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THE SHAREHOLDERS' APPRAISAL REMEDY AND HOW COURTS DETERMINE FAIR VALUE

BARRY M. WERTHEIMER†

Corporations created under modern corporation statutes are democratic organizations, subject to majority rule. As a result, minority shareholders are vulnerable to abuse at the hands of the majority.¹ For example, majority shareholders may take actions that have the short-term effect of depressing the price of a corporation's stock, in order to acquire the minority's interest in the corporation at an artificially low price.

Minority shareholders are granted limited statutory rights as a check against rampant majority rule. One such right is the ability of shareholders to dissent from certain corporate actions, primarily mergers and other fundamental corporate changes,² and to receive

† Associate Professor of Law, University of Tennessee College of Law. B.S. 1980, University of Florida; J.D. 1985, Duke University. The research for this Article was supported by a grant from the UTK Professional Development Award Program and funding from the W.W. Davis Faculty Development Fund. I would like to thank Brannon Denning and D. Jay Sumner for their valuable research assistance, and James D. Cox, Deborah A. DeMott, Robert W. Hamilton, Donald C. Langevoort, and John C. Weistart for their useful comments on an earlier draft of this Article.

1. Corporate law, unlike partnership law, does not permit an equity owner to dissolve the entity at will. See UNIF. PARTNERSHIP ACT § 801(1) (1994); UNIF. PARTNERSHIP ACT § 31(1)(b) (1914) (superceded 1994). The combination of majority rule and lack of liquidity makes minority shareholders in a closely-held corporation particularly vulnerable. The plight of minority shareholders in closely-held corporations has been well documented. See generally F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS (2d ed. 1985).

2. Under the Model Business Corporation Act (MBCA or Model Act), the following events trigger the availability of the appraisal remedy: 1) consummation of a plan of merger; 2) consummation of a plan of share exchange; 3) consummation of a sale or exchange of all, or substantially all, of the property of the corporation outside of the usual and regular course of

the appraised fair value of their shares.³ This is sometimes known as the dissent and appraisal remedy, dissenters' rights, or, simply, the appraisal remedy.⁴ Every state corporate statute contains at least some form of appraisal remedy,⁵ yet the proper role the appraisal remedy should play in corporate law remains elusive.

The efficacy of the appraisal remedy, as well as the purpose it serves, has been much debated.⁶ The origin of the appraisal remedy typically is tied to the move in corporate law to majority approval of fundamental corporate changes, and away from a requirement of unanimous shareholder consent. When unanimous approval was no longer required, and shareholders effectively lost their individual right to veto corporate changes, the appraisal remedy was provided

business; and 4) certain amendments to the corporation's articles of incorporation. See MODEL BUS. CORP. ACT § 13.02(a) (1991). Nineteen states have statutes that closely follow the Model Act. See MODEL BUS. CORP. ACT ANN. introduction at xli (Supp. 1996). Under Delaware law, only merger or consolidation transactions give rise to appraisal rights. See DEL. CODE ANN. tit. 8, § 262 (1991 & Supp. 1996). Virtually all states agree that mergers and consolidations should give rise to appraisal rights. See MODEL BUS. CORP. ACT ANN. § 13.02 statutory comparison 1.a. Outside of those two areas, however, state corporation statutes fail to agree on the events that should trigger appraisal rights. See *id.* § 13.02 statutory comparison 1.b.-f.

3. See DEL. CODE ANN. tit. 8, § 262; MODEL BUS. CORP. ACT § 13.02(a). Minority shareholders also are protected by doctrines that are largely derived from common law, particularly the fiduciary duties that apply to directors. See 2 O'NEAL & THOMPSON, *supra* note 1, § 7.02, at 5.

4. Under most corporate statutes, it is no longer necessary to actually vote against the action taken; rather, it is sufficient if the shareholder electing the appraisal remedy abstains from voting on the proposed action. See MODEL BUS. CORP. ACT § 13.21(a)(2) & cmt.; see also Mary Siegel, *Back to the Future: Appraisal Rights in the Twenty-First Century*, 32 HARV. J. ON LEGIS. 79, 133 & n.252 (1995) (noting that only the state of Louisiana requires a shareholder to actually dissent to be eligible for an appraisal remedy).

5. See MODEL BUS. CORP. ACT ANN. § 13.02 statutory comparison 1(a) (noting that all jurisdictions grant an appraisal remedy in at least some merger situations); 2 AMERICAN LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS 292 (1994) [hereinafter ALI, PRINCIPLES] (stating that every American state has some form of appraisal remedy); see also Don S. Clardy, Comment, *Valuation of Dissenters' Stock Under the Appraisal Remedy—Is the Delaware Block Method Right for Tennessee?*, 62 TENN. L. REV. 285, 285 & n.3 (1995) (citing the appraisal remedy statutes for all fifty states and for the District of Columbia).

6. For a sampling of the debate, see MELVIN A. EISENBERG, *THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS* 69-84 (1976); Daniel R. Fischel, *The Appraisal Remedy in Corporate Law*, 1983 AM. B. FOUND. RES. J. 875, 875-84; Hideki Kanda & Saul Levmore, *The Appraisal Remedy and the Goals of Corporate Law*, 32 UCLA L. REV. 429 (1985); Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 226-62 (1962); Joel Seligman, *Reappraising the Appraisal Remedy*, 52 GEO. WASH. L. REV. 829, 829-64 (1984); Siegel, *supra* note 4, at 82-86, 93-111; Robert B. Thompson, *Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law*, 84 GEO. L.J. 1, 3-5, 9-42 (1995); Barry M. Wertheimer, *The Purpose of the Shareholders' Appraisal Remedy*, 65 TENN. L. REV. (forthcoming 1998) (manuscript on file with the *Duke Law Journal*).

to them in return. Thus, the historical explanation for the existence of the appraisal remedy is as a quid pro quo for the loss of shareholders' right to veto fundamental corporate changes.⁷

The companion historical purpose ascribed to the appraisal remedy is a liquidity function.⁸ In the absence of an appraisal remedy, a shareholder opposed to a fundamental corporate change could nonetheless be forced, by majority approval of the other shareholders, to remain an investor in an enterprise that no longer resembled the original investment made by that shareholder. The appraisal remedy provides liquidity to a shareholder and a "way out" of an involuntarily altered investment.

The nature of fundamental corporate transactions has changed, however, and the appraisal remedy now serves different purposes.⁹ Majority rule of corporations is the established norm; providing an appraisal remedy to compensate shareholders for their loss of a veto right may provide an historical explanation for the appraisal remedy, but it lacks explanatory power for the remedy's continued existence. Similarly, very few current appraisal cases evidence the historic liquidity function of the appraisal remedy.¹⁰ On the other hand, in most jurisdictions it now is possible to engage in a fundamental transaction for the sole purpose of "cashing out" or eliminating minority shareholders.¹¹ As a result, the focus of the appraisal remedy has shifted. Most of the current appraisal litigation involves cash-out mergers, often instituted by a controlling shareholder.¹² The ap-

7. See *Voeller v. Neilston Warehouse Co.*, 311 U.S. 531, 535 n.6 (1941); *Steinberg v. Amplica, Inc.*, 729 P.2d 683, 687 (Cal. 1986) (en banc); Wertheimer, *supra* note 6, at 8.

8. See Thompson, *supra* note 6, at 18; Wertheimer, *supra* note 6, at 10.

9. For a complete discussion of the purposes now served by the appraisal remedy and how those purposes have changed over time, see generally Wertheimer, *supra* note 6. For the most part, of course, appraisal statutes read much as they did when they were first enacted. The different context in which most appraisal proceedings arise today, however, indicates that the remedy is now performing a different function than it did at an earlier time. See *id.*

10. See *id.* at 28-29.

11. For a discussion of the evolution of the "cash-out" merger, see generally Elliott J. Weiss, *The Law of Take Out Mergers: A Historical Perspective*, 56 N.Y.U. L. REV. 624 (1981). Professor Weiss labels this type of merger a "take out merger." See *id.* at 625; see also Wertheimer, *supra* note 6, at 22 (noting that the number of cash-out mergers for the sole purpose of eliminating minority shareholders began to increase in the 1970s, spurred by low stock prices and more permissive corporate statutes and interpretations of those statutes).

12. See Thompson, *supra* note 6, at 4. Indeed, Professor Thompson has concluded that 80-90% of recent appraisal litigation involves a cash-out merger. See *id.* at 25-28; see also Wertheimer, *supra* note 6, at 22 (observing increase in incidence of cash-out mergers to eliminate minority shareholders instigated by controlling shareholders).

praisal remedy today serves a minority shareholder protection role, sometimes providing liquidity to shareholders, but most often operating to protect minority shareholders who are cashed out of their investment. The remedy fulfills this function *ex ante*, deterring insiders from engaging in wrongful transactions,¹³ and *ex post*, providing a remedy to minority shareholders who are subjected to such transactions.¹⁴

Although the appraisal remedy has been available for quite some time, it has only recently seen much use.¹⁵ There are several explanations for the recent upsurge in appraisal litigation,¹⁶ but the changes brought about by the Delaware Supreme Court's landmark opinion in *Weinberger v. UOP, Inc.*¹⁷ surely account for some, if not much, of this increased activity.¹⁸ *Weinberger* apparently was intended to revamp the appraisal remedy so that shareholder challenges to merger transactions would be efficiently resolved in an appraisal proceeding, rather than some other form of legal challenge to the transaction.¹⁹ Toward that end, the court in *Weinberger* did three

13. See Fischel, *supra* note 6, at 878-81; Wertheimer, *supra* note 6, at 24-27.

14. See Wertheimer, *supra* note 6, at 24-27. Additionally, it has been noted that the appraisal remedy serves a "discovery" function, providing a mechanism for shareholders to uncover wrongful behavior. See Kanda & Levmore, *supra* note 6, at 443-44, 455-57, 463-65, 473 (discussing the discovery function of the appraisal remedy); Wertheimer, *supra* note 6, at 13-15, 38-39 (same).

15. See, e.g., EISENBERG, *supra* note 6, at 75 (noting that Ohio had enacted "rudimentary" appraisal statutes as early as 1851-52); Thompson, *supra* note 6, at 14-15 (noting that the first appraisal statutes appeared in the late nineteenth century, but did not become ubiquitous until the second half of the twentieth century); see also *infra* note 70 and accompanying text.

16. See *infra* Part I.B.

17. 457 A.2d 701 (Del. 1983).

18. Most state statutes, including those based on the Model Business Corporation Act, do not provide much guidance to courts with respect to how to determine fair value in an appraisal proceeding. See *infra* notes 72-75 and accompanying text. Among the states, Delaware has generated the largest body of case law with respect to the determination of fair value. Moreover, because Delaware is the preferred state of incorporation for a disproportionate number of U.S. corporations, see 1 ARTHUR FLEISCHER, JR. & ALEXANDER R. SUSSMAN, TAKEOVER DEFENSE § 4.01 (5th ed. 1997) (noting that over half of America's largest public corporations are incorporated in Delaware), the decisions of Delaware state courts on matters of corporate law, in general, and appraisal litigation, in particular, are very influential nationwide. Accordingly, this Article focuses largely on Delaware case law interpreting the appraisal remedy.

19. The most common way to object to a merger transaction, outside of an appraisal proceeding, is to allege that the officers, directors, or shareholders of the corporation breached a fiduciary duty in approving or recommending the transaction. See, e.g., *Smith v. Van Gorkom*, 488 A.2d 858, 872-73 (Del. 1985) (alleging directors breached fiduciary duty by failing to exercise due care in approving cash-out merger). A shareholder making such an allegation might seek injunctive relief, thus preventing the merger from going forward, see, e.g., *Sealy Mattress Co. v. Sealy, Inc.*, 532 A.2d 1324, 1326 (Del. Ch. 1987), or damages, see, e.g., *Cede & Co. v.*

things. First, it eliminated the ability of shareholders to challenge a merger on the ground that it was not undertaken for a valid business purpose.²⁰ Second, the court stated that the appraisal remedy should ordinarily be the exclusive remedy available to a shareholder objecting to a merger.²¹ Finally, and perhaps most importantly, in order to make this now generally exclusive appraisal remedy workable and fair, the court abandoned the inflexible "Delaware block" method of valuation as the exclusive means of establishing fair value.²² Instead, courts were directed to take a "more liberal approach [that] must include proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court."²³

In order for the appraisal remedy to fulfill its current purpose of protecting minority shareholders, most often in connection with cash-out mergers, it must be administered in a manner consistent with that purpose. The changes adopted in *Weinberger* have advanced this goal, but there are problems with the appraisal remedy that must be solved if it is to be fully effective. This will require amendments to existing appraisal statutes, accompanied by changes in the way that courts determine the fair value of shares in appraisal proceedings.

Specifically, appraisal statutes should be amended to insure that they apply to the various forms in which it is possible to structure a fundamental corporate transaction. Statutory exclusions from the

Technicolor, Inc., No. CIV.A.7129, 1990 Del. Ch. LEXIS 171, at *2-3 (Oct. 19, 1990), *rev'd*, 684 A.2d 289 (Del. 1996).

20. See *Weinberger*, 457 A.2d at 715. In 1977, the Delaware Supreme Court had concluded that a majority shareholder could not "cause a merger to be made for the sole purpose of eliminating a minority on a cash-out basis." *Singer v. Magnavox Co.*, 380 A.2d 969, 978-79 (Del. 1977), *overruled by* *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983); *cf.* *Tanzer v. International General Indus., Inc.*, 379 A.2d 1121, 1123-25 (Del. 1977) (holding that a parent corporation can engage in a cash-out merger of a subsidiary corporation, if the real purpose of the transaction is not to "rid itself of unwanted minority shareholders in the subsidiary," and the transaction satisfies the "entire fairness" test), *overruled by* *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983).

21. See *Weinberger*, 457 A.2d at 714. The court noted that the appraisal remedy may not be adequate in some instances, particularly situations involving "fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching," and left open the possibility that litigants may not be limited to the appraisal remedy in those circumstances. *Id.*; see also MODEL BUS. CORP. ACT § 13.02(b) (1991) (making the appraisal remedy the exclusive means of challenging corporate action creating an entitlement to appraisal *unless* such action is unlawful or fraudulent).

22. See *infra* note 66 and accompanying text for a brief description of the Delaware block method.

23. *Weinberger*, 457 A.2d at 712-13.

applicability of the appraisal remedy, particularly exclusions in some states that render the remedy inapplicable to publicly traded corporations, should be eliminated. The statutory procedures governing appraisal proceedings should be made less onerous and more clear.

It is particularly important that courts determining fair value in appraisal proceedings be aware of the purposes now served by the remedy. Courts should be willing to entertain all relevant evidence bearing on the fair value of the corporation. They should not place undue reliance on market prices, and should not permit minority or "lack of marketability" discounts. If a corporation's value is derived by reference to a per share market price, the value should be adjusted upward to remove the inherent minority discount embodied in market prices. When available, evidence as to the price an unaffiliated third party would be willing to pay for the corporation as a whole should be particularly probative in the appraisal context. Finally, courts must be aware of the equitable context in which the appraisal proceeding has arisen, and be especially vigilant when dealing with conflict of interest transactions.

Part I of this Article will briefly recount the history of the appraisal remedy, and explain the increased frequency of its use in response to changes in law and finance. Part II will examine how courts determine fair value in appraisal proceedings, focusing on several recurrent problems that arise in such proceedings. Finally, Part III will propose changes in the statutory provisions governing the appraisal remedy and in the way courts handle appraisal litigation.

I. HISTORY OF APPRAISAL RIGHTS

A. *The Origins of the Appraisal Remedy: A Brief History*

The first corporations were created by legislative grants of corporate charters, rather than pursuant to a statutorily created procedure for incorporation.²⁴ By the 1870s, however, corporate statutes had become widespread.²⁵ Prior to the enactment of such statutes, the general rule in most states was that a corporation could not

24. See William J. Carney, *Fundamental Corporate Changes, Minority Shareholders, and Business Purposes*, 1980 AM. B. FOUND. RES. J. 69, 82. These legislatively-granted charters were typically made available to corporations to carry on businesses that were public in nature (e.g., mills, bridges, canals, and railroad companies), with the corporation performing a function that might otherwise have been undertaken by the state. See *id.* at 82-83.

25. See *id.* at 84.

merge or consolidate with another corporation without the unanimous consent of its shareholders.²⁶ The courts chipped away at this general rule in classic common law fashion;²⁷ ultimately, the requirement of unanimous approval was abrogated by statute, so that "[o]ver the first third of the twentieth century the pattern of allowing fundamental changes in all corporations to take place on something less than a unanimous shareholder vote became the norm."²⁸

The creation of a statutory appraisal remedy accompanied this departure from the requirement of unanimous action.²⁹ Today, the statutory norm is to permit fundamental corporate changes to occur with the approval of the majority,³⁰ and to provide an appraisal remedy to those shareholders that dissent from the merger or fundamental change.³¹

B. *The Rise in the Use of the Appraisal Remedy*

Although the statutory appraisal remedy has existed for some time, until recently the remedy had been infrequently invoked, at

26. See 2 VICTOR MORAWETZ, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS § 951, at 908 (2d ed. 1886).

27. See Carney, *supra* note 24, at 86-90. For example, the requirement of unanimous consent was not applied as rigidly to the sale of corporate assets as it was to mergers and consolidations. See *id.* at 86-87.

28. *Id.* at 94.

29. See Joseph L. Weiner, *Payment of Dissenting Stockholders*, 27 COLUM. L. REV. 547, 548 n.7 (1927) (noting that 20 states had adopted a statutory appraisal remedy by 1927); see also *supra* note 7 and accompanying text. The adoption of appraisal statutes may have lagged somewhat behind the adoption of statutes permitting merger by less than unanimous shareholder approval. See Thompson, *supra* note 6, at 14-15. Even before the enactment of appraisal statutes, courts sometimes refused to enjoin a merger or consolidation that lacked unanimous consent, instead concluding that the proper remedy should be the payment to the objecting shareholder of a pro rata share of the corporation's value. See Carney, *supra* note 24, at 93-94.

30. See, e.g., MODEL BUS. CORP. ACT §§ 11.03(e), 12.02(e) (1991) (requiring only majority approval for merger and sale of assets). Although majority approval is the norm, some jurisdictions require the approval of certain transactions by a supermajority vote. See, e.g., MASS. GEN. LAWS ch. 156B, § 78(c)(1)(iii) (1992) (requiring a two-thirds vote to approve a merger or consolidation); VA. CODE ANN. § 13.1-718(E) (Michie 1993) (same). In addition, most corporate statutes allow the parties to deviate from the statutory approval requirements (e.g., requiring something greater than majority approval), if such a provision is included in the corporation's articles of incorporation. See, e.g., MODEL BUS. CORP. ACT §§ 11.03(e), 12.02(e) (allowing corporations to require, in the articles of incorporation, greater than majority vote to approve mergers and sales of assets).

31. See *supra* note 5.

least as measured by reported legal decisions.³² Although the number of reported decisions undoubtedly understates the actual use of the appraisal remedy,³³ it seems clear that the remedy has not been invoked with great frequency. There are many explanations for its infrequent use in the past, and also for its increased use in recent years.

Transactions triggering an appraisal right were much less common during most of the lifetime of the appraisal remedy than they have become in the last twenty to thirty years. Dramatic changes have occurred in the capital markets since the advent of the appraisal remedy, and merger activity is far more common today than it was at an earlier time.³⁴

At the onset of this exponential increase in capital market activity, unhappy shareholders sometimes looked to the federal securities laws as a means of challenging acquisition transactions.³⁵ At one point it looked as if the law of mergers and acquisitions was becoming "federalized." Shareholders, or their lawyers, perceived signifi-

32. See Seligman, *supra* note 6, at 829 & n.3 (noting that between 1972 and 1981 there were roughly 20 reported state court decisions involving an appraisal valuation even though there were over 16,000 mergers of U.S. concerns).

33. Many appraisal proceedings are settled prior to trial or otherwise do not generate reported decisions. See *id.* at 830. Some state appraisal statutes permit the trial court to appoint an appraiser to fix fair value in the first instance. See, e.g., NEV. REV. STAT. ANN. § 92A.490(4) (Michie Supp. 1997) (authorizing trial court to appoint appraisers to receive evidence and recommend a decision as to fair value). When this is done, decisions are generally not reported unless the case reaches the appellate level. See Seligman, *supra* note 6, at 830.

Furthermore, in many transactions that might otherwise give rise to an appraisal remedy, the acquiring party pays a price greatly in excess of the pre-transaction market price. To the extent the acquiring party pays a substantial premium over market price, the likelihood that a dissatisfied shareholder will seek to litigate over the acquisition price is diminished. See *id.*; see also Bernard S. Black, *Bidder Overpayment in Takeovers*, 41 STAN. L. REV. 597, 598 (1989) (noting that takeover premiums averaged 50% in the 1980s); Lynn A. Stout, *Are Takeover Premiums Really Premiums? Market Price, Fair Value, and Corporate Law*, 99 YALE L.J. 1235, 1259 (1990) (stating that target company shareholders receive, on average, 50% more than the prevailing price in a takeover or merger transaction).

34. Acquisition activity accelerated with the rising stock market of the 1960s, and the attendant conglomerate merger wave. See VICTOR BRUDNEY & WILLIAM W. BRATTON, BRUDNEY AND CHIRELSTEIN'S CASES AND MATERIALS ON CORPORATE FINANCE 652-54 (4th ed. 1993). The bear market and recession of the 1970s slowed this process, but the 1980s brought a booming stock market, leveraged acquisition transactions financed with junk bonds, and the acceptance of hostile takeovers as an acquisition technique. See *id.* Merger activity continues today at very high levels. See Steven Lipin, *Gorillas in Our Midst: Megadeals Smash Records as Firms Take Advantage of Favorable Climate*, WALL ST. J., Jan. 2, 1997, at R8 ("Merger-and-acquisition activity in 1996 smashed records . . .").

35. See, e.g., *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 464-67 (1977) (noting that a federal securities law claim was used instead of a state law appraisal remedy to challenge the fairness of a cash-out merger transaction).

cant advantages to a federal forum, and increasingly brought federal securities law claims, rather than appraisal or other state court proceedings, to challenge acquisition transactions.³⁶ Since the mid-1970s, however, the Supreme Court has consistently refused to allow the federal securities laws to substitute for state corporate law in the absence of a federal disclosure violation.³⁷ As federal securities law remedies became less available, shareholders more often turned to state court remedies, including the appraisal remedy.

Despite the increase in capital market activity noted above, statutory limitations on the availability of the appraisal remedy continue to inhibit its more frequent use. The appraisal remedy is available only when a statutory triggering event occurs, and different states have adopted different triggering events. Although the Model Business Corporation Act (MBCA or Model Act) is drafted fairly broadly to grant an appraisal remedy in the event of a merger transaction, a sale of assets transaction, a share exchange, and certain amendments to a corporation's certificate of incorporation,³⁸ states that do not follow the Model Act often have more limited statutory triggering events. In Delaware, for example, appraisal rights arise only in the event of a merger or consolidation.³⁹ A transaction that is substantively equivalent to a merger or consolidation—for example, a sale of all of a corporation's assets—does not trigger appraisal

36. See Thompson, *supra* note 6, at 50 ("Rule 10b-5 for a short time became a vehicle to attack unfair use of majority power in squeeze-out situations when state law was viewed as ineffective.").

37. See Schreiber v. Burlington N., Inc., 472 U.S. 1, 5-8 (1985) (holding that there is no federal securities law remedy in connection with tender offer absent misrepresentation or non-disclosure); *Santa Fe Indus.*, 430 U.S. at 474, 479 (holding that as long as the transaction "was neither deceptive nor manipulative" then there was no violation of federal law because "we [the Court] are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities"); see also *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 86-87 (1987) (finding that federal law does not preempt an Indiana statute making takeovers more difficult). The Supreme Court's attempt to narrow the role played by federal securities law in the acquisition context has not, however, been wholly successful. Litigants have, at times, managed to avoid the holdings of the Supreme Court and assert federal securities law challenges to acquisition transactions. See, e.g., *Howing Co. v. Nationwide Corp.*, 972 F.2d 700, 705-10 (6th Cir. 1992) (allowing federal securities claim to be brought where allegedly faulty going private disclosure may have affected minority shareholders' decision not to seek appraisal in connection with a cash-out merger); *Goldberg v. Meridor*, 567 F.2d 209, 220-21 (2d Cir. 1977) (allowing federal securities claim to be brought where allegedly deceptive disclosures lulled minority shareholders into not seeking injunctive relief under state law).

38. See MODEL BUS. CORP. ACT § 13.02(a) (1991).

39. DEL. CODE ANN. tit. 8, § 262 (1991 & Supp. 1996).

rights under Delaware law. Undoubtedly, parties have used this "flexibility" to try to avoid triggering appraisal rights.⁴⁰

Many states also have adopted statutory exceptions that withhold appraisal rights in transactions that would ordinarily give rise to such rights. The most common of these is the market exception, which makes appraisal rights unavailable to shareholders of a corporation whose stock is traded on an active market.⁴¹ This type of statutory provision, which is still relatively common,⁴² further reduces the number of appraisal cases.

Another explanation for the unpopularity of the appraisal remedy lies in the procedural requirements of the remedy itself. This was particularly true before the adoptions of the 1978 amendments to the MBCA (and the subsequent enactment of those amendments by states whose statutes are based on the Model Act); this problem continues today, albeit to a somewhat lesser extent. For example, shareholders are required to comply with several notice provisions in order to assert the right to an appraisal.⁴³ Failure to comply strictly with these provisions leads to a loss of the remedy.⁴⁴

In addition, under the pre-1978 version of the MBCA,⁴⁵ and in Delaware⁴⁶ and some other non-Model Act states today,⁴⁷ a shareholder who seeks appraisal following a triggering transaction receives no payment from the corporation until the fair value of his stock is determined in an appraisal proceeding, often years after the occur-

40. See, e.g., *Hariton v. Arco Elecs., Inc.*, 182 A.2d 22, 25-26 (Del. Ch. 1962) (holding that a transaction structured as an arm's-length sale of assets was not a de facto merger triggering appraisal rights), *aff'd*, 188 A.2d 123 (Del. 1963); cf. *Farris v. Glen Alden Corp.*, 143 A.2d 25, 29-30 (Pa. 1958) (recharacterizing a transaction structured as a purchase of assets as a de facto merger).

41. See, e.g., DEL. CODE ANN. tit. 8, § 262(b) (Supp. 1996); TENN. CODE ANN. § 48-23-102(c) (1995).

42. See *infra* notes 101-02 and accompanying text.

43. See *infra* notes 58-63 and accompanying text.

44. See MODEL BUS. CORP. ACT §§ 13.21(b), 13.23(c), 13.28(b) (1991); see also, e.g., *Pritchard v. Mead*, 455 N.W.2d 263, 266-67 (Wis. Ct. App. 1990) (affirming lower court's entering of summary judgment against shareholder who failed to comply with procedural requirements of appraisal remedy). But cf. *In re Fair Value of Shares of Bank of Ripley*, 399 S.E.2d 678, 682-84 & n.11 (W. Va. 1990) (holding that failure to timely tender share certificates does not bar dissenters' rights if delay is insubstantial and not prejudicial).

45. See MODEL BUS. CORP. ACT ANN. § 13.25 historical background (Supp. 1996) ("The requirement that the corporation pay the dissenter its estimate of the fair value of his shares when the proposed corporate action is effectuated was an innovation of the 1978 revision.").

46. See DEL. CODE ANN. tit. 8, § 262(h)-(i) (1991).

47. See, e.g., OHIO REV. CODE ANN. § 1701.85(B) (Anderson 1994).

rence of the triggering event.⁴⁸ This creates an incentive for defendants in such suits to delay as much as possible.⁴⁹ In contrast, non-dissenting shareholders receive the merger consideration as soon as the merger takes place.⁵⁰

The cost of pursuing the appraisal remedy also inhibits its widespread use. Dissenting shareholders typically bear the cost of hiring their own experts and attorneys.⁵¹ The cost of the appraisal proceeding, balanced against the likely gains and the uncertainty involved, no doubt causes many shareholders to think twice about pursuing an appraisal remedy. Certainly for any small shareholder, the costs would often seem to outweigh the likely benefits.⁵²

The current version of the MBCA has eliminated some of the procedural disadvantages of the prior version. Under the current version, shareholders are entitled to receive payment, very early in the process,⁵³ of the amount the corporation deems to be the fair

48. For example, the transaction triggering appraisal rights involving Technicolor took place in early 1983, *see Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182, 1185 (Del. 1988), and remains unresolved today. *See infra* note 403. The less complicated appraisal litigation involving Pabst Brewing continued for ten years. *See infra* note 326.

49. One court has fashioned a judicial solution to this problem by granting the shareholder partial summary judgment, limited to the amount the corporation claimed the shares were worth. *See Hunter v. Vercellotti*, 649 N.E.2d 557 (Ill. App. Ct. 1995). The shareholder, of course, claimed the shares were worth more than that amount, *see id.* at 558, but by granting partial summary judgment, the court required the corporation to pay the undisputed amount immediately, while the parties continued to dispute the fair value of the stock. *See id.* at 560. Although there was no direct statutory authority to, in effect, order an interim payment by the corporation, the appellate court concluded that the trial court had the authority to order this type of relief. *See id.*

50. These shareholders may still be able to bring a non-appraisal challenge to the transaction if they can avoid the exclusivity of the appraisal remedy. *See supra* note 21.

51. *See, e.g.*, MODEL BUS. CORP. ACT § 13.31(b)(2) (1991) (giving courts discretion to shift attorney and expert fees to either party if such party "acted arbitrarily, vexatiously, or not in good faith").

52. *See* 2 ALI, PRINCIPLES, *supra* note 5, ch. 4, reporter's note 3. There are numerous economic incentives for shareholders to challenge acquisition transactions in class action lawsuits alleging breach of fiduciary duty, rather than in appraisal proceedings. *See Siegel, supra* note 4, at 102-04. The Reporter's Note to the American Law Institute's Principles of Corporate Governance states that the chapter on the appraisal remedy does not seek to model the remedy after the class action, preferring instead to accept the prevailing "opt in" approach to the appraisal remedy, requiring an affirmative act by a shareholder to assert appraisal rights. *See* 2 ALI, PRINCIPLES, *supra* note 5, ch. 4, reporter's note 6. The ALI Principles do propose a useful mechanism allowing dissenting shareholders to use common counsel as an efficiency measure. *See id.* § 7.23(f).

53. *See* MODEL BUS. CORP. ACT §§ 13.23, 13.25(a). The payment must be made at the time the corporate action giving rise to the appraisal right is taken, for example, at the time a merger is effective. *See id.* § 13.25(a). "Section 13.25 changes the relative balance between

value of the shares.⁵⁴ If the shareholder does not agree with that valuation, a process is provided to resolve that dispute, culminating in judicial appraisal if necessary;⁵⁵ while this process is ongoing, the shareholder has not been completely deprived of all payment for his shares. The MBCA also directs the court to assess the costs of the appraisal proceeding, including the costs associated with a court appointed appraiser, against the corporation.⁵⁶ Each party still typically bears its own legal expenses and expert witness fees.⁵⁷

Despite the MBCA's improved procedures for exercising appraisal rights, difficulties remain. A shareholder who wishes to exercise appraisal rights must first give written notice of his intent to dissent prior to the meeting at which the matter giving rise to appraisal rights (e.g., a merger) will be voted upon.⁵⁸ The shareholder must not vote in favor of the action.⁵⁹ If the action is approved, the shareholder must then timely demand payment for his shares and deposit his share certificates with the corporation.⁶⁰ The corporation must then pay the shareholder the fair value of the shares.⁶¹ If the shareholder does not agree with the corporation's determination of value, the shareholder is then required to notify the corporation of his estimate of fair value and demand payment from the corporation.⁶² If the corporation disagrees with the shareholder's estimate, it must initiate a judicial appraisal proceeding.⁶³ Any failure by a shareholder

corporation and dissenting shareholders by requiring immediate payment by the corporation upon the completion of the transaction or (if the transaction did not need shareholder approval and has been completed) upon receipt of the demand for payment." *Id.* § 13.25 official cmt.

