

The Chancery Bank of Delaware: Appraisal Arbitrageurs Expose Need to Further Reform Defective Appraisal Statute

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INTRODUCTION

Appraisal rights are codified by section 262 of the Delaware General Corporation Law (“DGCL”), which grants dissenting target shareholders in a merger the right to seek judicially determined fair value for their shares.¹ Appraisal rights therefore aim to protect dissenting shareholders from majority expropriation.² However, a new class of shareholders has emerged, testing the bounds of this remedy. “Appraisal arbitrageurs” are hedge funds who seek to exploit the once-seldom-used appraisal remedy by buying target company stock after the announcement of the merger solely to pursue appraisal. These appraisal arbitrageurs have fueled the ongoing resurgence of appraisal litigation, sparking debate among corporate law practitioners and academics, many of whom condemn the investment strategy. Powerful opponents argue that appraisal arbitrage creates significant transaction costs for merger parties by extracting rents from target shareholders and creating deal uncertainty. Moreover, appraisal arbitrage has sparked a close look at Delaware courts’ methodology in appraisal proceedings, exposing inconsistencies in valuing companies and revealing the judiciary’s inappropriate legislative role. Accordingly, the backlash against appraisal arbitrage has not only uncovered a need

1. DEL. CODE ANN. tit. 8, § 262(a)–(b) (2013).

2. *Infra* Section I.A.

for additional legislative reform; it has also unveiled Delaware judges' shortcomings in engaging in highly technical corporate valuation.

This Note proposes reforming Delaware's appraisal statute to curb appraisal arbitrage and ensure certainty in appraisal proceedings, upholding the purpose of the appraisal remedy and addressing practical concerns. Part I reviews Delaware's appraisal statute and its related practical considerations, evaluates the economic incentives surrounding appraisal arbitrage, and chronicles the anti-arbitrage call for legislative reform. Part II analyzes specific aspects of the appraisal statute and its attendant judicial application in context with intended policy goals and underlying economic principles. It suggests the market-out exception is unnecessary for disinterested mergers and critiques how the appraisal statute and its judicial interpretation promote appraisal arbitrage and undermine the purpose of the remedy. It also explores Delaware courts' valuation methods, inconsistent appraisal doctrine, and improper political motives and legislative role. Part III advocates for legislative reform beyond recent amendments to section 262, including constricting aspects of appraisal rights to eliminate the perverse economic incentives that attract arbitrageurs and to effect the purpose of the appraisal remedy. While the *de minimis* and interest-reduction amendments are a welcome start, Delaware should also (1) confine the market-out exception's cash carve-out to interested transactions, (2) limit appraisal rights to shareholders as of the record date, and (3) delegate valuation in appraisal proceedings to a panel of independent finance professionals.

I. DELAWARE APPRAISAL RIGHTS: A WELL-INTENTIONED STATUTORY REGIME WITH UNINTENDED CONSEQUENCES

This Part first summarizes the appraisal remedy and its policy rationales, specifically focusing on the practical implications for mergers and consolidations. It then reviews Delaware's appraisal statute, emphasizing triggering events, standing requirements, and valuation methodologies—the peculiar, arbitrage-fueling components of the statute. Next, this Part summarizes the economics of appraisal arbitrage and chronicles the surge in Delaware appraisal litigation, positing potential explanations for the spike in activity. Additionally, this Part explores the practical dangers of appraisal arbitrage through the lens of business entities and corporate law practitioners lobbying for statutory reform. Finally, this Part evaluates the *de minimis* and

interest-reduction amendments and their intended—but currently insufficient³—effect on appraisal arbitration.⁴

A. Overview of Appraisal Rights

Appraisal rights are a statutory remedy allowing target⁵ shareholders to dissent from a merger or consolidation by asserting inadequacy of the merger price and seeking a judicially determined valuation of their shares.⁶ Exercising appraisal rights generally involves: (1) a triggering event, (2) perfecting procedural requirements, and (3) judicial valuation of the shares.⁷

The appraisal remedy emerged as state corporate codes shifted from unanimous shareholder approval to majority ratification of mergers, countering the holdout problem where a single shareholder could block a significant corporate transaction.⁸ Although this move toward majority approval was necessary to facilitate efficiency in public equity markets,⁹ it eroded minority shareholders' leverage against potential majority oppression.¹⁰ Put differently, minority shareholders who opposed a majority-ratified merger could not stop the merger and thus would be forced to sell their shares in a transaction they deemed unfair. Accordingly, the appraisal remedy represented a compromise between facilitating transactions to achieve greater economic efficiency

3. See *infra* Part III for additional proposed statutory reforms necessary to curb predatory appraisal arbitration.

4. Daniel G. Dufner et al., *Increasing Hostility Towards Appraisal Arbitrage*, WHITE & CASE LLP (Apr. 17, 2015), <http://www.whitecase.com/publications/alert/increasing-hostility-towards-appraisal-arbitrage> [<https://perma.cc/ACP3-LSF7>] (“[The 2015 Council legislative reforms] have been criticized as insufficient to effectively address the problems of appraisal arbitration”); *M&A Briefing: 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, HARRIS, SHRIVER & JACOBSON LLP 5–6 (Mar. 23, 2015), <http://www.friedfrank.com/siteFiles/Publications/FINAL%20-%203-23-2015%20-%20Proposed%20Appraisal%20Statute%20Amendments.pdf> [<https://perma.cc/295N-3327>].

5. “Target” or “seller” refers to the corporation being acquired, while “acquirer” or “purchaser” refers to the purchasing corporation in a merger.

6. See generally tit. 8, § 262 (providing appraisal rights to shareholders of corporations that are parties to mergers or consolidations).

7. *Id.*; 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, *THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS* § 9.43 (3d ed. Supp. 2016); Jennifer McLellan, *An Appraisal of Appraisal Rights in Delaware*, 92 DENV. U. L. REV. ONLINE 109, 111 (2015).

8. See, e.g., Robert B. Thompson, *Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law*, 84 GEO. L.J. 1, 11–14 (1995); Barry M. Wertheimer, *The Shareholders' Appraisal Remedy and How Courts Determine Fair Value*, 47 DUKE L.J. 613, 618–19 (1998).

9. Thompson, *supra* note 8, at 12–13.

10. *Id.*

and protecting minority shareholders' rights where a less-than-unanimous vote is sufficient to approve a merger.¹¹

*B. The Statutory Construct and Practical Implications
of Appraisal in Delaware*

1. Triggering Events and Availability of the Appraisal Remedy

Section 262 governs appraisal rights,¹² which are limited to mergers and consolidations¹³ on which shareholders have voting rights.¹⁴ Appraisal rights are unavailable for target shareholders of publicly traded stocks under section 262(b)(1)'s "market-out exception,"¹⁵ *unless* the buyer uses cash consideration wholly or partially.¹⁶ Further, notwithstanding the market-out exception, appraisal rights remain available for target shareholders in a short-form merger where a parent company merges with its 90%-or-more-owned subsidiary.¹⁷ Target shareholders in short-form mergers retain appraisal as an absolute remedy because such transactions substitute procedural rigor for efficiency,¹⁸ justifying value insurance of minority shares for which the market does not always provide an accurate valuation.

11. See BALOTTI & FINKELSTEIN, *supra* note 7, § 9.42 (detailing the origin of dissenters' appraisal rights); Thompson, *supra* note 8, at 12–13.

12. Tit. 8, § 262 (2013).

13. For brevity in this Note, the term "mergers" includes "consolidations." In practice, a merger involves one or more corporations merging into and becoming part of another corporation that continues its existence, while a consolidation occurs when two or more corporations combine to form a new corporation. See BALOTTI & FINKELSTEIN, *supra* note 7, § 9.2 (describing the generally accepted meanings of mergers and consolidations).

14. Other states extend appraisal rights to transactions involving other fundamental corporate structural changes. Compare, e.g., tit. 8 § 262 (limiting appraisal to mergers and consolidations), with MODEL BUS. CORP. ACT § 13.02(a) (AM. BAR ASS'N 1999) (allowing appraisal for sales of assets).

15. See tit. 8, § 262(b)(1) (prohibiting appraisal rights for stocks "(i) listed on a national securities exchange or (ii) held of record by more than 2,000 holders").

16. See tit. 8, § 262(b)(2)(d) (allowing appraisal rights for "[a]ny combination" of stock and cash).

17. Tit. 8, § 253.

18. For example, minority shareholders generally do not have voting rights in short-form mergers, which streamlines the merger consummation; the appraisal remedy is therefore minority shareholders' primary weapon against majority oppression. See, e.g., tit. 8, § 253; Glassman v. Unocal Expl. Corp., 777 A.2d 242, 242–45 (Del. 2000) (holding appraisal remedy absolute for short-form mergers as an "efficient and fair method"); George S. Geis, *An Appraisal Puzzle*, 105 NW. U. L. REV. 1635, 1644 (2011) ("While freezeout mergers can promote efficient and desirable outcomes, they also forge a powerful weapon for majority shareholders interested in taking advantage of minority owners." (citation omitted)).

Similarly, target shareholders have appraisal rights in “interested,”¹⁹ long-form,²⁰ cash-out mergers.²¹ Additionally, the *Weinberger v. UOP* decision requires the buyer in interested mergers to establish “entire fairness” of the transaction when target shareholders allege specific facts indicating unfair merger terms; this requires the buyer to show both fair price and fair, arms-length dealing.²² Courts value the target company in both appraisal actions and the “fair price” prong of “entire fairness” analyses using the same approach—accounting for “all relevant factors.”²³

To compensate target shareholders who dissent from the merger and therefore do not get paid when the deal closes, the appraisal award includes quarterly compounded interest at 5% above the Federal Reserve discount rate²⁴ which accrues throughout the years-long appraisal process.²⁵ Section 262 therefore permits an opportunistic individual to seek higher merger consideration by acquiring appraisal-eligible shares *after* the shareholder vote—but *before* the effective date²⁶—and relying on the statutory interest rate to hedge against the downside risk of lower judicially determined merger consideration.²⁷

19. In this context, a transaction is “interested” when the buyer is on both sides of the transaction. For example, a cash-out merger is interested when a buyer owns a substantial stake in a target company and uses cash to purchase the rest of the company from the target shareholders, thereby “cashing out” the target shareholders. For a detailed definition of interested transactions, see MODEL BUS. CORP. ACT § 13.01(5) (AM. BAR ASS’N 1999).

20. “Long-form” simply refers to non-short-form mergers (i.e., where the parent company owns less than 90% of the subsidiary).

21. See generally DEL. CODE ANN. tit. 8, § 262.

22. See, e.g., *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983) (“The concept of fairness has two basic aspects: fair dealing and fair price.”); *infra* Section II.C.1 (discussing fair price and fair dealing requirements in entire fairness analysis).

23. See, e.g., *Owen v. Cannon*, No. 8860–CB, 2015 WL 3819204, at *31 (Del. Ch. June 17, 2015) (“The fair price inquiry in a fiduciary duty claim is largely equivalent to the fair value determination in an appraisal proceeding, although the remedies may be different.”); *Weinberger*, 457 A.2d at 712 (“In this breach of fiduciary duty case, the Chancellor perceived that the approach to valuation was the same as that in an appraisal proceeding.”).

24. “The [Federal Reserve] discount rate is the interest rate charged to commercial banks and other depository institutions on loans they receive from their regional Federal Reserve Bank’s lending facility—the discount window.” *The Discount Rate*, FEDERALRESERVE.GOV, <https://www.federalreserve.gov/monetarypolicy/discountrate.htm> (last updated Oct. 18, 2016). [<https://perma.cc/Y3Y7-2NLQ>]. Delaware has no legislative history explaining the rationale behind the 5% interest rate.

25. Tit. 8, § 262(h) (“Unless the Court in its discretion determines otherwise for good cause shown . . . interest . . . shall be compounded quarterly and shall accrue at 5% over the Federal Reserve discount rate . . .”).

26. See *infra* Section I.B.2 (detailing § 262’s standing requirements, which allow shareholders to seek appraisal for shares purchased after the shareholder vote).

27. See *infra* Sections I.D.1 and 2 (describing the risks and rewards of appraisal arbitrage).

2. Standing

“Any stockholder” can get standing by “perfecting” their appraisal rights through four steps: (1) holding their shares on the date of demand for appraisal, (2) continuously holding those shares through the effective date of the merger, (3) complying with the form and timeliness requirements of subsection (d), and (4) not voting in favor of the merger.²⁸ “Stockholder” refers to the stockholder on the record date,²⁹ also called a “record holder,”³⁰ which is generally a broker holding disparate investors’ undifferentiated shares in “fungible bulk.”³¹ Consequently, to ensure efficiency and certainty in the appraisal process, only record holders have standing to perfect appraisal rights under section 262.³²

However, the statute still provides an avenue for non-record holders to get standing; a “beneficial owner,” or a stockholder who acquires shares after the record date, may still seek appraisal in their own name under subsection (e) so long as the beneficial owner ensures the record holder perfects appraisal rights on their behalf under subsections (a) and (d).³³ Thus, a beneficial owner who purchased shares after the record date may seek appraisal without voting on the

28. *E.g.*, tit. 8, § 262; *Merion Capital LP v. BMC Software, Inc.*, No. 8900-VCG, 2015 WL 67586, at *3 (Del. Ch. Jan. 5, 2015).

29. “Record date” refers to a board-fixed date to determine which stockholders are entitled to vote on a “corporate action,” including mergers. *See, e.g.*, tit. 8, § 213(a)–(b). Stockholders on the record date—or record holders—are entitled to vote and therefore receive appraisal rights. *E.g.*, tit. 8, § 262(a).

