APPRAISAL ARBITRAGE: IN CASE OF EMERGENCY, BREAK GLASS

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"But may not the existence of just such a[n] [appraisal] right—a switch which will be pulled only in case of emergency—be desirable[?]"[1]

Introduction

For most of its history, academics considered the statutory right to appraisal a sleepy, burdensome remedy with little to no economic value.[2] Yet as the contemporary uptick in appraisal filings and scholarship indicate, this once idle remedy has seen a rebirth in the past decade—to the consternation of many.[3] Indeed, appraisal in Delaware has shifted from a seldom used antidote to corporate law's majority rule to a new form of short-term investment strategy dubbed "appraisal arbitrage."[4] Appraisal arbitrage occurs when large investors, typically hedge funds,[5] purchase shares of a company after the announcement of a merger in order to contest the sufficiency of the deal

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1 Melvin Aron Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 Calif. L. Rev. 1, 85–86 (1969).

2 In the 1960s and 1970s, scholars for the most part dismissed or "heaped scorn" on the remedy, including—most notably—Yale Law Professor Bayless Manning, who described appraisal as "of virtually no economic advantage to the usual shareholder except in highly specialized situations." Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 Wash. U. L. Rev. 1551, 1560 (2015) (quoting Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 Yale L.J. 223, 260 (1962)) (internal quotation marks omitted).

3 *See, e.g.*, Charles Korsmo & Minor Myers, *Reforming Modern Appraisal Litigation*, 41 Del. J. Corp. L. 279, 282–84 (2017). *See generally* Korsmo & Myers, *supra* note 2, at 1560–66.

4 Wei Jiang et al., *Appraisal: Shareholder Remedy or Litigation Arbitrage?*, 59 J.L. & Econ. 697, 701 (2016).

5 *Id.* at 698.

price and hopefully get more consideration for their shares.[6] Under Delaware's appraisal statute,[7] any shareholder—even an abhorred appraisal arbitrageur—has an absolute right to appraisal in certain types of merger transactions, provided they meet the procedural requirements of the statute.[8]

Although appraisal petitions only represent about "one out of every twenty merger-related lawsuits,"[9] the recent explosion of the remedy has drawn attention and criticism from all sides. Many scholars—and especially practitioners—contend appraisal arbitrage is "rent-seeking,"[10] unnecessarily increases transaction costs,[11] and is generally of little to no social value.[12] Some even worry that it will eventually turn into a form of "nuisance litigation," if it is not that already.[13]

Yet the fundamental critique of appraisal arbitrage focuses not necessarily on the costs it imposes or the judicial resources it consumes, but rather on the misalignment between the strategy as currently utilized and the historic purpose of the remedy—providing liquidity for shareholders who, without a veto right, are forced to receive an "illiquid instrument."[14] Indeed, appraisal arbitrageurs typically purchase their shares after the announcement of a merger, choosing to buy into the transaction rather than looking for an escape hatch out.[15] Although this is certainly not the way in which the statute was originally designed to be utilized,[16] this criticism largely overlooks one of the main goals of stockholder litigation: deterrence.[17] As most scholars agree that the more emergent purpose of the appraisal remedy is to protect minority shareholders from being compelled to accept less than the fair value of their shares,[18] having a large, sophisticated party in the wings who is able to bring suit absent a fair price is powerful. In this sense, what looks like opportunistic behavior by arbitrageurs might actually be socially desirable.

This Note argues two points, each fairly modest in ambition. First, it suggests that appraisal is a justified and desirable remedy, despite the unde-

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6 Jay B. Kesten, *The Uncertain Case for Appraisal Arbitrage*, 52 WAKE FOREST L. REV. 89, 89 (2017).

7 DEL. CODE ANN. tit. 8, § 262 (2016).

8 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 9.43 (3d ed. 2017).

9 Korsmo & Myers, *supra* note 3, at 282.

10 Desiree M. Baca, Note, *Curbing Arbitrage: The Case for Reappraisal of Delaware's Appraisal Rights*, 13 N.Y.U. J.L. & BUS. 425, 427 (2017).

11 Stanley Onyeador, Note, *The Chancery Bank of Delaware: Appraisal Arbitrageurs Expose Need to Further Reform Defective Appraisal Statute*, 70 VAND. L. REV. 339, 375 (2017).

12 Trevor Norwitz, *A Debate: Is the Delaware Appraisal Rights Remedy in Need of Repair?*, BUS. L. TODAY, Jan. 2017, at 1, 1–2.

13 Korsmo & Myers, *supra* note 2, at 1600.

14 Kesten, *supra* note 6, at 93.

15 *Id.* at 110.

16 *See infra* Section I.B.

17 Korsmo & Myers, *supra* note 3, at 317.

18 *See* 4 JAMES D. COX & THOMAS LEE HAZEN, TREATISE ON THE LAW OF CORPORATIONS § 22:24 (3d ed. 2016).

sirability of appraisal petitioners in recent years. In a world that loves to root for the underdog, no matter the circumstances,[19] arbitrageurs are the antithesis. Yet if we accept that today appraisal is at its core about deterrence and protecting minority shareholders, then it should not matter who is bringing the suit, so long as it is meritorious.[20] As there is evidence that appraisal arbitrage continues to benefit shareholders, especially ex ante, there is little reason for the Delaware legislature to adopt additional requirements meant to keep out the arbitrageurs who are bringing these cases.

Second, this Note argues that although Delaware's contemporary trend toward using merger price as the best evidence of fair value—in auction settings where there was publicly available information and arm's-length dealing—should, in conjunction with the 2016 amendments to the appraisal statute, eliminate many of the concerns about unmeritorious appraisal litigation, there are nevertheless potential issues with such a trend. Specifically, this Note argues that to the extent this trend indicates a greater skepticism of alternative valuation methods, even in suspect transactions, there is a risk that the court will too often simply return the merger price as fair value, disincentivizing even meritorious appraisal petitions and harming the deterrence value of the remedy. Accordingly, this Note suggests appointing a neutral expert to arbitrate valuation disputes (specifically when examining Discounted Cash Flow models), which could offer the court some much needed reliability and increase the likelihood that alternative valuation methods will be used instead of the merger price.

Part I of this Note introduces the appraisal remedy, outlining its history, purpose, and modern justifications. It also details the procedural process for bringing an appraisal claim. Part II examines the rise of appraisal in its current arbitrage form, delving into the various reasons set forth to explain its rise, as well as how the recent amendments to the Delaware appraisal statute have addressed these issues. This Part also analyzes Delaware's recent merger price "presumption" trend. Part III puts forth several arguments in light of this trend, with the intent that such arguments will both justify and protect the remedy's deterrence value. This is followed by a brief conclusion.

I. Appraisal in Delaware: A Historical Overview

This Part provides a brief overview of appraisal rights and the appraisal process in order to offer the reader a foundation for understanding the current appraisal debate. Although much could be said about the appraisal remedy from a historical standpoint,[21] this Note seeks to address appraisal as it is currently utilized given that the remedy's trajectory has changed drastically over time. This Part lays the groundwork for several justifications and

19 *See* Daniel Engber, *The Underdog Effect*, Slate (Apr. 30, 2010), http://www.slate.com/articles/health_and_science/science/2010/04/the_underdog_effect.html.

20 *See* Korsmo & Myers, *supra* note 3, at 316.

21 For a historical overview before the recent sea change in appraisal, see generally Manning, *supra* note 2.

defenses of the appraisal remedy, which will become relevant to the arguments in Part III.

A. *The Role and History of Appraisal*

Historically, merger approval required the unanimous consent of all stockholders.[22] The rationale for unanimity was that purchasing stock in a firm gave you a contract right, and thus the stockholder's approval was necessary before you could divest him of that right.[23] Unanimity, however, allowed just a single shareholder to prevent a majority-approved merger from going forward, creating a holdup problem for corporations across the United States.[24] Yet as Professors James Cox and Thomas Hazen note, "[b]ecause of the importance of contract and property rights, courts [initially] held grave doubts regarding the constitutionality of permitting corporate actions over the protest of any single shareholder."[25] Indeed, the skepticism of corporate consolidations and mergers was reflected in an opera at the time, which had the line: "Is it worse to rob a bank than merge a bank?"[26] Nevertheless, as the holdout problem persisted, the courts' concern quickly gave way to practicality. Pennsylvania was the first state to provide an appraisal remedy to a minority, dissenting shareholder in a merger,[27] and other states eventually followed suit.[28] Delaware, the state around which most of corporate law centers, enacted its appraisal statute in 1899.[29]

The original purpose of appraisal was "to compensate stockholders for the loss of veto power and to give dissenters the right to exit the corporation and recover the cash value of their shares," which is commonly referred to as the liquidity rationale.[30] Absent a veto right, a shareholder could, as illustrated by Professor Bayless Manning, own a horse and suddenly find that

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22 1 BALOTTI & FINKELSTEIN, *supra* note 8, § 9.42.

