalty or a board's disclosure obligations, evidence of deal process deficiencies, such that dissenters can argue the deal process is not pristine, will be sufficient to generate potential appraisal liability for the surviving corporation. In that way, where the deal process was less than pristine but still well short of a non-exculpable fiduciary claim, the appraisal option can transform itself into litigation with a settlement value for plaintiffs. Rather than eliminating incentives for arbitrageurs to bring appraisal actions, by anchoring appraisal's statutory fair value remedy to merger price, the court may have unwittingly created new incentives for litigants to pursue appraisal.<sup>214</sup>

Of course, this result is incongruous given the current state of *Revlon* doctrine as well as the statutory purposes of the appraisal remedy.<sup>215</sup> Although in the sale of control context, boards are charged with deploying their business judgment in a manner reasonably conceived to achieve the highest price reasonably available to shareholders, there is no checklist of activities required of directors to that end.<sup>216</sup> In *Lyondell*, the Delaware Supreme Court made it clear that there are no specific "acts" that a board must undertake in order to meet its obligations under *Revlon*.<sup>217</sup> There is no requirement that directors engage in a pre-signing market check, auction, or any other action. In the words

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213. Although a shareholder seeking access to books and records via a Section 220 action faces a relatively low bar, it is not insignificant. In addition, access to books and records in such actions is typical fairly narrow in scope. See *Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 121 (Del. 2006) (requiring the plaintiff present some evidence to suggest a credible basis from which the court can infer that mismanagement, waste, or wrongdoing may have occurred).

214. Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CALIF. L. REV. 1051, 1100–02 (2000).

215. Lyman Johnson, *The Reconfiguring of Revlon*, in RESEARCH HANDBOOK ON MERGERS AND ACQUISITIONS 263 (Claire A. Hill & Steven Davidoff Solomon eds., 2016).

216. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 180 (Del. 1986); *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 44 (Del. 1994).

217. *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 243 (Del. 2009) ("The trial court decided that the *Revlon* sale process must follow one of three courses, and that the *Lyondell* directors did not discharge that 'known set of [*Revlon*] "duties."' But, as noted, there are no legally prescribed steps that directors must follow to satisfy their *Revlon* duties. Thus, the directors' failure to take any specific steps during the sale process could not have demonstrated a conscious disregard of their duties.") (footnote omitted).

of the court in *Barkan*, “[T]here is no single blueprint” for a board to meet its obligations under *Revlon*.<sup>218</sup>

To the extent an arm’s length board undertakes a sale implicating *Revlon* that falls short of achieving the highest price reasonably available for shareholders, the result of fiduciary litigation will invariably be dismissal in favor of the board.<sup>219</sup> Absent facts suggesting self-dealing, a board’s failure to live up to its *Revlon* obligations results only in an exculpable violation of the duty of care, therefore no damages.

Although a board may face no liability under *Revlon* for engaging in a less than perfect sales process, the corporation may nevertheless face liability under an appraisal action in the form of quasi-fiduciary litigation because it failed to structure a sale transaction to comport with the requirements of the pristine deal process standard.<sup>220</sup> For example, a board that relies on an investment bank for valuation advice and then engages in an arm’s length sale to a single bidder will likely not face liability in a fiduciary action challenging the merger. However, if that same board failed to engage in an auction or an extensive market check or any series of box checking activities prior to agreeing to a sale of the

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218. *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1286 (Del. 1989) (citing *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985) (“It is true that a court evaluating the propriety of a change of control or a takeover defense must be mindful of ‘the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders. Nevertheless, there is no single blueprint that a board must follow to fulfill its duties. A stereotypical approach to the sale and acquisition of corporate control is not to be expected in the face of the evolving techniques and financing devices employed in today’s corporate environment.’”)).

219. CLAIRE A. HILL, BRIAN JM QUINN, & STEVEN DAVIDOFF SOLOMON, *MERGERS & ACQUISITIONS: LAW, THEORY, AND PRACTICE* 573 (2d ed. 2019). And *see QVC*:

Although an enhanced scrutiny test involves a review of the reasonableness of the substantive merits of a board’s actions, a court should not ignore the complexity of the directors’ task in a sale of control. There are many business and financial considerations implicated in investigating and selecting the best value reasonably available. The board of directors is the corporate decisionmaking body best equipped to make these judgments. Accordingly, a court applying enhanced judicial scrutiny should be deciding whether the directors made a reasonable decision, not a perfect decision. If a board selected one of several reasonable alternatives, a court should not second-guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board’s determination. Thus, courts will not substitute their business judgment for that of the directors, but will determine if the directors’ decision was, on balance, within a range of reasonableness.