30. Tit. 8, § 262(a) (defining “stockholder” as a “holder of record of stock in a corporation”); BALOTTI & FINKELSTEIN, *supra* note 7, § 9.43 (“The Delaware appraisal statute defines ‘stockholder’ as a stockholder of record.”).

31. *E.g., In re Appraisal of Ancestry.Com, Inc.*, No. 8173–VCG, 2015 WL 66825, at *5 (Del. Ch. Jan. 5, 2015) (explaining that many publicly traded securities are held in “an undifferentiated manner known as ‘fungible bulk’” by “central securities depositories” such as Cede & Co., “making [Cede] the registered owner or record holder”). Cede has therefore been a prevalent party in Delaware appraisal proceedings. For a summary of modern stock ownership structures, see Robert S. Reeder & Stanley Onyeador, *Delaware Chancery Disqualifies Lead Petitioners in Dell Appraisal Who Inadvertently Voted “FOR” Management Buyout*, 69 VAND. L. REV. EN BANC 279, 281–85 (2016).

32. *See, e.g., Nothstein v. Software Publ’g Corp.*, 718 A.2d 528, 528 (Del. 1998) (“It is settled Delaware law that only a stockholder of record may demand an appraisal.”); BALOTTI & FINKELSTEIN, *supra* note 7, § 9.43 (“The rationale behind limiting appraisal rights to stockholders of record is the need for efficiency and certainty in the appraisal process.”).

33. *See, e.g.*, tit. 8, § 262(e) (granting a “beneficial owner” or “nominee on [her] behalf” appraisal rights “in such person’s own name”); *In re Appraisal of Ancestry.Com, Inc.*, 2015 WL 66825, at *8 (explaining that, under section 262(e), a “beneficial owner must ensure that the record holder of his or her shares . . . demonstrat[es] perfection of appraisal rights under Sections 262(a) and (d)”; *see also In re Appraisal of Dell Inc.*, 143 A.3d 20, 21–23 (Del. Ch. 2016) (holding appraisal petitioner T. Rowe was not entitled to appraisal rights when it erroneously caused record holder Cede to vote in favor of the merger).

merger or proving the shares she acquired from the record holder were not voted in favor of the merger.³⁴

Although the *availability* of standing is expansive, the *process* of securing standing is expensive. Indeed, subsection (d)'s procedural hurdles led many commentators to dismiss the remedy as impractical.³⁵ First, perfecting appraisal rights is cumbersome, requiring significant time and resources to navigate the long, complex appraisal timeline.³⁶ Moreover, unlike fiduciary class action litigation where shareholders must “opt out” of the claim, dissenters seeking appraisal must “opt in,” creating procedural hurdles for class certification and agency costs that impair litigants’ cost-sharing ability and collective leverage to incentivize settlement.³⁷ Finally, unlike fiduciary class actions where plaintiffs receive merger consideration up front to fund litigation, appraisal petitioners are not paid merger consideration during the lengthy proceedings and consequently bear litigation costs out of pocket.³⁸ Despite these risks and expenses, appraisal litigation has skyrocketed,³⁹ indicating the market either mitigates these risks or deems potential returns sufficient to compensate for assumed risk.

3. A Primer on Delaware Judicial Valuation Under 262(h)

Subsection (h) grants broad judicial discretion in determining fair value, allowing the Court to “account all relevant factors” except those “[of] value arising from the accomplishment or expectation of the merger.”⁴⁰ Delaware courts consistently articulate this standard to

34. See, e.g., *Merion Capital LP v. BMC Software, Inc.*, 2015 WL 67586, at *8 (Del. Ch. Jan. 5, 2016) (rejecting share-tracing requirement for beneficial shareholders); *In re Appraisal of Ancestry.Com, Inc.*, 2015 WL 66825, at *9 (same); *In re Appraisal of Transkaryotic Therapies, Inc.*, No. Civ.A. 1554–CC, 2007 WL 1378345, at *4–5 (Del. Ch. May 2, 2007) (same).

35. See Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 WASH. U. L. REV. 1551, 1561 (2015) (discussing “the procedural burdens of preserving and asserting an appraisal remedy”).

36. For a detailed explanation of the procedural aspects of the Delaware appraisal statute, see BALOTTI & FINKELSTEIN, *supra* note 7, § 9.43 and Gaurav Jetley & Xinyu Ji, *Appraisal Arbitrage—Is There a Delaware Advantage?*, 71 BUS. LAW. 427, 428 (2016) (“Appraisal arbitrage is not risk free.”).

37. This “opt-in” characteristic impedes dissenters’ ability to establish strength in numbers; disparate shareholders must use resources to communicate with each other and assemble a faction sufficient for class certification and necessary to pressure the acquirer to settle. See Korsmo & Myers, *supra* note 35, at 1561–62 (discussing the “opt-in” nature of the appraisal remedy as a “main reason” for “the inability to proceed as a class”).

38. See *id.* at 1561. As discussed in Section I.A, however, the interest reduction amendment may create opportunities to decrease this risk by funding petitioners’ appraisal proceedings.

39. See *id.* at 1576–83.

40. DEL. CODE ANN. tit. 8, § 262(h) (2013).

mean the value of the company to the stockholder as a “going concern,”⁴¹ calculated at “the point just before” the transaction,⁴² excluding synergies,⁴³ control premia,⁴⁴ and minority and illiquidity discounts.⁴⁵ However, merger parties generally include these values—particularly synergies—when negotiating the merger price.⁴⁶ Predictably, Delaware courts and merger parties often differ when calculating a target’s “going concern value.”

Calculating fair value depends on a judge’s selected valuation method, including—most commonly—the discounted cash flow analysis (“DCF”),⁴⁷ comparable companies’ analysis (“comps”),⁴⁸ and the

41. “Going concern” is a principle in accounting that presumes a company will continue operating indefinitely. See Frank A. Corcell, *Going Concern*, 90 COM. L.J. 222, 222 (1985).

42. See, e.g., *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 298 (Del. 1996) (“[T]he dissenter in an appraisal action is entitled to receive a proportionate share of fair value in the *going concern* on the date of the merger”); BALOTTI & FINKELSTEIN, *supra* note 7, § 9.45 (discussing the standard for valuation in a Delaware appraisal proceeding).

43. “Synergy” refers to the financial benefit achieved through combining companies, which can be attributed to various factors including revenues or cost reduction. For a detailed discussion of valuing synergies, see ROBERT F. BRUNER, *APPLIED MERGERS & ACQUISITIONS* 325–47 (Univ. ed., John Wiley & Sons 2004).

44. “Control premium” refers to an amount a buyer is willing to pay over the current market price to acquire a controlling position in the company, enabling the buyer to dictate business policies. For a detailed discussion of valuing control premiums in mergers and consolidations, see *id.* at 465–75.

45. “Minority discounts” are the flipside of control premiums where buyers may discount shares of a majority-shareholder-controlled company fearing the majority shareholder will extract value from the company. For a detailed discussion of valuing minority discounts in mergers and consolidations, see *id.* at 456–60. “Illiquidity discounts,” or nonmarketability discounts, occur for shares that may not have a ready market for sale, limiting an investor’s ability to exit her investment via sale to another investor. Illiquidity and minority discounts often occur in tandem because minority shares are less liquid. For a detailed discussion on valuing illiquidity discounts in mergers and consolidations, see *id.* at 462–65.

46. See, e.g., *id.* at 326 (“Synergy assessment should be the centerpiece of M&A analysis”); Tarun K. Mukherjee et al., *Merger Motives and Target Valuation: A Survey of Evidence from CFOs*, J. APPLIED FIN., Fall 2004, at 7–9 (“[S]ynergy stands out as perhaps the most justifiable motive in M&As.”).

47. E.g., Wertheimer, *supra* note 8, at 628 (noting the DCF is “probably the most prominent and frequently used” method of appraisal). DCF valuation discounts future free cash flow projections to determine the present value of the target company. The central drivers of this method are the target’s cash flow projections and discount rate. For a detailed discussion of the DCF analysis, see BALOTTI & FINKELSTEIN, *supra* note 7, § 9.45; BRUNER, *supra* note 43, at 260–70.

48. The comparable companies analysis (“comps”) involves “(1) identifying comparable publicly traded companies; (2) deriving appropriate valuation multiples from the comparable companies; (3) adjusting those multiples to account for the differences from the company being valued and the comparables; and (4) applying those multiples to the revenues, earnings, or other values for the company being valued.” BALOTTI & FINKELSTEIN, *supra* note 7, § 9.45. For additional details on the comps valuation approach, see BRUNER, *supra* note 43, at 258–59.

comparable transactions analysis.⁴⁹ In contrast, merger parties employ a wider range of valuation methodologies that depend on factors such as the transaction type or target company's given industry.⁵⁰ For example, private equity firms often use a leveraged buyout ("LBO") approach that Delaware chancellors often criticize.⁵¹ Not only can each valuation method yield widely different values, competing parties' experts often reach divergent valuations using the same approach.⁵² Consequently, Delaware judicial discretion drives appraisal litigation value not only because judges choose different valuation methods than the merger parties, but also because they cherry-pick from competing experts' assumptions within the same approach.⁵³

C. Appraise the Roof: The Surge in Delaware Appraisal Litigation

To begin, the percentage of merger transactions challenged by appraisal more than tripled between 2004 and 2014.⁵⁴ The average percentage of challenged transactions from 2004 to 2010 was 4.5%, surging to a 13.8% average from 2011 to 2014.⁵⁵ Similarly, the aggregate dissenting equity value⁵⁶ between 2011 and 2014 was more

49. The comparable acquisition analysis values a target by deriving transaction multiples from similar past transactions, considering factors such as "the size of the transaction, the timing of the transaction, and the comparability of the companies involved." BALOTTI & FINKELSTEIN, *supra* note 7, § 9.45. For a more detailed discussion of the comparable transactions approach, see BRUNER, *supra* note 43, at 260, 455–77.

50. See BRUNER, *supra* note 43, at 254–73 (explaining several valuation approaches and scenarios for which each is appropriate).

51. See *id.* at 394–98 (discussing the prevalence of LBOs among private equity firms); see also *In re Appraisal of Dell Inc.*, No. 9322–VCL, 2016 WL 3186538, at *29 (Del. Ch. May 31, 2016) ("The first factor that undermined the persuasiveness of the Original Merger Consideration was the use of an LBO pricing model.").

52. This is because competing experts choose self-serving assumptions as part of their valuation inputs. See, e.g., *Golden Telecom, Inc. v. Glob. GT LP*, 11 A.3d 214, 218 (Del. 2010) (evaluating "wildly divergent expert opinions regarding value"); *Neal v. Alabama By-Products Corp.*, CIV. A. No. 8282, 1990 WL 109243, at *9 (Del. Ch. Aug. 1, 1990) (noting "widely divergent" assumptions yielding polar valuations); Charles Korsmo & Minor Myers, *Reforming Modern Appraisal Litigation*, 41 DEL. J. CORP. L. (forthcoming 2016) (manuscript at 19–20) (<https://ssrn.com/abstract=2712088> [<https://perma.cc/L3J4-BR3P>]) (finding a 208% difference between respondent and petitioner valuations as a percentage of the merger price).

53. For example, because Delaware courts generally use a lower Equity Risk Premium ("ERP") in their DCF valuations, "[s]uch a gap in ERP estimates between the chancery court and investment bankers seems to be favorable to appraisal arbitrageurs because [it] . . . leads to a higher valuation outcome under a DCF valuation approach." See Jetley & Ji, *supra* note 36, at 448.

54. For an empirical analysis on the increased incidence of appraisal litigation, see Korsmo & Myers, *supra* note 35, at 1551, 1566–83.

55. Korsmo & Myers, *supra* note 52 (manuscript at 9).

56. "Equity value" is the amount paid for the target and thus represents the total transaction value.

than five times that of the 2004–2010 period.⁵⁷ Although the raw volume of appraisal petitions filed in 2015 dropped to twenty from the 2014 record of thirty-three, this number still reflected an upward trend, more than doubling the nine-per-year average observed from 2004 to 2010.⁵⁸ Moreover, the value of dissenting shares held by hedge funds doubled to over \$2 billion between 2014 and 2015, suggesting a peculiar shift in the demographic of appraisal petitioners.⁵⁹ Delaware courts have thus experienced a surge in appraisal litigation in recent years, particularly by sophisticated investors.⁶⁰

D. Appraisal Arbitrage: A Sword and Shield Investment

Appraisal arbitrage occurs when hedge funds pursue appraisal claims solely as an investment vehicle.⁶¹ As the Delaware statute allows, an appraisal arbitrageur acquires a large equity stake in a target company after the announcement of the merger solely to pursue—or threaten—appraisal, seeking a higher, judicially determined merger price.⁶² The attractive economics of appraisal arbitrage has even spurred the emergence of appraisal-dedicated financial institutions, including Merion Capital.⁶³ As of early 2015, Merion Capital had approximately \$1 billion under management in several active appraisal cases,⁶⁴ indicating that appraisal actions offer significant economic returns relative to the risks posed.

57. Korsmo & Myers, *supra* note 52 (manuscript at 13–16).

58. *Id.* at 13.

59. Liz Hoffman, *Dole and Other Companies Sour on Delaware as Corporate Haven*, WALL ST. J. (Aug. 2, 2015, 10:38 PM), <http://www.wsj.com/articles/dole-and-other-companies-sour-on-delaware-as-corporate-haven-1438569507> [<https://perma.cc/FM7N-84AY>] (displaying a table showing “value of shares owned by hedge funds holding out for a higher price”).

60. See Korsmo & Myers, *supra* note 35, at 1572–76 (“[P]etitioners have become increasingly specialized and sophisticated over our time period, with repeat petitioners increasingly dominating appraisal activity.”)