23 David J. Ratway, *Delaware's Stock Market Exception to Appraisal Rights: Dissenting Minority Stockholders of* Warner Communications, Inc. *are "Market-Out" of Luck*, 28 U. TOL. L. REV. 179, 183 (1996).

24 *Id.*

25 4 COX & HAZEN, *supra* note 18.

26 Manning, *supra* note 2, at 246.

27 *See* Lauman v. Lebanon Valley R.R. Co., 30 Pa. 42, 42 (1858) (holding that "[a single stockholder] cannot be compelled by law to accept the stock of the other company in payment for the shares held by him" unless the majority members "first giv[e] security for the interest of such dissenting stockholder").

28 Robert B. Thompson, *Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law*, 84 GEO. L.J. 1, 14 (1995) (noting that in 1909 only about half of states still required a unanimous vote to approve a merger, but it was not until the 1920s and 1930s that the appraisal remedy spread throughout the United States). Today, all fifty states have an appraisal remedy. Albert Choi & Eric Talley, *Appraising the "Merger Price" Appraisal Rule* 2 (Va. Law & Econ., Research Paper No. 2017-01, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2888420.

29 *See In re* Appraisal of Ancestry.com, Inc., No. 8173, 2015 WL 66825, at *3 (Del. Ch. Jan. 5, 2015).

30 1 BALOTTI & FINKELSTEIN, *supra* note 8, § 9.42.

after the merger, he owned a cow instead.[31] The perceived injustice of this reality was informed by an early suspicion and distaste for corporate combinations in general, strengthening the need for some sort of remedy to let the shareholder out of the transaction in the absence of veto power.[32] Thus, to compensate shareholders for this perceived injustice and to provide liquidity, appraisal offered shareholders a choice: accept the deal—a cow for a horse—or dissent and seek appraisal.[33]

B. The Modern Justifications of Appraisal

The liquidity rationale, although still at play today, is largely secondary in significance to a more pressing concern: the need to protect minority shareholders from majority abuse, especially in transactions involving a perceived conflict of interest or the potential for self-dealing.[34] Appraisal petitions today tend to be used to dissent from transactions with "lower deal premia," as well as going-private transactions, which are precisely the ones most likely to take advantage of minority shareholders.[35]

A classic example of the type of merger in which concern for minority shareholders abounds (and one of the types of mergers granted appraisal rights in Delaware's appraisal statute),[36] is the short-form merger. A short-form merger occurs "when a subsidiary merges into a parent that already owns most of the subsidiary's shares,"[37] usually around ninety percent.[38] In such a scenario, there is a risk that the parent company will offer the subsidiary's shareholders a price for their shares that is less than fair value, because the transaction does not require a shareholder vote[39] (meaning there is less incentive to pay a competitive price). However, in such a scenario, the availability of the appraisal remedy serves as an ex ante threat to those companies

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31 Manning, *supra* note 2, at 246.

32 *See id.*

33 Helen M. Richards, Comment, Cede & Co. v. Technicolor, Inc.*: A Whole New Ball Game for Dissenting Shareholders*, 14 DEL. J. CORP. L. 999, 1002–03 (1989).

34 4 COX & HAZEN, *supra* note 18; Ernest L. Folk III, *De Facto Mergers in Delaware:* Hariton v. Arco Electronics, Inc., 49 VA. L. REV. 1261, 1293 (1963); Thompson, *supra* note 28, at 4.

35 Korsmo & Myers, *supra* note 2, at 1555. The authors measure merger premiums by computing an expected merger premium based on key variables such as the year of the merger, the size of the corporation, and the industry. They then use the difference between the expected and the actual premium to approximate the merits of the stockholders' claim. *Id.* at 1593–94. Negative deal premium indicates that petitioners are targeting deals with merit (i.e., the merger price is less than what it likely should have been). *Id.* at 1594–95.

36 DEL. CODE ANN. tit. 8, § 262(b)(3) (2016); 1 BALOTTI & FINKELSTEIN, *supra* note 8, § 9.43[A].

37 *Merger*, BLACK'S LAW DICTIONARY (10th ed. 2014).

38 *See Short-form Merger*, Practical Law Glossary Item 0-382-3820 (West 2017).

39 *See id.*

who would consider offering a low price,[40] and an ex post remedy for shareholders who feel they have not received a fair one.[41] Thus, appraisal can serve as a defense against "sloth, negligence, or unconscious bias in the sales process."[42]

Admittedly, fiduciary duty litigation is also meant in part to protect minority shareholders, albeit against particular directors personally rather than the company as a whole.[43] However, the appraisal remedy in recent years has been used more frequently to further this shared objective.[44] Although some scholars believe that the appraisal remedy unnecessarily duplicates fiduciary duty cases—specifically, management breaches of the duty of loyalty—others theorize that the remedy is a welcome complement to the fiduciary duty alternative.[45] Professors Hideki Kanda and Saul Levmore argue that appraisal is valuable notwithstanding the fiduciary duty alternative because it "does not require an allegation of managerial misconduct."[46] Indeed, appraisal is a fundamentally different inquiry from that of a fiduciary duty case: it is only concerned with whether the shareholders received a fair price for their shares.[47] The price could certainly be unfair because of a breach of fiduciary duty, but even without a breach, the court may—and often does—find that the fair price is higher than what was offered to the shareholders.[48] To put it another way, the "conclusion that a sale was con-

40 *See* Folk, *supra* note 34, at 1293 (describing appraisal rights as a "shield of protection" against insiders).

41 *See* Eisenberg, *supra* note 1, at 86 (noting that appraisal has value because it "serve[s] as a well-designed emergency switch to check management improvidence"); Jiang et al., *supra* note 4, at 698 (noting that appraisal can be used to "fight[ ] managerial agency costs that can lead to certain forms of mergers").

42 Korsmo & Myers, *supra* note 2, at 1555.

43 Korsmo & Myers, *supra* note 3, at 321–22.

44 *See, e.g.*, *In re* Appraisal of Dell Inc., No. 9322, 2015 WL 4313206, at *23 n.22 (Del. Ch. July 13, 2015) (noting that "[s]trong arguments can be made that appraisal represents a more rational and efficient alternative to traditional fiduciary duty litigation"); Thompson, *supra* note 28, at 4 ("In earlier times, policing transactions in which those who controlled the corporation had a conflict of interest was left to the courts through the use of fiduciary duty or statutes that limited corporate powers. Today, that function is left for appraisal in many cases.").

45 Paul G. Mahoney & Mark Weinstein, *The Appraisal Remedy and Merger Premiums*, 1 AM. L. & ECON. REV. 239, 251 (1999). *But see* Norwitz, *supra* note 12, at 2–3.

46 Mahoney & Weinstein, *supra* note 45, at 251 (citing Hideki Kanda & Saul Levmore, *The Appraisal Remedy and the Goals of Corporate Law*, 32 UCLA L. REV. 429 (1985)).

47 *See, e.g.*, Huff Fund Inv. P'ship v. CKx, Inc., No. 6844, 2013 WL 5878807, at *13 (Del. Ch. Nov. 1, 2013) ("[T]he issue in this case is fair value, not fiduciary duty.").

48 In this, the court is careful not to conflate fiduciary duty obligations with appraisal rights, since the two are "conceptually and doctrinally distinct." Brief of Law, Economics and Corporate Finance Professors as Amici Curiae in Support of Petitioners-Appellees and Affirmance at 6, DFC Glob. Corp. v. Muirfield Value Partners, L.P., No. 2016-548-13, 2017 WL 589458 (Del. Feb. 9, 2017) [hereinafter Brief of Law].

ducted by directors who complied with their duties of loyalty is not dispositive of the question of whether that sale generated fair value."[49]

C. Procedural Requirements

Although determining fair value can be difficult, as we will later see, understanding when and how appraisal becomes available is a different challenge entirely. Delaware's appraisal statute triggers an absolute right to appraisal for only certain types of mergers, such as mergers involving cash consideration, short-form mergers, and interested transactions.[50] Additionally, corporations may specify other enumerated situations that will trigger appraisal rights in their charters.[51] Yet, as original critics of the statute were quick to note, burdensome procedural requirements generally make it difficult to pursue appraisal claims, even if available in a plethora of circumstances.[52] Moreover, the Delaware courts require technical compliance with the statute, leaving little room for any equitable considerations.[53] Add in the fact that any shareholder electing to appraise his or her shares does not receive any consideration until the resolution of the appraisal[54]—which could be several years away—and one can begin to understand why appraisal had a reputation for being a "remedy of desperation" for much of its history.[55] Despite these difficulties, however, petitioners continue to bring their claims in accordance with the statute's requirements, as detailed below.