54. *See id.* § 13.25(a). The opportunity to receive this early payment is only guaranteed to shareholders who owned their stock at the time the transaction giving rise to appraisal rights was announced. *See id.* § 13.27(a). Shareholders who purchase their stock after a transaction is announced are not assured that they will receive payment until the appraisal process is completed. *See id.* (giving corporations the option of withholding the early payment from such shareholders).

55. *See id.* § 13.30.

56. *See id.* § 13.31(a).

57. *See id.* § 13.31(b). This provision does give the court the authority to engage in fee shifting in favor of one party or the other if there is a failure to comply with the statutory provisions or if one party acts in bad faith, but the usual rule is that unless the court orders otherwise, each party bears its own legal and expert costs.

58. *See id.* § 13.21(a).

59. *See id.*

60. *See id.* § 13.23(a).

61. *See id.* § 13.25(a).

62. *See id.* § 13.28(a).

63. *See id.* § 13.30.

to clear these procedural hurdles in a timely way results in a loss of the appraisal remedy.⁶⁴

If a shareholder successfully surmounts the procedural hurdles and obtains an appraisal remedy, is that shareholder likely to get a positive result in the appraisal process? The answer, prior to *Weinberger*, was generally "no."⁶⁵ This answer powerfully explains the relative dearth of pre-1983 appraisal proceedings.

Before *Weinberger*, appraisal proceeding valuations were typically conducted pursuant to the Delaware block method, which utilizes a weighted average of three separate valuations, one based on asset value, one based on earnings value, and one based on market value.⁶⁶ This mechanical approach to appraisal was not very hospitable to the claims of dissenting shareholders,⁶⁷ and did not accord with current financial methods of valuation.⁶⁸ As a result, the court in

64. See *id.* §§ 13.21(b), 13.23(c), 13.28(b).

65. See *infra* notes 66-68 and accompanying text. At least some courts relied heavily on market price in determining fair value in appraisal proceedings, thereby diminishing the utility of the remedy to dissenting shareholders. See *infra* notes 99-100 and accompanying text.

66. To calculate fair value under the Delaware block method, it is first necessary to value the corporation based on its asset value, its earnings value, and its market value. Next, each of these three valuations is accorded a percentage weight. The fair value of the corporation is deemed to be the weighted average of the three separate valuations. See, e.g., *Francis I. duPont & Co. v. Universal City Studios, Inc.*, 312 A.2d 344, 348-52 (Del. Ch. 1973) (determining fair value by Delaware block method), *aff'd*, 334 A.2d 216 (Del. 1975).

67. See, e.g., Elmer J. Schaefer, *The Fallacy of Weighting Asset Value and Earnings Value in the Appraisal of Corporate Stock*, 55 S. CAL. L. REV. 1031, 1036-40 (1982) (discussing how "[t]he weighting method always undervalues corporate stock"); Note, *Corporate Law - Chipping Away at the Delaware Block: A Critique of the Delaware Block Approach to the Valuation of Dissenters' Shares in Appraisal Proceedings*, 8 W. NEW ENG. L. REV. 191, 210-22 (1986) (discussing weaknesses in the Delaware block approach); cf. Fischel, *supra* note 6, at 890-93 (criticizing Delaware block method); Seligman, *supra* note 6, at 854-56 (criticizing the weighting process for being "indefensibly arbitrary and capricious"). The basic concept of a weighted average disadvantages dissenting shareholders because it assumes the corporation will not be operated to achieve its highest valuation. For example, if a corporation's highest value is based on its asset value, rational owners of the corporation would seek to achieve that value, yet the Delaware block method averages that value with lesser values. See Schaefer, *supra*, at 1038-39. In addition, courts frequently have applied the Delaware block method in rigid fashion, often to the disadvantage of the dissenting shareholder. See, e.g., *Universal City Studios, Inc.*, 312 A.2d at 347-49 (calculating earnings value based on average earnings over prior five years despite evidence that earnings from most recent year better represented future earnings prospects).

68. For example, the discounted cash flow method of valuation is "considered by experts to be the preeminent valuation methodology." *Neal v. Alabama By-Products Corp.*, No. CIV.A. 8282, 1990 WL 109243, at *7 (Del. Ch. Aug. 1, 1990) (citing SHANNON P. PRATT, VALUING A BUSINESS: THE ANALYSIS AND APPRAISAL OF CLOSELY HELD COMPANIES (2d ed. 1989)), *aff'd*, 588 A.2d 255 (Del. 1991). Despite its preeminent role in valuation, there was no place for discounted cash flow analysis under the Delaware block method; its use did not be-

Weinberger cast aside the block method as the exclusive means of valuation, opening the process up to all methods of valuation "generally considered acceptable in the financial community."⁶⁹

In sum, although impediments remain to more widespread use of the appraisal remedy, a number of events have combined to make it a more commonly used remedy: transactions that give rise to appraisal rights occur more frequently; federal securities law remedies are available less frequently; appraisal statutes have been amended to reduce somewhat the procedural burdens placed on dissenting shareholders; and, perhaps most significantly, *Weinberger* has fundamentally changed the way in which dissenting shares are appraised. As a result, the number of reported appraisal decisions has expanded greatly,⁷⁰ as has scholarly interest in the appraisal remedy.⁷¹

II. HOW COURTS DETERMINE FAIR VALUE

A. Approaches to Valuation

The key to the effectiveness of the appraisal remedy in protecting minority shareholder interests lies in the way in which courts appraise minority shares. If courts do not appraise shares in a manner consistent with the appraisal remedy's purpose of protecting minority shareholders, such shareholders will ignore the appraisal remedy in favor of other means of challenging fundamental transactions, principally breach of fiduciary duty claims, which may be less efficient and more time consuming to resolve.

The statutory command in an appraisal proceeding is to find the "fair value" of the dissenting shares,⁷² or sometimes the "fair market

come permissible in Delaware until *Weinberger* discarded the block method as the exclusive means of valuation. See *Cede & Co. v. Technicolor, Inc.*, No. CIV.A.7129, 1990 Del. Ch. LEXIS 259, at *23 (Oct. 19, 1990), *rev'd on other grounds*, 684 A.2d 289 (Del. 1996).

69. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983).

70. Thus, although Professor Seligman only found 19 reported appraisal cases in the decade prior to *Weinberger*, see Seligman, *supra* note 6, at 829-30 n.3, in the post-*Weinberger* decade, Professor Thompson found 103 reported appraisal cases, see Thompson, *supra* note 6, at 25.

71. See Siegel, *supra* note 4, at 79. Of course, the number of appraisal cases being brought continues to be limited by statutes that limit the events that trigger appraisal, or provide that appraisal rights do not apply in the case of securities traded on an active market. In order for the appraisal remedy to achieve its full utility, these statutory inhibitions must be removed. See *infra* notes 476-505 and accompanying text.

72. See, e.g., MODEL BUS. CORP. ACT § 13.02(a) (1991); DEL. CODE ANN. tit. 8, § 262(a) (Supp. 1996).

value" or "fair cash value."⁷³ Fair value is typically defined by statute as "the value of the shares immediately before the effectuation of the corporate action to which the dissenter objects, excluding any appreciation or depreciation in anticipation of the corporate action."⁷⁴ Statutes generally provide no further guidance with respect to ascertaining fair value in an appraisal proceeding.⁷⁵

Before *Weinberger*, the traditional means of determining fair value was the Delaware block method of valuation.⁷⁶ After *Weinberger* opened up the valuation process to "any techniques or methods which are generally considered acceptable in the financial community,"⁷⁷ the most prominent method of valuation in Delaware has been the discounted cash flow (DCF) method. This valuation technique operates on the premise that the value of a company is determined by the present value of its projected future cash flows.⁷⁸ The DCF method has been described by the Delaware courts as "the pre-eminent valuation methodology"⁷⁹ and "[i]n many situations . . . [theoretically] the single best technique to estimate the value of an economic asset."⁸⁰ As described by the Delaware Court of Chancery:

73. See *infra* note 213.

74. MODEL BUS. CORP. ACT § 13.01(3). The Model Act further provides that appreciation or depreciation resulting from the corporate action does not have to be excluded from consideration if it would be fair and equitable to take account of such effects. See *id.* The Delaware statute directs the court to determine fair value of the dissenting shares "exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation," DEL. CODE ANN. tit. 8, § 262(h) (1991), and goes on to state that in determining fair value, "the Court shall take into account all relevant factors." *Id.*

75. See MODEL BUS. CORP. ACT § 13.01 cmt. (3) ("The definition of 'fair value' . . . leaves to the parties (and ultimately to the courts) the details by which 'fair value' is to be determined . . .").

76. See *supra* notes 66-68 and accompanying text for a discussion of this method. Prior to *Weinberger*, the Delaware block method was the exclusive means of appraising shares in Delaware. See *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 934 n.6 (Del. 1985).

77. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983).

78. See *Neal v. Alabama By-Products Corp.*, No. CIV.A.8282, 1990 WL 109243, at *7 (Del. Ch. Aug. 1, 1990), *aff'd*, 588 A.2d 255 (Del. 1991).

79. *Id.* (citing PRATT, *supra* note 68).

80. *Cede & Co. v. Technicolor, Inc.*, No. CIV.A.7129, 1990 Del. Ch. LEXIS 259, at *23 (Oct. 19, 1990) (stating that DCF technique has "become prominent"), *rev'd on other grounds*, 684 A.2d 289 (Del. 1996).

The DCF model entails three basic components: an estimation of net cash flows that the firm will generate and when, over some period; a terminal or residual value equal to the future value, as of the end of the projection period, of the firm's cash flows beyond the projection period; and finally a cost of capital with which to discount to a present value both the projected net cash flows and the estimated terminal or residual value.⁸¹

The DCF method, although probably the most prominent and frequently used post-*Weinberger* method of appraisal, has not been the exclusive valuation method employed. The Delaware courts have continued to use a variety of valuation techniques, depending on the facts and circumstances of the particular case, including the Delaware block method,⁸² valuation based on a comparison to other companies

81. *Id.* Dean Samuel C. Thompson, Jr., recognizing the importance of the DCF method in appraisal proceedings (as well as for purposes of fairness opinions, disclosure documents, etc.), has written a "lawyer's guide" explaining the nuts and bolts of this valuation technique. See generally Samuel C. Thompson, Jr., *A Lawyer's Guide to Modern Valuation Techniques in Mergers and Acquisitions*, 21 J. CORP. L. 457 (1996).

82. *Weinberger* did not prohibit use of the Delaware block method, and this method has continued to be used in Delaware and elsewhere. See, e.g., *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 940 (Del. 1985) (noting that "*Weinberger* did not abolish the block formula, only its exclusivity"); *Gonsalves v. Straight Arrow Publishers, Inc.*, No. CIV.A.8474, 1996 WL 696936, at *4-8 (Del. Ch. Nov. 27, 1996) (noting that *Weinberger* "did not invalidate the Delaware Block Method," and ultimately adopting the valuation calculated by the corporation's expert using that method), *rev'd on other grounds*, 701 A.2d 357 (Del. 1997); *Elk Yarn Mills v. 514 Shares of Common Stock of Elk Yarn Mills*, 742 S.W.2d 638, 640-44 (Tenn. Ct. App. 1987) (applying the Delaware block method); *cf. Oakridge Energy, Inc. v. Clifton*, 937 P.2d 130, 135 (Utah 1997) (suggesting that the appraisal valuation should consider each of three measures of value used in the Delaware block method); *Hernando Bank v. Huff*, 609 F. Supp. 1124, 1126-27 (N.D. Miss. 1985) (considering each of the three Delaware block measures of value, but not employing a weighted average approach), *aff'd*, 796 F.2d 803 (5th Cir. 1986).

In fact, it appears that at least one state, Tennessee, may still insist on the exclusive use of the Delaware block method even after *Weinberger*. See *Blasingame v. American Materials, Inc.*, 654 S.W.2d 659, 668 n.1 (Tenn. 1983) (opinion on petition to rehear) (affirming the court's pre-*Weinberger* decision based on the "weighted average method," which is essentially the Delaware block method, and noting that "[w]e do not find anything in *Weinberger* that causes us to alter the adoption of the weighted average method"); *Elk Yarn Mills*, 742 S.W.2d at 640 ("The parties all agree that the correct method for calculating the value of the shares in this case is the Delaware Block method adopted by our Supreme Court in [Blasingame]"). *But cf. Genesco, Inc. v. Scolaro*, 871 S.W.2d 487, 490 (Tenn. Ct. App. 1993) (concluding that the Delaware block method is neither required nor prohibited when valuing preferred stock, but that its use was appropriate in the instant case). Tennessee's strict adherence to the Delaware block method is certainly not mandated by statutory language, see TENN. CODE ANN. §§ 48-23-101(4), 48-23-102(a) (1995), nor does it make sense to prohibit other relevant appraisal evidence as a matter of general policy. See generally Clardy, *supra* note 5.

(the "comparable company approach"),⁸³ valuation based on net asset value,⁸⁴ valuation based on earnings and book value,⁸⁵ and valuation based on combinations of these techniques.⁸⁶

The valuation technique used by a court is highly dependent on the valuation evidence presented by the parties. "The parties, not the court, establish the record and the court is limited by the record created."⁸⁷ Thus, if both parties present evidence of fair value utilizing the DCF method, the court's resolution of the dispute will likely employ a DCF analysis.⁸⁸ Similarly, if the parties agree that a net asset value approach is called for, the court typically will adopt such an approach.⁸⁹

There are problems endemic to an appraisal proceeding that cannot be eliminated by the choice of appraisal methodology. Each appraisal technique is but a way of estimating the "fair value" or "true value" or "intrinsic value" of a company, and undeniably, "[v]aluation is an art rather than a science."⁹⁰ The valuation "answer" given by each of these techniques is very dependent on the assumptions underlying the calculations employed.⁹¹ For example, even though the DCF approach is highly regarded, it relies heavily on a guess as to the future cash flows of the enterprise. This "guess" may be informed by looking at historical data, operating trends, and other relevant factors, but it is still nothing more than a prediction of future events. Once these future cash flows are predicted, they must

83. See *Rapid-American Corp. v. Harris*, 603 A.2d 796, 800-01 (Del. 1992); *Hodas v. Spectrum Tech., Inc.*, No. CIV.A.11265, 1992 Del. Ch. LEXIS 252, at *4-5, *10 (Dec. 7, 1992).

84. See *Kahn v. Household Acquisition Corp.*, 591 A.2d 166, 175 (Del. 1991) (quasi-appraisal proceeding); *Campbell v. Caravel Academy, Inc.*, No. CIV.A.7830, 1988 Del. Ch. LEXIS 86, at *14-16 (June 16, 1988), *aff'd*, 553 A.2d 638 (Del. 1988); *Robbins & Co. v. Israel*, No. CIV.A.7919, 1985 Del. Ch. LEXIS 498, at *27-30 (Oct. 2, 1985).

85. See *Pinson v. Campbell-Taggart, Inc.*, No. CIV.A.7499, 1989 Del. Ch. LEXIS 50, at *48-50 (Nov. 8, 1989).

86. See *Kleinwort Benson Ltd. v. Silgan Corp.*, No. CIV.A.11107, 1995 WL 376911, at *10 (Del. Ch. June 15, 1995) (assigning a percentage weight to the DCF model and a percentage weight to a comparable company approach).

87. *Cede & Co. v. Technicolor, Inc.*, No. CIV.A.7129, 1990 Del. Ch. LEXIS 259, at *26 (Oct. 19, 1990), *rev'd on other grounds*, 684 A.2d 289 (Del. 1996).

88. See *id.* at *4, *23-26.

89. See *Perlman v. Permonite Mfg. Co.*, 568 F. Supp. 222, 223 (N.D. Ind. 1983), *aff'd*, 734 F.2d 1283 (7th Cir. 1984).

90. *In re Appraisal of Shell Oil Co.*, No. CIV.A.8080, 1990 Del. Ch. LEXIS 199, at *16 (Dec. 11, 1990) (quoting testimony of expert witness), *aff'd*, 607 A.2d 1213 (Del. 1992).

91. See *id.* ("While the assumptions had a basis, almost every figure used . . . could have just as well been a different figure and the selection of the figure to be used necessarily involved a choice or guess by the witness . . .").

be discounted to a present value. What discount rate should be employed? Again, there is much room for guesswork and subjectivity.⁹² The DCF technique also requires that a terminal value be established and then discounted to a present value; both are further exercises in guesswork and subjectivity.⁹³

As a practical matter, this means that both parties to the appraisal proceeding will present expert testimony of valuation. Because of the inherent subjectivity and estimation involved, the parties' experts can compute dramatically different valuations, even if they utilize the same methodology.⁹⁴ Of course, each expert is "handsomely paid by one side or the other"⁹⁵ such that, "whether consciously or unconsciously, the opinions expressed by the expert witnesses significantly reflect[] the desires of their clients."⁹⁶ Thus, the expert retained by the dissenting shareholder invariably concludes that the corporation has a very high fair value, while the cor-

92. Factors courts have looked at to determine the discount rate include the firm's cost of equity capital, the risk-free rate of return as reflected in United States treasury bill rates, and the riskiness of the firm's business. See, e.g., *Technicolor*, 1990 Del. Ch. LEXIS 259, at *90-93 (using the cost of capital to supply the discount rate); *Neal v. Alabama By-Products Corp.*, No. CIV.A.8282, 1990 WL 109243, at *20 (Del. Ch. Aug. 1, 1990) (accepting capital asset pricing model to determine the discount rate), *aff'd*, 588 A.2d 255 (Del. 1991).

93. These criticisms are not unique to the DCF method. The Delaware block method and other valuation techniques are susceptible to similar criticisms. Under the Delaware block method, it is necessary to determine a company's asset value on a going concern basis. This requires estimation and guesswork. Determining earnings value requires the selection of a price/earnings multiplier, an inherently imprecise and subjective endeavor. After these tasks are accomplished, and a market value is selected, the various valuation factors must be weighted. The selection of the appropriate weight to be accorded each type of valuation is almost wholly arbitrary. See Seligman, *supra* note 6, at 854-56. As a result, huge discrepancies in the value of companies, as determined by each party's expert, are common under the Delaware block method. See *Francis I. duPont & Co. v. Universal City Studios, Inc.*, 312 A.2d 344, 346 (Del. Ch. 1973) (illustrating how two parties, each employing the Delaware block method, obtained substantially different values: the plaintiff argued for a per share value of \$131.89, while the defendant argued for a \$52.36 per share value), *aff'd*, 334 A.2d 216 (Del. 1975).

94. For example, differences in future cash flow assumptions can yield very different valuations under the DCF method. For illustrations of the variance in expert valuations, see *Technicolor*, 1990 Del. Ch. LEXIS 259, at *4; *Neal*, 1990 WL 109243, at *7-8; *Cavalier Oil Corp. v. Harnett*, Nos. CIV.A.7959, 7960, 7967, 7968, 1988 Del. Ch. LEXIS 28, at *32-36, *70-72 (Feb. 22, 1988), *aff'd*, 564 A.2d 1137 (Del. 1989). Sometimes the respective experts use different valuation methodologies, which also can lead to significant variance in their valuation conclusions.

95. *In re Appraisal of Shell Oil Co.*, 1990 Del. Ch. LEXIS 199, at *16.

96. *Id.*; see also *Salomon Bros., Inc. v. Interstate Bakeries Corp.*, No. CIV.A.10054, 1992 Del. Ch. LEXIS 100, at *20 (May 1, 1992) ("It appeared to me, both from the experts' reports and their testimony, that their assumptions and choices of multiples were colored by their respective clients' interests.").

poration's expert determines that the fair value of the corporation is much lower. It is not unusual for the opinions of the experts to differ by a factor of ten.⁹⁷ It is, therefore, not surprising that courts have evidenced frustration with this process.⁹⁸

B. The Role of Market Price in Valuation

The proper role, if any, to be accorded market price in an appraisal proceeding has long been controversial. Dean Manning noted in his 1962 article that courts have virtually refused to extend the appraisal inquiry beyond market price, so that shareholders realized no benefit by using the appraisal remedy for actively traded stock; shareholders were better off just selling in the market.⁹⁹ There are

97. See, e.g., *Hodas v. Spectrum Tech., Inc.*, No. CIV.A.11265, 1992 Del. Ch. LEXIS 252, at *7, *9 (Dec. 7, 1992) (involving expert opinions ranging from \$68 per share to \$896.37 per share); *Cavalier Oil Corp. v. Harnett*, Nos. CIV.A.7959, 7960, 7967, 7968, 1988 Del. Ch. LEXIS 28, at *34, *54 (Feb. 22, 1988), *aff'd*, 564 A.2d 1137 (Del. 1989) (involving expert opinions ranging from \$44.45 per share to \$676.80 per share); see also *infra* Appendix.

98. See *Kleinwort Benson Ltd. v. Silgan Corp.*, No. CIV.A.11107, 1995 WL 376911, at *5 (Del. Ch. June 15, 1995) (noting the "adversarial hyperbole that inevitably influences an expert's opinion in valuation proceedings"); *Salomon Bros.*, 1992 Del. Ch. LEXIS 100, at *20 (noting that experts' views were "colored by their respective clients' interests"); *In re Appraisal of Shell Oil Co.*, 1990 Del. Ch. LEXIS 199, at *14 (noting that the adversary system's "procurement and presentation of expert testimony is widely considered a sore spot in judicial administration" (quoting 1 MCCORMICK ON EVIDENCE § 17 (3d ed. 1984))); *Technicolor*, 1990 Del. Ch. LEXIS 259, at *4 ("The evidence . . . was structured around the elaborate testimony of dueling experts."); *Charlip v. Lear Siegler, Inc.*, No. 5178, 1984 WL 8248, at *2 (Del. Ch. Nov. 27, 1984) ("The breadth of the dispute that has developed in this [appraisal] proceeding tends to border on the absurd."); *Sieg Co. v. Kelly*, 512 N.W.2d 275, 278 (Iowa 1994) ("What we have here is the usual stand off inherent in stock valuation cases. Both parties believe their expert's stock valuation calculations are the 'correct' ones.").

99. See Manning, *supra* note 6, at 231-32. Dean Manning was largely critical of the appraisal remedy, suggesting that it may not be needed at all, and that if not altogether eliminated, it should be restrictively employed. See *id.* at 260-61. Manning did note one possible scenario where appraisal might be of some value: where a transaction is announced, and, as a result of the announcement, the market price of the stock of one of the participants plummeted. See *id.* at 233. In that situation, a shareholder owning stock in the company whose shares had plummeted could seek appraisal, and ask the court to value the shares without taking into account the effects of the proposed transaction, thereby factoring out the drop in stock price following the announcement of the transaction. See *id.* Professor Eisenberg also wrote of the need for an appraisal remedy, even for publicly traded companies, when the effect of the structural change depressed the market price because it is "an ill-considered one." EISENBERG, *supra* note 6, at 81-82.

The idea of providing a remedy for the shareholder of a company whose stock has declined as a result of a merger announcement has little relevance today. The acquired company in a merger is invariably purchased at a premium to its pre-merger market price. It is only the acquiring company's share price that might, and often does, fall when a merger is announced. See Black, *supra* note 33, at 602-05 (summarizing studies on stock price of bidding companies

certainly cases in which courts have found market value dispositive of fair value for appraisal purposes.¹⁰⁰

The ultimate extension of Manning's argument is found in statutory market exceptions to the availability of the appraisal remedy. These exceptions, found in the statutes of some states,¹⁰¹ provide that the appraisal remedy is not available to shareholders owning publicly

following takeover announcement; stock price of bidder tends to decline in the period immediately following the announcement; returns of zero to slightly negative over longer period). Under modern corporation statutes and practice, however, acquiring corporation shareholders will virtually never obtain appraisal rights. Appraisal rights generally are granted only to shareholders who have the right to vote on a merger, *see* MODEL BUS. CORP. ACT § 13.02(a)(1)(i) (1991), and the shareholders of the acquiring corporation often do not obtain the right to vote on merger transactions, *see id.* § 11.03(g). Even if the transaction might otherwise confer voting rights on acquiring corporation shareholders, the common practice is for the acquiring corporation to form a subsidiary to engage in the merger transaction. The subsidiary merges with the acquired company in a forward or reverse triangular merger. When this structure is used, the acquiring corporation is not a party to the merger; the merging parties are its wholly owned subsidiary and the acquired corporation. Thus, when the acquiring corporation uses a triangular merger structure, its shareholders do not vote on the merger transaction and do not obtain appraisal rights. *See* Thompson, *supra* note 6, at 32.

100. *See* Gallois v. West End Chem. Co., 8 Cal. Rptr. 596, 600-01 (Cal. Dist. Ct. App. 1960) (applying a statute entitling dissenting shareholders to "fair market value"); *In re Paterson & Hudson River R. Co.*, 94 A.2d 657, 660 (N.J. 1953) (applying a statute entitling dissenting shareholders to "full market value"); *Armstrong v. Marathon Oil Co.*, 513 N.E.2d 776, 787-90 (Ohio 1987); *cf. Oakridge Energy, Inc. v. Clifton*, 937 P.2d 130, 132-35 (Utah 1997) (holding that the trial court erred in relying exclusively on market value, but that the error was harmless in this instance); *Jones v. Healy*, 55 N.Y.S.2d 349, 359-60 (N.Y. Sup. Ct. 1945) (holding that market value was entitled to "particular weight," but it was not the only measure employed), *aff'd mem.*, 62 N.Y.S.2d 605 (N.Y. App. Div. 1946). In his response to Dean Manning, Professor Eisenberg disputed Manning's contention that courts defer entirely to market price when appraising stock. *See* EISENBERG, *supra* note 6, at 70 & n.5.

101. Twenty-four states have a market exception. *See* Siegel, *supra* note 4, at 96 n.85. This includes Delaware, whose market exception actually is only a partial exception. *See infra* notes 110-12 and accompanying text. The Model Business Corporation Act, which once embraced a market exception, no longer does. *See infra* note 104. Similarly, the ALI Principles of Corporate Governance have rejected a market exception. 2 ALI, PRINCIPLES, *supra* note 5, § 7.21 & cmt. d. Most commentators have argued against a market exception, at least for transactions initiated by a controlling shareholder or insider. *See, e.g.,* EISENBERG, *supra* note 6, at 79-84 (arguing that market prices do not adequately protect public shareholders and that the appraisal remedy should be retained for public corporations); Seligman, *supra* note 6, at 840-41 (arguing that the market exception should not apply to conflict of interest transactions); Siegel, *supra* note 4, at 124-29 (recommending that the market exception apply only to non-conflict transactions); Stout, *supra* note 33, at 1286-95 (arguing that the market exception "is an unwise doctrinal development"); Thompson, *supra* note 6, at 54 (concluding that "if market exceptions are continued they should not apply to conflict transactions"). *But see* Manning, *supra* note 6, at 261 (arguing that if the appraisal remedy is to exist at all, it should apply only when there is no market for the shares).

traded shares.¹⁰² There are two possible explanations for the market exception in appraisal statutes. First, consistent with Manning's arguments, legislatures may have felt that the market adequately valued corporate stock, making the appraisal remedy unnecessary for publicly traded stock.¹⁰³ Another possibility, however, is that the market exception was incorporated into law based on the historical liquidity rationale for the appraisal remedy.¹⁰⁴ Why have an appraisal remedy to serve a liquidity function with respect to publicly traded companies, when liquidity already exists? The appraisal remedy, however, is no longer primarily motivated by a liquidity purpose,¹⁰⁵ and the market exception can no longer be defended on that basis.

Today, the market exception is applicable only in some jurisdictions, and the trend appears to be a movement away from market ex-

102. The typical language provides that the appraisal remedy is not available to holders of stock that is registered on a national securities exchange or held of record by not fewer than 2000 shareholders. See, e.g., KAN. STAT. ANN. § 17-6712(k) (1995). States are, in some instances, expanding the exception to include NASDAQ traded securities, see Thompson, *supra* note 6, at 29-31, a development that is not necessarily desirable, see *id.*

103. The adoption of market exceptions to the appraisal remedy coincided with the ascendancy of modern financial theory and the efficient capital market hypothesis. See Stout, *supra* note 33, at 1285-86. This hypothesis states that market prices reflect investors' estimates of the intrinsic value of securities. See *id.* at 1286. As a result, proponents of this theory have argued that appraisal is unnecessary for publicly traded companies, because the shareholders may obtain true value by selling in the efficient market. See *id.*; Seligman, *supra* note 6, at 837-38, 842-46 (asserting that an appraisal valuation greater than market value would award a windfall to dissenting shareholders); Note, *A Reconsideration of the Stock Market Exception to the Dissenting Shareholder's Right of Appraisal*, 74 MICH. L. REV. 1023, 1030 (1976). By the 1970s, the drafters of the Model Act were no longer confident of the ability of market prices to adequately protect shareholders. See *infra* note 119. For arguments that market prices do not sufficiently protect shareholders, see *infra* Part II.C.; see also Thompson, *supra* note 6, at 29-30 (arguing that it is not necessary to resolve the debate over the efficiency of markets because market price, even in an efficient market, does not compensate for self-dealing).

104. See Thompson, *supra* note 6, at 29. A market exception was originally included in the 1969 version of the Model Business Corporation Act; it was removed in the 1978 revisions. See MODEL BUS. CORP. ACT ANN. § 13.02 historical background (1985). The official comment to the 1969 Model Act notes the addition of the market exception, but contains no explanation for its inclusion. See MODEL BUS. CORP. ACT ANN. § 80 cmt. (1971). An explanation for the inclusion appears in Willard P. Scott, *Changes in the Model Business Corporation Act*, 24 BUS. LAW. 291 (1968). The explanation notes that the appraisal right was designed to fit the needs of a minority shareholder in corporations where there exists a limited market, and serves that purpose well, but that it is not useful for large corporations with an established market for their shares. See *id.* at 302-03. Thus, Scott's explanation seems grounded in the liquidity rationale for the appraisal remedy. The explanation also discusses the pricing prowess of established markets, indicating that a belief in the adequacy of market prices is also behind the inclusion of the market exception. See *id.*

105. See *supra* notes 9-14 and accompanying text; Wertheimer, *supra* note 6, at 3.

ceptions.¹⁰⁶ Although the Model Business Corporation Act once contained a market exception, that provision was subsequently deleted,¹⁰⁷ and states that have adopted the current version of the Model Act typically do not employ a market exception.¹⁰⁸ In eliminating the market exception, the drafters of the Model Act concluded that an ability to sell in the market did not adequately protect the interests of minority shareholders.¹⁰⁹

Delaware law incorporates a market exception,¹¹⁰ but the exception is rendered inapplicable to shareholders who, pursuant to a plan of merger or consolidation, are required to accept anything other than stock in the surviving corporation or stock in another publicly traded corporation.¹¹¹ The appraisal remedy is therefore available to shareholders of a public Delaware corporation who receive cash in a merger; as a result, a large number of post-*Weinberger* Delaware appraisal proceedings have involved publicly traded corporations whose minority shareholders have been cashed out.¹¹²

The remaining question is whether courts should defer to market price when fixing fair value. In answering this question, it is important again to recognize that most of the transactions now generating appraisal claims are cash-out mergers.¹¹³ Cash-out mergers are typically accomplished at a premium to the prevailing market price.¹¹⁴ As a result, if a court defers to market price in assessing fair value, the appraisal remedy will be of no value to a dissenting shareholder.¹¹⁵

106. See *supra* note 101.

107. See *supra* note 104.

108. But see TENN. CODE ANN. § 48-23-102(c) (1995) (retaining market exception even though statute based on current version of MBCA).