61. Abigail Pickering Bomba et al., *New Activist Weapon—the Rise of Delaware Appraisal Arbitrage: A Survey of Cases and Some Practical Implications*, FRIED FRANK (June 18, 2014), <http://www.friedfrank.com/siteFiles/Publications/FINAL%20-%206182014%20TOC%20Memo%20-%20New%20Activist%20Weapon--%20The%20Rise%20of%20Delaware%20Appraisal%20Arbitrage.pdf> [<https://perma.cc/L4YH-JFD3>] (defining “appraisal arbitrage” as “a new and expanding phenomenon of shareholder activists and hedge funds focusing on appraisal claims as a kind of investment in and of themselves”).

62. *Id.*

63. See Korsmo & Myers, *supra* note 35, at 1572–73 (discussing repeat-petitioner hedge funds in appraisal proceedings).

64. Liz Hoffman, *Hedge Funds Plan to Seek Higher Price for Safeway*, WALL ST. J. (Feb. 2, 2015, 4:48 PM), <http://www.wsj.com/articles/hedge-funds-plan-to-seek-higher-price-for-safeway-1422913728> [<https://perma.cc/9ZQ8-WGFA>].

1. The Sword: Delayed Gratification of Higher Merger Consideration

Appraisal arbitrageurs generally value delaying their investment because it allows them to gather more information to make a better-informed decision, reducing risk and maximizing return.⁶⁵ Because the value of an asset or security is largely rooted in the availability of recent relevant information,⁶⁶ more information begets a more accurate valuation.⁶⁷

Under the current statute, arbitrageurs may not only seek appraisal for shares purchased after the merger announcement, they may seek appraisal for shares purchased after the record date.⁶⁸ The average time period between a merger announcement and record date is fifty-four days, and the average duration between the record and effective date is seventy-four days.⁶⁹ Significant developments concerning merger parties often emerge in the 128-day interim between the merger announcement and effective date,⁷⁰ including the target's Definitive Proxy Materials.⁷¹

65. See Jetley & Ji, *supra* note 36, at 433 (“It is well established in finance that the ability to delay an investment is valuable because it allows the investor to make a more informed investment decision.”).

66. *Id.* at 433–40 (discussing the value of delaying an investment to gather more information).

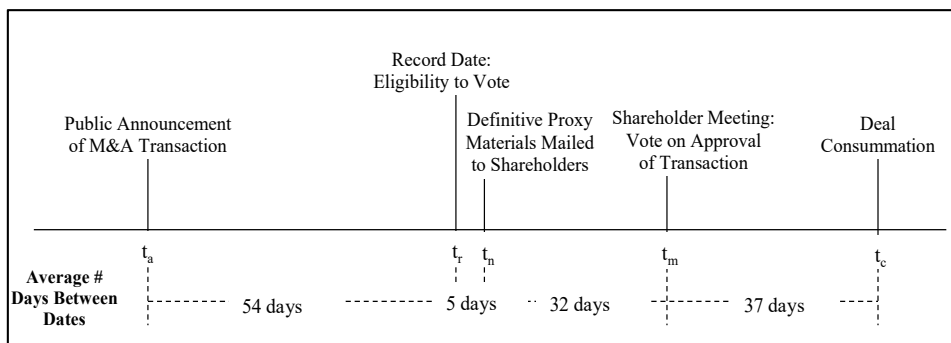
67. BRUNER, *supra* note 43, at 227 (“Research [and] . . . valuation . . . should be linked closely.”).

68. *E.g.*, Merion Capital LP v. BMC Software, Inc., No. 8900–VCG, 2015 WL 67586, at *3 (Del. Ch. Jan. 5, 2015); *In re* Appraisal of Ancestry.com, Inc., No. 8173–VCG, 2015 WL 66825, at *5 (Del. Ch. Jan. 5, 2015).

69. Jetley & Ji, *supra* note 36, at 436.

70. See *id.* (“[P]ostponing the share purchase to after the record date enables the arbitrageur to take advantage of any development or new information, including any relevant information concerning the at-issue transaction that may not be available until after the record date has been set.”).

71. Disclosure requirements for proxy statements describing a merger provide pivotal valuation-relevant information, including: a summary of the material terms of the transaction, financial data, any director or executive conflicts, and opinions, reports, or appraisals used to evaluate the transaction. See *In Practice: M&A, Document Description—Proxy Statements*, BLOOMBERG LAW, <https://www.bloomberglaw.com/p/e85c8641b21f57a06736df1e0cb10faf/document/X8JTABKG000000> (last visited Feb. 27, 2016) [<https://perma.cc/9TXU-JPK6>].

FIGURE 1: TIMELINE OF A TYPICAL DEAL PROCESS⁷²

The arbitrageurs—armed with fresh, valuation-relevant information—then receive the extended option to buy the target company’s stock while evaluating the probability of higher judicially determined consideration without holding stock or bearing common early-stage risks.⁷³ This advantage may be palatable but for the fact that existing target shareholders shoulder the risk of merger nonconsummation or uncertain appraisal outcomes while arbitrageurs free ride at their expense.⁷⁴ Despite the valuable option to buy shares after the record date, return-eroding procedural risks could otherwise render appraisal arbitrage returns insufficient; however, the generous statutory interest rate alleviates such concerns.⁷⁵

2. The Shield: Delaware’s Interest Rate Allows Arbitrageurs to Hedge Against Downside Risk

Until recently, corporate commenters often criticized appraisal as an impractical and seldom-used remedy, citing cumbersome procedural risks that corroded appraisal investment returns.⁷⁶ Because appraisal proceedings average three years in length,⁷⁷ and dissenting

72. Jetley & Ji, *supra* note 36, at 436.

73. *See id.* at 437–40 (discussing arbitrageurs’ valuable option to buy maximizing value and minimizing deal risk, including risk of non-consummation).

74. *See id.* at 432 (inquiring “why appraisal arbitrageurs should not be required to carry the same risk” as other investors).

75. *See supra* Section I.B.3 (explaining the statutory interest rate).

76. *See* Jetley & Ji, *supra* note 36, at 432 (discussing procedural risks associated with the appraisal remedy); *see also* DEL. CODE ANN. tit. 8, § 262(d) (2013) (detailing procedural requirements for perfecting appraisal rights); Korsmo & Myers, *supra* note 35, at 1560–66 (discussing “the procedural burdens of preserving and asserting an appraisal remedy”).

77. *See* Wei Jiang et al., *Influencing Control: Jawboning in Risk Arbitrage* 26 n.14 (Columbia. Bus. Sch. Research Paper No. 15-41, 2015), http://www.shareholderforum.com/access/Library/20150600_Jiang-Li-Mei.pdf [<https://perma.cc/78UP-PPDE>] (finding “average (median)

shareholders must fund litigation out of pocket, dissenters face considerable liquidity risk and opportunity costs that could erode returns.⁷⁸

However, the statutory interest rate under Delaware's appraisal statute more than hedges against these procedural risks, allowing arbitrageurs to have their cake and eat it too.⁷⁹ The interest rate under section 262 is particularly attractive given low interest rates in recent years: the statutory interest rate is more than ten times greater than the current risk-free rate.⁸⁰ Moreover, Delaware courts rarely award below the merger price; the courts, on average, award higher merger consideration.⁸¹ Accordingly, section 262(h)'s statutory interest rate allows appraisal arbitrageurs to hedge against procedural downside risk by accruing interest while pursuing the upside probability of higher merger consideration from the appraisal proceeding. This irresistible "win-win" economic incentive was integral to the recent spike in appraisal-challenged mergers—regardless of whether these mergers merited appraisal.

3. Setting the Stage: The Anatomy of an "Arbitrage-Worthy" Merger

This Section notes which merger characteristics *should* attract appraisal litigation then compares these attributes with those of deals challenged by arbitrageurs. This analysis shows that, by challenging many mergers that do not have characteristics of unfair merger pricing, arbitrageurs do not use the appraisal remedy to ensure fairness to minority shareholders as the remedy intends.

Unlike fiduciary class action plaintiffs, who target nearly all mergers regardless of the deal's characteristics, arbitrageurs are

length between deal completion and the appraisal decision is 1,043.1 (1,106) calendar days[,] or just over three years).

78. Under time value of money principles, "a dollar today is worth more than a dollar tomorrow" because you could invest that money to earn interest or expand business. *See, e.g.*, RICHARD A. BREALEY ET AL., PRINCIPLES OF CORPORATE FINANCE 18–19 (11th ed. 2014) (demonstrating how postponing consumption of money leads to more money in the future); BRUNER, *supra* note 43, at 249 (explaining the importance of "time value of money" and "opportunity cost"). Because dissenting shareholders receive no merger consideration until the three-year appraisal proceeding ends, those shareholders' deferred merger payment loses value during this period *unless* interest accrues.

79. Theodore N. Mirvis et al., *Delaware Court Decisions on Appraisal Rights Highlight Need for Reform*, WLRK (Jan. 21 2015), <http://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.23798.15.pdf> [<https://perma.cc/J2HY-PG7U>] (highlighting the "heads I win, tails you lose" perspective of appraisal fund investors").

80. As of January 21, 2016, the six-month Treasury rate was 0.5%, meaning the Delaware statutory interest rate was 5.5%.

81. *See* Korsmo & Myers, *supra* note 52 (manuscript at 1–2) (finding a 10% mean premium awarded to dissenting shareholders in Delaware).

presumed more particular in pursuing appraisal litigation.⁸² And although fiduciary class actions are more prevalent, appraisal actions nonetheless reach trial at an unusually high percentage compared to other merger litigation.⁸³ Nevertheless, the need for appraisal should vary by transaction.

Theoretically, appraisal arbitrageurs should want to target deals with a high probability of underpricing; for instance, buyout transactions involving a financial buyer or cash-out mergers where there is a greater power imbalance between the acquirer and target.⁸⁴ Private equity firms and other financial buyers generally value targets as standalone entities and have a short investment horizon within which to hit target returns.⁸⁵ Conversely, strategic buyers focus on long-term synergistic value⁸⁶ and are therefore willing to pay more for target companies.⁸⁷ However, because private equity buyers rely heavily on debt to finance acquisitions, these financial buyers are willing to pay as much or more than strategic buyers when low interest rates decrease the cost of debt.⁸⁸ Accordingly, the recent near-zero interest rate environment increased private equity M&A activity and normalized valuation differences between financial and strategic buyers.⁸⁹ As such, there should theoretically be a negligible difference in the likelihood that an appraisal arbitrageur will challenge a private-equity-backed acquisition over a strategic acquisition.⁹⁰

However, target shareholders should more likely dissent from interested transactions. Cash-out or parent-subsidary mergers—

82. See *id.* at 6 (arguing that arbitrageurs are targeting “the right transactions”).

83. While almost 90% of mergers over \$100 million attract fiduciary class action litigation, approximately 15% of appraisal-eligible mergers attract petitions. *Id.* at 9–10. However, fiduciary class action cases have a high settlement rate, while 15% of appraisal cases reach trial. *Id.* at 17.

84. See Bomba, *supra* note 61 (“[T]he 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.”).

85. See Alexander S. Gorbenco & Andrey Malenko, *Strategic and Financial Bidders in Takeover Auctions*, 69 J. FIN. 2513, 2541 (2014) (comparing financial and strategic buyer merger strategies and valuations); Marc Martos-Vila et al., *Financial vs. Strategic Buyers* 3–7 (Harvard Bus. Sch., Working Paper No. 12–098, 2014), http://www.hbs.edu/faculty/Publication%20Files/12-098_dc44025a-785b-45c5-9d31-60e02f091b7d.pdf [<https://perma.cc/KMX5-6AH5>] (same).

86. For a definition of “synergy”, see *supra* note 43.

87. Gorbenco & Malenko, *supra* note 85, at 2513; Martos-Vila, *supra* note 85, at 3–7.

88. See Martos-Vila, *supra* note 85, at 3–9 (finding financial buyers increase their willingness to pay in low interest rate environments while strategic buyers do not).

89. See *id.* at 4–5 (discussing how low interest rates enhance “the ability of financial buyers to increase leverage and pay more” than strategic buyers).

90. See Korsmo & Myers, *supra* note 52 (manuscript at 10) (finding “statistically insignificant” the difference in appraisal litigation between strategic and financial buyers).

considered “interested” transactions in Delaware—generally increase the likelihood of unfair merger pricing resulting from an uncompetitive sale process.⁹¹ Unsurprisingly, appraisal litigation stemming from interested transactions result in higher judicially determined valuation premia than their disinterested counterparts.⁹² However, since 2011, the number of appraisal decisions involving disinterested transactions has exceeded those involving interested ones, suggesting the number of appraisal petitions filed for disinterested transactions is the same—or greater—than for interested transactions.⁹³ Therefore, though appraisal arbitrageurs *should* pursue only transactions with a greater probability of target-shareholder oppression to better align with the remedy’s intent, these petitioners seem to adopt a quantity-over-quality approach, challenging transactions that do not necessitate the protection of the appraisal remedy. Understandably, anti-arbitrage stakeholders want to curb such abuse.

*E. Appraisal Uprising:
Lobbying a Legislative Curb to Appraisal Litigation*

Recently, advocates for merger parties bearing the cost of increased appraisal litigation have emerged as formidable opponents against the arbitrage phenomenon.⁹⁴ This call for change began in 2008 when then-Chancellor William Chandler affirmed that stock acquired *after* the record date is eligible for appraisal, inciting defense counsel concerns.⁹⁵ Further, in 2013, the power of the appraisal remedy became

91. *E.g.*, Melvin Aron Eisenberg, *Self-Interested Transactions in Corporate Law*, 13 J. CORP. L. 997, 998–1008 (1988) (describing risks of price and procedural oppression of target shareholders in interested transactions).

