COMMENT

MAYBE PUBLIUS WAS RIGHT: RELYING ON MERGER PRICE TO DETERMINE FAIR VALUE IN DELAWARE APPRAISAL CASES

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"Every thing is worth what its purchaser will pay for it."
—*Publius Syrus*[1]

INTRODUCTION

In less than a decade, the annual value of appraisal claims in Delaware has increased tenfold over historical levels.[2] The driving force behind this growth has been the emergence of an investment strategy known as appraisal arbitrage.[3] Appraisal arbitrageurs buy a target company's shares after the announcement of a merger, oppose the transaction, and then make—or threaten to make—an appraisal claim in order to capture a value greater than the merger price.[4] Because of the development and growth of this investment strategy, the "appraisal remedy has been transformed from a forgettable attribute of stock ownership" into a viable mechanism for challenging opportunistic mergers.[5] Thus, absent further legislative reform or a shift in the Delaware Court of Chancery's approach to appraisal, the appraisal remedy stands to remain an important part of the framework for ensuring corporate accountability going forward.

Much noise has been made concerning the development of "buying into" a lawsuit. On the one hand, some scholars have embraced appraisal arbitrage, viewing its development as a net positive.[6] They argue that decisions to initiate appraisal proceedings are correlated to litigation merit and can serve as a safeguard against poor sales processes.[7] Nonrobust sales processes, including those that lack a market auction, may not result in the highest price possible, and indeed, the transactions targeted for appraisal proceedings tend to have unusually low premia.[8] As such, appraisal suits may actually be initiated when target shareholders are receiving too little consideration for their shares. On the other hand, deal lawyers unsurprisingly have been vocal

1 PUBLIUS SYRUS, THE MORAL SAYINGS OF PUBLIUS SYRUS, A ROMAN SLAVE 71 (D. Lyman, Jr. trans., Cleveland, L.E. Barnard & Co. 1856) (46-29 BC).

2 *See* Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 WASH. U. L. REV. 1551, 1553 (2015) [hereinafter Korsmo & Myers, *Appraisal Arbitrage*] (noting the rise in value of appraisal claims to $1.5 billion in 2013, a "tenfold increase from 2004").

3 *See id.* (discussing the development and staggering growth of "specialized investment strategies based on appraisal").

4 *See* Philip Richter et al., *The Rise of Delaware Appraisal Arbitrage: A Survey of Cases and Some Practical Implications*, INSIGHTS, July 2014, at 18 (describing the mechanics of appraisal arbitrage).

5 Charles Korsmo & Minor Myers, *Reforming Modern Appraisal Litigation* 1 (Brooklyn Law Sch. Legal Studies, Research Paper No. 431, 2016) [hereinafter Korsmo & Myers, *Appraisal Litigation*], http://ssrn.com/abstract=2712088 [https://perma.cc/773H-VFAL].

6 *See, e.g.*, Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 2, at 1555 (concluding from empirical evidence that appraisal arbitrage is, on the whole, a "beneficial development").

7 *See id.* at 1554-55 (discussing the additional control, and risk, that appraisal arbitrageurs have when bringing their claims, as opposed to plaintiffs' attorneys).

8 *See* Korsmo & Myers, *Appraisal Litigation*, *supra* note 5 (noting that "[a]ppraisal petitions are associated with deals that have abnormally low merger premia").

critics of this practice.[9] They argue that the mere threat of appraisal litigation stands to reduce the number of beneficial deals that are closed and to block shareholders from capturing higher value in transactions that are actually consummated.[10] Under this view, the possibility of appraisal litigation causes potential acquirers to offer lower bids and require restrictive closing conditions in order to account for potential litigation costs and the uncertain outcome of an appraisal proceeding, leading to deal failures and lower purchase prices.[11]

Both sides of this debate have called on the Delaware legislature to reform its appraisal statute.[12] Scholars who approve of the appraisal remedy have suggested a number of amendments that would expand and, in their view, improve the appraisal process.[13] Deal lawyers, conversely, have advocated for the Delaware legislature to restrict appraisal rights by denying them to shareholders who purchase shares after the record date for the merger vote.[14] Currently, the relevant date for entitlement to appraisal rights is the closing date of the transaction. Transactional advisors claim that reforming that date will prevent appraisal arbitrageurs from having the option to wait and then "buy into" a lawsuit if there are developments between the record date and the

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9 *See, e.g.*, Trevor S. Norwitz, *Delaware Legislature Should Act to Curb Appraisal Arbitrage Abuses*, COLUM. L. SCH.: CLS BLUE SKY BLOG (Feb. 10, 2015), http://clsbluesky.law.columbia.edu/2015/02/10/delaware-legislature-should-act-to-curb-appraisal-arbitrage-abuses/ [https://perma.cc/U4X3-5ZZJ] (arguing that there is an "urgent need for legislative reform in Delaware to ameliorate the risk that appraisal arbitrage—now a multibillion dollar industry—poses to transactional vitality and shareholder value").

10 *See* Korsmo & Myers, *Appraisal Litigation*, *supra* note 5, at 3-4 (distilling the arguments commonly made by those who favor amending the appraisal statute).

11 Korsmo and Myers make just this point, stating, "Merger agreements might cabin appraisal liability by including a closing condition allowing the acquirer to walk away if more than some specified percentage of stockholders demands appraisal, but that solution is unattractive to sellers (because it reduces the certainty of the deal) and also to buyers (because it allows dissenting stockholders to veto the transaction). The result of this uncertainty, in the transactional advisors view, is that acquirers facing potential appraisal liability will lower their bid to account for the expectation of an appraisal suit, and non-dissenting stockholders will be penalized by this holdback." *Id.* at 4.

12 *See, e.g.*, *id.* at 5 (suggesting expansion and improvement of the statutory remedy rather than its curtailment); Letter from Cravath, Swaine & Moore LLP, Davis Polk & Wardell LLP, Latham & Watkins LLP, Skadden, Arps, Slate, Meagher & Flom LLP, Simpson Thacher & Bartlett LLP, Sullivan & Cromwell LLP & Wachtell, Lipton, Rosen & Katz, to Council of the Corporate Law Section, Del. State Bar Ass'n & Lawrence A. Hamermesh, Ruby R. Vale Professor of Corp. & Bus. Law, Widener's Inst. of Del. Corp. Law 2-3 (Apr. 1, 2015) (on file with author) [hereinafter Seven Firm Letter] (calling for amendment of the Delaware appraisal statute).

13 *See* Korsmo & Myers, *Appraisal Litigation*, *supra* note 5, at 5 (suggesting that Delaware policymakers "consider a number of amendments to expand and improve the appraisal remedy: eliminating the exception for all-stock transactions, introducing a de minimis exception, and requiring more disclosure from companies so that stockholders are in a position to make an informed decision about exercising their appraisal rights").

14 *See* Seven Firm Letter, *supra* note 12, at 2 (arguing that there is "no justification for permitting holders who purchased their shares after the record date for the vote to seek appraisal as if they were 'dissenters'").

closing date that arbitrageurs believe would increase a court's determination of the fair value of their shares.[15]

Delaware's Corporation Law Council (the Council), the body responsible for suggesting amendments to the corporate code to the Delaware legislature,[16] heard these cries for reform and proposed two amendments to the appraisal statute in the spring of 2015.[17] First, the Council suggested a de minimis requirement in order to eliminate nuisance suits. Under that proposal, shareholders seeking appraisal would have to collectively hold at least one percent of total shares outstanding or one million dollars' worth of shares.[18] Second, the Council proposed a provision intended to offset the potential economic incentive created by the interest owed to successful appraisal plaintiffs. Specifically, the amendment sought to allow the acquiring company "at any time before the court enters judgment in an appraisal action, . . . [to] pay to each stockholder seeking appraisal rights an amount of cash, with interest continuing to accrue only on the amount that is the difference between that cash payment and the court's ultimate award."[19] The Delaware legislature did not adopt these amendments in 2015.[20] The Council then issued substantially the same suggestions in the spring of 2016, only adding that the de minimis requirement should not apply to parent/subsidiary mergers approved under section 253 or 267 of the Delaware General Corporation Law (DGCL).[21] The legislature responded by approving the addition of these amendments on June 8, 2016.[22]

In this Comment, I argue that further calls for reform to the appraisal remedy should be aimed at the Delaware Court of Chancery. The purpose of this Comment is not to express a normative judgment about the overall

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15 *See, e.g.*, Norwitz, *supra* note 9 (deeming this phenomenon the "'heads-I-win-tails-I-don't-lose' option for arbitrageurs").

16 *See About the Section of Corporation Law*, DEL. ST. B. ASS'N (2016), http://www.dsba.org/sections-committees/sections-of-the-bar/corporation-law/ [https://perma.cc/BBR9-B9VJ] (discussing the responsibilities of the Council, including recommending amendments to the Delaware corporate code).

17 *See Proposed 2015 Amendments to the Delaware General Corporation Law*, WILSON SONSINI GOODRICH & ROSATI (Mar. 16, 2015), https://www.wsgr.com/WSGR/Display.aspx?SectionName=publications/PDFSearch/wsgralert-DCGL.htm [https://perma.cc/S7CF-2FLF] (summarizing the Council's proposed amendments to the DGCL, including those targeting appraisal rights).

18 *See id.* (describing the Council's first proposed amendment).

19 *Id.*

20 *See* Korsmo & Myers, *Appraisal Litigation*, *supra* note 5, at 36 ("In an unusual turn, the amendments proposed by the Council were never introduced in the Delaware legislature.").

21 *See* Allison L. Land et al., *Proposed Delaware General Corporation Law Amendments Would Address Appraisal Proceedings, Short-Form Mergers, Court of Chancery Jurisdiction*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM (Mar. 16, 2016), http://www.skadden.com/insights/proposed-dgcl-amendments-would-address-appraisal-proceedings-short-form-mergers-court-of-chancery-jurisdiction [https://perma.cc/EU5A-9AGN] (discussing the Council's proposed amendments for 2016).

22 David Shine et al., *Delaware Legislature Acts to Limit Appraisal Rights*, STAY CURRENT (Paul Hastings LLP, Los Angeles, Cal.), May 2016, https://www.paulhastings.com/docs/default-source/PDFs/stay-current-delaware-legislature-acts-to-limit-appraisal-rights-(june-15).pdf [https://perma.cc/R7NA-FUL7].

desirability of appraisal arbitrage; rather, I propose a shift away from the Chancery Court's oft-favored valuation technique, discounted cash flow (DCF) analysis,[23] in appraisal cases arising out of certain third-party, or arm's-length, transactions. The Chancery Court should instead rely on merger price as the best estimate of the "fair value"[24] of an appraisal petitioner's shares when (1) the inputs required for a DCF analysis are unreliable and (2) there has been a genuine market test.

Reliance on the merger price under these conditions would allay concerns on both sides of the debate. For proponents of appraisal arbitrage, this valuation approach does not impinge on shareholders' ability to resort to the appraisal remedy by restricting their deadline to the record date. Additionally, the Chancery Court's embrace of merger price would incentivize additional disclosure by target companies in order to demonstrate that the sale process was fulsome.[25] For opponents of appraisal arbitrage, when there has been a genuine market test and a DCF analysis is unreliable, the use of merger price punishes appraisal petitioners when their claims are unwarranted (i.e., purely speculative investments aimed at low-premium transactions). Appraisal arbitrageurs cannot profit from "buying into" a lawsuit when the merger price is used as fair value; they must bear litigation expenses and additionally may face a "synergy deduction," as appraisal claimants cannot capture any value arising from the expectation of the merger.[26] Thus, this approach to valuation would only encourage claims where there is real reason to believe that the price achieved in the merger was not "fair"—namely, in controlling shareholder and parent/subsidiary mergers—and would remove some uncertainty from third-party mergers (the transactions that are the primary focus of M&A lawyers).

Following a description of the history and purpose of the appraisal statute and the mechanics of an appraisal suit in Part I, Part II of this Comment

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23 *See, e.g.*, *In re* Orchard Enter., No. 5713-CS, 2012 WL 2923305, at *1 (Del. Ch. July 18, 2012) ("The proper way to value the petitioners' shares is to value Orchard as a going concern . . . . This approach marries perfectly with the DCF method of valuation, which is based on the notion that a corporation's value equals the present value of its future cash flows. By allocating the DCF value of Orchard in accordance with the dividend formula in the Certificate of Designations . . . the mandate of 8 Del. C. § 262 to award the petitioners 'the fair value of [their] shares' is faithfully implemented." (footnote omitted)).

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

25 This approach is similar to a proposed statutory "safe harbor from appraisal claims where [a target company] can demonstrate that the merger price was subjected to a genuine market test." Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 2, at 1608. The proposed reliance on merger price advocated by this Comment, however, requires that the DCF inputs be unreliable, which can occur in situations like those discussed in Part III, *infra*.

26 *See* § 262(h) ("Through such proceeding 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 or consolidation*, together with interest, if any, to be paid upon the amount determined to be the fair value." (emphasis added)).

provides an overview of the recent emergence and growth of appraisal claims and discusses factors that may have contributed to this increase. While none of these factors alone seems to explain the rise in appraisal claims, when taken together, they indicate that unless there are further legislative or judicial restrictions, appraisal arbitrageurs will persist in employing the remedy in order to check—or profit from—third-party mergers. Part III addresses the Chancery Court's historical approach to determining fair value, as well as its increasing willingness to use merger price as the best evidence of fair value.[27] This Part also discusses the need to calculate synergies if merger price is to be used to find fair value, given that section 262(h) of the DGCL requires fair value to be determined exclusive of any value arising from the merger.[28] Although a legal framework for this calculation is not well-established, it is a feasible calculation for parties and the court to make. Part IV discusses the Chancery Court's decision in *LongPath Capital, LLC v. Ramtron International Corp.*,[29] a case in which appraisal arbitrage and the court's use of merger price to determine fair value dovetail. *Longpath* exemplifies not only a situation where the use of DCF analysis is inappropriate, but also illustrates the need to develop a robust analytical framework for valuing synergies. This Part also addresses the Chancery Court's recent appraisal decisions in *In re Appraisal of Dell Inc.*[30] and *In re Appraisal of DFC Global Corp.*,[31] in which the court did not rely exclusively on merger price, and explains why these decisions are not inconsistent with this Comment's ultimate argument. Finally, in Part V, I propose a framework for when the Chancery Court should rely on merger price as the best evidence of fair value in appraisal proceedings, namely, when there has been a genuine market test and the inputs for a DCF analysis are unreliable.