109. See MODEL BUS. CORP. ACT ANN. § 13.02 historical background (1985) (stating that "access to market value is not a reasonable alternative for a dissenting shareholder" (quoting Alfred F. Conard, *Amendments of Model Business Corporation Act Affecting Dissenters' Rights (Sections 73, 74, 80, and 81)*, 33 BUS. LAW. 2587, 2595 (1978))). The ALI Principles of Corporate Governance similarly reject a market exception. See 2 ALI, PRINCIPLES, *supra* note 5, § 7.21 & cmt. d.

110. See DEL. CODE ANN. tit. 8, § 262(b)(1) (Supp. 1996).

111. See *id.* § 262(b)(2). Payment of some cash in lieu of fractional shares will not cause the inapplicability of the market exception. See *id.* § 262(b)(2)(iii).

112. See Thompson, *supra* note 6, at 4, 25-28.

113. See *supra* notes 9-12 and accompanying text.

114. See *supra* note 33. The persistent willingness of purchasers to pay large premiums over existing market prices is at odds with the efficient capital market theory, see Stout, *supra* note 33, at 1259-60, and therefore undercuts the efficient market rationale for a market exception to the appraisal remedy. See *supra* note 103.

115. Under many existing appraisal statutes, courts are directed to ascertain fair value "immediately before the effectuation of the [merger,] . . . excluding any appreciation or depre-

Presumably, legislatures in the many states that have enacted appraisal statutes without market exceptions, and legislatures such as Delaware's which make the market exception inapplicable to cash-out mergers,¹¹⁶ did not intend to provide a useless remedy. It necessarily follows that courts should not rely exclusively on market price to determine fair value. Further, minority shareholders that have been cashed out of their investment at a time not of their choosing, typically by a controlling shareholder, will not be protected if courts rely exclusively on market price in appraisal proceedings; a remedy that relies on a market price that is less than the merger price is no remedy at all.

C. Why Market Price Alone Is Not Sufficient

Legislatures that have enacted appraisal statutes without market exceptions appear to have recognized that the market does not always adequately protect minority shareholders, and that minority shareholders cashed out at a price at or above the market price may require additional protection. There are, in fact, good reasons why reliance on market price does not adequately protect the interests of minority shareholders.

Market prices swing rather widely. It takes only a brief look at the fifty-two week high and low prices for publicly traded securities to see that there can be a great deal of variance in a corporation's stock price over the course of a year,¹¹⁷ even when no major changes

ciation in anticipation of the [merger]." MODEL BUS. CORP. ACT § 13.01(3) (1991). Under such statutes, a court applying a valuation standard deferential to market price could proceed in two possible ways. First, the court could look to the market price immediately before the consummation of the merger. Under this approach, fair value would invariably be very close to the merger price because the market price and the merger price will converge right before the merger is consummated. Alternatively, a court might construe the statutory requirement that "appreciation or depreciation in anticipation of the [merger]" be excluded from fair value to require an adjustment of the market price to exclude the increase in price that resulted from the announcement of the merger. In that event, the court would look to the market price prior to the announcement of the merger, which would invariably be below the merger price. Thus, in either case, a shareholder opposed to the merger would be in a worse position by dissenting than by going along with the cash-out merger transaction. The best the dissenting shareholder could hope for would be to receive something very near the merger price, and the shareholder would also bear the expenses of the appraisal proceeding. Therefore, reliance on market price to determine fair value renders the appraisal remedy useless to shareholders.

116. See *supra* notes 110-12 and accompanying text.

117. The high and low prices for the 52-week period ending on July 10, 1997, for the first 10 stocks, alphabetically, that make up the Dow Jones Industrial Averages were as follows:

have taken place within the corporation or its industry. If appraised value is to be derived from market price alone, should it be the high market price over the last year, or the low market price? Or, should it be the price that happens to prevail around the time of the merger? Is there any reason to believe that the market price on any given day of the year is a more accurate measure of fair value than the price on some other day?

Because market prices can swing rather dramatically over relatively short periods of time, if market price is to be relied upon in determining fair value, the timing of the transaction giving rise to dissenters' rights is crucial. The timing of the transaction is controlled, however, by those who propose the transaction; often, it is the controlling shareholder who proposes the transaction. Those in control have the ability to manipulate the timing of the transaction to their own advantage, and to the detriment of the minority shareholders. This potential for abuse provides a sound reason to look beyond prevailing market price at the time of the transaction in determining fair value.

In fact, reported cases demonstrate that controlling shareholders do sometimes attempt to time cash-out mergers to their advantage. For example, in *Berkowitz v. Power/Mate Corp.*,¹¹⁸ a merger cashing out minority shareholders was timed to coincide with the historical

	<u>High</u>	<u>Low</u>
AT&T	\$ 42 5/8	\$ 30 3/4
Allied Signal	89	52 3/4
Alcoa	80 7/16	55 1/8
Am Express	83 1/2	39 3/8
Boeing	58	39 15/16
Caterpillar	112 1/4	62 3/4
Chevron	77 1/4	55 7/8
Coca Cola	72 5/8	44 1/4
Disney	85 1/8	53 1/4
DuPont	66	36 7/16

See *New York Stock Exchange Composite Transactions*, WALL ST. J., July 11, 1997, at C3-4. This phenomenon is not unique to 1997. High and low price data from 1968 and 1974 for 10 random New York Stock Exchange traded companies exhibited similar, if not greater, annual fluctuations. See EISENBERG, *supra* note 6, at 81-82. Lesser known, smaller corporations are probably even more volatile. For example, as of July 10, 1997, the first 10 stocks alphabetically listed on the NASDAQ exchange showed a high price on average more than 2.5 times greater than the low price over the prior 52 weeks. See *NASDAQ National Market Issues*, WALL ST. J., July 11, 1997, at C7.

118. 342 A.2d 566 (N.J. Super. Ct. Ch. Div. 1975).

low point in the market price for the corporation's stock.¹¹⁹ Not only did the insiders propose a cash-out merger at a time when the corporation's market price was at its nadir, the merger was also timed to take place before an improvement in operating results had been adequately disclosed to the public.¹²⁰ The ability of insiders to time a transaction to their benefit counsels against reliance on market price in an appraisal proceeding.¹²¹

119. Power/Mate went public at a price of \$5 per share in 1968. *See id.* at 568. The price fluctuated between \$2.25 and \$21 during the period 1968-1970. *See id.* The price declined in the 1971-1974 period, and in 1975 it was quoted at \$1.25 bid and \$2 asked. *See id.* at 569-70. At this point, insiders proposed a cash-out merger at \$2 per share. *See id.* at 570.

The Berkowitz transaction was not unique in this respect. As the Berkowitz court pointed out:

Numerous privately-held companies which were taken "public" by their insiders during the boom market for new issues that prevailed during the 1960's are now, as a result of the current stock market depression, seeking—through the same insiders—to buy back the public's interest at a fraction of the price paid by the public for its stock.

Id. These same concerns, initially generated by the depressed market conditions of the mid-1970s, led the Securities Exchange Commission to propose a rule governing "going private" transactions. As first proposed, the rule would have placed a substantive fairness requirement on going private transactions. *See* Going Private Transactions by Public Companies or Their Affiliates, Securities Act Release No. 5884, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,366, at 88,746-47 (Nov. 17, 1977); Notice of Public Fact-Finding Investigation and Rulemaking Proceeding in the Matter of "Going Private" Transactions by Public Companies and Their Affiliates, Securities Act Release No. 5567, [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,104, at 85,092-93 (Feb. 6, 1975). Ultimately, however, the Commission adopted a rule without a substantive fairness requirement, opting instead for a disclosure-oriented rule. *See* 17 C.F.R. § 240.13e-3(e) (1996); Going Private Transactions by Public Companies or Their Affiliates, Securities Act Release No. 6100, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,166, at 82,124-25 (Aug. 2, 1979). One of the items that must be disclosed, however, is "whether the issuer . . . reasonably believes that the . . . transaction is fair or unfair to unaffiliated security holders." 17 C.F.R. § 240.13e-100, Item 8(a) (1996). The issuer is required to "[d]iscuss in reasonable detail the material factors upon which the belief . . . is based." *Id.*, Item 8(b).

The ability of insiders to take advantage of a "demoralized market" to take companies private at unfair prices, as evidenced by the market experience in the 1970s, also lay behind the decision to eliminate the market exception to appraisal rights from the Model Business Corporation Act. *See* MODEL BUS. CORP. ACT ANN. § 13.02 historical background (1985) (quoting Conard, *supra* note 109, at 2595).

120. Toward the end of 1974, the two individuals who were the principal officers, directors, and controlling shareholders of Power/Mate caused the corporation to pay to each of them a \$100,000 bonus. *See Berkowitz*, 342 A.2d at 568-69. As a result, the reported earnings for the six-month period ending December 31, 1974, were \$.41 per share, as opposed to the \$1.01 per share figure that would have been reported had the bonuses not been paid. *See id.* As the court noted, "it may be doubted whether the market price of Power/Mate stock would have remained at \$1.25 bid and \$2 asked had the company announced earnings for the six-month period ending December 31, 1974 in excess of \$1 a share." *Id.* at 573-74.

121. *See id.*

The *Berkowitz* case also illustrates some of the other arguments that can be made against reliance on market price in an appraisal proceeding. The insiders proposing a cash-out merger have the potential to manipulate the corporation's actions in the period leading up to the proposed merger. Insiders may conduct the corporation's affairs in a manner that depresses share prices, thereby allowing the insiders to acquire the minority's interest at a depressed price. In *Berkowitz*, for example, the insiders paid to themselves \$200,000 in bonuses in the financial reporting period prior to the proposed cash-out merger.¹²² These bonuses lowered the corporation's reported earnings and probably kept its stock price from rising.¹²³

Another powerful argument that counsels against reliance on market price to determine fair value stems from informational asymmetry. Insiders proposing a cash-out merger are likely to have access to information that is not available to minority shareholders, and that is not reflected in market prices.¹²⁴ It is unfair to allow insiders to use such information to their benefit, and unfair to relegate dissenting shareholders to a market price that does not reflect information known only to insiders.¹²⁵ For example, there is little doubt that the insiders proposing the merger in *Berkowitz* had a far greater appreciation of the fact that the company had turned the corner toward greater profitability than did the market or the minority shareholders.¹²⁶

The argument has been made that as long as shareholders receive a higher price in a cash-out merger than the pre-merger market

122. See *supra* note 120.

123. See *supra* note 120; see also *Sealy Mattress Co. v. Sealy, Inc.*, 532 A.2d 1324, 1336 (Del. Ch. 1987) (suggesting a "calculated effort to depress the price of Sealy until the minority stockholders were eliminated by merger or some other form of acquisition"); *In re Spang Indus., Inc.*, 535 A.2d 86, 90 (Pa. Super. Ct. 1987) (affirming the trial court's holding that the corporation understated its assets and overstated its liabilities in preparation for a cash-out merger).

124. One court has recognized that insiders may possess exclusive "bits and pieces of *non-material* information" that, when put together, have value and provide insight into the company's future. *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182, 1187 n.8 (Del. 1988); accord *Kanda & Levmore, supra* note 6, at 467 ("A firm's market value is not always a good . . . predictor of its real value because the market by hypothesis is unaware of the firm's secrets."); see also 2 ALI, PRINCIPLES, *supra* note 5, § 7.21 & cmt. d (rejecting "stock market exclusion" in part because "management may be in a position to know that the current market price of a company's stock undervalues the corporation").

125. See *Technicolor*, 542 A.2d at 1187 n.8 ("Information and insight not communicated to the market may not be reflected in stock prices; thus, minority shareholders being cashed out may be deprived of part of the true investment value of their shares." (citations omitted)).

126. See *Berkowitz*, 342 A.2d at 568-69 (discussing trends in financial results).

price they are better off, and that any legal rule that mandates a merger price in excess of some bare minimum over market price will unnecessarily and unwisely discourage efficiency-enhancing mergers.¹²⁷ This argument, however, assumes that all mergers are engaged in to unlock hidden efficiencies; it is impaled by the sword of informational asymmetry. If insiders can personally profit by engaging in cash-out mergers based on their informational advantage, they have not created efficiencies by engaging in the merger. They have merely transferred wealth from the prior shareholders to themselves.¹²⁸

In sum, there is a risk that insiders will take advantage of their positions and propose cash-out mergers to benefit themselves because they control the timing of transactions, can conduct or manipulate corporate affairs in a manner that depresses market prices prior to mergers, and maintain informational advantages over minority shareholders. As Professor Coffee has recognized, it is extremely important to examine this problem from an *ex ante* point of view:

[T]he more the minority fears transactions structured by the majority, which expropriate their proportionate share in the corporation, the less they will be willing to pay for equity in corporations that are subject to such risks. Thus, at least to the extent that the controlling shareholder expects to raise capital by selling equity, it too will share an interest in an adequate appraisal remedy that deters uncompensated wealth transfers.

This perspective leads quickly to the realization that stock market value alone cannot be the standard for determining fair value in circumstances where a controlling shareholder is cashing out the mi-

127. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 698 (1982) ("We argue . . . that those who produce a gain [those who propose efficiency-enhancing corporate transactions] should be allowed to keep it, subject to the constraint that other parties to the transaction be at least as well off as before the transaction. Any attempt to require sharing simply reduces the likelihood that there will be gains to share."); Fischel, *supra* note 6, at 886 (arguing that giving shareholders a premium over pre-transaction market price would "decrease the number of value-increasing transactions by making them more expensive"); Benjamin Hermalin & Alan Schwartz, *Buyouts in Large Companies*, 25 J. LEGAL STUD. 351, 355 (1996) ("[F]or companies whose shares trade widely enough to have a market price[,] . . . efficiency is achieved . . . by awarding the shareholder the preinvestment market price of the firm's shares."); see also Berkowitz, 342 A.2d at 574 ("Defendants urge in effect that any price offered the minority in excess of the market price is *per se* fair and reasonable.").

128. See John C. Coffee, Jr., *Transfers of Control and the Quest for Efficiency: Can Delaware Law Encourage Efficient Transactions While Chilling Inefficient Ones?*, 21 DEL. J. CORP. L. 359, 410-11 & n.239 (1996).

nority. The stock price, particularly in an efficient market, inherently factors in the likelihood that the majority will overreach the minority.¹²⁹

Further, courts have recognized that market price is particularly unreliable when a control block of stock resides in the hands of a controlling shareholder.¹³⁰ The presence of a large block of stock leads to less liquidity, fewer trades, and a less reliable market price. As one court has stated, its presence has a "controlling and restrictive" effect on trading.¹³¹

Apart from the effect a control block has on market price, one might also ask exactly what market price measures, and how that measure relates to appraised fair value. The market price for a security is the price at which relatively small blocks of shares change hands.¹³² In other words, it is the price at which noncontrol or minority shares change hands, and therefore reflects a "minority discount." As a result, the Delaware courts have cautioned against placing "too much emphasis on market value."¹³³ The courts have stated that an appraisal proceeding seeks to determine a corporation's intrinsic value, and an *overstated* reliance on market price to determine intrinsic value is a defective approach.¹³⁴ The role that minority discounts (and, conversely, control premiums) play in valuing shares for appraisal purposes is a matter of continuing controversy.

129. *Id.* at 407 (footnotes omitted).

130. *See, e.g.,* Ryan v. Tad's Enters., Inc., Nos. CIV.A. 10229, 11977, 1996 WL 936160, at *9 n.14 (Del. Ch. Apr. 24, 1996) (stating that the market price for shares of Tad's Enterprises, Inc. reflected the existence of a 72.6% control block and therefore was not a reliable measure of the fair value of the corporation), *aff'd* 693 A.2d 1082 (Del. 1997); *In re Spang Indus., Inc.*, 535 A.2d 86, 90 (Pa. Super. Ct. 1987) (agreeing with the trial court that it is appropriate to accord minimal weight to market value where there is a large control block outstanding); *see also* Coffee, *supra* note 128, at 401-05, 408 (discussing empirical evidence suggesting that presence of control block of stock has negative effect on market value); *cf. In re Glosser Bros., Inc.*, 555 A.2d 129, 133-36 (Pa. Super. Ct. 1989) (concluding that the trial court erred in completely disregarding market value, but that according low weight to market value would be appropriate in light of the presence of a large control block of stock that affects market price).

131. *See In re Spang Indus., Inc.*, 535 A.2d at 90.

132. *See* Smith v. Van Gorkom, 488 A.2d 858, 876 (Del. 1985).

133. *Rapid-American Corp. v. Harris*, 603 A.2d 796, 806 (Del. 1992); *see also Van Gorkom*, 488 A.2d at 875-76 (finding that the use of market price to determine "true value" of company was "clearly faulty").

134. *See Rapid-American Corp.*, 603 A.2d at 806.

D. Minority Discounts and the Confusion Over "Control Premiums"

1. *Minority Discounts.* Perhaps the most fundamental issue in appraisal valuation is whether the court should attempt to value the minority interest held by the dissenting shareholder or should instead attempt to value the corporation as a whole. The former approach would permit the application of a minority discount to the dissenting shares, while the latter approach would not. The Delaware courts have emphatically embraced the latter approach, concluding that the appraisal process should seek to value the corporation as a whole, with a pro rata share of that value awarded to the dissenting shareholder.¹³⁵

The appraisal process almost always begins with an attempt by each party to establish the value of the corporation as a whole; the issue of minority status does not arise until the corporation and its expert contend that, having arrived at a valuation for the corporation as a whole, a minority discount should be applied to arrive at the value of the dissenting shareholder's stock.¹³⁶ Delaware has rejected

135. See, e.g., *In re Appraisal of Shell Oil Co.*, 607 A.2d 1213, 1218 (Del. 1992) (stating that the shareholder is entitled to his proportionate interest in a going concern); *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1144 (Del. 1989) (stating that the shareholder is entitled to his proportionate interest in the corporation, appraised as an entity).

136. See, e.g., *Cavalier Oil Corp. v. Harnett*, Nos. CIV.A. 7959, 7960, 7967, 7968, 1988 Del. Ch. LEXIS 28, at *24-25 (Feb. 22, 1988) (noting that after valuing companies, companies' experts employed 55% discount to value dissenters' shares); *Richardson v. Palmer Broad. Co.*, 353 N.W.2d 374, 376 (Iowa 1984) (stating that corporation's expert attempted to discount valuation by 30-40% based in part on dissenting shareholder's minority status); see also Robert B. Heglar, *Rejecting the Minority Discount*, 1989 DUKE L.J. 258, 260 (discussing two-step process of valuing corporation as a whole, then deciding whether to reduce value of minority shareholders' shares). The term "minority discount" refers to a valuation of minority shares at less than their proportionate share of the value of the corporation as a whole, reflecting the minority shareholder's inability to exercise control over corporate decisionmaking. See *id.*

Closely-held corporations involved in appraisal proceedings sometimes contend that dissenting minority shares also should be discounted for their lack of marketability. See, e.g., *Friedman v. Beway Realty Corp.*, 661 N.E.2d 972, 974-75 (N.Y. 1995). A "lack of marketability" discount is another form of minority discount in that, if permitted, the dissenting shareholder receives less than a proportionate share of the value of the corporation as a whole. It therefore should be rejected for the same reasons minority discounts should be rejected. See *infra* notes 141-47 and accompanying text. Nonetheless, two courts that have rejected minority discounts in the appraisal context inexplicably have permitted a lack of marketability discount. See *Friedman*, 661 N.E.2d at 975-77; *Columbia Management Co. v. Wyss*, 765 P.2d 207, 209 (Or. Ct. App. 1988). But see *Sieg Co. v. Kelly*, 568 N.W.2d 794, 800 & n.3 (Iowa 1997) (noting trial court's conclusion that lack of marketability discount was not permitted by Iowa law, but declining to rule on this issue because it was not raised on appeal). The New York position is particularly difficult to understand. *Friedman* provides a powerful rejection of minority dis-

any attempt to saddle dissenting shares with a minority discount,¹³⁷ as have the majority of other courts,¹³⁸ including New York's,¹³⁹ but some

counts for all of the correct reasons, *see infra* note 144 and accompanying text, yet permits a lack of marketability discount. The dissenting shareholder in *Friedman* apparently did not pursue on appeal the issue of a lack of marketability discount. *See Friedman*, 661 N.E.2d at 975. Lack of marketability discounts crept into New York law in two intermediate appellate level cases that arose in the context of a dissolution proceeding, rather than an appraisal proceeding. *See infra* note 138. Hopefully, the New York Court of Appeals will rethink this issue when it next arises.

137. *See Cavalier Oil Corp.*, 564 A.2d at 1145 ("The application of a discount to a minority shareholder is contrary to the requirement that the company be viewed as a 'going concern.'").

138. *See, e.g., Foy v. Klapmeier*, 992 F.2d 774, 780-81 (8th Cir. 1993) (concluding that district court's imposition of minority discount was erroneous under Minnesota law, and noting that this conclusion is "in accordance with the approach of the majority of states which have addressed" the issue); *Walter S. Cheesman Realty Co. v. Moore*, 770 P.2d 1308, 1312-13 (Colo. Ct. App. 1988) (finding that the trial court erred in applying minority discount); *Sieg Co. v. Kelly*, 512 N.W.2d 275, 284 (Iowa 1994) (noting that "caselaw prohibits applying a discount because of the stockholder's status as a minority shareholder"); *Palmer Broad. Co.*, 353 N.W.2d at 379 (viewing minority discounts as "contrary to spirit of 'fair value' determinations for dissenting minority shareholders" under Iowa law); *In re Valuation of Common Stock of McLoon Oil Co.*, 565 A.2d 997, 1004 (Me. 1989) (stating that appraisal remedy should not incorporate minority discount); *MT Properties, Inc. v. CMC Real Estate Corp.*, 481 N.W.2d 383, 386-88 (Minn. Ct. App. 1992) (prohibiting minority discount, and noting that this is the majority view); *Rigel Corp. v. Cutchall*, 511 N.W.2d 519, 524-26 (Neb. 1994) (finding that appraisal statute disallowed minority discount); *Woolf v. Universal Fidelity Life Ins. Co.*, 849 P.2d 1093, 1095 (Okla. Ct. App. 1992) (arguing that "since the Delaware court has rejected the discount rule, Oklahoma should follow the same rule"); *Columbia Management Co.*, 765 P.2d at 212-14 (rejecting minority discount under Oregon law, though accepting marketability discount for shares of closely held corporation); *see also Robblee v. Robblee*, 841 P.2d 1289, 1293-95 (Wash. Ct. App. 1992) (rejecting minority discount in a valuation performed pursuant to a private division of assets agreement, analogizing to appraisal law); *Coffee, supra* note 128, at 364 n.11 (collecting caselaw on minority discounts). *Compare Hunter v. Mitek Indus., Inc.*, 721 F. Supp. 1102, 1106-07 (E.D. Mo. 1989) (declining to impose minority or lack of marketability discount, but noting that under Missouri law, the imposition of such discounts is within the discretion of the trier of fact), *with King v. F.T.J., Inc.*, 765 S.W.2d 301, 305-06 (Mo. Ct. App. 1988) (holding that application of minority and marketability discounts is within trial court's discretion, and affirming trial court's decision to reject marketability discount and apply minority discount only to that portion of the corporation's value attributable to non-saleable assets that were integral to the corporation's business).

Another context in which courts are called on to value corporate stock is in a dissolution proceeding. If a minority shareholder requests that a court dissolve a corporation, the court has the power to order the buyout of that shareholder in lieu of ordering dissolution. *See Davis v. Sheerin*, 754 S.W.2d 375, 378-80 (Tex. App. 1988, writ denied). In addition, under the Model Business Corporation Act, if a shareholder petitions the court for dissolution, the corporation or the other shareholders can elect to purchase the shares owned by the petitioning shareholder at fair value. *See MODEL BUS. CORP. ACT* § 14.34(a) (1991). Buyouts in the context of dissolution proceedings present similar issues to buyouts in the context of dissenters' appraisal rights. Most courts have rejected the imposition of minority discounts when determining fair value in the context of a dissolution buyout. *See, e.g., Ronald v. 4-C's Elec. Packaging, Inc.*, 214 Cal. Rptr. 225, 230 (Cal. Ct. App. 1985); *Charland v. Country View Golf Club, Inc.*, 588 A.2d 609, 612 (R.I. 1991); *cf. Raskin v. Walter Karl, Inc.*, 514 N.Y.S.2d 120, 121 (N.Y. App. Div. 1987)

courts have allowed the appraised value of stock to reflect a minority discount.¹⁴⁰

Courts that have declined to apply a minority discount in the appraisal context have correctly focused on the purpose of the appraisal remedy to justify their conclusion. The primary purpose of the appraisal remedy today is to protect minority shareholders from wrong-

(rejecting minority discount, but approving lack of marketability discount). *But see* McCauley v. Tom McCauley & Son, Inc., 724 P.2d 232, 243-45 (N.M. 1986) (finding it within the discretion of the trial court to apply minority discount to shares). Discounts in the dissolution context, both minority and lack of marketability, should be rejected for the same reasons discounts are inappropriate in the dissenting shareholder context. *See infra* notes 141-47 and accompanying text; *see also* Charles W. Murdock, *The Evolution of Effective Remedies for Minority Shareholders and Its Impact Upon Valuation of Minority Shares*, 65 NOTRE DAME L. REV. 425, 428-29, 478-89 (1990) (arguing that minority discount is not justified). In fact, given that dissolution proceedings are often triggered by oppressive and inequitable conduct, *see id.* at 455-71, 475-78, courts should be very skeptical of discounting minority shares in dissolution proceeding buyouts.

139. *See Friedman*, 661 N.E.2d at 975-77.

140. *See* *Hernando Bank v. Huff*, 609 F. Supp. 1124, 1126 (N.D. Miss. 1985) (applying Mississippi law and concluding that "in the present case a minority discount is proper"), *aff'd*, 796 F.2d 803 (5th Cir. 1986); *Perlman v. Permonite Mfg. Co.*, 568 F. Supp. 222, 230-32 (N.D. Ind. 1983) (concluding that under Indiana law the appraising court must consider evidence that the plaintiff's shares represent a minority interest or lack marketability, and finding that the minority and lack of marketability discounts applied by the corporation's expert were proper), *aff'd*, 734 F.2d 1283 (7th Cir. 1984); *Atlantic States Constr., Inc. v. Beavers*, 314 S.E.2d 245, 251 (Ga. Ct. App. 1984) (holding that trial court not prevented by statute from considering minority interest factor and devaluing stock accordingly); *Weigel Broad. Co. v. Smith*, 682 N.E.2d 745, 750-51 (Ill. App. Ct.) (holding that application of minority and lack of marketability discounts is within trial court's discretion, and affirming trial court's decision to apply such discounts), *appeal denied*, 689 N.E.2d 1147 (Ill. 1997); *Independence Tube Corp. v. Levine*, 535 N.E.2d 927, 931 (Ill. App. Ct. 1989) (stating that "the trial court properly considered both the minority factor and the illiquidity factor"); *see also* *Moore v. New Ammest, Inc.*, 630 P.2d 167, 177 (Kan. Ct. App. 1981) (pre-*Weinberger*) (concluding that trial court's acceptance of appraiser's valuation, which included a minority discount, was not improper). A significant portion of the precedent permitting minority discounts, therefore, has been generated by federal courts, attempting to guess as to the appropriate state court rule in a diversity case.

Atlantic States is one of the few decisions of a state court to embrace the notion of minority discounts, and the corresponding notion that the purpose of the appraisal proceeding is to value the dissenting shareholders' minority interest rather than to accord the dissenting shareholder a pro rata share of the corporation as a whole. *See Atlantic States Constr.*, 314 S.E.2d at 250-51. Interestingly, the only authority cited by the Georgia court in reaching this conclusion was the trial court decision in *Jones v. Healy*, 55 N.Y.S.2d 349, 356-57 (N.Y. Sup. Ct. 1945) (stating that the valuation process should find the value of the dissenting shareholders' stock, not simply give those shareholders a pro rata interest), *aff'd mem.*, 62 N.Y.S.2d 605 (N.Y. App. Div. 1946). No mention was made of better known, yet contrary, authority, such as *Bell v. Kirby Lumber Corp.*, 395 A.2d 730, 735 (Del. Ch. 1978) (holding shareholder entitled to proportionate interest in going concern), *modified*, 413 A.2d 137 (Del. 1980), and *Tri-Continental Corp. v. Battye*, 74 A.2d 71, 72 (Del. 1950) (same). The New York courts have since concluded that a dissenting shareholder is entitled to a proportionate share in the going concern value of the corporation, without a minority discount. *See Friedman*, 661 N.E.2d at 975-77.

ful conduct.¹⁴¹ If this purpose is to be fulfilled, the dissenting shareholder must receive a pro rata share of the value of the corporation.¹⁴² As the Delaware Supreme Court stated in rejecting the application of a minority discount, "fail[ure] to accord to a minority shareholder the full proportionate value of his shares imposes a penalty for lack of control, and unfairly enriches the majority shareholders who may reap a windfall from the appraisal process by cashing out a dissenting shareholder, a clearly undesirable result."¹⁴³

If a minority shareholder did not receive a full pro rata share of the value of the corporation, those engaging in the cash-out merger would, by definition, receive more than their pro rata share of the value of the corporation. This would permit them to "profit" from engaging in a cash-out merger, and would encourage controlling shareholders to attempt to take advantage of minority shareholders. The New York Court of Appeals recognized this policy concern when it rejected the imposition of a minority discount:

[A] mandatory reduction in the fair value of minority shares to reflect their owners' lack of power in the administration of the corporation will inevitably encourage oppressive majority conduct, thereby further driving down the compensation necessary to pay for the value of minority shares. "Thus, the greater the misconduct by the majority, the less they need to pay for the minority's shares."¹⁴⁴

Imposing a minority discount in the appraisal process¹⁴⁵ encourages controlling shareholders to take advantage of minority share-

141. See *supra* notes 9-14 and accompanying text.

142. See *Friedman*, 661 N.E.2d at 976; *Cawley v. SCM Corp.*, 530 N.E.2d 1264, 1266 (N.Y. 1988).

143. *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1145 (Del. 1989).

144. *Friedman*, 661 N.E.2d at 977 (quoting *Murdock*, *supra* note 138, at 487).

145. Appraisal is a fairly specialized proceeding requiring the valuation of minority shares. The other context in which minority shares are frequently "valued" is for tax purposes, and more specifically, for estate and gift tax purposes when minority shares are transferred at death or by gift. As Professor *Murdock* has written: "Valuation theory is essentially conservative. This is in large measure due to the fact that it has been tax driven. Most of the cases and articles in the field are generated by the taxing process." *Murdock*, *supra* note 138, at 471 (citations omitted). It is not surprising that the owners of minority shares argue in favor of a minority discount when those shares are valued in the tax context, in order to minimize their tax burden. This type of tax creates a need for liquidity (to pay the tax) at a point in time when the shares have not been disposed of for value. "[P]ublic policy and equity dictate a conservative valuation process" in such circumstances. *Id.*

Although minority discounts make sense in a tax setting, it does not follow that they should be imported into the appraisal setting. See *id.* at 472. This is not merely because the

holders, and allows them to appropriate a portion of the value of the corporation from the minority shareholders.¹⁴⁶ This problem is exacerbated when the corporation's value as a whole is initially determined by reference to market price. Because market price reflects the value of a small quantity of stock, market price already reflects a minority discount. If a court values a corporation by reference to market price, and then imposes a minority discount, it in effect discounts the stock twice to reflect its minority status, and confers a further windfall on the majority shareholder.¹⁴⁷

discount benefits the minority shareholder in one context, and burdens it in another, but because the nature and purpose of the two proceedings are so different.