First, at least twenty days prior to a meeting in which the shareholders will be voting for or against the merger or consolidation, the company must inform all stockholders entitled to appraisal rights[56] of the upcoming vote.[57] At that time, the company must also provide shareholders with the necessary material facts that will allow them to determine whether to accept the merger

49 *In re* Appraisal of Ancestry.com, Inc., No. 8173, 2015 WL 399726, at *16 (Del. Ch. Jan. 30, 2015).

50 1 BALOTTI & FINKELSTEIN, *supra* note 8, § 9.43[A].

51 *Id.*

52 ROBERT CHARLES CLARK, CORPORATE LAW § 12.2, at 508 (1986) ("[A]ppraisal is often a cumbersome remedy."); PETER V. LETSOU, CASES AND MATERIALS ON CORPORATE MERGERS AND ACQUISITIONS 429 (2006) (referring to the appraisal statute as a "complicated maze"); Korsmo & Myers, *supra* note 2, at 1561 (characterizing the appraisal process as a "supposedly Byzantine procedure").

53 *See* Berger v. Pubco Corp., 976 A.2d 132, 144 (Del. 2009) ("Our case law is replete with examples where dissenting minority shareholders that failed to comply strictly with certain technical requirements of the appraisal statute, were held to have lost their entitlement to an appraisal . . . .").

54 *See* Turner v. Bernstein, 776 A.2d 530, 547–48 (Del. Ch. 2000). Shareholders also lose other benefits of ownership, such as the right to vote or the right to receive dividends. 1 BALOTTI & FINKELSTEIN, *supra* note 8, § 9.44[J].

55 Eisenberg, *supra* note 1, at 85.

56 1 BALOTTI & FINKELSTEIN, *supra* note 8, § 9.44[A]. Those entitled to appraisal rights must be stockholders of record (i.e., they must own the stock of the company on whatever day the company determines its stockholders for notice purposes). *Id.* § 9.43[B].

57 *Id.* § 9.44[A].

consideration or to instead seek appraisal.[58] These material facts comprise detailed information about premerger financials, the proper procedure for seeking out a judicial appraisal of shares, and a copy of the appraisal statute itself, which is strictly required.[59]

Any shareholder wishing to pursue appraisal must then submit a written demand to the corporation prior to the merger vote.[60] Simply voting against the merger does not preserve one's appraisal rights; a stockholder, largely for notice reasons, must submit the written demand ex ante.[61] This is important because it allows the corporation to get some sense of the risk, in dollar terms, of going forward with a merger.[62] Finally, at the vote itself, the shareholder may not vote in favor or consent to a vote in favor of the merger.[63] Should this occur, appraisal rights are strictly forfeited.[64]

After the vote, the corporation must, within ten days, notify each stockholder—who provided a written demand for appraisal, and did not vote in favor of the merger—of the effective date of the merger.[65] Only stockholders who held their shares continually from the date of their written demand through the effective date of the merger will preserve their appraisal rights,[66] in large part because the statute is designed to prevent any opportunistic behavior in this regard.[67] At this time, stockholders are also entitled to receive a statement documenting the aggregate number of shares for which appraisal was demanded, as this information can be useful in determining whether or not to proceed with appraisal.[68]

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58 *Id.* § 9.44[B]. "Materiality" is determined using the same standards as in other contexts. *Id.*

59 DEL. CODE ANN. tit. 8, § 262(d)(1) (2016); 1 BALOTTI & FINKELSTEIN, *supra* note 8, § 9.44[A].

60 tit. 8, § 262(d)(1).

61 1 BALOTTI & FINKELSTEIN, *supra* note 8, § 9.44[C].

62 *See* Ala. By-Prods. Corp. v. Cede & Co., 657 A.2d 254, 263 (Del. 1995) ("This information allows the corporation to allocate the funds necessary to pay the dissenting shareholders the fair value of their stock." (citing Salt Dome Oil Corp. v. Schenck, 41 A.2d 583, 589 (Del. 1945))). If a corporation senses that many of its shareholders will dissent, it may call off the vote altogether or actually increase the deal price to try and prevent arbitrageurs from following through with their threatened claims. *See* Baca, *supra* note 10, at 443.

63 tit. 8, § 262(a); 1 BALOTTI & FINKELSTEIN, *supra* note 8, § 9.43[B].

64 tit. 8 § 262(a); Richards, *supra* note 33, at 1005.

65 1 BALOTTI & FINKELSTEIN, *supra* note 8, § 9.44[D]. This is assuming the merger receives enough shareholder votes to be approved; if not, there will be no effective date because there will be no merger.

66 tit. 8, § 262(a); Abraham & Co. v. Olivetti Underwood Corp., 204 A.2d 740, 742–43 (Del. Ch. 1964).

67 *See* 1 BALOTTI & FINKELSTEIN, *supra* note 8, § 9.43[B] ("This requirement is intended to deny appraisal rights to a party who was a stockholder of record when the demand was made, then sold shares only to reacquire other shares so as to become a stockholder of record on the effective date.").

68 *Id.* § 9.44[E].

Dissenting shareholders who still wish to seek appraisal then have 120 days after the effective merger date to file an appraisal petition with the court.[69] A single filing by a dissenting shareholder preserves the remedy for all of the shareholders eligible for appraisal, although each petitioner will have to proceed individually, as there are no class action or collective action procedures in the appraisal context.[70] Alternatively, shareholders may decide to negotiate a settlement rather than endure protracted litigation to determine the fair value of their shares.[71] Professors Charles Korsmo and Minor Myers postulate that in the appraisal context, the strongest claims are the ones most likely to settle, although conclusive data remains admittedly limited.[72]

After jumping through each of these procedural hoops—which are necessary simply to preserve the remedy and do not in any way prove or validate a claim—the court may additionally require a hearing to establish which stockholders have met all of the procedural requirements and are thus entitled to appraisal.[73] In that hearing, each stockholder bears the burden of proof of having achieved perfect compliance with the statute,[74] as the corporation itself has no responsibility to determine stockholders' eligibility for the remedy.[75] If a shareholder successfully makes it through all of the highly technical requirements above, he or she can finally proceed with the claim. Yet the hard work is far from over: appraisal petitions going through the judicial process take an average of two to three years to resolve.[76] During this time, shareholders must fund the litigation out of pocket, as they receive no consideration for their shares until a judicial resolution determines whether they were offered a fair price for their shares or are justified in receiving a different one.[77]

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69 *Id.* § 9.44[F].

70 *Id.* One caveat to this statement: quasi-appraisal is available as an equitable remedy for disclosure violations and allows the stockholders to proceed with an appraisal claim as an opt-out class. Korsmo & Myers, *supra* note 3, at 337.

71 According to Korsmo and Myers, "[p]ractioners have reported . . . that as many as one in four appraisal demands settles without a public filing." Korsmo & Myers, *supra* note 3, at 292. However, settlements may be more difficult to achieve than in the fiduciary duty context, largely because appraisers lack a class structure that can use "collective leverage" to reach a settlement with the relevant parties. Onyeador, *supra* note 11, at 346.

72 Korsmo & Myers, *supra* note 3, at 292–93. More recent research indicates that more than eighty percent of appraisal cases settle before trial. Jiang et al., *supra* note 4, at 699.

73 1 BALOTTI & FINKELSTEIN, *supra* note 8, § 9.44[H]. The corporation can expressly or impliedly waive its right to this hearing. *Id.*

74 *Id.*

75 *See* Dirienzo v. Steel Partners Holdings L.P., No. 4506, 2009 WL 4652944, at *7 (Del. Ch. Dec. 8, 2009) ("[N]othing in Section 262 requires a company to notify dissenting stockholders prior to the filing of an appraisal petition that they failed to comply with Section 262. The court determines those who are entitled to appraisal *after* an appraisal petition has been filed.").

76 Gaurav Jetley & Xinyu Ji, *Appraisal Arbitrage—Is There a Delaware Advantage?*, 71 BUS. LAW. 427, 452 n.86 (2016).

77 DEL. CODE ANN. tit. 8, § 262(h), (i) (2016).

II. The Rise of Appraisal Arbitrage: New Developments

But there is a different species of professional shareholder-at-large whose mind and method run somewhat differently. He, or his counsel, sees in the appraisal statutes a jimmy that will open windows. . . . He can abuse the procedural process under the appraisal statute to the cost and disruption of the enterprise.

Bayless Manning, 1962[78]

Despite a strong normative belief in the necessity of the appraisal remedy given shareholders' loss of veto power, appraisal was viewed for most of its history as unhelpful and practically useless.[79] Referred to as a "last-ditch check on management improvidence,"[80] scholarly criticisms largely stemmed from the understanding that sophisticated parties could simply structure transactions to avoid triggering appraisal rights.[81] Others dismissed the remedy outright because of its onerous procedural requirements, as outlined above.[82]

Notwithstanding these requirements, however, the twenty-first century has seen an increase in appraisal proceedings, most of which fall under what has been termed "appraisal arbitrage."[83] Between 2004 and 2010, for example, only five percent of appraisal-eligible transactions led to an appraisal petition, but by 2013 more than fifteen percent of eligible transactions attracted appraisal.[84] This increase in appraisal occurred despite no corresponding increase in merger activity.[85] Moreover, not only were repeat players such as investment firms and hedge funds the ones bringing these petitions,[86] but the amount of money at stake had also significantly increased.[87]

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78 Manning, *supra* note 2, at 238.