92. Since 2010, Delaware courts have awarded an average 2% and 77% average premium in disinterested and interested transactions, respectively. *See, e.g.*, Steven Epstein et al., *A Study of Recent Delaware Appraisal Decisions: Part 1*, LAW360 (July 28, 2015, 4:38 PM), <http://www.law360.com/articles/683402/a-study-of-recent-delaware-appraisal-decisions-part-1> [<https://perma.cc/PT27-MPHJ>]. For detailed outcomes of Delaware appraisal decisions since 2010, see summary table in *id.*

93. *Id.*

94. *See infra* Section I.E (chronicling the backlash stemming from increased appraisal litigation).

95. *See, e.g.*, *In re Appraisal of Transkaryotic Therapies, Inc.*, No. 1554–CC, 2007 WL 1378345, at *3–5 (Del. Ch. May 27, 2007) (finding that “only a record holder . . . may claim and perfect appraisal rights”); Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1038–39 (2007) (exploring the implications of hedge funds using the appraisal remedy); *Appraisal Arbitrage: Will It Become a New Hedge Fund Strategy?*, LATHAM & WATKINS LLP (May 2007), https://www.lw.com/upload/pubContent/_pdf/pub1883_1.pdf [<https://perma.cc/X78M-ER66>] (“Transkaryotic Therapies . . . has the potential to revolutionize the use of appraisal rights in cash mergers involving Delaware target companies.”).

even more evident when Carl Ichan threatened to dissent from Dell Inc.'s impending take-private transaction, prompting the buyer to increase merger consideration by \$400 million.⁹⁶ Inspired by this resounding shareholder victory, hedge funds led a 12% shareholder dissent from Dole's 2013 take-private transaction.⁹⁷ Dole management responded by threatening to lead a reincorporation exodus from Delaware if the State failed to reform the appraisal statute.⁹⁸ By early 2015, other powerful companies and corporate defense counsel began lobbying for legislative reform, noting the risks associated with appraisal arbitration and recommending statutory overhaul.⁹⁹

Almost two years after Dole's call to action, the Council of the Corporation Law Section of the Delaware State Bar Association (the "Council")¹⁰⁰ responded by proposing minimal reform that inadequately reflected defense counsel recommendations.¹⁰¹ Subsequently, a group of seven blue-chip corporate defense firms wrote a letter to the Council, reiterating a desire for sweeping statutory reform.¹⁰²

96. See David A. Katz & Laura A. McIntosh, *Corporate Governance Update: Shareholder Activism in the M&A Context*, WLRK (Mar. 27, 2014), <http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.23255.14.pdf> [<https://perma.cc/6UDY-7KFF>] (summarizing "Carl Ichan's campaign against the Dell going-private transaction").

97. Liz Hoffman, *Dole Food Deal Passes by Slim Margin as Hedge Funds Seek Appraisal*, WALL ST. J. (Oct. 31, 2013 3:55 PM), <http://blogs.wsj.com/moneybeat/2013/10/31/dole-food-deal-passes-by-slim-margin-as-hedge-funds-seek-appraisal/> [<https://perma.cc/549E-42KR>].

98. Korsmo & Myers, *supra* note 52 (manuscript at 28–29).

99. See, e.g., Hoffman, *supra* note 59 (finding "a sharp rise in hedge funds suing to squeeze more money from corporate takeovers"); Maurice M. Lefkort, *Hedge Funds Can Still Manipulate Corporate Law*, WHARTON MAG. (Feb. 12, 2015), <http://whartonmagazine.com/blogs/hedge-funds-can-still-manipulate-stock-market-rule/> [<https://perma.cc/JPW5-55A3>] (arguing that appraisal rights "are being manipulated by sophisticated market players to reap above-market, low-risk returns . . . at the expense of the stockholders who are not manipulating these rules, and at the efficiency of the mergers and acquisitions marketplace"); Trevor S. Norwitz, *Delaware Legislature Should Act to Curb Appraisal Arbitrage Abuses*, COLUM. L. SCH. 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/E72D-LZ5L>] (chronicling the risks associated with appraisal arbitration).

100. The Council, comprised of corporate practitioners in the Delaware State Bar Association, is responsible for formulating and recommending to the Delaware General Assembly amendments to the Delaware General Corporation Law. See *About the Section of Corporation Law*, DSBA.ORG (2016), <http://www.dsba.org/sections-committees/sections-of-the-bar/corporation-law/> [<https://perma.cc/X77X-XVZN>].

101. See *infra* Section I.F (discussing recent amendments to Delaware's appraisal statute).

102. See Korsmo & Myers, *supra* note 52 (manuscript at 32) (quoting Letter from Cravath, Swaine & Moore LLP; Davis Polk & Wardwell LLP; Latham & Watkins LLP; Skadden, Arps, Slate, Meagher & Flom LLP; Simpson Thacher & Bartlett LLP; Sullivan & Cromwell LLP; and Wachtell, Lipton, Rosen, & Katz to the Council of the Corporation Law Section of the Delaware State Bar Association (Apr. 1, 2015) ("In our view, the proposed legislation does 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 arbitration.'")).

These firms and other anti-arbitrage commentators agree that appraisal arbitrage improperly increases deal risk and uncertainty for an acquiring company.¹⁰³ On one hand, the threat of appraisal creates merger-closing uncertainty by incentivizing acquirers to include an appraisal rights provision, which is often rebuked by sellers and can gridlock a deal.¹⁰⁴ Conversely, appraisal arbitrage creates significant liquidity risk for acquirers who may have to pay far more for a target company than the negotiated merger price.¹⁰⁵ Therefore, anticipating the aforementioned value-destroying risks, acquirers may underprice the merger in initial negotiations, stripping value from long-term target stockholders and placing it in the hands of predatory arbitrageurs—an outcome antithetical to policy goals of the appraisal remedy.¹⁰⁶ Despite these justifications and calls for overhauling Delaware’s appraisal statute, the Delaware General Assembly confined its amendments to the Council’s minor recommendations detailed in the next Section.

*F. Interest Reduction and De Minimis Amendments:
A Drop in the Bucket*

In February 2014, the Council established a subcommittee to evaluate potential amendments to section 262 and to address

103. See, e.g., Norwitz, *supra* note 99 (arguing that appraisal arbitrage “creates significant risks for buyers” resulting in “increase in acquisition costs”).

104. Appraisal rights closing conditions are tied to the level of shares that assert appraisal, providing that appraisal rights must not have been sought by target shareholders holding more than a specified percentage of the target’s outstanding stock. *2013 M&A Report*, WILMERHALE (2013), http://www.wilmerhale.com/uploadedFiles/WilmerHale_Shared_Content/Files/Editorial/Publication/2013-wilmerhale-ma-report.pdf [<https://perma.cc/PY5E-XZQM>]. Such provisions are generally disfavored. See Korsmo & Myers, *supra* note 52 (manuscript at 3) (acknowledging appraisal rights closing conditions are “unattractive to sellers (because it reduces the certainty of the deal) and also to buyers (because it allows dissenting stockholders to veto the transaction)”; Steven Epstein et al., *Delaware Appraisal: Practical Considerations*, A.B.A. (Oct. 2014), http://www.americanbar.org/publications/blt/2014/10/keeping_current_epstein.html# [<https://perma.cc/8JXA-44QM>] (explaining that appraisal conditions “may provide more leverage to last-minute opportunistic investors who can threaten to derail the deal by triggering the condition, thus causing more uncertainty for both the buyer and the seller”); Norwitz, *supra* note 99 (describing “an appraisal rights closing condition” as the “most undesirable development for the seller and its shareholders . . . because it would be strongly resisted”).

105. See, e.g., Norwitz, *supra* note 99 (suggesting that arbitrage may render buyers be “obligated to pay much more for a target company than they had expected to when negotiating the deal,” which may result in buyer “bankruptcy”).

106. See Dufner et al., *supra* note 4 (arguing that appraisal arbitrage creates “incentives for buyers to lower their price in anticipation of having to pay appraisal arbitrageurs post-closing and therefore shift[s] value away from long-term stockholders towards short-term arbitrageurs without advancing the underlying public policy rationale for appraisal rights”).

increasing negative appraisal arbitration commentary.¹⁰⁷ The Council proposed two amendments that were adopted in August 2016: (1) a de minimis exception in section 262(g), and (2) an interest reduction provision in section 262(h).¹⁰⁸ The de minimis exception applies only to public companies, barring appraisal claims where (a) the number of shares seeking appraisal is less than 1% of the outstanding shares entitled to appraisal, or (b) the value of the merger consideration for the shares entitled to appraisal is less than \$1 million.¹⁰⁹ The interest reduction provision gives acquirer-defendants an option to toll the accrual of interest on any up-front merger consideration paid to target-petitioners.¹¹⁰ Accordingly, acquirer-defendants have an option to pay up front to decrease or eliminate hedging provided by Delaware's substantial, risk-free statutory interest rate.

Although the proposed amendments to section 262 are insufficient, they represent a welcome effort to curb appraisal arbitration. The de minimis exception should eliminate weak appraisal claims filed by a small number of shareholders pursuing nuisance settlement value rather than protecting target shareholder rights. Moreover, because appraisal proceedings usually cost millions of dollars to litigate, the million-dollar threshold ensures cost-benefit efficiency in pursuing the appraisal remedy. However, the proposed de minimis carve-out does little to curb institutional arbitrageurs who have adequate resources to purchase enough shares to meet the threshold and pursue higher-stakes proceedings.¹¹¹ Indeed, "the \$1 million minimum seemingly unfairly knocks out small shareholders but not professional hedge funds."¹¹²

Conversely, the proposed interest reduction amendment may slow appraisal arbitration activity by limiting arbitrageurs' ability to hedge their downside risk in purchasing weak appraisal claims. The statutory interest rate allows arbitrageurs to reap above-market returns in weak appraisal claims involving disinterested transactions

107. Council of the Corp. Law Section of the Del. State Bar Ass'n, *Section 262 Appraisal Amendments*, LOWENSTEIN (Mar. 6, 2015), <https://www.lowenstein.com/files/upload/DGCL%20262%20Proposal%203-6-15%20Explanatory%20Paper.pdf> [https://perma.cc/RYE6-2PGQ].

108. DEL. CODE ANN. tit. 8, § 262(g)-(h) (2013).

109. *Id.*

110. *Id.*

111. See Korsmo & Myers, *supra* note 35, at 1574 (showing the lowest mean value of all dissenters per case is "\$1,039,458," well above the proposed \$1 million threshold).

112. Steven Davidoff Solomon, *Delaware Effort to Protect Shareholders May End Up Hurting Them*, N.Y. TIMES (May 24, 2016), <http://www.nytimes.com/2016/05/25/business/dealbook/delaware-effort-to-protect-shareholders-may-end-up-hurting-them.html?ref=dealbook&r=0> [https://perma.cc/C2YE-8M6D].

generally considered less prone to target shareholder oppression.¹¹³ Although Delaware courts awarded no premiums in 2015 on disinterested transactions, arbitrageurs still received a lucrative 12% average premium from the statutory interest rate,¹¹⁴ incentivizing arbitrageurs to continue targeting fair transactions despite low probabilities of getting a higher judicially awarded premium.

The amendment to section 262(h) affords acquiring corporations the ability to limit the accrual of interest by paying merger consideration up front. For example, when an acquirer pays dissenting target shareholders 75% of the merger price up front, an arbitrageur only receives interest on the remaining 25% and any judicially determined premium. Considering arbitrageurs' recent propensity for challenging fair transactions that award no premium,¹¹⁵ giving acquirers the ability to eliminate potential interest arbitrage may increase arbitrageurs' credit risk and decrease the number of claims that serve no legitimate shareholder interests. On the other hand, an acquirer who chooses this option would decrease the arbitrageur's liquidity risk by funding his or her appraisal proceeding, which may perversely *encourage* arbitrage activity.¹¹⁶ Accordingly, without additional reform, the interest reduction amendment may at best render appraisal arbitrage unchanged or at worst incentivize arbitrage activity by fronting arbitrageurs' litigation costs.

Notably, the Council never proposed the corporate-defense juggernauts' recommended amendments to curb appraisal arbitrage. As

113. See *supra* Section I.D.3 (discussing the hedging effect of Delaware's substantial interest rate under § 262(h)).

114. Refer to summary table in Epstein et al., *supra* note 92 (summarizing the merger price premiums represented by statutory interest for appraisal decisions since 2010).

115. See *supra* Section I.D.3 (“Though appraisal arbitrageurs *should* pursue only transactions with a greater probability of target-shareholder oppression to better align with the remedy's intent, these petitioners seem to adopt a quantity-over-quality approach, challenging transactions that do not necessitate the protection of the appraisal remedy.”).

116. As described in Section I.A.2, dissenters generally receive no merger consideration until the end of the appraisal proceeding and, therefore, must fund litigation out of pocket. However, if the acquirer elects to pay dissenters up front to toll interest under this amendment, arbitrageurs can now fund appraisal litigation with these funds. For additional commentary on this point, see, for example, Solomon, *supra* note 112 (arguing that “[r]ather than discourage appraisal petitions, the elimination of interest accrual through prepayment may actually spur more appraisal actions because hedge funds would be paid sooner and be able to use that money to bring more appraisal actions”); *Companies Face Tough Decision Under New Del. Appraisal Law*, BLOOMBERG BNA (July 28, 2016), <http://www.bna.com/companies-face-tough-n73014445604/> [<https://perma.cc/BG2S-E6W8>] (mentioning that “early payments to shareholders . . . may inadvertently fuel more litigation by unlocking money for shareholder litigants”). *But see* Wei Jiang et al., *Appraisal: Shareholder Remedy or Litigation Arbitrage?* 35 (Vanderbilt Law and Economics Research Paper No. 16-11, 2016), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2766776 [<https://perma.cc/6RPE-X4FD>] (suggesting that the “Interest Reduction Amendment” will “discourag[e] interest rate driven appraisal cases”).

such, despite these amendments, the advantage Delaware corporate law once provided to many state-revenue-generating acquirers—and, by extension, defense counsel—remains with oppressive appraisal arbitrageurs.