637 A.2d at 45 (emphasis omitted) (footnote omitted).

220. *Blueblade Capital Opportunities LLC v. Norcraft Cos.*, C.A. No. 11184-VCS, 2018 WL 3602940, at \*6 (Del. Ch. July 27, 2018).

corporation that establishes a pristine deal process, it may face a substantial post-closing risk in the form of appraisal. The effect of the pristine deal process and quasi-fiduciary litigation may stretch even further, creating costly incentives for boards in mergers that do not involve a sale of control and are otherwise only subject to review under the business judgment rule to engage in check-the-box approaches to a mergers.

Reliance on merger price and the pristine deal process standard thus threatens to create substantive changes to the legal requirements in the context of merger transactions that perhaps were neither contemplated nor desired by the Delaware Supreme Court. Indeed, in *Lyondell* the court specifically disclaimed this approach to a board's meeting its fiduciary obligations.<sup>221</sup> Nevertheless, directors currently seeking to mitigate the risk of quasi-fiduciary litigation in the form of appraisal actions will have incentives to impute onto *Revlon* transactions actions and deal structures that are not required by the law. As a consequence of the court's adoption of merger price, the pristine deal process standard, and the resulting anchoring effects, the court may have unwittingly created incentives that substantively change board obligations in the context of a sale of control.

### C. *Inherent Contradiction of Merger Price*

The court's newfound love of the efficient capital market hypothesis is an uncomfortable fit. Perhaps the single most important question in the corporate law is the proper allocation of decision-making authority between the board of directors and shareholders (i.e., the market), particularly in the context of a merger or sale of control. The court's recent decisions to place the efficient capital market hypothesis at the center of fair value determinations in appraisal actions undermines many of the policy rationales in support of board-centric decision making. One must wonder whether its endorsement of the efficient capital market hypothesis is intended to call into question much of the work of the courts over past three decades.<sup>222</sup> If not, it sits at odds with other aspects of the court's jurisprudence.

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221. *Lyondell*, 970 A.2d at 239.

222. In a host of earlier fiduciary duty cases, courts have regularly declined to agree with plaintiff contentions that premium offers should have any influence over board decisions to accept or not accept offers. *See, e.g.*, *Smith v. Van Gorkom*, 488 A.2d 858, 875 (Del. 1985) (“[T]he fact of a premium alone does not provide an adequate basis upon which to assess the fairness of an offering price.”); *In re El Paso Corp. S’holder Litig.*, 41 A.3d 432, 434–35 (Del. Ch. 2012) (finding reasonable probability of success on the merits of breach of fiduciary duty claim despite nominal 47.8% premium over pre-

During the 1980's hostile takeover boom, courts were asked to litigate the proper allocation of decision-making authority between boards and shareholders in the context of defensive measures adopted to forestall unwanted takeover offers. This question was probably best represented by a vigorous academic debate that played out in law reviews during the early 1980s by a generation of scholars, chief among them Profs. Frank Easterbrook, Daniel Fischel, Ronald Gilson, and Lucien Bebchuk, as well as attorney Martin Lipton.<sup>223</sup> The professors argued strenuously that in the face of a fully-funded, unconditional bid, boards should not be permitted to adopt takeover defenses prohibiting shareholders from selling their shares into such an offer.<sup>224</sup> Shareholders should be masters of their own fate and should be permitted to accept a market offer for their shares. On the other side of this debate, Mr. Lipton argued that boards, and not shareholders, have the best understanding of corporate value.<sup>225</sup> The market was not perfect, and shareholders are not likely going to be in position to understand the true value of the corporation. Lipton argued that absent defenses, hedge funds and speculators would take advantage of short-run dips in stock market prices to take control of firms underpriced by the market.<sup>226</sup>

In the line of cases that represent the *Unocal* jurisprudence, the courts attempted to walk a fine line between these two views but ultimately came down

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announcement market price); *In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813, 817–19 (Del. Ch. 2011) (same despite nominal 40% premium); *In re Tele-Comm'ns, Inc. S'holders Litig.*, C.A. 16470, 2005 WL 3642727, at \*1–2 (Del. Ch. Dec. 21, 2005) (finding at the summary judgment stage that defendants had not demonstrated entire fairness despite 37% premium); *Gholl v. eMachines, Inc.*, No. Civ.A. 19444-NC, 2004 WL 2847865, at \*15 (Del. Ch. Nov. 24, 2004) (giving “little weight” to the “control premium argument” despite a premium of 96%); *In re Rural Metro Corp. Stockholders Litig.*, 88 A.3d 54, 102 (Del. Ch. 2014) (“The fact that the deal with Warburg generated a premium over the pre-announcement market price did not mean that the merger was the best value reasonably available or that stockholders were not harmed by RBC’s activities.”).