79 Korsmo & Myers, *supra* note 2, at 1560.

80 *Id.* (quoting Victor Brudney & Marvin A. Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 Harv. L. Rev. 297, 304 (1974)).

81 *Id.*

82 *Id.* at 1560–61; *see also supra* Section I.C.

83 Korsmo & Myers, *supra* note 2, at 1573–74.

84 Claudia H. Allen et al., *Proceedings of the 2016 Delaware Business Law Forum: A Review and Debate of the Public Policy Implications of Delaware Law*, 72 Bus. Law. 755, 759–60 (2017) (citing Korsmo & Myers, *supra* note 2, at 1570). Of these petitions, an unusually high rate, around fifteen percent, end up resulting in a trial. Korsmo & Myers, *supra* note 3, at 286.

85 Korsmo & Myers, *supra* note 2, at 1571–72.

86 *Id.* at 1572 ("Since 2011, more than eighty percent of appraisal proceedings have involved a repeat petitioner . . . ."); *see also* Jiang et al., *supra* note 4, at 706 ("Merion Capital, Magnetar Capital, Merlin Partners, Ancora, and Quadre Investments are the main players. Together they file[d] petitions in 61 deals, or about 27.1 percent of all the deals challenged between 2000 and 2014.").

87 Korsmo & Myers, *supra* note 2, at 1553 ("The value of claims in appraisal in 2013 was nearly $1.5 billion, a tenfold increase from 2004 . . . ."). This value is "more than five times the highest value of dissenting shares in the five years prior." Craig Boyd, Comment, *Appraisal Arbitrage: Closing the Floodgates on Hedge Funds and Activist Shareholders*, 65 U. Kan. L. Rev. 497, 503 (2016).

Although there is not a firm consensus within the scholarly community about why appraisal arbitrage occurs, there are three chief reasons cited for its rise, each of which will be discussed in turn below. This Part then briefly overviews the 2016 amendments to the Delaware appraisal statute—which were put in place to address some of these concerns—and also identifies a recent trend in the Delaware Supreme Court's jurisprudence that casts light on the appraisal remedy's future and grounds the suggestions made in Part III.

A. *Record Date and the Opportunistic Investor*

Delaware's appraisal statute allows only those who are holders of record and who did not vote their shares in favor of the merger to seek appraisal.[88] Yet in *In re Appraisal of Transkaryotic Therapies, Inc.*,[89] the court held that those seeking appraisal do not need to prove that their specific shares were not voted in favor of the merger.[90] This is in large part because shares are often held by stockholders—holders of record—on behalf of multiple beneficial owners.[91] These stocks are held in large depositories and registered in name to the holder of record, and beneficial owners own a pro rata share of these stocks rather than specific shares or blocks of shares.[92] Thus, it would be impossible and, indeed, a judicial fiction, to decide which specific shares a beneficial owner owned and told the holder of record not to vote in favor of the merger.[93] It is sufficient to show that enough shares were not voted in favor of the merger such that it is mathematically possible that the beneficial owner's shares were not voted in favor of it.[94]

The judge in *Transkaryotic* noted that the decision he reached might "encourage appraisal litigation initiated by arbitrageurs who buy into appraisal suits," but noted that this was for the legislature rather than the courts to manage.[95] Subsequent articles have frequently pointed to this decision as one of the major driving forces behind appraisal arbitrage,[96] because arbitrageurs can acquire stock after the announcement of a merger and still pursue appraisal.[97] Indeed, the *Transkaryotic* decision is significant because it

88 Del. Code Ann. tit. 8, § 262(a) (2016).

89 No. 1554, 2007 WL 1378345 (Del. Ch. May 2, 2007).

90 *Id.* at *3.

91 *Id.* at *2.

92 *Id.*

93 *See id.*

94 *Id.* at *4; Norwitz, *supra* note 12, at 3.

95 *Appraisal of Transkaryotic Therapies, Inc.*, 2007 WL 1378345, at *5.

96 *See, e.g.*, Kesten, *supra* note 6, at 102–05; Baca, *supra* note 10, at 434–37; Boyd, *supra* note 87, at 503–05; Onyeador, *supra* note 11, at 363–66. *But see* Richard A. Booth, *The Real Problem with Appraisal Arbitrage*, 72 Bus. Law. 325, 327–30 (2017); Korsmo & Myers, *supra* note 2, at 1553–54.

97 *See, e.g.*, Merion Capital LP v. BMC Software, Inc., No. 8900, 2015 WL 67586, at *1 (Del. Ch. Jan. 5, 2015) (noting that the merger was announced in May, and the appraisal arbitrageurs began purchasing their shares in July; this was after determining to "invest" in appraisal because the target in the acquisition appeared to be undervalued).

allows shareholders to purchase shares up until the date of the shareholder vote, giving appraisal arbitrageurs ample time to peruse the company-provided information about the upcoming merger to determine whether to buy-in or not.[98] Opponents of appraisal arbitrage say this offers arbitrageurs an unfair advantage—essentially a free call option[99]—and that it contravenes the purpose of the appraisal statute.[100]

There are others, however, who suggest that allowing appraisal arbitrageurs to essentially buy into a case is advantageous.[101] It allows petitioners to not only signal serious intent by buying in, but by thoroughly reviewing the case before deciding to proceed with it, petitioners can generally ensure that more cases are brought on their merits.[102] Rather than simply contesting any deal above a certain dollar amount, as we see happening in the fiduciary duty class action context, arbitrageurs can bring a claim in which they actually suspect there is a difference between what was offered for the shares and the fair value of what they are worth.[103]

B. Interest Rate Advantage

Another oft-cited reason for the recent uptick in appraisal arbitrage is the statutory interest rate associated with the appraisal statute.[104] In 2007, the Delaware legislature changed the interest rate on appraisal claims to five percent above the federal funds rate, compounded quarterly.[105] This generous rate arguably encourages appraisal arbitrageurs to bring suit because even if their shares do not receive a large premium over the merger price at trial, they still accrue interest throughout the litigation, which usually takes

98 *See* Kesten, *supra* note 6, at 102. *But see* Booth, *supra* note 96, at 328 (arguing that "[i]t is almost impossible for any information revealed after a merger is announced to affect fair price as determined by an appraisal court").

99 Jetley & Ji, *supra* note 76, at 430. There is an average of ninety-one days between the announcement of a merger and the shareholder meeting in which arbitrageurs would need to vote against the merger. *Id.* at 436 fig.1.

100 *See* Theodore Mirvis, *Delaware Court Decisions on Appraisal Rights Highlight Need for Reform*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE & FIN. REG. (Jan. 21, 2015), https://corpgov.law.harvard.edu/2015/01/21/delaware-court-decisions-on-appraisal-rights-highlight-need-for-reform/.

101 *See, e.g.*, Baca, *supra* note 10, at 445.

102 *See* Charles R. Korsmo & Minor Myers, *The Structure of Stockholder Litigation: When Do the Merits Matter?*, 75 OHIO ST. L.J. 829, 836 (2014).

103 An estimated ninety percent of all mergers are challenged by fiduciary duty litigation, with the percentage being even higher in mergers of over 100 million dollars. Korsmo & Myers, *supra* note 2, at 1581. For broader litigation trends in corporate business transactions, see Matthew D. Cain & Steven M. Davidoff, *Takeover Litigation in 2012* (Feb. 1, 2013), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2216727.

104 *See, e.g.*, Jiang et al., *supra* note 4, at 700.

105 76 Del. Laws 145 (2007); Korsmo & Myers, *supra* note 2, at 1580. The Delaware courts have power, in equity, to apply a different interest rate if there has been bad faith or improper delay on the part of the petitioning party. DEL. CODE ANN. tit. 8, § 262(h) (2016); *In re* Appraisal of Metromedia Int'l Grp., Inc., 971 A.2d 893, 907 (Del. Ch. 2009).

two to three years.[106] This so-called interest rate advantage explains in part why Merion Capital, an appraisal arbitrageur, was reportedly allocated one billion dollars to pursue appraisal related claims as an investment strategy in 2013,[107] and observed in its promotional materials that the "'typical' worst case scenario [in an appraisal petition] is the deal price plus statutory interest."[108] Although some scholars argue that the interest rate that petitioners receive in appraisal actions is not actually that attractive when you compare it to the stock market and other comparable investments,[109] others nevertheless see the interest rate as a driver of appraisal activity.[110] As such, this issue was expressly addressed in the 2016 amendments, which will be discussed shortly.