In the tax context, the minority shareholder's interest in the corporation is maintained in the hands of the transferee, who is typically related to the transferor, and who remains a minority shareholder. The shares being valued remain minority shares. The person suffering the detriment from the minority discount is the tax collector. The harm, however, is not necessarily permanent, because if the shares are later disposed of without a minority discount, taxes will likely be due on the full, non-discounted value, less the taxpayer's basis.

In the appraisal context, the minority shareholder's interest in the corporation typically is being terminated. That shareholder will have no other opportunity to dispose of the shares and receive their full pro rata value. The person suffering the detriment from a minority discount is the minority shareholder, and the benefit flows to those doing the cashing out. As a result, it is appropriate to value minority shares differently for appraisal and tax purposes. *See Robbins & Co. v. Israel*, No. CIV.A.7919, 1985 Del. Ch. LEXIS 498, at *9 (Oct. 2, 1985) (according estate tax valuation no independent weight in later appraisal proceeding).

146. It might be argued that if a dissenting shareholder acquired his stock taking advantage of a minority discount, for example by purchasing the stock at a market price, the shareholder should similarly be saddled with a minority discount at the time of exit via an appraisal proceeding. This argument is misguided for several reasons. First, as noted above, if minority shareholders receive less than their pro rata share of the value of the corporation, those engaging in the cash-out merger would necessarily receive more than their pro rata share. This would violate tenets of fundamental fairness, and encourage wrongful conduct. Second, shareholders willing to invest their capital and purchase a minority position in a corporation do so with the expectation that if the corporation is acquired or taken private, they will realize their pro rata share of the corporation's value. If such shareholders can be involuntarily removed from their investments through a cash-out merger without receiving a pro rata share of the corporation's value, they will be less willing to make such investments. This would result in an increase in the cost of capital for corporations. *See supra* note 129 and accompanying text. Finally, shareholders who are able to acquire corporate stock at a minority discount "pay" for that discount by virtue of their inability to control or influence corporate decision making. They should not have to pay again by virtue of a discount in connection with a forced exit from the corporation.

147. *See Coffee, supra* note 128, at 407-08.

2. *The Confusion over "Control Premiums."* The goal of the appraisal proceeding in most states is to determine the dissenting shareholder's proportionate interest in the corporation as a whole, without any discount for minority status.¹⁴⁸ Another issue that has arisen in the appraisal context is whether an upward adjustment to the appraised value should be made to allow the dissenting shareholder to obtain a proportionate share of the control premium that would be reflected in a sale of control of the corporation. When the corporation as a whole is valued by comparison to the stock price of a publicly traded company, the resulting valuation necessarily is of a minority interest.¹⁴⁹ In that event, it would be logically consistent to make an upward adjustment to remove the inherent minority discount reflected in a "market price based valuation."¹⁵⁰

This issue was raised in the appraisal proceeding in *Rapid-American Corp. v. Harris*.¹⁵¹ Rapid-American's controlling shareholder engaged in a cash-out merger of the minority shareholders, some of whom dissented from the merger and sought appraisal of their shares.¹⁵²

Rapid-American was a holding company that derived virtually all of its income and revenue from three wholly-owned subsidiaries, each of which was engaged in a different business.¹⁵³ Because Rapid-American was a holding company, and no other company was comparable in terms of its mix of different businesses, the expert engaged by the minority shareholders separately valued each of Rapid-American's three subsidiaries, using a "comparable company" approach.¹⁵⁴ Similar publicly traded companies were examined to determine pricing multiples, and those multiples were then applied to

148. See *supra* notes 135-47 and accompanying text.

149. See *supra* notes 132-34 and accompanying text.

150. "Market price based valuation" is used to refer to valuing a company by reference to the price of its own publicly traded shares, or valuing a company by comparing it to other, similar publicly traded companies. This would typically be done by looking at the ratios of market price to certain financial measures (e.g., price/earnings ratio) for similar public companies, and utilizing those ratios to value the company in question. For example, the price/earnings ratio of a similar company could be multiplied by the earnings of the company being appraised to generate a valuation that is based on a comparable publicly traded company.

151. 603 A.2d 796 (Del. 1992).

152. See *id.* at 798-800.

153. See *id.* at 799. One subsidiary, McCrory, was engaged in retailing and merchandising. See *id.* Another, Schenley, was a "distiller, importer and distributor of alcoholic spirits." *Id.* The third, McGregor, was a clothing manufacturer and distributor. See *id.*

154. See *id.* at 800-01.

the financial results of the Rapid-American subsidiaries.¹⁵⁵ This resulted in a valuation for each of the Rapid-American subsidiaries that was derived from a comparison to similar *publicly traded* companies. The value attributed to each subsidiary was therefore a market price based valuation.

The dissenting shareholder argued that a control premium should then be added to the valuations generated by a comparison to public companies.¹⁵⁶ The Delaware Court of Chancery rejected the inclusion of a control premium,¹⁵⁷ but the Delaware Supreme Court disagreed with the chancery court, holding that "Delaware law *compels* the inclusion of a control premium under the unique facts of this case."¹⁵⁸ A rejection of the control premium would "place[] too much emphasis on market value."¹⁵⁹

The Delaware Supreme Court carefully attempted to limit its holding to the "unique facts of [the] case."¹⁶⁰ Failure to add a control premium in *Rapid-American* "artificially and unrealistically treated Rapid as a minority shareholder" of its subsidiaries, when in fact those subsidiaries were wholly owned by Rapid.¹⁶¹ As a result, the court concluded that the addition of a control premium in this case would not be at the shareholder level, which might be impermissible, but instead would be at the parent or corporate level, which was not only permitted, but required.¹⁶²

155. These multiples were based on revenues, earnings before interest and taxes (EBIT), earnings before depreciation, amortization, interest and taxes, and tangible book value of invested capital. See *id.* at 800. The expert located, for example, a publicly traded company with a business similar to McCrory. It then determined the amount by which the aggregate market price of this similar company exceeded its annual revenues (or its annual EBIT). This generated a revenues multiplier (or an EBIT multiplier) based on a comparable publicly traded company. That multiplier was then applied to McCrory's revenues (or EBIT), thereby generating a value for McCrory based on a comparable publicly traded company. See *Harris v. Rapid-American Corp.*, No. CIV.A.6462, 1990 WL 146488, at *9-16 (Del. Ch. Oct. 2, 1990), *aff'd in part, rev'd in part*, 603 A.2d 796 (Del. 1992).

156. See *Rapid-American*, 603 A.2d at 798, 804.

157. See *Harris*, 1990 WL 146488, at *7.

158. *Rapid-American*, 603 A.2d at 806.

159. *Id.*; see also *id.* at 806-07 (stating that the trial court's rejection of a control premium "implicitly placed a disproportionate emphasis on pure market value").

160. *Id.* at 806. In *Le Beau v. M.G. Bancorporation, Inc.*, No. CIV.A.13414, 1998 WL 44993 (Del. Ch. Jan. 29, 1998), the corporation argued that *Rapid-American* should be limited to its "unique" facts involving subsidiaries in different industries. See *id.* at *11. The court rejected this construction of *Rapid-American* as "too narrow." *Id.*

161. *Rapid-American*, 603 A.2d at 806.

162. See *id.* The court discussed *Tri-Continental Corp. v. Battye*, 74 A.2d 71 (Del. 1950), and *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137 (Del. 1989), as standing for the general

Because the court carefully limited its holding, it might be possible to argue that *Rapid-American* stands for the proposition that the addition of a control premium is appropriate only when valuing a holding company that has more than one wholly-owned subsidiary. Then, the premium could be added at the corporate level, rather than at the shareholder level. This argument, however, does not withstand careful analysis and is inconsistent with the rationale for the decision in *Rapid-American*.

If Rapid-American operated its three distinct businesses through separate divisions rather than separate subsidiaries, and each line of business was valued by a comparison to comparable public companies, then under the rationale of *Rapid-American* a control premium should be added to the value of each division to avoid undue emphasis on market value, which reflects a minority discount. Rapid-American should not be valued differently if it operates its businesses as divisions rather than subsidiaries. If Rapid-American had only one line of business and no subsidiaries, and the corporation was valued based on a comparable public company, a control premium similarly would have to be added to alleviate the inherent minority discount reflected in the market price based valuation.

The need to add a control premium is therefore generated by the type of valuation method used. If a market price based valuation is used, with its inherent minority discount, it is necessary to adjust the valuation upward in order to establish the value of the company as a whole, not the value of a minority interest in the company. The fact that Rapid-American had multiple, wholly-owned subsidiaries was really irrelevant. It was the use of a market price based valuation that triggered the upward price adjustment.

Logical consistency requires that any valuation based on market prices be adjusted upward to eliminate the minority discount embodied in market prices. This is merely the flip side of the conclusion that minority discounts in appraisal proceedings are inappropriate,¹⁶³ as is reliance on market price.¹⁶⁴ Unfortunately, the courts and liti-

proposition that shareholder level adjustments, either discounts or premiums, are not permitted. See *Rapid-American Corp.*, 603 A.2d at 805-06. This presumably is because of the established Delaware principle that the dissenting shareholder is entitled to a proportionate share of the value of the corporation as a whole, rendering shareholder level adjustments inappropriate. The court also noted another chancery court decision rejecting the addition of a control premium, but expressed no views on the merits of that decision. See *id.* at 806 n.2.

163. See *supra* notes 135-47 and accompanying text.

164. See *supra* notes 99-134 and accompanying text.

gants have confusingly phrased the issue in terms of whether the addition of a control premium is appropriate. This is unfortunate because the real question is not whether to add a control premium, but is instead whether a market price based valuation should be adjusted upward to correct for the inherent minority discount reflected therein.¹⁶⁵ This confusion in phrasing the issue has led to confusion in analyzing the issue.

The following principles should therefore guide appraisal proceedings: dissenting shareholders should be entitled to receive a pro rata share of the value of the corporation as a whole, rather than the value of their minority interest; dissenting shares should not be subject to a minority discount; and a market price based valuation should receive an upward adjustment to eliminate the minority discount inherent therein.

The Delaware courts have, at times, acted consistently with these principles. For example, in *In re Radiology Associates, Inc.*,¹⁶⁶ the corporation was valued based on a discounted cash flow model.¹⁶⁷ The dissenting shareholder argued that this valuation should be adjusted upward to compensate for an implicit minority discount.¹⁶⁸ The

165. The term "control premium," when properly used, refers to a premium received by a controlling shareholder selling a controlling block of stock. See *Coffee*, *supra* note 128, at 360. The buyer is willing to pay that premium to obtain control, and the selling shareholder typically has the legal ability to accept such a premium. See *id.* But see *Perlman v. Feldmann*, 219 F.2d 173, 176-78 (2d Cir. 1955) (holding director/controlling shareholder of steel producer breached fiduciary duty owed to minority shareholders by selling controlling block at a premium to a steel end-user, thus depriving the corporation of its opportunity to take advantage of a wartime steel shortage). Several different "values" are therefore possible for corporate stock. The "market price" of stock values a minority interest in the corporation. See *supra* notes 132-34 and accompanying text. Alternatively, the corporation as a whole can be valued, and the corporate stock assigned a proportionate share of that value. This is the "value" used by most courts in the appraisal context. See *supra* notes 135-47 and accompanying text. This proportionate share of the corporation as a whole will typically exceed market value. It therefore contains a "premium" over market value, but it is not a control premium; rather, it represents the elimination of a minority discount. Finally, a shareholder selling a controlling block of stock may command a share price that is greater than a proportionate share of the corporation as a whole, the excess being a true control premium. See *generally Coffee*, *supra* note 128 (evaluating how corporate law should treat control premiums in light of the economic goal of encouraging efficient transactions).

166. 611 A.2d 485 (Del. Ch. 1991).

167. See *id.* at 490-91.

168. See *id.* at 494. A similar approach was taken by the dissenting shareholders' expert in *Le Beau v. M.G. Bancorporation, Inc.*, No. CIV.A.13414, 1998 WL 44993, at *2 (Del. Ch. Jan. 29, 1998) (adding control premium to DCF valuation). The court did not address the appropriateness of this approach because it rejected both parties' DCF valuations on other grounds. See *id.* at *10-11. The decision whether to adjust upward a DCF valuation to reflect an acquisi-

court correctly rejected this argument because the discounted cash flow analysis utilized was not a market price based valuation and therefore did not embody an inherent minority discount.¹⁶⁹

In *Hodas v. Spectrum Technology, Inc.*,¹⁷⁰ however, the court implicitly accepted the addition of a control premium to both a DCF valuation and a comparable company valuation.¹⁷¹ Only the latter is a market price based valuation. The logic requiring an upward adjustment to a market price based valuation to compensate for its inherent minority discount does not apply to the DCF valuation.¹⁷²

*Salomon Brothers Inc. v. Interstate Bakeries Corp.*¹⁷³ is more troubling. In this case, one of the valuation methods used by the dissenting shareholder's expert was an historical earnings approach, apparently using multipliers based on publicly traded companies.¹⁷⁴ The expert made a 15% upward adjustment to the value obtained with this technique in order to compensate for the "implicit minority discount" embodied in this approach.¹⁷⁵ The court rejected this adjustment, expressing doubt that "a market value adjustment to compensate for an implicit minority discount is a valuation method that is generally accepted in the financial community."¹⁷⁶ It went on to state that the expert did not "adequately distinguish between an implicit minority discount adjustment and a control premium"¹⁷⁷ and that to the extent the expert was proposing, "in whole or in part, a control premium adjustment, it is inappropriate."¹⁷⁸ These statements evi-

tion premium should depend on whether a third-party purchaser would pay a premium above DCF value in order to acquire the company as a whole.

169. This was not, however, the rationale used by the court. The court rejected the argument because it believed that permitting an upward adjustment would be an impermissible attempt to include a premium. *See id.* Because this case pre-dates the Delaware Supreme Court's acceptance of premiums at the corporate level in *Rapid-American*, this reasoning is somewhat suspect.

170. No. CIV.A.11265, 1992 Del. Ch. LEXIS 252 (Dec. 7, 1992).

171. *See id.* at *6-7, *10.

172. To be completely fair to the court, the corporation's expert applied a control premium to both types of valuation, *see id.* at *6-7, and no one appears to have objected to this approach.

173. No. CIV.A.10054, 1992 Del. Ch. LEXIS 100 (May 1, 1992).

174. *See id.* at *8-9.

175. *Id.* at *14.

176. *Id.* at *14-15 (citing *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983)).

177. *Id.* at *15.

178. *Id.* at *16; *see also* *Neal v. Alabama By-Products Corp.*, No. CIV.A.8282, 1990 WL 109243, at *9 n.6 (Del. Ch. Aug. 1, 1990) (pre-*Rapid-American*) (questioning, in dicta, addition of "acquisition premium" to valuation based on historical earnings and multiplier derived from comparable publicly traded companies "in the circumstances of this case"), *aff'd*, 588 A.2d 255 (Del. 1991).

dence confused thinking; the court did not recognize that by using multipliers based on publicly traded companies, a market price based valuation method had been adopted, and that it did, in fact, embody an implicit minority discount. The use of the control premium nomenclature seemed to throw off both the court and the expert.¹⁷⁹

The issue arose again in *Kleinwort Benson, Ltd. v. Silgan Corp.*¹⁸⁰ In this appraisal proceeding, both parties' experts included a valuation based on comparable public companies.¹⁸¹ The shareholders' expert then added an 86% premium to adjust for the inherent minority discount embodied in the market price based valuation.¹⁸² The court stated that a "decision to remove the minority discount embedded in the market price does not violate Delaware law," but that "[p]etitioners cannot add a premium to the market price unless they prove that publicly traded shares include a minority discount."¹⁸³ Because both parties' experts testified that publicly traded shares trade below the proportionate enterprise value of the corporation, the court concluded that "the record compels [the court] to find that the market price for publicly traded stock includes a minority discount."¹⁸⁴ The court reconciled the difference with *Salomon Brothers* by stating that the record in *Salomon Brothers* did not satisfy the Vice Chancellor that an adjustment to compensate for implicit minority discount was required,¹⁸⁵ whereas the record in *Kleinwort Benson* compelled the opposite conclusion.¹⁸⁶

In the wake of these two cases, it is not clear whether dissenting shareholders are required, in each case, to build a record demonstrating that publicly traded shares include an inherent minority discount. Certainly, a prudent shareholder who wants to upwardly ad-

179. See *Salomon Bros.*, 1992 Del. Ch. LEXIS 100, at *16-17.

180. No. CIV.A.11107, 1995 WL 376911 (Del. Ch. June 15, 1995).

181. See *id.* at *2.

182. See *id.*

183. *Id.* at *3.

184. *Id.*; see *Le Beau v. M.G. Bancorporation, Inc.*, No. CIV.A.13414, 1998 WL 44993, at *7-8 (Del. Ch. Jan. 29, 1998) (concluding that valuation based on pricing multiples derived from selected publicly traded companies improperly resulted in valuation of minority interest).

185. See *id.*

186. The court ultimately rejected the dissenting shareholders' argument that an 86% upward adjustment was required to compensate for the inherent minority discount, and instead applied a 12.5% adjustment. See *id.* at *3-4. The court stated that the 86% "premium" argued for by the dissenting shareholder impermissibly contained elements of value arising from the accomplishment or expectation of the merger. See *id.* For a discussion of this statutory limitation on fair value, see *infra* notes 214-26 and accompanying text.

just a market price based valuation method to eliminate the inherent minority discount should try to build such a record. It is also not clear exactly what shareholders can do to build such a record, other than to offer expert testimony.¹⁸⁷ It is even less clear why this should have to be done in each case. The basic question whether a market price based valuation method embodies a minority discount should be answered affirmatively, and that answer should not change from case to case.¹⁸⁸

Another recent case, *Gonsalves v. Straight Arrow Publishers, Inc.*,¹⁸⁹ demonstrates continued confusion in the Delaware courts over whether it is appropriate to add a control premium (or, more properly phrased, whether an adjustment should be made to compensate for the inherent minority discount in a market price based valuation). *Gonsalves* was an appraisal action involving the corporation, Straight Arrow Publishers, Inc. (SAP), that published *Rolling Stone* magazine.¹⁹⁰ The controlling shareholder of SAP proposed a cash-out merger transaction that eliminated the minority shareholders, and Gonsalves dissented.¹⁹¹

Gonsalves' expert determined the value of the corporation using an earnings capitalization method.¹⁹² He first calculated an adjusted earnings base,¹⁹³ and multiplied that by a price/earnings ratio derived from transactions involving sales of comparable magazines and companies.¹⁹⁴ The resulting value was not based on the publicly traded market prices of comparable companies, but rather on the sales prices of comparable companies as a whole. The court, in a footnote, stated that this technique "masks a complex issue: whether in an ap-

187. If so, future cases can be expected to involve partisan expert testimony on this issue. See *supra* notes 90-98 and accompanying text.

188. Of course, the amount by which any given market price based valuation should be adjusted upward to eliminate its inherent minority discount will have to be resolved on a case-by-case basis, undoubtedly with the benefit of expert testimony. Nonetheless, the focus should be on the *amount* of upward adjustment, rather than on the propriety of making any adjustment at all.

189. No. CIV.A.8474, 1996 WL 696936 (Del. Ch. Nov. 27, 1996), *rev'd*, 701 A.2d 357 (Del. 1997).

190. See *id.* at *1.

191. See *id.*

192. See *id.* at *3.

193. The adjusted earnings base was calculated using 1985 earnings, adjusted to eliminate taxes and non-recurring expenses, to add an incremental yearly increase in deferred subscription income, and to add back administrative costs associated with discontinued operations. See *id.*

194. See *id.* at *4.

praisal action 'fair value' . . . includes a pro rata share of a control premium."¹⁹⁵ The court stated that by determining a multiple with reference to sales of other companies, Gonsalves' expert had in effect included a control premium.¹⁹⁶ The court concluded, however, that it was not required to address the control premium issue in the instant case.¹⁹⁷

Instead, the court ultimately accepted the valuation provided by the corporation's expert.¹⁹⁸ This valuation was based on the Delaware block method, with most of the weight (80%) attributed to a capitalized earnings measure.¹⁹⁹ The defendant's expert used a five-year earnings average,²⁰⁰ and multiplied that by a price/earnings multiple generated by a comparison to public companies.²⁰¹ In other words, the valuation accepted by the court was a market price based valuation, and therefore embodied an implicit minority discount. Although the court professed not to address the question whether a control premium was permissible, its holding implicitly rejected such a premium, and in fact, adopted a valuation method reflecting a minority discount.²⁰²

195. *Id.* at *4 n.9.

196. *See id.*

197. *Id.* This issue arose again in *Le Beau v. M.G. Bancorporation, Inc.*, No. CIV.A.13414, 1998 WL 44993 (Del. Ch. Jan. 29, 1998). The court in *Le Beau* held that valuation of a corporation by reference to the sales prices of comparable companies is a valid technique that does not include an impermissible control premium. *See id.* at *11. The court correctly analyzed and applied the rationale of *Rapid-American* to reach this conclusion. *See id.*

198. *See Gonsalves*, 1996 WL 696936, at *6. This decision was reversed by the Delaware Supreme Court because of the trial court's decision, announced just prior to trial, to choose in its entirety the valuation evidence of one party or the other, "hook, line and sinker." *Gonsalves v. Straight Arrow Publishers, Inc.*, 701 A.2d 357, 358 (Del. 1997). The "choose one party's" valuation aspect of this decision is discussed *infra* at notes 447-60 and accompanying text. The Delaware Supreme Court did not address the trial court's control premium analysis.

199. Market value received a 10% weighting, as did asset value. *See Gonsalves*, 1996 WL 696936, at *5. The defendant's expert calculated asset value based on an earnings capitalization method, which, at least as described in the opinion, seems to make little sense. *See id.* at *5 & n.16.

200. The plaintiff's expert had used only 1985 earnings rather than a five-year average. *See id.* at *4.

201. The expert actually used multiples that were lower than the median multiples of comparable public companies. *See id.*

202. The court deflected attention from this by pointing out, correctly, that much of the difference between the valuation conclusions of the plaintiff's expert and the defendant's expert resulted from a difference in the earnings base, rather than the multiplier. *See id.* at *6. This difference in earnings base arose because one side used a five-year earnings average and the other side used a single year's earnings. *See id.* at *7. The court then pointed out that the defendant's expert used a multiplier of 13, which was quite close to the multiplier of 14 chosen by

In sum, Delaware and most jurisdictions have concluded that a dissenting shareholder is entitled to a proportionate share in the value of the corporation as a whole. This standard accords with the minority shareholder protection rationale of the appraisal remedy. As a necessary corollary, courts adopting this approach have generally rejected attempts to impose a minority discount on dissenting shareholders. At the same time, there is support for the proposition that it is appropriate to upwardly adjust a market price based valuation to correct for the inherent minority discount included in such a valuation. The courts have not, however, always acted consistently with this proposition.

E. The Role of Third-Party Sales Value

Another recurring issue in appraisal litigation is the effect, if any, that should be accorded the "third-party sales value" of the corporation being valued. Third-party sales value refers to the price at which the corporation, as an entity, could be sold to a third party in an arm's-length transaction. Because transactions triggering appraisal generally involve a merger, or "sale" of the company, third-party sales value may include the price paid in the actual transaction that triggered the appraisal claim. The use of third-party sales value in appraisal proceedings raises questions related to those surrounding the application of minority discounts and control premiums.

An appraisal proceeding is a valuation proceeding intended to determine what something is worth. The common sense answer to the question "what is an asset worth?" is "whatever someone is willing to pay for it."²⁰³ If you want to know what a home or car is worth, put it up for sale and its value will be determined. Anything short of third-party sales value is merely theoretical, or guesswork. An appraiser's opinion that a home is worth \$100,000 will not do the

the plaintiff's expert, thereby implying that the choice of multiplier was really not very important in this case. *See id.* at *6. The court's observation is, however, extremely misleading because the defendant's expert used a multiplier of 13 in calculating *asset value*, which in this case received only a 10% weighting. *See id.* When the defendant's expert calculated *earnings value*, which comprised 80% of the value as ultimately calculated, he used multipliers of 8.5-9.5, *see id.* at *5, *7; these multipliers were significantly different from the multiplier of 14 chosen by the plaintiff's expert. Thus, although the difference in earnings base certainly accounted for much of the variation in the experts' conclusions, differences in the multipliers were also very important.

203. *See* GLENN M. DESMOND & RICHARD E. KELLEY, BUSINESS VALUATION HANDBOOK 1 (1988) ("Everything is worth what its purchaser will pay for it." (quoting Publus (1st Century B.C.))).

seller much good if the best offer it receives from potential buyers is \$90,000.

It is not always feasible to put an asset up for sale to determine its worth, and in those circumstances it is necessary to settle for second best—an appraisal of the asset. For example, if someone wants to refinance a home, the lender will be interested in the value of that home. Because the owner does not intend to sell the property, an appraiser will be retained to provide a best guess as to its value. The appraiser may look at comparable home sales, replacement value, or, if it is an income producing property, the appraiser might use a capitalized earnings or discounted cash flow analysis to appraise the property. Any one of these methods, however, is merely a second best substitute for valuing the property in an actual third-party sale.

If the asset being appraised is an interest in a corporation, the same principles should apply. The best evidence of value, if available, is third-party sales value. If such evidence is not available, there is no choice but to resort to less precise valuation techniques. Despite the compelling sensibility of this argument, courts conducting appraisal proceedings have accorded third-party sales value a mixed and confusing reception. Although third-party sales value appears to be gaining greater acceptance as a valuation method,²⁰⁴ courts have not accorded it the weight it deserves. Five problem areas have impeded the acceptance of third-party sales value as a valuation technique.

1. *The Issue of What Is Actually Being Valued.* It is first necessary to determine what is actually being valued in the appraisal proceeding. This is essentially the same question as whether to permit a minority discount. The Delaware approach, and the one followed by the vast majority of jurisdictions, is to value the corporation as a whole, and award the dissenting shareholder a proportionate share of that value.²⁰⁵ As a result, if third-party sales

204. The American Law Institute Principles of Corporate Governance have strongly endorsed third-party sales value. They provide that for third-party arm's-length transactions, the acquisition price should be presumed to be the fair value of the corporation, absent proof to the contrary by clear and convincing evidence. See 2 ALI, PRINCIPLES, *supra* note 5, § 7.22(b). In addition, if the transaction is not a third-party arm's-length arrangement, the ALI Principles state that "the court generally should give substantial weight to the highest realistic price that a willing, able, and fully informed buyer would pay for the corporation as an entirety." *Id.* § 7.22(c).

205. See *supra* notes 135-47 and accompanying text.

value is to be employed in such a jurisdiction, the court should look to the value of the corporation as a whole in an arm's-length sale to a third party, and accord the dissenting shareholder a proportionate share of that value.²⁰⁶

The minority approach is to place a value on the specific shares held by the dissenting shareholder, as a minority interest. Under this approach, a court would ask what a third party would be willing to pay for the actual minority block of stock owned by the dissenting shareholder. The resulting value would embody a minority discount.²⁰⁷

206. This issue was tackled most directly by the court in *BNE Massachusetts Corp. v. Sims*, 588 N.E.2d 14 (Mass. App. Ct. 1992). The court stated that the task assigned under the appraisal statute was "not to reconstruct an 'intrinsic value' of each share of the enterprise but, rather, to determine what a willing buyer realistically would pay for the enterprise as a whole on the statutory valuation date." *Id.* at 19. Importantly, the court went on to tie this conclusion to the minority shareholder protection rationale for the appraisal statute by asserting that "[o]nly in this fashion can minority stockholders be assured that insiders in control of a company, burdened by conflicting interests, may not purchase the enterprise at a price less than that obtainable in the marketplace of qualified buyers and avoid paying a full and fair price to the minority." *Id.*

207. This approach is embodied in *Armstrong v. Marathon Oil Co.*, 513 N.E.2d 776 (Ohio 1987). In *Armstrong*, the intermediate appellate court had stated a view consistent with *BNE Massachusetts*, concluding that the appraisal process should not look to the value of a single share of stock in an isolated sale, but the per share value of all shares of the corporation on the basis of a hypothetical sale of all of its shares. *See id.* at 789. The Ohio Supreme Court, however, rejected this approach as a mistaken view of the statute and the court's prior holdings. *See id.*

The Ohio Supreme Court viewed the calculation of a per share value based on a hypothetical sale of all shares as impermissible because it would allow a dissenting shareholder to share in a premium from the transaction. *See id.* Instead, the court held that, as long as a significant trading market for the stock exists, appraisal should be based on market price adjusted to offset the impact of the proposed transaction, *see id.* at 790, in effect, calling for valuation of the minority interest owned by the dissenting shareholder. In addition, the requirement that the market price be adjusted to eliminate the effect of the merger effectively confined the dissenting shareholder to the market price prior to the merger announcement. The court thereby rendered the appraisal remedy useless to minority shareholders of publicly traded corporations, and guaranteed that it will not be invoked in this context in the future. No matter how low the merger price, it will invariably exceed the prevailing market price prior to the announcement of the merger; thus no sensible shareholder would elect to dissent, and the appraisal remedy in Ohio has been rendered largely impotent by judicial construction.

To make matters worse, the Ohio Supreme Court has held that the appraisal remedy is the exclusive remedy available to minority shareholders complaining about the fairness of a merger price. *See Stepak v. Schey*, 553 N.E.2d 1072, 1075 (Ohio 1990); *Armstrong*, 513 N.E.2d at 798. The appraisal remedy in Ohio is thus both useless and exclusive. In effect, as long as the controlling shareholder pays any amount over the prevailing market price, it is free to cash out the minority shareholders and appropriate to itself any value not accurately reflected in the market price.

The minority approach would allow those engaging in the merger to acquire the dissenting shareholders' stock at less than its full pro rata value, thereby obtaining a windfall. This would encourage controlling shareholders to cash out minority shareholders at unfair prices. In short, all of the arguments against minority discounts apply with equal force to this approach.²⁰⁸ Third-party sales value should apply with respect to a sale of the corporation as a whole, and not to a sale of the dissenting shareholders' minority interest.

2. *Problems of Semantics.* To some extent, the third-party sales value approach has been a victim of semantics. There is a tendency to view the third-party sales value approach as a "willing buyer, willing seller standard."²⁰⁹ In other words, what price would a willing buyer and willing seller reach in an arm's-length negotiation? This has caused confusion, however, because at times courts have equated a willing buyer, willing seller approach with a market price approach.²¹⁰ This has led courts to reject the willing buyer, willing seller standard, believing that it inappropriately and unduly relies on

The court in *Armstrong* relied on a change in the Ohio statute, apparently made in response to case law that had adopted an intrinsic value test under which all factors relevant to value were to be considered. *See id.* at 784-85. The revised statute defined fair cash value in terms of a willing seller, willing buyer test. *See id.* Although it is not a necessary conclusion that the statute's willing seller, willing buyer test should be applied with respect to a minority block of shares, rather than the corporation as a whole, this statutory amendment makes the Ohio situation *sui generis*, and a poor precedent for other jurisdictions.