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27 *See, e.g.*, LongPath Capital, LLC v. Ramtron Int'l Corp., No. 8094-VCP, 2015 WL 4540443, at *20 (Del. Ch. June 30, 2015) ("[I]n the situation of a proper transactional process likely to have resulted in an accurate valuation of an acquired corporation, this Court has looked to the merger price as evidence of fair value and, on occasion, given that metric one-hundred percent weight."); Merlin Partners LP v. AutoInfo, Inc., No. 8509-VCN, 2015 WL 2069417, at *16 (Del. Ch. Apr. 30, 2015) ("[B]ecause the Merger price appears to be the best estimate of value, the Court will put full weight on that price."); *In re* Appraisal of Ancestry.com, Inc., No. 8173-VCG, 2015 WL 399726, at *23 (Del. Ch. Jan. 30, 2015) (finding "fair value in these circumstances best represented by the market price"); Huff Fund Inv. P'ship v. CKx, Inc., No. 6844-VCG, 2013 WL 5878807, at *11 (Del. Ch. Nov. 1, 2013) (deciding, under the circumstances, to "rely on the merger price as the best and most reliable indication of CKx's value"); Union Ill. 1995 Inv. Ltd. P'ship v. Union Fin. Grp., 847 A.2d 340, 343 (Del. Ch. 2003) (concluding that "the Merger Price is the best evidence of fair value").

28 *See* § 262(h) (providing 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 or consolidation").

29 2015 WL 4540443.

30 No. 9322-VCL, 2016 WL 3186538 (Del. Ch. May 31, 2016).

31 No. 10107-CB, 2016 WL 3753123 (Del. Ch. July 8, 2016).

I. Overview of Appraisal Rights

Shareholders' statutory right to appraisal grew out of the shift away from the traditional requirement that shareholders unanimously consent in order to proceed with a merger or other fundamental corporate change.[32] Although the unanimity requirement afforded great protection to individual shareholders, it also gave rise to a holdout problem, as an equity holder with just one share could block the entire transaction.[33] To cure this issue, states amended their corporate statutes to replace the unanimity requirement with a majority-vote rule.[34] This change increased overall corporate efficiency, but it left minority shareholders vulnerable to the will of the majority in the context of changes in corporate control.[35] States addressed this new issue by expanding statutory appraisal rights, which allow dissenting minority shareholders to escape a transaction approved by the majority.[36] More specifically, appraisal rights permit dissenting shareholders who believe the merger price is inadequate to petition the court for a determination of the fair value of their shares.[37]

Because appraisal rights are creatures of state law, they vary by jurisdiction.[38] In Delaware, shareholders must meet certain standing requirements and take certain affirmative actions in order to exercise their appraisal rights. To start, the appraisal remedy is only permitted in the merger context.[39] Additionally, for public companies, the availability of

32 *See* Barry M. Wertheimer, *The Shareholders' Appraisal Remedy and How Courts Determine Fair Value*, 47 DUKE L.J. 613, 615 (1998) (explaining that the appraisal remedy developed "as a quid pro quo for the loss of shareholders' right to veto fundamental corporate changes").

33 *See* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 2, at 1558 (describing the "holdout problem" that arose from unanimous consent requirements); *see also* George S. Geis, *An Appraisal Puzzle*, 105 NW. L. REV. 1635, 1642 (2011) ("[A]ny single shareholder could block the deal, and the expansion of shareholder rosters during [the early twentieth century] raised serious holdout problems . . . .").

34 *See* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 2, at 1558 (describing the transition from a unanimity requirement to majority-vote rule).

35 *See id.* (noting that the change to majority-voting "stripped minority shareholders of protection against majority expropriation"); *see also* Geis, *supra* note 33, at 1642-43 (explaining that the shift away from the unanimity requirement "led to concerns that majority owners could trample over the interests of minority shareholders—say, by merging with firms engaged in risky or objectionable activity").

36 *See* Geis, *supra* note 33, at 1643 ("A merger could move forward with less-than-unanimous approvals, but minority owners had an escape if they disliked the shift in direction.").

37 *See* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 2, at 1558-59 ("Appraisal affords minority shareholders who object to a fundamental transaction the opportunity to exit from the enterprise on terms set by a judge . . . .").

38 States that have adopted the Model Business Corporation Act (MBCA) have the same or similar appraisal remedies. *See id.* at 1559 (discussing the broad availability of appraisal in MBCA states). In this Comment, I focus on the Delaware appraisal statute, given that more than fifty percent of all publicly traded companies in the United States are incorporated in Delaware. *Division of Corporations: About Agency*, ST. DEL., http://www.corp.delaware.gov/aboutagency.shtml [https://perma.cc/T6A3-GG5H].

39 *See* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 2, at 1559 ("In Delaware . . . only mergers give rise to appraisal rights.").

appraisal rights depends on the form of the merger consideration: the remedy exists in an all-cash merger but generally not in a stock-for-stock merger—i.e., when shareholders receive relatively liquid equity securities in exchange for their shares in the target company or any other public company.[40] This "market-out exception," which denies appraisal rights to minority shareholders, exists when the merger consideration consists of stock listed on a national securities exchange or is held by more than 2000 record owners.[41] Additionally, to have standing, a shareholder must be a record stockholder continuously from the time the appraisal claim is made through the effective date of the merger.[42]

The 2016 amendments to section 262 imposed an additional standing requirement. The Court of Chancery must dismiss any appraisal action unless (1) the number of shares entitled to appraisal is greater than one percent of the outstanding shares in that class; (2) the merger consideration for the shares entitled to appraisal is greater than one million dollars; or (3) the transaction in question is structured as a short-form merger.[43] These amendments were aimed at eliminating appraisal claims having a de minimus amount of money at stake, while explicitly preserving the appraisal remedy in the short-form merger context, which the courts historically have viewed with suspicion.[44]

Shareholders must also comply with a number of affirmative requirements to perfect their appraisal rights. First, they must deliver a written demand for appraisal to the company before the merger vote.[45] Second, shareholders must either vote against the transaction or abstain from the vote entirely.[46] Finally, assuming the merger was approved by shareholder vote, the dissenting shareholders must file a petition seeking appraisal with the Delaware Court of Chancery within 120 days of the effective date of the merger.[47] In contrast to breach of fiduciary duty lawsuits, there is no class action or fee-shifting mechanism available in appraisal actions, making appraisal suits riskier for plaintiffs.[48]

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

41 *Id.* § 262(b)(1); *see also* Geis, *supra* note 33, at 1646 (explaining that the "market-out exception" is premised on the thought that appraisal proceedings would be "a waste of time if dissenters preserve their equity position while still enjoying an exit option via a public sale").

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

43 *Id.* § 262(g).

44 *See, e.g.*, Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1116 (Del. 1994) ("Entire fairness remains the proper focus of judicial analysis in examining an interested merger, irrespective of whether the burden of proof remains upon or is shifted away from the controlling or dominating shareholder, because the unchanging nature of the underlying 'interested' transaction requires careful scrutiny.").

45 DEL. CODE ANN. tit. 8, § 262(d)(1) (2016).

46 *Id.* § 262(a).

47 *Id.* § 262(e).

48 *See* Richter et al., *supra* note 4, at 19 ("Importantly, unlike other litigation challenging a deal, stockholders are unable to proceed as a class and shift attorneys' fees to stockholders as a whole or to the defendants.").

These procedural hurdles, together with the threat that a court may determine that the fair value of the plaintiff's shares is *less* than the merger price,[49] mean that the incidence of appraisal claims is substantially less than breach of fiduciary duty claims.[50] Nevertheless, due to the factors described in Section II.A. appraisal plaintiffs are incentivized to bring claims, and the appraisal remedy will continue to be a means of enforcing corporate accountability.

II. THE GROWTH OF APPRAISAL ARBITRAGE

Although the statutory appraisal remedy has been available for decades, activity in this area, once characterized as "a sleepy corporate law backwater,"[51] has exploded with the development of appraisal arbitrage as an investment strategy.[52] In the 1960s and 1970s, corporate law scholars were dismissive of the usefulness of appraisal claims,[53] and this view persisted into the twenty-first century.[54] These critics rightly pointed out that transactions simply could be structured to avoid the appraisal remedy altogether[55] and that the process of seeking appraisal was "chock-full of disadvantages for [dissenting] shareholders."[56] However, the value of appraisal claims increased tenfold from 2004 to 2013, amounting to nearly $1.5 billion, a figure representing almost "one percent of the equity value of all merger activity in 2013."[57] Commentators attribute this exponential growth to appraisal arbitrageurs,[58] who tend to be

49 *See* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 2, at 1561 (explaining that courts "can, and occasionally do, determine fair value of the plaintiff's share to be less than the merger consideration" (footnote omitted)).

50 *See* Korsmo & Myers, *Appraisal Litigation*, *supra* note 5, at 47 (noting that "[v]irtually every merger faces a fiduciary duty class action").

51 Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 2.

52 *Id.*

53 *See, e.g.*, Victor Brudney & Marvin A. Chirelstein, *Fair Shares in Corporate Merger and Takeovers*, 88 HARV. L. REV. 297, 304 (1974) (referring to appraisal claims as a "last-ditch check on management improvidence"); Melvin Aaron Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CALIF. L. REV. 1, 85 (1969) (characterizing appraisal actions as a "remedy of desperation"); Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 260 (1962) ("The appraisal remedy is of virtually no economic advantage to the usual shareholder except in highly specialized situations.").

54 *See* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 2, at 1560 (noting that, as of 2015, "[a]cademic commentary continue[d] to take a sweepingly dismissive view of appraisal").

55 *Id.*

56 *Id.* (quoting Turner v. Bernstein, 776 A.2d 530, 547 (Del. Ch. 2000)); *see also id.* at 1560-61 ("These disadvantages tend to fall into three categories: (1) the procedural burdens of preserving and asserting an appraisal remedy; (2) the inability to proceed as a class and shift attorneys' fees to shareholders as a whole or to defendants; and (3) the narrow and inflexible nature of the remedy available.").

57 *Id.* at 1553.

58 Guarav Jetley & Xinyu Ji, *Appraisal Arbitrage—Is There a Delaware Advantage?*, 71 BUS. LAW. (forthcoming 2016) (manuscript at 3), http://ssrn.com/abstract=2616887 [https://perma.cc/M7FM-6XZP].

sophisticated, institutional investors.[59] A number of hedge funds have filed multiple appraisal claims. The largest investor is Merion Capital, which has invested over $700 million in seven cases since 2010.[60] Merion Capital, which is based in the suburbs of Philadelphia and is led by successful plaintiffs' lawyer Andrew Barroway, raised a reported one billion dollars for a dedicated appraisal fund in 2013.[61] This investment strategy has proven quite lucrative for Merion Capital, which "has averaged an 18.5% annualized return across five completed appraisals, four of which settled" prior to appraisal proceedings.[62] As a point of comparison, the S&P 500 had a 12.9% annualized return for the period between January 1, 2010 and December 31, 2015.[63] Hedge funds, however, are not the only asset managers employing this investment strategy. Mutual funds and insurance companies, which have traditionally avoided shareholder litigation, have also filed appraisal petitions.[64]

A. *Factors Influencing the Rise of Appraisal Arbitrage Claims*

Commentators have set forth a number of possible reasons for the rise of appraisal arbitrage, yet none seems to explain the phenomenon on its own; rather, a confluence of these factors appears to have given rise to the growth of appraisal petitions.[65] Although the purpose of this Comment is not to argue why appraisal suits have gained popularity, I lay out three factors as potential explanations. Understanding these factors helps to explain why appraisal arbitrage suits will continue to be an investment tactic if the status quo remains intact.

First, the Delaware Court of Chancery's holding in *In re Appraisal of Transkaryotic Therapies, Inc.* opened the door for an increase in appraisal arbitrage suits by extending the window of time in which investors can buy target companies' shares and assert appraisal rights before the effective date of

59 *See* Korsmo & Meyers, *Appraisal Arbitrage*, *supra* note 2 (noting that the "explosive growth" in appraisals has been "driven by sophisticated parties who specialize in bringing appraisal claims").

60 *See id.* at 1574-75 (discussing Merion Capital's appraisal activity).

61 *See id.* at 1575 (describing the fund and its activities).

62 Liz Hoffman, *Judge Rules in Favor of Hedge Fund 'Appraisal Arbitrage' Strategy*, WALL ST. J. (Jan. 7, 2015, 1:15 AM), http://www.wsj.com/articles/judge-rules-in-favor-of-hedge-fund-appraisal-arbitrage-strategy-1420571897 [https://perma.cc/PY8H-PC5S].

63 *See Compound Annual Growth Rate (Annualized Return)*, MONEYCHIMP, http://www.moneychimp.com/features/market_cagr.htm [https://perma.cc/C43H-86WS] (in "Date Range" box, enter "2010" after "Jan 1" and "2015" after "Dec 31"; then hit "Calculate") (calculating an annualized return of 12.93% for that time period).

64 *See* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 2, at 1575 (noting the recent filing of appraisal petitions by major mutual funds and insurance companies).