II. THE DELAWARE ADVANTAGE?

As drafted, section 262 and its judicial application neither effects the purposes of the appraisal remedy nor benefits merger parties, thus threatening the once-presupposed advantage of Delaware incorporation. This Part analyzes components of Delaware’s appraisal statute and courts’ interpretation thereof. First, a normative and financial analysis reveals the futility of Delaware’s cash carve-out to the market-out exception. Second, this Part explores the perverse economic and policy implications underlying Delaware courts’ interpretation of section 262 that affords appraisal rights to investors who purchase shares after the record date. Finally, this Part critiques the inconsistency of Delaware courts’ judicially driven appraisal analyses, concluding that (1) chancellors and justices inflate valuations, award target-petitioners windfalls, and therefore incentivize appraisal arbitrage; (2) Delaware courts incorrectly analyze appraisal proceedings under enhanced scrutiny generally reserved for premerger fiduciary duty litigation; (3) Delaware chancellors and justices are not well-suited for appraisal valuation; and (4) by changing their fair value determination approach in response to political pressure, chancellors and justices improperly assume a legislative role.

A. Green Isn’t Good: The Cash Exception to the “Market-Out” Exception

According to famed stock trader Jesse Livermore, “the market is always right”;¹¹⁷ Delaware appears to agree—unless cash is involved. Delaware was the first state to implement a statutory “market-out” exception eliminating appraisal rights for public-company shareholders,¹¹⁸ and thirty-six other states have since followed.¹¹⁹ For Delaware, however, this restriction extends only to transactions

117. *The Market Is Always Right*, STOCKTRADER.COM (Mar. 27, 2009), <https://www.stocktrader.com/2009/03/27/the-market-is-always-right/> [https://perma.cc/4TAZ-VV9L] (“Livermore was quoted to have said, ‘[t]he market is always right.’”).

118. *A Reconsideration of the Stock Market Exception to Dissenting Shareholder’s Right to Appraisal*, 74 MICH. L. REV. 1023, 1031 (1976) [hereinafter *Reconsideration*]; Gilbert E. Matthews & Michelle Patterson, *Public Shareholders, Fair Value, and the ‘Market-Out Exception’ in Appraisal Statutes*, 21 BUS. VALUATION UPDATE 1, 18 (Feb. 2015), <http://www.bvresources.com/pdfs/February2015BVU.pdf> [https://perma.cc/98T7-D2TG].

119. Matthews & Patterson, *supra* note 118, at 18.

financed solely by stock.¹²⁰ Public-target shareholders therefore retain appraisal rights when the merger consideration includes *any* cash.¹²¹ Although the justifications for the market-out exception seem clear,¹²² rationales for the cash carve-out remain a mystery. Accordingly, revisiting rationales for the market-out exception may reveal justifications—or lack thereof—for the cash carve-out.

The following justifications for the market-out exception are most relevant in the appraisal arbitrage context: (1) liquidating shareholders are not motivated by the nature of their investment, but rather by maximizing their share value therein, which a public exchange measures and allows; and (2) appraisal affords no advantage that a sale on the market cannot provide.¹²³ However, these rationales do not support the need for a categorical cash carve-out.

Maximizing target-shareholder value requires a market that accurately values target shares and facilitates liquidity. First, the Semi-Strong Efficient Capital Market Hypothesis (“ECMH”)¹²⁴ indicates public markets provide an accurate valuation system, as share prices incorporate all publicly available information.¹²⁵ Second, a public share exchange provides a system where shareholders may easily sell their shares.¹²⁶ Public markets thus accurately value dissenting shares and allow shareholders to sell to the highest bidder.

120. DEL. CODE ANN. tit. 8, § 262(b) (2013).

121. Even a merger financed by 99% stock and only 1% cash would still trigger appraisal rights. *Id.*

122. *E.g.*, *Gibbons v. Schenley Indus., Inc.*, 339 A.2d 460, 467 (Del. Ch. 1975) (noting “market price alone . . . is . . . worthy of high weight” for publicly traded companies); Jeff Goetz, *A Dissent Dampened by Timing: How the Stock Market Exception Systematically Deprives Public Shareholders of Fair Value*, 15 *FORDHAM J. CORP. & FIN. L.* 771, 797 (arguing that because “the market adequately values stock; valuation through appraisal is unnecessary”); Matthews & Patterson, *supra* note 118, at 20 (“Proponents of market-out exceptions argue that, because shareholders of publicly traded companies may freely sell their shares, appraisal rights are unnecessary.”).

123. *See Reconsideration*, *supra* note 118, at 1029–31 (discussing rationales for the market-out exception).

124. Though the Semi-Strong ECMH is not the only information-based capital market hypothesis, it “has the greatest effect on securities regulation.” *See* STEPHEN J. CHOI & A.C. PRITCHARD, *SECURITIES REGULATION: CASES AND ANALYSIS* 33 (Robert C. Clark et al. eds., 3d ed. 2012). The two other hypotheses are the Weak and Strong Form: the Weak ECMH posits that current market price reflects the information found in all past prices for that security, while the Strong ECMH holds that market prices incorporate all information. *Id.* at 32–34.

125. *See, e.g.*, Joel Seligman, *Reappraising the Appraisal Remedy*, 52 *GEO. WASH. L. REV.* 829, 837–38 (1984) (“Given the widely recognized validity of the ‘semi-strong’ form of the efficient-market hypothesis . . . it is reasonable to believe that the market price of a security fairly reflects all publicly known material information about the underlying firm. An appraisal in such circumstances is superfluous.”).

126. *See Wertheimer*, *supra* note 8, at 633 (discussing the liquidity rationale for the market-out exception).

As such, the value-maximization rationale does not justify the cash carve-out and may even indicate that the appraisal remedy is less compelling for cash-financed mergers.

Including cash consideration does not ostensibly change these valuation and liquidity characteristics. Practically, because public stock exchanges are denominated in cash currency rather than complex stock-for-stock exchange ratios,¹²⁷ a public target company's valuation should be deemed *more* accurate where cash consideration is included.¹²⁸ Moreover, a shareholder could cash out her shares by selling to other public exchange investors or to the acquirer at a premium upon merger, ensuring a market for his or her shares.¹²⁹ However, these liquidity and accuracy characteristics may hold true only in disinterested mergers, as minority shares in a cash-out merger may be thinly traded and therefore less liquid and discounted on the public market.¹³⁰

Nevertheless, returns are generally higher in cash-financed mergers,¹³¹ rendering public target shareholders *more* likely to maximize their share value in a cash transaction. Consequently, because offering cash consideration generally results in higher merger premia and does not inherently decrease target shares' marketability, the appraisal remedy is not an indispensable remedy in cash-financed mergers, and its rationales no longer outweigh the abuse of arbitrageurs.

Similarly, the appraisal remedy affords shareholders no benefit that sale on the market does not provide;¹³² the appraisal remedy simply creates a special market where a shareholder may sell at a judicially determined price, albeit at the expense of litigation and opportunity costs of capital.¹³³ Accordingly, a public market values dissenters' stock and allows shareholders to sell their shares without

127. BRUNER, *supra* note 43, at 589 ("The *exchange ratio* in a share-for-share deal is the number of buyer shares offered per target share.") (emphasis in original).

128. *See id.* (noting that calculating exchange ratios renders stock-for-stock deals "more complicated" and therefore more prone to inaccuracy).

129. *See* Wertheimer, *supra* note 8, at 633 (describing the view that "the market adequately value[s] corporate stock"). This, of course, assumes the shares are widely traded.

130. *See id.* at 635 ("[R]eliance on market price does not adequately protect the interests of minority shareholders.").

131. *See* BRUNER, *supra* note 43, at 567 ("*Payment in cash*: Target shareholder returns are materially higher."). For detailed analyses comparing stock and cash consideration, see *id.* at 567–79.

132. *See supra* sources accompanying note 118.

133. *See Reconsideration, supra* note 118, at 1030–31 (describing the "special market" created by the appraisal remedy and the associated expenses of such a judicial determination).

incurring the exorbitant litigation or opportunity costs¹³⁴ associated with appraisal, thereby rendering the remedy unnecessary in cash-financed mergers.

Finally, cash consideration does not magically enhance target shareholder benefits in an appraisal proceeding. Target company shares in a disinterested cash-*financed* merger are still accurately priced by and marketable to the public market.¹³⁵ Target company shares in interested cash-*out* mergers, however, are generally less liquid and are therefore discounted in the open market.¹³⁶ Consequently, the appraisal remedy *may* provide an additional benefit in such scenarios if judicially determined valuations exceed the market price. Still, a judge who values merger consideration far beyond any *merger* price does not award “fair value” as the statute requires,¹³⁷ but rather unjustifiably grants an inappropriate windfall to dissenting shareholders.¹³⁸ Since cash consideration neither erodes the accuracy of market pricing nor undermines the marketability of target company shares, a cash-financed merger involving a public target company should not per se give dissenting shareholders appraisal rights. Nevertheless, minority shareholders in interested mergers are particularly vulnerable to majority oppression, justifying the cash carve-out in such scenarios.

In sum, the cash exception contradicts the foundational rationales of section 262’s market-out exception and is therefore unnecessary—at least for disinterested mergers. Public share exchanges value public target companies as accurately in cash-financed mergers as in all-stock transactions. Moreover, the public market affords liquidating shareholders the opportunity to maximize their share value in cash-financed mergers equally or better than in all-stock transactions, particularly in disinterested scenarios. Because appraisal arbitrageurs exclusively target cash-financed transactions, Delaware should therefore join eleven Model Business Corporation Act states in confining the cash carve-out to interested transactions, thereby limiting

134. *Id.* at 1031 (discussing significant costs associated with the appraisal proceeding).

135. *See* Seligman, *supra* note 125, at 838 (“[I]t is reasonable to believe that the market price of a security fairly reflects all publicly known material information about the underlying firm.”).

136. *See supra* note 130 (“[R]eliance on market price does not adequately protect the interests of minority shareholders.”).

137. DEL. CODE ANN. tit. 8, § 262 (2013).

138. The merger price at which minority shareholders are cashed out is generally already a premium above the market price at which shareholders purchased the shares. Therefore, a judicially determined valuation beyond the merger price tacks an additional premium and therefore awards dissenters a windfall. *See* Goetz, *supra* note 122, at 787 n.58 (“[I]f corporate statutes allow [publicly traded] shareholders to receive a ‘fair value’ that is higher than the market price, the shareholders would receive a windfall.”).

the pool of viable opportunities for predatory arbitrageurs, while ensuring that minority shareholders remain protected in interested cash-out mergers. Yet, without also eliminating arbitrageurs' ability to seek appraisal for shares purchased after the record date, abuse of the remedy will likely persist.

B. Inviting the Wolves to Dinner: Post-Record Date Appraisal Rights

The 2007 *In re Appraisal of Transkaryotic Therapies* decision sparked the debate over appraisal arbitrage when it affirmed Delaware precedent that a dissenting shareholder may seek appraisal for shares acquired after the record date.¹³⁹ The court held that appraisal rights remain available under section 262 even when a dissenting shareholder (1) purchases his or her shares after the record date, (2) votes a portion of his or her shares in favor of the merger, and (3) cannot trace all of his or her shares to an abstention from or vote against the merger on the record date, as long as the record holder holds enough shares that were not voted in favor of the merger to cover the appraisal class.¹⁴⁰

More recently, *In re Appraisal of Ancestry.Com* (“*Ancestry I*”) affirmed these propositions, citing legislative intent in post-*Transkaryotic* amendments to section 262(e).¹⁴¹ On the same day, Vice Chancellor Sam Glasscock extended *Ancestry I* in *Merion Capital LP v. BMC Software, Inc.* (“*BMC I*”), holding that a shareholder who becomes a record owner *after* the record date need not trace his or her specific shares.¹⁴² As a certified record holder, Merion then participated in a

139. No. 1554-CC, 2007 WL 1378345, at *4–5 (Del. Ch. May 2, 2007); see *Appraisal Arbitrage: Will It Become a New Hedge Fund Strategy?*, *supra* note 95 (noting the case’s “potential to revolutionize the use of appraisal rights in cash mergers involving Delaware target companies”).

140. *In re Appraisal of Transkaryotic Therapies*, 2007 WL 1378345, at *4–5; see also *Merion Capital LP v. BMC Software, Inc.*, No. 8900-VCG, 2015 WL 67586, at *5 (Del. Ch. Jan. 5, 2015); *In re Appraisal of Ancestry.com, Inc.*, No. 8173-VCG, 2015 WL 66825, at *5 (Del. Ch. Jan. 5, 2015).

141. See *In re Appraisal of Ancestry.com*, 2015 WL 66825, at *6 (“Notably, when presented with occasion to reconsider the role of beneficial owners in appraisal actions in light of modern trading practices, the General Assembly decided to allow beneficial owners to file a petition in their own name . . .”). Vice Chancellor Sam Glasscock reasoned that, because the Delaware “General Assembly took no action to amend the statute in light of the [*In re Appraisal of Transkaryotic Therapies*] holding” that a beneficial owner need not prove the record owner did not vote the shares in question for the merger, Merion need not trace to a vote against or abstention from the merger for the *Ancestry* shares for which it sought appraisal. *Id.* at *6–7.