223. Easterbrook & Fischel, *Takeover Bids, Defensive Tactics, and Shareholders' Welfare*, *supra* note 17, at 1749–50; Easterbrook & Fischel, *The Proper Role*, *supra* note 17, at 1161; Gilson, *supra* note 17, at 891; Lipton, *Takeover Bids in the Target's Boardroom*, *supra* note 17, at 130–31; Martin Lipton, *Takeover Bids in the Target's Boardroom: A Response to Professors Easterbrook and Fischel*, 55 N.Y.U. L. REV. 1231, 1236 (1980); Martin Lipton, *Takeover Bids in the Target's Boardroom: An Update After One Year*, 36 BUS. LAW. 1017, 1026–28 (1981); Lucian A. Bebchuk, Comment, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028, 1050–52 (1982).

224. Gilson, *supra* note 17, at 845; Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers: A Reply and Extension*, 35 STAN. L. REV. 23, 24 (1982).

225. Lipton, *supra* note 17, at 120.

226. *Id.* at 104.

emphatically on the side of boards rather than markets.<sup>227</sup> The themes of these *Unocal* cases are generally the same: In the face of an unwanted takeover offer, the board refuses to remove takeover defenses and justifies that decision by arguing the offeror and the market do not understand the value of the corporation and that the offer and the stock market price undervalue the corporation.<sup>228</sup> Shareholders in these cases typically argue because the offer in question represents a premium over the market price, it cannot possibly represent a threat to shareholders, and boards should be required to defer to shareholders in that situation. In upholding the board's prerogative to adopt takeover defenses and its unwillingness to accept premium cash bids, courts implicitly endorse the idea that shareholders and markets may have myopic views with respect to value and that as between boards and markets, boards are in a better position to know what is in the best long-term interests of the corporation and stockholders.<sup>229</sup> Leaving the locus of decision-making with the board in these cases is thus an implicit rejection of the logic of the efficient capital market hypothesis.

By adopting the position that efficient capital market hypothesis is valid in the context of evaluating what was fair value in a merger transaction, the court makes it difficult to justify arguments for deference to board decisions to adopt takeover defenses in the presence of a fully-financed, unconditional premium bid, which is the current state of the law.<sup>230</sup> If an efficient market has a better view on the value of a corporation than the corporation's board, a board's decision to defy the market can only be interpreted as a disloyal act of entrenchment. Nevertheless, in *DFC* and then subsequently in *Dell*, the court

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227. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 957 (Del. 1985); *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1155 (Del. 1989); *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1388 (Del. 1995); *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 129 (Del. Ch. 2011).

228. See, e.g., *Air Prods.*, 16 A.3d at 97–98 (making that argument).

229. In *Equity-Linked Investors v. Adams*, the Chancery Court observed that “it is entirely up to the board to exercise judgment over what time-frame the corporation's resources are to be developed and how.” 705 A.2d 1040, 1055 (Del. Ch. 1997).

230. This is a position taken by Chancellor Chandler in *Air Products*. 16 A.3d at 56–57. This position is also consistent with positions taken by then Vice-Chancellor, now Chief Justice, Strine in *Chesapeake Corp. v. Shore*, 771 A.2d 293, 328 (Del. Ch. 2000) (“Our law should also hesitate to ascribe rube-like qualities to stockholders. *If stockholders are presumed competent to buy stock in the first place, why are they not presumed competent to decide when to sell in a tender offer after an adequate time for deliberation has been afforded them?*”).

accepted the efficient capital market hypothesis as a starting point for judicial determinations of fair value in the context of appraisal opinions.<sup>231</sup>

