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Thomas J. Meriam

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Protecting the Social Utility of Appraisal Arbitrage

A CASE FOR AMENDING DELAWARE LAW TO STRENGTHEN THE APPRAISAL REMEDY AFTER *DELL*

INTRODUCTION

The landscape of M&A litigation in Delaware has undergone a substantial transformation within the last decade.[1] Almost every transaction involving the acquisition of a publicly traded company has attracted stockholder litigation.[2] To challenge the fairness of a merger, minority stockholders of the acquired company have primarily two means of recourse: (1) commence an action alleging that there has been some breach of fiduciary duty that resulted in a lower than expected deal price; or (2) petition the court for an appraisal of a judicially determined "fair value" of the stockholder's stock.[3] Although the vast majority of merger litigation is based on breach of fiduciary duty claims, the sudden rise in the number of appraisal lawsuits has perhaps made the role of the appraisal remedy the most divisive and contentiously debated issue in Delaware corporate law.[4]

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[1] *See generally* Matthew D. Cain et al., *The Shifting Tides of Merger Litigation*, 71 VAND. L. REV. 603 (2018) (analyzing the recent trends of merger related litigation in Delaware).

[2] *Id.* at 610 ("Virtually all deals are challenged through litigation—with the rate of such challenges in deals over $100 million hovering between 94% and 96%.").

[3] *See* Matt Levine, *Appraisal Arbitrage Is in Trouble*, BLOOMBERG (Feb. 22, 2018, 10:01 AM), https://www.bloomberg.com/view/articles/2018-02-22/appraisal-arbitrage-is-in-trouble [https://perma.cc/79H2-G3MC].

[4] *See* Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 WASH. U. L. REV. 1551, 1570 (2015) [hereinafter Korsmo & Myers, *Appraisal Arbitrage*] (finding that "[a]pproximately five percent of appraisal-eligible transactions attracted at least one appraisal petition from 2004 through 2010[,] [t]he appraisal rate more than doubled in 2011 and has continued to increase since then[,] [and] [b]y 2013, more than fifteen percent of transactions attracted an appraisal petition"); *see also* Malaina J. Weldy, Note, *Appraisal Arbitrage: In Case of Emergency, Break Glass*, 93 NOTRE DAME L. REV. 2191, 2192 (2018).

In a typical transaction, where stockholders of the target company will receive non-stock consideration,[5] the target will announce the proposed merger and set a record date[6] for a stockholder meeting to vote on the deal.[7] Stockholders who own stock as of the record date and do not vote in favor of or consent to the merger are entitled under Delaware law to assert appraisal rights.[8] Until recently, the right of appraisal was seldom utilized;[9] however, the remedy has undergone a modern revival as hedge funds and activist stockholders have begun using appraisal litigation as a short-term investment strategy, commonly referred to as "appraisal arbitrage."[10]

In the case of appraisal arbitrage, an arbitrageur's strategy entails purchasing the shares of the target company upon the announcement of a merger (and before the record date), and evaluating that company's proxy materials to determine the adequacy of the deal price.[11] If the arbitrageur determines that the deal price is insufficient, or even equivalent to fair value,[12] it can advance its economic returns by accumulating more shares before the closing date for its petition for appraisal.[13] Alternatively, should the arbitrageur conclude that the deal price reflects a premium above fair value, it can then vote in favor of the merger and reap the benefits from the deal consideration itself.[14] While arbitrageurs may be the sole pecuniary beneficiaries *ex post* in an appraisal proceeding, a meaningful threat of appraisal litigation benefits all stockholders *ex ante* by establishing a minimum reserve price at which a company may be sold.[15]

Although the prevalence of merger litigation remains extraordinarily high at a national level—approximately 86

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[5] Non-stock consideration is any form of consideration other than stock in the surviving or resulting corporation, which would include consideration that is a combination of both stock and cash. DEL. CODE ANN. tit. 8, § 262(b)(2) (2018).

[6] A corporation's board of directors will set a record date to determine which stockholders (those owning stock as of the record date) are entitled to vote in regard to a corporate action requiring stockholder approval. DEL. CODE ANN. tit. 8, § 213(b).

[7] Craig Boyd, Comment, *Appraisal Arbitrage: Closing the Floodgates on Hedge Funds and Activist Stockholders*, 65 U. KAN. L. REV. 497, 504 (2016).

[8] DEL. CODE ANN. tit. 8, § 262(a); *see also* Boyd, *supra* note 7, at 504.

[9] *See* Weldy, *supra* note 4, at 2191 ("For most of its history, academics considered the statutory right to appraisal a sleepy, burdensome remedy with little to no economic value.").

[10] Boyd, *supra* note 7, at 498.

[11] *Id.* at 506.

[12] A judicial determination that the fair value of the target's shares is equivalent to the deal price would still result in a profit for arbitrageurs because of the award of statutory interest. *Id.* at 509.

[13] *Id.* at 506–07.

[14] *See id.*

[15] FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 145 (1991).

percent of all completed deals face legal challenges[16]—the Delaware courts and legislature have made a concerted effort to curb this flood of litigation and, at least to the extent of limiting the number of actions actually filed in Delaware state courts, have been largely successful.[17] With "half of . . . publicly-traded corporations in the United States and 66% of Fortune 500 corporations . . . incorporated in Delaware," Delaware has a vested interest in maintaining its position as the preeminent destination for business incorporation.[18] In order to remain competitive with other states, Delaware has been willing to afford corporations additional protections to deter frivolous litigation.[19] These protections, however, come at the expense of limiting stockholders' rights.[20]

Consistent with this trend, the Supreme Court of Delaware, in *Dell, Inc. v. Magnetar Global Event Driven Mast Fund Ltd.*, reversed the Court of Chancery's award to petitioners of fair value reflecting a 30 percent premium above the merger consideration.[21] Emphasizing the importance of market-based evidence,[22] the court held that a deal price that is the result of an arm's length negotiation, coupled with an informed and

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[16] An empirical study showed that between 2009-2017, approximately 86% of completed deals on average were challenged by litigation, with a low of 73% of deals in 2016 and a peak of 96% in 2013. Cain et al., *supra* note 1, at 620–21. During this same period, an average of approximately 44% of these actions were filed in Delaware, with a low of 9% in 2017 and a peak of 60% in 2015. *Id.*

[17] *See id.* at 630–31 (explaining that plaintiffs have been responsive to changes in Delaware law and have pursued out-of-state or federal court jurisdiction litigation and have adopted new litigation strategies in an attempt to avoid the effects of recent rulings).

[18] *See* Matthew Evans Miehl, Note, *The Cost of Appraisal Rights: How to Restore Certainty in Delaware Mergers*, 52 GA. L. REV. 651, 654 (2018).

[19] *Cf.* DEL. COUNCIL OF CORP. LAW, SECTION 262 APPRAISAL AMENDMENTS 2 (2015), https://www.appraisalrightslitigation.com/files/2015/03/DGCL-262-Proposal-3-6-15-Explanatory-Paper-1.pdf [https://perma.cc/2LWY-XHET] ("Studies of appraisal arbitrage do not suggest it encourages frivolous litigation. Unlike the case of representative litigation, which occurs in more than 90% of the public mergers and consolidations, only 17% of the appraisal eligible transactions during 2013 resulted in appraisal litigation in Delaware.").

[20] *See* Cain et al., *supra* note 1, at 637–39. A total depletion of viable stockholder remedies, however, has a deleterious effect on countervailing public policy goals. *See* Matthew Schoenfeld, *From* Corwin *to* Dell*: The Cost of Turning a Blind Eye* 1 (Feb. 12, 2018), https://ssrn.com/abstract=3122511 [https://perma.cc/2Q6R-DLZE]. For example, the weakening of stockholder defenses leads to: (1) "lower deal premi[ums]"; (2) "higher agency costs"; (3) "faster CEO pay growth"; and (4) "higher industry-specific measures of concertation." *Id.* Taken together, research shows that these factors lead to "lower levels of labor market mobility, wage stagnation, and increasing inequality in the United States." *Id.* at 1–2.

[21] *See* Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1, 5, 23 (Del. 2017).

[22] Theodore N. Mirvis & William Savitt, Wachtell, Lipton, Rosen & Katz, *Delaware Supreme Court Again Speaks to Market Evidence in Appraisal:* Dell (2017), https://corpgov.law.harvard.edu/2017/12/16/delaware-supreme-court-again-speaks-to-market-evidence-in-appraisal-dell/ [https://perma.cc/LQ47-H27C].

competitive market valuation, must be given significant, if not dispositive, weight in determining fair value.[23]

The underlying principles of the court's decision are sound and, in theory, level the playing field of appraisal litigation. Where there has been a robust sales process resulting in a real-world market check of the fair value of a company, judges should defer to that real-world evidence rather than rely on the theoretical projections of fair value given by expert witnesses whose beliefs are shaped by the counsel that pay them.[24] The problem, however, is that the *Dell* trial court's finding of fact regarding the sufficiency of the deal process did not support deal price deference.[25] By ignoring the trial court's factual findings, the court, in all but name, adopted a merger price deference rule and effectively limited claims ripe for appraisal to those involving breaches of fiduciary duty.[26] Even more problematic, inconsistent application of *Dell* by the lower courts has resulted in a level of uncertainty that can be considered no less than a crushing blow to appraisal arbitrage practitioners,[27] which will ultimately have a derivative impact on stockholders who stood to benefit from the activity of such arbitrageurs.[28]

There is a dire need for the liberalization and resuscitation of the appraisal remedy to restore balance to appraisal litigation in Delaware in the aftermath of *Dell*. First, acquirers should have to earn the right to receive deal price deference by proving that the sale process was sufficiently robust so as to serve as a reliable tool for price discovery.[29] Second, the weight a deal price receives in a fair value

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[23] *See Dell*, 177 A.3d at 23.

[24] *See* Sam Glasscock III, *Ruminations on Appraisal*, DEL. LAW., Summer 2017, at 8, 10–11, 29 n.12 (2017) (discussing reasons for being apprehensive of a policy that allows the judiciary to make an independent fair value determination in the context of a "clean" merger, but not classifying what exactly constitutes a "clean" merger).

[25] Guhan Subramanian, *Appraisal After* Dell, *in* THE CORPORATE CONTRACT IN CHANGING TIMES: IS THE LAW KEEPING UP 222, 238 (2019) (arguing the lower court awarded the deal process "a B+" and the Delaware Supreme Court "engaged in a *de novo* review of the Chancery Court's key factual determinations to award an A Grade").

[26] *Id.*

[27] *See* Allison Frankel, *Has Appraisal Litigation Gone from Can't Lose to No-Win for Stockholders?*, REUTERS (Mar. 12, 2018), https://www.reuters.com/article/legal-us-otc-appraisal/has-appraisal-litigation-gone-from-cant-lose-to-no-win-for-shareholders-idUSKCN1GD6A6 [https://perma.cc/URM4-YP3H] ("The arbitrageurs who founded hedge funds to bring appraisal actions are too smart to throw their money away on doomed litigation. For good or ill . . . the appraisal boom will be busted by the end of this year.").

[28] Schoenfeld, *supra* note 20, at 5–6.

[29] *See* Subramanian, *supra* note 25, at 235–38. A well-structured and executed auction with multiple independent and viable bidders would likely satisfy this burden, whereas a transaction involving a single bidder, or one where an insider bidder unduly controls or influences the process, would face a heavier burden of proving that the deal price reflects a genuine arm's length transaction. *See* discussion *infra* Section V.A (describing criteria for sufficiently robust sales process).

determination should be binary: if the deal process was a probative price discovery tool, it should be afforded 100 percent weight; if not, it should not be afforded any weight.[30] Third, because society benefits from litigating claims with merit,[31] we should encourage arbitrageurs to challenge ostensibly conflicted transactions regardless of whether the acquirer in the transaction is a financial or strategic buyer. Many strategic transactions, however, incorporate anticipated synergies—value that will be created through the combining of the two entities[32]—in the deal price.[33] As written, Delaware law allows the buyer to absorb 100 percent of those synergies because the fair value determination excludes "any element of value arising from the accomplishment or expectation of the merger."[34] Evidenced by recent rulings, a merger price including synergies, whether or not the result of a robust sale process, will likely result in a fair value determination substantially below the deal price.[35] The Delaware General Corporation Law's (DGCL) treatment of synergistic value ignores the reality that the target company is responsible for creating a portion of that value.[36] If the target firm is "responsible for the creation of a synergistic gain . . . [,] the gain was an opportunity belonging to the target and, thus, part of its going concern value."[37] Once a minority stockholder is effectively forced to liquidate their investment in a cash-out merger, it is inherently unfair to exclude synergistic gain that is

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[30] Subramanian, *supra* note 25, at 235.

[31] *See* Rebekah Briggs, Comment, *Private Ordering in the Old Dominion: A Solution to Frivolous Litigation or the Elimination of a Fundamental Shareholder Right?*, 53 U. RICH. L. REV. 297, 299 (2018) (explaining that encouraging meritorious litigation provides a social benefit because it allows a court to promulgate standards of best conduct); *see also* Weldy, *supra* note 4, at 2215.

[32] *See* Aswath Damodaran, The Value of Synergy 3 (Oct. 2005) (unpublished manuscript) (on file with New York University Stern School of Business) ("Synergy is the additional value that is generated by combining two firms, creating opportunities that would not been available to [the] firms operating independently."). There are two categories of synergistic value: (1) operating synergies (value created by growth in economies of scale); and (2) financial synergies (value created by cutting down costs). *See id.* at 3–5. Cost synergies are generally not unique to the specific combination of parties in a transaction and are gains that could be achieved through any other merger. *See id.* at 36.

[33] *See* Ankur Agrawal et al., *Making M&A Deal Synergies Count*, MCKINSEY & CO. (Oct. 2017), https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/making-m-and-a-deal-synergies-count [https://perma.cc/P27K-YDE2].

[34] DEL. CODE ANN. tit. 8, § 262(h).

[35] *See, e.g.*, *In re* Appraisal of AOL, Inc., No. 11204, 2018 WL 1037450, at *21 (Del. Ch. Feb. 23, 2018) (determining fair value of AOL stock at $48.70 per share), *modified by* No. 11204, 2018 WL 3913775, at *5 (Del. Ch. Aug. 15, 2018) (readjusting fair value downwards to $47.08 per share).