C. *Judicial Valuation of Shares*

Finally, the true goal of appraisal arbitrage is to receive a judicially determined fair value for one's shares above and beyond the merger price per share.[111] Without that possibility, it is unlikely that any information advantage or attractive interest rate alone will incentivize appraisal. This is in large part because appraisal arbitrageurs seek a value for their shares which is above the going concern value, and receive a low or potentially even negative return when the court's valuation is merely the merger price.[112] Accordingly, the most pervasive, powerful, and consistent criticism of appraisal is simply that courts are ill suited to return accurate valuations of "fair value," which is what is required of courts under Delaware's appraisal statute.[113] Not just academics but the justices themselves have repeatedly noted the difficulty of this task.[114]

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106 Jetley & Ji, *supra* note 76, at 452 n.86.

107 Miles Weiss, *Dell Value Dispute Spotlights Rise in Appraisal Arbitrage*, BLOOMBERG (Oct. 3, 2013), http://www.shareholderforum.com/dell/Library/20131003_Bloomberg.htm.

108 Mirvis, *supra* note 100.

109 *See, e.g.*, Booth, *supra* note 96, at 339–40; Jetley & Ji, *supra* note 76, at 431; Korsmo & Myers, *supra* note 2, at 1580.

110 *See* Jetley & Ji, *supra* note 76, at 431.

111 Yet getting fair value for your shares can be a "casino-like" process. James C. Morphy, *Doing Away with Appraisal in Public Deals*, 26 DEL. LAW. 30 (2008); *see also* Michael P. Dooley, *Rules, Standards, and the Model Business Corporation Act*, 74 LAW & CONTEMP. PROBS. 45, 53 (2011) (noting that appraisal is "something of a lottery").

112 *See* Baca, *supra* note 10, at 440 ("The newest research actually shows that not only is the merger price valuation the strategic equivalent of nullifying appraisal rights altogether, but that it can even undercompensate dissenting shareholders.").

113 *See* Korsmo & Myers, *supra* note 2, at 1602; Norwitz, *supra* note 12, at 3, 6 (noting that "[a]ppraisal rights themselves are not the problem," and that the fight in appraisal litigation "centers on valuation metrics").

114 *See* Golden Telecom, Inc. v. Glob. GT LP, 11 A.3d 214, 217 (Del. 2010) (noting that determining fair value is an "imperfect process"); *In re* Appraisal of Ancestry.com, Inc., No. 8173, 2015 WL 399726, at *1 (Del. Ch. Jan. 30, 2015) ("I have commented elsewhere on the difficulties, if not outright incongruities, of a law-trained judge determining fair value of a company in light of an auction sale, aided by experts offering wildly different opinions on value."); Union Ill. 1995 Inv. Ltd. P'ship v. Union Fin. Grp., Ltd., 847 A.2d 340, 359

For a long time, the Delaware courts exclusively used the Delaware Block Method to determine the fair value of shares.[115] Yet the courts eventually disclaimed this as unduly structured and inflexible,[116] and shifted toward other methods, including comparable company analysis, Discounted Cash Flow modeling, and the merger price itself.

In a comparable company analysis, the court examines companies of similar size and type, comes up with a valuation multiple, adjusts the multiple to the company at hand, and then uses the multiple to value the revenue streams of the company being appraised.[117] From this, the court gets an estimate of fair value. Yet this method is subject to various limitations, such as the similarities between the companies, and becomes ultimately worthless if the companies are significantly different.[118] As such, the more favored model and the one more frequently utilized is the Discounted Cash Flow (DCF) model.[119]

The three components of a DCF analysis are the cash flow projections of the company (at the point just before the merger transaction), the terminal value, and the discount rate.[120] The terminal value is an estimate of the present value of the company's future cash flows after a certain projection period and then into perpetuity, while the discount rate is based on the cost of the company's weighted average cost of capital for both debt and equity.[121] The DCF model is used to value the corporation as a going concern in today's dollars, and is generally preferred by the financial community because it can be used to value almost any company, not just a publicly traded one.[122] Moreover, unlike the comparable company analysis—the accuracy of which relies on similarities such as industry, geographical location, business model, and strategy—the DCF model can be used to calculate the value of any company given its existing realities.[123]

(Del. Ch. 2004) (noting that the valuation process "involves an exercise in hubris and, at best, reasoned guess-work").

115 1 BALOTTI & FINKELSTEIN, *supra* note 8, § 9.45[B][8]. The Delaware Block Method was a "combination of three generally accepted methods for valuation: the asset approach, the market approach, and the earnings approach." *Id.* (internal quotation marks omitted) (quoting *In re* Radiology Assocs., Inc., 611 A.2d 485, 496 (Del. Ch. 1991)). The court calculated a company's value based on each of these methods, assigned a percentage weight subject to certain limitations, and arrived at the judicially determined fair value of the corporation, which could then be broken into a "per share" value for each stockholder. *Id.*

116 *See, e.g.*, Weinberger v. UOP, Inc., 457 A.2d 701, 713 (Del. 1983) (rejecting the "very structured and mechanistic [valuation] procedure that has heretofore governed such matters").

117 1 BALOTTI & FINKELSTEIN, *supra* note 8, § 9.45[B][2].

118 *See id.*

119 *Id.* § 9.45[B][1].

120 *Id.*

121 *Id.*

122 *See* Ratway, *supra* note 23, at 202–03.

123 *See id.* at 203.

The shift away from the Delaware Block Method and to these alternative models has shaken up the court system. Whereas before there was some certainty, albeit imperfection, in the appraisal method, today the courts can rely on any combination of possible analyses to determine "fair value," so long as the methods utilized are generally accepted in the financial community.[124] This is a messy process for which judges are not inherently well suited, leading to inconsistencies in rulings and occasionally some outrageous premiums.[125] Such judgments raise concerns as to the suitability, consistency, and ability of courts to determine fair value.

D. Delaware's 2016 Amendments

Although the legislature's 2016 amendments to the Delaware Appraisal Statute[126] did not seek to address the valuation issues just discussed, they did seek to lessen appraisal arbitrage by focusing on the statutory interest rate as well as who can bring an appraisal claim.

Model Business Corporation Act jurisdictions have long required companies to pay their shareholders the estimated fair value of their shares before appraisal litigation starts.[127] Delaware, on the other hand, wrote its appraisal statute in such a way that corporations provide shareholders no consideration for their shares until the end of litigation.[128] The downside of this is that interest accrues on those shares throughout litigation,[129] which can take several years.[130] To combat appraisal arbitrageurs, who might seek litigation in part for this interest rate accrual,[131] one of the 2016 amendments now allows corporations to pay cash upfront to dissenting shareholders at any point during an appraisal petition.[132] This largely addresses the concern that the interest rate in appraisal was incentivizing unworthy appraisal actions.[133]

The second amendment the legislature added is an exception for de minimis appraisal claims, which are classified as those in which the collective number of shares seeking appraisal is less than one percent of the shares

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124 Weinberger v. UOP, Inc., 457 A.2d 701, 712–13 (Del. 1983).

125 *See, e.g.*, *In re* Appraisal of Dell Inc., No. 9322, 2016 WL 3186538 (Del. Ch. May 31, 2016), *aff'd in part, rev'd in part sub nom.* Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1 (Del. 2017) (the Chancery Court offered appraisal arbitrageurs a twenty-eight percent premium over the merger price).

126 DEL. CODE ANN. tit. 8, § 262 (2016).

127 Baca, *supra* note 10, at 454.

128 *Id.*

129 *Id.*

130 Jetley & Ji, *supra* note 76, at 452 n.86.

131 Jiang et al., *supra* note 4, at 700 ("We also find a positive relation between the rate of prejudgment interest accrual and the filing of appraisal petitions.").

132 DEL. CODE ANN. tit. 8, § 262(h) (2016). At the end of the litigation, the corporation would need to pay interest on any difference between the amount of cash they paid out and the fair value of the shares as determined by the court. *Id.*

133 Jiang et al., *supra* note 4, at 700 ("Therefore, the [interest rate] amendment is likely to significantly reduce the motive for seeking appraisal.").

outstanding and the consideration provided for the shares is less than one million dollars.[134] This amendment is expected to slow the amount of appraisal petitions filed because appraisal arbitrageurs can no longer bring a claim with just a few shares.[135] Indeed, some experts postulate that given historical filing rates in Delaware, this portion of the amendment could lead to a twenty-five percent reduction in appraisal cases.[136] As it costs corporations the same amount to litigate an appraisal claim regardless of how many shares are at stake,[137] this amendment serves as a protection against what many view as "nuisance litigation."[138] Moreover, this de minimis exception is key because there is no procedural way to limit appraisal petitions to only those with merit: there are no motions to dismiss in the appraisal context.[139] This amendment, of course, does not ensure merit, but it at least limits appraisals to situations in which petitioners have a fairly significant financial stake in the game.[140]

E. Jurisprudential Trends in Appraisal

Although in no way does this Note attempt to identify all of the recent trends in Delaware appraisal litigation, there is at least one significant trend worth mentioning: a greater deference to merger price in certain appraisal transactions. Beginning as early as 2010, some have argued that in cases involving an arm's-length transaction and a fair auction, the court should presumptively defer to the merger price as the best evidence of fair value.[141] However, as the court first made clear in *Golden Telecom, Inc. v. Global GT LP*,[142] and again most recently in *DFC Global Corp. v. Muirfield Value Partners, L.P.*,[143] the appraisal statute's requirement to determine fair value by taking into account "all relevant factors"[144] means there is no statutory presumption

134 tit. 8, § 262(g) (2016).