Of course, there is a fallacy in the statement that merger price is an example of an efficient price for the target company. It is decidedly not that. Prior to a merger announcement, if one takes the semi-strong ECMH at face value, the stock market price of a relatively liquid publicly traded target is a relatively good proxy for value prior to any merger.<sup>232</sup> According to the hypothesis, a company's stock price will reasonably reflect all the publicly available information.<sup>233</sup> Although this model is not perfect, there are many examples of markets being inefficient with respect to price levels, in general price movements move on the margin in a manner that is consistent with the proposition that new information is valuable.<sup>234</sup>

When a merger is announced, the stock price will typically react and increase to somewhere near the merger price. This reaction to new information, the merger announcement, is consistent with tenants of the ECMH. However, at this point, the stock price no longer reflects the long-term value of *the company*. Rather, it represents a short-term assessment by the market of *the acquirer's ability to complete the proposed transaction*. Following the announcement of an offer, the intrinsic value of the company at this point is irrelevant. Rather, the stock price, to the extent it reflects anything, reflects the risk adjusted present value of the acquirer's bid for the target. Factors like the likelihood of regulatory hurdles or stockholder resistance to the proposed

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231. DFC Global Corp. v. Muirfield Value Partners, 172 A.3d 346, 365 (Del. 2017); Dell, Inc. v. Magnetar Global Event Driven Master Fund, 177 A.3d 1, 24–25 (Del. 2017).

232. Under *weak form*, prices simply reflect only historical prices and such prices are not necessarily efficient. Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383, 383 (1970). Under *semi-strong form*, the hypothesis prices efficiently adjust to publicly available information (e.g., announcements of annual earnings, stock splits, etc.) such that market prices are efficient, but private information can move markets. *Id.* Finally, under the strong form version of the efficient market hypothesis, all information, both public and private, is completely accounted for in current stock price. *Id.*

233. *Id.*

234. Subsequent to the development of the ECMH, behavioral economists called into question many basic conclusions of ECMH. *Efficient Market Hypothesis*, BEHAVIORALECONOMICS.COM, (citing Nicholas Barberis & Richard Thaler, *A Survey of Behavioral Finance*, in HANDBOOK OF THE ECONOMICS OF FINANCE 1053 (G.M. Constantinides, M. Harris, & R. Stulz eds., 2003), <https://www.behavioraleconomics.com/resources/mini-encyclopedia-of-be/efficient-market-hypothesis/> [<https://perma.cc/NWG4-YQQK>] (last visited Jan. 5, 2020) (“Findings in behavioral finance, by contrast, suggests that asset prices also reflect the trading behavior of individuals who are not fully rational, leading to anomalies such as asset bubbles.”).

merger may cause the stock price to trade at a discount to the merger price. The possibility that there may be other potential acquirers circling the company prepared to make a competing offer may cause the stock price to trade at a premium to the merger price. Note that neither of these have anything to do with the target's intrinsic value, but rather they are market assessments on the quality of the offer. When a court concludes that stock market prices following announcement of an offer reflect a valuation of the target company, the court is simply incorrect.

Given that the pristine deal process standard is inconsistent with the court's past approach to reviewing board actions in the context of fiduciary duty challenges, what might explain why the court has decided to go this route? There are at least two possible explanations. First, is the instrumental explanation: Faced with rapid growth in appraisal petitions and a perceived abuse of the appraisal remedy, courts rely on merger price as a way of cutting off economic incentives to pursue arbitrage strategies.<sup>235</sup> Of course, this has the equivalent effect of making the appraisal remedy a nullity for public mergers.

The second possible explanation for the court's embrace of the ECMH might be traced to the court's current make up. It is no secret that in the application of the *Unocal* standard there have been differences in views between the Chancery Court and the Delaware Supreme Court. In general, the Chancery Court has been much more open to engaging in substantive review of board actions in the context of its application of *Unocal*, a view generally more consistent with the views expressed by Profs. Gilson and Bebchuk. In *Interco*, then-Chancellor Allen adopted a version of Prof. Gilson's framework for application of the then new *Unocal* standard.<sup>236</sup> This framework was specifically rejected by the Delaware Supreme Court in *Paramount Communications v. Time*.<sup>237</sup> Notwithstanding the Delaware high court's view

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235. Jonathan Kalodimos & Clark Lundberg, *Shareholder Rights in Mergers and Acquisitions: Are Appraisal Rights Being Abused?* 1 (2017), <https://ssrn.com/abstract=2894434> [<https://perma.cc/FA5N-JFSP>] (evaluating claims of abuse of the appraisal process).