65 *See id.* at 1582 ("In the end, we can identify no single causative factor to account for the rise in appraisal arbitrage. We suspect that it may simply be a case of a few investors who, somewhat by accident, found themselves considering appraisal as a method for salvaging an investment following a bad merger, became intrigued by the opportunity, and explored it further. As word spread of their success, others mimicked the strategy.").

the merger.[66] In *Transkaryotic*, shareholders owning approximately $400 million in foregone merger consideration sought appraisal.[67] Of the nearly eleven million shares seeking appraisal, however, about eight million were acquired after the record date for voting on the merger, but before the actual vote was held.[68] Thus, the legal issue presented by the case, as stated by the court, was whether "a beneficial shareholder, who purchased shares *after* the record date but before the merger vote, [must] prove, by documentation, that each newly acquired share (*i.e.*, after the record date) is a share not voted in favor of the merger by the *previous* beneficial shareholder?"[69]

The court ruled that the answer to this question was simple: "No."[70] One oft-cited law firm commentary summarized the holding as follows:

> The court ruled that the beneficial holders seeking appraisal did not have to establish how the specific shares they acquired after the record date were voted—which the parties to the litigation and the court agreed would be a practical impossibility. Rather, the Court embraced Cede as the holder of record and ruled that so long as beneficial owners of fewer than the aggregate number of Cede shares that were eligible for appraisal (that is, Cede shares either voted against the merger or not voted) directed Cede to seek appraisal, those shares would meet the statutory requirement and be eligible for appraisal.[71]

In short, *Transkaryotic* gives investors more time to consider whether or not to bring an appraisal claim. Although some commentators have dismissed the *Transkaryotic* decision as having little effect on the frequency of claims,[72] others have noted that there is inherent value in being able to delay an

66 *See* No. 1554-CC, 2007 WL 1378345, at *3 (Del. Ch. May 2, 2007) (holding that a beneficial shareholder who acquires shares after the record date, but before the merger vote, need not prove by documentation that the previous beneficial owner did not vote the shares in favor of the merger).

67 *See id.* at *1 (noting that nearly eleven million shares sought appraisal after foregoing merger consideration of thirty-seven dollars per share).

68 *Id.*

69 *Id.* at *3 (emphasis in original); *see also* Korsmo & Myers, *Appraisal Litigation*, *supra* note 5, at 25-26 ("For most publicly traded stock, the record owner is a depository trust such as Cede & Co., with purchases and sales on public exchanges merely altering the beneficial ownership of the relevant shares . . . . [S]tock most [sic] is held by depository trusts in fungible bulk." (footnote omitted)).

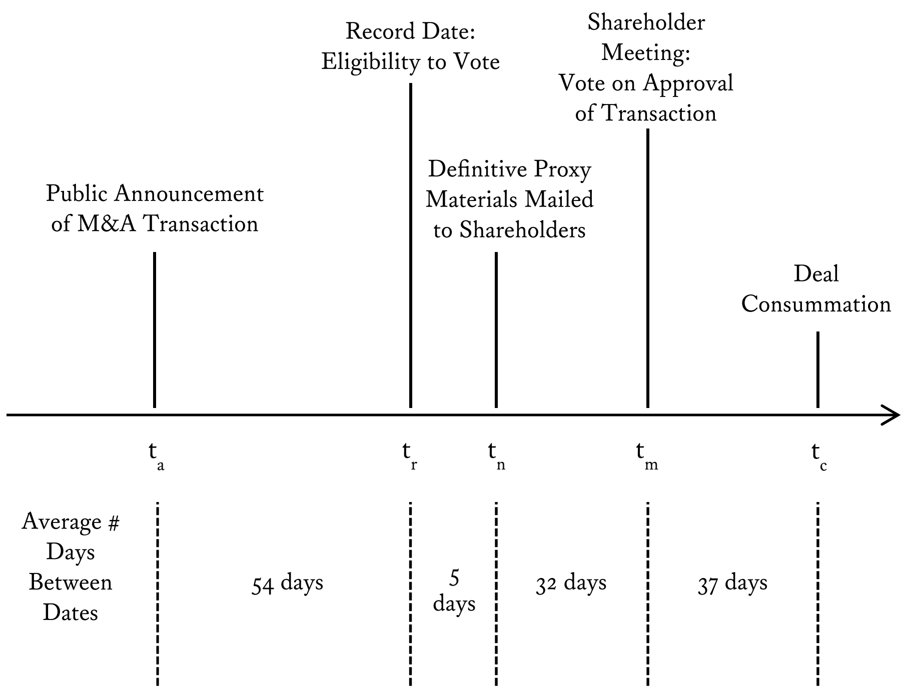
70 *Id.*

71 *Appraisal Arbitrage: Will It Become a New Hedge Fund Strategy?*, M&A DEAL COMMENT. (Latham & Watkins LLP, L.A., Cal.), May 2007, https://www.lw.com/upload/pubContent/_pdf/pub1883_1.pdf [https://perma.cc/SC44-LQRH] [hereinafter Latham & Watkins].

72 *See* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 2, at 1579 (arguing that because the subset of appraisal actions that *were* affected by the *Transkaryotic* ruling did not increase with the same frequency as those that were *not*, "whatever legal changes [that] were wrought by the *Transkaryotic* decision do not appear to have moved the needle on appraisal activity").

investment.[73] Indeed, this ability to delay is akin to giving a free call option to appraisal arbitrageurs.[74]

The option to delay investment provides a number of advantages to potential appraisal arbitrageurs, since the court determines fair value as of the time the deal closes, as opposed to the date of the merger announcement or vote. Take, for instance, the timeline of a typical deal as diagrammed by Jetley and Ji:[75]



The *Transkaryotic* decision thus extended the time in which investors could buy shares of the target company from t_r to t_c, giving appraisal arbitrageurs, on average, a seventy-four-day call option.[76] This option is valuable because it gives an investor more time to analyze a potential investment.

73 *See* Jetley & Ji, *supra* note 58 (manuscript at 6-7) (discussing how the simple ability to delay investment in a target company allows arbitrageurs to reduce their risk and maximize returns).

74 *See id.* (manuscript at 7) ("Allowing appraisal arbitrageurs to delay their investment in target company stock . . . is akin to giving them [a call] option. . . . [A]ppraisal arbitrageurs do not pay for this option and, thus, the value of the option is essentially a transfer of value from the acquiring company to the arbitrageurs."). It is this "free option" that prominent defense law firms have called upon the Delaware legislature to remove.

75 *Id.* (manuscript at 18 fig.1).

76 *See id.* (manuscript at 17) (explaining that in a "typical cash-only friendly transaction . . . the average time period between the record date and the deal consummation is 74 days").

This delay allows an investor "to take advantage of any development[s] or new information," such as macroeconomic changes, industry shifts, or company-specific material from the definitive proxy statement.[77] Moreover, postponing the share purchase may help an investor minimize deal risk, or the probability that the transaction later falls through.[78]

A second factor that commentators have pointed to as an explanation for the increase in appraisal arbitrage activity is the interest rate that is statutorily due to appraisal petitioners,[79] and which is awarded regardless of whether the appraisal value is higher or lower than the merger price.[80] Pursuant to section 262, appraisal petitioners are owed interest on the value of their shares at "5% over the Federal Reserve discount rate," compounded quarterly, using the effective date of the merger as a starting point.[81] Thus, the attractiveness of bringing an appraisal claim is amplified in an era of historically low interest rates.[82]

It is unlikely, however, that this disparity between the statutorily imposed interest rate and the prevailing market interest rate would, in and of itself, drive the spike in appraisal claims. The statutory interest rate, while attractive compared to the return on money market funds, is far less than the foregone equity rate in a robust market.[83] The appraisal process is also rife with risk, as the court may award a fair value that is less than the merger price.[84] Returns

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77 *Id.* (manuscript at 18).

78 *Id.*

79 *See* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 2, at 1579-80 (explaining that "in an era of historically low interest rates, the interest rate available to appraisal petitioners" under the Delaware appraisal statute may be "attract[ing] investors to appraisal").

80 Jetley & Ji, *supra* note 58 (manuscript at 48).

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

82 *See* Jetley & Ji, *supra* note 58 (manuscript at 10) ("While the extent to which the statutory rate may drive arbitrageurs to seek appraisal is debatable, our findings are consistent with the notion that the relatively high current statutory rate does improve the economics for arbitrageurs."); *see also* Daniel E. Wolf et al., *Appraisal Rights—The Next Frontier in Deal Litigation?*, KIRKLAND M&A UPDATE (Kirkland & Ellis LLP, New York, N.Y.), May 1, 2013, at 2, http://www.kirkland.com/siteFiles/Publications/MAUpdate_050113.pdf [https://perma.cc/8FGF-VCDG] ("In today's ultra-low interest rate setting, the accumulating interest payments represent, if not an intriguing stand-alone investment opportunity, at least a meaningful offset to the extended period of illiquidity and litigation costs imposed on the dissenting shareholders for the duration of the proceedings.").

83 Even with the recession of 2008, the average annual return of the S&P 500 between 2006 and 2015 remained 9.03%. Aswath Damodaran, *Annual Returns on Stock, T.Bonds and T.Bills: 1928–Current*, N.Y.U. STERN SCH. BUS., http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html [https://perma.cc/4WN5-6CX4] (last updated Jan. 5, 2016); *see also* Jetley & Ji, *supra* note 58 (manuscript at 52) ("[I]n cases where the credit of the acquiring company (or the entity responsible for paying the fair value awarded to the petitioner) is rated 'BB' or higher, the statutory rate appears to overcompensate petitioners for a bond-like claim.").

84 *See* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 2, at 1580-81 ("Petitioners are only entitled to demand an award of interest if they take their claims all the way to trial, which typically takes well over a year and carries with it the risk that the appraised value could be less than the foregone merger consideration. The idea that sophisticated investors are pouring hundreds of millions of dollars into risky appraisal proceedings to chase above-market interest rates simply is not credible.").

for investors in appraisal arbitrage claims are not as simple as the judicially determined fair price of their shares plus the interest rate. Rather, returns must also exclude enforcement costs, such as attorneys' and experts' fees, as well as the hedge fund's management and performance fees.[85] Additionally, this interest rate incentive was likely neutralized by the 2016 amendments to section 262, since acquiring companies can prepay merger consideration to appraisal plaintiffs, offsetting the statutory interest rate.[86]

Third, and finally, an increase in appraisal activity may be attributed to the simple fact that more people, especially sophisticated investors, have begun to pay more attention to the remedy.[87] As previously discussed, the appraisal arbitrage market has recently become composed of sophisticated, repeat players with significant amounts of capital at their disposal.[88] Furthermore, as opposed to fiduciary duty merger litigation, where lawsuits are omnipresent and the decision to bring a case is not tied to merit, there is evidence that the decision to invoke the appraisal remedy is correlated with litigation merit.[89] Thus, the recent prominence of appraisal arbitrage claims may simply be the result of more smart, wealthy people recognizing that appraisal can be an attractive investment strategy. However, there is a risk that, like in the private equity industry, an influx of new entrants and their attendant capital will increase competition for a limited number of appraisal claims and result in lower appraisal returns for investors.[90]

B. *Backlash Against the Practice of Appraisal Arbitrage*

Although there is debate surrounding the reasons why appraisal claims have grown, it is undisputed that the practice of appraisal arbitrage has been met with resistance. Both corporations and defense-side law firms have been vocal in advocating for restrictive reforms to the Delaware appraisal statute. The first rumblings for change emerged in the wake of *Transkaryotic*. One prominent law firm predicted that the decision "ha[d] the potential to

85 Dan Barufaldi, *Hedge Funds: Structure*, INVESTOPEDIA, http://www.investopedia.com/university/hedge-fund/structures.asp [https://perma.cc/8SAZ-KVFJ].

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

87 *See* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 2, at 1572 ("[T]he rise in appraisal activity since 2011 appears to reflect a secular increase in interest in appraisal, rather than a mere cyclical phenomenon tied to the conditions of the merger market.").

88 *See supra* notes 58–64 and accompanying text.

89 *See* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 2, at 1556-57 (noting that while "the evidence suggests that the merits matter" in appraisal litigation, "the evidence suggests the legal merits are functionally irrelevant" in the decision to bring suit alleging breach of fiduciary duty in a merger).

90 *See* Steven Kaplan & Antoinette Schoar, *Private Equity Performance: Returns Persistence and Capital* 24-25 (Nat'l Bureau of Econ. Research Working Paper Series, Working Paper No. 9807, 2003), http://www.nber.org/papers/w9807.pdf [https://perma.cc/LZ5D-2DJY] (discussing the effect of new entrants on various types of funds).

revolutionalize the use of appraisal rights" and warned of the possibility of "the creation of a new 'market' in appraisal rights" that could have a disruptive effect on the M&A market.[91] While the firm may have been prescient, it nonetheless still took a few more years, the emergence of dedicated appraisal arbitrageurs, and two high-profile going-private transactions before appraisal suits came into the spotlight.

In 2010, Merion Capital filed its first appraisal petition.[92] In that same year, a number of other investors who all subsequently became prominent repeat players in the appraisal arbitrage market also filed claims.[93] While these sophisticated investors were appraisal arbitrage trailblazers and are at the center of current policy debates, it was two multi-billion, highly publicized going-private transactions that really garnered appraisal attention. The first was the eventually-successful attempt to privatize Dell Inc. by Michael S. Dell and Silver Lake Partners.[94] This transaction proved to be contentious, and the most prominent of the investors opposed to the deal consideration was billionaire investor Carl Icahn, who had also been part of the dissenting group in *Transkaryotic*.[95] As part of a tactic to extract a price greater than that offered by Michael Dell and Silver Lake, Icahn threatened to oppose the transaction and exercise his appraisal rights.[96] In the end, Icahn did not follow through with his appraisal threat,[97] but the pressure it created forced Dell and Silver Lake to increase their offer from $13.65 per share to $13.75 per share, plus a $0.13 dividend.[98] This sequence of events provides at least three takeaways. First, Icahn's campaign against Dell raised the profile of appraisal actions as

91 Latham & Watkins, *supra* note 71.

92 *See supra* notes 60–61 and accompanying text; *see also* Korsmo & Myers, *Appraisal Litigation*, *supra* note 5, at 29 ("Merion is reputed to have raised capital devoted solely to the strategy of pursuing appraisal rights, and Merion's investments in some targets were so large that it crossed the 5% threshold, triggering SEC filing requirements. Merion appears to invest in target companies exclusively *after* the announcement of a deal, with all Merion purchases of target stock disclosed on the relevant Form 13Gs occurring after the announcement of the merger transaction." (footnote omitted)).