135 Jiang et al., *supra* note 4, at 708–09. But note that "short-form mergers are not subject to the de minimis exception." *Id.* at 708.

136 *Id.* at 700.

> [A]bout 32 percent of the cases involve stakes that are both below $1 million in value and constitute less than 1 percent of the stock of the company. Taking into account that certain forms of mergers are not subject to the limit, we estimate that the size threshold for a de minimis exception would have been binding on about one-quarter of the cases.

Id.

137 Korsmo & Myers, *supra* note 102, at 880.

138 Korsmo & Myers, *supra* note 2, at 1600.

139 Korsmo & Myers, *supra* note 3, at 334.

140 *See* Jiang et al., *supra* note 4, at 708–09; Korsmo & Myers, *supra* note 3, at 334 (questioning whether there was even a big enough problem to necessitate this amendment).

141 *See, e.g.*, Golden Telecom, Inc. v. Glob. GT LP, 11 A.3d 214, 217–18 (Del. 2010).

142 *Id.*

143 172 A.3d 346 (Del. 2017).

144 DEL. CODE ANN. tit. 8, § 262(h) (2016).

in favor of the merger price as the best evidence of fair value.[145] That being said, the Delaware courts have more recently begun to defer to the merger price in auction situations where there was arm's-length dealing and adequate publicly available information.[146]

In *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*,[147] one of Delaware's most recent appraisal decisions, the court again acted in accordance with this trend, chastising the Chancery Court for disregarding the merger price altogether and using its own DCF model to value the shares instead.[148] Although the court recognized that the process of determining fair value is a difficult one, it noted that the lower court's conclusions did not "follow logically from th[e] facts," and were not grounded in "relevant, accepted financial principles."[149] More significantly, however, the court expressly articulated a sentiment that is central to the future of appraisal as a remedy: "'[F]air value' does not equal 'best value.'"[150]

III. Protecting the Emergency Switch

This Part proceeds in two Sections. First, defending appraisal arbitrage based on its more emergent deterrence purpose and accordingly, urging the legislature to avoid adopting a revised ownership requirement. And second, arguing that although the contemporary trend toward using merger price as the best evidence of fair value should stem the tide of appraisal arbitrage, there is valid concern that such a trend will bleed over into other transactions outside of the fair auction setting that it has come to typify. To the extent this concern stems from the unreliability of the other valuation approaches, the courts should look to improve dependability, particularly in the use of DCF models, through appointing a neutral, independent expert to arbitrate DCF disagreements.

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145 *See, e.g.*, *DFC Global Corp.*, 172 A.3d at 348 (noting that although the respondent argued in favor of establishing "a presumption that in certain cases involving arm's-length mergers, the price of the transaction giving rise to appraisal rights is the best estimate of fair value," the court would not "engage in that act of creation, which in our view has no basis in the statutory text"); *Golden Telecom, Inc.*, 11 A.3d at 218 ("Requiring the Court of Chancery to defer—conclusively or presumptively—to the merger price, even in the face of a pristine, unchallenged transactional process, would contravene the unambiguous language of the statute . . . .").

146 *DFC Global Corp.*, 172 A.3d at 349 ("[E]conomic principles suggest that the best evidence of fair value was the deal price, as it resulted from an open process, informed by robust public information."); *In re* Appraisal of PetSmart, Inc., No. 10782, 2017 WL 2303599, at *2 (Del. Ch. May 26, 2017) ("I am satisfied that the deal price of $83 per share, 'forged in the crucible of objective market reality,' is the best indicator of the fair value of PetSmart." (footnote omitted) (quoting Van de Walle v. Unimation, Inc., No. 7046, 1991 WL 29303, at *17 (Del. Ch. Mar. 7, 1991))).

147 177 A.3d 1 (Del. 2017).

148 *Id.* at 21–26.

149 *Id.* at 23, 44.

150 *Id.* at 23.

A. *Deterrence: The Case for Maintaining Procedural Requirements*

Appraisal arbitrage may not actually be a problem when you look at the data comparatively: only about fifteen percent of appraisal eligible proceedings result in a petition, which is significantly lower than the estimated ninety percent of mergers that are challenged by a fiduciary duty class action lawsuit.[151] Indeed, scholars note that if courts consistently overvalued companies in appraisal litigation, we would expect to see appraisal petitions filed in nearly every eligible merger, regardless of their merits, much as is the case in fiduciary duty litigation.[152] Yet the research shows the opposite: appraisal litigation is heavily associated with going private transactions, transactions with low deal premia, and transactions with "perceived conflicts of interest"[153]—all situations more likely to take advantage of minority shareholders.[154] Thus, appraisal arbitrage is arguably doing what it should be: protecting minority shareholders. These findings support the contention that appraisal "can serve as a back-end check on abuses by corporate managers, controlling shareholders, or other insiders in merger transactions."[155]

Yet the common sentiment that more appraisal claims are being brought for arbitrage purposes is not without merit. From 1977 to 1997, only an average of fourteen appraisal claims were brought each year in Delaware,[156] while today the average is closer to twenty-two.[157] This sharp increase in the number of appraisals filed is what inspired the interest rate and de minimis amendments in 2016. And although these amendments, in conjunction with a greater reliance on merger price, should stem the appraisal arbitrage flow, it remains a possibility that the Delaware legislature will in the future seek further procedural limits on appraisal. The most likely limit would be one relating to the record owning requirement, which this Note argues against.

Several scholars have proposed overturning the *Transkaryotic* case[158] or otherwise amending the Delaware appraisal statute in order to strip beneficial owners of appraisal rights if they did not own stock of the company on the record date.[159] The record date is used for voting purposes, which means that under the current regime, an owner might not have voted in the

151 Korsmo & Myers, *supra* note 2, at 1581.

152 *Id.* at 1603. The authors found that the bulk of fiduciary duty cases targeted transactions with "no statistically significant regard for the merger price." Korsmo & Myers, *supra* note 3, at 287. Additionally, they found that fiduciary duty litigation is associated with the deal size, but no other significant factors, indicating that these suits are brought without regard for merit. Korsmo & Myers, *supra* note 102, at 836.

153 Jiang et al., *supra* note 4, at 699.

154 *See supra* note 34 and accompanying text.

155 Korsmo & Myers, *supra* note 2, at 1598. Additionally, the authors note that "[w]hile these results do not prove that appraisal arbitrage is a positive development, it does at least suggest that appraisal is not simply a new frontier of nuisance litigation." *Id.* at 1597.

156 Jiang et al., *supra* note 4, at 701.

157 Baca, *supra* note 10, at 429.

158 *In re* Appraisal of Transkaryotic Therapies, Inc., No. 1554, 2007 WL 1378345 (Del. Ch. May 2, 2007).

159 *See* Korsmo & Myers, *supra* note 3, at 339; Norwitz, *supra* note 12, at 3, 6.

merger, but can still contest the fair value of their shares.[160] This might seem fundamentally wrong. Yet getting rid of the large players (who are the ones who can afford to bring suit,[161] yet are also often the owners complained of above) through a change in appraisal ownership requirements would likely mean the remedy regains its formerly sleepy status.[162] This would be socially undesirable.

A recent study "analyz[ing] data on over 2,000 acquisitions of publicly traded Delaware targets between January 2003 and December 2016 . . . f[ound] that appraisal-eligible deals had higher average announcement premia over appraisal-ineligible deals,"[163] reaffirming the value of appraisal for shareholders ex ante.[164] Yet fundamentally, it remains difficult to bring an appraisal claim, and changing procedural requirements to further limit who can seek appraisal might make bringing a claim nearly impossible.

First, the procedural requirements are quite technical, and even a tiny misstep could mean a forfeiture of appraisal rights.[165] For example, in *Konfirst v. Willow CSN Inc.*,[166] the court found that shareholders who were away on vacation when they received notice of their appraisal rights and thus submitted their demand for appraisal a day late, had no recourse.[167] In *Raab v. Villager Industries, Inc.*,[168] the court held that for jointly owned stock, it was acceptable for only one party to sign the written demand for appraisal, but it was not adequate for just one to sign the demand for payment.[169] Technicalities such as these trip up individual shareholders, but are less likely to confuse sophisticated parties, meaning more potentially meritorious suits can reach trial with large shareholders at the helm.