236. *City Capital Assocs. L.P. v. Interco Inc.*, 551 A.2d 787, 797–98 (Del Ch. 1988).

237. 571 A.2d 1140, 1153 (Del. 1989):

Plaintiffs' position represents a fundamental misconception of our standard of review under *Unocal* principally because it would involve the court in substituting its judgment as to what is a "better" deal for that of a corporation's board of directors. To the extent that the Court of Chancery has recently done so in certain of its opinions, we hereby reject such approach as not in keeping with a proper *Unocal* analysis.

*Id.*



that *Unocal* should do less, members of the Chancery Court continued to express their view that *Unocal* should mean something more.<sup>238</sup> The elevation of the Chancellor of the Chancery Court to Chief Justice of the Supreme Court creates an opening for the court to pivot away from the court's traditional application of *Unocal* towards a more exacting application of the standard. If that is true, the court's explicit embrace of the ECMH in the context of fair value determinations may be an opening move in what could prove to be a gradual transition in judicial philosophy.<sup>239</sup>

## VI. WHAT SHOULD APPRAISAL BE?

In recent years, courts have responded to the increase in appraisal claims by aggressively relying on the lever of fair value to reduce incentives for litigants to bring such claims. The move by the court raises important questions. First and foremost, a standard that requires the trial judge to justify using some source of valuation other than merger price is, if nothing else, a light touch presumption in favor of merger price for purposes of valuation in appraisal claims notwithstanding claims to the contrary. To the extent merger price becomes the presumptive indicator of valuation, such a presumption either reduces the statutory remedy to a mere nullity or it creates additional option value by promoting the pursuit of appraisal as a quasi-fiduciary litigation. It

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238. *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 94 (Del. Ch. 2011); *Chesapeake Corp. v. Shore*, 771 A.2d 293, 320 (Del. Ch. 2000); *Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 278, 289 (Del. Ch. 1989) (“It is difficult to understand how, as a general matter, an inadequate all cash, all shares tender offer, with a back end commitment at the same price in cash, can be considered a continuing threat under *Unocal*.”).

239. Chief Justice Strine has been an active participant in recent debates with the late Prof. Lynn Stout and others about the role of the corporation in society. His position is nuanced and sophisticated, as one would expect of the Chief Justice of the highest court in the State of Delaware, but it starts from the view that the law of Delaware is that directors' fiduciary duties are geared towards maximizing stockholder value. Leo E. Strine, Jr., *Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 136 (2012) (“Instead of recognizing that for-profit corporations will seek profit for their stockholders using all legal means available, we imbue these corporations with a personality and assume they are moral beings capable of being ‘better’ in the long-run than the lowest common denominator. We act as if entities in which only capital has a vote will somehow be able to deny the stockholders their desires, when a choice has to be made between profit for those who control the board's reelection prospects and positive outcomes for the employees and communities who do not.”); Hon. Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 763 (2015) (“[T]hat directors do not have to make stockholder welfare the sole end of corporate governance, within the limits of their legal discretion, under the law of the most important American jurisdiction—Delaware.”).

may be that the current development of fair value jurisprudence provides a reasonable opportunity to revisit the usefulness of the appraisal remedy in its current form and return appraisal petitions to the litigation backwater that had been its hallmark until recent years. Returning appraisal to its more modest beginnings can be done in one of two ways. First, the legislature can recognize the reality of the court's recent moves and simply broaden the market out exception to exclude all public company transactions from the appraisal remedy. Alternatively, the court could remain faithful to both the ECMH and Section 262(h)'s limiting principle by relying on unaffected stock price, rather than merger price, for fair value determinations.

#### *A. Broaden the Market Out Exception*

Given the limited goals of appraisal, it would be appropriate to amend the appraisal statute to limit its applicability in two ways. First, the current "market out" should be replaced with the pre-1969 market out exception. Before the 1969 amendment, the market out exception eliminated appraisal rights for the stock of any publicly traded corporation without regard for the type or nature of consideration available in the transaction.<sup>240</sup> Eliminating the appraisal remedy for publicly traded companies recognizes the consequence of the court's move towards embracing the ECMH and merger price for fair value determinations while preserving appraisal for private companies where merger prices are not exposed to the oversight of the market.