The fact that the Ohio appraisal remedy is both useless and exclusive probably explains, in part, *Howing Co. v. Nationwide Corp.*, in which minority shareholders engaged in a lengthy dispute in federal court trying to assert a federal securities law claim in the absence of an effective state law remedy. *See generally* *Howing Co. v. Nationwide Corp.*, 625 F. Supp. 146 (S.D. Ohio 1985), *rev'd*, 826 F.2d 1470 (6th Cir. 1987); *Howing Co. v. Nationwide Corp.*, 927 F.2d 263 (6th Cir.), *vacated*, 502 U.S. 801 (1991); *Howing Co. v. Nationwide Corp.*, 972 F.2d 700 (6th Cir. 1992).

208. For a discussion of the arguments against minority discounts, see *supra* notes 135-47 and accompanying text.

209. *See, e.g.*, *Cooper v. Pabst Brewing Co.*, No. CIV.A.7244, 1993 Del. Ch. LEXIS 91, at *23 (June 8, 1993) (discussing the significance of actual offers to buy the company at issue, and noting that "[o]rdinarily, the value of any commodity in a competitive market is what a willing buyer would pay a willing seller for that commodity"). The willing buyer, willing seller test is typically employed in valuations undertaken in the tax context, where fair market value is the standard for valuation. *See* *Murdock*, *supra* note 138, at 479-80. Tax law, however, generally seeks the value of minority interests, rather than the value of a proportionate share of the corporation as a whole. *See supra* note 145. Confusion resulted when this same terminology was carried over to the dissent and appraisal context.

210. *See, e.g.*, *Atlantic States Constr., Inc. v. Beavers*, 314 S.E.2d 245, 249 (Ga. Ct. App. 1984); *Armstrong*, 513 N.E.2d at 789.

market price.²¹¹ Because the willing buyer, willing seller standard has sometimes been equated with a third-party sales value approach, judicial rejection of the former could cast aspersion on the latter.

This is merely a problem of nomenclature and a failure to clarify what the willing buyer is buying and what the willing seller is selling. If it is the corporation as a whole, the willing buyer, willing seller standard is appropriate and consistent with the majority approach to valuation. If it is the dissenting shareholder's minority block of stock, however, the standard would inappropriately adopt a market price/minority discount²¹² approach to valuation.²¹³ Thus, if courts are clear that it is the corporation as a whole that is being valued, the price reached by a willing buyer and willing seller in an arm's-length transaction should be strong indicia of fair value.

3. *The Statutory Command to Ignore the Effects of the Transaction Giving Rise to Appraisal Rights.* Appraisal statutes almost universally include a statement that the value of the dissenting shares is to be determined without regard to any appreciation or depreciation in anticipation of the corporate action giving rise to the

211. See *Atlantic States Constr.*, 314 S.E.2d at 249; *Genesco, Inc. v. Scolaro*, 871 S.W.2d 487, 490-91 (Tenn. Ct. App. 1993). For a critique of undue reliance on market price, see *supra* Part II.C.

212. Ironically, after the court in *Atlantic States* rejected the willing buyer, willing seller test because it was unduly tied to market value, it went on to approve the imposition of a minority discount. See 314 S.E.2d at 249-51.

213. Some of the semantic confusion results from statutes that adopt different terminology to describe what shareholders are entitled to receive in an appraisal proceeding. Today, the overwhelming majority of jurisdictions provide that dissenting shareholders are entitled to receive "fair value." See, e.g., DEL. CODE ANN. tit. 8, § 262(a) (Supp. 1996); N.J. STAT. ANN. § 14A:11-3(2) (West Supp. 1997); N.Y. BUSINESS CORPORATION LAW § 910(a) (McKinney Supp. 1997-1998); OR. REV. STAT. § 60.554(1) (1995); TENN. CODE ANN. § 48-23-102(a) (1995). Many of these statutes are based on the Model Business Corporation Act, which also adopts a fair value standard. See MODEL BUS. CORP. ACT § 13.02(a) (1991). A small number of states do not use the fair value standard, but use terms such as "fair market value," see CAL. CORP. CODE § 1300(a) (West 1990 & Supp. 1998), "fair cash value," see LA. REV. STAT. ANN. § 12:131(C) (West 1994 & Supp. 1997); OHIO REV. CODE ANN. § 1701.85(A)(2) (Banks-Baldwin 1994), and "value," see KAN. STAT. ANN. § 17-6712(b) (1995 & Supp. 1996); MASS. ANN. LAWS ch. 156, §§ 46, 46E (Law. Co-op. 1992). Although only a few states now depart from the fair value formulation, there may have been more variation prior to the widespread use of the Model Act. See *In re Valuation of Common Stock of Libby, McNeill & Libby*, 406 A.2d 54, 60 n.5 (Me. 1979) (discussing states whose statutes then used fair market value and other formulations).

right to dissent.²¹⁴ Much of the difficulty in determining fair value revolves around this statutory language.²¹⁵ Courts have been reluctant to use third-party sales value on the grounds that it would award to the dissenting shareholder part of the merger consideration, or a control premium, in violation of the statutory command to exclude any appreciation in anticipation of the merger.²¹⁶ This reasoning is not consistent with the purpose of the statutory language, it is not consistent with economic realities, and it is certainly not compelled as a matter of statutory interpretation. The statutory appraisal standard should not be construed to prevent courts from placing greater reliance on third-party sales value in appraisal proceedings.

214. See, e.g., MODEL BUS. CORP. ACT § 13.01(3); DEL. CODE ANN. tit. 8, § 262(h) (1991). The Model Act states that the effects of the transaction need not be excluded if it would be fair and equitable to take such effects into account. See MODEL BUS. CORP. ACT § 13.01(3).

215. The Delaware Supreme Court has recently given this statutory language a fairly narrow construction. See *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 299 (Del. 1996). Technicolor was acquired in two stages. See *id.* at 293. First, pursuant to a tender offer, the buyer acquired control of Technicolor. See *id.* After control was obtained, but before the cash-out merger was completed, the buyer began to implement its new business plan for Technicolor. See *id.* The issue in the appraisal proceeding was whether to value the company with the new business plan in place, or as it had existed prior to the commencement of the two-stage acquisition. See *id.* at 293-94. The court held that the company was to be valued as of the time at which the merger took place, i.e., after the implementation of the new business plan. See *id.* at 298-99. The court construed narrowly the statutory directive to exclude elements of value arising from the accomplishment of the merger, concluding that it is designed only to "eliminate use of *pro forma* data and projections of a speculative variety." *Id.* at 299 (quoting *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983)). It is unclear whether *Technicolor* is a unique case limited to two-stage acquisitions where interim changes have been accomplished, or whether the court is signaling an increased willingness to consider merger-related changes.

216. See, e.g., *Kleinwort Benson Ltd. v. Silgan Corp.*, No. CIV.A.11107, 1995 WL 376911, at *3-4 (Del. Ch. June 15, 1995) (rejecting evidence of premiums paid in similar transactions because such premiums include potential synergies from merger; that portion of the "control premium" cannot be included in the appraised value because it represents value from the accomplishment or expectation of the merger); *Cooper v. Pabst Brewing Co.*, No. CIV.A.7244, 1993 Del. Ch. LEXIS 91, at *24 (June 8, 1993) (noting that "Delaware courts . . . have been unwilling to consider just the results of an 'auction' between competing tender offerors as evidence of a firm's value because such offers ordinarily contain a control premium unrelated to the value of the firm as a going concern" (citations omitted)); *Cede & Co. v. Technicolor, Inc.*, No. CIV.A.7129, 1990 Del. Ch. LEXIS 259, at 68-70 & n.41 (Oct. 19, 1990) (discussing with approval case law indicating that third-party sales value incorporates a control premium that should not be included in appraisal valuation), *rev'd*, 684 A.2d 289 (Del. 1996); *Armstrong v. Marathon Oil Co.*, 513 N.E.2d 776, 789 (Ohio 1987) (noting that dissenting shareholders are not entitled to receive "any of the premium value offered as consideration to those who in fact tendered their shares"). *But see Le Beau v. M.G. Bancorporation, Inc.*, No. CIV.A.13414, 1998 WL 44993, at *11 (Del. Ch. Jan. 29, 1998) (holding that valuation by reference to sales of comparable companies is permissible, does not add improper control premium, and does not violate statutory command to exclude effects of merger).

The statutory provision excluding appreciation or depreciation in anticipation of the merger has its roots in the history of the appraisal remedy. When the remedy originated, it was intended to provide liquidity to shareholders whose investment had been fundamentally altered by a transaction those shareholders did not choose.²¹⁷ The paradigm transaction was a stock-for-stock merger where, absent appraisal, the shareholder's investment would continue in a fundamentally changed enterprise, and the shareholder would be trapped in an illiquid and altered investment.

By dissenting, a shareholder elected to be bought out rather than to participate in the new, merged entity. As a result, appraisal statutes required that appreciation or depreciation in anticipation of the merger be excluded.²¹⁸ This operated in the nature of an estoppel. By exercising appraisal rights, a shareholder "dissented" from or declined to participate in the merger and thus was "estopped" from claiming any benefit from the merger in the resulting appraisal proceeding.²¹⁹ This meant that in determining the fair value of the company, the court was not to value the merged entity on a pro forma basis, but instead was to value the corporation as it existed before the merger.

The cash-out merger, unanticipated when appraisal statutes were drafted,²²⁰ presents an entirely different situation. The shareholder dissenting from a cash-out merger is not dissenting from or declining to participate in the merger and in no sense can be said to be estopped from claiming the benefit of the merger. The cashed out shareholder is eliminated, without choice, from continued participation in the investment.²²¹ The merger prevents the shareholder from participating in the corporation.²²² The shareholder in this context

217. See *supra* note 8 and accompanying text.

218. See Thompson, *supra* note 6, at 20-21.

219. Similarly, if the merger was a bad deal, and caused the corporation's stock price to drop, the appraisal process allowed a shareholder to avoid the negative effects of the merger. See *supra* note 99.

220. See *supra* notes 9-12 and accompanying text; Wertheimer, *supra* note 6, at 20-21.

221. Historically, a merger combined two "operating" companies, resulting in a different enterprise. See Thompson, *supra* note 6, at 9-10. A cash-out merger, on the other hand, is a merger in form only. The company whose shareholders are being cashed out, an "operating company," is combined with a shell corporation, a "nonoperating company," solely for the purpose of cashing out the shareholders. See *id.* The resulting business is not changed, although it has different owners. The owners may or may not have different plans for the operation of the business, but that is another matter.

222. This can also be true in a cash-out sale of assets. If the corporation sells all or substantially all of its assets for cash, and distributes the cash to its shareholders, the shareholders

only dissents from being cashed out at the stated price. Thus, the estoppel rationale for the exclusion of appreciation or depreciation in anticipation of the merger carries no force with respect to a cash-out merger.²²³

The argument that third-party sales value incorporates a control premium and therefore allocates appreciation in anticipation of the merger is also flawed from an economic perspective, and finds no support in the statutory language. Third-party sales value is simply a method of valuing an asset (in the case of a statutory appraisal, the corporation as a whole). It does not depend on "appreciation in anticipation of the merger," but rather is based on the fair price on which a willing buyer and willing seller of the corporation agree.²²⁴ It

similarly are prevented from participating in the continuing enterprise. This situation occurred in *Oakridge Energy, Inc. v. Clifton*, 937 P.2d 130 (Utah 1997). The court in *Oakridge Energy* did not seem to recognize this fact, however, because it stated that the shareholder, having decided to dissent, could not rely in any way on the sales price for the assets, and that the shareholder could not seek to benefit both from the corporate action and the dissent. See *id.* at 133-34. These statements evidence outdated reasoning dependent on the liquidity rationale for the appraisal remedy and "estopping" shareholders who chose not to stay in the venture. The dissenting shareholders in *Oakridge Energy*, however, did not have the option to stay in the venture.

223. For this reason, Professor Thompson has argued that in the context of a cash-out merger, fair value should not exclude consideration of the effects of the transaction. See Thompson, *supra* note 6, at 35-38. In this vein, New York's statute no longer prohibits consideration of the effects of the transaction when determining fair value. See N.Y. BUS. CORP. LAW § 623(h)(4) (McKinney 1986); Thompson, *supra* note 6, at 36. Professor Thompson has argued that "[the] Delaware Supreme Court [has] interpreted its statute to achieve the same result without a statutory amendment." *Id.* Although the Delaware courts have certainly moved in that direction, see *supra* note 215, Professor Thompson somewhat overstates the case. Delaware courts, at times, have continued to rely on the statute's exclusion of the effects of the transaction. See *supra* note 216 and *infra* notes 280-81 and 405-30 and accompanying text.

The Model Business Corporation Act states that fair value should exclude "appreciation or depreciation in anticipation of the corporate action" giving rise to the appraisal remedy, *unless such "exclusion would be inequitable."* MODEL BUS. CORP. ACT § 13.01(3) (1991) (emphasis added). As a result, courts in Model Act states have a statutory basis to take into account the effects of the transaction that gives rise to the appraisal remedy, as equity requires. It would be especially appropriate to do so in the context of a cash-out merger where the estoppel rationale for the exclusion does not apply. Unfortunately, the comment to the Model Act fails adequately to make this point. See Thompson, *supra* note 6, at 37-38.

224. See *Hernando Bank v. Huff*, 609 F. Supp. 1124, 1126 (N.D. Miss. 1985) (noting that purchase offers for a company or comparable companies are relevant and not precluded by statutory command to ignore effects of merger, and that such offers have "particular relevance" because going concern value equals what the corporation is worth as an operating business to a third party), *aff'd*, 796 F.2d 803 (5th Cir. 1986); *Le Beau v. M.G. Bancorporation, Inc.*, No. CIV.A.13414, 1998 WL 44993, at *11 (Del. Ch. Jan. 29, 1998) (holding that valuation on basis of sales of comparable companies is valid and not precluded by statutory command to ignore effects of merger).

does not depend on the inherently subjective testimony of experts, but is based on the objective testimony of market forces.²²⁵

The question again boils down to “what is actually being valued?” If it is a proportionate interest in the corporation as a whole, as Delaware and most states have concluded, third-party sales value with respect to the corporation as a whole is strong evidence as to the value of the corporation. If such evidence exists, it should be used. The statutory exclusion of merger-related appreciation should not prevent a court from taking into consideration the market value of the corporation, as determined by third-party sales value.²²⁶

4. *Existing Case Law on the Applicability of a Third-Party Sales Value Standard.* Existing case law is another impediment to the full utilization of third-party sales value. The starting point for this analysis is *Bell v. Kirby Lumber Corp.*²²⁷ Kirby Lumber owned a substantial amount of forest land, which it harvested on a “sustained yield” basis.²²⁸ It also operated a sawmill and plywood plant and, at the time of the dispute, had a new plywood plant and a particleboard plant under construction.²²⁹ Kirby had been controlled by Santa Fe Industries or its predecessors for many years.²³⁰ By 1973, Santa Fe

This point continues to be lost on some courts. In *Oakridge Energy, Inc. v. Clifton*, 937 P.2d 130 (Utah 1997), the court ignored the price paid for substantially all of the assets of the corporation because the court thought that price included appreciation in anticipation of the corporate action. *See id.* at 133-34. The court awarded the dissenting shareholder a price per share well below the price per share paid for the assets of the corporation, reasoning that the assets must have had some “unique value” to that purchaser justifying the inflation of the “value of the assets above their realistic pre-sale value.” *Id.* at 134. In other words, the court thought the purchaser overpaid for the assets, despite a lack of evidentiary basis for this conclusion, and ignored the general principle that an asset is worth what someone will pay for it. *See supra* notes 203-04 and accompanying text. The court also stated that it did not trust this evidence of third-party sales value because there were not several bidders competing to purchase the assets. *See Oakridge Energy*, 937 P.2d at 134.

225. *See Van de Walle v. Unimation*, No. CIV.A.7046, 1991 WL 29303, at *17 (Del. Ch. Mar. 7, 1991) (“The fact that a transaction price was forged in the crucible of objective market reality (as distinguished from the unavoidably subjective thought process of a valuation expert) is viewed as strong evidence that the price is fair.”).

226. The Delaware statute specifically directs the court, when determining fair value, to “take into account all relevant factors.” DEL. CODE ANN. tit. 8, § 262(h) (1991). Third-party sales value should certainly qualify as a relevant factor in determining the value of a corporation.

227. 395 A.2d 730 (Del. Ch. 1978), *modified*, 413 A.2d 137 (Del. 1980).

228. *See id.* at 733.

229. *See id.*

230. *See id.* at 732.

owned 95% of Kirby.²³¹ Santa Fe then engaged in a short form merger to cash out the shareholders owning the remaining 5% of Kirby at a price of \$150 per share.²³² Some of these shareholders perfected their right to an appraisal.²³³ Under the procedures existing at that time, the court appointed an appraiser, who used the Delaware block method to determine that the fair value of Kirby was \$254.40 per share.²³⁴

Both parties disagreed with the appraiser's conclusions.²³⁵ The major dispute between the parties concerned the value of Kirby's assets, and the weight to be assigned to that asset value.²³⁶ The shareholders claimed the asset value of Kirby was \$682 per share, and argued that a 90% weight should be attached to the asset value; the corporation claimed the asset value was \$456 per share and should carry a weight of 5%; the appraiser valued the assets of Kirby at \$456 per share and assigned the asset value a 40% weight.²³⁷

Both sides agreed that the value of Kirby's assets far exceeded both its earnings value and the price at which its shares traded in the market.²³⁸ The dissenting shareholders argued that Kirby should be valued based on what the shareholders would receive in a merger negotiated at arm's length with a third party.²³⁹ They asserted that any third party acquiring a natural resource company like Kirby would pay a price based on the value of its assets, and that to be treated fairly, the minority shareholders should be paid based on that value.²⁴⁰ The court "appreciated the logic of this argument," but concluded that the appraiser did not err in rejecting it.²⁴¹

231. *See id.*

232. *See id.*

233. *See id.*

234. *See id.* at 732-33.

235. *See id.* at 732.

236. *See id.* at 733.

237. *See id.* The parties also disagreed with respect to earnings value, *see id.*, but the larger part of their dispute revolved around asset value.

238. *See id.* The highest market price for Kirby stock in the years prior to the cash-out merger was \$92.50, and this represented purchases by Santa Fe. *See id.* at 740. Undoubtedly, given Santa Fe's dominant ownership position, trading in Kirby stock was very thin, and its market price not a very reliable indicator, thereby explaining why the appraiser gave market value no weight. *See id.* at 733. The corporation presented two valuation scenarios, one with market value weighted at 55%, and, in case the court agreed with the appraiser that market value was entitled to little or no weight, another with market value receiving no weight. *See id.*

239. *See id.* at 734-35.

240. *See id.* at 734.

241. *Id.* at 735.

The court based its conclusion on existing Delaware case law, which held that dissenting shareholders were entitled to a "proportionate interest in a going concern."²⁴² This meant that value was to be fixed on a going concern basis rather than a liquidation basis.²⁴³ The court recognized that the shareholders' third-party sales value argument was not exactly a liquidation value argument, but thought it was too close to one, stating that it "seem[s] to go beyond the 'going concern' standard."²⁴⁴ The court defined a company's "going concern" value as its value "as long as [it] continue[s] in business,"²⁴⁵ and concluded that an arm's-length sales analysis was inappropriate because it "presupposes an acquisition value based on the very fact that the company will not continue in business on the same basis."²⁴⁶

The court failed to explain why the company, if acquired in an arm's-length merger, would not continue in business in the same manner. Perhaps the court thought that an acquiror buying Kirby at a price based on the value of its assets would have to liquidate it in order to realize that value. It seems just as likely, however, that a buyer would continue the business as it was then being run, believing that to be the best use of those assets over the long run.²⁴⁷

Kirby Lumber thus stands for the proposition that a dissenting shareholder is entitled to a proportionate interest in a going concern, and that fair value should not be based on liquidation value (at least if the corporation had no plan, as of the time of the transaction giving rise to appraisal rights, to liquidate). It is generally cited for this proposition.²⁴⁸ In so holding, however, the court rejected the shareholders' third-party sales argument; this remains an impediment to the use of such an approach today.

Kirby Lumber, of course, was decided before the Delaware Supreme Court's makeover of the appraisal remedy in *Weinberger v.*

242. *Id.* at 735 (citing *Tri-Continental Corp. v. Battye*, 74 A.2d 71, 72 (Del. Ch. 1950)).

243. *See id.*

244. *Id.*

245. *Id.* at 736 (citing *Tri-Continental Corp.*, 74 A.2d at 76).

246. *Id.* The Delaware Supreme Court affirmed the Vice Chancellor's conclusion, quoting his opinion without additional analysis. *See Bell v. Kirby Lumber Corp.*, 413 A.2d 137, 142 (Del. 1980).

247. Of course, the buyer could always pursue a liquidation at a later date, or resell the company or its assets to another third party in order to realize on the value of the assets.

248. *See Rapid-American Corp. v. Harris*, 603 A.2d 796, 802-03 (Del. 1992).

*UOP, Inc.*²⁴⁹ *Weinberger* requires that fair price be established by "consideration of all relevant factors involving the value of a company."²⁵⁰ The question is whether *Kirby Lumber's* rejection of the dissenting shareholders' third-party sales value argument survives *Weinberger*. The Delaware Supreme Court has not directly addressed this question. *Kirby Lumber* has been cited approvingly by the Delaware Supreme Court after *Weinberger* as a case in which the dissenting shareholders' "liquidation value" argument was rejected, but the citing opinions have not directly addressed the third-party sales value question.²⁵¹ The issue has arisen several times in the Delaware Court of Chancery, with mixed results.

In *In re Radiology Associates, Inc.*,²⁵² the dissenting shareholder's expert made the argument that her discounted cash flow analysis included an implicit minority discount, and therefore should be adjusted upward to remove that discount.²⁵³ This argument is suspect because a DCF analysis is not a market price based valuation.²⁵⁴ The court stated that the DCF analysis "arguably may have left out a premium that normally accrues when shareholders sell a company," but that "the appraisal process is not intended to reconstruct a pro forma sale" of the company.²⁵⁵ The court concluded "[p]laintiff is not entitled to the proportionate sales value of Radiology. Plaintiff is entitled to the proportionate value of Radiology as a *continuing shareholder*."²⁵⁶ Thus, in a discussion of whether it is appropriate to adjust upward a DCF analysis to correct for an implicit minority discount, the court cast doubt upon the utility of third-party sales value, an issue not really presented in the case.

The *Radiology* court misapplied precedent when it stated that "the appraisal process is not intended to reconstruct a pro forma sale but to assume the shareholder was willing to maintain his investment

249. 457 A.2d 701 (Del. 1983).

250. *Id.* at 713 (citing *Tri-Continental Corp.*, 74 A.2d at 72).

251. See *Rapid-American Corp.*, 603 A.2d at 803; see also *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 298 (Del. 1996) (citing both *Kirby Lumber* and *Rapid American* for the proposition that a shareholder is entitled to a proportionate share of the corporation as a going concern, rather than on a liquidated basis).

252. 611 A.2d 485 (Del. Ch. 1991).

253. See *id.* at 494.

254. See *supra* notes 166-69 and accompanying text.

255. *In re Radiology Assocs., Inc.*, 611 A.2d at 494 (quoting *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1145 (Del. 1989)).

256. *Id.*

position, however slight, had the merger not occurred."²⁵⁷ The court cited *Cavalier Oil Corp. v. Harnett*²⁵⁸ as its sole authority for this proposition.²⁵⁹ In *Cavalier*, however, the court was rejecting the argument that a minority discount should be applied in an appraisal proceeding.²⁶⁰ The pro forma sale that the *Cavalier* court refused to reconstruct was a pro forma sale of the dissenting shareholder's minority interest, at a minority discount. The court in *Cavalier* made no statement about the applicability of third-party sales value with respect to the company as a whole. *Cavalier* thus stands for the proposition that the appraisal court should not attempt to ascertain the third-party sales value of a minority block of stock. It does not stand for the proposition that the appraisal court should not attempt to ascertain the third-party sales value of the corporation as a whole. The *Radiology* court's citation to the contrary is simply incorrect.

The latest court of chancery opinion to discredit third-party sales value is *Gonsalves v. Straight Arrow Publishers, Inc.*²⁶¹ In this proceeding, the dissenting shareholder in a cash-out merger argued that the chief executive officer of the corporation was paid more than the market price for someone that could be hired to do a comparable job.²⁶² The dissenting shareholder contended that any purchaser of the corporation, or its assets, would take this into account in deciding what to pay for the company, and that this excessive compensation should therefore be considered in valuing the company.²⁶³

The court acknowledged that "in a sale of corporate control the price that a buyer can pay may be affected by the compensation of the CEO."²⁶⁴ Nonetheless, the court concluded that testimony with

257. *Id.*

258. 564 A.2d 1137 (Del. 1989).

259. See *In re Radiology Assocs., Inc.*, 611 A.2d at 494.

260. See *Cavalier Oil Corp.*, 564 A.2d at 1145.

261. No. CIV.A.8474, 1996 WL 483093 (Del. Ch. Aug. 22, 1996), *rev'd on other grounds*, 701 A.2d 357 (Del. 1997).

262. See *id.* at *1.

263. See *id.* The shareholder did not contend that the compensation was so high as to amount to a breach of fiduciary duty. The court indicated that if a derivative claim to that effect were pending, "there would be strong logic in including the net settlement value of such a claim as an asset of the corporation for appraisal purposes." *Id.* at *1.

264. *Id.* at *2. It is common practice in small corporations for the owners to extract some of the benefits of ownership in the form of salary, in order to avoid double taxation. See *id.* It is equally common that buyers of small corporations are aware of this practice, and carefully look at the amount of compensation being paid to shareholders in determining the value of the corporation. See SHANNON P. PRATT, VALUING SMALL BUSINESSES AND PROFESSIONAL PRACTICES 57, 92-93 (2d ed. 1993).

respect to the corporation's ability to replace the CEO at a lesser salary was irrelevant because the appraisal remedy "does not define fair value as the change in control value of the firm."²⁶⁵ No authority was cited for this proposition.²⁶⁶ Thus, the court of chancery again cast doubt on the validity of third-party sales value in a case not actually involving evidence of third-party sales value.²⁶⁷

Despite the negative implications of *Radiology* and *Gonsalves* with respect to third-party sales value,²⁶⁸ other Delaware Court of

265. *Gonsalves*, 1996 WL 483093, at *2.

266. The Delaware Supreme Court upheld the trial court's conclusion that, in the absence of a derivative claim attacking excessive compensation, the appraisal proceeding may not take into account the level of compensation paid to executive officers or the possibility that the corporation could reduce such payments in the future. See *Gonsalves v. Straight Arrow Publishers, Inc.*, 701 A.2d 357, 362-63 (Del. 1997). The main concern of both the trial court and the supreme court seemed to be that taking into account changes that might be made by new management would include value arising from accomplishment of the merger, in violation of the statute. Cf. *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 293-99 (Del. 1996) (permitting consideration of changes planned by purchaser that had acquired control of the target corporation several months prior to the transaction giving rise to appraisal rights.).

267. Although the Delaware Supreme Court affirmed the chancery court decision to exclude consideration of the level of executive compensation, it did so without casting aspersions on the use of third-party sales value. See *Gonsalves*, 701 A.2d at 362-63. The decision of the court with respect to the relevance of the salary of the CEO/controllers shareholder is, however, questionable. Under *Weinberger*, appraisal requires consideration of all relevant factors. See *Weinberger v. UOP, Inc.*, 457 A.2d 701, 712-13 (Del. 1983). If a shareholder has been, in essence, withdrawing corporate income in the form of salary, that should be a relevant factor, even if no derivative claim has been asserted. Any buyer of the corporation would find the level of compensation paid to the CEO/controllers shareholder highly relevant (as even the chancery court conceded). Prior to *Gonsalves*, other decisions addressing this issue had uniformly concluded that, in determining fair value, it is appropriate to make adjustments to account for distributions to shareholders in the form of salary that might otherwise have constituted corporate income. See *In re Radiology Assocs., Inc.*, 611 A.2d 485, 491 (Del. Ch. 1991); see also *Hodas v. Spectrum Tech., Inc.*, No. CIV.A.11265, 1992 Del. Ch. LEXIS 252, at *10-12 (Dec. 7, 1992) (refusing, based on a finding that the salaries were not excessive, an adjustment for excessive salaries paid to shareholders, but expressing no doubts about the propriety of making an adjustment when salaries are found to be excessive); cf. *Raskin v. Walter Karl, Inc.*, 514 N.Y.S.2d 120, 121 (N.Y. App. Div. 1987) (stating, in a case involving a buyout in the context of a dissolution rather than a merger, that "net income is adjusted by eliminating from the corporate expenses a portion of the officer-shareholders' salaries that is considered excess compensation").

268. Another possible example might be *Campbell v. Caravel Academy, Inc.*, No. CIV.A.7830, 1988 Del. Ch. LEXIS 86 (June 16, 1988), *aff'd*, 553 A.2d 638 (Del. 1988), where the court stated that "the market price of a proprietary school is a particularly inappropriate method of valuation." *Id.* at *9 (citing 1 BONBRIGHT, THE VALUATION OF PROPERTY 419 (1st ed. 1937)). The petitioner argued for a "willing buyer, willing seller" standard with respect to the corporation as a whole. See *id.* at *8. The court did not reject this standard out of hand, but seemed to find it inappropriate in the particular factual context. Although the court did not really explain its reasoning, it seemed troubled with petitioner's evidence of third-party sales

Chancery decisions have taken a much more favorable approach to this valuation technique. The strongest statement in support of third-party sales value in the appraisal context in Delaware is *Cooper v. Pabst Brewing Co.*²⁶⁹ Pabst received a proposal to be acquired at a price of \$16 per share at a time when its public share price was in the \$14-15 range.²⁷⁰ The proposed acquisition price was soon raised to \$20.50 per share.²⁷¹ Pabst rejected the offer, but after consulting with its investment banker, indicated a willingness to be acquired at \$25 per share.²⁷² Before long, a bidding war broke out, with four different bidders attempting to acquire Pabst, at escalating prices.²⁷³

Heileman ultimately prevailed in this war, acquiring Pabst with a two-tier offer, paying \$32 per share in a front-end tender offer and then consummating a back-end merger to acquire the rest of the Pabst shares, paying for these shares with a \$24 principal amount subordinated debenture.²⁷⁴ The court determined that the blended value of the consideration paid by Heileman was \$29.50 per share.²⁷⁵ Pabst shareholders dissented from the merger and sought an appraisal of their shares.²⁷⁶

Both parties presented appraisal evidence, but the court concluded that neither party had established a persuasive value, requiring the court to conduct its own analysis.²⁷⁷ In its analysis, the court relied extensively on the price actually paid by Heileman and used language very supportive of a third-party sales value approach.²⁷⁸ The court stated that:

“[o]rdinarily, the value of any commodity in a competitive market is what a willing buyer would pay a willing seller for that commodity. . . . Therefore, under conventional principles of economics, the results of the auction for Pabst might be expected to provide a rea-

value. *See id.* (stating that petitioner's expert “gave no basis for [his] novel assumption” with respect to the market price of the corporation on a third-party sales value basis).

269. No. CIV.A.7244, 1993 Del. Ch. LEXIS 91 (June 8, 1993).

270. *See id.* at *2-3.

271. *See id.* at *3.

272. *See id.*

273. *See id.* at *3-6.

274. *See id.* at *5-6.

275. *See id.* at *22.

276. *See id.* at *6.

277. *See id.* at *21 (citing *In re Shell Oil Co.*, 607 A.2d 1213 (Del. 1992)).