93 *See* Korsmo & Myers, *Appraisal Litigation*, *supra* note 5, at 29 (describing a number of funds that brought appraisal actions in 2010, which have "come to be among the most active appraisal petitioners in terms of dollars at stake" and which "all appear committed to appraisal as an investment strategy, making and dissenting on numerous large positions in target companies").

94 *See* Michael J. de la Merced, *Icahn's Latest Gamble at Dell: Appraisal Rights*, N.Y. TIMES: DEALBOOK (July 10, 2013, 10:33 AM), http://dealbook.nytimes.com/2013/07/10/icahns-latest-gamble-at-dell-appraisal-rights/ [https://perma.cc/GQG3-RGJB] (reporting on the "new tactic" Carl Icahn was employing by urging his "fellow Dell shareholders . . . to start preparing appraisal rights for their shares").

95 *See* Korsmo & Myers, *Appraisal Litigation*, *supra* note 5, at 30 (noting that Icahn was "a large part of the dissenting group in Transkaryotic").

96 de la Merced, *supra* note 94.

97 Other investors, however, did seek appraisal. *See infra* Section IV.C.

98 Miles Weiss, *Carl Icahn Withdraws His Appraisal Request for Dell Stake*, BLOOMBERG (Oct. 4, 2013, 4:16 PM), http://www.bloomberg.com/news/articles/2013-10-04/icahn-says-he-withdrew-request-for-appraisal-on-dell [https://perma.cc/FK7E-9CAE].

an investment strategy with the widespread media coverage it received.[99] Second, Icahn showed that the mere threat of an appraisal action could lead to a higher ultimate merger price.[100] Third, if Icahn had extracted this higher offer, and nevertheless sought appraisal, Icahn could have used the higher offer as evidence of unfair bargaining on the part of Michael Dell and Silver Lake. Icahn could have potentially used this evidence in both the fiduciary duty and appraisal contexts.

The second of these going-private transactions, a freeze-out merger of Dole Food Company by its Chief Executive (and controlling shareholder) David Murdock,[101] resulted in Dole management seeking an amendment to Delaware's appraisal statute. The appraisal action in *In re Appraisal of Dole Food Company, Inc.* was led by funds such as Merion Capital, Hudson Bay Capital, Magnetar Capital, and Fortress Investment Group, which collectively acquired nearly twenty percent of Dole stock immediately prior to the deal closing on November 1, 2013.[102]

In response—and with one billion dollars on the line—Dole put on a full-court press both inside and outside the courtroom, lobbying Delaware officials to amend the state's appraisal statute.[103] Importantly, Dole is the Port of Wilmington's largest tenant, providing the state with steady revenues and 850 jobs, which in theory should have provided Dole with leverage.[104] Barely a month after the close of the Dole privatization, and after considering a move to Paulsboro, New Jersey, Dole signed a new fifteen-year lease with the Port of Wilmington.[105] While corresponding about the lease, Andrew Lippstone,

99 *See, e.g.*, *id.* (reporting on Icahn's threatened appraisal action); *see also* David Benoit & Ben Fox Rubin, *Icahn Calls on Dell Holders to Seek Appraisal of Shares*, WALL ST. J. (July 10, 2013, 3:02 PM), http://www.wsj.com/articles/SB10001424127887323740804578597433825380870 [https://perma.cc/XE2R-4T55] (same); de la Merced, *supra* note 94 (same).

100 *See* Korsmo & Myers, *Appraisal Litigation*, *supra* note 5, at 30 (noting that Dell, Inc.'s "counsel has since explained that Icahn's threat to dissent from the transaction prompted the merger parties to increase the merger consideration by $400 million").

101 Liz Hoffman, *Dole Executives Ordered to Pay $148 Million in Buyout Lawsuit*, WALL ST. J. (Aug. 27, 2015), http://www.wsj.com/articles/dole-executives-ordered-to-pay-148-million-in-buyout-lawsuit-1440686542 [https://perma.cc/83S5-DKSJ].

102 *See* Tom Hals, *America's Oldest CEO Puts His Dole Buyout to a High-Stakes Test*, REUTERS (Aug. 14, 2015, 2:02 PM), http://www.reuters.com/article/us-usa-dole-litigation-idUSKCN0QJ1ZK20150814 [https://perma.cc/E4R4-HCU5] (discussing the investors involved in the appraisal suit); *see also Dole Food Company, Inc. Stockholders Approve Merger*, BUSINESSWIRE (Oct. 31, 2013, 3:49 PM), http://www.businesswire.com/news/home/20131031006489/en/Dole-Food-Company-Stockholders-Approve-Merger [https://perma.cc/Z7YG-DP42] (stating that the merger was expected to close on November 1, 2013).

103 *See* Hals, *supra* note 102 (noting that Dole had taken to "lobbying Delaware officials to amend" the state's appraisal statute).

104 *Id.*

105 *See Dole Signs 15-Year Lease with Port of Wilmington*, DELAWAREONLINE (Dec. 10, 2013, 6:55 PM), http://www.delawareonline.com/story/money/2013/12/10/dole-signs-15-year-lease-with-port-of-wilmington/3969765/ [https://perma.cc/6VE6-F3X2] (announcing the signing of the lease).

Delaware's Governor's general counsel, wrote to Genevieve Kelly, Dole's general counsel, expressing a willingness to attempt to amend the corporate code, stating he was "[h]appy to discuss next steps at [her] convenience."[106] As the litigation continued, Dole continued to press for reforms that would prevent hedge funds from buying lawsuits by restricting appraisal rights to long-term investors only and cutting the statutory interest rate.[107] Dole even threatened reincorporation in a different state if changes were not made.[108]

Prominent defense firms, many of which also have lucrative transactional advisory practices, jumped into the fray shortly thereafter. With appraisal arbitrage creating uncertainty and, thus, a potential decline in the M&A market, the firms supported Dole's call for reform.[109] These firms constitute a powerful voice because they advise many Delaware corporations on corporate transactions, and they also play a prominent role in selecting local counsel when disputes escalate to litigation in the Chancery Court.[110] Deal lawyers at these firms rushed to publish commentary, arguing that the practice of appraisal arbitrage is not consistent with the purpose of appraisal statutes,[111] hurts long-term shareholders,[112] can lead to unrealistically high valuations,[113] and poses a threat to efficient transactions.[114] The target

106 Hals, *supra* note 102.

107 *See id.* (discussing the specifics of Dole's lobbying efforts).

108 *See id.* (describing a letter in which Kelly "wrote that hedge funds pursuing appraisal 'show companies why there is a need to re-incorporate in more business friendly states'" as well as an email to Reuters in which Kelly stated "we have communicated that Dole will incorporate elsewhere if changes are not made").

109 *See* Liz Hoffman, *Wall Street Law Firms Challenge Hedge-Fund Deal Tactic*, WALL ST. J. (Apr. 6, 2015, 8:53 PM), http://www.wsj.com/articles/wall-street-law-firms-challenge-hedge-fund-deal-tactic-1428362171 [https://perma.cc/GE25-8CAD] (reporting that seven major law firms had sent a letter to the Council "urging changes to rules governing" appraisal proceedings).

110 *See* Korsmo & Myers, *Appraisal Litigation*, *supra* note 5, at 35 ("[I]t is these New York firms that often select Delaware counsel, and staying in the good graces of these firms is understandably crucial to the livelihoods of many Delaware lawyers.").

111 *See* Maurice M. Lefkort, *Hedge Funds Can Still Manipulate Corporate Law*, WHARTON MAG.: WHARTON BLOG NETWORK (Feb. 12, 2015), http://whartonmagazine.com/blogs/hedge-funds-can-still-manipulate-stock-market-rule/ [https://perma.cc/5MFK-RU2W] ("Appraisal Arbitrage exploits the failure of the statutes governing appraisal rights to keep up with modern custody practice. Appraisal rights were designed to protect stockholders in a merger that they felt offered them too low a price. In Appraisal Arbitrage, an investor buys into a deal for the purpose of exercising appraisal rights.").

112 *See id*. ("Allowing this practice to continue will come at the expense of the stockholders who are not manipulating these rules, and at the efficiency of the mergers and acquisitions marketplace.").

113 *The Growth of Appraisal Litigation in Delaware*, WILSON SONSINI GOODRICH & ROSATI (Nov. 18, 2013), https://www.wsgr.com/WSGR/Display.aspx?SectionName=publications/PDFSearch/wsgralert-delaware-appraisal-litigation.htm [https://perma.cc/SA8G-2K39] ("Management presentations made to the board in the context of the board considering its alternatives often include an 'upside' case that is admissible for appraisal purposes even if it was unrealistic as a practical alternative.").

114 *See* Norwitz, *supra* note 9 (arguing that there is an "urgent need for legislative reform in Delaware to ameliorate the risk that appraisal arbitrage—now a multibillion dollar industry—poses to transactional vitality and shareholder value").

audience for the calls for reform was the Council, the body "responsible for formulating and recommending to the Delaware General Assembly . . . amendments to the Delaware General Corporation Law."[115]

When the Council issued its proposed amendments in the spring of 2015, advocates for reform were underwhelmed. The Council suggested two amendments, neither of which went as far as the defense-side law firms wanted.[116] First, the Council suggested a de minimis requirement in order to eliminate nuisance suits: the shareholders seeking appraisal would have to collectively hold at least one percent of total shares outstanding or one million dollars' worth of shares.[117] Second, the Council proposed a provision intended to offset the potential economic incentives of the statutory interest rate:

> [A]t any time before the court enters judgment in an appraisal action, the company surviving the merger can pay to each stockholder seeking appraisal rights an amount of cash, with interest continuing to accrue only on the amount that is the difference between that cash payment and the court's ultimate award.[118]

In response to this perceived failure to act, seven prominent law firms sent a letter directly to the Council expressing their disappointment over the limited scope of the proposed amendments and advocating for further reform.[119] In the letter, the firms expressed their view that "the proposed

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115 *See supra* note 16.

116 *See* Daniel G. Dufner, Jr. et al., *Increasing Hostility Towards Appraisal Arbitrage*, CLIENT ALERT MERGERS & ACQUISITIONS (White & Case LLP, New York, N.Y.), Apr. 2015, at 2, http://www.whitecase.com/sites/whitecase/files/files/download/publications/alert-increasing-hostility-towards-appraisal-arbitrage.pdf [https://perma.cc/7JLG-QQKH] ("Despite the expectation that the proposed legislative reforms will be adopted by the Delaware legislature, they have been criticized as insufficient to effectively address the problems of appraisal arbitrage . . . ."); *see also* Abigail Pickering Bomba et al., *Proposed Appraisal Statute Amendments Would Permit Companies to Reduce Their Interest Cost—Likely to Discourage "Weaker" Appraisal Claims and Make Settlement of "Stronger" Claims Harder*, FRIED FRANK M&A BRIEFING (Fried Frank, New York, N.Y.), Mar. 23, 2015, at 5-6, http://www.friedfrank.com/siteFiles/Publications/FINAL%20-%203-23-2015%20-%20Proposed%20Appraisal%20Statute%20Amendments.pdf [https://perma.cc/XHC7-PBM4] ("The Amendments do not include any of the more far-reaching changes that have been advocated by companies and others seeking to limit the volume of appraisal claims and the prevalence of appraisal arbitrage, or to ameliorate the burden on the court of determining 'fair value', such as: a limitation on the types of transactions to which appraisal rights would be applicable; restrictions on the timing for filing an appraisal petition; a change in the definition of fair value; limiting appraisal rights to stockholders who owned their shares before announcement of the merger; further requirements with respect to establishing that shares have not been voted in favor of the merger; or establishing a burden of proof on the parties (rather than the Chancery Court) to determine fair value.").

117 *See supra* note 18 and accompanying text.

118 *Proposed 2015 Amendments to the Delaware General Corporation Law*, *supra* note 17. It is unclear what would happen if the court's ultimate award is less than the merger price.

119 *See* Seven Firm Letter, *supra* note 12, at 1-2 (opining that "the proposed legislation [did] not adequately respond" to the threats created by appraisal arbitrage and advocating for reforms that they believed constituted a "minimum appropriate solution" to the situation); *see also* Hoffman, *supra* note 109 (describing the letter).

legislation [did] not adequately respond to the current circumstance in which decisions of the Delaware courts have opened the door to what has come to be called 'appraisal arbitrage.'"[120] Quoting a passage from *Transkaryotic*, the firms argued that the practice of appraisal arbitrage perverts the true purpose of the statutory appraisal right.[121] The firms suggested amending the statute such that appraisal rights would only be available to those holding shares before the record date for the merger vote.[122] This solution would remove the "free option"[123] that appraisal arbitrageurs have when deciding to buy into a lawsuit and restrict the ability to resort to appraisal.

In 2016, the Council recommended almost identical amendments, adding only that an appraisal suit should not be dismissed if the merger is a parent/subsidiary merger approved under section 253 or 267 of the DGCL.[124] The Delaware legislature responded to this repeated advocacy for reform by adopting these amendments on June 8, 2016.[125] These amendments show that the Delaware legislature realizes that there is potential for appraisal arbitrage abuse,[126] but the amendments do not go far enough to have meaningful impact. The amendments prevent nuisance suits, where paying off an opportunistic, small investor is cheaper than the cost of litigation. The amendments also negate the financial incentives created by the relatively high statutory interest rate. However, as one defense-side law firm points out, the amendments do

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120 Seven Firm Letter, *supra* note 12, at 1.