Merger price as a starting point for fair value determinations has the effect of closing off the appraisal remedy for mergers involving publicly traded corporations. There are good reasons for broadening the market out exception. As presently configured, the market out lacks much coherence. Stockholders receiving consideration in the form of cash have access to appraisal rights under the market out exception. On the other hand, stockholders receiving stock in the surviving corporation or other publicly traded corporation as consideration do not have access to appraisal rights, on the theory that shareholders receiving publicly traded stock or stock of the survivor can fend for themselves. This distinction appears almost arbitrary. Stockholders receiving publicly traded stock or stock in the survivor are not able to use the market to fend for themselves in the event they believe the consideration received in the transaction is unfair. Assuming the ECMH is correct, following announcement of such a transaction, prices respond and the only remedy available to such

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240. 57 Del. Laws c. 148, § 22 (1969–70).

shareholders to is to suffer the effects of an underpriced merger by selling the shares received as consideration into the market at what may be an unfair value.<sup>241</sup> At the same time, preserving appraisal for public company transactions where consideration received is cash, but then leaning heavily on merger price as an indicator of value, seems to leave little more than a fig leaf. If providing dissenting shareholders liquidity and deterrence against majority opportunism are goals of the appraisal remedy, then the current market out exception with its arbitrary distinctions with respect to consideration received is misguided. Rather best “to call a spade, a spade” and eliminate appraisal for most publicly traded corporations altogether.

Second, the focus for the appraisal remedy should remain on private corporations and controlled corporations. Shareholders in private corporations will always lack access to a liquid exit in the event of a merger; consequently, access to a judicial appraisal remedy is critically important in order to deter potential opportunistic behavior. To the extent the court wishes to be guided by the ECMH in the valuation question, such indicators of value are rarely available to private companies and the court’s recent jurisprudence in this area is not altogether helpful. Private company merger price provides little or no information with respect to the valuation question. Not only is private company stock not traded, this stock is not able to benefit from robust, market-based indications of value unaffected by the merger. And, since the acquirer’s merger price is never tested by the market—indeed most private company acquisitions are not announced to the public until after the deals are closed, usually with little or no pricing information disclosed—there is no reasonable prospect that, in the private company context, an unpriced merger will ever result in a topping bid.

The same basic logic is true of controlled corporations, including publicly traded controlled corporations. Controlled corporations will lack reasonably efficient markets for their stock since shares trading in such markets will trade at a discount. In broadening the market out exception, legislators would be well advised to leave a provision that permits stockholders in controlled corporations access to the appraisal remedy without regard to the consideration offered. The

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241. Shareholders, who would not have access to appraisal rights because of the nature of the consideration received, would suffer the equivalent harm that shareholders suffer when boards pursue value decreasing midstream corporate charter amendments. The harm they suffered cannot be remedied through a sale into the market. See Lucien Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1853–54 (1989).

rationale for new a controlled corporation exception to the market out exception would be dissimilar from the rationale for appraisal in the context of Section 253 short form mergers.<sup>242</sup> Because minority shareholders are subject to a minority discount and opportunistic behavior by the controller, access to the appraisal remedy will remain an extremely important tool in ensuring minority shareholders in such transactions are treated fairly.

### B. *Unaffected Stock Price*

Although the legislature has not shown itself averse to amending the appraisal statute over the years, if amendments to the appraisal statute are for some reason unavailable, courts can, consistent with the new focus on ECMH as well as Section 262(h)'s statutory limitations on fair value, engage in self-help that ameliorates some of the issues raised by the merger price jurisprudence while still meeting the court's goal of reducing incentives for appraisal arbitrageurs to access the remedy.

First, courts should begin to look to the unaffected stock price rather than merger price for indications of fair value.<sup>243</sup> The unaffected stock price as a starting point for the valuation of publicly traded companies, more than merger price, represents a market valuation for the company that meets the goals of providing a liquidity backstop for target shareholders while not including any element of value arising from the transaction as required by statute.<sup>244</sup> As always, shareholders remain free to accept merger consideration rather than the

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242. By their nature, short form mergers are inherently unfair; consequently it is appropriate that shareholders receive access to an appraisal remedy. *See* *Glassman v. Unocal Expl. Corp.*, 777 A.2d 242, 247 (Del. 2001).