Second, large shareholders can buy into appraisal cases and thus selectively choose the ones with merit. Although some are still opposed to the idea of appraisal arbitrageurs buying their way in,[170] this view is somewhat

160 *Cf.* Korsmo & Myers, *supra* note 3, at 339.

161 4 COX & HAZEN, *supra* note 18, § 22:24 (noting that "seldom is appraisal sought by investors whose holdings are less than $100,000").

162 This is because deterrence only works if you have two factors: "capability," which is currently at risk, and "will." *See* Jimmy Vielkind, *At Conservative Party Conference, Harry Wilson Aims at Cuomo*, Politico (Feb. 1, 2016), https://www.politico.com/states/new-york/albany/story/2016/02/at-conservative-party-conference-harry-wilson-aims-at-cuomo-030756 (quoting Chris Gibson, former U.S. Representative from New York).

163 Scott Callahan, Darius Palia & Eric Talley, *Appraisal Arbitrage and Shareholder Value*, COLUM. L. SCH. BLOG ON CORP. & THE CAP. MKT. (Dec. 14, 2017), http://clsbluesky.law.columbia.edu/2017/12/14/appraisal-arbitrage-and-shareholder-value/.

164 *See* Kanda & Levmore, *supra* note 46, at 436 ("Presumably, appraisal's expense and potential to drain liquid assets would encourage managers not to abandon shareholders but, instead, to make plans that carried old shareholders on . . . .").

165 *Cf.* Eisenberg, *supra* note 1, at 72.

166 No. 1737, 2006 WL 3803469 (Del. Ch. Dec. 14, 2006).

167 *Id.* at *1.

168 355 A.2d 888 (Del. 1976).

169 *Id.* at 891–92.

170 *See* Korsmo & Myers, *supra* note 3, at 314.

antiquated: people buy and sell legal claims all the time.[171] Moreover, buying into the suit, as appraisal arbitrageurs frequently do, may actually be advantageous. The arbitrageurs cannot only signal serious intent by buying into a transaction, but by thoroughly reviewing the case before deciding to proceed with it, they can ensure that more cases are brought on their merits.[172] As it remains expensive to litigate an appraisal claim regardless of the number of shares owned,[173] it makes more economical sense for the hedge funds—who have more resources, wherewithal, and knowledge—to bring suit.[174] Hedge funds may also be able to more easily amass the shares necessary to overcome the new de minimis exception, and thus represent a solution to the collective action problem that has arguably prevented more appraisal petitions from being brought in the past.[175]

Additionally, although some still argue that appraisal arbitrageurs should be kept out of the appraisal remedy altogether because their use of the statute is not in alignment with its original purpose, this argument fails to take into consideration that even non–appraisal arbitrageurs no longer use the appraisal statute for liquidity purposes.[176] In the 1960s, cash became an acceptable form of consideration in mergers, and courts "interpreted the new cash merger statutes to permit disparate treatment that forced out minority shareholders."[177] Since minority shareholders were being forced out rather than obligated to take stock they did not want, "appraisal served no liquidity function": the cash for their shares was the liquidity.[178] Additionally, the liquidity justification lost ground with the eventual emergence of a ready stock market in which shareholders could sell their publicly traded shares.[179] This is why many states, including Delaware, added a market out exception to their appraisal rights statutes: if shareholders receive solely stock in a transaction and can sell their shares on the market in order to exit the

171 *Id.* (noting that, in modern society, "[c]ontract claims are often freely assignable," claims related to property "can often be transferred with the property," and many legal claims such as corporate class action suits have rights that "typically transfer[ ] with the shares").

172 Korsmo & Myers, *supra* note 102, at 836.

173 Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 423 (2006) ("[S]hareholders seeking an appraisal . . . must pay the costs of providing the remedy, making it attractive only in the most extreme cases." (footnote omitted)).

174 *See* Korsmo & Myers, *supra* note 102, at 880; Randall S. Thomas, *Revising the Delaware Appraisal Statute*, 3 DEL. L. REV. 1, 27 (2000).

175 *Cf.* Onyeador, *supra* note 11, at 346 (discussing how the procedural complexities of appraisal generally make "the process of securing standing . . . expensive" (emphasis omitted)). To the extent hedge funds can secure standing more economically than the average shareholder due to their more extensive resources (financial and otherwise), they can accordingly bring more appraisal petitions.

176 *See* Thompson, *supra* note 28, at 21–22.

177 *Id.*

178 *Id.* at 22.

179 *Id.*

company, there is no need for the court to appraise their shares and duplicate what the market is already offering.[180]

Therefore, the more modern view of appraisal's purpose, as a policing mechanism against the opportunistic behavior of the majority, is more persuasive. Yet in order for this policing or deterrence method to continue to work, appraisal arbitrageurs must be able to bring appraisal claims. Changing the record date or ownership requirements likely ends most remaining appraisal arbitrage, but at the expense of protecting minority shareholders. The legislature should think carefully in the future before proceeding with such a change.

B. Merger Price Deference: Cause for Concern?

The trend in Delaware toward greater deference to the statutory merger price in situations where there was a fair auction, arm's-length dealing, and adequate publicly available information, is a welcome development given frequent concerns about the court's appraisal methods.[181] As many have noted, one of the issues with appraisal valuation is that it can be highly subjective or unreliable:[182] the DCF model, which is largely favored by the courts,[183] is subject to a number of different inputs,[184] and valuations can vary widely between the opposing parties' experts.[185] The advantage of the merger price is that, depending on the circumstances, it represents the best estimate of a company's value.[186] Moreover, generally deferring to the merger price going forward is expected to limit appraisal arbitrage.[187]

Choosing the merger price as the best indication of fair value functions a bit like the business judgment rule from an analytical standpoint, which

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180 *See id.*

181 *See* Daniel E. Meyer, Comment, *Maybe Publius Was Right: Relying on Merger Price to Determine Fair Value in Delaware Appraisal Cases*, 165 U. PA. L. REV. 153, 174–76 (2016). *See generally* Booth, *supra* note 96; Boyd, *supra* note 87.

182 *See, e.g.*, Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1, 35 (Del. 2017) (referring to DCF models generally as "less-than-surefire"); LongPath Capital, LLC v. Ramtron Int'l Corp., No. 8094, 2015 WL 4540443, at *12–13 (Del. Ch. June 30, 2015).

183 *See* Jetley & Ji, *supra* note 76, at 442.

184 *See supra* Section II.C.

185 For example, the expert for the appraisal petitioners in *DFC Global Corp. v. Muirfield Value Partners, L.P.* calculated a valuation for the company using a DCF model which resulted in a per share price that was eighty-eight percent above the merger price, while the defense's DCF model resulted in a value less than the merger price. 172 A.3d 346, 357–58 (Del. 2017).

186 *See* William J. Carney & George B. Shepherd, *The Mystery of Delaware Law's Continuing Success*, 2009 U. ILL. L. REV. 1, 26–28.

187 *See* Paul Bork et al., *Latest Amendments to Delaware Law Revise Appraisal Rights*, FOLEYHOAG LLP (Aug. 17, 2016), http://www.foleyhoag.com/publications/alerts-and-updates/2016/august/latest-amendments-to-delaware-law-revise-appraisal-rights; Gail Weinstein et al., *The Appraisal Landscape: Key Points, Open Issues, and Practice Points*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE & FIN. REG. (Jan. 23, 2018), https://corpgov.law.harvard.edu/2018/01/23/the-appraisal-landscape-key-points-open-issues-and-practice-points/.

presumes that a board of directors' decisions were made in good faith, on an informed basis, and with an honest and reasonable belief that the decision was in the best interests of the company.[188] Indeed, the court's more explicit recognition that "'fair value' does not equal 'best value'"[189] implies a range of prices within which the court may determine a reasonably fair price lies.[190] This range may or may not include the merger price, but in an auction setting (absent issues with the transaction itself), it likely does.

Selecting the merger price as the best indicator of fair value in such an auction setting is precisely what the courts should do. An auction is the standard against which interested transactions are compared,[191] and an auction generally ensures that the company, and therefore the shareholders, gets the best price possible: "[W]hat someone would be willing to pay."[192] Far from adopting a blanket presumption of the merger price as the best evidence of fair value in *all* transactions—or even in all transactions involving an auction—the Delaware courts appear willing and able to deeply examine a transaction and determine whether it resulted in a fair price or not.[193] Although some argue that this line of reasoning steers the court toward auction theory, which is arguably more of a technical discipline than the valuation methodologies the court currently handles,[194] there is no evidence as of yet to suggest the court is not up to this task. Moreover, in the past the court has skirted auction technicalities,[195] and it could likely do so going forward.