278. *See id.* at *21-24.

sonable indication of Pabst's value that this Court can consider"²⁷⁹

The court indicated some discomfort considering the results of an "auction" between competing bidders, noting that Delaware courts in the past had been reluctant to do so because "such offers ordinarily contain a control premium unrelated to the value of the firm as a going concern."²⁸⁰ The court cited *Bell v. Kirby Lumber Corp.* at this point.²⁸¹ Nonetheless, clearly swayed by the third-party sales value, the court concluded that the fair value of Pabst for appraisal purposes was \$27 per share.²⁸² The court went on to test its conclusion against other evidence in the record, and, after considering all of the evidence, was satisfied with the \$27 per share valuation.²⁸³

Another Delaware case providing strong support for a third-party sales value approach is *Van de Walle v. Unimation, Inc.*²⁸⁴ Condec owned 78.4% of Unimation; the remaining 21.6% was publicly held.²⁸⁵ Condec, in need of cash, consulted its investment banker for

279. *Id.* at *23-24. The court also found that there was a competitive market for the acquisition of Pabst. *See id.*

280. *Id.* at *24.

281. *See id.* (citing *Bell v. Kirby Lumber Corp.* 413 A.2d 137, 140-42 (Del. 1980)). *Kirby Lumber* was also cited by the chancery court in *Cede & Co. v. Technicolor, Inc.*, No. CIV.A.7129, 1990 Del. Ch. LEXIS 259, at *68 (Oct. 19, 1990), *rev'd*, 684 A.2d 289 (Del. 1996). The chancery court in *Technicolor* viewed third-party sales value as incorporating a control premium and concluded that, under *Kirby Lumber*, intrinsic value to be received by the dissenting shareholders should not include a proportionate share of a control premium. *Id.* at *68-69. The chancery court considered the possibility that *Weinberger* may have signaled a departure from *Kirby Lumber*, but concluded that it did not. *See id.* at *69-70. Although the chancery court's decision in *Technicolor* was later reversed by the Delaware Supreme Court, the supreme court did not discuss the third-party sales value issue. It did, however, narrowly construe the statutory requirement that fair value be determined exclusive of any element arising from the accomplishment or expectation of the transaction. *See Technicolor*, 684 A.2d. at 297-99; *see also supra* notes 215, 223.

282. *See Pabst Brewing Co.*, 1993 Del. Ch. LEXIS 91, at *21. The difference between the \$29.50 third-party sales value and the \$27 value adopted by the court can be explained in two ways. One way to explain the price differential relates to concerns over "setting a floor price." *See infra* notes 317-30 and accompanying text. The second explanation is the court's desire to skirt the holding of *Kirby Lumber* by not relying exclusively on third-party sales value; this was accomplished by backing out \$2.50 per share as the maximum control premium incorporated in the \$29.50 price. *See Pabst Brewing Co.*, 1993 Del. Ch. LEXIS 91, at *25. The court of chancery was not free to reject outright *Kirby Lumber*, a supreme court decision, and hold that third-party sales value is an accurate measure of the value of the corporation.

283. *See Pabst Brewing Co.*, 1993 Del. Ch. LEXIS 91, at *25-28.

284. No. CIV.A.7046, 1991 WL 29303 (Del. Ch. Mar. 7, 1991).

285. *See id.* at *1.

advice on how to raise capital.²⁸⁶ The banker suggested a sale of Unimation at a price of \$110-120 million.²⁸⁷ Condec did not believe that Unimation could be sold for that price, but authorized the investment banker to explore a sale of Unimation with an asking price of \$120-150 million.²⁸⁸

Over seven months, fifty to sixty potential purchasers were contacted, culminating in an initial offer from Westinghouse to buy Unimation for \$85 million, which was then raised to \$95 million, and then to \$107 million.²⁸⁹ Condec accepted the offer at \$107 million.²⁹⁰ Condec and the public shareholders of Unimation both received equivalent consideration for the shares of Unimation they owned.²⁹¹ Subsequently, a class action suit was commenced on behalf of the public shareholders of Unimation to challenge the Westinghouse acquisition.²⁹² This was not an appraisal case, but one asserting that the merger was unfair and that the approval of the merger constituted a breach of fiduciary duty by Unimation and its board of directors.²⁹³

Because the acquisition of Unimation was a bona fide arm's-length transaction, the court concluded that the business judgment rule, rather than the intrinsic fairness test, should be utilized to evaluate the transaction.²⁹⁴ Nonetheless, the court gave the plaintiffs the benefit of the doubt and applied the intrinsic fairness test, concluding that the standard to be applied did not matter because the transaction passed muster under either test.²⁹⁵ Under Delaware law, intrinsic fairness incorporates both fair dealing and fair price.²⁹⁶ Ad-

286. *See id.* at *2.

287. *See id.*

288. *See id.* at *2-3.

289. *See id.* at *3, *5-6. The only other potential purchaser that offered to buy Unimation was General Electric, and its highest bid was \$65 million. *See id.* at *4. After the receipt of Westinghouse's \$107 million proposal, an attempt was made to induce General Electric to top that bid. General Electric responded that it might be prepared to offer as much as \$85-90 million, but it never did so. *See id.*

290. *See id.* at *6.

291. *See id.* at *13.

292. *See id.* at *1.

293. The plaintiffs alleged breaches of the duty of loyalty, duty of care, and the duty of candor. *See id.* at *8.

294. *See id.* at *11.

295. *See id.*

296. *See id.*; Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983); Ryan v. Tad's Enters., Inc., Nos. CIV.A.10229, 11977, 1996 WL 936160, at *5 (Del. Ch. Apr. 24, 1996), *aff'd*, 693 A.2d 1082 (Del. 1997).

addressing the latter, the court concluded that the merger price was fair, stating:

The most persuasive evidence of the fairness of the . . . merger price is that it was the result of arm's-length negotiations between two independent parties, where the seller (Condec and Unimation) was motivated to seek the highest available price, and a diligent and extensive canvas of the market had confirmed that no better price was available.

The fact that a transaction price was forged in the crucible of objective market reality (as distinguished from the unavoidably subjective thought process of a valuation expert) is viewed as strong evidence that the price is fair.²⁹⁷

Although "fair price" for purposes of intrinsic fairness analysis may not be the same as "fair value" for appraisal purposes,²⁹⁸ the court's discussion of the accuracy and validity of third-party sales value rings equally true in either context.

Courts outside of Delaware, unconstrained by *Kirby Lumber*, often have been willing to consider evidence of fair value derived from reliable third-party sales value data.²⁹⁹ Probably the most articulate statement in favor of third-party sales value is found in *BNE Massachusetts Corp. v. Sims*.³⁰⁰ In that case, a corporation engaged an investment banker to explore a merger, and received acquisition proposals from six potential buyers.³⁰¹ The corporation agreed to merge with one of the six suitors; some of its shareholders dissented from the merger.³⁰²

297. *Unimation*, 1991 WL 29303, at *17; see also *Kahn v. Lynch Communication Sys., Inc.*, 638 A.2d 1110, 1116 (Del. 1994) (noting, in a nonappraisal challenge to a cash-out merger engaged in by controlling shareholder, that minority shareholders are in need of procedural protections because "no court could be certain whether the transaction terms fully approximate what truly independent parties would have achieved in an arm's-length negotiation").

298. The Delaware courts have consistently left open the possibility that the measure of damages in an intrinsic fairness/breach of fiduciary duty case may be greater than in an appraisal case, including elements of "rescissory damages." See *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182, 1187-88 (Del. 1988); *Rabkin v. Philip A. Hunt Chem. Corp.*, 498 A.2d 1099, 1107 (Del. 1985); *Weinberger*, 457 A.2d at 714. Professor Coffee has persuasively argued that "fair value" and "fair price" should be integrated and given equivalent meanings. See Coffee, *supra* note 128, at 412-18.

299. See *infra* note 309 and accompanying text.

300. 588 N.E.2d 14 (Mass. App. Ct. 1992).

301. See *id.* at 16.

302. See *id.*

The corporation argued that the merger was an arm's-length transaction resulting from a "controlled auction."³⁰³ The court stated that, assuming this was true, "the trial judge could appropriately consider whether the . . . merger price should be binding upon both parties" in the appraisal proceeding.³⁰⁴ The court rejected the corporation's argument that the dissenting shareholders should get less than the merger price, characterizing this as a penalty for dissenting, and also rejected the dissenting shareholders' argument that they should get more than the merger price, characterizing this as a reward for dissenting.³⁰⁵

Given the untainted nature of this merger transaction—if that is the fact of the matter—we are unable to perceive any sound reason why dissenting stockholders should receive any more or less than the amount received by all other stockholders in a transaction approved by the board of directors upon the advice of investment bankers. The purpose of [the appraisal statute], as we have said, is to assure minority stockholders that those in control of the enterprise will not obtain unfair advantage. In this case, neither party has suggested that unfair advantage was sought or obtained.³⁰⁶

The court went on to state that the merger agreement provides the information required for an appraisal: the "price a knowledgeable buyer would pay for the entire corporation."³⁰⁷ Finally, the court noted that experts' opinions "cannot match the reality experienced by *this* institution in setting the terms of the merger with the actual buyer who prevailed over five competing institutions."³⁰⁸

There are many other non-Delaware cases recognizing the value of third-party sales value, sometimes explicitly, and at other times, without much discussion of the appropriateness of that approach.³⁰⁹

303. *Id.* at 20 (internal quotation marks omitted).

304. *Id.*

305. *See id.* at 20-21.

306. *Id.*

307. *Id.* at 21 (quoting *Sarrouf v. New England Patriots Football Club, Inc.*, 492 N.E.2d 1122, 1125 (Mass. 1986)).

308. *Id.* The case was remanded, at which time the dissenting shareholders would be able to test whether the merger was, in fact, the product of an arm's-length bidding process, or tainted by conflicts of interest at the board or officer level. *See id.* The trial judge was instructed that he could determine fair value based on the testimony of experts if he was not persuaded that the financial terms of the merger agreement should prevail. *See id.*

309. *See, e.g.,* *Hunter v. Mitek Indus., Inc.*, 721 F. Supp. 1102, 1107 (E.D. Mo. 1989) (holding that a negotiated financial transaction with a third party bears on what a company as a whole is worth); *Hernando Bank v. Huff*, 609 F. Supp. 1124, 1126-27 (N.D. Miss. 1985) (finding

There is little contrary authority,³¹⁰ with the exception of those courts that have adhered to the notion that the purpose of the appraisal process is to value a minority interest.³¹¹

It is time for the Delaware Supreme Court to disapprove the language in *Kirby Lumber* that casts doubt on the utility of third-party sales value.³¹² The *Weinberger* approach to valuation, which

particular relevance in purchase offers for company or comparable companies), *aff'd*, 796 F.2d 803 (5th Cir. 1986); *Knight v. Pine Island Fruit Corp.*, 445 So. 2d 684, 685 (Fla. Dist. Ct. App. 1984) (finding that where corporation sold its only asset at fair market value, dissenting shareholder entitled to proportionate share of sales price); *Institutional Equip. & Interiors, Inc. v. Hughes*, 562 N.E.2d 662, 664, 666 (Ill. App. Ct. 1990) (affirming the trial court's reliance, in part, on offer from third party to buy entire company); *Ely, Inc. v. Wiley*, 546 N.W.2d 218, 220 (Iowa 1996) (accepting the argument that actual transaction price with third party should be considered); *In re Valuation of Common Stock of McLoon Oil Co.*, 565 A.2d 997, 1004-05 & n.7 (Me. 1989) (finding relevant the inquiry as to the highest price a buyer would reasonably pay for the whole enterprise); *Cawley v. SCM Corp.*, 530 N.E.2d 1264, 1267 (N.Y. 1988) (noting that the lower court properly used a third-party merger price to arrive at a figure that was fair and "comparable to an amount that would have been set by arm's-length negotiations"); *Alpert v. 28 Williams St. Corp.*, 473 N.E.2d 19, 29 (N.Y. 1984) (finding that the stock price was fair because it was tied to fair market value of corporation's only asset, as determined in arm's-length negotiation); *Chrome Data Sys., Inc. v. Stringer*, 820 P.2d 831, 832-33 (Or. Ct. App. 1991) (concluding that a preliminary offer from a third party was relevant and provided a floor on the value of the corporation, and noting that an "offer to buy the assets of a business is a good indicator of the value of the business as a whole"); *cf. Spinnaker Software Corp. v. Nicholson*, 495 N.W.2d 441, 444-45 (Minn. Ct. App. 1993) (considering application of third-party sales value standard, but finding that the evidence did not show an arm's-length negotiated price).

310. *But see supra* note 224.

311. *See, e.g., Armstrong v. Marathon Oil Co.*, 513 N.E.2d 776, 789 (Ohio 1987) (finding "no reason to consider . . . any of the premium value offered as consideration to those who in fact tendered their shares").

312. *Kirby Lumber* is subject to criticism on several other grounds as well. Because *Kirby Lumber* was predominately a natural resources company, the value of its assets should have been extremely relevant in the appraisal proceeding. *See, e.g., Walter S. Cheesman Realty Co. v. Moore*, 770 P.2d 1308, 1311 (Colo. Ct. App. 1988) (holding net asset value entitled to great weight where business is devoted to possession of assets—here, a real estate holding company); *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 933-36 (Del. 1985) (stating that parties placed heavy emphasis on value of assets in oil and gas company); *Swanton v. State Guar. Corp.*, 215 A.2d 242, 245-46 (Del. Ch. 1965) (noting that it is appropriate to place heavy emphasis on asset value where corporation has emphasized capital appreciation rather than current income, as was the case with the instant real estate holding company). Even though the minority shareholders were cashed out at \$150 per share, the corporation's own expert, hired for purposes of the appraisal proceeding, valued the corporation's assets at \$456 per share, but argued that asset value only should receive a 5% weighting. *See Bell v. Kirby Lumber Corp.*, 395 A.2d 730, 733 (Del. Ch. 1978), *modified*, 413 A.2d 137 (Del. 1980). The dissenting shareholders argued for a 90% weighting of asset value. *See id.* The court itself recognized that asset value was important in valuing *Kirby Lumber*, and justified a higher weighting than would typically be the case, but it was unwilling to second guess the conclusion of the court-appointed appraiser who accorded a 40% weight to asset value. *See id.* at 741. In addition, another appraiser hired by the corporation, in advance of and in preparation for the cash-out merger, valued the com-

pany's assets at over \$600 per share. *See id.* at 737-38. There was also evidence indicating that in deciding whether to cash out the minority shareholders, the controlling shareholder itself took into account "the overriding asset value feature." *Id.* at 734. Thus, there was powerful evidence in the record that \$150 per share did not fairly represent the value of the corporation, and that, based on asset value, the corporation was worth at least \$456 per share, and probably more. *See id.* at 740-41.

Further problems are evidenced in the court's analysis of the corporation's earnings value. The usual approach to fixing earnings value at the time *Kirby Lumber* was decided was to determine average earnings over the prior five years and multiply that amount by a price/earnings multiplier chosen by reference to comparable public companies. *See, e.g.,* Francis I. duPont & Co. v. Universal City Studios, Inc., 312 A.2d 344, 347-50 (Del. Ch. 1973) (noting that "[t]he five-year period immediately preceding the merger is ordinarily considered to be the most representative and reasonable period of time over which to compute the average" earnings), *aff'd*, 334 A.2d 216 (Del. 1975). The court adopted this approach in *Kirby Lumber*. *See* 395 A.2d at 739-40. There were, however, two glaring problems with this approach as applied by the court—one with the calculation of earnings, and the second with the choice of multiplier. First, *Kirby Lumber* was, at the time of the merger, in the process of completing a new plywood plant and a new particleboard plant. *See id.* at 733. The two new plants were scheduled to be completed in the year following the merger. *See id.* Prior to the merger, *Kirby Lumber* had very little manufacturing capacity, so the two new facilities promised to add significantly to earnings. *See id.* at 733, 739. Nonetheless, the earnings potential from these new facilities was not taken into account in establishing the "earnings value" of the corporation, because the facilities did not contribute to the earnings of the company over the prior five years. *See id.* at 734. Although the dissenting shareholders pointed this out, the court found no reason to depart from the usual five-year earnings average approach. *See id.* at 739-40; *cf.* Bell v. Kirby Lumber Corp., 413 A.2d 137, 151 (Del. 1980) (Quillen, J., concurring) (questioning the use of five-year averaging approach in this case, but unwilling to conclude that it constituted reversible error). Thus, earnings value, which was weighted by the court at 60%, did not accurately measure the value of the company going forward. *See Kirby Lumber*, 395 A.2d at 740.

In addition, a significant error appears to have been made in the methodology for choosing an appropriate multiplier. The multiplier was chosen based on the market multipliers of comparable companies. *See id.* at 739. These multipliers represented the market price of those comparable companies, divided by the earnings of those companies. The earnings figures used in determining comparable multipliers, however, appear to have been earnings from the most recent year, rather than a five-year average of earnings. *See id.* Because these companies, like *Kirby Lumber*, had shown steadily increasing earnings over the prior five years, the multipliers based on the most recent year's earnings were much lower than they would have been had a multiplier been calculated based on a five-year average of earnings. Because *Kirby Lumber* was being valued on a five-year average of its earnings, logical consistency required that the multiplier derived from comparable companies be calculated in the same manner. The dissenting shareholders attempted to make this point, arguing that the "multiplier should have been based on the five-year average prices of the comparable companies." *Id.* The court's reply to this argument was simply that it would not disturb the appraiser's choice of a multiplier so long as it was within the range of reason, and the court said it was in this case. *See id.* at 740.

There are strong arguments that the dissenting shareholders in *Kirby Lumber* did not receive fair value in the appraisal proceeding. At the same time, *Kirby Lumber* presents exactly the kind of transaction that should draw the attention of courts—a cash-out merger engaged in by a controlling shareholder. This was a classic conflict of interest transaction that would ordinarily be strictly scrutinized by courts under the intrinsic or entire fairness test. *See, e.g., Rosenblatt*, 493 A.2d at 937. The final result in *Kirby Lumber* can best be explained as a compromise verdict on the part of the appraiser, and a substantial reluctance by both the court of

calls for consideration of any valuation technique generally acceptable in the financial community,³¹³ requires courts to use reliable evidence of third-party sales value. Further, the Delaware statute does not support the *Kirby Lumber* position on third-party sales value; instead it requires that courts take into account "all relevant factors" in conducting a valuation.³¹⁴ Although Delaware courts have tentatively explored the use of third-party sales value, sometimes giving effect to it when it appears persuasive,³¹⁵ *Kirby Lumber* currently impedes the full use of this valuation technique.³¹⁶

chancery and the supreme court to second guess the appraiser. Perhaps the courts' unwillingness to deviate from the appraiser's opinion was unduly influenced by the fact that the cash-out merger was proposed at an amount, \$150 per share, that exceeded prior market prices by a fair margin. See *Kirby Lumber*, 395 A.2d at 735. The appraiser found fair value to be \$254.50 per share, well below the \$639 per share asked for by the dissenting shareholders, but well above the \$150 merger price, and well above the \$126-\$135 per share amount the corporation claimed to be fair value in the appraisal proceeding. See *id.* at 732-33. In short, a compromise result was reached by the appraiser, and the opinions of both the court of chancery and the Delaware Supreme Court are liberally laced with references to deference to the appraiser. See *id.* at 737-41; *Kirby Lumber*, 413 A.2d at 146-48; see also *id.* at 151 (Quillen, J., concurring).

313. See *supra* notes 22-23 and accompanying text.

314. See DEL. CODE ANN. tit. 8, § 262(h) (1991).

315. See *supra* notes 269-98 and accompanying text. In the cases discussed in the text, *Cooper*, *Unimation*, and *BNE Massachusetts Corp.*, the courts have indicated a willingness to rely on third-party sales value in situations where the use of third-party sales value worked to the benefit of the corporation, rather than the dissenting shareholder. See *supra* notes 269-98 and accompanying text; see also *Ely, Inc. v. Wiley*, 546 N.W.2d 218, 220 (Iowa 1996) (accepting the corporation's argument that third-party sales value should be considered in appraisal). In other words, the price paid in a bona fide arm's-length transaction acted as a limitation on the amount the shareholder could recover in an appraisal proceeding, see *Cooper v. Pabst Brewing Co.*, No. CIV.A.7244, 1993 Del. Ch. LEXIS 91, at *23-24 (May 14, 1993); *BNE Massachusetts Corp. v. Sims*, 588 N.E.2d 14, 20 (Mass. App. Ct. 1992), or to demonstrate the fairness of the price in a nonappraisal challenge to the transaction. See *Van de Walle v. Unimation*, No. CIV.A.7046, 1991 WL 29303, at *17 (Del. Ch. Mar. 7, 1991). If courts are willing to use third-party sales value when it favors the corporation, they should also be willing to utilize that approach when a dissenting shareholder is able to provide evidence that the third-party sales value exceeds the transaction price.

316. Ironically, although the Delaware courts have been somewhat reluctant to embrace true third-party sales value as a valuation technique, the same courts have placed heavy emphasis on the use of procedural devices that purportedly simulate arm's-length negotiations. Thus, in cases involving a cash-out merger by a controlling shareholder, the Delaware courts have attached significance to whether procedures were used to approximate true bargaining, and have encouraged corporations to appoint an independent committee of the board of directors to negotiate with the controlling shareholder, and make available to that committee independent legal and financial advice. See *Rosenblatt*, 493 A.2d at 937-38; *Weinberger v. UOP, Inc.*, 457 A.2d 701, 709 n.7 (Del. 1983); *Citron v. E.I. Du Pont de Nemours & Co.*, 584 A.2d 490, 504 (Del. Ch. 1990); *Pinson v. Campbell-Taggart, Inc.*, No. CIV.A.7499, 1989 Del. Ch. LEXIS 50, at *20 & n.7 (Nov. 8, 1989). It is difficult, however, for any such arrangement truly to approximate third-party bargaining. See *Kahn v. Lynch Communication Sys., Inc.*, 638 A.2d 1110, 1117-21 (Del. 1994) (finding that use of independent committee did not simulate third-

5. *The Problem of Setting a Floor Price.* One final hurdle to the increased utilization of third-party sales value as a valuation technique is that by using this approach, the price paid in the transaction that triggered the appraisal claim could effectively become a floor on the appraised fair value of the corporation.³¹⁷ If such a floor price is set, shareholders might be encouraged to bring meritless appraisal suits, knowing that the worst possible result would be receipt of the consideration offered in the triggering transaction. Bringing the appraisal litigation therefore might be viewed as a no-lose situation,³¹⁸ thus encouraging baseless litigation brought to extract settlements based on the nuisance value of the lawsuit. Although this is a potential problem, and two Delaware chancery court opinions have expressed concern over this point,³¹⁹ it can be addressed directly, and is not a valid reason to exclude reliable evidence of third-party sales value.

One response to the concern that a floor price will encourage undesirable litigation is that it may actually have the opposite effect. If it is clear to potential litigants that courts will rely on third-party sales value, shareholders will have nothing to gain by bringing an appraisal action if the triggering transaction involves a bona fide third-party sale. In fact, an appraisal proceeding will lead to an inferior result because the shareholders will have to bear their expenses in the appraisal proceeding, typically including attorney and expert fees. Thus, use of third-party sales value may actually discourage undesirable litigation.

The other response to the floor price problem is to police directly meritless litigation through existing or improved procedural devices. First, courts must be willing to rapidly dispose of appraisal litigation, generally by summary judgment, if it is clear that a bona fide third-party sale has taken place. If the corporation produces evidence that a true third-party sale has occurred, and the dissenting shareholder cannot establish a genuine issue of fact as to the exis-

party transaction); *Rabkin v. Philip A. Hunt Chem. Corp.*, 498 A.2d 1099, 1106 n.7 (Del. 1985) (referring to "quick surrender" by special committee). One would think that if the Delaware courts find simulated third-party bargaining to be persuasive, they would not ignore authentic third-party bargaining.

317. See *Cooper v. Pabst Brewing Co.*, No. CIV.A.7244, 1993 Del. Ch. LEXIS 91, at *24 (June 8, 1993); *Cede & Co. v. Technicolor, Inc.*, No. CIV.A.7129, 1990 Del. Ch. LEXIS 259, at *70 n.41 (Oct. 19, 1990), *rev'd*, 684 A.2d 289 (Del. 1996).

318. See *Cooper*, 1993 Del. Ch. LEXIS 91, at *24-25.

319. See *supra* note 317.

tence of a true third-party sale, the corporation should be entitled to summary judgment.

Second, courts must be willing to use the authority granted to them to shift fees and costs to deter meritless appraisal litigation. Most appraisal statutes give courts the authority to assess costs against the dissenters in some circumstances.³²⁰ Many statutes also grant to courts the authority to assess against either party the fees and expenses of counsel and experts.³²¹ The Delaware statute permits shifting of costs, but unfortunately does not allow courts to assess fees and expenses of counsel and experts.³²² Courts should consider exercising the authority to shift costs, fees, and expenses when it is clear that a third-party sale has occurred, and the dissenting shareholders are unable to put forth any credible evidence disputing the existence of a true third-party sale.

*Cooper v. Pabst Brewing Co.*³²³ presents a case in which the third-party sales value approach could have been profitably adopted. In *Cooper*, a fairly spirited bidding war erupted for Pabst, culminating in a merger and an appraisal proceeding.³²⁴ In the absence of any conflicting evidence as to the bona fides of the third-party sale, this should have warranted a quick disposition of the case, an award of the merger consideration to the dissenting shareholders, and consideration of the appropriateness of shifting fees onto the dissenting shareholders. Although the court stated that, "under conventional principles of economics, the results of the auction for Pabst might be expected to provide a reasonable indication of Pabst's value," the court felt unable to rely on third-party sales value because of *Kirby Lumber*, and because of the "floor price" problem.³²⁵ As a result, the

320. See, e.g., MODEL BUS. CORP. ACT § 13.31(a) (1991) (stating that courts may assess costs against dissenting shareholders if they act "arbitrarily, vexatiously, or not in good faith in demanding payment"); DEL. CODE ANN. tit. 8, § 262(j) (1991) (stating that the court may tax costs of proceeding "upon the parties as the Court deems equitable in the circumstances").

321. See MODEL BUS. CORP. ACT § 13.31(b).

322. Although the Delaware statute expressly permits the court to assess costs against either party, it does not contain the same authority to assess attorney and expert fees and expenses. See DEL. CODE ANN. tit. 8, § 262(j); *Pinson v. Campbell-Taggart, Inc.*, No. CIV.A.7499, 1989 Del. Ch. LEXIS 50, at *21-24 (Nov. 8, 1989); *Technicolor*, 1990 Del. Ch. LEXIS 259, at *112-14. The Delaware legislature should consider granting courts increased authority to shift attorney and expert fees and expenses in appropriate cases.

323. No. CIV.A.7244, 1993 Del. Ch. LEXIS 91 (June 8, 1993).

324. See *supra* notes 270-74 and accompanying text.

325. See *Cooper*, 1993 Del. Ch. LEXIS 91, at *24-25.

corporation was forced to endure ten years of litigation and a full appraisal trial complete with abundant expert witness testimony.³²⁶

Two Delaware cases have expressed concern with the floor price problem.³²⁷ Both cases involved what was arguably an acquisition by an unrelated third party, as opposed to a cash-out merger by an existing controlling shareholder. It is no coincidence that in both of these cases the trial court fixed the appraised fair value at slightly below the merger consideration.³²⁸ In both cases, it seems clear that the courts were sending a message to potential dissenting shareholders that there is a risk in dissenting; it is not a "no-lose" tactic.³²⁹ These courts delivered the message that it is possible for a dissenting shareholder to obtain less than the merger consideration, particularly if the facts show the presence of a true third-party sale. Unfortunately, these courts were unable to directly embrace third-party sales value, and were also prevented by Delaware law from fully utilizing fee-shifting to send their message.³³⁰

F. *The Role of Inequitable Conduct*

If the primary purpose of the appraisal remedy is to protect minority shareholders from wrongful conduct,³³¹ the reported appraisal cases should evidence this purpose. In fact, the reported cases evidence a fairly consistent pattern. In cases where the dissenting shareholders achieve a favorable result, there almost invariably is evidence that the acquiring party acted inequitably or engaged in overreaching. Virtually all of these cases involve an acquisition by a controlling shareholder. On the other hand, in appraisal cases where the acquiring party achieves a favorable result, there is evidence that the acquiring party did not act inequitably. These cases typically involve a third-party, arm's-length transaction, or other indicia of fair dealing. In short, there is a strong correlation between the particular

326. The transaction that gave rise to the litigation was consummated on March 18, 1983, *see id.* at *6, and the case was not finally disposed of until June 8, 1993, *see id.* at *1.

327. *See supra* note 317 and accompanying text.

328. In *Cooper*, the merger consideration was \$29.50 per share and the appraised fair value was fixed at \$27 per share. *See supra* notes 275-83 and accompanying text. In *Technicolor*, the merger price was \$23 per share and the court of chancery determined the appraised fair value of \$21.60 per share. *See Cede & Co. v. Technicolor, Inc.*, No. CIV.A.7129, 1990 Del. Ch. LEXIS 259, at *1-2, *4-5 (Oct. 19, 1990), *rev'd*, 684 A.2d 289 (Del. 1996).

329. *See Cooper*, 1993 Del. Ch. LEXIS 91, at *25.

330. *See supra* note 322.

331. *See supra* notes 9-14 and accompanying text.

equities of each case and the result reached. Given the purpose of the appraisal remedy, this is a desirable outcome.

Most of the appraisal cases decided since *Weinberger* that have been litigated to a final disposition have resulted in favorable verdicts for the dissenting shareholders.³³² These cases share some common traits. At issue in nearly all of them was a transaction initiated by a controlling shareholder. In many of these cases there was evidence that the price offered in the transaction triggering appraisal rights was obviously unfair. When this was not the case, there was typically some evidence that the controlling shareholder breached a fiduciary duty or otherwise engaged in unfair conduct.

Three illustrative cases are *Cavalier Oil Corp. v. Harnett*,³³³ *In re Radiology Associates, Inc.*,³³⁴ and *Neal v. Alabama By-Products Corp.*³³⁵ In *Cavalier*, the controlling shareholders wrongfully usurped opportunities belonging to the corporation whose shares were being appraised.³³⁶ In *In re Radiology Associates, Inc.*, the insiders who froze out the dissenting shareholder failed to fully disclose information with respect to the cash-out merger, and failed to use due care in effecting the merger, constituting a breach of fiduciary duty.³³⁷ In *Neal*, the dissenting shareholders raised allegations of inadequate disclosure, self-dealing, and unfair dealing, that, "for the most part,

332. See *infra* Appendix; see also 2 ALI, PRINCIPLES, *supra* note 5, introductory note at 298-99, reporter's note 5 (noting several instances where courts awarded amounts exceeding the offered merger price); Seligman, *supra* note 6, at 856 (noting that, in general, judicial determinations of fair value "virtually always exceed market value"). The valuation pattern in these cases is predictable. The corporation claims that fair value for appraisal purposes is at or near the price at which the acquisition, generally a cash-out merger, took place. The dissenting shareholder claims that fair value exceeds the acquisition or merger price by a large amount. See, e.g., *Hodas v. Spectrum Tech., Inc.*, No. CIV.A.11265, 1992 Del. Ch. LEXIS 252, at *1, *7, *9 (Dec. 7, 1992) (acquisition price of \$70.57 per share; corporation alleged fair value equaled \$68 per share; dissenting shareholder alleged fair value equaled \$896.37 per share); *Neal v. Alabama By-Products Corp.*, No. CIV.A.8282, 1990 WL 109243, at *1, *6, *8 (Del. Ch. Aug. 1, 1990) (acquisition price of \$75.60 per share; corporation alleged fair value equaled \$64 per share; dissenting shareholder alleged fair value equaled \$193.40 per share), *aff'd*, 588 A.2d 255 (Del. 1991). As used in the text, a result favorable to the dissenting shareholder means that the judicial determination of fair value significantly exceeded the acquisition price.

333. 564 A.2d 1137 (Del. 1989).