243. *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, C.A. No. 11448-VCL, 2018 WL 922139, at \*24 (Del. Ch. Feb. 15, 2018) (finding the unaffected stock price as best indicator of fair value where the sales transaction did not show indicia of being robust). On appeal, the Delaware Supreme Court held that the trial court's determination was unsupported by the trial record. Notwithstanding the court's holding in this case, future litigants could still demonstrate at a future proceeding in the record that unaffected stock price is the appropriate measure of fair value. *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, 210 A.3d 128, 140–42 (Del. 2019). In a subsequent case, *In re Appraisal of Jarden Corp.*, defendants entered into the record evidence of unaffected stock price and Vice Chancellor Slight then relied on unaffected market price in determining fair value. C.A. No. 12456-VCS, 2019 WL 3244085, at \*4 (Del. Ch. July 19, 2019).

244. Where the market for a company's stock is efficient, the stock price reflects the present value of streams of future income. *See* RICHARD A. BREALEY & STEWART C. MYERS, *PRINCIPLES OF CORPORATE FINANCE* 63–65 (6th ed. 2000). So, in liquid market where information is readily available, the unaffected stock price should be the best reflection of the value of the business, excluding any speculative elements of value attributable to a proposed merger. *Id.*

statutory fair value. Provided it is higher than the unaffected stock price, rational shareholders will do so. This result is consistent with one of the purposes of the appraisal remedy. Appraisal is not intended to replace the obligations of a board seeking to fulfill its obligations under *Revlon*, rather it plays an important function in deterring opportunistic behavior by majorities and nothing more.

Rather than rely on a “deal price minus synergies” approach, unaffected stock price appears to be an easier and more sensible starting point for most valuation exercises that remains aligned with the ECMH.<sup>245</sup> The use of unaffected stock price of the target as an indicator of fair value also does not represent a departure from current or past valuation practices. It received favorable notice in *DFC Global Holdings*: “[W]here there is a free and active market, averaging of market prices on the last trading day before the announcement of a merger will reflect the fair market price.”<sup>246</sup> Indeed,

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245. In *Verition Partners Master Fund, V.C.* Laster declined to rely on a “deal price minus synergies” approach for the following reasons:

First, my deal-price-less-synergies figure is likely tainted by human error. Estimating synergies requires exercises of human judgment analogous to those involved in crafting a discounted cash flow valuation. The Delaware Supreme Court’s preference for market indications over discounted cash flow valuations counsels in favor of preferring market indications over the similarly judgment-laden exercise of backing out synergies.

Second, my deal-price-less-synergies figure continues to incorporate an element of value derived from the merger itself: the value that the acquirer creates by reducing agency costs. A buyer’s willingness to pay a premium over the market price of a widely held firm reflects not only the value of anticipated synergies but also the value created by reducing agency costs. The petitioners are not entitled to share in either element of value, because both arise from the accomplishment or expectation of the merger. The synergy deduction compensates for the one element of value arising from the merger, but a further downward adjustment would be necessary to address the other.

Fortunately for a trial judge, once Delaware law has embraced a traditional formulation of the efficient capital markets hypothesis, the unaffected market price provides a direct route to the same endpoint, at least for a company that is widely traded and lacks a controlling stockholder. Adjusting down from the deal price reaches, indirectly, the result that the market price already provides.

2018 WL 922139, at \*2–4 (footnotes omitted) (internal quotations omitted). *See also Jarden*, 2019 WL 3244085, at \*27 (noting “[w]hen the market is efficient, the trading price of a company’s stock can be a proxy for fair value”).

246. *DFC Global Corp. v. Muirfield Value Partners*, 172 A.3d 346, 365 (Del. 2017). “When, as here, the company had no conflicts related to the transaction, a deep base of public shareholders, and highly active trading, the price at which its shares trade is informative of fair value, as that value reflects

unaffected market price as the best and most reliable indicator of “fair value” is a return to the roots of appraisal before the recent attentions given to it by the financial industry, so hardly a radical move.<sup>247</sup> As a rule, then, a finder of fact in an appraisal proceeding should start from the unaffected stock price for fair value determinations, rather than merger price. Where a finder of fact wishes to deviate from the unaffected stock market price, then the finder of fact should justify that decision.

### C. Challenges of the Controlled Corporation

Of course, deploying either of the changes recommended above is not without their respective challenges. However, such challenges are likely to be limited to threshold questions and well within the competence of courts. First and foremost, private companies will neither have the benefit of merger price nor unaffected stock price for purposes of valuation. For dissident shareholders in such corporations, courts will continue to rely on the traditional valuation methods of which they are accustomed, including DCF.