[36] Lawrence A. Hamermesh & Michael L. Wachter, *Finding the Right Balance in Appraisal Litigation: Deal Price, Deal Process, and Synergies*, 73 BUS. LAW. 961, 1003 (2018) (explaining some scholars "advance the view that synergistic merger gains almost exclusively benefit target stockholders, and acquiring firms retain none of those gains").

[37] *Id.* at 1004.

not unique to the subject transaction as a component of going concern value,[38] especially since such exclusion penalizes those who dare to assert appraisal rights.[39]

This note argues that appraisal arbitrage faces an existential crisis in a post-*Dell* world and that legislative reform is needed to balance the scale of appraisal litigation. Part I provides an overview of the appraisal remedy. Part II explores the rise of appraisal arbitrage and the corporate world's response, as well as its efficacy as a mechanism for corporate governance. Part III provides an in-depth analysis of the *Dell* decision. Part IV provides a survey of *Dell*'s progeny and the widely inconsistent results *Dell* has yielded in the Court of Chancery, as the vice chancellors grapple with the arduous task of applying a seemingly unworkable framework, to illustrate the drastic uncertainty surrounding appraisal litigation in Delaware. Finally, Part V proposes that the Delaware legislature amend section 262 of the DGCL to: (1) codify a clearer standard for when deal price should take precedence; and (2) grant the court equitable discretion, depending on the factual circumstances of the case, to include in its fair value determination certain elements of value arising from the accomplishment of the merger.

I. OVERVIEW OF THE APPRAISAL REMEDY

Section I.A discusses the legislative origins of Delaware's appraisal statute, the relief it intended to provide stockholders, and how the role of the appraisal remedy has transformed over time. It also discusses the legislative prescriptions on how courts should determine fair value in an appraisal proceeding. Section I.B explains what types of transactions are eligible for appraisal and the procedural requirements a stockholder must satisfy before asserting a claim. Section I.C discusses the methods courts have used to determine fair value at trial.

A. Legislative Origins and Development

Although the rise of appraisal litigation is a recent phenomenon, the statutory remedy of appraisal was initially

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[38] *See* Ann M. Lipton, *Shareholder Divorce Court*, 44 J. CORP. L. 297, 339–40 (2018) (arguing that the concept of fair value should be extended to include "merger-related gains that would ordinarily be shared with a target firm" that would be generated by any bidder).

[39] *See* Barry M. Wertheimer, *The Stockholders' Appraisal Remedy and How Courts Determine Fair Value*, 47 DUKE L.J. 613, 702 (1998).

enacted in Delaware during the late 1890s.[40] Prior to the modern corporate regime, in which corporations operate as democratic organizations controlled by majority rule, corporate statutes generally required that any fundamental change to the business be approved by the unanimous consent of its stockholders.[41] Because of the inherent impracticalities of such a system, state legislatures eventually moved toward a majority-voting rule and created appraisal rights to "afford[] minority [stock]holders . . . the opportunity to exit from the enterprise on terms set by a judge instead of majority [stock]holders."[42] The original legislative intent recognized that, without an option for liquidity—due to the lack of widely traded public exchanges at the time—stockholders would have lost alienability of their ownership interest in a business that was fundamentally different from the business originally invested in.[43]

In its current form, section 262 of the DGCL provides a statutory right that "[a]ny stockholder of a corporation of [Delaware] . . . who has neither voted in favor of [a] merger or consolidation nor consented thereto . . . shall be entitled to an appraisal by the Court of Chancery of the fair value of the stockholder's shares of stock."[44] The statute further provides 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 . . . . [and] shall take into account all relevant factors."[45] In addition, the final determination of fair value is accreted by accrued interest at the rate of 5 percent over the Federal Reserve Discount Rate[46] measured "from the effective date of the merger through the date of payment of the judgment."[47] As a whole, the statute is designed to provide a remedy for minority stockholders where the consideration for a proposed transaction is less than the fair value of the target company's shares as a standalone entity.

At a time when cash-out mergers were non-existent, Delaware's legislature devised the concept of excluding the value

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[40] Charlotte K. Newell, *The Legislative Origins of Today's Appraisal Debate: A Look Back at the Evolution of the DGCL and the Origins of the Explosive Rise in "Appraisal Arbitrage" Filings*, DEL. LAW., Summer 2017, at 12, 12–13.

[41] *See* Wertheimer, *supra* note 39, at 618–19.

[42] Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 4, at 1558–59.

[43] Robert B. Thompson, *Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law*, 84 GEO. L.J. 1, 4 (1995).

[44] DEL. CODE ANN. tit. 8, § 262(a).

[45] *Id.* § 262(h).

[46] The Federal Discount Rate is the interest rate that the U.S. Central Bank charges commercial lending institutions. *The Discount Rate*, FED. RES. BOARD, https://www.federalreserve.gov/monetarypolicy/discountrate.htm [https://perma.cc/JAE4-TXQH].

[47] DEL. CODE ANN. tit. 8, § 262(h).

arising out of a merger, but it has nonetheless remained a staple of Delaware's appraisal statute.[48] Excluding any appreciation or depreciation resulting from a fundamental corporate change makes sense when a stockholder in a stock-for-stock merger is presented with the opportunity to continue in a surviving corporation but affirmatively chooses to exit.[49] After all, the stockholder has acted on its own volition to decide that it would rather be compensated fair value of its original investment than dragged along in the new venture. Arguably, this rationale would also extend to circumstances in which a stockholder receives a significant portion of stock in a transaction consisting of a combination of stock and non-stock consideration, since the stockholder would still retain an interest in the surviving corporation. In contrast, a minority stockholder, who on terms unilaterally set by management and approved by a majority of stockholders, is forcefully divested of its ownership interest and precluded from participating in the surviving enterprise, is fundamentally different than a stockholder that is stuck in an illiquid investment looking for an escape-hatch.[50] A minority stockholder, who has been eliminated without choice, should not be unduly punished for exercising their statutory right to seek a judicially determined appraisal and receive below the merger consideration where the court has found that deal price is the best of evidence of fair value.[51]

B. Transactional Requirements and Procedure for Perfecting Appraisal Rights

1. Triggering Events

In Delaware, appraisal rights are only available in certain types of transactions.[52] Section 262(b) of Delaware General Corporation Law prescribes a "market-out exception,"[53] which denies appraisal rights for stockholders of publicly traded companies if the transaction is an all-stock deal.[54] The reasoning behind a market-out exception for widely traded companies is that

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48 *See* Wertheimer, *supra* note 39, at 660.

49 *Id.*

50 *Id.*

51 *See id.*

52 *See* DEL. CODE ANN. tit. 8, § 262(b).

53 Delaware was the first state to enact the "market-out" exception, and a majority of states have followed suit and amended their own appraisal statutes. Stanley Onyeador, Note, *The Chancery Bank of Delaware: Appraisal Arbitrageurs Expose Need to Further Reform Defective Appraisal Statute*, 70 VAND. L. REV. 339, 359 (2017).

54 Boyd, *supra* note 7, at 502.

dissenters can easily liquidate their shares on a public exchange should they wish to divest ownership in the surviving company.[55] Public stockholders of a target company, however, retain their right to seek appraisal if the consideration provided includes any cash, other than compensation for fractional shares.[56]

Though some commentators have criticized this cash carve-out,[57] this exception to the exception makes sense when viewed in the context of the appraisal remedy's legislative history. When legislatures first contemplated appraisal, their purpose was to provide liquidity to stockholders who did not want to continue in a fundamentally changed business from the one originally invested in when there was no market available to relinquish their shares.[58] Today, acquisitions of publicly traded companies are generally structured using a "reverse triangular merger"[59] or a "two-step merger"[60] in which the target becomes a wholly owned subsidiary of the acquirer.[61] Because all-stock transactions are becoming increasingly rare and a majority of deals are financed either wholly or in part with cash,[62] target

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[55] Onyeador, *supra* note 53, at 360–61. *But see* Daniel R. Fischel, *The Appraisal Remedy in Corporate Law*, 8 AM. B. FOUND. RES. J. 875, 885 (1983) (arguing that the "stock market exception . . . is inconsistent with the purpose of appraisal—establishing a reservation price" at which a firm may be sold).

[56] Onyeador, *supra* note 53, at 360. Fractional shares are shares that are "[l]ess than one full share of equity" and are often created in a merger where stock is a form of consideration and the new shares are converted at a predetermined ratio; since they are difficult to market, they are often compensated for in cash. *Fractional Share*, INVESTOPEDIA (Jan. 29, 2020), https://www.investopedia.com/terms/f/fractionalshare.asp [https://perma.cc/2Z56-KAZX].

[57] Onyeador, *supra* note 53, at 361 (arguing that because the Semi-Strong Efficient Capital Market Hypothesis accurately values dissenting shares and a public exchange "denominated in cash currency . . . should be deemed *more* accurate where cash consideration is included," a dissenting stockholder can readily cash-out at a premium before closing). *But see* Fischel, *supra* note 55, at 885 (arguing against a "market-out exception" in general and noting that at least the "cash carve-out" recognizes that a cash-out situation presents the greatest risk of wealth appropriation from minority stockholders by reinstating the availability of appraisal).

[58] Thompson, *supra* note 43, at 3–4.

[59] In a "reverse triangular merger," the acquirer forms a wholly owned subsidiary, called the "acquisition corporation," which merges into the target. LATHAM & WATKINS LLP, GUIDE TO ACQUIRING A U.S. PUBLIC COMPANY 3 (2015). The target's stockholders then receive the agreed upon consideration and the target becomes a wholly owned subsidiary of the acquirer. *Id.* Thus, target stockholders will only be completely eliminated from the surviving enterprise in an all-cash transaction.

[60] In a "two-step" merger, the acquirer's first step is to make an initial tender offer to public stockholders of the target company and commence a statutory merger. *Id.* at 7. The second step is to obtain the untendered shares to squeeze out remaining stockholders, thus ultimately making the target a wholly owned subsidiary of the acquirer. *Id.* at 7–8.

[61] *See id.* at 7.

[62] *See* Sujeet Indap & James Fontanella-Khan, *Companies Shunned All-Stock Mergers in 2017*, FIN. TIMES (Dec. 7, 2017), https://www.ft.com/content/a1e52920-cb07-11e7-aa33-c63fdc9b8c6c [https://perma.cc/T7R8-FJTA] (explaining, consistent with a declining trend, that all-stock transactions accounted for just 11.4 percent of all M&A deals in 2017).

stockholders are forcefully divested of their ownership interests, on terms set unilaterally by management and approved by the majority, and, in an all-cash deal, denied the opportunity to participate in the surviving company.[63]

2. Perfecting Standing

The appraisal remedy's onerous procedural requirements are perhaps the primary reason appraisal claims were rarely pursued historically.[64] The statutory guarantee of appraisal does not automatically vest upon the incidence of a triggering event; the stockholder must affirmatively meet all the procedural hurdles to perfect standing to assert the claim.[65] Section 262 prescribes that a stockholder must: (1) in advance of the stockholder vote, notify the corporation of the stockholder's intent to demand appraisal; (2) either abstain or vote against the merger; (3) retain ownership of stock through the closing date; (4) forbear receipt of the merger consideration; and (5) file an appraisal petition within 120 days of closing.[66] Because each petitioner must individually perfect standing, "opting-in" prior to the stockholder vote and far in advance of the filing of the actual petition, the class action device favored in fiduciary litigation is all but unavailable in appraisal actions.[67] Once the petition is filed, the court may also hold a hearing to ensure that the petitioners have satisfied all procedural requirements before moving further, "leaving little room for any equitable considerations."[68]

In addition to these procedural hurdles, petitioners bear the full economic cost of the appraisal litigation out-of-pocket since they must decline the consideration for the merger.[69] Furthermore, in most circumstances, petitioners cannot seek attorney cost fee-shifting awards at the end of litigation.[70] Finally, there is always the possibility that the court determines

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[63] *See* Thompson, *supra* note 43, at 4.

[64] Weldy, *supra* note 4, at 2197.

[65] *See id.*

[66] Audra Boone et al., *Merger Negotiations in the Shadow of Judicial Appraisal*, 62 J.L. & ECON. 281, 286 (2019); *see also* DEL. CODE ANN. tit. 8, § 262(a), (d)–(e).

[67] Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 4, at 1562.

[68] Weldy, *supra* note 4, at 2197–99; *see also* Michael J. de la Merced, *Dell Buyout Deal Shortchanged Stockholders, Court Rules*, N.Y. TIMES (May 31, 2016), https://www.nytimes.com/2016/06/01/business/dealbook/dell-buyout-deal-shortchanged-stockholders-court-rules.html [https://perma.cc/Z65W-MAFB] (explaining that the mutual fund T. Rowe Price, which owned approximately twenty-seven million shares of Dell and vehemently opposed the leveraged buyout, was disqualified from seeking appraisal because it mistakenly voted in favor of the deal).

[69] *See* DEL. CODE ANN. tit. 8, § 262(d).