121 *See id*. at 2 ("[Respondents] argue that this decision will pervert the goals of the appraisal statute by allowing it to be used as an investment tool for arbitrageurs as opposed to a statutory safety net for objecting stockholders. That is, the result I reach here may . . . encourage appraisal litigation initiated by arbitrageurs who buy into appraisal suits by free-riding on Cede's votes on behalf of other beneficial holders—a disfavored outcome. To the extent that this concern has validity, relief more properly lies with the Legislature." (alteration in original) (internal quotations omitted) (quoting *In re* Appraisal of Transkaryotic Therapies, Inc., No. 1554-CC, 2007 WL 1378345, at *5 (Del. Ch. May 2, 2007))).

122 This recommendation would effectively undo the *Trankaryotic* holding. The firms argued, "We believe that strong equitable arguments can be made to deny appraisal rights to anyone purchasing after public announcement of a transaction, but at a minimum there is no justification for permitting holders who purchased their shares after the record date for the vote to seek appraisal as if they were 'dissenters.' This approach would fulfill the legislative purpose of protecting stockholders of Delaware corporations who dissent from a merger that is subject to appraisal rights. It would also reduce the unseemly claims-buying that is rampant and serves no legitimate equitable or other purpose, but threatens to undermine transactional certainty and reduce value to shareholders of Delaware corporations as acquirers, particularly in leveraged transactions, may be forced to factor the enhanced appraisal risk into their calculations." *Id.* at 2-3.

123 *See supra* notes 75–78 and accompanying text.

124 *See* Land et al., *supra* note 21 (describing the Council's 2016 proposed amendments to the DGCL).

125 *See supra* note 22 and accompanying text.

126 When I refer to abusive appraisal claims, I mean those that are merely speculative investments, usually without any merit other than a relatively low premia. Appraisal arbitrageurs may use these claims to extract a settlement above the merger price, and acquiring companies may acquiesce due to the ex ante uncertainty of appraisal proceedings. *See* Hoffman, *supra* note 62 and accompanying text (noting that four of the five claims that Merion Capital brought were settled).

"not help buyers manage the deal price risk associated with the exercise of appraisal rights (including risk related to appraisal arbitrage), which is a long-standing, unaddressed issue in Delaware public company transactions."[127]

A way to address the price risk issue is reform aimed at the Chancery Court. One means of disincentivizng the potentially abusive practice of appraisal arbitrage is the use of merger price as the best evidence of fair value when certain conditions hold. The conditions I suggest are (1) unreliable DCF inputs and (2) a true market test. By shifting to a situation-dependent use of merger price as fair value, courts will greatly disincentivize bringing meritless appraisal claims because claimants will no longer be able to profit from that strategy. At the same time, claimants could bring meritorious appraisal claims without worrying about this alternative to valuation methods such as DCF, because if there is a real reason to suspect the merger price was too low, the court will conduct its own independent analysis. Thus, the concepts of appraisal arbitrage and the use of merger price as fair value dovetail, presenting an approach to combat deal price uncertainty when there should be no uncertainty.

III. DELAWARE'S APPROACH TO VALUATION IN APPRAISAL CASES

The sole purpose of an appraisal proceeding is for the court to determine what minority shareholders are equitably owed for their stock. The DGCL defines the court's role:

> [The Court of Chancery] shall determine the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with interest, if any, to be paid upon the amount determined to be the fair value. In determining such fair value, the Court shall take into account all relevant factors.[128]

This statutory instruction supplies four directives to the courts. First, the court must determine the "fair value" to be awarded to dissenting shareholders.[129] The term "fair value," however, is left undefined and is therefore left to courts' interpretations. Second, the "fair value" must be "exclusive of any element of the value arising from the accomplishment or expectation of the merger or consolidation."[130] This provision has been interpreted to mean that any synergies arising out of a merger must be excluded

127 Memorandum from Davis Polk & Wardwell LLP, Recent Delaware Appraisal Rights Developments Address Interest Rate Risk but Leave Certain Transactions Vulnerable on Deal Price 3 (Aug. 18, 2016), https://www.davispolk.com/publications/recent-delaware-appraisal-rights-developments-address-interest-rate-risk-leave-certain/ [https://perma.cc/J5RC-MJVQ].

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

129 *Id.*

130 *Id.*

from the calculation of "fair value."[131] Third, in addition to "fair value," petitioners are also owed interest on their shares.[132] The rate of interest is statutorily defined as the sum of the Federal Reserve discount rate plus five percent,[133] compounded quarterly, starting as of the effective date of the merger.[134] Finally, courts must take into account "all relevant factors" when determining fair value.[135]

A. *Calculating "Fair Value"*

Courts often refer to the legal concept of "fair value" as the "going concern,"[136] "true,"[137] or "intrinsic"[138] value. In 1950, the Delaware Supreme Court explained the legal meaning of "fair value": "The basic concept of value under the appraisal statute is that the stockholder is entitled to be paid for that which has been taken from him, viz., his proportionate interest in a going concern."[139] In *Cavalier Oil Corp. v. Harnett*, the Delaware Supreme Court added that "[t]he dissenting shareholder's proportionate interest is determined only after the company as an entity has been valued. In that determination, the Court of Chancery is not required to apply further weighting factors at the shareholder level, such as discounts to minority shares for asserted lack of marketability."[140] Therefore, in determining fair value, a court must pretend as if the merger had not occurred and calculate what the entire target company was worth as of the actual closing date. After determining that value, the court must then award the dissenting shareholders their pro rata share of the total going concern value.

These guidelines, however, do not provide much guidance to the courts regarding how to calculate an actual numerical figure representing fair value. In 1983, the Delaware Supreme Court, in *Weinberger v. UOP, Inc.*, established the current approach to measuring fair value, under which, "any techniques or methods which are generally considered acceptable in the financial

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131 *See* Union Ill. 1995 Inv. Ltd. P'ship v. Union Fin. Grp., 847 A.2d 340, 356 (Del. Ch. 2003) (noting that "the definition of fair value used in a § 262 proceeding . . . involves policy considerations, such as the need to exclude synergies in order to value the entity as a going concern").

132 § 262(h).

133 *Id.*

134 *Id.*

135 *Id.*

136 *See, e.g.*, *Union Ill.*, 847 A.2d at 356 (describing the court's "mandate [under section 262] that the subject company in an appraisal be valued as a going concern").

137 *See, e.g.*, LongPath Capital, LLC v. Ramtron Int'l Corp., No. 8094-VCP, 2015 WL 4540443, at *9 (Del. Ch. June 30, 2015) (using the term "true value" as a substitute for "fair value").

138 *See, e.g.*, Gearreald v. Just Care, Inc., No. 5233-VCP, 2012 WL 1569818, at *11 (Del. Ch. Apr. 30, 2012) (referring to fair value as a company's "intrinsic value").

139 Tri-Continental Corp. v. Battye, 74 A.2d 71, 72 (Del. 1950).

140 564 A.2d 1137, 1144 (Del. 1989).

community" may be used to calculate fair value.[141] This approach appears to be in harmony with the statutory mandate that "the Court shall take into account all relevant factors" when determining fair value.[142] Accordingly, there are a number of possible approaches the courts can use when determining fair value, including a DCF analysis, a comparable companies analysis, a comparable transactions analysis, or the merger price less synergies.[143] Courts are free to use any, none, or a combination of these approaches.

Since *Weinberger*, the Chancery Court has grown to favor DCF analysis—the preferred valuation methodology in the finance community—for its own determinations of fair value.[144] DCF analysis requires the court to value the target company by discounting all future projected cash flows to their present value.[145] The DCF approach has become favored in appraisal proceedings for both theoretical and contextual reasons. As a matter of theory, DCF analysis is universally considered the most accurate way to value a corporation because it provides a rigorous analytical framework. Additionally, appraisal is often conducted in the context of a target company that is either private or only thinly traded. Although this context presents difficulties for a DCF analysis, since many of its inputs are dependent on a liquid trading market for the company's stock,[146] a DCF analysis is often still considered more reliable than a comparables analysis, especially when the target company operates in a

141 457 A.2d 701, 713 (Del. 1983).

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

143 Samuel C. Thompson, Jr., *A Lawyer's Guide to Modern Valuation Techniques in Mergers and Acquisitions*, 21 J. CORP. L. 457, 460 (1996) (listing these various techniques "for determining the value of the assets or shares of a target corporation").

144 *See* Lawrence A. Hamermesh & Michael L. Wachter, *The Short and Puzzling Life of the "Implicit Minority Discount" in Delaware Appraisal Law*, 156 U. PA. L. REV. 1, 47 (2007) [hereinafter, Hamermesh & Wachter, *Implicit Minority Discount*] ("In the appraisal remedy, the favored method for calculating the fair value of the corporation is the preferred method in finance for calculating the fair value of the corporation—that is, the discounted future free cash flows or DCF."); *see also* Neal v. Ala. By-Products Corp., No. 8282, 1990 WL 109243, at *7 (Del. Ch. Aug. 1, 1990) (describing the DCF method as "the preeminent valuation methodology"); Cede & Co. v. Technicolor, Inc., No. 7129, 1990 WL 161084, at *7 (Del. Ch. Oct. 19, 1990) ("In many situations, the discounted cash flow technique is in theory the single best technique to estimate the value of an economic asset."), *rev'd on other grounds*, 684 A.2d 289 (Del. 1996).

145 The Court outlined DCF analysis in *ONTI, Inc. v. Integra Bank*, explaining, "The DCF model entails three basic components: an estimation of net cash flows that the firm will generate and when, over some period; a terminal value equal to the future value, as of the end of the projection period, of the firm's cash flows beyond the projection period; and finally a cost of capital with which to discount to a present value both the projected net cash flows and the estimated terminal or residual value." 751 A.2d 904, 917 (Del. Ch. 1999) (quoting *Technicolor*, 1990 WL 161084, at *7).

146 *See* Lawrence Hamermesh & Michael L. Wachter, *The Fair Value of Cornfields in Delaware Appraisal Law*, 2005 J. CORP. L. 119, 125 n.33 [hereinafter Hamermesh & Wachter, *Cornfields*] (explaining that "the theory assumes stock trades in liquid capital markets, which rules out closely held but publicly traded stock").

niche market.[147] When the target company is either privately held or thinly traded, it is difficult, if not impossible, to identify publicly traded companies that are sufficiently comparable to provide a reliable valuation.[148] Likewise, similar difficulties arise when trying to identify comparable transactions when the target company is small and operates in a niche market.[149]

The DCF methodology, however, is more of an art than a science, as it is highly sensitive to a number of important assumptions.[150] Furthermore, even the staunchest proponents of the DCF method acknowledge that it is weakest when used in the typical appraisal context.[151] To start, flawed income statement projections render a DCF analysis useless ab initio. Additionally, other assumptions, such as the terminal value multiple and appropriate discount rate, may be extremely difficult to ascertain and vehemently disputed by the parties. Due to the sensitivity of the DCF methodology to such inputs, accepting one party's assumptions over another may lead to wild swings in valuations. Nonetheless, the burden of proof does not direct the court to favor one party over another—the court must conduct its own independent analysis.[152] Thus,

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147 *See, e.g.*, *In re* Orchard Enter., No. 5713-CS, 2012 WL 2923305, at *9 (Del. Ch. July 18, 2012) ("A comparable, or market-based, approach to valuation is rooted in the same intuition as the DCF method. But rather than directly estimating the future cash flows of the subject company and reducing them to present value, the market-based methods draw inferences about the future expected cash flows from the market's expectations about comparable companies . . . . [But] [r]eliance on a comparable companies or comparable transactions approach is improper where the purported 'comparables' involve significantly different products or services than the company whose appraisal is at issue, or vastly different multiples." (footnotes omitted)).

148 *See In re* Radiology Assocs., Inc. Litig., 611 A.2d 485, 490 (Del. Ch. 1991) ("The utility of the comparable company approach depends on the similarity between the company the court is valuing and the companies used for comparison. At some point, the differences become so large that the use of the comparable company method becomes meaningless for valuation purposes.").

149 *See* Highfields Capital, Ltd. v. AXA Fin., Inc., 939 A.2d 34, 56 (Del. Ch. 2007) (noting that an expert's "comparable company methodology suffer[ed] from the same problem the court found with his comparable transactions analysis—namely, the companies [he] examined were not sufficiently comparable to [the target company] to render his work reliable for purposes of a Delaware appraisal proceeding").

150 *See* Richter et al., *supra* note 4, at 19 ("The methodology most often used by the court to determine going concern value is a discounted cash flow analysis, which is based in large part on assumptions and projections that themselves can be highly uncertain, including the company's internally generated projections and speculative data about how the company would have performed if the merger had not occurred.").

151 That is, when companies are not widely traded. *See* Hamermesh & Wachter, *Cornfields*, *supra* note 146, at 125-26 (noting that finance theory, i.e., DCF analysis, "is in fact weakest in those areas where appraisal is available").

152 The court in *In re Appraisal of Ancestory.com, Inc.* articulated this point, stating, "[Appraisal] is made particularly difficult for the bench judge, not simply because his training may not provide a background well-suited to the process, but also because of the way the statute is constructed . . . . A judge in a bench trial relies . . . on the burden of proof; he holds on to it like a shipwreck victim grasps a floating deckchair or an ex-smoker hoards his last piece of nicotine gum. Section 262 is unusual in that it purports explicitly to allocate the burden of proof to the petitioner *and* the respondent, an allocation not meaningful in light of the fact that no default exists if the burden is not met; in reality, the 'burden'

while DCF analysis is valuable in many cases, there may be certain instances where the court does not have particular expertise and cannot fall back on default presumptions to determine the appropriate inputs. Under such circumstances, the court cannot credibly conduct a DCF analysis, and as a result, has at times resorted to the merger price achieved in a robust sales process.[153]

B. *Calculating Synergies*

Delaware courts, however, cannot entirely defer to M&A markets because they must calculate the deal synergies that they are statutorily required to deduct when determining fair value.[154] By formulating a structured approach to deducting synergies after adopting the proposed merger price framework, courts could create an even greater disincentive for bringing meritless appraisal claims, as petitioners would receive even *less* than the merger consideration they would have received had they not brought the claim.