142. 2015 WL 67586, at *8. Unlike in *Ancestry I*, Merion was the record holder in *BMC I*. However, Merion did not become record holder until *after* the record date when the arbitrageur withdrew its shares from Cede upon learning the broker’s newfound policy against perfecting appraisal rights for such beneficial-owner arbitrageurs. *Id.* at *1–2. Cede’s refusal to perfect appraisal rights on Merion’s behalf may signal brokers—like many corporate defense firms—are growing tired of arbitrageurs. See *id.* at *2 (explaining that Merion sought to become record holder because Cede “refused [to perfect appraisal], citing a policy change within the broker company”).

back-dated vote that did not require perfection of its appraisal rights by a third party.¹⁴³ More notably, Vice Chancellor Sam Glasscock again relied on legislative intent in post-*Transkaryotic* amendments to section 262(e), condemning judicial legislation and punting policy-driven statutory reform to the Delaware legislature.¹⁴⁴ Like in *Ancestry I*, the Vice Chancellor reasoned that the General Assembly deliberately omitted a share-tracing requirement when amending section 262(e).¹⁴⁵

Delaware's approach to post-record date arbitrageurs presents several practical and policy concerns. First, as Vice Chancellor Sam Glasscock admitted in *BMC I*, the statute as-is could lead to absurdity where "the number of shares for which appraisal is sought exceed[s] the number not voted for the merger," eviscerating the fundamental requirement that dissenters not vote in favor of the merger.¹⁴⁶ Put differently, failing to read "a share-tracing requirement into the statute could allow a majority, or even all of a corporation's shares [to seek] appraisal, notwithstanding the fact that for a transaction to have been approved, at least a majority of the shares would have had to have been voted in favor of it."¹⁴⁷ For example, Cede holds all hundred of a corporation's outstanding shares in fungible bulk. Fifty-five of those shares ratify a merger on the record date, while forty-five vote against the merger. An arbitrageur then purchases forty-five shares on the open market—forty of which were beneficially owned by shareholders who voted in favor of the merger. The arbitrageur could nevertheless seek appraisal for forty-five shares voted (including those voted in favor of the merger)—an absurd result.

Moreover, affording appraisal rights to arbitrageurs who did not participate in the merger vote undermines the intent of the appraisal remedy. The appraisal remedy emerged to compensate dissenting

143. *See id.* Although the record date was a month before Merion became record holder, the merger vote did not occur until after Merion became record holder, thereby allowing Merion to participate in the back-dated vote. *Id.* Focusing on the record holder on the date of the merger vote rather than the record date, Vice Chancellor Glasscock held Merion did not vote in favor of the merger and therefore had standing for appraisal. *Id.* at *8.

144. *Id.* at *7 ("[R]elief more properly lies with the Legislature." (quoting *In re Appraisal of Transkaryotic Therapies*, 2007 WL 1378345, at *5)). As this Note shows in Section II.C.4, chancellors contradict their stance by engaging such judicial legislation in analyzing fair valuation.

145. *Id.* at *5–7.

146. *See id.* at *7 (conceding that "the General Assembly may not have picked a fail-safe method to achieve its goals"). Vice Chancellor Sam Glasscock also acknowledged the possibility of "a majority, or even all of a corporation's shares . . . seeking appraisal, notwithstanding the fact that . . . at least a majority of the shares . . . voted in favor of [the merger]." *Id.* at *7 (quoting Brief in Support of Respondent's Motion for Summary Judgment at 16–17, *Merion Capital LP v. BMC Software, Inc.*, No. 8900–VCG, 2015 WL 67586 (Del. Ch. Jan. 5, 2015)).

147. *Id.*

shareholders for their loss of ability to block mergers under a unanimous voting regime.¹⁴⁸ In other words, the appraisal remedy did not emerge to protect those without voting rights. Shareholders who do not (beneficially) own shares on the record date have no voting rights and therefore need not be compensated via the appraisal remedy. Accordingly, post-record date arbitrageurs circumvent the shareholder vote-appraisal quid pro quo contemplated in enacting the appraisal remedy.

Finally, by allowing opportunistic investors who purchase stock after the record date to seek appraisal, section 262 effectively allows arbitrageurs to reap high-risk returns without assuming high amounts of risk.¹⁴⁹ Usually, returns and risks are correlated: higher risks beget higher potential payoff. Appraisal arbitrageurs, however, are able to invert this relationship and gain an unwarranted advantage, thus decreasing risk while increasing potential upside.¹⁵⁰

First, arbitrageurs reduce risk by waiting until after the record date to purchase shares and seek appraisal because the risk of deal failure generally declines as the closing date draws nearer.¹⁵¹ Moreover, waiting beyond the record date gives arbitrageurs the valuable option to buy while decreasing informational risk by assessing new developments pertinent to their appraisal investment's prospective return.¹⁵² Meanwhile, voting record-date shareholders bear these informational and deal failure risks.¹⁵³ Accordingly, "appraisal arbitrageurs [have] the ability to 'free ride' during the period between

148. See, e.g., *In re Appraisal of Ancestry.com, Inc.*, No. 8173-VCG, 2015 WL 66825, at *3 (Del. Ch. Jan. 5, 2015) ("[R]ecognizing the need for give-and-take to compensate dissenting stockholders for their loss of the ability to block mergers, an appraisal remedy was provided by statute."); *supra* Section I.A (discussing the shareholder-voting impetus for the appraisal remedy).

149. See Jetley & Ji, *supra* note 36, at 430–31 (summarizing arbitrageurs' low-risk, high-return investment); *supra* Section I.D.1 ("Appraisal arbitrageurs generally value delaying their investment because it allows them to gather more information to make a better-informed decision, reducing risk and maximizing return.").

150. See Jetley & Ji, *supra* note 36, at 433–40 (discussing arbitrageurs' ability to minimize risk and maximize returns); *supra* Section I.D.1 (same).

151. See Jetley & Ji, *supra* note 36, at 433–40 (discussing the value of delay); *supra* Section I.D.1 (describing the benefits of arbitrageurs' ability to delay their investment).

152. See Jetley & Ji, *supra* note 36, at 433–39 (detailing the "free option" to buy target shares after collecting information); *supra* Section I.D.1 (examining the "fresh, valuation-relevant information" that arbitrageurs may obtain after the record date).

153. See, e.g., Jetley & Ji, *supra* note 36, at 440 ("[T]here does not seem to be an obvious economic argument for giving appraisal arbitrageurs the ability to 'free ride' during the period between the record date and the deal closing, allowing them to wait while factors that might affect the value of the target company and the deal risk evolve."); Norwitz, *supra* note 99 (explaining how arbitrageurs extract rents from other target shareholders); *supra* Section I.D.1 ("[E]xisting target shareholders shoulder the risk of merger nonconsummation or uncertain appraisal outcomes while arbitrageurs free ride at their expense.").

the record date and deal closing” at existing shareholders’ expense, while retaining the option to reap high returns afforded by Delaware’s inflated judicial valuations.¹⁵⁴

*C. Fish Out of Water: Judicial Valuation,
Conflated Standards, Political Sways, and Legislation*

Delaware judges are highly regarded for their sophistication in corporate matters,¹⁵⁵ but this expertise does not justify extending their role to that of an investment banker or legislator in appraisal proceedings. Because Delaware courts willingly—and sometimes unyieldingly—assume roles that exceed their skillset and authority, their judges often flounder to fuse their doctrinal expertise with these unfamiliar roles, resulting in detriment to merger parties and advantage to appraisal arbitrageurs. This Section explores the consequences of these ill-fitted judicial roles by (1) evaluating how Delaware’s judicial valuation methodology inflates merger awards in appraisal proceedings; (2) positing that Delaware courts inappropriately impose an elevated, quasi-*Revlon* standard in appraisal proceedings, and do so incorrectly; and (3) exposing Delaware courts’ self-contradicting legislative role in responding to political pressure by changing their fair value analyses.

1. Inflated Judicial Valuation

Delaware courts historically award above the merger price on average, which creates uncertainty in acquirers’ calculation of an appropriate merger price, invites appraisal arbitrage, and increases the postclosing risks associated with appraisal litigation.¹⁵⁶ Although appraisal petitioners should expect a premium award in interested transactions without a robust market check, Delaware courts have still awarded an average 3.4% premium in disinterested transactions since 2013.¹⁵⁷ Although the percentage may seem insignificant, this premium represents tens of millions of dollars in additional transaction costs,

154. Jetley & Ji, *supra* note 36, at 440; *supra* Section I.D.1.

155. Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1078 (“Delaware chancery judges are known for their expertise in business matters, and the court has developed a reputation for its sophistication in corporate law.”).

156. See Jetley & Ji, *supra* note 36, at 451–55 (discussing courts’ “preference for independent valuations over the merger price in determining fair value”).

157. See *supra* Sections I.D.1 and 2.

especially in tandem with the generous statutory interest rate.¹⁵⁸ Accordingly, buyers may either hold back value on the front end to cover feared post-closing appraisal litigation costs or demand an appraisal closing condition, thus eroding target shareholders' negotiated value and increasing risk of deal failure.¹⁵⁹ In addition to inflating target valuations in appraisal proceedings, Delaware courts have improperly used a higher level of scrutiny borrowed from fiduciary duty litigation, imposing a quasi-*Revlon* analysis of the merger consideration.

2. Improper Application of a Quasi-*Revlon* Analysis

A close analysis of judicial valuation in Delaware courts shows they interpret section 262(h) to impose a quasi-*Revlon* scrutiny in disinterested transactions, unduly burdening acquirers post-merger with a standard that sufficiently protects target shareholders pre-merger. Put differently, because target shareholders' merger value is adequately protected under the preclosing *Revlon* standard,¹⁶⁰ it is redundant, unnecessary, and unfair to require that acquirers meet a similar standard postclosing.¹⁶¹ Moreover, by awarding a premium on a merger price already within a range of reasonableness, Delaware courts are even unfaithful in their application of the *Revlon* doctrine.

Generally, in appraisal proceedings, Delaware judges rely on the merger price where (1) the target was shopped in a competitive sale process representing a full market check, and (2) the parties' competing financial valuation methodologies are particularly unreliable.¹⁶² In

158. Epstein et al., *supra* note 104. For example, though the disinterested merger in *Merion v. 3M Cogent* yielded only an 8.5% premium, the dollar value was approximately \$32.8 million (the difference between the merger and awarded price multiplied by the number of shares)—a significant award. Moreover, the statutory interest totaled an additional \$137 million (14.3%), totaling approximately \$170.6 million paid out by the acquirer. See *Merion Capital, LP v. 3M Cogent, Inc.*, No. 6247-VCP, 2013 WL 3793896, at *24–25 (Del. Ch. July 8, 2013) (discussing statutory interest at the legal rate); Epstein et al., *supra* note 92 (showing 3M Cogent merger premium and statutory interest of 8.5% and 14.3%, respectively).

159. See Norwitz, *supra* note 99 (“[W]hen they recognize these risks . . . buyers will seek to pass them on to target companies and their shareholders.”).

160. Note, however, that *Revlon* litigation oftentimes occurs after the merger closes. “Preclosing” simply refers to when the directors' challenged merger-related conduct occurs.

161. Though the same holds true for interested transactions and attendant preclosing entire fairness reviews, this analysis focuses on Delaware courts' *Revlon* scrutiny of disinterested transactions, which is less defensible given the lower probability of target shareholder oppression.

162. *E.g.*, *Merion Capital LP v. BMC Software, Inc.*, No. 8900-VCG, 2015 WL 6164771, at *14–15 (Del. Ch. Oct. 21, 2015) (discussing each side's valuation and the “robust, arm's-length sales process” conducted by BMC); *In re Appraisal of Ancestry.com*, No. 8173-VCG, 2015 WL 399726, at *23–24 (Del. Ch. Jan. 30, 2015) (finding the merger price to be “the best indicator of Ancestry's fair value”); *Huff Fund Inv. P'ship v. CKx, Inc.*, No. 6844-VCG, 2013 WL 5878807, at *10–13 (Del. Ch. Nov. 1, 2013) (relying on the merger price “as the best and most reliable indication

evaluating the first prong, however, Delaware courts impose a quasi-*Revlon* scrutiny standard reserved for fiduciary duty litigation about directors' preclosing conduct. The January 2015 *In re Appraisal of Ancestry.Com* ("*Ancestry II*") decision illustrates how Delaware courts employ a preclosing quasi-*Revlon* review postclosing by evaluating sales processes in appraisal proceedings for disinterested mergers. Put simply, *Revlon* requires a board of directors to maximize shareholder value when the corporation initiates an active bidding process or considers strategic alternatives in response to a bidder's offer.¹⁶³ Once *Revlon* duties exist, Delaware courts apply enhanced scrutiny, evaluating the reasonableness of directors' "business and financial considerations implicated in investigating and selecting the best value available."¹⁶⁴ Target directors meet this standard by "conducting an auction" or "canvassing the market,"¹⁶⁵ prompting the court to afford business judgment deference, even if the value-maximization choice was "not a perfect decision."¹⁶⁶ Accordingly, after deeming the *Ancestry II* auction sale process "reasonable" and "free from the taint of breaches of fiduciary duty," Vice Chancellor Sam Glasscock effectively deferred to the negotiated merger price—an analysis precisely mirroring the *Revlon* review.¹⁶⁷

But the May 2016 *In re Appraisal of Dell Inc.* decision suggests Delaware courts now impose a postclosing standard even greater than what *Revlon's* preclosing standard requires—which appears inconsistent with *Ancestry II*.¹⁶⁸ In *Dell*, Michael Dell and his private equity partner Silver Lake Management led a leveraged management buyout¹⁶⁹ "LMBO" of Dell Inc.¹⁷⁰ The LMBO included a forty-five-day

of CKx's value" after considering the unreliability of other valuation methods and the thoroughness of CKx's sale process).