334. 611 A.2d 485 (Del. Ch. 1991).

335. No. CIV.A.8282, 1990 WL 109243 (Del. Ch. Aug. 1, 1990), *aff'd*, 588 A.2d 255 (Del. 1991).

336. See *Cavalier Oil Corp.*, 564 A.2d at 1144. There were also allegations that the insiders caused the corporation to assign them options to purchase additional stock for inadequate consideration. See *Cavalier Oil Corp. v. Harnett*, Nos. CIV.A.7959, 7960, 7967, 7968, 1988 Del. Ch. LEXIS 28, at *8 (Feb. 22, 1988), *aff'd*, 564 A.2d 1137 (Del. 1989).

337. See *In re Radiology Assocs.*, 611 A.2d at 487.

went unchallenged by respondents.”³³⁸ In each of these cases, the appraisal result was very favorable to the dissenting shareholders.³³⁹

In *Neal* there was also evidence that the dissenting shareholders were offered an obviously unfair price. First, the cash-out merger was accomplished at a price well below the price paid by the controlling shareholder for its own stock.³⁴⁰ In addition, the controlling shareholder had previously made and abandoned two specific proposals to engage in a cash-out merger: in one instance, an investment banker recommended a minimum price for the merger transaction that exceeded the price ultimately paid in the cash-out merger;³⁴¹ in the other instance, the controlling shareholder proposed a cash-out merger that was deemed unfair by an investment banker.³⁴²

338. *Neal*, 1990 WL 109243, at *3.

339. In *Cavalier Oil Corp.*, the appraised value determined by the court was \$347,000, compared to \$93,950 offered by the corporation. See *Cavalier Oil Corp.*, 564 A.2d at 1139. In *Radiology*, the court determined the appraised fair value to be \$1,084 per share, far greater than the \$457 per share argued by the corporation and the \$400 per share paid in the original cash-out merger. See *In re Radiology Assocs.*, 611 A.2d at 488-89, 501. In *Neal*, the court appraised the stock at \$180.67 per share versus \$75.60 per share paid in the cash-out merger and \$64 per share asserted as the fair value by the corporation. See *Neal*, 1990 WL 109243, at *1, *8, *21. Other cases also illustrate the principle that wrongdoing or breach of fiduciary duty significantly impacts the outcome of appraisal proceedings. See, e.g., *Harris v. Rapid-American Corp.*, No. CIV.A.6462, 1990 WL 146488, at *1, *3, *18 (Del. Ch. Oct. 2, 1990) (noting that controlling shareholders engaging in cash-out merger were subject to several shareholder suits and Securities and Exchange Commission enforcement actions; appraising value at \$51 per share as compared to \$28 per share offer price), *aff'd in part, rev'd in part*, 603 A.2d 796 (Del. 1992), *on remand*, 1992 WL 69614, at *4 (Del. Ch. Apr. 6, 1992) (fixing fair value at \$73.29 per share); *Pinson v. Campbell-Taggart, Inc.*, No. CIV.A.7499, 1989 Del. Ch. LEXIS 50, at *1, *15 & n.5, *63 (Nov. 8, 1989) (noting allegations of disclosure inadequacies and procedural unfairness; finding fair value to be \$2,819 per share compared to cash-out price of \$1,935.75); *In re Spang Indus., Inc.*, 535 A.2d 86, 90-91 (Pa. Super. Ct. 1987) (noting that corporation understated its assets and overstated its liabilities in preparation for cash-out merger; remanding for recalculation of fair value); *cf. Ryan v. Tad's Enters., Inc.*, Nos. CIV.A.10229, 11977, 1996 WL 936160, at *1, *2, *22 (Del. Ch. Apr. 24, 1996) (evaluating fairness of price in context of fiduciary duty claim; noting self-dealing and unfair dealing by controlling shareholder and determining a fair value of \$23.86 per share, compared to \$13.25 merger price), *aff'd*, 693 A.2d 1082 (Del. 1997); *Kalabogias v. Georgou*, 627 N.E.2d 51, 55-58 (Ill. App. Ct. 1993) (looking to appraisal statute in evaluating fair value for buyout pursuant to dissolution petition; noting corporation underreported revenues on tax records and financial statements and accepting minority shareholders' valuation of corporation at \$1,393,682, compared to controlling shareholders' asserted value of \$102,279).

340. See *Neal*, 1990 WL 109243, at *1.

341. Goldman Sachs and Company recommended a minimum price of \$85 per share to engage in a cash-out merger, and the controlling shareholder determined not to pursue the transaction. See *id.* at *2.

342. The controlling shareholder's \$65 cash-out merger proposal was deemed to be "not fair from a financial point of view" by Kidder, Peabody and Company, Inc. See *id.*

Courts have looked at several different kinds of evidence indicating that the dissenting shareholders were offered an obviously unfair price. In some cases, evidence indicated that a third party had been willing to pay more than the cash-out merger price.³⁴³ In other cases, the cash-out merger was instituted at a price below the price previously offered to the dissenting shareholder by the controlling shareholder in an attempt to buy the dissenting shareholder's shares,³⁴⁴ or at a price below the low end of a price range deemed fair by an independent investment banker.³⁴⁵ In each of these instances, the dissenting shareholders received a favorable appraisal result.³⁴⁶

On the other hand, when the merger price is determined in third-party, arm's-length dealings, the appraisal result typically favors the corporation rather than the dissenting shareholder. *Cooper v. Pabst Brewing Co.* and *BNE Massachusetts Corp. v. Sims*, discussed previously,³⁴⁷ are probably the best examples.³⁴⁸

Similarly, if there is other evidence of the fairness of the merger price, the corporation is likely to achieve a better result in the appraisal proceeding. *Kleinwort Benson, Ltd. v. Silgan Corp.*³⁴⁹ illustrates this point. In *Kleinwort*, insiders owning the Class A stock of a corporation engaged in a cash-out merger to eliminate the Class B stock at a price of \$6.50 per share.³⁵⁰ More than two-thirds of the Class B stock was owned by The Morgan Stanley Group and related parties.³⁵¹ Morgan Stanley consented to the merger.³⁵² Some of the

343. See *Institutional Equip. & Interiors, Inc. v. Hughes*, 562 N.E.2d 662, 664-66 (Ill. App. Ct. 1990); *Chrome Data Sys., Inc. v. Stringer*, 820 P.2d 831, 832-33 (Or. Ct. App. 1991).

344. See, e.g., *TV58 Ltd. Partnership v. Weigel Broad. Co.*, No. CIV.A.10798, 1993 Del. Ch. LEXIS 146, at *5-6 (July 22, 1993).

345. See *In re Shell Oil Co.*, No. CIV.A.8080, 1990 Del. Ch. LEXIS 199, at *4-6 (Dec. 11, 1990), *aff'd*, 607 A.2d 1213 (Del. 1992); *Pinson v. Campbell-Taggart, Inc.*, No. CIV.A.7499, 1989 Del. Ch. LEXIS 50, at *44-48 (Nov. 8, 1989).

346. See *infra* Appendix.

347. See *supra* notes 269-83, 300-08 and accompanying text.

348. Another good example is found in *Cawley v. SCM Corp.*, 530 N.E.2d 1264, 1267-68 (N.Y. 1988) (noting that active bidding contest provided evidence that merger price was fair).

349. No. CIV.A.11107, 1995 WL 376911 (Del. Ch. June 15, 1995).

350. See *id.* at *1.

351. See *id.* The Morgan Stanley Group and the Morgan Stanley Leveraged Equity Fund, L.P. (MSLEF) owned more than two-thirds of the Class B stock. See *id.* The general partners of MSLEF were Morgan Stanley Leveraged Capital Fund, Inc., L.P., another Morgan Stanley affiliate, and CIGNA Leveraged Capital Fund, Inc., an affiliate of CIGNA Corporation. See *id.*

352. See *id.*

other Class B shareholders, unrelated to Morgan Stanley, elected to dissent from the cash-out merger.³⁵³

The court fixed the fair value of the Class B stock at \$5.94 after hearing all of the appraisal evidence.³⁵⁴ Although the court did not expressly rely on the fact that Morgan Stanley went along with the transaction, it appears unavoidable that the court was strongly influenced by this fact.³⁵⁵ A significant shareholder, highly sophisticated in financial matters, unrelated to the acquiring party, and with the likely power to scuttle the transaction, was willing to accept \$6.50 per share. This provided a strong indicia of the fairness of that price.³⁵⁶

The significant role equity plays in an appraisal proceeding is also demonstrated in *Salomon Brothers Inc. v. Interstate Bakeries Corp.*³⁵⁷ In this case, Salomon Brothers acquired its ownership interest in a corporation after the announcement of a merger transaction giving rise to appraisal rights, with full knowledge of the proposed merger transaction and the fact that the acquiring company owned sufficient shares to carry out the merger.³⁵⁸ In effect, Salomon bought its stock in order to bring an appraisal action. The court rejected the corporation's argument that Salomon should not be able to demand appraisal because it had acquired its stock after the announcement of the merger.³⁵⁹ There is little doubt, however, that this equitable fact affected the final result in the appraisal proceeding. Salomon was awarded \$32.50 per share in the appraisal proceeding, an amount well below the merger price of \$39.25 to \$40.50 per share.³⁶⁰

353. *See id.*

354. *See id.*

355. The court described Morgan Stanley's ownership interest and noted its consent to the merger. *See id.* These facts were not related to the appraisal proceeding, other than to show acquiescence in the merger transaction by a sophisticated, unrelated party.

356. *See also* *Alpert v. 28 Williams St. Corp.*, 473 N.E.2d 19, 22, 24, 29 (N.Y. 1984) (finding a transaction "fair" where the cash-out price was determined by looking at the price paid to majority stockholders in arm's-length transactions prior to the merger).

357. 576 A.2d 650 (Del. Ch. 1989) (denying corporation's motion for summary judgment); No. CIV.A.10054, 1992 Del. Ch. LEXIS 100 (May 1, 1992) (decision after trial).

358. *See Salomon Bros.*, 576 A.2d at 651.

359. *See id.*

360. *See Salomon Bros.*, 1992 Del. Ch. LEXIS 100, at *1, *4-5. A management-led buyout group initially offered \$38 per share for the company, after the company had been shopped for about six months. *See id.* at *4-5. Following negotiations, the buyout group agreed to pay \$40.50 in cash for approximately 89% of the company and preferred stock with a liquidation preference of \$40.50 for the remaining shares. *See id.* at *5. Goldman Sachs opined that the blended value of the consideration was between \$39.25 and \$39.75 per share. *See id.* The fact that the company was actively shopped prior to the insider-led buyout no doubt contributed to the corporation's equitable position.

Although it appears that equitable factors strongly influence the outcome of appraisal proceedings, the argument might be made that courts are not attempting to achieve "equity" in appraisal proceedings, but are merely appraising corporations. Where, after all, does equity fit in a discounted cash flow analysis or similar number crunching exercise?³⁶¹ The nature of the appraisal process belies this argument. As already pointed out, appraisal is not an exact science, and entails much subjectivity, estimation, and prediction.³⁶² The dissenting shareholder typically alleges that the stock has a fair value between two and ten times the fair value claimed by the corporation.³⁶³ Equity has a lot of room to operate within such a large range of fair value and the outcomes in these cases indicate that courts generally attempt to achieve equitable results.

The ability of a court to manipulate the numbers to reach a "fair result" is demonstrated in *In re Appraisal of Shell Oil Co.*³⁶⁴ In *Shell*, a controlling shareholder was interested in cashing out the minority shareholders.³⁶⁵ It retained an investment banker who opined that the value of the minority shares was \$53 per share.³⁶⁶ A cash-out merger at \$55 was proposed.³⁶⁷ An independent committee of the corporation was formed to evaluate the bid.³⁶⁸ The committee retained its own investment banker, Goldman Sachs, who opined that \$80-\$85 was the "high confidence" range for the value of the corporation's shares, with the lowest fair price being \$70 per share.³⁶⁹ The committee thus rejected the \$55 proposal and indicated a willingness to negotiate a \$75 offer.³⁷⁰ The parent dropped the merger proposal and launched a tender offer at \$58 per share.³⁷¹ Litigation ensued and

361. Similarly, the opinions in appraisal cases do not speak extensively about equity, but instead primarily are devoted to dissecting experts' valuation testimony. See, e.g., *Cavalier Oil Corp. v. Harnett*, Nos. CIV.A.7959, 7960, 7967, 7968, 1988 Del. Ch. LEXIS 28, at *8, *32-98 (Feb. 22, 1988) (making only a passing reference to equitable considerations and engaging in a lengthy discussion devoted to valuation testimony), *aff'd*, 564 A.2d 1137 (Del. 1989). It often is necessary to read between the lines to ascertain the equitable posture of the proceeding.

362. See *supra* notes 90-98 and accompanying text.

363. See *infra* Appendix.

364. No. CIV.A.8080, 1990 Del. Ch. LEXIS 199 (Dec. 11, 1990), *aff'd*, 607 A.2d 1213 (Del. 1992).

365. See *id.* at *3-4.

366. See *id.* at *4.

367. See *id.*

368. See *id.*

369. See *id.*

370. See *id.* at *4-5.

371. See *id.* at *5.

was settled, and a cash-out merger ultimately took place at \$58 per share.³⁷² Some of the shareholders asserted appraisal rights.³⁷³

In the appraisal proceeding, the dissenting shareholders, and their expert, asserted that the shares had a fair value of \$89.³⁷⁴ The corporation, and its expert, asserted a fair value of \$55.³⁷⁵ The court, after chiding the parties for presenting biased expert testimony,³⁷⁶ concluded that the dissenting shareholders' expert's valuation was the more credible of those presented, although it too was "not without error and distortion."³⁷⁷ As a result, the court took the dissenting shareholders' valuation result of \$89, discounted it by 20%, and concluded that fair value was equal to \$71.20 per share.³⁷⁸ The court gave no explanation for the 20% discount. Presumably, it was to correct for the "error and distortion"³⁷⁹ found in the \$89 valuation, but there is no explanation as to why 20%, rather than 10%, or 30%, or any other number, was chosen. The court did indicate that the resulting valuation of \$71.20 per share was not far from the \$70 per share "low" value arrived at by Goldman Sachs.³⁸⁰ This indicates that the court had in mind an equitable solution, and found enough play in the numbers to achieve the desired result.³⁸¹

372. See *id.* at *6-9.

373. See *id.* at *10. In assessing the equities of this case, it is interesting to note that the corporation was determined to have failed adequately to disclose all material facts to the minority shareholders. See *id.* at *2, *6; *In re Appraisal of Shell Oil Co.*, 607 A.2d 1213, 1215 (Del. 1992).

374. *In re Appraisal of Shell Oil Co.*, 1990 Del. Ch. LEXIS 199, at *17.

375. See *id.* at *92.

376. See *id.* at *14-16, *93.

377. *Id.* at *94-95.

378. See *id.* at *95-96.

379. *Id.* at *95.

380. See *id.* at *96. It also was not far from the \$75 price at which the independent committee was willing to strike a deal. See *id.* at *4-5. Presumably, if the independent committee's first offer was \$75, the committee might have been willing to agree to a price somewhat below \$75. This, of course, lends credence to the equity of the \$71.20 result reached by the court.

381. The corporation appealed from the court of chancery's valuation determination and the Delaware Supreme Court upheld the chancellor's valuation, applying a deferential standard of review. *In re Appraisal of Shell Oil Co.*, 607 A.2d 1213, 1215, 1219 (Del. 1992). The supreme court candidly noted that the chancery court had to sort out figures that were "poles apart," and chose a final value "very close to the mid-way mark between the two values." *Id.* at 1220.

G. Limitations on the Ability of Courts to Achieve Equitable Results

Although courts generally have managed to conduct appraisal proceedings with an eye to the underlying equities, certain doctrinal problems interfere with the ability of courts to consistently reach equitable results. These doctrinal problems fall into three categories. The first concerns the relationship between the appraisal process and allegations of unfairness or breach of fiduciary duty. The second relates to whether courts conducting appraisal proceedings are permitted to consider events that take place after the transaction triggering the appraisal remedy. The last deals with institutional concerns that arise in appraisal proceedings.

1. *The Relationship Between the Appraisal Remedy and Allegations of Unfair Conduct or Breach of Fiduciary Duty.* Although it appears that courts consider unfair conduct or breaches of fiduciary duty to reach equitable appraisal results,³⁸² they are restricted in their ability to do so under existing Delaware case law. The Delaware courts have held that the appraisal remedy is a limited legislative remedy and that the only litigable issue in an appraisal proceeding is the value of the dissenting shareholders' stock on the date of the merger.³⁸³ As a result, the Delaware courts have concluded that claims of unfair dealing may not be litigated within the context of a statutory appraisal proceeding.³⁸⁴ The Delaware Supreme Court has stated that "[a] determination of fair value does not involve an inquiry into claims of wrongdoing in the merger."³⁸⁵

382. See *supra* Part II.F. *But see* *Sieg Co. v. Kelly*, 568 N.W.2d 794, 802 (Iowa 1997) (stating that appraisal "is not an equitable proceeding wherein the court assigns a value to the dissenters' stock that it considers 'fair and equitable under all the circumstances'" (citation omitted)).

383. See *Alabama By-Products Corp. v. Neal*, 588 A.2d 255, 256-57 (Del. 1991); *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1142 (Del. 1989); *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182, 1187 (Del. 1988).

384. See *Neal*, 588 A.2d at 257; *See also Sieg*, 568 N.W.2d at 802 (agreeing with Delaware courts that appraisal proceeding is limited to determining fair value).

385. *Technicolor*, 542 A.2d at 1189. The court stated that the proper forum to address claims of "wrongdoing" is a "fraud action seeking monetary relief for unfair dealing." *Id.* The court has thus created a dual litigation model in which the fraud action is the remedy for wrongdoing and the appraisal action is a mere legislative remedy to determine fair value. The court's analysis, however, fails to address the reason for the legislatively created appraisal remedy. The legislature must have had some minority shareholder protection rationale in mind, and this purpose should inform the appraisal proceeding. See *supra* notes 6-14 and accompanying text. The appraisal proceeding does not exist in a vacuum merely to render a finding as to fair value. Nor did the court explain its apparent retreat from *Weinberger's* statement that

The courts of other states have not taken as firm a stance on this issue, and often permit claims of misconduct to be asserted in an appraisal proceeding.³⁸⁶

The Delaware position presents an apparent paradox. Inequitable conduct should, and in fact does, appear to influence the results of appraisal proceedings,³⁸⁷ yet the Delaware Supreme Court has stated that claims of wrongdoing do not belong in the appraisal process.³⁸⁸ This apparent paradox has been resolved in two ways. First, evidence of wrongdoing continues to find its way indirectly into the appraisal process to impeach the credibility of the wrongdoer. Determining fair value in an appraisal proceeding depends very much on the underlying factual assumptions made as to the future prospects of the business.³⁸⁹ Inevitably the corporation, through its agents, will either testify as to those underlying assumptions, or provide information to an expert witness for use by that witness in determining fair value. In either case, the dissenting shareholder may then challenge the underlying assumptions by attacking, with evidence of unfair dealing, the credibility of the corporation's agents.³⁹⁰ As a result, although the dissenting shareholder may not submit evidence of unfair dealings in an appraisal proceeding directly to support an unfair dealing claim, that same evidence may be used indirectly to impeach the credibility of the valuation contentions of the

the appraisal remedy should ordinarily be the exclusive remedy to a shareholder objecting to a merger transaction. *See supra* note 21 and accompanying text. Obviously, there is some overlap between the appraisal remedy and the fraud action when both arise out of a contested fundamental corporate transaction. The exact relationship between the two remedies, and the degree to which the appraisal remedy is, or should be, an exclusive remedy, is beyond the scope of this Article, and will be addressed in a forthcoming article by the author.

386. *See, e.g.*, *Czajkowski v. Jovanovich*, No. 92-55787, 1994 U.S. App. LEXIS 14153, at *11 (9th Cir. June 8, 1994) (permitting allegations of fraud and breach of fiduciary duty to be considered in appraisal proceeding under New York law); *Steinberg v. Amplica, Inc.*, 729 P.2d 683, 690 (Cal. 1986) (en banc) (holding that shareholder's claim of misconduct can be vindicated in appraisal proceeding); *Sturgeon Petroleum Ltd. v. Merchants Petroleum Co.*, 195 Cal. Rptr. 29, 33 (Cal. Ct. App. 1983) (allowing misconduct affecting value of corporation to be asserted in appraisal proceeding); *cf. Foy v. Klapmeier*, 992 F.2d 774, 779 (8th Cir. 1993) (taking into account usurpation of corporate opportunity in valuing corporation). *But see Sieg*, 568 N.W.2d at 802 (holding that an appraisal action is not the appropriate forum for recovery of damages for wrongdoing).

387. *See supra* Part II.F.

388. *See supra* notes 383-85 and accompanying text.

389. *See supra* notes 91-93 and accompanying text.

390. *See Alabama By-Products Corp. v. Neal*, 588 A.2d 255, 257 (Del. 1991) (holding that evidence of unfair dealing is admissible to impeach respondents' credibility); *In re Radiology Assocs., Inc.*, 611 A.2d 485, 498 (Del. Ch. 1991) (noting that breach of fiduciary duty by defendant "undermines the credibility of the information" supplied to expert witness).

opposing party.³⁹¹ What is not permitted in the front door may freely enter through the back door.

Further, the Delaware courts have consistently stated that they will not, in conducting an appraisal proceeding, ignore the manner and procedures used to determine the price offered in the transaction triggering appraisal rights.³⁹² Thus, if there is self-dealing, or the procedures utilized in setting the price are not calculated to yield a fair price, this will be considered by the court in assessing the reliability of the corporation's valuation assertions.³⁹³ This provides another means for courts to assess the conduct of the parties in the appraisal process.

Second, the appraisal process has been used as a means of uncovering wrongdoing that can be asserted in separate litigation, thereby providing a means to remedy the inequitable conduct. Dissenting shareholders in appraisal proceedings have been permitted to conduct discovery aimed at uncovering evidence of unfair dealing or breach of fiduciary duty. In *Chang's Holdings v. Universal Chemicals & Coatings, Inc.*,³⁹⁴ for example, the court permitted the dissenting shareholder in an appraisal proceeding to take depositions aimed at determining whether that shareholder had a basis for asserting a breach of fiduciary duty claim.³⁹⁵ The court reasoned that because such information may affect the credibility of the board of directors or other persons who supplied information used in valuing the company, it could be relevant to an appraisal proceeding.³⁹⁶

In addition to the limited permissible use of discovered wrongdoing in the appraisal proceeding itself, the shareholder may utilize such wrongdoing to assert claims of unfair dealing or breach of fiduciary duty in separate litigation, instituted well after the appraisal

391. See *Neal*, 588 A.2d at 257.

392. See *Neal v. Alabama By-Products Corp.*, No. CIV.A.8282, 1990 WL 109243, at *5 (Del. Ch. Aug. 1, 1990), *aff'd*, 588 A.2d 255 (Del. 1991); *Pinson v. Campbell-Taggart, Inc.*, No. CIV.A. 7499, 1989 Del. Ch. LEXIS 50, at *20 (Nov. 8, 1989).

393. See *Pinson*, 1989 Del. Ch. LEXIS 50, at *20.

394. No. CIV.A.10856, 1992 WL 301327 (Del. Ch. Oct. 13, 1992).

395. See *id.* at *1-2.

396. See *id.* at *1. The court in *Chang's Holdings* was influenced by the discussion in *Neal*. The court recognized that "expert valuations are based on assumptions, . . . many of [which] are derived from information provided by [the] board of directors." *Id.* As a result, the credibility of the board is at issue in an appraisal proceeding, making evidence of unfair dealing or breach of fiduciary duty relevant to the appraisal proceeding, and a proper matter of discovery. See *id.* at *1-2.

claim has been brought.³⁹⁷ The Delaware Supreme Court has noted that “only shareholders pursuing discovery during an appraisal proceeding are likely to acquire the relevant information needed to pursue a fraud action if such information exists,”³⁹⁸ and thereby has recognized the value of the appraisal proceeding as a discovery mechanism aimed at uncovering evidence of wrongful conduct directed toward minority shareholders.³⁹⁹

2. *The Ability of Courts to Consider Events Subsequent to the Transaction Giving Rise to Appraisal Rights.* An appraisal proceeding seeks to value a corporation as of the time immediately before the effectuation of the corporate action giving rise to appraisal rights.⁴⁰⁰ It is the future prospects of the corporation, however, that are critical to the determination of what the corporation is worth at that particular time,⁴⁰¹ and the opposing experts typically take very different positions with respect to these future prospects.⁴⁰²

An interesting dynamic of the appraisal process is that by the time the appraisal proceeding comes to trial, some of those “future prospects” no longer lie in the future, but are known. For example, in *Cede & Co. v. Technicolor, Inc.*, the initial appraisal proceeding took place more than seven years after the merger that gave rise to the appraisal proceeding.⁴⁰³ The obvious issue raised by such a delay is whether the court that conducts the appraisal proceeding should consider the actual events that have transpired after the consummation of the transaction that triggered the appraisal proceeding.⁴⁰⁴

397. See *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182, 1188-92 (Del. 1988) (holding that filing of appraisal claim does not preclude later filing of separate claim alleging breach of fiduciary duty).

398. *Id.* at 1189; see also *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1143-44 (Del. 1989) (noting that dissenting shareholder lacked knowledge of usurpation of corporate opportunity prior to instituting appraisal proceeding).

399. See Wertheimer, *supra* note 6, at 38-39 (discussing the discovery rationale for the appraisal remedy).

400. See, e.g., MODEL BUS. CORP. ACT § 13.01(3) (1991).

401. See *supra* notes 78-81 and accompanying text.

402. See *supra* notes 94-97 and accompanying text.

403. See *Cede & Co. v. Technicolor, Inc.*, No. CIV.A.7129, 1990 Del. Ch. LEXIS 259 (Oct. 19, 1990), *rev'd on other grounds*, 684 A.2d 289 (Del. 1996). This appraisal proceeding is still ongoing, having been remanded back to the chancery court by the Delaware Supreme Court late in 1996. See *Technicolor*, 684 A.2d at 302.

404. See *Technicolor*, 1990 Del. Ch. LEXIS 259, at *54 n.36 (noting that the appraisal action “imaginatively stands in the past and pretends to look toward a future that has already occurred”), *rev'd on other grounds*, 684 A.2d 289 (Del. 1996). This is best illustrated by assuming

At first blush, it would appear that courts should consider this post-transaction information because the use of actual facts, rather than predictions, would lead to more accurate appraisals. The countervailing argument, however, derives from the statutory directives that the corporation should be appraised as of the time of the appraisal-triggering event, and that the appraised value must exclude any appreciation or depreciation that arises from the expectation or accomplishment of the event giving rise to the appraisal proceeding.⁴⁰⁵ The use of post-transaction financial results might be impermissible if such results include appreciation that was unforeseeable at the time of the transaction or that arose from the accomplishment of the transaction. As a result, several courts have concluded that it would be inappropriate in the appraisal process to use information acquired after the event giving rise to the appraisal proceeding.⁴⁰⁶

This conclusion is illustrated by *Cede & Co. v. Technicolor, Inc.*⁴⁰⁷ One issue in *Technicolor* was how to value Technicolor's videocassette business.⁴⁰⁸ This business was only eighteen months old at the time of the merger that triggered the appraisal proceeding, and had

that a corporation is being valued with the discounted cash flow method. Using this method, the appraiser estimates future cash flows, as of the time the corporation is being appraised, and discounts those future cash flows to a present value. See *supra* notes 78-81 and accompanying text. Much of the difficulty with this valuation method involves estimating the future cash flows. One expert tends to take a dim view of future cash flows, and the other an optimistic view. If the appraisal is done several years later, however, it would be possible to use the actual cash flows, rather than estimated ones.

405. See *supra* notes 214-26 and accompanying text.

406. See, e.g., *Gonsalves v. Straight Arrow Publishers, Inc.*, No. CIV.A.8474, 1996 WL 696936, at *7 (Del. Ch. Nov. 27, 1996) (referring to hindsight as an "inappropriate" means of determining whether earnings in the year preceding the merger were sustainable), *rev'd*, 701 A.2d 357 (Del. 1997); *Cede & Co. v. Technicolor, Inc.*, No. CIV.A.7129, 1990 Del. Ch. LEXIS 259, at *53-55 (Oct. 19, 1990) (refusing to consider whether valuation model in fact approximated what actually occurred), *rev'd*, 684 A.2d 289 (Del. 1996); *Kahn v. Household Acquisition Corp.*, 591 A.2d 166, 175 (Del. 1991) (quasi-appraisal proceeding) (excluding from consideration post-merger offers for corporation); *cf.* *Meadows v. Bicrodyne Corp.*, 785 F.2d 670, 672-73 (9th Cir. 1986) (noting that where parties stipulated that appraisal evaluation was to be based on all the information at hand on the date before the merger was announced, evidence of post-merger earnings was properly excluded). *But see Gonsalves*, 701 A.2d at 362 ("[P]ost-merger evidence is not necessarily inadmissible to show that plans in effect at the time of the merger have born [sic] fruition."); *Neal v. Alabama By-Products Corp.*, No. CIV.A.8282, 1990 WL 109243, at *14 (Del. Ch. Aug. 1, 1990) (taking into account post-merger accounting write down), *aff'd*, 588 A.2d 255 (Del. 1991).

407. No. CIV.A.7129, 1990 Del. Ch. LEXIS 259 (Oct. 19, 1990), *rev'd*, 684 A.2d 289 (Del. 1996).

408. See *id.* at *49-57.

been profitable at that time for only six months.⁴⁰⁹ As a result, predicting its future prospects was difficult. The court rejected the dissenting shareholder's expert's analysis of this business as "too strikingly odd to be accepted."⁴¹⁰ In a footnote, the court stated that it was "mindful of the fact that petitioner sought to show that its model closely approximated the performance that in fact later occurred."⁴¹¹ In other words, the dissenting shareholder attempted to show that its expert's valuation model, rejected by the court as "odd," in fact closely approximated the business results experienced in the intervening time period.⁴¹² The court rejected this evidence as "irrelevant to a statutory appraisal."⁴¹³

The court noted several problems with this evidence. First, the court stated that such evidence did not bear on the issue of what a reasonable person would have been likely to expect as of the merger date;⁴¹⁴ the court did not, however, explain why this was the crucial inquiry. Second, the court was concerned that the actual post-merger results would incorporate the effects of the merger, in violation of the statute.⁴¹⁵ Finally, the court noted that if this sort of evidence was accepted, it would be too easy, after the fact, to fit an appraisal model to mirror actual financial results.⁴¹⁶ The court did not explain why this necessarily was a problem.

The court's analysis of this issue in *Technicolor* is incomplete. As the court recognized, the appraisal proceeding seeks to establish the fair value of the corporation as of the merger date.⁴¹⁷ This requires the court to choose between competing expert appraisal models. The court's focus on the expectations of a reasonable person at the time of the merger makes sense because it is consistent with a third-party sales value approach. The reasonable expectations of third-party purchasers necessarily affect the price that a willing buyer would be willing to pay for the corporation. The court was therefore correct in refusing to rely exclusively on post-merger information to determine what would have been reasonably expected by potential

409. *See id.* at *53-54.

410. *Id.* at *55.

411. *Id.* at *55 n.36.