Synergy, according to one scholar, "is the additional value that is generated by combining two firms, creating opportunities that would not [have] been available to these firms operating independently."[155] Synergies are deal-specific,[156] and must be calculated as such.[157] Synergies can be divided broadly into two categories: operating synergies, which typically affect cash flow, and financial synergies, which can affect cash flow and discount rate.[158] Strategic buyers must be distinguished from financial investors, since strategic buyers are presumed to be able to benefit from synergies while financial investors are not.[159] Thus, in an appraisal action where a financial

falls on the judge to determine fair value, using 'all relevant factors.'" No. 8173-VCG, 2015 WL 399726, at *1 (Del. Ch. Jan. 30, 2015); *see also* Korsmo & Myers, *Appraisal Litigation*, *supra* note 5, at 20 ("A common lament from the members of the Court of Chancery is that the divergent valuations produced by the dueling experts often put them in an awkward situation in attempting to arrive at a sensible valuation in a situation where both parties formally share the ultimate burden of proof.").

153 *See supra* note 27.

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

155 Aswath Damodaran, The Value of Synergy 3 (Oct. 30, 2005) (unpublished manuscript), http://ssrn.com/abstract=841486 [https://perma.cc/5R3T-YJAZ].

156 *See Capturing Synergies in Dealmaking*, CAP. AGENDA INSIGHTS (Ernst & Young, N.Y.), Oct. 2013, at 1, http://www.ey.com/Publication/vwLUAssets/EY_Capturing_synergies_in_dealmaking/$FILE/EY-Capturing-synergies-in-dealmaking.pdf [https://perma.cc/K4YD-ZYPZ] (discussing how "[a]cquirers can use company-specific synergies as a competitive advantage").

157 *See* LongPath Capital, LLC v. Ramtron Int'l Corp., No. 8094-VCP, 2015 WL 4540443, at *25 (Del. Ch. June 30, 2015) (rejecting the application of average market premium to determine synergies because "general data . . . does not tell me anything about *this specific* transaction, which must be the focus in a Section 262 action").

158 Erik P. Gilje, Assistant Professor of Fin., The Wharton Sch., Synergy Valuation (Oct. 30, 2015).

159 *See* Jan Vild & Claudia Zeisberger, *Strategic Buyers v. Private Equity Buyers in an Investment Process* 2 (INSEAD, Working Paper No. 2014/39/DSC/EFE, 2014), http://ssrn.com/abstract=2439589 [https://perma.cc/SDG2-594A] (noting that "strategic buyers were considered to have a significant

sponsor has acquired the target company, the fair value may simply be the merger price. Conversely, when the acquirer is a strategic buyer, there will be synergies that the court must back out when appraising the fair value of shares by using merger price as a starting point.

The academic literature provides a rigorous analytical framework for valuing different kinds of synergies.[160] Nevertheless, in the appraisal context, determining a synergy deduction from the merger price to arrive at fair value presents two notable problems: first, valuing synergies is highly dependent on inputs and assumptions, and it often requires the use of DCF analysis;[161] second, after the synergies are valued, it must be determined how much of them were embedded in the merger price.[162]

These problems, however, are not insurmountable. Admittedly, it is somewhat awkward for proponents of merger-price-as-fair-value that the financial community quantifies most synergies using a DCF analysis.[163] However, it is not entirely inconsistent with the merger price approach. Being forced to use a DCF method for calculating synergies simply presents courts with a choice. On one hand, the court can just use a DCF method to value the entire target company, but the downside of this approach is that the court may believe that the DCF inputs in this scenario are inherently unreliable. On the other hand, the court can use the merger price as a starting point when it is skeptical of the inputs needed for a DCF, and then subtract from it the synergies calculated using the DCF analysis. While this approach also introduces a potentially flawed DCF analysis into the appraisal process, it narrows the possible valuation range somewhat because the merger price acts as an anchor and competing DCFs of synergies will likely yield a smaller range than competing DCFs of an entire target company.

The second problem is the allocation of the value of the synergies between the buyer and the seller. Acquirers would not rationally buy other companies if the entire amount of the expected synergies were included in the merger price.[164] The use of discovery is the solution to the problem of determining the relative allocation of value. Delaware law permits discovery of pre-suit

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advantage over financial investors . . . due to their ability to share with the sellers a portion of the value generated by the post-acquisition synergies").

160 *See generally* Damodaran, *supra* note 155 (reviewing numerous valuation approaches and variables).

161 *See id.* at 10 (valuing operating synergies within a DCF framework).

162 *See id.* at 10-11 (noting "synergy in a merger may well be worth $2 billion, but paying $3 billion as a premium to get the acquisition done will destroy $1 billion of the acquiring company's stockholder wealth").

163 *See id.* at 10 (discussing how to value operating synergy using a DCF analysis).

164 *See supra* note 159 and accompanying text.

valuation materials in appraisal proceedings.[165] Thus, courts can look at an acquiring company's valuation of the target, which certainly quantifies anticipated synergies. By comparing the acquirer's valuation of the target company with synergies, the valuation without synergies, and the ultimate merger price, courts can triangulate the percentage of anticipated synergy value imbedded in the merger price. Multiplying the total synergy value—as determined by the court—with the percentage of synergies embedded in the deal price, courts can determine independently the appropriate synergy deduction from the deal price. Additionally, consideration of the acquiring company's predicted synergies provides a check for the court in its own calculation of synergy value.

Calculation of deal-specific synergies is feasible and should not pose a barrier to courts' use of merger price as the best evidence of fair value in accordance with section 262. Delaware courts, however, have yet to put forth an analytical framework that both describes a deal-specific approach to valuing synergies and allocates the synergies between the buyer and the seller. Academics provide a rigorous approach to the former, and discovery is the best solution to the problem presented by the latter. By creating such a framework, the use of merger price as the best evidence of fair value is more credibly aligned with the statutory mandate of section 262.

IV. APPRAISAL ARBITRAGE, MERGER PRICE, AND DELAWARE PRECEDENT

The practice of appraisal arbitrage and the use of merger price as fair value dovetail in the case of *LongPath Capital, LLC v. Ramtron International Corp*.[166] The opinion emphasizes the impact of questionable DCF assumptions and a strong sale process in the appraisal context, with the court ultimately concluding that merger price represented the best evidence of fair value under such circumstances.[167] The facts and analysis in the decision illustrate the difficulty courts face in independently valuing companies in certain circumstances. The decision also contains undertones of disapproval concerning the practice of appraisal arbitrage, which suggests that policy motivations may have also been at play in the court's decision to rely on the merger price. Further, while the court did subtract out synergies from the merger price, as it is statutorily obligated to do, the court's somewhat cursory treatment of the issue highlights the need for Delaware to strengthen its law governing the

165 *See In re* Appraisal of Dole Foods Co., Inc., 114 A.3d 541, 549 (Del. Ch. 2014) (rejecting objections to production of pre-suit valuation-related materials).

166 No. 8094-VCP, 2015 WL 4540443 (Del. Ch. June 30, 2015).

167 *See id*. at *24 (concluding that "the Merger price [was] a reliable indication" of the company's fair value).

analysis of synergies. This is especially important if Delaware courts wish to credibly continue placing full weight on merger price in appraisal proceedings. Finally, the Chancery Court's recent decisions in *In re Appraisal of Dell Inc.*[168] and *In re Appraisal of DFC Global Corp.*[169] highlight instances in which this Comment's proposed framework is inapplicable.

A. *Background of* LongPath

Ramtron International Corporation (Ramtron) was "a fabless semiconductor company that design[ed], develop[ed] and market[ed] specialized semiconductor memory and integrated semiconductor solutions."[170] Ramtron produced a type of memory called ferroelectric RAM (F-RAM) and outsourced the manufacturing of "the silicon wafers used in its products . . . to a separate company known as a 'fab' or a 'foundry.'"[171] F-RAM presents benefits over other types of memory because it is fast and durable, uses little power, and "retain[s] memory when power is lost."[172]

Perhaps somewhat obviously, Ramtron's relationship with its foundry was "vitally important" to its existence since it could not produce F-RAM without these outsourced silicon wafers.[173] In 2009, Fujitsu, Ramtron's foundry at the time, "gave Ramtron a 'last-time buy' notice," signifying that it intended to end its relationship in two years.[174] Transitioning to a new foundry is a complicated process that can take years, as the court described:

> [T]ransitioning to a new foundry requires understanding the foundry's manufacturing technology and how it interacts with the semiconductors as designed, then modifying the product design to eliminate any resulting errors, then completing several rounds of product testing followed by further design modifications to eliminate any previously undiscovered errors, and then allowing the customers to evaluate the product before finally moving to full-scale production.[175]

When Ramtron received this last-time buy notice, it had already been attempting over the past five years to establish a second foundry relationship with Texas Instruments (TI), yet this relationship was not fully formed until

168 No. 9322–VCL, 2016 WL 3186538 (Del. Ch. May 31, 2016).

169 No. 10107–CB, 2016 WL 3753123 (Del. Ch. July 8, 2016).

170 Ramtron Int'l Corp., Annual Report (Form 10-K), at 4 (Mar. 7, 2012). The term "fabless" refers to "an electronics business: that has no manufacturing plant; that contracts out the manufacture of components (esp. microchips) to another company." *Fabless*, OXFORD ENGLISH DICTIONARY (2016).

171 *LongPath*, 2015 WL 4540443, at *1.

172 *Id.*

173 *Id.* at *2.

174 *Id.*

175 *Id.*

2011.[176] Because of its difficult transition from Fujitsu to TI, Ramtron experienced product shortages and had to put its customers on allocation.[177] Customers placed on allocation would only be supplied a reduced percentage of their total order.[178] To avoid this situation from occurring again, Ramtron tried to develop a new secondary foundry relationship with IBM.[179] This attempt, which spanned from 2009 to 2012, was a failure and cost Ramtron $33 million, a large sunk cost for a company that had about $66 million in revenue in 2011.[180] However, in July 2012, "Ramtron entered into a manufacturing agreement with ROHM Co., Ltd. ('ROHM')" for ROHM to serve as Ramtron's second foundry.[181]

The combination of putting its customers on allocation and the way Ramtron's point-of-purchase revenue recognition system worked resulted in masked actual demand for Ramtron's products and an inventory buildup.[182] Ramtron recognized revenue on a point-of-purchase basis, rather than a point-of-sale basis, meaning that it recognized revenue when its products were shipped to a distributor rather than when its products were purchased by end users.[183] This choice in revenue recognition systems made it more difficult for Ramtron to forecast future sales.[184] Furthermore, because they were placed on allocation, Ramtron's customers began over-ordering to "game the allocation system" in an effort to ensure they received a sufficient supply of F-RAM, and Ramtron, in turn, began ordering more wafers from TI to meet this inflated demand.[185] The result of this order manipulation was an inventory bubble for Ramtron, an over-recognition of revenue,[186] and a cash crunch due to increased inventory costs.[187] The outcome of these practices was distorted (and unrealistically high) demand and revenue figures.

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176 *See id.* at *3 (describing this shaky transition).

177 *Id.*

178 *See id.* at *4 (describing how a customer might be "allocated 80% of its ordered amount").

179 *Id.* at *3.

180 *See id.* (detailing Ramtron's failed IBM investment and its associated costs).

181 *Id.*

182 *See id.* at *4 (noting the "chain of events" that led to a "massive inventory bubble, over recognition of revenue, and resulting cash crunch" for Ramtron).

183 *Id.* at *3.

184 *See id.* at *4 (explaining that the point-of-purchase method increases the difficulty of forecasting future actual demand because of the "buffer" distributors provide).

185 *Id.*

186 There was over-recognition because Ramtron forced excess inventory into distribution channels, a practice known as "channel stuffing," and its point-of-purchase recognition system allowed Ramtrom to recognize revenue at that point in time. *Id.*

187 *Id.* Ramtron repeatedly missed or was forced to renegotiate its loan covenants due to shortfalls in cash because of these increased inventory costs. *Id.* at *5.

While Ramtron was facing these difficulties, Cypress Semiconductor Corporation (Cypress) began pursuing the company.[188] "On March 8, 2011, Cypress made a nonpublic written offer . . . of $3.01 per share," representing a thirty-seven percent premium over the closing price of Ramtron's stock.[189] Ramtron later rejected the offer as inadequate, but still desperately needed capital to fund its excess inventory.[190] Because there was a dearth of willing lenders, Ramtron launched a secondary public offering in July 2011 of 4,750,000 shares, representing approximately twenty percent of outstanding shares, at $2 per share.[191] Indicative of Ramtron's struggles was the fact that the price of its secondary offering was *lower* than the market price of its stock in July 2011, which fluctuated between $3.12 per share and $2.19 per share.[192] Even after this equity infusion, Ramtron continued to face severe cash shortages.[193]

Despite being initially rebuffed, Cypress continued to try to acquire Ramtron. On June 12, 2012, Cypress publicly declared that it wanted to acquire Ramtron for $2.48 per share, which represented the same thirty-seven percent premium as its previous, nonpublic offer.[194] In response, Ramtron rejected the offer as inadequate, announced that it was exploring strategic alternatives, and decided to generate long-term management projections.[195] Importantly, Ramtron's management had been newly installed and had never before created multiyear projections, but rather had prepared five-quarter forecasts.[196] On June 14, two days after the announcement of Cypress's offer, Balzer, Ramtron's CEO, told his executive team by email that he wanted a "product by product build up, with assumptions, for it to hold water in the event of a subsequent dispute."[197] Richards, Ramtron's CFO, later testified that he understood that the long-term projections were to be used to market the company to a white knight and as inputs for a DCF analysis.[198]

Meanwhile, "Cypress commenced a hostile tender offer for Ramtron at $2.68 per share" on June 21.[199] Ramtron's board rejected this offer and

188 *Id.*

189 *Id.*

190 *Id.*

191 *Id.*

192 *See Ramtron International*, GOOGLE FIN., https://www.google.com/finance/historical?cid=656974&startdate=Jul+1%2C+2011&enddate=Jul+31%2C+2011&ei=ngXnVrmoJM2aecz8iqgM [https://perma.cc/6CDY-XEPB] (reporting a monthly high closing price of $3.12 per share on July 19, 2011, and a monthly low closing price of $2.19 per share on July 28, 2011).