163. *E.g.*, *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 39–47 (Del. 1993) (describing this "obligation of acting reasonably to seek the transaction offering the best value reasonably available to the stockholders").

164. *Id.* at 45.

165. *Id.* at 44.

166. *Id.* at 45.

167. *See In re Appraisal of Ancestry.com*, 2015 WL 399726, at *16 (holding the merger price fair because "[t]he sales process was reasonable, wide-ranging and produced a motivated buyer"). *But see generally In re Appraisal of Dell Inc.*, No. 9322–VCL, 2016 WL 3186538, *25–29 (Del. Ch. May 31, 2016) (contrasting the appraisal and breach of fiduciary duty inquiries). Though Vice Chancellor J. Travis Laster in *In re Appraisal of Dell Inc.* explicitly contrasted appraisal proceeding analyses with breach of fiduciary duty inquiries, *id.*, the Vice Chancellor nevertheless scrutinized the Dell sales process like a breach of fiduciary duty analysis, *id.* at *29–45.

168. *See generally In re Appraisal of Ancestry.com*, 2015 WL 399726.

169. An LMBO occurs when company management uses debt to buy the company they manage. *See, e.g.*, Iman Anabtawi, *Predatory Management Buyouts*, 49 U.C. DAVIS L. REV. 1285, 1288–89 (2015) (describing LMBOs).

170. *In re Appraisal of Dell Inc.*, 2016 WL 3186538, at *2.

postsigning go-shop¹⁷¹ period where the Dell special committee's financial advisors contacted sixty potential buyers, including strategics.¹⁷² Vice Chancellor Travis J. Laster conceded that Dell's "process easily would sail through if reviewed under [*Revlon's*] enhanced scrutiny, and that the "court could not hold that the directors breached their fiduciary duties or that there could be any basis for liability."¹⁷³ Even though the deal price was a nearly 30% premium and was within the range of DCF values provided by the Dell special committee's financial advisors,¹⁷⁴ the Vice Chancellor nevertheless awarded an additional 28% premium above the merger price.¹⁷⁵ Thus, Delaware courts in appraisal proceedings analyze targets' sales processes using a postclosing standard that *exceeds Revlon's* preclosing enhanced scrutiny standard, tending towards the most-searching entire fairness standard under *Weinberger*.¹⁷⁶

Arbitrageurs have forced Delaware courts' hands by improperly devolving appraisal proceedings to postclosing, quasi-*Revlon* or entire fairness reviews and burdening acquirers with substantiating a transaction under these steep, preclosing fiduciary duty class action standards. Shareholders can already test the adequacy of sales processes—and merger consideration by extension—preclosing under *Revlon* or entire fairness (if applicable), so Delaware courts need not—and should not—serve arbitrageurs by reopening this door postclosing. Further, when transactions pass *Revlon* scrutiny, courts should essentially bless the merger price as within a range of reasonableness.

Thus, a quasi-*Revlon* analysis proving that the merger price is within a range of reasonableness should end the matter. Yet, even when a postclosing, quasi-*Revlon* review warrants business judgment deference—adhering to the merger price as in *Ancestry II*—Delaware judges still miss the mark by independently valuing the target.

171. A postsigning go-shop is a market check that allows the target board to actively solicit offers from other potential buyers after signing a merger agreement with an initial buyer. See J. Russel Denton, *Stacked Deck: Go-Shops and Auction Theory*, 60 STAN. L. REV. 1529, 1529 (2008) (describing go-shops). Notably, the go-shop in *In re Appraisal of Dell Inc.* was a week longer than the average go-shop in similar financial-sponsor-backed transactions in 2015. Cf. Doug Warner & Sandra Rutova, *A Look at U.S. Sponsor-Backed Going Private Transactions*, WEIL, GOTSHAL & MANGES LLP (Aug. 12, 2016), <https://privateequity.weil.com/whats-market/look-u-s-sponsor-backed-going-private-transactions-2/> [<https://perma.cc/JB36-M7AM>] (showing go-shops in financial-sponsor-backed mergers in 2015 spanned an average of 38 days).

172. *In re Appraisal of Dell Inc.*, 2016 WL 3186538, at *14.

173. *Id.* at *29.

174. *Id.* at *12.

175. *Id.* at *1.

176. See *supra* text accompanying note 22.

3. Judicial Investment Banking

Notwithstanding the quasi-*Revlon* analyses suggesting an auction-generated merger price is—at worst—within a “range of reasonableness,”¹⁷⁷ Delaware judges insist on maintaining their valuation discretion and therefore reject deference to the merger price in *any* context.¹⁷⁸ Delaware judges thus continue to assume an investment banking role, conducting their own DCF analyses even when a robust sales process and reliable management projections exist.¹⁷⁹ Interestingly, Delaware judges often admit their limitations in valuing companies.¹⁸⁰ Their admitted valuation shortcomings, coupled with their almost exclusive reliance on the highly subjective DCF valuation method, unsurprisingly yield significant appraisal premiums in interested transactions where merger-price deference is less prevalent.¹⁸¹

Moreover, because negotiated, DCF-generated merger prices inherently “bake-in” synergies, control premiums, and illiquidity and minority discounts,¹⁸² Delaware judges still undermine statutory fair valuation when awarding the merger price in disinterested mergers.

177. *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 45 (Del. 1993) (“Thus, courts will not substitute their business judgment for that of the directors, but will determine if the directors' decision was, on balance, within a range of reasonableness.”).

178. *See e.g.*, *Merion Capital LP v. BMC Software, Inc.*, No. 8900-VCG, 2015 WL 6164771, at *11 (Del. Ch. Oct. 21, 2015) (“[T]his Court has the latitude to select one of the parties' valuation models as its general framework, or fashion its own, to determine fair value.”); *Huff Fund Inv. P'ship v. CKx, Inc.*, No. 6844-VCG, 2013 WL 5878807, at *12 (Del. Ch. Nov. 1, 2013) (rejecting “call to establish a rule requiring the Court of Chancery to defer to the merger price in any appraisal proceeding” even when facing “a pristine, unchallenged transactional process” (quoting *Golden Telecom, Inc. v. Glob. GT LP*, 11 A.3d 214, 218 (Del. 2010))).

179. *E.g.*, *In re Appraisal of Ancestry.com*, No. 8173-VCG, 2015 WL 399726, at *19–24 (Del. Ch. Jan. 30, 2015) (conducting a DCF valuation where sales process was “robust,” while acknowledging “management is uniquely situated” to produce reliable projections).

180. *See, e.g.*, *Golden Telecom, Inc. v. Glob. GT LP*, 11 A.3d 214, 218 (Del. 2010) (“[I]t is difficult for the Chancellor and Vice Chancellors to assess wildly divergent expert opinions regarding value”); *In re ISN Software Corp. Appraisal Litig.*, No. 8388-VCG, 2016 WL 4275388, at *8 (Del. Ch. Aug. 11, 2016) (“[R]elying on the mathematical skill of this superannuated history major—even as assisted by an able judicial clerk—would be hubristic.”); *In re Appraisal of Dell Inc.*, No. 9322-VCL, 2016 WL 3186538, at *22 (Del. Ch. May 31, 2016) (“The statutory obligation to make a single determination of a corporation's value introduces an impression of false precision into appraisal jurisprudence.”); *In re Appraisal of Ancestry.com*, 2015 WL 399726, at *19 (“I freely admit that the formulas did not spring form [sic] the mind of this judge, softened as it has been by a liberal arts education.”); *Union Ill. 1995 Inv. Ltd. P'ship v. Union Fin. Grp.*, 847 A.2d 340, 359 (Del. Ch. 2003) (“For me (as a law-trained judge) to second-guess the price . . . involves an exercise in hubris and, at best, reasoned guess-work.”).

181. *See In re Appraisal of Dell Inc.*, 2016 WL 3186538, at *45–51 (addressing the DCF analysis and its relationship with the merger price).

182. *See supra* Section I.B.3 for additional details regarding the role of synergies, control premiums, and illiquidity and minority discounts in merger valuation.

Section 262(h) prohibits consideration of “value arising from the accomplishment or expectation of the merger,” which includes synergies, control premiums, and illiquidity and minority discounts.¹⁸³ Delaware judges have been reluctant to analyze and “back out” these values, passing this burden to merger parties¹⁸⁴ or accepting a proposed adjustment without discussion.¹⁸⁵ Delaware judges’ gun-shy or absent analysis of synergies would be palatable but for their insistence on maintaining unchecked discretion in judicial valuation under section 262(h). Accordingly, by refusing to surrender any discretion while generating incomplete, inflated, and hardly “fair” valuations, Delaware courts invite appraisal arbitrageurs to extract rents from merger parties by exploiting methodology gaps in judicial valuation. Equally troubling is how this discretion has resulted in Delaware judges assuming a legislative role in response to political pressure, revealing a concerning inconsistency between what the judges say they cannot do—legislate—and what they actually do—legislate.

4. Judicial Legislation and Political Sways

Although Vice Chancellor Sam Glasscock eschewed judicial legislation by declining to limit appraisal rights to record-date shareholders,¹⁸⁶ Delaware chancellors assume a legislative role in valuing merger targets in appraisal proceedings. In *Ancestry I*, Vice Chancellor Sam Glasscock noted that “appraisal rights are a creation of the legislature, not judge-made law,” allowing appraisal arbitrage to persist despite practical concerns and threats to policy goals underlying the appraisal remedy.¹⁸⁷ Delaware chancellors’ reactionary approach in determining fair value under section 262(h), however, reveals a tacit, politically driven willingness to affect substantive appraisal rights through judicial legislation.

Analyzing recent appraisal proceedings shows Delaware courts’ mercurial fair valuation doctrine, which uses their statutorily granted

183. See BALOTTI & FINKELSTEIN, *supra* note 7, § 9.45 (discussing prohibited valuation considerations in Delaware appraisal proceedings).

184. See *Merlin Partners LP v. AutoInfo, Inc.*, No. 8509–VCN, 2015 WL 2069417, at *16 (Del. Ch. Apr. 30, 2015) (placing the burden on the merger parties to back out cost synergies).

185. See *LongPath Capital, LLC v. Ramtron Int’l Corp.*, No. 8094–VCP, 2015 WL 4540443, at *26 (Del. Ch. June 30, 2015) (subtracting nominal synergy from the merger price because the court found this approach, as suggested by LongPath, to be “reasonable”).

186. See *supra* Section II.B and accompanying sources (discussing Vice Chancellor Sam Glasscock’s holding in *BMC D*).

187. See *supra* Section II.B (citing *In re Appraisal of Ancestry.com*, No. 8173–VCG, 2015 WL 66825, at *4 (Del. Ch. Jan. 5, 2015) (discussing Vice Chancellor Sam Glasscock’s reluctance to legislate away arbitrage).

discretion to conform their approach with the political climate, rather than the factual circumstances at issue.¹⁸⁸ Before 2010, Delaware courts considered the merger price indicative of fair value. In *Union Illinois v. Union Financial Group*, then-Vice Chancellor Leo Strine deemed the merger price fair, noting that “(as a law-trained judge) to second-guess the price that resulted from that [sales] process involves an exercise in hubris and, at best, reasoned guess-work.”¹⁸⁹ In 2010, however, chancellors reversed course to recapture substantial discretionary power. In *Golden Telecom Inc. v. Glob. GT LP*, the Delaware Supreme Court rejected deference to the merger price, reasoning that such deference would “contravene the unambiguous language of the statute” and “inappropriately shift the responsibility to determine ‘fair value’ from the court to the private parties.”¹⁹⁰ Accordingly, though Delaware did not amend section 262(h) fair valuation between *Union* and *Golden Telecom*, Delaware judges reclaimed broad judicial discretion.

Unsurprisingly, the reestablished discretion in fair valuation following 2010’s *Golden Telecom* affected parties’ substantive appraisal rights, increasing judicially awarded merger premiums through the third quarter of 2013.¹⁹¹ However, in November 2013—the same month Dole’s CEO began lobbying for reform¹⁹²—Delaware courts backpedaled toward relying on the merger price. *Huff Fund Inv. P’Ship v. CKx, Inc.* demonstrates this shift.¹⁹³ In that case, Vice Chancellor Sam Glasscock deemed the merger price appropriate given unreliable DCF assumptions and an adequate sales process.¹⁹⁴ Almost two years later—and only two days after a Wachtell, Lipton, Rosen, & Katz partner’s publicized call for legislative reform to curb appraisal arbitrage—Chief Justice Strine affirmed the *CKx* decision, going as far as lauding deference to merger price: “[Y]ou can think you’re smarter than the market, but . . . you’re not, and the best indication of market value is in

188. Delaware courts refused to defer to the merger price before anti-arbitrage lobbying intensified in 2013 when the courts softened their perspective. For an illustration of this temporal shift, compare *Golden Telecom, Inc. v. Glob. GT LP*, 11 A.3d 214, 217–19 (Del. 2010), where the court forbade deference to the merger price in a disinterested merger with a sufficient market check, with *Huff Fund Inv. P’ship v. CKx, Inc.*, No. 6844-VCG, 2013 WL 5878807, at *11–15 (Del. Ch. Nov. 1, 2013), where the court embraced the merger price under similar facts.

189. 847 A.2d 340, 359 (Del. Ch. 2004).

190. *Golden Telecom*, 11 A.3d at 218.