[70] *See id.* § 262(j); *see also* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 4, at 1562–63.

fair value of the target company to be below the deal price, resulting in further economic loss for plaintiffs.[71]

The cost, complexity, and collective action problems of seeking appraisal make fiduciary litigation much more appealing to stockholders.[72] In contrast to appraisal, fiduciary litigants proceed in a class action in which stockholders must "opt-out," can typically receive the merger consideration to finance the litigation, and face no real economic downside since there is no risk of an award less than the deal price.[73] Further, the remedies available for a breach of fiduciary duty can be more catastrophic than appraisal for a defendant and, consequently, the threat that a court may order an injunction or rescission of a suspect transaction increases fiduciary litigants' leverage in settlement discussions.[74] Due to the ubiquity of transactions susceptible to breach of fiduciary challenges, coupled with the minimal financial risk involved, strike suit attorneys are incentivized to pursue the nuisance value of such claims irrespective of the merits.[75]

C. Methods of Judicial Valuation in Appraisal Proceedings

In *Weinberger v. UOP, Inc.*, the Supreme Court of Delaware established the modern era of judicial valuation standards.[76] There, the court held that proof of fair value must be determined using "any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court."[77] These financial techniques include a "comparable company analysis, Discounted Cash Flow [DCF] modeling, and the merger price itself."[78] The most commonly employed method to calculate the "going concern

[71] Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 4, at 1561.
[72] *See id.* at 1560–61.
[73] *Id.*
[74] *Id.* at 1564.
[75] *See id.* at 1564–65.
[76] Weinberger v. UOP, Inc., 457 A.2d 701, 713 (Del. 1983). Historically, courts utilized the "Delaware Block Method" to arrive at a judicially determined fair value calculation. EASTERBROOK & FISCHEL, *supra* note 15, at 154. This method required an appraiser to compute "separate values for market, earnings, and net assets," of a company, assign each valuation a certain weight, and then add them together to arrive at fair value. *Id.* The Delaware Block method posed several complications and was eventually abandoned altogether. *Weinberger*, 457 A.2d at 712–13.
[77] *Weinberger*, 457 A.2d at 713.
[78] Weldy, *supra* note 4, at 2204.

value"[79] of a corporation is the DCF analysis.[80] The DCF methodology postulates that a firm's overall value is equivalent to its expected streams of future cash flows discounted to present value.[81] The methodology is comprised of "three basic components: (i) cash flow projections, (ii) terminal value, and (iii) discount rate."[82] The first component requires the expert to implement industry-specific methods to project future cash flows over a designated time period, typically five years.[83] Terminal value, the second component, accounts for the estimates of the present value of future cash flow after the specified projection period and into perpetuity.[84] Lastly, a discount rate, based on the firm's Weighted Average Cost of Capital (WACC),[85] is applied "to determine the present value of the annual cash flows for the projection period and the terminal value."[86] Due to the sensitivity of inputted values in a DCF analysis, opposing experts using the same methodology often reach widely divergent results.[87]

The main criticism against appraisal litigation is that a law-trained judge is given the arduous task of refereeing a proceeding that devolves into a battle of the experts, at the end of which, the judge must arrive at their own judicially determined valuation.[88] The Court of Chancery,[89] however, "given its diet of

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[79] Lawrence A. Hamermesh & Michael L. Wachter, *The Fair Value of Cornfields in Delaware Appraisal Law*, 31 J. CORP. L. 119, 137–38 (2005) (explaining that "going concern" value is the fundamental value of the business as currently operated, which should include the business's current cash flows and reinvestment opportunities).

[80] *See* R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 9.45[B][1] (3d ed. 2018).

[81] *Id.* Because of the existence of positive interest rates, there is a time-value component to money and, therefore, a designated amount of money is worth more now than in the future. WILLIAM A. KLEIN ET AL., BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES 322 (11th ed. 2010). Consequently, expected future cash flows must be discounted to reflect present value.

[82] BALOTTI & FINKELSTEIN, *supra* note 80, § 9.45[B][1].

[83] *Id.*

[84] *Id.*

[85] WACC is the firm's average cost of capital from selling either debt or equity. *See* KLEIN ET AL., *supra* note 81, at 336 ("The basic idea is that . . . the proper discount rate is the weighted average of the market-determined return or yield on the corporation's target mix of securities . . . ."). For an explanation on how a corporation's cost of debt and equity is calculated, see generally *id.* at 336–43.

[86] BALOTTI & FINKELSTEIN, *supra* note 80, § 9.45[B][1].

[87] *See* Onyeador, *supra* note 53, at 348.

[88] *See* Glasscock III, *supra* note 24, at 8, 10–11; *see also* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 4, at 1602–04 (arguing that the courts are well equipped to make valuation determinations); Weldy, *supra* note 4, at 2214 (agreeing with Korsmo and Myers' assessment, but also proposing a judicially appointed independent valuation expert in appraisal proceedings).

[89] Prior to 1943, the Court of Chancery was required to appoint independent expert appraisers for appraisal proceedings. *See* Gonsalves v. Straight Arrow Publishers, Inc., 701 A.2d 357, 360–61 (Del. 1997). In 1976, however, the Legislature concluded that the chancery was sophisticated enough to make the valuations itself and amended the statute to remove the appointment requirement in order to streamline the process;

corporate cases and its disinterested stance, is uniquely well-positioned to" carry out complex business valuations, and the DCF methodology "is a second-best method for estimating the value of a company" where an alleged market failure has occurred.[90] Moreover, the DCF methodology is not conducted in a vacuum, the market-based evidence presented at trial provides a "reality check on the ultimate output" of the financial model, and vice versa.[91]

Less controversial is the idea that the chancery is extremely well-equipped to determine the sufficiency of a sales process. To reiterate, courts do not go straight to a DCF analysis to make a fair value determination. Each case must be decided after review of its own unique facts given that "[e]very company is different; every merger is different,"[92] and the "[a]ppraisal [endeavor] is, by design, a flexible process."[93] Accordingly, each decision begins with a substantive review of the sales process to determine whether it revealed valuable price discovery information about the target firm.[94] Prior to *Dell*, former Chief Justice Strine, then as Vice Chancellor, held that "a negotiated price reflect[s] the fair value of a company when the 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.'"[95] In a subsequent opinion by then Vice Chancellor Strine, the Court of Chancery "denied a request to enjoin [a] transaction on fiduciary grounds [and] emphasized" that any "loss of dollar value . . . can be rectified adequately in a later appraisal proceeding"; thus recognizing that a sales process in which managers satisfied their fiduciary duties does not necessarily mean the resulting merger price is equivalent

though the chancery retains the inherent authority to appoint an independent appraiser if needed. *See id.*; *see also* Weldy, *supra* note 4, at 2214 (proposing reinstating a neutral independent expert in appraisal proceedings).

[90] Charles Korsmo & Minor Myers, *The Flawed Corporate Finance of* Dell *and* DFC Global, 68 EMORY L.J. 221, 274–78 (2018) [hereinafter Korsmo & Myers, *Flawed Corporate Finance*].

[91] *Id.*; *see also* discussion *infra* Section II.A (discussing survey evidence showing how close judicially calculated fair value determinations have been to transactions with a robust sales processes).

[92] *In re* Appraisal of Petsmart, No. 10782-VCS, 2017 WL 2303599, at *26 (Del. Ch. May 26, 2017).

[93] Golden Telecom, Inc. v. Glob. GT LP, 11 A.3d 214, 218 (Del. 2010).

[94] *See, e.g.*, *In re* Appraisal of Ancestery.com, Inc., No. 8713-VCG, 2015 WL 399726, at *3–8 (Del. Ch. Jan. 30, 2017); Merlin Partners v. AutoInfo, Inc., No. 8509-VCN, 2015 WL 2069417, at *1–6 (Del. Ch. Apr. 30, 2015); Huff Fund Inv. P'ship v. CKX, Inc., No. 6844-VCG, 2013 WL 5878807, at *3–7 (Del. Ch. Nov. 1, 2013).

[95] Korsmo & Myers, *Flawed Corporate Finance*, *supra* note 90, at 236 (quoting Union Ill. 1995 Inv. Ltd. P'ship v. Union Fin. Grp., Ltd., 847 A.2d 340, 358 (Del. Ch. 2004)); *see infra* note 275 (discussing Chief Justice Strine's role in reshaping appraisal jurisprudence in *Dell*).

to fair value.[96] Within this framework, the chancery deferred to deal price only after careful scrutiny of the relationship between the parties, the structure of the deal, whether there was an auction or negotiated sale, the number of bidders solicitated and information disseminated, and the use of deal protection devices.[97]

II. APPRAISAL ARBITRAGE

Section II.A discusses the emergence of appraisal arbitrage as an investment strategy and discusses its early successes. Section II.B discusses the backlash from the corporate world to the practice of appraisal arbitrage and explains why, so far, much of the criticism appears to be unfounded as evidence tends to show that appraisal arbitrage has produced an overall positive social impact. Section II.C compares appraisal litigation with fiduciary litigation and argues that appraisal arbitrage should replace fiduciary litigation as the primary deterrent and policing tool to challenge unfair transactions. Lastly, Section II.D discusses the legislature's 2016 amendments that recognized the social utility of appraisal litigation and took a measured approach to deter frivolous appraisal suits but also limit the remedy's availability to the sophisticated entities pursuing appraisal arbitrage.

A. *The Rise and Success of Appraisal Arbitrage*

Some scholars suggest that the appraisal arbitrage investment strategy was fortuitously stumbled upon in the mid-2000s.[98] In the 2007 decision in *In re Appraisal of Transkaryotic Therapies, Inc.*, Shire Pharmaceuticals (Shire) acquired Transkaryotic Therapies, Inc. (TKT) for $37 per share, representing a 44 percent premium over TKT's trading price.[99] The merger agreement was announced on April 21, 2005 and a record date was set for June 10, 2005.[100] On June 20, 2005, ten days after the record date, TKT announced "positive clinical trial results, and various hedge funds began amassing large amounts of stock with the

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[96] Korsmo & Myers, *Flawed Corporate Finance*, *supra* note 90, at 271 (internal quotation marks omitted) (quoting *In re* Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 979, 1023 (Del. Ch. 2005)).

[97] *See, e.g.*, *In re Ancestery.com*, 2015 WL 399726, at *16–17, *24; *AutoInfo, Inc.*, 2015 WL 2069417, at *11–14, *17–18; *CKX, Inc.*, 2013 WL 5878807, at *13–15.

[98] *See, e.g.*, Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 4, at 1582.

[99] *In re* Appraisal of Transkaryotic Therapies, Inc., No. 1554-CC, 2007 WL 1378345, at *1 (Del. Ch. May 2, 2007).

[100] *Id.*

intention of demanding appraisal."[101] At a July 27, 2005, stockholder meeting, the merger agreement was approved by 52 percent of TKT stockholders.[102] Dissenting stockholders subsequently brought an appraisal petition representing 10,972,650 shares, 8,071,217 of which were purchased after the record date.[103] TKT moved for summary judgment to disqualify petitioners' shares that were acquired after the record date because petitioners, as beneficial owners, could not prove how their shares had actually been voted.[104] The court held that beneficial owners of stock purchased after the record date did not need to prove that their shares had been voted a certain way in order to seek appraisal, so long as the total number of shares seeking appraisal is not greater than the number of shares that voted against the merger or abstained.[105] Depending on one's point of view, the court's holding either reaffirmed precedent or opened the flood gates to appraisal arbitrage.[106]

Professors Korsmo and Myers, the leading scholars on the rise of appraisal arbitrage, posit that *Transkaryotic*'s holding was of little consequence and that no single factor can be attributed to the rise of appraisal arbitrage.[107] Rather, they suggest that it is more likely that appraisal arbitrage as a viable investment strategy was accidentally stumbled upon because of the *Transkaryotic* transaction itself and the class of investors who had dissented from the merger.[108] Perhaps the most noteworthy aspect of *Transkaryotic* then, since it was never actually litigated to completion, was the terms of Shire's settlement with petitioners.[109] Following the June 10, 2005, announcement of clinical trial results, financial analysts began valuing TKT at $45 to $50.[110] When Shire disclosed the terms of its settlement for the

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[101] Charles R. Korsmo & Minor Myers, *Reforming Modern Appraisal Litigation*, 41 DEL. J. CORP. L. 279, 302–03 (2017) [hereinafter Korsmo & Myers, *Reforming Appraisal Litigation*].

[102] *In re Transkaryotic*, 2007 WL 1378345, at *1 (stating Cede & Co., the record holder of TKG stock, "voted 12,882,000 shares in favor of the merger, 9,888,663 shares against it, and abstained or did not vote 6,949,411 shares").

[103] *Id.*

[104] *Id.*

[105] *Id.* at *4–5.

[106] *Compare* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 4, at 1554 ("*Transkaryotic* expanded the time frame for purchasing appraisal-eligible stock in advance of a stockholder vote to approve a merger. But the judicial ruling itself likely contributed little, if at all, to the rise in appraisal arbitrage."), *with* Boyd, *supra* note 7, at 504 (arguing the *Transkaryotic* court's statutory interpretation of section 262 "opened the floodgate for hedge funds to take advantage of Delaware's appraisal statute").

[107] *See* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 4, at 1582.

[108] *Id.* ("Among the class of dissenting [stock]holders in *Transkaryotic* were some of the most sophisticated entities on Wall Street, including various Carl Icahn affiliates, SAC Capital Advisors, and Millennium Management.").

[109] Korsmo & Myers, *Reforming Appraisal Litigation*, *supra* note 101, at 305.

[110] *Id.* at 304.

appraisal claims, it asserted that it paid petitioners the same merger price ($37 per share) plus interest.[111] Korsmo and Myers note that, upon closer scrutiny of the settlement, Shire's so-called "interest" payment plus merger price equated to $50 per share, the top of the range at which analysts valued TKT after the June 10 announcement.[112] As they put it, "[t]his result—known to the many sophisticated entities that pursued appraisal rights in Transkaryotic—was no doubt a key reason the case generated interest in pursuing appraisal as an investment strategy."[113]

In the nascent stages of appraisal arbitrage, the pendulum swung heavily in favor of the arbitrageurs as they frequently obtained fair value determinations in excess of the merger consideration and faced virtually non-existent downside, leading to an explosion of appraisal petitions.[114] A survey of fifteen appraisal petitions that were litigated to a final decision by the trial courts between 2010 and 2016 is demonstrative of this winning-streak.[115] The survey looked at nine cases in which there was a disinterested buyer and, in all but one situation, a sufficient sales process.[116] The trial courts typically found a sufficient sales process had occurred where the transaction was between unaffiliated/disinterested parties, the seller conducted an auction, and the structures of the deal did not create barriers of entry to other potential bidders.[117] In four of these cases, the trial court awarded the deal price; and in three, the trial courts awarded premiums ranging from 3.5 to 15.6 percent.[118] In only two of the nine proceedings did petitioners receive a fair value determination below the merger consideration.[119] In the case with a less than adequate sale process, a significant reduction of 14.4 percent was the outcome, and in the other, a modest 1 percent reduction.[120] In contrast, in a second group comprising six cases, each of which had an interested buyer, and where, in all but one,[121] did not have an auction or a go-shop, readily seen

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[111] *Id.* at 305.

[112] *Id.*

[113] *Id.*

[114] *See* Frankel, *supra* note 27.

[115] *See* Christine Carroll & T.J. Hope, *Appraisals Gone Wild: Spotlight on Fair Value Appraisal Cases in Delaware*, STOUT (Sept. 1, 2016), https://www.stout.com/en/insights/article/appraisals-gone-wild-spotlight-fair-value-appraisal-cases-delaware/ [https://perma.cc/K3ZY-N696].