193 *LongPath*, 2015 WL 4540443, at *5.

194 *Id.* at *6.

195 *Id.*

196 *Id.*

197 *Id.*

198 *Id.*

199 *Id.* at *7.

"recommended that the shareholders not tender their shares."[200] Yet, soon thereafter, Ramtron issued second quarter earnings substantially below expectations.[201] Ramtron had offered public guidance for 2012 revenue of $70 million, yet, at its current pace, it was on track to miss this target by at least $10 million.[202] "Merriman Capital, the only analyst covering Ramtron, downgraded the" company's rating to "neutral" and predicted that its stock price could fall below $2 per share.[203] Although there are many potential explanations for Ramtron's decline in performance, the court found that "operational shortcomings of Ramtron were the primary cause of the decline in sales."[204]

Despite Ramtron's poor performance, Cypress increased its tender offer to $2.88 per share.[205] Ramtron's board again rejected this bid as inadequate, despite its inability to find another buyer.[206] Seemingly without any other option, representatives of Ramtron began meeting with representatives of Cypress on September 12, 2012.[207] These active negotiations resulted in a final transaction price of $3.10 per share, and on September 18, the parties entered into a merger agreement.[208] The merger was approved by a shareholder vote on November 20, 2012.[209]

Approximately one month after the announcement of the merger, LongPath Capital, LLC (LongPath) began acquiring Ramtron shares.[210] Ultimately, LongPath acquired 484,700 shares[211] and timely filed an appraisal action on December 11, 2012.[212] While LongPath could not have known then which method the Chancery Court would use to value its shares, there were some indications prior to LongPath even filing its suit that the merger price—and not a DCF analysis—may be the best indication of fair value.

To start, Longpath *should* have known that the Ramtron sale process was robust and that Ramtron's financial projections were untrustworthy. At the very least, Longpath had access to Ramtron's Preliminary Proxy Statement, which was filed with the SEC on October 19, 2012—the same time that Longpath began buying up Ramtrom shares.[213] Ramtron's Preliminary Proxy

200 *Id.*
201 *Id.*
202 *Id.*
203 *Id.*
204 *Id.*
205 *Id.* at *8.
206 *Id.*
207 *Id.*
208 *Id.*
209 *Id.*
210 *Id.* at *1.
211 *Id.*
212 *Id.* at *8.
213 Ramtron Int'l Corp., Preliminary Proxy Statement (Schedule 14A), at 3 (Oct. 19, 2012).

makes clear that the Ramtron board retained competent financial and legal counsel and attempted to run a robust sales process before ultimately concluding that a sale to Cypress was in the best interest of its shareholders.[214] This process included Ramtron reaching out to and negotiating with various third parties and repeatedly rejecting offers from Cypress over the course of several months before the parties finally agreed upon a merger price.[215]

Moreover, the Preliminary Proxy Statement could have also indicated to a keen observer that Ramtron's projections were likely to be suspect in the eyes of Delaware law. Most importantly, Cypress's bid prompted management to initiate a "process in generating an updated financial model in connection with Ramtron's strategic plan."[216] Further, given its sizable investment in Ramtron, LongPath almost certainly would have read the reports of Merriman Capital, the only analyst covering the company. After Ramtron released disappointing second quarter 2012 earnings, Merriman Capital suspended its target price for Ramtron's stock and stated that it "simply c[ould]n't figure out how to model this company consistently at the current time."[217] Thus, while LongPath may have genuinely believed that the merger price undervalued Ramtron, a DCF analysis did not seem like a strong way to make this argument.

B. *Holding and Reasoning of* Longpath

Ultimately, the court decided that the merger price, less synergies, was the fair value of LongPath's shares.[218] The court came to this conclusion because the "inputs [were] unreliable" for a DCF analysis and "the sales process . . . was thorough."[219] Specifically, the court noted four reasons why the assumptions underlying the DCF analysis in this case were fatally flawed. First, the court found management's projections to be unreliable because they were prepared after Cypress made an offer, giving Ramtron management an incentive to skew the projections upwards.[220] The court concluded that "the

214 After receiving Cypress's renewed bid on June 12, 2012, Ramtron's board authorized the retention of Shearman & Sterling as legal counsel and Needham & Company as financial advisor. *Id.* at 20. Additionally, Ramtron formed a "Strategic Transaction Committee" to "assist [the] board of directors in considering any acquisition proposals from Cypress and any transactions that may be considered as alternatives to Cypress's indication of interest." *Id.* at 17. Finally, Ramtron's board determined the merger was "advisable, fair to and in the best interests of Ramtron and its stockholders." *Id.* at 3.

215 *Id.* at 21-31.

216 *Id.* at 20.

217 *LongPath*, 2015 WL 4540443, at *13.

218 *Id.* at *1.

219 *Id.*

220 *See id.* at *11 (noting that the "projections were prepared in anticipation of potential litigation, or, at least, a hostile takeover bid" and that "one of the purposes of the projections was to serve as a marketing tool" in search of a white knight, which gave "the management team an incentive to err on the optimistic side").

projections were not prepared in the ordinary course of business," and as such, they "facially lack[ed] the indicia of reliability that generally have led Delaware courts to defer to management projections."[221] The "final nail on the coffin for the Management Projections [was] that Ramtron did not rely on them in the ordinary course of its business," as it used a different set of projections to manage Ramtron's finances.[222]

Second, the management projections were unreliable because they lacked forecasting ability; they were prepared by a new management team that did not have a deep understanding of the business or experience making long-term projections.[223] Ramtron's own management recognized its limitations with forecasting,[224] and, in evaluating Ramtron's recent forecasting record, the court concluded "that management, even under its traditional forecasting system, was of middling quality when it came to forecasting Ramtron's future business."[225]

Third, the projections did not fit with the realities of the F-RAM business. The management projections assumed that Ramtron would be able to transition to ROHM wafers in sixty days, even though it took seven years for Ramtrom to transition from Fujitsu to TI.[226] Additionally, transitioning to a new foundry required a substantial cash investment, yet Ramtron was cash-poor at the time of the merger.[227] Finally, the projections defied historical trends, indicating a period of "previously unknown prosperity" immediately following a time of enormous difficulty—a "dramatic turnaround . . . despite no underlying changes that would justify such an improvement of business."[228]

Finally, the projections relied on 2011 and 2012 revenue figures that were distorted by customer allocation issues and channel stuffing—in essence, revenue manipulation.[229] The court pointed out that these issues resulted in fundamentally flawed projections: "[i]f 2011 and 2012 are used as base years in forecasting, but those years include inflated revenue because of either over-ordering by customers placed on allocation or channel stuffing, then the reliability of the projections is affected."[230] The court declined to correct for this issue.[231]

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221 *Id.* at *11.

222 *Id.* at *17.

223 *See id.* at *18 (concluding that the management projections were unreliable in part because they "were prepared by a new management team").

224 *See id.* at *13 ("Ramtron's management also recognized its own limited success in forecasting.").

225 *Id.*

226 *Id.*

227 *Id.*

228 *Id.* at *16.

229 *Id.* at *14-15.

230 *Id.* at *15.

231 *See id.* ("I do not consider it productive (even assuming it is feasible) to attempt to quantify how much in extra revenue Ramtron recognized in 2011 or 2012 based on these factors.").

Given the numerous flaws in management projections, the court instead looked to merger price as a possible indication of fair value. The court recognized that while the merger price does not necessarily always equal fair value,[232] in the appropriate situation, where there has been a robust sale process, Delaware courts have viewed merger price as evidence of fair value:

> [I]n the situation of a proper transactional process likely to have resulted in an accurate valuation of an acquired corporation, this Court has looked to the merger price as evidence of fair value and, on occasion, given that metric one-hundred percent weight. In an oft-quoted passage, then-Vice Chancellor Jacobs wrote: "The fact that a transaction price was forged in the crucible of objective market reality (as distinguished from the unavoidably subjective thought process of a valuation expert) is viewed as strong evidence that the price is fair." Similarly, Chief Justice Strine, then writing as a Vice Chancellor, noted: "[O]ur case law recognizes that when there is an open opportunity to buy a company, the resulting market price is reliable evidence of fair value."[233]

The mere fact that only one company had made a bid for Ramtron did not affect the court's determination that a robust sales process had occurred.[234] In the court's view, Ramtron had conducted a thorough sale process by repeatedly rejecting Cypress's offers and doing everything in its power to solicit other buyers.[235] All of these factors led the court to accept the merger price as the best evidence of fair price.[236]

Taken together, the fact that the projections were irreparably tainted and that there was a robust sale process would have alone been enough for the court to use the merger price as the exclusive best evidence of fair value. The court, however, took the additional step of expressing its displeasure with the practice of appraisal arbitrage and, more generally, the use of litigation to determine a company's value. This additional discussion suggests that in using merger price as the best evidence of fair value, the court may have been motivated not by LongPath's substantive arguments, but by policy

232 *See id.* at *20 (offering a short-form merger as one such situation).

233 *Id.* (footnotes omitted).

234 *See id.* at *21 (noting that the court was "not aware of any case holding that a multi-bidder auction of a company is a prerequisite to finding that the merger price is a reliable indicator of fair value").

235 *See id.* ("Ramtron could, and repeatedly did, reject Cypress' overtures. Simultaneously, Ramtron actively solicited every buyer it believed could be interested in a transaction. The Company provided several of those potential buyers with the much-vaunted Management Projections. No one bid. LongPath contends that the lack of other bidders indicates a flawed process. I disagree. Any impediments to a higher bid resulted from Ramtron's operative reality, not shortcomings of the Merger process.").

236 *See id.* at *20 (concluding that "the Merger price offers the best indication of fair value").

considerations.[237] Indeed, the court criticized LongPath's investment strategy and implied that LongPath's arguments were absurd:

> LongPath asks this Court to adopt its $4.96 figure and conclude that the market left an amount on the table exceeding Ramtron's unaffected market capitalization. This would be a significant market failure, especially in the context of a well-publicized hostile bid and a target actively seeking a white knight. But, LongPath itself is a market participant. It bought its shares *after* the announcement of the Merger, thereby effectively purchasing an appraisal lawsuit. Although such arbitrage can be profitable on the merits when flawed deals undervalue companies, LongPath invested an amount so small that, even if I accepted its position and concluded that Ramtron's true value at the time of the Merger was somewhere in the range of $4.96 per share, this lawsuit is likely a less-than-break-even proposition for LongPath after considering its litigation expenses.[238]

Based on its investment strategy, it is unlikely that LongPath actually wanted to litigate this case, but rather bought into the lawsuit to use the threat of appraisal to extract higher consideration.[239]

Further, the court has expressed a dim view of buying into lawsuits just to extract a profit: "Much has been said of litigation-driven valuations, none of it favorable."[240] As the court pointed out, valuations generated for trials strain credibility.[241] In so noting, the court implied that valuations generated by a robust sales process should be preferred over the expert valuations that are presented in court. Extending the court's commentary to its logical conclusion, the court seems to indicate that it is willing and able to clamp down on appraisal suits when inappropriately brought.

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237 *See* Korsmo & Myers, *Appraisal Litigation*, *supra* note 5, at 24 ("[O]ne potential explanation—though perhaps too cynical—is that the recent spate of defeats the Delaware Court of Chancery has handed to appraisal petitioners was in part a shot across the bow of appraisal specialists, designed to staunch a perceived gold rush, and in part designed to let the appraisal alarmists—and the legislature—know that the court has appraisal well in hand, without the need for radical legislative reforms.").

238 *LongPath*, 2015 WL 4540443, at *9.

239 *See supra* note 62 and accompanying text (noting that four of Merion Capital's five appraisal claims had settled before trial).

240 *Longpath*, 2015 WL 4540443, at *9.

241 *See id.* at *9 n.78 ("In appraisal proceedings, the battling experts tend to generate widely divergent valuations as they strive to bracket the outer limits of plausibility." (internal quotation marks omitted) (quoting *In re* Appraisal of Dole Food Co., Inc., 114 A.3d 541, 557 (Del. Ch. 2014))); *see also* Finkelstein v. Liberty Digital, Inc., No. 19598, 2005 WL 1074364, at *13 (Del. Ch. Apr. 25, 2005) ("Men and women who purport to be applying sound, academically-validated valuation techniques come to this court and, through the neutral application of their expertise to the facts, come to widely disparate results, even when applying the same methodology.").

Because of the statutory requirements of section 262(h), the court was not finished in determining fair value; rather, it still had to back out any synergies that arose because of the merger. The court followed its mandate; however, it only provided a cursory explanation for its acceptance of one party's synergy figure over the other's.[242] Moving forward, for the Delaware courts to be able to credibly use merger price as the best evidence of fair value consistent with section 262, the courts must better articulate an analytical framework for assessing synergies. As shown in Section III.B., this is a feasible task.