191. Epstein, *supra* note 104.

192. See *supra* Section I.E for details regarding the lobbying efforts of Dole’s CEO.

193. See *CKx*, 2013 WL 5878807.

194. *Id.* at *10–15.

fact a market check.”¹⁹⁵ Accordingly, by responding to anti-arbitrage sentiment in resurrecting reliance on the merger price in fair valuation, the Delaware courts have engaged in the judicial legislation they condemned in *Ancestry I* and *BMC I*.¹⁹⁶

Though improper and self-contradictory, this quasi-legislative doctrinal shift towards merger-price deference is a welcome—but insufficient—start towards mitigating appraisal arbitrage.¹⁹⁷ Moreover, section 262 remains economically lucrative to predatory arbitrageurs and practically hazardous to merger parties, even with the recently adopted amendments.¹⁹⁸ As discussed, unaddressed arbitrage-fueling issues would still remain: the market-out exception’s cash carve-out invites arbitrageurs exclusively targeting cash-financed transactions;¹⁹⁹ allowing appraisal for shares purchased after the record date advantages arbitrageurs at merger parties’ expense, undermining the remedy’s policy rationales;²⁰⁰ and burdening Delaware judges with highly technical valuation allows arbitrageurs to exploit inflated judicial valuations and inconsistent doctrinal application. Accordingly, the Council should recapture its legislative responsibilities from the court and implement the statutory amendments proposed below, addressing the aforementioned issues, ending appraisal arbitrage, and restoring the integrity of the appraisal remedy and Delaware’s corporate-haven status.

III. DON’T BITE THE HAND: PROPOSED REFORMS NECESSARY TO CURB APPRAISAL ARBITRAGE

Delaware should not bite the hand that feeds it; with Delaware companies and prominent corporate defense counsel threatening to

195. Oral Argument at 8:23, *Huff Fund Inv. P’ship v. CKx, Inc.*, No. 348, 2014, 2015 WL 631586 (Del. Feb. 12, 2015), <http://livestream.com/DelawareSupremeCourt/events/3801168/videos/76805879> [<https://perma.cc/QEA8-7EXA>].

196. See *supra* Section II.B (characterizing the courts in each case as “condemning judicial legislation and punting policy-driven statutory reform to the Delaware legislature”).

197. Notwithstanding this trend, Vice Chancellor J. Travis Laster in *In re Appraisal of Dell Inc.* “fails to give weight to the result of a full and fair sale process of the market’s expectations” by rejecting the merger price. In re: *Appraisal of Dell Inc.: Delaware Court of Chancery Determines Fair Value Is 28% Higher Than Merger Price Following an Auctioned Arm’s-Length MBO*, SULLIVAN & CROMWELL LLP 1 (June 13, 2016), <https://sullcrom.com/in-re-appraisal-of-dell-inc-delaware-court-of-chancery-determines-fair-value-is-28-higher-than-merger-price-following-an-auctioned-arms-length-mbo> [<https://perma.cc/3G4S-BX8E>] (discussing *In re Appraisal of Dell Inc.*).

198. See *supra* Section I.F for a discussion on the proposed amendments to § 262.

199. See *supra* Section II.A (proposing changes to Delaware’s cash carve-out exception “[b]ecause appraisal arbitrageurs exclusively target cash-financed transactions”).

200. See *supra* Sections I.D.1, II.B (discussing the effects of allowing appraisal for shares bought after the record date).

reincorporate elsewhere, the State must take action to restore its reputation as an incorporation haven. To do so, the State must sanitize appraisal arbitrage, thereby realizing the appraisal remedy's intentions and sanctifying the judiciary's intended role. Therefore, this Part proposes statutory reforms that rectify the practical, arbitrage-inciting concerns in Delaware's appraisal statute discussed above. While the interest reduction and de minimis amendments are commendable, additional statutory amendments are necessary to curb the appraisal arbitrage phenomenon. Accordingly, this Part advocates that Delaware further amend the statute to narrow the cash carve-out to the market-out exception, thereby constricting cash-hungry arbitrageurs' opportunities. Moreover, Delaware should limit appraisal rights to beneficial shareholders as of the record date, thus lessening arbitrageurs' risk advantage. Finally, this Part proposes shifting appraisal valuation responsibility from chancellors to independent finance professionals, ending arbitrageurs' ability to exploit inflated judicial valuations.

*A. The Price Is Right: Confine the Cash Carve-Out
to the "Market-Out" Exception to Interested Transactions*

Delaware should join eleven MBCA states in narrowing the market-out exception's cash carve-out to only interested transactions, where the market price of minority shares is less likely to be accurate and a greater risk of target-shareholder oppression exists. Because an efficient market accurately prices publicly traded shares and often does so at a premium for disinterested cash-financed mergers, appraisal protection is unnecessary.²⁰¹ More importantly, appraisal arbitrageurs are short-term investors who do not target stock-financed mergers. Unsurprisingly, in 2015, all arbitrageur-led appraisal proceedings for disinterested mergers involved 100% cash consideration.²⁰² Because arbitrageurs target accurately priced public target shares in disinterested, cash-financed mergers, eliminating section 262(b)(2)'s cash carve-out for disinterested mergers would therefore eliminate disinterested-merger appraisal arbitrage while retaining necessary minority shareholder rights in interested transactions.

201. Delaware courts have awarded the merger price in all disinterested public-target transactions in 2015, suggesting the court agrees with this proposition. *See* Epstein, *supra* note 92. *See also* Section II.A for an extensive discussion on why the cash carve-out is unnecessary in disinterested, cash-financed transactions.

202. *See* Epstein, *supra* note 92.

B. Limit Appraisal Rights to Shareholders as of the Record Date

Although the aforementioned proposals would limit arbitrage activity for disinterested mergers, arbitrageurs could still extract rents from minority shareholders and acquirers and engender potential absurdity in interested transactions.²⁰³ The Delaware Council should therefore heed prominent corporate defense firms' call for statutory reform by limiting appraisal rights to those who owned shares on the record date.

Limiting appraisal rights to shares held as of the record date would (a) prevent absurd outcomes in appraisal proceedings, (b) limit the value transfer from acquirers to arbitrageurs, and (c) eliminate arbitrageurs' unfair risk-reduction advantages over target shareholders.²⁰⁴ First, because arbitrageurs often seek appraisal for shares purchased after the record date, absurd outcomes are possible in which the number of shares seeking appraisal exceeds the number of shares voted in favor of the merger.²⁰⁵ Limiting appraisal rights to shares on the record date would therefore guarantee appraisal rights for shares that *indisputably* did not vote in favor of a merger.

Second, arbitrageurs' "wait-and-see" approach imposes transaction costs on acquirers bearing risks of deal failure, threatened appraisal action, and a probable premium payout in an appraisal proceeding.²⁰⁶ The proposed record-date cutoff would erode the value of arbitrageurs' prolonged buy option by decreasing the period within which they may evaluate their appraisal investment, which in turn decreases acquirers' temporal exposure to significant, appraisal-related transaction risks. The announcement-record date interim should still afford dissenting shareholders ample opportunity to evaluate the merger consideration and determine whether appraisal is appropriate. On the other hand, merger proxy materials, which detail information pivotal in contemplating appraisal action, are generally mailed *after* the record date. Arbitrageurs would therefore lack information pertinent to contemplating appraisal litigation. However, because other target shareholders also lack such information, depriving arbitrageurs of this information rightfully levels the playing field.

Allowing appraisal rights for shares purchased after the record date unjustly awards arbitrageurs an informational advantage over

203. See *supra* Section II.B.

204. See *supra* Section II.B for further discussion of these concerns.

205. See *supra* Section II.B.

206. See *supra* Section II.B.

record holders.²⁰⁷ While existing target shareholders must shoulder significant deal risks by contemplating appraisal before receiving merger proxy materials, arbitrageurs bear reduced risk by sitting on the sidelines and analyzing merger information before deciding to pull the appraisal trigger.²⁰⁸ Because appraisal rights exist to protect voting shareholders, voting shareholders should not bear greater risks than free riding arbitrageurs. Accordingly, Delaware should limit appraisal rights to shares held on the record date to ensure all dissenting shareholders bear similar risks in contemplating appraisal, rendering arbitrageurs less likely to pursue opportunistic appraisal.

C. Appraisal Arbiters: Delegate Fair Value Determination to Independent Finance Professionals

Finally, the Council should amend section 262(h) to require a three-appraiser panel of independent valuation experts in appraisal proceedings, restoring certainty and fairness in Delaware courts and relieving judges of their current, ill-suited legislative and investment banking duties. Delaware judges' inconsistency in appraisal valuation engenders deal uncertainty for acquirers.²⁰⁹ More importantly, their tendency to award windfall premiums in appraisal proceedings invited arbitrageurs, spurring backlash that threatens Delaware's status as a corporate haven.²¹⁰ Despite Delaware courts' attempts to resist judicial policymaking,²¹¹ the current judicial-omnipotence approach to determining fair value forces judges to misapply doctrinal precedent and adopt legislative roles in futile attempts to appease revenue-generating players in the state.²¹² Requiring independent valuation experts under section 262(h)'s fair value determination would reduce inconsistent, windfall premiums in appraisal proceedings, decreasing arbitrage activity and restoring corporations' faith in Delaware.

Using a court-appointed independent expert would not be unprecedented in Delaware.²¹³ Moreover, the Delaware Supreme Court

207. *Supra* Section II.B.

208. See *supra* Section II.C for a discussion on Delaware courts' inconsistency in determining fair value under § 262(h).

209. See *supra* Sections I.B.3, II.C.1, 3.

210. See *supra* Sections II.C.1, 3.

211. See *supra* Section II.B (declining judicial legislation in context of requiring share tracing for appraisal rights).

212. See *supra* Section II.C.1 (discussing improper judicial application of a quasi-*Revlon* analysis).

213. See Randall S. Thomas, *Revising the Delaware Appraisal Statute*, 3 DEL. L. REV. 1, 26 (noting "the Delaware Supreme Court's repeated recommendations to the Delaware Chancery Court to employ independent court-appointed experts" in appraisal proceedings (citing *In re Shell*

has contemplated this requirement: “[W]e believe the time has come for the Court of Chancery to avail itself of such a practice whenever it believes that a more objective presentation of evidence is required, particularly in valuation matters.”²¹⁴ Considering the consistent impasse between competing valuation experts in appraisals, objective and accurate expertise should be welcomed.

The selected panel of experts must further objectivity, accuracy, and predictability in fair valuation. First, the court-appointed experts should be independent, without any current or prospective business with the petitioner or acquirer in the proceeding, therefore meeting the objectivity goal. Second, experts should be a mix of accounting or finance practitioners and academics, ensuring competing perspectives more likely to yield accurate valuations. Additionally, the panel’s expertise should be specific to the target’s industry and buyer’s profile, allowing use of valuation methodologies best suited for the merger parties, rather than deferring to the volatile DCF approach in every proceeding. Appointing an independent panel of experts would relieve “liberal arts” chancellors of their quantitative burden in valuation, which will increase valuation certainty and therefore decrease transaction costs for merger parties and impede arbitrage.

However, Delaware courts need not surrender *all* discretion—a power its judges have been reluctant to yield.²¹⁵ Accordingly, Delaware judges should retain primary gatekeeping responsibilities in excluding unreliable evidence.²¹⁶ Moreover, because chancellors have demonstrated expertise in assessing procedural fairness in *Revlon* and “entire fairness” proceedings, the court should still assess the adequacy of sales processes as indicators of substantive fairness. To ensure acquirers are not subject to the full burden of preclosing *Revlon* scrutiny, judges should further confine this review to *procedural* aspects simply to confirm no unfairness existed in negotiating the merger price. Finally, though both parties should share expert costs, chancellors should have discretion to place the entire cost on one party for frivolous petitioner-target claims or egregiously oppressive defendant-acquirer merger pricing. In any event, quantitative responsibilities should be delegated to independent experts.

Oil Co., 607 A.2d 1213, 1223 (Del. 1992) (discussing other uses of independent experts in Delaware courts))).

214. *In re Shell Oil Co.*, 607 A.2d at 1223.

215. See *supra* Section III.C for a discussion on Delaware court discretion.

216. *M.G. Bancorporation, Inc. v. Le Beau*, 737 A.2d 513, 521 (Del. 1999) (holding that chancellors’ evidentiary gatekeeping functions extend to fair valuation).

CONCLUSION

In sum, Delaware has brought a knife to a gunfight. Judicial legislation and valuation and the Council's recent amendments are insufficient to curb appraisal arbitrage, threatening Delaware's status as a corporate haven and undermining the appraisal remedy. More importantly, this reactionary hodgepodge of solutions—or lack thereof—may actually feed predatory arbitrage activity. Accordingly, Delaware should implement additional amendments to decrease opportunistic appraisal litigation.

First, because market pricing is no less efficient in a merger using cash consideration, the cash carve-out to the “market-out” exception should be confined to interested transactions, thereby ending publicly traded appraisal arbitrage while protecting minority shareholders in cash-out mergers. Second, because post-record date dissenters are often appraisal arbitrageurs, Delaware should limit appraisal rights to shareholders as of the record date. Finally, Delaware should retreat from its judge-centered fair valuation approach by delegating valuation responsibilities to independent finance professionals better suited to value target companies.

Appraisal arbitrage is singular in purpose—to make money—but multifaceted in the factors that contribute to achieve that end. Delaware should therefore pursue a varied but calculated approach to achieve its singular goal—closing arbitrage avenues to restore faith in the appraisal remedy and Delaware corporate law. Adopting the aforementioned solutions will plug arbitrageurs' profit channels, thereby eliminating appraisal arbitrage, rehabilitating the appraisal remedy, and reinforcing Delaware's status as the undisputed corporate haven.

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