[116] *Id.*

[117] *See id.*

[118] *Id.*

[119] *Id.*

[120] *Id.*

[121] The outlier in the survey was *In re Appraisal of Dell, Inc.*, No. 9322, 2016 WL 3186538 (Del. Ch. May 31, 2016), *rev'd sub nom. Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd.*, 177 A.3d 1 (Del. 2017). Even though the trial court had found

as a weak deal process, the court awarded substantial premiums "that ranged from 19.5% to 148.8% . . . over the transaction price."[122] These findings show that the Court of Chancery was willing to disregard deal price as evidence of fair value in instances where there had been a sufficient sales process—and, hence, had a real-world market check on the company's worth—to arrive at its own judicially determined idea of fair value, however minimal the difference between its DCF analysis and the parties' negotiated deal price.[123]

B. Corporate Backlash Against Appraisal Arbitrage

The success of appraisal arbitrage has, unsurprisingly, drawn severe backlash from Delaware's most influential corporations and deal lawyers, as well as several academics and commenters.[124] The most common arguments propagated by critics are that: (1) appraisal arbitrage is hurting stockholders because the threat of appraisal litigation creates deal uncertainty; (2) appraisal arbitrage drives up transaction costs and incentivizes acquirers to hold back value in anticipation of appraisal suits;[125] and (3) the opportunistic behavior of hedge funds is morally reprehensible and has led to the perversion of the appraisal remedy.[126]

This criticism is overstated, however, and there is a growing consensus among academics that a healthy market of appraisal arbitrage serves a crucial social utility,[127] an

that the Dell board had satisfied its fiduciary duties in selling the company, it held that there were serious flaws in how the auction was structured and, therefore, the deal price was an unreliable proxy as to the fair value of the company. *See id.* at *38–40; discussion *infra* Section III.A.

[122] Carroll & Hope, *supra* note 115.

[123] *See id.*

[124] *See, e.g.*, Trevor S. Norwitz, *Delaware Legislature Should Act to Curb Appraisal Abuses*, COLUM. L. SCH. BLUE SKY BLOG (Feb. 10, 2015) (urging the Delaware General Assembly to take substantial legislative action to eliminate appraisal arbitrage), https://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.23846.15.pdf [https://perma.cc/27KR-CWTL]; Boyd, *supra* note 7, at 524 (same); *see also* Korsmo & Myers, *Reforming Appraisal Litigation*, *supra* note 101, at 284, 284 nn.12–13. *But see* Korsmo & Myers, *Flawed Corporate Finance*, *supra* note 90, at 225 ("The arguments against appraisal have largely been anecdotal or emotional in nature and have thus far been carried forward primarily by law students and prominent deal advisers." (footnote omitted)).

[125] *See* Korsmo & Myers, *Reforming Appraisal Litigation*, *supra* note 101, at 284.

[126] *See* Miehl, *supra* note 18, at 662–66.

[127] *See, e.g.*, Korsmo & Myers, *Flawed Corporate Finance*, *supra* note 90, at 277 (arguing that the practice of appraisal arbitrage is a powerful corporate governance tool); Hamermesh & Wachter, *supra* note 36, at 965–66 (arguing appraisal arbitrage provides a beneficial social utility because it makes the "appraisal remedy viable in the case of a public company" where public stockholders are widely dispersed); Lipton, *supra* note 38, at 334 ("The prevalence of appraisal arbitrage has led to recognition of a new purpose for appraisal: that of a disciplining force that deters unfaithful managers—beholden either to

observation that the Delaware legislature itself has acknowledged.[128] Evidence shows that a healthy market of appraisal arbitrage may serve as the most effective deterrent against corporate malfeasance and produces demonstrable benefits for minority stockholders.[129] Any acquirer uncertain as to whether it will face appraisal litigation can easily contract around such uncertainty with closing conditions that void a transaction should a certain percentage of stockholders demand appraisal.[130] Moreover, the proposition that acquirers may hold back value in anticipation of having to pay an "appraisal tax" fails to recognize the reality that acquirers are already holding back "as much value as they can get away with" in the absence of any meaningful deterrence.[131] Lastly, contrary to the belief that appraisal arbitrage would deter acquisitions, the passage of time has produced evidence that tends to debunk many of these initial outcries of concern.[132] Studies now suggest that as the strength of the appraisal remedy increases: (1) the "likelihood of [a] Delaware firm[ ] becoming [an] acquisition target[ ] *increases*"; (2) deal prices yield higher premiums; and (3) company selling practices improve to ensure a robust market check.[133]

The critique that appraisal arbitrage should be condemned on some moral ground because it adulterates the appraisal remedy is almost nonsensical since it fails to acknowledge that "people buy and sell legal claims all the time."[134] Due to the many intricacies,

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their own conflicting interests, or demands of controlling stockholders—from underselling the target company."); Albert H. Choi & Eric Talley, *Appraising the "Merger Price" Appraisal Rule*, 35 J.L. ECON. & ORG. 543, 570 (2018) (finding appraisal arbitrage plays a key role in preserving appraisal's *ex ante* relief of setting a reserve price for selling a firm that benefits all stockholders); *see also* Matt Levine, *Should Courts Care Who Wins in a Merger?*, BLOOMBERG (Feb. 27, 2018), https://www.bloomberg.com/opinion/articles/2018-02-27/should-courts-care-who-wins-in-a-merger [https://perma.cc/XD7M-RHQZ] ("Without the threat of appraisal litigation, buyers won't feel the need to pay as much, and deal premiums will drop.").

[128] DEL. COUNCIL OF CORP. LAW, *supra* note 19, at 2 (explaining that, "the appraisal remedy is necessary to protect stockholders, [and] its effectiveness would be curtailed if the statute were amended to limit the ability to transfer the [appraisal] right" to arbitrageurs).

[129] *See, e.g.*, Korsmo & Myers, *Reforming Appraisal Litigation*, *supra* note 101, at 306–07 (explaining that Carl Ichan's threat of appraisal during Michael Dell's MBO going-private negotiation "prompted the merger parties to increase the merger consideration by $400 million").

[130] *Id.* at 326–27.

[131] *Id.* at 325 (arguing that fiduciary class actions have failed to achieve optimal deterrence and that the only real threat acquirers face is "an adverse [stock]holder vote or a topping bid").

[132] Korsmo & Myers, *Flawed Corporate Finance*, *supra* note 90, at 233.

[133] *Id.*

[134] Weldy, *supra* note 4, at 2210; *see also In re* Appraisal of Dell Inc., No. 9322, 2015 WL 4313206, at *23 (Del. Ch. July 13, 2015) ("In a market economy, the ability to transfer property, including intangible property, is generally thought to be a good thing; it allows the property to flow to the highest-valuing holder, thereby increasing societal wealth. . . . It is not apparent to me why a right held by the equity side of the capital

threshold requirements, and pecuniary demands of appraisal claims,[135] the ordinary stockholder of a publicly traded firm who holds a meritorious appraisal claim likely lacks the capacity to assert it.[136] Selling that claim to a sophisticated entity that can litigate it effectively is integral in preserving a formidable mechanism of corporate governance.[137]

C. *Appraisal Arbitrage Could Be the Last Line of Defense for Stockholders*

With the weakening of other stockholder protections traditionally used to police corporate control transactions, appraisal arbitrage could be the "last line of defense" for stockholders.[138] Acquiring firms, utilizing a variety of different deal structures, constantly purchase target firms that the acquirer believes have the potential to generate substantial gains.[139] In a transaction for corporate control, the target firm's management assumes the role of bargainer on behalf of the company[140] and negotiates the terms and price of the deal subject to a vote of approval by the majority of stockholders.[141] Management and stockholders' interests, however, often diverge, and there is potential for majority abuse in certain control transactions.[142]

For example, target management may have incentives to agree to a deal price lower than fair value in exchange for a higher purchase price of their own shares or lucrative employment

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structure should be treated differently . . . ."); Korsmo & Myers, *Reforming Appraisal Litigation*, *supra* note 101, at 314 (explaining contract claims are freely assignable and that, specifically, an existing legal claim against a corporation is transferred to the stockholder by operation of law when they purchase stock). One prominent example to this point has been the growing industry of third-party litigation financing, which enables a plaintiff, who lacks the financial means to do so, to assert a meritorious claim against a culpable defendant. *See* Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95. MINN. L. REV. 1268, 1326 (2011) ("[T]he risks involved in [litigation funding] are overwhelmed by two major benefits. One is the increased access to justice. The other is that litigation finance helps align the bargaining power of different categories of litigants and gives previously excluded categories . . . a chance to play for rule change as modified repeat players.").

[135] *See* discussion *supra* Section I.B.

[136] *Cf.* Weldy, *supra* note 4, at 2209–10.

[137] *See* Charles Korsmo & Minor Myers, *A Reality Check on the Appeal of* DFC Global *Appraisal Case*, COLUM. L. SCH. BLUE SKY BLOG (July 17, 2017), http://clsbluesky.law.columbia.edu/2017/07/17/a-reality-check-on-the-appeal-of-the-dfc-global-appraisal-case/ [https://perma.cc/L5KB-EJFR]; *see also supra* notes 11–15 and accompanying text (explaining arbitrageurs' strategy).

[138] Schoenfeld, *supra* note 20, at 3.

[139] *See* EASTERBROOK & FISCHEL, *supra* note 15, at 134.

[140] *See* Ellie G. Harris, *Antitakeover Measures, Golden Parachutes, and Target Firm Stockholder Welfare*, 21 RAND J. ECON. 614, 615 (1990).

[141] *See* Wertheimer, *supra* note 39, at 613–14.

[142] *See* EASTERBROOK & FISCHEL, *supra* note 15, at 145.

positions in the post-acquisition firm.[143] In the context of a management buyout (MBO), one study found that, on average, corporate insiders, perhaps based on private information indicating that the company is undervalued, tend to time MBOs and corporate freezeouts to coincide with periods of widespread industry undervaluation in order to opportunistically eliminate minority stockholders at an artificially depressed premium.[144] Appraisal arbitrageurs focus on "going private transactions, transactions with low deal premi[ums], and transactions with 'perceived conflicts of interest'—all situations more likely to take advantage of minority [stock]holders."[145] Accordingly, while arbitrageurs may be the sole beneficiaries *ex post*, a meaningful threat of appraisal litigation benefits all stockholders *ex ante* by establishing a minimum reservation price at which a company may be sold.[146]

1. The Demise of Fiduciary Litigation

A credible appraisal remedy becomes all the more crucial in light of the recent developments in Delaware stockholder fiduciary litigation.[147] The overwhelming majority of merger related lawsuits have been brought as class actions alleging a breach of a fiduciary duty.[148] "[P]rofessional plaintiffs," investors who own a small number of shares in the target company and have close ties with stockholder litigation firms, bring the majority of these types of actions.[149] These fiduciary litigants are incentivized to target transactions based on the size of the deal, regardless of the merits, in order to achieve the biggest settlement possible.[150] As a result, fiduciary litigation has become a "merger tax," comprised of a "disclosure-only"[151] settlement coupled with

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[143] *See* Harris, *supra* note 140, at 617 (explaining that such a bargained-for exchange, if it became public knowledge, would give rise to breach of fiduciary duty litigation).

[144] *See* Jarrad Harford et al., *Do Insiders Time Management Buyouts and Freezeouts to Buy Undervalued Targets?*, 131 J. FIN. ECON. 206 (2019).

[145] Weldy, *supra* note 4, at 2208 (footnotes omitted).

[146] EASTERBROOK & FISCHEL, *supra* note 15, at 145.

[147] *See* Schoenfeld, *supra* note 20, at 3.

[148] Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 4, at 1581 ("[F]iduciary class actions challenging mergers have recently become ubiquitous, touching over 90% of transactions above $100 million.").

[149] *Id.* at 1574.

[150] *See id.* at 1584–85.

[151] A "disclosure-only" settlement is a settlement that compels a defendant corporation and its directors to make additional disclosures in its proxy materials before a stockholder vote on a transaction. *See* Peter J. Walsh & Aaron R. Sims, Trulia *and the Demise of "Disclosure Only" Settlements in Delaware*, BUS. L. TODAY (Feb. 20, 2016), https://www.americanbar.org/groups/business_law/publications/blt/2016/02/delaware_insider/ [https://perma.cc/E6U8-A9F3]. They provide little actual benefit to stockholders but can generate substantial attorney fees. *Id.* This nuisance tactic has now been greatly restricted. *Id.*

attorney fees[152] that produces virtually no benefit to the class of stockholders who had an actual stake in the company.[153] Notwithstanding this devolution into an instrument used to extract nuisance value, following the decisions in *Corwin v. KKR Financial Holdings*[154] and in *In re Trulia, Inc. Stockholder Litigation*,[155] fiduciary litigation has been seriously weakened as a stockholder remedy that provides an opportunity to unearth corporate malfeasance.[156] *Corwin* denied stockholders access to discovery *ex post* where the transaction was approved by an uncoerced stockholder vote, while *Trulia* denied stockholders' access to discovery *ex ante* unless plaintiffs can make a showing that "discovery will yield information that can generate a settlement with meaningful benefits."[157] For all intents and purposes, without the chance for meaningful discovery, acts of corporate wrongdoing may be forever concealed and fiduciary duty litigation eviscerated.[158]

2. Policing Corporate Malfeasance with Appraisal Arbitrage

As discussed above, the threat of appraisal litigation establishes a minimum reservation price for which a firm can be sold, and thus all stockholders of the target company benefit whether or not they eventually seek appraisal.[159] Most of the recent appraisal activity has involved repeat players who are sophisticated investors "specializing in appraisal."[160] Evidence tends to show that these arbitrageurs, unlike fiduciary litigants, are highly selective in deciding which transactions to target and, accordingly, are focusing their resources to pursue only the *strongest* appraisal claims.[161] In an empirical study, Professors Korsmo and Myers report that "[o]ut of 1168 appraisal-eligible transactions . . . , 683 attracted at least one fiduciary class action[,] [and in] contrast, only 87 transactions involved a counseled appraisal petition."[162] In their research, Korsmo and Myers found that arbitrageurs are primarily targeting deals with

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152 *See* Levine, *supra* note 3.
153 *See* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 4, at 1584.
154 Corwin v. KKR Fin. Holdings, 125 A.3d 304 (Del. 2015).
155 *In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884 (Del. Ch. 2016).
156 Schoenfeld, *supra* note 20, at 2; *see also* Walsh & Sims, *supra* note 151.
157 Schoenfeld, *supra* note 20, at 2–3.
158 *See id.* at 3.
159 *See supra* note 146 and accompanying text.
160 Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 4, at 1574.
161 *See id.* at 1589.
162 *Id.*

merger prices that had "highly negative residual premi[ums]," relative to the excepted merger premium within a given industry, and specific deal structures that are inherently prone to conflicts of interests.[163] In addition, they observed that the larger the deal, the *less* likely it would be targeted for appraisal.[164] This finding suggests that appraisal arbitrageurs are focused on pursing meritorious lawsuits, and thus "are not merely looking for deep pockets and nuisance-value settlements."[165]

The fact that appraisal arbitrageurs are actively seeking claims that have actual merit makes sense because arbitrageurs face the possibility of suffering a substantial loss on their investment if they target the wrong transaction. After all, unlike fiduciary litigants who have no skin in the game and need not exercise discretion in bringing lawsuits, appraisal arbitrageurs are expending vast amounts of their own capital to purchase shares and then litigate appraisal claims, which, on average, take three years to litigate.[166] Consequently, it seems advantageous for appraisal arbitrage to supplant fiduciary litigation as the preeminent corporate policing mechanism because it creates actual *ex ante* benefits for stockholders by driving up merger premiums,[167] encourages claimants to bring meritorious cases,[168] and provides a last-ditch check on corporate wrongdoing.[169]

D. Delaware's Response to Calls for Arbitrage Reform

Despite its apparent social benefits, Delaware's influential corporate leaders[170] are fighting back against appraisal arbitrage and have urged their legislature to make changes to the current law such that it would strip the appraisal remedy from beneficial stockholders who acquired stock after the record date, as well as

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[163] *Id.* at 1593–94, 1596.