Yet opponents of this merger price "presumption," even in an auction setting, have valid concerns, chief of which is that such a presumption will chill appraisal petitions.[196] The argument goes as follows: in the process of negotiating a merger and determining a selling price, the "credible threat of appraisal plays a critical role in market design," by helping, in an auction setting, to set a "credible 'reserve price.'"[197]

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188 *See* Kaplan v. Centex Corp., 284 A.2d 119, 124 (Del. Ch. 1971).

189 Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1, 23 (Del. 2017).

190 *See* Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 466–67 (Del. Ch. 2011).

191 *See* Huff Fund Inv. P'ship v. CKx, Inc., No. 6844, 2013 WL 5878807, at *11 (Del. Ch. Nov. 1, 2013).

192 Baron v. Pressed Metals of Am., Inc., 123 A.2d 848, 854 (Del. 1956).

193 *See, e.g.*, Highfields Capital, Ltd. v. AXA Fin., Inc., 939 A.2d 34, 46 (Del. Ch. 2007) (refusing to rely on merger price because of "the lack of an open auction at the beginning of the sale process"); LongPath Capital, LLC v. Ramtron Int'l Corp., No. 8094, 2015 WL 4540443, at *24–25 (Del. Ch. June 30, 2015) (relying on merger price even when only one buyer made a firm offer, because there was a public sales process and unreliable DCF projections).

194 *See* Eric L. Talley, *Finance in the Courtroom: Appraising Its Growing Pains*, 35 DEL. LAW. 16, 18 (2017).

195 *See, e.g.*, *Huff Fund Inv. P'ship*, 2013 WL 5878807, at *14 ("Nothing in our jurisprudence suggests than an auction process need conform to *any* theoretical standard . . . .").

196 *See* Brief of Law, *supra* note 48, at *2.

197 *Id.* at *11; *see also* PAUL KLEMPERER, AUCTIONS: THEORY AND PRACTICE 112 (2004) ("The credibility of reserve prices is of special importance. If a reserve price is not a genu-

> By preserving investors' right to obtain their aggregate going-concern value (as the appraisal statute requires), the appraisal right helps protect against unfair and inefficient transfers to lower valuing buyers, providing more credible minimum price protection than the target's board itself may be willing/able to muster.
>
> *If in contrast, fair value hinged presumptively or exclusively on merger price, this credible minimum price protection disappears.*[198]

Essentially, the thought is that appraisal loses its ex ante value under a merger price presumption. Price protection in the auction process disappears for a complicated set of reasons,[199] but the resultant effect can be summed up as this: "[N]o shareholder would realistically pursue appraisal under a merger price [presumption], paying litigation expenses only to . . . return[ ] the same price."[200] Corporations, knowing that few shareholders—especially large, sophisticated investors—will be foolish enough to seek appraisal in this environment, may not be as diligent as they have been in achieving top prices for their companies.[201] This would hurt shareholders across the board by "depress[ing] both [the optimal] acquisition prices and target shareholders' expected welfare."[202]

Although there is some risk of this decrease in expected welfare, the key to analyzing this risk is to distinguish between appraisal petitions we do want (those with merit) versus those brought strictly for arbitrage purposes. If a share price derived in a fair auction setting with adequate publicly available information and arm's-length dealing is the gold standard for merger transactions,[203] then shareholders should not get more for their shares through an appraisal claim: they have received the fair value the market could bear. Accordingly, the minimal risk of merger price depression[204] should simply be tolerated.

If, on the other hand, appraisal arbitrageurs challenge a transaction that falls outside of this dichotomy or in some way questions whether the "presumption" should hold in a particular factual scenario, then the court needs to examine other valuation methods to determine fair value, and indeed, it has a statutory mandate to do so.[205] To the extent opponents of the merger price "presumption" are worried that the court will hesitate to consider other valuation methods, even when faced with a transaction outside of this gold

ine commitment to not sell an object if it does not reach its reserve, then it has no meaning and bidders will treat it as such.").

198 Brief of Law, *supra* note 48, at *12 (emphasis added).

199 *See, e.g.*, Choi & Talley, *supra* note 28, at 4–6.

200 Brief of Law, *supra* note 48, at *13; *see also* Choi & Talley, *supra* note 28, at 5.

201 *See* Booth, *supra* note 96, at 347 (noting that "bargaining happens in the shadow of the law" and just as appraisal can drive prices up towards fairness, the absence of a robust appraisal remedy can do the opposite); *see also* Folk, *supra* note 34, at 1293.

202 Choi & Talley, *supra* note 28, at 1.

203 *See* Huff Fund Inv. P'ship v. CKx, Inc., No. 6844, 2013 WL 5878807, at *11 (Del. Ch. Nov. 1, 2013).

204 *See* Choi & Talley, *supra* note 28, at 1.

205 *See* DEL. CODE ANN. tit. 8, § 262(h) (2016).

standard, there is cause for concern. This is because even if suspect transactions simply result in a judgment equal to the merger price, appraisal arbitrageurs will be disincentivized from bringing claims, even those with merit.[206] This would harm the deterrence value of the remedy, and ultimately, shareholders' welfare.

Insomuch as this concern is valid, there are steps Delaware could take to mitigate its actuation, including increasing the reliability of its other valuation methods so that they can be used more frequently.[207] DCF models are, like many models, subject to manipulation, especially when opposing experts are trying to convince the court to accept their model after the fact.[208] The incentive when creating a DCF model during litigation is clearly to come up with one that shows the highest (petitioner) or lowest (corporation) going-concern value that is generally defensible.[209] Rather than placing the court in a situation where it cannot reasonably rely on either party's DCF model because of the staggering, indefensible differences,[210] the court could instead look to an independent expert's objectively determined DCF model, which could control or arbitrate some of these variances.

Although the 1976 revision of the Delaware appraisal statute effectively replaced the role of the independent appraiser with the court itself,[211] courts do still have the ability to appoint a neutral expert witness and should consider doing so in order to increase the objectivity of DCF valuations.[212] Although in no way can an independent expert address all of the challenges related to DCF reliability, appointing such an expert is a small step toward doing so, and an important one since the DCF model remains the most robust valuation alternative to the merger price itself.[213]

Conclusion

The appraisal statute has undergone a revolution since it was first chastised as being "of virtually no economic advantage to the usual shareholder."[214] It has evolved from a remedy to offer shareholders liquidity to one designed to protect minority shareholders; from a remedy brought by few, to one brought by many; and from a largely ignored statute to one that

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206 *See* Baca, *supra* note 10, at 440.

207 *See Huff Fund Inv. P'ship*, 2013 WL 5878807, at *9 ("[T]he deficiencies of both DCF analyses lead me to conclude that they are unreliable measures.").

208 *See* 1 Balotti & Finkelstein, *supra* note 8, § 9.45[B][1].

209 *See, e.g.*, *In re* Appraisal of Dell Inc., No. 9322, 2016 WL 3186538, at *45 (Del. Ch. May 31, 2016) (observing that the experts "generated opinions that differed by 126%, or approximately $28 billion"), *aff'd in part, rev'd in part sub nom.* Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1 (Del. 2017).

210 *See, e.g.*, *id.*

211 *See* Gonsalves v. Straight Arrow Publishers, Inc., 701 A.2d 357, 360–61 (Del. 1997).

212 *See In re* Appraisal of Shell Oil Co., 607 A.2d 1213, 1222 (Del. 1992); Kenton K. Yee, *Dueling Experts and Imperfect Verification*, 28 Int'l Rev. L. & Econ. 246, 254 (2008). *But see In re* Appraisal of Dole Food Co. Inc., 114 A.3d 541, 557 (Del. Ch. 2014).

213 *See Shell Oil Co.*, 607 A.2d at 1222.

214 Manning, *supra* note 2, at 260.

has captured the attention of the public.[215] In the process, the remedy has attracted much critique, mostly centered on who is bringing and buying into these claims.

By focusing on the "who" of appraisal, however, we have lost sight of the "why." We miss what social benefit these arbitrageurs do provide, and gloss over the fact that many of these appraisal claims *are* in fact associated with merit. To ensure arbitrageurs can continue to bring these meritorious claims, the legislature should refrain from imposing additional statutory constraints, particularly those related to the record date and holding requirements. Indeed, the 2016 amendments—in conjunction with the court's trend toward relying on merger price in a fair auction setting—should do enough to cull unmeritorious appraisal.[216] But to the extent that such a trend goes too far, to disincentivizing even worthy petitions, the court needs to act. Bolstering the reliability of the DCF model through appointing neutral experts to arbitrate DCF valuations might be the logical next step. But regardless of whether the court heeds such a suggestion, the reality is simple: appraisal still has value as a deterrence method and as protection for minority shareholders. Shareholders need a functioning emergency switch in the form of the appraisal remedy, and Delaware, whatever its next actions in this space, must tread carefully to preserve it as such.

215 Korsmo & Myers, *supra* note 3, at 297 (noting that "[t]he relatively high incidence of trial may be one reason for the high public visibility of appraisal, in spite of the small number of actual cases").

216 *See* Meyer, *supra* note 181, at 191.