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the judgments of many stockholders about the company’s future prospects, based on public filings, industry information, and research conducted by equity analysts.” *Id.* at 373.

247. Prof. Manning noted that prior to the adoption of the modern corporate law in 1967, unaffected market price was usually the default position for courts determining value for shareholders seeking an appraisal. Bayless Manning, *The Shareholder’s Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 231–32 (1962).

To the shareholder who objects to a transaction covered by the appraisal statute and who pursues his claim with procedural precision, the statute promises payment of the “value” of his shares. In recognition that this standard is hardly self-executing in its clarity, some of the statutes refine it a bit by, for example, specifying the time at which the stock is to be valued, or making it clear that the deciding authority is to exclude changes in “value” attributable to the transaction the shareholder finds offensive. If the shareholder objects to a merger between corporations A and B, and his stock in corporation A plummets as a result of the announcement of the merger, he is entitled to a valuation that disregards the sudden drop. . . .

Their way so lighted, the courts have done their best to find, or assign, a “value” to dissenters’ stock. Where the corporation is listed on an exchange or where its shares are actively traded over the counter, the problem has proved manageable. The courts have virtually refused to go beyond an inquiry as to the market price on the date determined to be relevant.

*Id.* (citing *In re Marcus*, 79 N.Y.S.2d 76 (App. Div. 1948); *Application of Behrens*, 61 N.Y.S.2d 179 (Spec. Term 1946), *aff’d*, 69 N.Y.S.2d 910 (App. Div. 1947); *In re Silverman*, 122 N.Y.S.2d 312 (App. Div. 1953); *Dynamics Corp. of Am. v. Abraham & Co.*, 166 N.Y.S.2d 128 (Spec. Term 1956); Comment, *Valuation of Dissenting Minorities’ Shares Under Section 21 of the New York Stock Corporation Law*, 17 FORDHAM L. REV. 259 (1948)).

With respect to public corporations, dissident shareholders will likely litigate a number of threshold questions like whether a particular publicly traded corporation is a “controlled” corporation and thus eligible for appraisal. To the extent a corporation is controlled, the unaffected stock price is not likely to be a faithful indicator of fair value as the stock price incorporates a minority discount. As with private companies, where a court encounters a controlled corporation, it should deploy traditional metrics to determine fair value rather than merger price or unaffected stock price. With respect to the threshold question of whether a corporation is controlled or not, this question is easily managed in the context of appraisal. To the extent there is a question of the controlled nature the corporation, there will likely be ongoing fiduciary duty litigation accompanying the transaction.<sup>248</sup> In which case, the question will be resolved for purposes of any subsequent appraisal action. In the event there is no fiduciary duty litigation, the courts already have well-tested standards for determining whether a shareholder is a controller and can readily deploy those standards.<sup>249</sup>

A second potential threshold challenge will likely focus on market liquidity of the corporation’s unaffected stock price—whether the market is sufficiently efficient as to reflect an efficient price. Stock price efficiency is an area that is well-trod by securities litigators and is already regularly featured in current appraisal litigation. Where a court determines the pre-merger market for the company’s stock was reasonably efficient, then the unaffected stock price is a good proxy for valuation. Absent a reasonably efficient market, courts can, and should, rely on more traditional measures of valuation.

## VII. CONCLUSION

Recent moves by courts to lean more heavily on the merger price in determining fair value are misguided. While one may be sympathetic to the motivations of courts to reduce incentives for professional investors to, in the perception of some, abuse the appraisal remedy, doing so in a manner that is inconsistent with the statute and in a manner that raises serious questions about the sustainability of Delaware’s common law with respect to fiduciary duties is misguided. Indeed, because reliance on merger price is tied to a pristine deal process, when the court moves in this direction, it opens up new avenues for

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248. Fiduciary duty litigation accompanying freeze-out transactions is common. *See, e.g.*, Kahn v. M & F Worldwide Corp., 88 A.3d 635, 639 (Del. 2014).

249. *See, e.g.*, *In re Tesla Motors, Inc. Stockholder Litig.*, C.A. No. 12711-VCS, 2018 WL 1560293, at \*17 (Del. Ch. Mar. 28, 2018).

litigation and threatens to impose a backdoor check-the-box corporate governance in the sales context, something that the courts have until now been loath to do directly. Rather than do that, appraisal should be reformed to reduce its availability in a manner more consistent with its original purpose.