[164] *Id.* at 1593.

[165] *Id.* at 1595.

[166] *See* Korsmo & Myers, *Reforming Appraisal Litigation, supra* note 101, at 284.

[167] *See* Boone et al., *supra* note 66, at 285 (finding "higher acquisition premiums in appraisal-eligible as opposed to appraisal-ineligible" Delaware transactions).

[168] *See* Weldy, *supra* note 4, at 2215 (arguing that it is socially valuable to ensure that claims with merit are litigated).

[169] Schoenfeld, *supra* note 20, at 3 (arguing that appraisal has become stockholders' last line of protection in exposing conflicted corporate action).

[170] One of the most outspoken and powerful critics was Michael Carter, CEO of Dole Food Company, which itself was "the subject of a large appraisal action over a management-led going-private transaction." Korsmo & Myers, *Reforming Appraisal Litigation, supra* note 101, at 283. Carter threatened that Dole would reincorporate elsewhere if the legislature did not enact radical reforms to its appraisal statute. *Id.* at 308. Interestingly, the Dole merger was also simultaneously facing a class action lawsuit that ended in a final decision finding that "Carter had engaged in a pattern of fraud, attempting to mislead stockholders and other directors about the value of Dole." *Id.* at 312; *see In re* Dole Food Co., Inc. S'holder Litig., 2015 WL 5052214 (Del. Ch. Aug. 27, 2015).

reduce the statutory interest rate.[171] In 2016, in an effort to allay corporate leaders' concerns of appraisal arbitrage, Delaware's legislature took a measured response and made only slight reforms to its appraisal statute.[172] Amended section 262(h) now permits the surviving corporation to tender the merger consideration, in full or in part, to petitioners at any time before a final judgment is rendered in order to avoid the accretion of statutory interest on the amount tendered.[173] In allowing surviving corporations to tender consideration up-front, the legislature hoped to discourage weak appraisal petitions that were filed solely for the purposes of reaping a modest financial gain by accruing interest over a lengthy litigation process.[174]

The legislature also amended section 262(g), creating a *de minimis* requirement that denies appraisal rights to stockholders of publicly traded companies unless petitioners owned at least 1 percent of outstanding stock or the consideration paid for such shares exceeded $1 million.[175] Though this amendment does nothing to ensure that only meritorious claims are pursued, it will ultimately lead to the reduction in the number of appraisal petitions filed as it effectively limits claims for appraisal to stockholders with a substantial financial position in the corporation.[176] With these minor changes, Delaware's legislature recognized that a market of appraisal arbitrage, driven by large sophisticated investors, is necessary to maintain an effective appraisal remedy that provides meaningful *ex ante* protection to *all* Delaware stockholders.[177]

While the legislature has yet to succumb to the demands of Delaware's corporate magnates for more radical changes to

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[171] *See* Norwitz, *supra* note 124; *see also* Korsmo & Myers, *Reforming Appraisal Litigation*, *supra* note 101, at 291–93.

[172] *See* DEL. COUNCIL OF CORP. LAW, *supra* note 19, at 2 (explaining that, "the appraisal remedy is necessary to protect stockholders, [and] its effectiveness would be curtailed if the statute were amended to limit the ability to transfer the [appraisal] right" to arbitrageurs).

[173] DEL. CODE ANN. tit. 8, § 262(h); *see also* Weldy, *supra* note 4, at 2205 (explaining that jurisdictions which drafted their appraisal statutes using the Model Business Corporation Act have always required companies to provide petitioning stockholders the merger consideration before litigation starts, whereas Delaware, which has historically denied consideration up-front, does now offer it, but it is only optional).

[174] *See* Weldy, *supra* note 4, at 2205.

[175] DEL. CODE ANN. tit. 8, § 262(g).

[176] Weldy, *supra* note 4, at 2206.

[177] *See* DEL. COUNCIL OF CORP. LAW, *supra* note 19, at 1–2 (concluding that "appraisal arbitrage [does not] upset[ ] a proper balance between the ability of corporations to engage in desirable . . . transactions and the ability of dissenting stockholders to receive value for their holdings," and, moreover, any restrictions on the right to transfer an appraisal claim would drastically hinder the remedy's effectiveness in protecting all stockholders).

the appraisal remedy, it appears that the courts have taken up the initiative themselves.

III. A NEW ERA IN APPRAISAL LITIGATION: *DELL*

Within the span of four months, the Supreme Court of Delaware rendered two monumental decisions that made clear a new era in appraisal litigation had arrived. This tremendous shift was first signaled in *DFC Global Corp. v. Muirfield Value Partners*,[178] and subsequently confirmed in *Dell*. The significance of *Dell* is that, when viewed together with *DFC*, the court: (1) adopted, in all but name, a merger price deference rule;[179] (2) applied an "enhanced scrutiny" judicial standard to evaluate the sufficiency of the sales process, effectively limiting claims ripe for appraisal to those where a cognizable breach of duty occurred;[180] and (3) doubled down on an endorsement of market-based evidence as a proxy for fair value.[181] Given the various defects and conflicts of interest present in *Dell*'s factual record, the chancery's subsequent attempts to apply the *Dell* framework have led to a monumental upheaval of Delaware's appraisal jurisprudence.

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[178] *See* DFC Glob. Corp. v. Muirfield Value Partners, 172 A.3d 346 (Del. 2017). There, the Chancery Court concluded that a robust and sufficient sales process had taken place; however, it only assigned the deal price one-third weight in its fair value determination. *Id.* at 348–49. On appeal, the Delaware Supreme Court reversed and held that the "the best evidence of fair value was the deal price, as it resulted 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." *Id.* The court declined to adopt a deal price rule that would create a presumption that the merger price in an arm's length transaction was fair value. *Id.* at 348. For a debate on whether *DFC* was correctly decided, compare Subramanian, *supra* note 25, at 223–26, agreeing with reversal because there was a genuine arm's length transaction and, therefore, the deal price should be entitled to full weight, with Korsmo & Myers, *Flawed Corporate Finance*, *supra* note 90, at 255, disagreeing with reversal and arguing that regulatory company-specific risks plaguing the target required the acquirer to discount the deal price and, therefore, the company was worth more if it remained publicly held since public investors can diversify that risk.

[179] Subramanian, *supra* note 25, at 223–24.

[180] *See* Korsmo & Myers, *Flawed Corporate Finance*, *supra* note 90, at 277 (arguing that even though *DFC* and *Dell* did not explicitly hold, they heavily suggest the Court's view that "any sales process where target directors meet their fiduciary obligations is fully informative of the company's value" and reflects fair value); *see also* Hamermesh & Wachter, *supra* note 36, at 962 (agreeing with the Court's adoption of fiduciary duty "enhanced scrutiny" test).

[181] Korsmo & Myers, *Flawed Corporate Finance*, *supra* note 90, at 259.

A. Dell *Standard: Deal Price Deference and Market-based Indicators*

1. Background and Sales Process

In 2013, Michael Dell announced a $24.4 billion deal that would take his company private in a management-led buyout with private equity firm Silver Lake.[182] On the day of the announcement, Dell's publicly traded stock closed at $13.42 per share, slightly below the buyout's offer of $13.65 per share.[183] After a trial for appraisal, the Court of Chancery found that Mr. Dell bought his company at a 21 percent discount, and that the fair value of the corporation's stock was $17.62 per share.[184]

The decision to take the company private was precipitated by Mr. Dell's growing frustration that, despite a recent company transformation and entry into the software and services sector, the market continued to perceive Dell as solely a PC business and failed to understand its long-term strategy.[185] With the emergence of new technologies, investor pessimism regarding the future outlook of the PC industry drove Dell's stock price from $18 to $12 per share.[186] Unable to sell his vision to the market, Mr. Dell resolved that "it would be easier to execute the [c]ompany's transformation plan unencumbered by stockholder pressure," and brought the idea of an MBO to Dell's board.[187] To explore the possibility of a sale, Dell's Board established an independent special committee vested with authority to evaluate Mr. Dell's proposal, as well as other "possible strategic alternatives."[188]

The sales process consisted of a pre-signing marketing phase followed by a forty-five day go-shop period.[189] During the pre-market canvass, the committee, which retained Evercore

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[182] Michael J. de la Merced & Quentin Hardy, *Dell in $24 Billion Deal to Go Private*, N.Y. TIMES (Feb. 5, 2013, 9:22 PM), https://dealbook.nytimes.com/2013/02/05/dell-sets-23-8-billion-deal-to-go-private/ [https://perma.cc/7HQK-X5MR].

[183] *Id.*

[184] *In re* Appraisal of Dell, Inc., No. 9322, 2016 WL 3186538, at *1 (Del. Ch. May 31, 2016), *rev'd sub nom.* Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1 (Del. 2017); *see also* Merced, *supra* note 68. Within just one year of going private, Dell's equity value was estimated to be worth at least $10.8 billion, almost twice as much as the $5.6 billion of equity invested by Mr. Dell and Silver Lake. David Carey & Jack Clark, *Dell, Silver Lake Said to Reap 90% Gain a Year After LBO*, BLOOMBERG (Nov. 6, 2014, 12:01 AM), https://www.bloomberg.com/news/articles/2014-11-06/dell-silver-lake-said-to-reap-90-gain-a-year-after-lbo [https://perma.cc/MPD6-PLDK].

[185] *Dell*, 177 A.3d at 7.

[186] *Id.* at 6.

[187] *Id.* at 8.

[188] *Id.*

[189] *Id.* at 11–12.

Partners (Evercore) as one of its financial advisors, reached out to a limited number of private equity firms: Silver Lake, Kohlberg Kravis Roberts & Co. L.P. (KKR), and, later on in the process, Texas Pacific Group (TPG).[190] Acting on Evercore's advice, the committee did not reach out to Blackstone, "which had just hired Dell's former M&A head," or the obvious strategic choice, Hewlett Packard (HP), "even though Evercore . . . estimated $3 billion to $4 billion of synergies between Dell and HP."[191] Most significantly, Evercore's advice was seriously conflicted because it would receive "a large contingent payment for any overbid it found during the go-shop period, and no such payment for a pre-signing overbid";[192] and Evercore believed that Blackstone and HP were its "most promising possibilities."[193] In fact, when news began to leak of a possible sale, Blackstone reached out to Evercore to express its interest in Dell, and Evercore assured Blackstone that there would be a meaningful go-shop period to participate in.[194] Facing limited competition, Silver Lake emerged from the pre-signing phase as the winning bidder.[195]

Silver Lake's final offer was $13.65 per share, and the Board, without Mr. Dell present, unanimously approved the transaction.[196] The final proposal (the Merger Agreement) was structured as a leveraged buyout (LBO) in which Silver Lake and Mr. Dell (the Buyout Group) would acquire a 25.1% and 74.9% stake in the company, respectively.[197] In addition, Mr. Dell, owning 15.4% of the company's outstanding stock, entered into a voting agreement that required him to vote his shares in favor of a "Superior Proposal" arising from the go-shop period.[198] The Buyout Group was granted a one-time match right should any topping bid emerge.[199]

During the go-shop period, Evercore "contacted sixty-seven parties, including twenty potential strategic buyers and

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[190] *Id.* at 9–10.

[191] Subramanian, *supra* note 25, at 228.

[192] *Id.*

[193] *In re* Appraisal of Dell, Inc. No. 9322, 2016 WL 3186538 at *13 (Del. Ch. May 31, 2016), *rev'd sub nom.* Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1 (Del. 2017).

[194] *Compare Dell*, 177 A.3d at 10 n.37 ("[E]vidence in the record suggests that Blackstone proposed waiting until the go-shop on its own."), *with* Subramanian, *supra* note 25, at 229 ("[The Delaware Supreme Court's finding] is a highly convenient and important fact . . . . [T]he idea that Blackstone preferred to participate in the go-shop rather than the pre-signing process defies common sense.").

[195] *Dell*, 177 A.3d at 11.

[196] *Id.*

[197] *Id.* at 9, 11.

[198] *Id.* at 11.