C. Dell *and* DFC Global

The Chancery Court had been on a streak of allotting one-hundred percent weight to merger price as evidence of fair value in appraisal cases.[243] In the summer of 2016, however, the court deviated from this trend. In *In re Appraisal of Dell Inc.*, the Chancery Court refused to give any credence to the merger price and entirely relied on DCF analysis,[244] while in *In re Appraisal of DFC Global Corp.* the Court opted for an equal balancing of DCF analysis, comparable companies analysis, and transaction price to arrive at its determination of fair value.[245] These decisions, nevertheless, do not spell the death of the exclusive use of merger prices as the best indication of fair value in certain cases. *Dell* and *DFC Global* are readily distinguishable from decisions like *LongPath*, and do not undercut the framework advanced by this Comment: that the Court of Chancery should defer to merger price when there is a true market test and the inputs for DCF analysis are unreliable.

Neither *Dell* nor *DFC Global* had both conditions that this Comment suggests must be present for an acquiring company to be shielded with use of the merger price as the best evidence of fair value. In particular, neither case would be afforded protection because there was not a true market test in either case.

In *Dell*, the court determined that the fair value of Dell's shares was $17.62,[246] approximately twenty-six percent higher than the merger consideration of $13.65 per share.[247] The court eschewed the merger price and relied exclusively on DCF analysis to arrive at its determination of fair value.[248] While acknowledging and citing recent decisions that relied exclusively on merger price, the court distinguished the case at hand, in part, by noting that all of the decisions

242 *See Longpath*, 2015 WL 4540443, at *25-26 (accepting, without significant explanation, LongPath's proposed synergy figure).

243 *See supra* note 27.

244 No. 9322–VCL, 2016 WL 3186538, at *51 (Del. Ch. May 31, 2016).

245 No. 10107–CB, 2016 WL 3753123, at *23 (Del. Ch. July 8, 2016).

246 *Dell*, 2016 WL 3186538, at *51.

247 *Id.* at *12.

248 *Id.* at *51.

deferring to merger price "either involved a more active pre-signing market check or the process was kicked off by an unsolicited third-party bid."[249]

When seeking to sell the company, Dell only reached out to three potential bidders, all financial sponsors.[250] Financial sponsors are generally believed to be able to pay less for companies because they do not benefit from the same sort of synergies as strategic buyers,[251] and they are constrained by return thresholds for their investors.[252] Two of the three financial sponsors quickly dropped out, eliminating price competition and leaving Dell negotiating with one other party.[253] The court found that this set of facts resulted in "a lack of meaningful price competition during the pre-signing phase."[254] The court was also dismissive of the effectiveness of the go-shop during the post-signing phase.[255] Thus, because there was not a robust market test in *Dell*, the company would not have been afforded the merger price protection proposed in this Comment.

In *DFC Global*, the court held that the fair value of the company's shares was $10.21, $0.71 above the merger price.[256] The court reached this conclusion through an equal "blend of three imperfect techniques: a discounted cash flow model incorporating certain methodologies and assumptions each expert made and some of [the court's] own, the comparable company analysis respondent's expert performed, and the transaction price."[257] While the court acknowledged that there was "an arm's-length process and a robust bidding environment,"[258] it refused to afford one-hundred percent weight to the merger price because the transaction "was negotiated and consummated during a period of significant company turmoil and regulatory uncertainty, calling into question the reliability of the transaction price as well as management's financial projections."[259] Thus, because market conditions undermined the reliability of the sales process and

249 *Id*. at *23 n.13.

250 *Id*. at *4, *8, *37.

251 *See supra* Section III.B.

252 *See Dell*, 2016 WL 3186538, at *29 ("What the sponsor is willing to pay diverges from fair value because of (i) the financial sponsor's need to achieve IRRs of 20% or more to satisfy its own investors and (ii) limits on the amount of leverage that the company can support and the sponsor can use to finance the deal.").

253 *Id*. at *36-37.

254 *Id*. at *37.

255 *Id*. at *37-44.

256 *In re* Appraisal of DFC Global Corp., No. 10107–CB, 2016 WL 3753123, at *1 (Del. Ch. July 8, 2016).

257 *Id.*

258 *Id.*

259 *Id.*

resulting merger price,[260] DFC Global would not have been afforded merger price protection under this Comment's proposed framework.

V. A (LONG)PATH FORWARD

Although they have not articulated a formal test for when to use merger price as the best indication of fair value in the appraisal context, Delaware courts have tended to take a two-pronged approach in the third-party merger context: first, there must be reason to doubt the reliability of the inputs needed to conduct a DCF; and second, there must have been a robust sale process of the target company.[261] This approach first provides a rationale for bucking the DCF default, and then identifies a reasonable alternative to valuation. I contend that when these two conditions hold, the Chancery Court should automatically defer to merger price as the best indication of fair value.

Some scholars fundamentally disagree with the use of the merger price, even less synergies, as the best evidence of fair value. They argue that third-party sale value is equivalent to the opportunity cost of the asset, which is analytically distinct from the concept of going concern value.[262] They point out that, in fact, "opportunity cost as a theoretical concept actually results in a lower value" than going concern value, because "[i]n equilibrium, all value-enhancing transactions have already taken place, so that the value to the next best user is

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260 *See id.* at *21-22 ("By the same token, the market price is informative of fair value only when it is the product of not only a fair sale process, but also of a well-functioning market. . . . Th[e] same uncertainty inherent in the projections underlying the discounted cash flow analysis [due to the unpredictable regulatory environment] was present in the sale process.").

261 For example, looking to reliability, the court in *LongPath* stated, "The utility of a DCF ceases when its inputs are unreliable; and, in this instance, I conclude that the management projections that provide the key inputs to the petitioner's DCF analysis are not reliable . . . . I conclude that the sales process in this instance was thorough and that the transaction price less synergies provides the most reliable method of determining the fair value of the petitioner's shares." LongPath Capital, LLC v. Ramtron Int'l Corp., No. 8094-VCP, 2015 WL 4540443, at *1 (Del. Ch. June 30, 2015). Regarding the sales process, for example, the court in *In re Appraisal of Ancestry.com, Inc.* stated that "[b]ecause the inputs here . . . are problematic . . . , and because the sales process here was robust, I find fair value in these circumstances best represented by market price." No. 8173-VCG, 2015 WL 399726, at *23 (Del. Ch. Jan. 30, 2015) (footnote omitted).

262 *See, e.g.*, Hamermesh & Wachter, *Implicit Minority Discount*, *supra* note 144, at 31 ("The definition of value used by economists is a version of third-party sale value—that is, the opportunity cost of the asset in its next-best use. The term opportunity cost is used because, if the inputs were not used by the firm, they could be deployed elsewhere. The difference in value of the firm's inputs in an alternative use represents its opportunity cost. The opportunity cost concept is *not* a measure of *going concern* value, but a measure of *next-best-use* value." (footnotes omitted)); *see also* Lawrence A. Hamermesh & Michael L. Wachter, *Rationalizing Appraisal Standards in Compulsory Buyouts*, 50 B.C. L. REV. 1021, 1040 (2009) ("The flaw of the third-party sale value argument is that it assumes that assets are generally deployed inefficiently so that a higher use is readily available in an appraisal setting. One reason that the great majority of firms are not up for sale at every moment is that higher bidders do not naturally lurk in the shadows waiting for the 'for sale' sign to be posted.").

actually lower than current use value."[263] While the logical coherence of this argument is indisputable, it overlooks the fact that these scholars' favored approach to valuation, the DCF methodology, may be nearly impossible in certain situations.[264] The extended discussion of the *LongPath* decision above is intended to illustrate just how difficult it can be for courts to conduct their own independent valuations in certain circumstances. Thus, in such instances, courts must choose between conducting an inherently flawed DCF analysis and deferring to a market outcome. When choosing between these imperfect alternatives, courts should elect to embrace the third-party sale option.

Additionally, the rationale behind deferring to the merger price in instances where there was a true market test for the company is consistent with longstanding tenets of Delaware law.[265] In general, when decisions are informed, voluntary, and unconflicted, Delaware courts favor deferring to corporate decisionmakers, rather than imposing their own judgment.[266] In the appraisal setting, Delaware courts have invoked a principle analogous to the business judgment rule when accepting the merger price as the best evidence of fair value.[267] The existence of a robust sales process gives courts confidence that the eventually agreed upon transaction price was fair, since potential buyers with actual dollars at stake vetted the target company with the goal of

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263 Hamermesh & Wachter, *Cornfields*, *supra* note 146, at 134.

264 *See supra* notes 151–153.

265 *See* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 2, at 1602 ("Allowing courts to declare the fair value of a company where there has been no showing of any process-based wrongdoing . . . flies in the face of the usual strong presumption—in Delaware, at least—that competitive markets are the best arbiters of economic value."). Others have also made this point, stating, "While the only consideration in an appraisal proceeding is the determination of fair value (and wrongdoing by the target board or flaws in the sales process are legally irrelevant for these purposes), the transactions that attract appraisal petitions generally involve some basis for a belief that the deal price significantly undervalues the company—that is, transactions involving controlling stockholders, management buyouts, or other transactions for which there did not appear to be a meaningful market check or significant minority shareholder protections as part of the sales process." Richter et al., *supra* note 4, at 21-22.

266 *See, e.g.*, Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 360 (Del. 1993) (articulating a preference against "a court . . . imposing itself unreasonably on the business and affairs of a corporation"); *In re* Morton's Rest. Grp., Inc. S'holders Litig., 74 A.3d 656, 663 n.34 (Del. Ch. 2013) (stating that "when disinterested approval of a sale to an arm's-length buyer is given by a majority of stockholders who have had the chance to consider whether or not to approve a transaction for themselves, there is a long and sensible tradition of giving deference to the stockholders' voluntary decision").

267 *See, e.g.*, *In re* Appraisal of Ancestry.com, Inc., No. 8173-VCG, 2015 WL 399726, at *1 (Del. Ch. Jan. 30, 2015) (noting "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 (Del. Ch. 2003) ("For me (as a law-trained judge) to second-guess the price that resulted from [the market's opportunity to price the target company directly as an entity] involves an exercise in hubris and, at best, reasoned guess-work."); Van de Walle v. Unimation, Inc., No. 7046, 1991 WL 29303, at *17 (Del. Ch. Mar. 7, 1991) ("The fact that a transaction price was forged in the crucible of objective market reality (as distinguished from the unavoidably subjective thought process of a valuation expert) is viewed as strong evidence that the price is fair.").

putting forth a competitive offer.[268] Potential acquirers, of course, are expected to conduct their own DCFs as part of their individual valuations. However, these DCFs are not performed with an eye toward litigation, but rather as a starting point in a negotiating process with the target company.[269] Sophisticated investors are also arguably better at performing DCF analyses than law-trained judges. The final merger price, in a competitive auction process, is the outcome of real-world bargaining that represents what a buyer is actually willing to pay for a company, while a judge-conducted DCF performed by the courts is simply the court's best estimate of what a company was hypothetically worth.[270]

Increased use of merger price as the best evidence of fair value could have a dramatic effect on appraisal arbitrageurs' investment strategy. Courts may embrace merger price because of the rationales detailed above or out of a desire to fight the practice of appraisal arbitrage itself,[271] but no matter the courts' motivation, the outcome for appraisal arbitrageurs is the same—they cannot profit from this investment strategy. This movement away from DCF analysis, therefore, could be the death knell for appraisal as a speculative investment strategy, at least in the third-party merger context when the underlying assumptions for a DCF analysis are suspect and there was a robust sales process. When these two conditions hold, any appraisal claims are at best inefficient, and, at worst, frivolous. For an appraisal arbitrageur to buy into a lawsuit in such a situation would be pure financial speculation because he does not have any reliable financial data to support an argument that the fair value is higher than the merger price. Financial markets, not courtrooms, are the appropriate forums for such speculation. The likely outcome of this shift to a merger price safe harbor would be reductions in frivolous appraisal claims and in the threat of appraisal to beneficial deals, as well as increased disclosure to demonstrate that the sales process was thorough.

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268 *See, e.g.*, *Union Ill.*, 847 A.2d at 359 ("The benefit of the active market for [the target company] as an entity that the sales process generated is that several buyers with a profit motive were able to assess these factors for themselves and to use those assessments to make bids with actual money behind them.").

269 *See In re* Appraisal of Dole Food Co., Inc., 114 A.3d 541, 549 (Del. Ch. 2014) (granting motion to compel production of valuation-related materials in an appraisal case because "pre-litigation valuations are relevant to the central issue in the proceeding" and "also are relevant to issues of [sic] such as the appropriate inputs and considerations for valuation methodologies").

270 *See Union Ill.*, 847 A.2d at 359 ("For me (as a law-trained judge) to second-guess the price that resulted from that [robust sales] process involves an exercise in hubris and, at best, reasoned guess-work.").

271 *See supra* note 237.

CONCLUSION

Not only is it statutorily permissible to use merger price as the best evidence of fair value, under certain circumstances, it is preferable. If there is a thorough sales process and the inputs required for a DCF analysis are unreliable, then the merger price is almost certainly a better indication of fair value than a court's own independent DCF analysis. This approach not only incentivizes greater disclosure regarding the sale process of the target company, but also it deters appraisal arbitrage when it is likely frivolous. When a DCF analysis is unreliable and there was a fulsome sale process, appraisal arbitrageurs are likely doing no more than engaging in financial speculation. Rather than protecting long-term shareholder interests, appraisal arbitrageurs may simply be looking for a settlement above the merger price. The Chancery Court has the institutional capacity to deter these unwanted, speculative, and potentially abusive appraisal claims; indeed, through the use of a merger price framework, this Comment argues that the court is better suited to solve this problem than the legislature is, even considering the recently enacted amendments.

By adopting the proposed merger price framework and formulating a method for deducting synergies, courts can lessen the uncertainty of the appraisal process, deter meritless appraisal claims, and, hopefully, increase the frequency of deals that are beneficial to long-term shareholder interests.