[199] *Id.* at 12.

seventeen financial sponsors."[200] Two competing non-binding proposals emerged, one led by Carl Icahn, who had opposed the idea of an MBO, and one by Blackstone.[201] Blackstone eventually withdrew its proposal, and the threat of Carl Icahn's recapitalization plan drove the Buyout Group to increase their offer to $13.75 per share.[202] The Buyout Group's proposal was ultimately approved by a 57 percent majority stockholder vote.[203]

2. The Trial

Appraisal arbitrageurs petitioned for a judicial appraisal of their 38,765,130 shares.[204] In a well-reasoned opinion, Vice Chancellor Laster concluded that the Dell sales process was ultimately an inefficient price discovery tool and, therefore, afforded it no weight in determining fair value.[205] The court noted that, although the "Committee and its advisors did many praiseworthy things," the purpose of an appraisal proceeding is not to determine whether management has breached its fiduciary duties, but whether the merger consideration is indicative of fair value.[206] In reaching its conclusion, the court found that Dell's pre-market canvass was an unreliable determinant of fair value because it consisted solely of financial buyers employing LBO pricing models that gauge a financial sponsor's optimal internal rate of return and not the value of the target itself.[207]

The court also found that the structure of the go-shop period undermined the reliability of deal price as an instrument for price discovery.[208] While the length of the go-shop period was about average, thorough due diligence of a company as large and complex as Dell was a virtually insurmountable task in such a short time frame.[209] Accordingly, third-party bidders had only forty-five days to learn what Silver Lake had learned in six months, and what Mr. Dell had known for decades.[210] Moreover, the court reasoned that the "winner's curse," the theory that incumbent management possesses asymmetric information and

[200] *Id.*
[201] *Id.* at 13.
[202] *Id.* at 15.
[203] *Id.*
[204] *Id.*
[205] *In re* Appraisal of Dell, Inc. No. 9322, 2016 WL 3186538, at *44 (Del. Ch. May 31, 2016), *rev'd sub nom.* Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1 (Del. 2017).
[206] *Id.* at *29.
[207] *Id.* at *29–30.
[208] *Id.* at *39–42.
[209] *See id.*
[210] *Id.*

outbidding them will reveal why management was dissuaded from bidding further, likely deterred third-party interest.[211]

Finally, the court concluded that a significant valuation gap existed in the market that further called into question the deal price's reliability.[212] It explained that "investor myopia," a market too focused on short-term quarterly results, depressed the price of Dell's shares to as low as $9; however, the company's own financial advisors were contemporaneously valuing Dell "at between $20 and $27 per share."[213] The court noted that, while neither Mr. Dell nor the company maliciously encouraged the valuation gap as they actively tried to convince the market of its long-term strategy, the market disconnect presented an opportunity for the Buyout Group to purchase Dell at an artificially depressed premium.[214] Finding that the deal price deserved no weight in determining fair value, the court relied solely on a DCF analysis and held that the fair value of Dell's stock was $17.62 per share.[215]

3. The Supreme Court of Delaware Weighs In

On appeal, the Supreme Court of Delaware, which had just issued another monumental decision on appraisal,[216] reversed the lower court's decision[217] and emphasized the importance of relying on market-based indicators to arrive at a fair value determination.[218] Foremost, the court held that the "deal price deserved heavy, if not dispositive weight."[219] The court explained that the deal process had minimal structural barriers to entry, Evercore was incentivized to ensure a robust go-shop period,[220] and that there is no rational nexus between

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211 *Id.* at *42–43.

212 *Id.* at *32.

213 *Id.* at *34.

214 *Id.* at *33–34.

215 *Id.* at *51.

216 *See* DFC Glob. Corp. v. Muirfield Value Partners, 172 A.3d 346, 366 (Del. 2017) (holding that "the price of a merger that results from a robust market check, against the backdrop of a rich information base and a welcoming environment for potential buyers, is probative of the company's fair value.").

217 Subramanian, *supra* note 25, at 227 (arguing that the "[Delaware] Supreme Court engaged in a *de novo* review of the critical process choices rather than applying the required 'abuse of discretion' standard," leading to a complete mischaracterization of the factual record).

218 Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1, 24 (Del. 2017).

219 *Id.* at 23.

220 *But see* Subramanian, *supra* note 25, at 229–30 ("A news report . . . nine days after the go-shop period had expired—cited sources saying that '[Blackstone's] due diligence process is still the early stages, and that Blackstone is just starting to put

whether a deal price is fair and a buyer's status as a financial sponsor.[221] The court further stated that the lack of strategic bidders does not undermine the credibility of the deal price; in fact, the lack of strategic[222] interest in the target firm suggests a lower fair value estimation, not a higher one.[223]

In addition, the court chastised the lower court's finding of a valuation gap, and reiterated its embrace of the efficient market hypothesis.[224] The court explained that "[a] market is more likely efficient, or semi-strong efficient, if it has many stockholders; no controlling stockholder; 'highly active trading'; and if information about the company is widely available and easily disseminated to the market."[225] The court reasoned that, absent a finding that management withheld material information, Dell's stock price was highly indicative of its fair value because Dell "had a deep public float, was covered by over thirty equity analysts . . . , [and] was actively traded with over 5% of shares changing hands each week."[226] Accordingly, the court remanded and strongly urged a fair value determination at deal price.[227]

4. Delaware's Embrace of Market-Based Evidence: Efficient Capital Market Hypothesis

Other than its stunning interpretation of the trial court's factual findings of the sales process to arrive at its reversal, the most notable aspect of *Dell* is the court's embrace of the Efficient Capital Market Hypothesis (ECMH) as a proxy of fair value.[228] The

together a business plan.' None of this catch-up needed to happen if Blackstone [was able to] participate[ ] in the pre-signing process . . . ." (internal citations omitted)).

[221] *Dell*, 177 A.3d at 27–29.

[222] *Id.* at 12 (noting that HP, the most natural strategic choice, entered into a confidentiality agreement during the go-shop but never even logged into Dell's data room). *But see* Subramanian, *supra* note 25, at 230 (arguing that another equally consistent interpretation of this fact is that "HP did not perceive a pathway to success in a bidding contest against Michael Dell").

[223] *Dell*, 177 A.3d at 29.

[224] *Id.* at 24. *But see* Korsmo & Myers, *Flawed Corporate Finance*, *supra* note 90, at 259–60 (finding the court's proclamation that Delaware has long embraced the efficient market hypothesis is incredulous because a substantial portion of its anti-takeover jurisprudence is cemented by the idea that markets are not fundamentally efficient). *See also* discussion *infra* Section III.A.4 (explaining the Efficient Capital Market Hypothesis).

[225] *Dell*, 177 A.3d at 25.

[226] *Id.* (footnotes omitted).

[227] *See id.* at 44. After trial, 70 percent of the petitioners settled with respondents at the deal price urged by the court, reasoning that, and with the vice chancellor in accord, a rehearing on remand was rendered pointless given the court's strong instructions. *See* Settling Dissenters' Brief in Support of their Motion for Approval of Settlement and an Award of Attorneys' Fees at 8, *In re* Appraisal of Dell, No. 9322-VCL, 2018 WL 4540130 (Del. Ch. Sept. 17, 2018) (discussing the procedural aftermath of the reversal).

[228] *See* Korsmo & Myers, *Flawed Corporate Finance*, *supra* note 90, at 259.

ECMH posits that markets are efficient in the: (1) weak-form;[229] (2) semi-strong form;[230] or (3) strong-form.[231] It is widely accepted that markets are informationally efficient in the semi-strong form and that trading prices reflect all publicly available information about a certain security; however, "it is important to distinguish between *informational* efficiency and *fundamental* efficiency."[232] Informational efficiency does not mean that the market is responding "rationally or accurately" to the information and, therefore, the market price for a security may be drastically diverging from or converging with the security's fundamental value at any point of time.[233] Aside from the problem of asymmetric information between insiders and the market, testing whether markets are fundamentally efficient is an almost insurmountable task.[234] Undaunted, "the Supreme Court [of Delaware] has boldly gone where few economists have gone in thirty-five years—conflating well-supported notions of semi-strong market efficiency, often known as informational efficiency, with an unfounded and widely discredited notion of value efficiency."[235]

Professors Korsmo and Myers pointedly explain how the court's endorsement of ECMH in the context of appraisal may have reverberating consequences that extend to other areas of Delaware law.[236] First, the court's claim that it has always endorsed the ECMH is in direct contravention with Delaware's long-established fiduciary duty jurisprudence in the anti-takeover context, which hinges solely on the proposition that markets are fundamentally inefficient and, therefore, managers, who know the firm's fundamental value, can take defensive measures to fend off unwanted takeovers.[237] Second, stock prices "do not reflect the value of corporate control," which is only

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[229] The "weak-form" claims that all information regarding past prices of a certain security are incorporated into its market price and, therefore, an investor cannot profit on previous pricing trends. KLEIN ET AL., *supra* note 81, at 441.

[230] The "semi-strong form" states that market prices instantaneously reflect all publicly available information of a security and, therefore, a trader cannot beat the market upon learning new public information because the market has already incorporated that information. *Id.*

[231] The "strong-form" claims that stock prices incorporate all public and non-publicly available information about a security. *Id.* at 442.

[232] Bradford Cornell & John Haut, *How Efficient Is Sufficient: Applying the Concept of Market Efficiency in Litigation*, 74. BUS. LAW. 417, 420 (2019).

[233] *Id.*

[234] *See id.* at 430, 433.

[235] Korsmo & Myers, *Flawed Corporate Finance*, *supra* note 90, at 261.

[236] *See id.* at 259–69.

[237] *See id.* at 259 (arguing that if this endorsement of ECMH is not merely situational, it marks "a tectonic shift in Delaware . . . beyond the appraisal context").

created when the shares are aggregated in a transaction.[238] Lastly, stock and deal markets are disparate markets.[239] Unlike stock, where there is an efficient market consisting of theoretically infinite willing buyers and sellers that leads to the price discovery of an individual security, the market for the sale of an entire company is illiquid, with only a handful of potential buyers, and thus there can be no meaningful price discovery absent a well-structured auction or genuine arm's length transaction.[240] The vice chancellor in *Dell* heeded the court's embrace of the ECMH and demonstrated the absurdity of the result shortly thereafter.[241]

IV. APPRAISAL IN A POST-*DELL* WORLD

In early 2018, the Court of Chancery issued a series of decisions involving synergy-driven mergers where there was a strategic purchaser and both companies were publicly traded entities.[242] Two cases in particular, decided days apart, illustrate the post-*Dell* conundrum facing parties seeking appraisal rights. In both cases, the court concluded that fair value was less than the merger price.[243] Interestingly, it did so on remarkably different background facts. In the first of these cases, *Verition Partners Master Fund Ltd. v. Aruba Networks Inc.*, Vice Chancellor Laster (whose decision was later reversed in *Dell*), having found that the deal price was probative of fair value, refused to conduct a "deal price minus synergies" calculation and instead entered a fair value determination based on the target's pre-announcement market price.[244] Although the trial court's decision was ultimately reversed, the Supreme Court of Delaware's failure to engage in a substantive review of the chancery's findings has led to far-ranging guesses

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[238] *Id.* at 266–67 (explaining individual shares trade at minority positions, and a dissenter is entitled to "the 'proportionate interest in [the] going concern'—a pro rata share of the whole" company when sold, and hence includes a control premium) (alteration in original) (citation omitted).

[239] *See id.* at 267–68.

[240] *Id.*

[241] *See* Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., No. 11448, 2018 WL 922139, at *54–55 (Del. Ch. Feb. 15, 2018) (relying on the thirty-day average unaffected market price), *rev'd*, 210 A.3d 128, 130 (Del. 2019) (ordering trial court to enter final judgment at respondent's "deal price minus synergies" estimate).

[242] *See* Marianna Wonder et al., *M&A Update: A Trio of Recent Delaware Decisions Discount Deal Price in Appraisal Litigation*, NAT'L L. REV. (Mar. 26, 2018), https://www.natlawreview.com/article/ma-update-trio-recent-delaware-decisions-discount-deal-price-appraisal-litigation [https://perma.cc/L9WL-CWMP].

[243] *See In re* Appraisal of AOL, Inc., No. 11204, 2018 WL 1037450, at *21 (Del. Ch. Feb. 23, 2018) (using a DCF analysis to arrive at a fair value determination); *Aruba Networks*, 2018 WL 922139, at *55 (relying on the thirty-day average unaffected market price).

[244] *See Aruba Networks*, 210 A.3d. at 130; *see also* discussion *infra* Section IV.A.

over the ultimate legacy *Aruba Networks* will have on the future of appraisal litigation,[245] with many commentators' guesses already proven wrong.[246] In the second of these cases, in *In re AOL, Inc. Appraisal*, Vice Chancellor Glasscock coined the term "*Dell* Compliant," and articulated: "[a] transaction is *Dell* Compliant where (i) information was sufficiently disseminated to potential bidders, so that (ii) an informed sale could take place, (iii) without undue impediments imposed by the deal structure itself."[247] Applying this framework, Vice Chancellor Glasscock circumvented *Dell*'s deal price deference rule and conducted his own DCF analysis to calculate fair value.[248]

A. Dell *Compliant:* Aruba Networks

In 2015, HP acquired Aruba Networks (Aruba) in a cash-out merger for consideration of $24.67 per share, and dissenters sought appraisal.[249] After the *Aruba Networks* trial concluded, Vice

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[245] *See, e.g.*, Allison Frankel, *Appraisal Litigation After* Aruba*? It's Still a Bad Bet for Shareholders*, REUTERS (Apr. 17, 2019), https://www.reuters.com/article/us-otc-appraisal/appraisal-litigation-after-aruba-its-still-a-bad-bet-for-shareholders-idUSKCN1RT2N4 [https://perma.cc/2D9N-WD5A] ("[T]he bad news in *Aruba* is that the Delaware Supreme Court now seems to regard the per-share deal price as a ceiling – not a floor – for the fair value of a company acquired by a publicly-traded competitor."); S. Michael Sirkin, Verition v. Aruba Networks*: Some Answers and Some Questions About Market Efficiency in Delaware Courts*, M&A LAW., May 2019, at 1, 4 ("For all the twists and turns . . . and the anticipation for the Supreme Court Decision, doctrinally, *Aruba* ends not with a bang but with a whimper. It doesn't change the law. . . . It cements the most likely outcome of an appraisal case involving a third-party deal for a public company as the deal price minus synergies . . . ."); Jeff Montgomery, *Strine-Laster Clash in Spotlight with Del.* Aruba *Appraisal*, LAW360 (Apr. 17, 2019), https://www.law360.com/articles/1150977/strine-laster-clash-in-spotlight-with-del-aruba-appraisal [https://perma.cc/NKA5-K4KA] (discussing Professor Myers' comments that the Delaware Supreme Court's decision failed to address the problems plaguing the chancery's application of *Dell* and *DFC* to appraisal proceedings, and his concern that the decision sends a message to stockholders that if they challenge a deal full of conflicts they will ultimately be penalized for it); Michael Kass, *Sometimes Silence is Golden: "*Dell *Compliance" Following* Aruba III, at 20 (May 25, 2019), https://ssrn.com/abstract=3394316 (arguing that "the Delaware Supreme Court's silence [in *Aruba*] suggests an intention, ironic as it may be, to return discretion to the Chancery Court" to determine deal price deference).

[246] *Compare* Frankel, *supra* note 245 ("The good news is that the [Delaware] Supreme Court outright rejected the notion that a company's pre-deal share price is the most reliable indicator of its fair value."), *with In re* Appraisal of Jarden Corp., No. 12456, 2019 WL 3244085, at *4 (Del. Ch. July 19, 2019) (holding that Jarden's unaffected market price was the most reliable indicator of the company's fair value).

[247] *In re* Appraisal of AOL, Inc., No. 11204, 2018 WL 1037450, at *8 (Del. Ch. Feb. 23, 2018).

[248] *In re AOL*, 2018 WL 1037450, at *8–9, *21; *see* discussion *infra* Section IV.B.

[249] Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., No. 11448, 2018 WL 922139, at *1 (Del. Ch. Feb. 15, 2018), *rev'd*, 210 A.3d 128 (Del. 2019). Petitioners attested that Aruba's fair value was worth $32.57. *Id.* at *2. Aruba's financial advisors internally valued Aruba at a valuation range between "$23.50 to $31.08 per share," and HP's internal team "estimated the pro forma value of Aruba could be as high as $32.05 per share." *Id.* at *10–11.

Chancellor Laster requested *sua sponte* that the parties submit supplemental post-trial briefs to address how the court should proceed in light of *Dell*, which was rendered in the interim.[250] In a 130-page opinion, the motivation of which has been the matter of much speculation,[251] Vice Chancellor Laster arrived at a fair value determination for which no party had argued.[252]

In painstaking fashion, the trial court's factual findings paint a deal process tainted with collusion, manipulation, and conflicts of interest, resembling anything but an arm's length transaction.[253] First, Aruba's CEO, Dominic Orr, led the deal negotiations, but his personal interests diverged from that of the company's.[254] Orr's motivation, though by no means a nefarious one, was to get a deal done as quickly as possible in order to return to retirement.[255] More problematic, however, is that HP wanted Orr to remain on post-acquisition to oversee network integration and breached its non-solicitation agreement with Aruba to recruit him.[256] Orr eventually agreed and, therefore, became conflicted because he was negotiating against his future employer.[257] Second, Aruba's financial advisors, Qatalyst and Evercore, were alleged to have been highly conflicted and catered extensively to HP for personal gain.[258] Qatalyst, on the one hand, had previously represented HP in a disastrous deal ending in an $8.8 billion lawsuit, and HP's CEO, Meg Whitman, vowed to never work with

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[250] *Id.* at *23.

[251] *See, e.g.*, Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., 210 A.3d 128, 139 (Del. 2019) (acknowledging petitioners' argument that trial judge was motivated to generate odd-result because of reversal in *Dell*); *see* Kass, *supra* note 245, at 3–4 (discussing alleged divide between Vice Chancellor Laster and Chief Justice Strine, and Laster's literal application of *Dell* in *Aruba*); Levine, *supra* note 127 ("[I]t almost seems like [Laster's] goal in this opinion might be to embarrass the [Delaware] Supreme Court into reversing him again and admitting that markets aren't *that* efficient."); Allison Frankel, *Shareholders in* AOL *Appraisal Case: If Judge Fixes 'Computational Errors,' Case Is a Win*, Reuters (Mar. 5, 2018), https://www.reuters.com/article/otc-frankel-aol/shareholders-in-aol-appraisal-case-if-judge-fixes-computational-errors-case-is-a-win-idUSKBN1GH34T [https://perma.cc/59DY-Q75D] ("Vice-Chancellor Laster may not even believe in the legal theory he applied [in *Aruba Networks*] . . . .").

[252] *See Aruba Networks*, 2018 WL 922139, at *55.

[253] Kass, *supra* note 245, at 20.

[254] *Aruba Networks*, 2018 WL 922139, at *43.

[255] *See id.* Delaware's jurisprudence has recognized that a potential conflict of interest exists when retirement-age executives sell a company in which they hold an equity position. *See, e.g.*, *In re* Lear Corp. S'holder Litig., 926 A.2d 94, 116–17 (Del. Ch. 2007) (discussing how management's equity position and retirement compensation can create a divergence with stockholder interests); *see also* Korsmo & Myers, *Flawed Corporate Finance*, *supra* note 90, at 255 (explaining this divergence exists through corporate finance theory because, unlike diversified public stockholders, management's equity stake is a non-diversifiable, firm-specific risk and, therefore, management may be encouraged to offload this risk by cashing out at a sale price less than fair value).

[256] *Aruba Networks*, 2018 WL 922139, at *11.

[257] *See* Kass, *supra* note 245, at 20; *see also Aruba Networks*, 2018 WL 922139, at *11.

[258] *Aruba Networks*, 2018 WL 922139, at *42.

Qatalyst again.[259] Because Qatalyst's business was technology-centered and HP was a powerful player, its primary goal throughout the deal process "was to rehabilitate [its] relationship with HP."[260] Evercore, on the other hand, was entering into the Silicon Valley tech-market for the first time, and "saw the sale process as an extended audition for HP's business."[261] The court concluded that Aruba's financial advisors' own motivations negatively impacted Aruba.[262] Lastly, when the market began to sour on Aruba and its shares dropped to $16.07, Aruba's "management knew internally that [it] was having an excellent quarter and would beat" the market's predictions.[263] Aruba had just received HP's initial deal offer, however, and feared that the chances of getting the deal approved would diminish if its stock price increased.[264] "[R]ather than correcting the market's perception," Aruba decided to report its earnings in conjunction with the announcement of the merger.[265]

Finding that this sales process was no worse than that in *Dell*, the court held that there had been a robust and informed sales process and, therefore, the deal price was probative in determining fair value, but likely included anticipated synergies.[266] Because the appraisal remedy excludes synergistic value, the court concluded that the most reliable evidence of fair value was Aruba's thirty-day average unaffected market price before the announcement of the deal,[267] since a deal price minus synergies calculation would be inherently "tainted by human error."[268] Consequently, Aruba's fair value determination was $17.13 per share, a 31 percent discount from the merger

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[259] *Id.* at *8 (explaining that the relationship between Qatalyst and HP was so hostile that Aruba initially feared Qatalyst's involvement in a deal would threaten the merger altogether).

[260] *Id.* at *42.

[261] *Id.* at *33.

[262] *Id.*

[263] *Id.*

[264] *Id.*

[265] *Id.*

[266] *Id.* at *52.

[267] *Id.* at *55. Commentators that endorse the use of the pre-announcement market price as fair value rely on *Aruba Networks* and *Dell* to argue that judges should not be able to second-guess corporate insiders and the market on the valuation of a price of stock; however, these commentators fail to address that Mr. Dell's primary reason for taking the company private was that he was convinced that a valuation gap existed and the firm's stock was being undervalued. *See generally* William J. Carney & Keith Sharfman, *The Death of Appraisal Arbitrage: Ending Windfalls for Deal Dissenters*, 43. DEL J. CORP. L. 61 (arguing for market price as fair value).

[268] *Aruba Networks*, 2018 WL 922139, at *54 (reasoning that the premium an acquirer is willing to pay includes anticipated synergies and, therefore, "[t]he value belongs to the buyer, although the seller may extract a portion of it through negotiations").

consideration of $24.67, and lower even than respondent's own DCF calculation of $19.75 per share.[269]

In an uncharacteristically harsh rebuke,[270] the Supreme Court of Delaware reversed for abuse of discretion and ordered a fair value determination at respondent's "deal price minus synergies" valuation.[271] The holding in the court's brief per curiam opinion is narrow; it held that the trial court abused its discretion by "relying exclusively on the thirty-day average market price" because it was not supported by the record and, furthermore, raised "due process and fairness problems" since the issue was not raised until after trial.[272] Most significantly, the court tacitly accepted the factual findings of the trial court regarding the sufficiency of a suspect deal process as a reliable proxy of Aruba's fair value,[273] adding only that "a buyer in possession of material nonpublic information about the seller is in a strong position . . . to properly value the seller."[274] The *Aruba Networks* decision may have been a strategic attempt to challenge the Supreme Court of Delaware (specifically Chief Justice Strine)[275] as one commentator stated:

> Not to be outdone by this deft, "hoisted on your own petard" tactic by the Vice Chancellor, the Chief Justice returned the favor in a manner that only a superior tribunal can—by (a) reversing the Chancery Court on the [Unaffected Stock Price Relevance] holding via a scathing criticism of its reductionist argumentation, (b) affirming its *Dell Compliance* holding with virtually no discussion on the merits of the Chancery Court's adjudication of that issue, and (c) directing a verdict in reliance on the *Dell Compliance* holding—notwithstanding obvious conflicts in the trial record on the quantification of deductible synergies that, absent judicial gloss, would have frustrated such implementation[,] . . . and, by implication, . . . set in stone the Vice

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[269] *Id.* at *55.

[270] Montgomery, *supra* note 245 (discussing the surprised reactions of Delaware's practitioners and academics to the tone of Supreme Court's critique).

[271] Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., 210 A.3d 128, 130 (Del. 2019).

[272] *Id.* at 139.

[273] *See generally id.*

[274] *Id.* at 137.

[275] Chief Justice Strine has now retired from the bench, Press Release, Governor John Carney, Delaware Chief Justice Leo E. Strine, Jr. to Retire from Delaware Supreme Court (July 8, 2019), https://news.delaware.gov/2019/07/08/delaware-chief-justice-leo-e-strine-jr-to-retire-from-delaware-supreme-court/ [https://perma.cc/6V39-59CG], and it is believed he was the driving force behind the *Dell* opinion, although he did not author it. Kass, *supra* note 245, at 3. It will be interesting to see what views Chief Justice Seitz will have regarding the role of appraisal in Delaware, and whether his views will give rise to another judicial showdown in some cases that may be ripe for appeal. *See* cases discussed *infra* note 277.

> Chancellor's findings of fact that implicitly sanction as "reliable[,]" a very, very dirty deal.[276]

While that commentator suggests that the supreme court's silence in *Aruba Networks* may signal a retreat from *Dell* and an attempt to return the discretion to the Court of Chancery, so far—at least in cases heard by Vice Chancellor Laster—*Aruba Networks* has lowered the bar in terms of a robust sales process.[277]

*B. Non-*Dell *Compliant:* AOL

In *AOL, Inc.*, Verizon acquired AOL in a cash-out merger for consideration of $50.00 per share.[278] The merger agreement provided a forty-two day window before closing that was constrained by a no-shop provision, post-merger employment for AOL's management, unlimited three-day matching rights, as well as a public statement from AOL's CEO declaring his intent to do a deal with Verizon.[279] Petitioners sought appraisal and asserted that the fair value of AOL stock was $68.98 per share.[280]

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[276] Kass, *supra* note 245, at 4.

[277] *See generally In re* Appraisal of Stillwater Mining Co., No. 2017-0385-JTL, 2019 WL 39443851 (Del. Ch. Aug. 21, 2019) (determining deal price was equivalent to fair value where the seller's CEO negotiated the sale of the company and his change of control compensation without board approval, CEO negotiated the premium with the bidder before retaining an investment bank, company conducted abbreviated pre-market canvass in which the winning bidder was favored, and the company's general counsel made a noisy withdrawal over his concerns of management's conduct over the sale); *In re* Appraisal of Columbia Pipeline Grp., Inc., No. 12736-VCL, 2019 WL 3778370 (Del. Ch. Aug. 12, 2019) (determining deal price was equivalent to fair value where there was evidence suggesting that the CEO and CFO of the seller orchestrated a fire sale of the company to cash out retirement benefits). In both these cases, the Vice Chancellor created an extensive record through questioning the sufficiency of the deal price, but ultimately the Vice Chancellor determined that the insufficiencies in the deal process were no worse than that in *Aruba Networks*. *See In re Stillwater*, 2019 WL 39443851, at *44; *In re Columbia*, 2019 WL 3778370, at *43. Notably, the Vice Chancellor, in both cases, rejected respondents' requests to make a downward adjustment for synergies or to rely on the unaffected deal price. The Vice Chancellor reasoned that the respondents had failed to meet the burden of proof. *In re Stillwater*, 2019 WL 39443851 at *45, *59; *In re Columbia*, 2019 WL 3778370, at *43–45, *49. Ironically, the petitioners in these cases—cases where Vice Chancellor Laster seemed to recognize the significant deficiencies in deal process but, nonetheless, deferred to deal price anyway without making downward adjustments—have fared much better than petitioners in cases presided by other vice chancellors, where the deal process appeared relatively smooth, but the court ultimately disregarded the merger price as unreliable and determined fair value below the deal price. *See, e.g.*, *In re* Appraisal of Jarden Corp., No. 12456-VCS, 2019 WL 3244085, at *4 (Del. Ch. July 19, 2019); *In re* Appraisal of AOL, Inc., No. 11204, 2018 WL 1037450, at *21 (Del. Ch. Feb. 23, 2018).

[278] *In re AOL*, 2018 WL 1037450, at *6.

[279] *Id.* at *6–7, *9.

[280] *Id.* at *11.

Coming just days after the decision in *Aruba Networks*, the *AOL* trial court held that the deal process had been defective[281] and did not assign it any weight as evidence of fair value.[282] Applying the *Dell* Compliant criteria to the case at bar, the court found that there was a robust pre-market canvass for AOL because it was well-known among industry players that the company was up for sale, and AOL appeared to willingly engage each suitor that approached it.[283] The court concluded, however, that the merger's closing provisions, coupled with a public statement made by AOL's CEO on getting the Verizon deal done, created a "considerable risk of informational and structural disadvantages dissuading any prospective bidder" thereby rendering the deal price unreliable as a price discovery tool.[284] In contrast to *Aruba Networks*, the *AOL* court did not rely on the thirty-day average unaffected market price[285] and, instead, conducted its own DCF analysis to arrive at a fair value determination below the deal price, explaining that the discrepancy was likely due to the anticipated synergies that were factored into the deal consideration as a premium.[286]

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[281] Notably, the transaction in *AOL* appeared to be far more robust than the process in *Aruba*. *When Appraisal Is Likely to Be Below the Deal Price in Arm's-Length Mergers . . . and When It Is Not—The Meaning of* Aruba, AOL, *and* SWS, FRIED FRANK (2018), https://www.friedfrank.com/siteFiles/Publications/When_Appraisal_is_Likely_to_Be_Below_the_Deal_Price1.pdf [https://perma.cc/D6V2-JLXU].

[282] *In re AOL*, 2018 WL 1037450, at *2.

[283] *Id.* at *9.

[284] *Id.*

[285] Of note though, and following the *Aruba Networks* reversal, a recent case, *In re Appraisal of Jarden Corporation*, applied the *AOL* framework and eschewed the deal price deference rule, but unlike *AOL*, relied exclusively on the thirty-day average unaffected market price to award a fair value determination 18 percent below the deal price. *In re* Appraisal of Jarden Corp., No. 12456-VCS, 2019 WL 3244085, at *4 (Del. Ch. July 19, 2019). This case is noteworthy in a few respects: (1) the deal process did not seem nearly conflicted as that in *Aruba Networks*, but more conflicted than *AOL*; (2) the deal consideration involved receipt of both cash and stock (the alleged conflicted managers specifically negotiated the deal so target stockholders would participate in the synergistic gain in the surviving corporation); (3) the use of unaffected market price is not dead, and its proxy to fair value was litigated at trial; and (4) the court conducted an independent DCF analysis that actually came in slightly below the trading price. *See generally id.*; *see also* Roger A. Cooper & Mark E. McDonald, *Appraisal Update: Unaffected Market Price Makes a Comeback*, CLEARY GOTTLIEB (July 24, 2019), https://www.clearygottlieb.com/news-and-insights/publication-listing/appraisal-update-unaffected-market-price-makes-a-comeback [https://perma.cc/TG4X-AM9L].

[286] *In re AOL*, 2018 WL 1037450, at *2 (holding fair value was $48.70 per share, a 3.6% discount of the merger consideration of $50.00 per share), *modified by* No. 11204, 2018 WL 3913775, at *5 (Del. Ch. Aug. 15, 2018) (readjusting fair value further downwards to $47.08 per share).

V. PROPOSED SOLUTIONS

These recent rulings beg the question: "Who would ever bring an appraisal action again?"[287] The sky once seemed the limit for appraisal arbitrageurs seeking a valuation in excess of the merger consideration. Now, however, it appears that the deal price may often be the ceiling. And in any deal involving synergies, irrespective of the sufficiency of the sales process, the appraisal process is more likely than not to result in a fair value determination below the merger price. As the cases above illustrate, the difference could be substantial. If this new reality was the Delaware legislature's intended result when it made reforms to its appraisal statute in 2016,[288] it seems apparent that the legislature should have repealed the remedy all together. Nonetheless, *Dell*'s weakening of the appraisal remedy has had an immediate impact on M&A activity in Delaware as deal premiums are shrinking while the size of executive compensation severance packages is rising.[289] Delaware's legislature should take steps to mitigate the threat of substantial economic losses for dissenting stockholders.

A. *Overruling* Dell *and* Aruba Networks *through Legislative Amendment*

First, the Delaware legislature should add language to section 262(h) that restricts a court's ability to rely solely on deal process unless there has been a genuinely robust arm's length negotiation. Based on the factors articulated in *AOL*, section 262(h) should be amended by adding, immediately after the sentence, "In determining such fair value, the Court shall take into account all relevant factors," the following language:

> The Court shall assign no weight to the merger consideration as indicative of fair value unless a preponderance of the evidence establishes that: (1) all potential bidders had a sufficient and equal opportunity to access relevant information; (2) the market was fully aware of any material information that would have the tendency to effect firm value; (3) the deal had no meaningful structural barriers; and (4) the actors involved were without conflicts of interest that may call into question the integrity of the sales process.[290]

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[287] Levine, *supra* note 3.

[288] *See generally* DEL. COUNCIL OF CORP. LAW, *supra* note 19.

[289] Schoenfeld, *supra* note 20, at 5–6.

[290] This last factor, suggested to be added to the *AOL* framework, would be aimed at erasing the impermissibly low deal process standard approved by *Aruba Networks*. As one commentator stated, "On its face, [in] the 'black-letter law' [*Aruba*] holding . . . the Chancery Court did not abuse its discretion by giving decisive evidentiary weight to deal

A true market test requires a fair and competitive auction,[291] and a level of judicial scrutiny that only requires fiduciary standards be fulfilled is far too permissive in determining whether there has been a sales process resulting in meaningful price discovery.[292]

Applying this framework to *Dell* illustrates how a board may satisfy its fiduciary duties while simultaneously failing to conduct a sale process that is a reliable proxy for fair value. There, the Board formed an independent special committee to approve the sale of the Company to its CEO, and the transaction was approved by an uncoerced stockholder vote.[293] Thus, the Board cleansed the self-interested transaction and satisfied their fiduciary duties.[294] Nevertheless, the sales process was not a meaningful tool for price discovery because HP, the most likely strategic partner for Dell, was precluded from participating in the pre-market canvass.[295] Evercore, the Board's financial adviser, was conflicted when it advised the Board to not reach out to HP during the pre-market canvass because Evercore stood to receive a substantial contingency fee if a topping bid emerged during the go-shop period; and Evercore realized HP was its best bet to collect the fee.[296] HP's late entry into the sales process, however, put HP at a significant informational disadvantage to make a meaningful bid. Under the proposed statutory framework, prong (4) would bar the deal price from being

price . . . despite the litany of process defects and conflicts it identified." Kass, *supra* note 245, at 5; *see also* Brief of Law, Economics and Corporate Finance Professors as *Amici Curiae* in Support of Petitioners-Appellees and Affirmance at 11–12, DFC Glob. Corp. v. Muirfield Value Partners, 172 A.3d 346, 366 (Del. 2017) (No. 518, 2016) [hereinafter Brief of Law, Economics and Corporate Finance Professors] ("Even in contexts involving no clear financial conflicts at the board level . . . . other non-board participants in the sales process (such as financial advisers) tend to receive compensation only once a deal closes, and they may pressure for sales process that ensures a deal by weakening a credible reserve.").

[291] *See* Albert H. Choi & Eric Talley, *Appraising the "Merger Price" Appraisal Rule*, 35 J.L. ECON. & ORG. 543, 559 (2018) (arguing that a merger price rule, where the fair value is always equivalent to the winning bid, is sub-optimal because management's divergent interests prevents them from committing to a credible reserve price during the sales process when there is no viable threat of a judge eschewing that price in an appraisal proceeding); *see also* Peter Cramton & Alan Schwartz, *Using Auction Theory to Inform Takeover Regulation*, 7 J.L. ECON. & ORG. 27, 40 (1991) ("Efficiency is best served by an English auction without a reserve price, which guarantees that the target goes to the highest-valuing firm even when firm values are not identically distributed. Revenue maximization is achieved by an auction (either English or sealed-bid) with a reserve price that exceeds the target's own value.").

[292] *See* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 4, at 1609; Brief of Law, Economics and Corporate Finance Professors, *supra* note 290, at 18 ("The merger price is surely suspect where the target company's board has breached its fiduciary duties. But even outside that context, sales processes are far from uniform.").

[293] *See* discussion *supra* Section III.A.1.

[294] *See* discussion *supra* Section III.A.1.

[295] *See* discussion *supra* Section III.A.1.

[296] *See* discussion *supra* Section III.A.1.

considered as fair value in an appraisal proceeding because Evercore's conflicted advice detrimentally altered the sufficiency of the auction process.[297] If HP had been presented the opportunity to participate in the pre-market canvass, the sales process would likely have been sufficiently robust to warrant deal price deference.

B. Amending 262(h) with an Equitable Consideration Provision

Delaware should also modify the existing language in section 262(h) with the proposed changes:

> Through such proceeding the Court shall determine the fair value of the shares exclusive of any *acquirer specific* element of value arising from the accomplishment or expectation of the merger or consolidation, *unless exclusion would be inequitable*, together with interest, if any, to be paid upon the amount determined to be the fair value.

This provision would serve three primary functions. First, where the court concludes there has been a robust sales process earning deal price deference, the merger consideration in most cases should serve as the floor price regardless of the buyer's status. In *Dell*, the court found that a buyer's status as a financial sponsor did not undermine the probative value of a deal price resulting from a "robust sales process"; the same logic should apply to a strategic buyer.[298] If *Dell* has any meaning, it should stand for the proposition that fair value should never be less than a merger price formed in the crucible of market forces, unless the party advocating for a deduction can prove within a reasonable certainty that the synergies incorporated into the deal price were unique to the specific acquirer. If the acquirer cannot prove that the synergies it paid to target stockholders were unique to the deal,[299] or if the dissenting stockholders have made a good faith showing of identifiable flaws in the sales process (but not enough to eschew deal price deference), the chancery would have equitable discretion to award deal price

[297] *See* discussion *supra* Section III.A.1.

[298] Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1, 27–29, 35 (Del. 2017).

[299] The estimate of synergistic value in any given deal is extremely difficult to ascertain. *See, e.g.*, Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., No. 11448-VCL, 2018 WL 922139, at *44 (Del. Ch. Feb. 15, 2018) ("The respondent's expert conceded that '[t]he percentage of synergies actually paid by HP to Aruba *cannot* be accurately measured.'"(alteration in original) (emphasis added)), *rev'd*, 210 A.3d 128 (Del. 2019).

without having to make a downward adjustment calculation that is inherently "tainted by human error."[300]

Second, where deal process in not indicative of fair value, this provision will give the court discretion, where appropriate, to allocate expected synergistic gain generated by the target.[301] As exemplified in recent cases, petitioners who have proved that a sales process was detrimentally flawed, thereby rebutting deference to deal price, are almost guaranteed to receive an award below the deal price in a synergy-driven merger since synergistic gain must be excluded.[302] In a sense, respondents are now better off conducting a wholly inadequate sales process because dissenting shares in a subsequent appraisal proceeding will be acquired at a discount to the original deal price; and petitioners are worse off for successfully challenging a suspect transaction. This result can hardly be considered fair; and the DGCL's total proscription of synergistic gain is not reflective of real-world market conditions in which the target is responsible for a portion of synergistic gain.[303] An equitable provision, however, would allow the court to extend the concept of fair value to include any "merger-related gains that would ordinarily be shared with a target firm, such as those associated with reduced agency costs," that are not "unique to the combination of a particular buyer and target,"[304] and certain merger specific gains that "the target could, on its own, have realized" by means other than a merger.[305]

While academic scholarship is sparse on how to determine exactly how transaction specific synergies are allocated between the target and acquirer,[306] the court could arrive at this value by estimating the total synergistic value of

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[300] *Id.* at *54.

[301] Lipton, *supra* note 38, at 339 (arguing for a new approach to determining fair value by adding a premium to the target's going concern value for merger-related gains that would reasonably be shared in any acquisition involving the company, excluding only those gains that are buyer-specific); *see also* Edward M. McNally & Patricia A. Winston, *Is Appraisal Arbitrage Past Its Prime?*, MORRIS JAMES LLP (June 7, 2017), https://www.jdsupra.com/legalnews/is-appraisal-arbitrage-past-its-prime-83962/ [https://perma.cc/BE5Z-J2N5] ("It may well be that even if a company lacks the ability to realize all the value of its assets by itself, that value is still there. To let the buyer take all the synergies in such a case by excluding that value from the appraisal award does not seem fair.").

[302] *See, e.g.*, *In re* Appraisal of AOL, Inc., No. 11204-VCG, 2018 WL 1037450, at *21 (Del. Ch. Feb. 23, 2018), *modified by* No. 11204-VCG, 2018 WL 3913775, at *5 (Del. Ch. Aug. 15, 2018) (readjusting fair value further downwards to $47.08 per share); *In re* Appraisal of Jarden Corp., No. 12456-VCS, 2019 WL 3244085, at *4 (Del. Ch. July 19, 2019).

[303] Hamermesh & Wachter, *supra* note 36, at 1003.

[304] Lipton, *supra* note 38, at 339–40.

[305] Hamermesh & Wachter, *supra* note 36, at 997 (explaining example of value generated by target's tax credits).

[306] *See id.* at 1003.

the parties[307] and then allocating a fair division of those synergies based on various factors.[308] For example, the court can consider the respective bargaining positions of the prospective buyer and company during negotiations,[309] the amount of synergies a target typically captures within the subject industry, the target's financial condition, and the terms of the transaction.[310] The burden should then shift to the respondent to show that the value generated by the target's assets was achieved by an externality belonging to the acquirer and should be excluded from the target's going concern value.[311]

The last function of an equitable clause is to modernize the appraisal remedy to provide both exit and liquidity relief. Accordingly, the applicable fair value calculation of dissenting stockholders' shares would be based on the type of merger consideration received in the transaction. If the petitioners have been cashed out entirely, appraisal should serve as an exit function; and, therefore, the concept of fair value would be extended to include the certain synergistic gains described above, if any exist. Conversely, if petitioners have received a significant portion of stock in the surviving entity, appraisal should serve its liquidity function; and, thus, fair value would be confined to the traditional concept of going concern value that excludes synergistic gains.

CONCLUSION

In light of the diminishing role of fiduciary litigation and limited stockholder protections, a fresh look at the appraisal remedy's role in Delaware is warranted. It is imperative that hedge funds and other sophisticated entities still view appraisal arbitrage as a viable and lucrative investment strategy. In a post-*Dell* world, the new risks and uncertainties in appraisal litigation will no doubt deter arbitrageurs' future activity, resulting in lower deal premiums and encouraging less than best practices in the market for corporate control. In the absence of

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[307] *Cf. id.* at 999 (explaining a DCF methodology to estimate anticipated synergies in a specific transaction).

[308] *See* Lipton, *supra* note 38, at 339; *see also* Korsmo & Myers, *Flawed Corporate Finance*, *supra* note 90, at 281 (arguing that, where the court uses deal price for fair value, the appropriate treatment of synergies is to deduct only value that is unique to the acquirer).

[309] Hamermesh & Wachter, *supra* note 36, at 1005–06 (explaining that as bargaining strength increases, so does the receipt of synergies).

[310] JENS KENGELBACH ET AL., BOS. CONSULTING GRP., DIVIDE AND CONQUER: HOW SUCCESSFUL M&A DEALS SPLIT THE SYNERGIES 10 (2013).

[311] *Cf.* Alexander R. Slusky & Richard E. Caves, *Synergy, Agency, and the Determinants of Premia Paid in Mergers*, 39 J. INDUS. ECON. 227, 278 (1991).

legislative action, the benefits of appraisal arbitrage, such as the litigation of meritorious claims, the unearthing of corporate malfeasance, and the *ex ante* protections it provides minority stockholders will be eviscerated.

Thomas J. Meriam†

† J.D. Candidate, Brooklyn Law School, 2020; B.A. College of the Holy Cross, 2013. Thank you to Megan Adams, Muhammad Sardar, Max Lovrin, Dean Ferrogari, and the entire *Brooklyn Law Review* staff for all of their time, hard work, and thoughtful feedback throughout the writing process. Special thanks to my brother in-law, Aaron Ford, for introducing me to this topic and providing insight from a finance perspective, and to my father, Tom Meriam, for constantly making the time to offer feedback and advice from a legal perspective. Finally, and most importantly, thank you to my girlfriend, Brittany Carroll, for all of her love and support throughout law school.