412. *See id.*

413. *Id.*

414. *See id.*

415. *See id.*

416. *See id.*

417. *See id.*

purchasers at the time of the merger.⁴¹⁸ On the other hand, the fact that one model more closely mirrored actual events seems relevant to ascertaining which model was more reasonable in the first instance.⁴¹⁹ Care should be taken not to rely excessively on actual, post-merger financial results, but that does not mean that such results should be entirely excluded from consideration.⁴²⁰

Similarly, given existing statutes, courts generally must ensure that post-transaction financial results not be relied on to the extent they embody appreciation that arises as a result of the transaction.⁴²¹ Once again, however, this does not mean that post-transaction results

418. This analysis is also relevant to the court's third objection to the use of post-transaction information—that it would be too easy, after the fact, to fit an appraisal model to the events that actually occurred. The problem with such a model is that, because it operates in hindsight, it is not necessarily relevant to what a willing buyer would have been willing to pay for the corporation at the time of the transaction in question.

419. Post-merger financial data can thus operate as a "reality check" on the experts' forecasts. The Delaware Supreme Court recently lent credence to this idea in *Gonsalves v. Straight Arrow Publishers, Inc.*, 701 A.2d 357 (Del. 1997). In *Gonsalves*, the corporation's expert had used a five-year earnings average to compute the value for the corporation, and the dissenting shareholder's expert had used the most recent year's earnings. See *Gonsalves v. Straight Arrow Publishers, Inc.*, No. CIV.A.8474, 1996 WL 696936, at *3-4 (Del. Ch. Aug. 22, 1996), *rev'd on other grounds*, 701 A.2d 357 (Del. 1997). The dissenting shareholder argued that earnings for the most recent year were more probative of value than a five-year average because the most recent year "was a precursor year and indicative of post-merger growth." *Gonsalves*, 701 A.2d at 361. The court of chancery rejected this argument, concluding that there was no way to judge whether the most recent year was aberrant or sustainable, "without the inappropriate aid of hindsight." *Gonsalves*, 1996 WL 696936, at *7. The supreme court "question[ed]" the chancery court's "offhand rejection" of the most recent year's earnings as not sustainable without the aid of hindsight, and, importantly, stated that "post-merger evidence is not necessarily inadmissible to show that plans in effect at the time of the merger have born [sic] fruition." *Gonsalves*, 701 A.2d at 362.

420. The Delaware statute requires that courts take into account "all relevant factors" in determining fair value. DEL. CODE ANN. tit. 8, § 262(h) (1991).

421. See *supra* notes 214-26 and accompanying text. New York's statute, however, no longer requires exclusion of appreciation or depreciation arising from the corporate action giving rise to the shareholder's right to appraisal. See N.Y. BUS. CORP. LAW § 623(h)(4) hist. note (McKinney 1986) (noting 1982 amendment deleting the phrase "excluding any appreciation or depreciation directly or indirectly induced by such corporate action or its proposal" from the subsection instructing the court to determine fair value). As a result, New York courts are willing to look at "postmerger factors." *Cawley v. SCM Corp.*, 530 N.E.2d 1264, 1267 (N.Y. 1988).

Many other statutes today do not categorically prohibit the consideration of effects of the merger or transaction giving rise to appraisal rights. For example, the Model Business Corporation Act permits consideration of such effects if exclusion of such effects would be inequitable. See MODEL BUS. CORP. ACT § 13.01(3) (1991). Exclusion of the effects of the transaction makes much less sense with respect to a cash-out merger than with respect to a transaction evidencing the historical liquidity rationale for the appraisal remedy. See *supra* notes 217-23 and accompanying text.

have no place in the calculation. It just means that courts must be careful to distinguish between appreciation that results from the transaction and that which would have been likely to occur in the absence of the transaction. In many cases, drawing this distinction will not be difficult. For example, if Technicolor operated the videocassette business in the same manner after the merger as it did before the merger, there is no reason to think that the actual, post-merger results of that business were effected in any way by the merger.

To the extent this issue has been addressed in the cases, courts have tended summarily to conclude, without much discussion, that it is not permissible to consider post-merger developments,⁴²² although this view has not been universally adopted.⁴²³ The courts that have refused to consider post-merger developments have failed to distinguish between post-merger developments that reflect effects of the merger and post-merger developments that do not reflect effects of the merger. The latter may in fact provide important evidence as to the value of the corporation as of the merger date, to the extent such post-merger developments could reasonably have been foreseen at the time of the merger.

A particularly relevant form of post-merger information that courts should consider is an offer to purchase the corporation made by a third-party purchaser, especially if such an offer arises near the time of the event giving rise to the appraisal proceeding. As previously noted, third-party sales value is probably the best evidence of the fair value of a corporation,⁴²⁴ and reliable evidence of third-party sales value near in time to the transaction triggering appraisal rights should be assessed by courts determining fair value. Blind invocation of a rule that post-merger events may not be considered would, however, prevent such consideration.

This precise problem is reflected in *Kahn v. Household Acquisition Corp.*⁴²⁵ Wien Air Alaska, Inc. was acquired via merger by its principal shareholder, Household Acquisition Corp.⁴²⁶ Wien minority shareholders brought suit challenging the transaction,⁴²⁷ and were

422. See *supra* note 406 and accompanying text.

423. See *Neal v. Alabama By-Products Corp.*, No. CIV.A.8282, 1990 WL 109243, at *14 (Del. Ch. Aug. 1, 1990) (taking into account post-merger write down of investment over objection that post-merger information should not be considered), *aff'd*, 588 A.2d 255 (Del. 1991).

424. See *supra* notes 203-04 and accompanying text.

425. 591 A.2d 166 (Del. 1991).

426. See *id.* at 168.

427. See *id.*

deemed entitled to a quasi-appraisal remedy.⁴²⁸ The court in *Household Acquisition* approvingly stated that the chancery court “was careful to exclude from its value consideration plaintiff’s evidence of ‘postmerger offers’ received by Household for Wien.”⁴²⁹ The problem with considering evidence of such “discussions and overtures,” according to the court, was that this evidence “arose ‘from the accomplishment or expectation of the merger.’”⁴³⁰ The court provided no explanation for how or why the post-merger offers for Wien arose from accomplishment of the merger. In fact, there was no evidence of any relationship between the post-merger offers for Wien and the accomplishment of the merger between Household and Wien. If Household had reshaped Wien, or changed the way it was being run in a way that made Wien more attractive to third-party purchasers, this might have been a concern. There was no indication, however, that any such changes had taken place.

Post-merger offers from unrelated third parties are strong indicators of the value of the corporation, and do not necessarily arise from accomplishment of the merger. In the event that post-merger changes to the corporation, in whole or in part, gave rise to the third-party offer, courts can take that into account. They can either discount the third-party offer to reflect the post-merger developments, or ignore the third-party offer if post-merger developments render it lacking in probative value with respect to the worth of the corporation as of the time of the merger. These possibilities, however, do not justify a blanket prohibition of post-merger evidence of third-party sales value, particularly if such evidence is near in time to the merger.

428. *Household Acquisition* was actually brought not as an appraisal proceeding, but as a breach of fiduciary duty claim. See *id.* at 168. As part of its holding in *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), the Delaware Supreme Court concluded that plaintiffs in cases pending at the time of that decision would be entitled to a quasi-appraisal remedy because it was likely that such litigants, not anticipating the holding in *Weinberger*, had “abjured an appraisal” claim. *Id.* at 714-15. The court in *Household Acquisition* determined that the plaintiffs fell into that protected category and were therefore entitled to a quasi-appraisal remedy. See *Household Acquisition Corp.*, 591 A.2d at 172-73.

429. *Household Acquisition Corp.*, 591 A.2d at 175. Within one year of cashing out Wien’s minority shareholders at a price of \$6 per share, Household entered into an agreement to sell all of its Wien stock for \$10.50 per share. See *Kahn v. Household Acquisition Corp.*, No. CIV.A.6293, 1983 WL 103279, at *1 (Del. Ch. Apr. 26, 1983).

430. *Household Acquisition Corp.*, 591 A.2d at 175 (citing DEL. CODE ANN. tit. 8, § 262(h)); see also *Sieg Co. v. Kelly*, 568 N.W.2d 794, 803-04 (Iowa 1997) (relying on *Household* in upholding trial court’s decision to reject consideration of corporation’s post-merger sale of assets).

Although Delaware courts generally have not been receptive to arguments based on post-merger information in the appraisal context,⁴³¹ a line of Delaware cases dealing with discovery issues in appraisal proceedings supports the proposition that post-merger information may be probative with respect to the value of a corporation at the time of the merger. Delaware courts have permitted dissenting shareholders to obtain discovery with respect to post-merger events because such information may cast light on the value of the corporation at the time of the merger.⁴³² The courts have permitted discovery of two types of post-merger information: post-merger financial results⁴³³ and post-merger offers to purchase the corporation or a substantial portion of its assets.⁴³⁴ The reasoning of the courts in permitting discovery of both types of information supports the arguments in favor of consideration of such information in the appraisal context.

In the first scenario, dissenting shareholders have sought discovery of documents relating to post-merger financial results. In *Kaye v. Pantone, Inc.*, the court stated that the plaintiff is entitled to review documents that could be useful to a determination of whether financial gains registered within a reasonable time after the merger date resulted from the merger, or were attributable to trends in earnings that may have been known or foreseen by the corporation, its directors, or officers, prior to the merger.⁴³⁵ In the latter case, the data would be relevant in determining fair value as of the date of the merger.⁴³⁶ This supports the argument that post-merger information should be considered in the appraisal proceeding to the extent it re-

431. See *supra* notes 406-30 and accompanying text.

432. See, e.g., *Lane v. Cancer Treatment Ctrs. of Am., Inc.*, No. CIV.A.12207, 1994 Del. Ch. LEXIS 67, at *10-11 (May 25, 1994) (holding that post-merger data may be relevant to the valuation of shares at the time of the merger and thus are discoverable); *Ross v. Proco Management, Inc.*, No. CIV.A.6146, 1983 Del. Ch. LEXIS 494, at *6-7 (May 23, 1983) (permitting discovery of post-merger events that are "reasonably calculated to lead to admissible evidence"); *Household Acquisition Corp.*, 1983 WL 103279, at *1 (same); *Kaye v. Pantone, Inc.*, No. CIV.A.5466, 1981 Del. Ch. LEXIS 607, at *8 (Oct. 6, 1981) (permitting discovery limited to time periods "reasonably related to the date of the merger" and stating that "[t]hree years after the merger should be an adequate time period"); see also *Onti, Inc. v. Integra Bank, Nos. CIV.A.14514, 14515*, 1996 Del. Ch. LEXIS 52, at *14-16 (May 10, 1996) (permitting discovery of post-merger information in connection with breach of fiduciary duty claim).

433. See *Lane*, 1994 Del. Ch. LEXIS 67, at *3; *Kaye*, 1981 Del. Ch. LEXIS 607, at *7-10.

434. See *Ross v. Proco Management, Inc.*, No. CIV.A.6146, 1983 Del. Ch. LEXIS 494, at *2-3 (May 23, 1983); *Household Acquisition Corp.*, 1983 WL 103279, at *1.

435. See *Kaye*, 1981 Del. Ch. LEXIS 607, at *9-10.

436. See *id.* at *10.

flects appreciation, unrelated to the merger, that was foreseeable at the time of the merger.

Similarly, in *Lane v. Cancer Treatment Centers of America, Inc.*,⁴³⁷ the court permitted discovery of financial information for the one-year period following the merger that triggered the appraisal claim.⁴³⁸ The court did so in response to the dissenting shareholder's argument that "comparisons between pre-merger projections made by [the corporation's] management and post-merger actual performance . . . could be useful in assessing the reasonableness of the pre-merger projections."⁴³⁹ Again, this suggests that courts should be willing to consider post-merger financial information in assessing the reasonableness of competing valuation models.

In the second scenario, dissenting shareholders have sought and obtained discovery with respect to post-merger offers received for the corporation or its assets that were well in excess of the merger price.⁴⁴⁰ In *Kahn v. Household Acquisition Corp.*, the court stated that if discovery were to disclose information showing that the corporation's value had increased as a result of post-merger factors, the post-merger offer would not be useful in the appraisal proceeding, presumably because the appreciation arose from the accomplishment of the merger.⁴⁴¹ On the other hand, if the discovery revealed no marked difference in the company's performance or prospects since the merger, the offer to purchase the company at a price well above the merger price might lead to discovery of information or knowledge that existed at the time of the merger, and would have a bearing on the fairness of the merger price.⁴⁴² "[F]or purpose of discovery, Delaware courts have considered evidence relating to large jumps in value over short periods of time relevant to the true value of

437. No. CIV.A.12207, 1994 Del. Ch. LEXIS 67 (May 25, 1994).

438. *See id.* at *10.

439. *Id.* at *4.

440. *See* *Ross v. Proco Management, Inc.*, No. CIV.A.6146, 1983 Del. Ch. LEXIS 494, at *2 (May 23, 1983) (noting that assets valued at \$17 million at time of merger were sold two years later for almost \$54 million); *Kahn v. Household Acquisition Corp.*, No. CIV.A.6293, 1983 WL 103279, at *1 (Del. Ch. Apr. 26, 1983) (noting that corporation was sold for \$10.50 per share within one year of cash-out merger at price of \$6 per share).

441. *See Household Acquisition Corp.*, 1983 WL 103279, at *1.

442. *See id.* The court in *Household Acquisition* ultimately concluded that the post-merger offer should not be considered. *See supra* notes 425-30 and accompanying text.

shares.”⁴⁴³ Such evidence should also be relevant for purposes of assessing fair value in an appraisal proceeding.

3. *Institutional Concerns in Appraisal Proceedings—The “Dueling Expert” Problem.* The primary institutional issue in appraisal proceedings involves the court’s task of sorting through the testimony of dueling experts to arrive at the fair value of a corporation. The experts’ valuation opinions tend to be partisan, and highly divergent.⁴⁴⁴ Accordingly, while recognizing that these problems are “to be expected in an adversarial system,”⁴⁴⁵ courts have expressed frustration with the use of competing experts to resolve appraisal proceedings.⁴⁴⁶

The Delaware courts have gingerly explored two mechanisms to alleviate some of the problems associated with the inevitable battle of partisan experts. Although these mechanisms have some appeal in reducing the courts’ task of resolving conflicting expert testimony, they unfortunately import the risk that they will operate to frustrate the achievement of equitable results in appraisal proceedings.

a. *Choosing One Party’s Valuation.* The first mechanism that has been employed in appraisal cases to deal with the “dueling experts” problem is a “rule,” adopted in two Delaware Court of Chancery decisions, stating that a court should decide which of the experts’ opinions is the more credible, and then accept that expert’s model, rather than attempt judicially to create a valuation model composed of the more credible portions of each expert’s model.⁴⁴⁷ In other

443. *Onti, Inc. v. Integra Bank*, Nos. CIV.A.14514, 14515, 1996 Del. Ch. LEXIS 52, at *13 (May 10, 1996).

444. *See supra* notes 94-97 and accompanying text.

445. *In re Appraisal of Shell Oil Co.*, 607 A.2d 1213, 1222 (Del. 1992).

446. *See supra* note 98 and accompanying text.

447. *See Gonsalves v. Straight Arrow Publishers, Inc.*, No. CIV.A. 8474, 1996 WL 696936, at *1 n.2 (Del. Ch. Nov. 27, 1996), *rev’d*, 701 A.2d 357 (Del. 1997); *Cede & Co. v. Technicolor, Inc.*, No. CIV.A.7129, 1990 Del. Ch. LEXIS 259, at *27 n.17 (Oct. 19, 1990), *rev’d*, 684 A.2d 289 (Del. 1996). *But cf. Cavalier Oil Corp. v. Harnett*, Nos. CIV.A.7959, 7960, 7967, 7968, 1988 Del. Ch. LEXIS 28, at *64 (Feb. 22, 1988) (stating that under the Delaware statute the court has an obligation to appraise the shares, so that in the absence of adequate proof by either side, the court may not simply rule against the party having the burden of proof), *aff’d*, 564 A.2d 1137 (Del. 1989). Another approach is to begin by choosing the expert’s analysis that best represents the corporation’s value, but to then adjust that value to correct for “adversarial hyperbole” that influenced the expert’s opinion, or other perceived inadequacies in the expert’s analysis. *See Kleinwort Benson Ltd. v. Silgan Corp.*, No. CIV.A.11107, 1995 WL 376911, at *5 (Del. Ch. June 15, 1995).

words, after each party presents its case, the court should choose the more credible of the two and not attempt to craft a compromise valuation (referred to as a rule requiring a court to “choose one party’s valuation”).⁴⁴⁸ The benefit of this approach, as explained by the Delaware Court of Chancery, is as follows:

Simply to accept one experts’ [sic] view or the other would have a significant institutional or precedential advantage. . . . [I]f the court will ultimately reject both parties [sic] . . . analysis and do its own, the incentive of the contending parties is to arrive at estimates of value that are at the outer margins of plausibility—that essentially define a bargaining range. If it is understood that the court will or is likely to accept the whole of one witnesses [sic] testimony or the other, incentives will be modified. . . . [A]t least the parties will have incentives to make their estimate of value appear most reasonable. This would tend to narrow the range of estimates, which would unquestionably be a benefit to the process.⁴⁴⁹

The court was undoubtedly correct in stating that, *if* litigants understand that courts will (or at least are very likely to) choose one party’s valuation, it would likely narrow the range of dispute, and cause parties to provide more reasonable valuation estimates at the outset. The problem is that no such understanding exists. Although the court of chancery first articulated the concept of choosing one party’s valuation in 1990,⁴⁵⁰ it was not applied in another case until 1996.⁴⁵¹ In the meantime, courts routinely reached compromise results in appraisal proceedings,⁴⁵² often “splitting the baby,” at times

448. The astute sports fan will recognize that this is the model used in baseball salary arbitration. See Robert C. Berry, *Collective Bargaining in Professional Sports*, in 1 LAW OF PROFESSIONAL AND AMATEUR SPORTS § 4.03[4] (Gary A. Uberstine ed., 1997). The player and the team each state the salary they believe the player should earn for the next year. See *id.* The player, of course, proposes a higher salary figure than that proposed by the team. Each side makes their case to the arbitrator, and the arbitrator chooses the salary proposed by either the player or the team, but cannot split the difference or compromise between the two positions. See *id.* This is referred to as “final offer” arbitration. See *id.*

449. *Technicolor*, 1990 Del. Ch. LEXIS 259, at *26 n.17.

450. See *id.*

451. See *Gonsalves*, 1996 WL 696936, at *1 n.2. In *Gonsalves*, the court informed the parties at a pretrial conference on August 21, 1996, that it intended to employ the “choose one party’s valuation” technique at the trial set to begin on August 27, 1996. See *Gonsalves v. Straight Arrow Publishers, Inc.*, 701 A.2d 357, 358 (Del. 1997). Because this information appears to have been sprung on the parties with very short notice, it is unlikely that the technique was useful in narrowing the range of dispute in this case.

452. See, e.g., *In re Radiology Assocs., Inc.*, 611 A.2d 485, 489, 501 (Del. Ch. 1991) (finding fair value per share of \$1,084 where plaintiff argued for fair value of \$2,300 and defendant ar-

expressly noting the compromise nature of the valuation decision adopted.⁴⁵³ Under the splitting the baby approach, each party was encouraged to stake out the most favorable valuation position possible, expecting the court to come down in the middle.⁴⁵⁴

The choose one party's valuation concept can only work if it is uniformly and consistently applied so that the parties know what to expect when they put on valuation evidence. This probably would require either a legislative directive, or at the least, the pronouncement of a firm rule from a state's supreme court. Neither has occurred. In fact, the Delaware Supreme Court recently held that the court of chancery committed reversible error by deciding in advance of trial, and informing the parties, that it would employ the choose one party's valuation technique.⁴⁵⁵ The court reasoned that the use of this technique contravened the statutory requirement that the chancery court "shall appraise" fair value.⁴⁵⁶ It was therefore impermissible for the Chancellor to "announce[] in advance that he intended to choose between absolutes."⁴⁵⁷ Without such an advance announce-

gued for fair value of \$457); *Pinson v. Campbell-Taggart, Inc.*, No. CIV.A.7499, 1989 Del. Ch. LEXIS 50, at *7-12, *63 (Nov. 8, 1989) (finding fair value per share of \$2,819 where plaintiff argued for fair value of \$3,465 or \$4,679 and defendant argued for fair value of \$1,218); see also *infra* Appendix.

453. For example in *In re Appraisal of Shell Oil Co.*, the Delaware Supreme Court stated that the "final value chosen [was] very close to the mid-way mark between the two values the court found to be most credible"; one of the two values was presented by the dissenting shareholder's expert, and the other by the corporation's expert. See 607 A.2d 1213, 1220 (Del. 1992); see also *Kahn v. Household Acquisition Corp.*, 591 A.2d 166, 174 (Del. 1991) (stating that value chosen by chancery court was the "midpoint" between valuations reached by two different pricing methods).

454. This probably overstates the case. It probably is never beneficial for a party to stake out an outlandish valuation position, because it will damage that party's credibility. It may be more accurate to say that each party will stake out the most favorable valuation position that can pass the "straight face" test. In *Santa's Workshop v. A.B. Hirschfeld Press, Inc.*, the dissenting shareholder alleged that the fair value was \$16.80 per share, and the cash-out merger took place at \$3.50 per share. See 851 P.2d 264, 265 (Colo. Ct. App. 1993). The court fixed fair value at \$4.04 per share and upheld the imposition of attorney fees against the dissenting shareholder, whose initial demand was deemed "unreasonable and arbitrary if not vexatious." *Id.*

455. See *Gonsalves*, 701 A.2d at 358; see also *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 299 (Del. 1996) (stating that the chancery court has the discretion to "select one of the parties' valuation models as its general framework, or fashion its own," and that "its choice of a framework does not require it to adopt any one expert's model, methodology, or mathematical calculations *in toto*" (emphasis added)).

456. See *Gonsalves*, 701 A.2d at 361.

457. *Id.*

ment, however, the institutional benefits attributable to the choose one party's valuation approach cannot be realized.

The Delaware Supreme Court stated that it would not necessarily be arbitrary to choose one party's valuation, but that to decide in advance to do so was error.⁴⁵⁸ Future litigants therefore may be forced to deal with the same random and arbitrary imposition of the choose one party's valuation concept that has applied over the last eight years. In most cases, this valuation concept will not be applied, in which case it makes sense to argue for the most aggressive valuation that is defensible.⁴⁵⁹ If a court does decide to invoke the choose one party's valuation concept, the parties will lack advance notice that the game will be played in that fashion. This could lead to the occasional arbitrary result, and diminish the utility of the appraisal remedy because its application lacks predictability. It may also frustrate the remedy's purpose of providing equitable relief to minority shareholders in a given case.⁴⁶⁰

458. *See id.*

459. In fact, it is likely that the choose one party's valuation approach will seldom turn up again in Delaware. Although the supreme court in *Gonsalves* left open the possibility that this approach may be employed in a given case, although not announced in advance, the example used by the court to illustrate its point indicates this will not happen frequently. The court referred to the possibility that the chancery court might reject the testimony of a "thoroughly discredited" witness, and presumably accept, in full, the testimony of the other party's witness. *See Gonsalves*, 701 A.2d at 361. Presumably, this sort of "thorough discrediting" will not be a common occurrence. In addition, the bulk of the supreme court's decision in *Gonsalves* appears to call for the trial court to sift and comb through each side's contentions in the typical fashion, picking and choosing aspects of each side's valuation that appear reasonable. *See id.* at 361-62.

460. These problems are evidenced in the chancery court's decision in *Gonsalves v. Straight Arrow Publishers, Inc.*, in which the owner of 79% of Straight Arrow Publishers, Inc. (SAP) engaged in a cash-out merger to eliminate the minority shareholders. *See* No. CIV.A.8474, 1996 WL 696936, at *1 (Del. Ch. Nov. 27, 1996), *rev'd*, 701 A.2d 357 (Del. 1997). There was no active market for the stock of SAP. *See id.* In short, this was precisely the type of transaction that poses the greatest risk of unfair treatment of minority shareholders by a controlling shareholder, where the appraisal remedy should provide minority shareholder protection, both *ex post* and *ex ante*. *See Wertheimer, supra* note 6, at 26-27.

The chancery court adopted the corporation's valuation of \$131.60 per share, which resulted in a total valuation for SAP of approximately \$11,250,000, given the 85,428 shares of SAP outstanding. *See Gonsalves*, 1996 WL 696936, at *1 n.1. In 1985, the last full year before the merger, SAP had pre-tax earnings of \$3,470,000. *See id.* at *3. Thus, the court valued SAP at approximately 3.24 times the most recent pre-tax earnings, a number that appears to be quite low.

In addition, it appears that 1985 earnings were depressed by non-recurring costs associated with the cash-out merger and non-recurring losses from operations that had been discontinued by the end of 1985. *See id.* at *3. Earnings in 1985 were also decreased by the compensation SAP paid to its controlling shareholder; the dissenting shareholder contended that this

b. Court-Appointed Neutral Experts. The second mechanism courts have explored in appraisal cases to address the dueling experts problem is the use of a court-appointed neutral expert. The Delaware Supreme Court, in *In re Appraisal of Shell Oil Co.*, took “the occasion to comment upon a recurring theme in recent appraisal cases—the clash of contrary, and often antagonistic, expert opinions on value.”⁴⁶¹ The court noted that this process often forced the trial court to “pick and choose from a limited record without the benefit of objective analysis and opinion.”⁴⁶² In such circumstances, the court stated, “the Court of Chancery should consider, in a proper case, appointing its own expert witness.”⁴⁶³ The court concluded that the court of chancery has the inherent authority to appoint a neutral expert on its own initiative.⁴⁶⁴

In *Kleinwort Benson Ltd. v. Silgan Corp.*, the chancery court followed the suggestion of the Delaware Supreme Court and appointed a neutral expert to assist it in sorting through the opposing experts’ valuation testimony.⁴⁶⁵ The court had the neutral expert critique the opinions of the parties’ experts, but instructed him not to provide an independent valuation of the corporation.⁴⁶⁶ The court noted that it “used [the neutral expert’s] report to critically evaluate each expert’s opinion.”⁴⁶⁷ In addition, after the court concluded that the corporation’s expert’s valuation most closely represented the corporation’s value, the court used the neutral expert’s testimony to

compensation exceeded market value for the services rendered, but the court refused to consider this argument. See *Gonsalves v. Straight Arrow Publishers, Inc.*, No. CIV.A.8474, 1996 WL 483093, at *1 (Del. Ch. Aug. 22, 1996); see also *supra* notes 261-67 and accompanying text (discussing the *Gonsalves* court’s treatment of the excessive compensation issue). The net result is that SAP was valued at a low multiple of current earnings, and that those earnings were probably understated. It is also worth noting that in 1984, SAP’s own internal projections forecast rising earnings and revenues for the next four years, indicating that 1985 was not expected to be an aberrational year for earnings. See *Gonsalves*, 1996 WL 696936, at *2.

461. 607 A.2d 1213, 1222 (Del. 1992).

462. *Id.*

463. *Id.* The court was careful to note that “[t]here is, of course, no requirement” that a neutral expert be appointed. See *id.*

464. See *id.* Because no statute or rule explicitly permits the appointment by the court of its own neutral witness, the authority to do so had to be inherent. See *id.*; see also *Gonsalves*, 701 A.2d at 362 (noting inherent authority of court of chancery to appoint neutral expert).

465. See No. CIV.A.11107, 1995 WL 376911, at *1 (Del. Ch. June 15, 1995).

466. See *id.*

467. *Id.* at *5.

help it adjust that valuation to remove some of the "adversarial hyperbole" attached to it.⁴⁶⁸

The use of a neutral expert can, in proper circumstances, be useful to a court conducting an appraisal proceeding. There are, however, two points of caution. First, the use of an additional expert imposes additional costs to the proceeding and probably increases the time involved to reach a final result. It also adds a host of procedural issues associated with the appointment of the expert and how the expert will function in the process.⁴⁶⁹ The court must be careful to insure that the benefits of appointing a neutral expert justify the added time and expense and the additional layer of procedure.

The second point of caution involves the potential for excessive reliance by the court on the neutral expert. The court is charged with the statutory responsibility of conducting the appraisal,⁴⁷⁰ and should not excessively delegate that responsibility to the neutral expert. The Delaware Supreme Court, in authorizing the appointment of a neutral expert, was careful to point out that the trial court is not required to accept the findings or opinions of any such expert, and is not limited by such an appointment from exercising its "broad discretion in fixing fair value."⁴⁷¹ This is especially important in view of the critical role that equitable conduct plays in the appraisal proceeding.⁴⁷² The neutral expert, in all probability, will not have access to the full range of information that will be available to the court with respect to the relative equities of the parties' conduct, or may not fully appreciate

468. See *id.* at *5, *8. The court frequently noted the position taken by each party's expert, together with the neutral expert's views, as it addressed specific valuation points of contention. See *id.* at *8-10.

469. As the Delaware Supreme Court stated in *In re Appraisal of Shell Oil Co.*: "The expert should be appointed sufficiently in advance of trial as to permit opportunity for hearings on the appointment, consent of the expert, notification of duties, research by the expert, and a communication by the expert to the parties informing them of his findings." 607 A.2d 1213, 1223 (Del. 1992); see also *Recent Use of Independent Expert in Merger Appraisal Offers Guidance, But Area Said to Remain "Twilight Zone,"* 10 Corp. Counsel Wkly. (BNA) No. 32, at 8 (Aug. 16, 1995) [hereinafter *Twilight Zone*] (noting that both sides in *Kleinwort* were required to communicate with the neutral expert through the court to prevent ex parte contact).

470. See DEL. CODE ANN. tit. 8, § 262(h) (1991); see also *Cavalier Oil Corp. v. Harnett*, Nos. CIV.A.7959, 7960, 7967, 7968, 1988 Del. Ch. LEXIS 28, at *64 (Feb. 22, 1988) ("The statute directs that the Court 'shall appraise' the . . . shares."), *aff'd*, 564 A.2d 1137 (Del. 1989).

471. *In re Appraisal of Shell Oil Co.*, 607 A.2d at 1223 n.3.

472. See *supra* Part II.F.

such information.⁴⁷³ Accordingly, the court must guard against excessive reliance on the neutral expert.

III. IMPROVING THE APPRAISAL REMEDY

The appraisal remedy continues to serve a liquidity function in isolated cases, providing a “way out” for shareholders trapped in an involuntarily altered investment.⁴⁷⁴ Its greater use, however, is to protect minority shareholders, primarily in the context of cash-out transactions, often initiated by controlling shareholders.⁴⁷⁵ Because appraisal statutes were not originally drafted with cash-out transactions in mind, existing statutes do not fully achieve these purposes. In addition, courts applying appraisal statutes often do not do so in a manner fully consistent with these purposes. The appraisal remedy would better fulfill its current purpose if appraisal statutes were amended to suit these functions, and if courts applied the statutes in a manner more consistent with the current purpose of the remedy.

A. Appraisal Statutes

1. *Triggering Events.* The first area where current appraisal statutes are inadequate, given the purpose of the remedy, is with respect to the events that trigger the right to dissent and appraisal. Acquisitions can take many different forms, including mergers, asset purchases, share exchanges, and recapitalizations, and each of these forms can be utilized to cash out a minority shareholder. In order to adequately protect the interest of the minority shareholder, the availability of appraisal should not depend on the form that the transaction takes, particularly when the controlling shareholder is the party that selects the form of the transaction.

The Delaware statute is the worst offender in this regard. It provides an appraisal remedy only in the event of a merger or con-

473. One of the parties may, in fact, prefer it that way. In *Kleinwort*, the court determined that the fair value of the corporation was less than the merger price. See *supra* notes 349-56 and accompanying text. The attorney for the corporation, obviously pleased with the result achieved by his client, has stated: “[a]n appraisal action isn’t about credibility of witnesses, good guys and bad guys,” but instead “should be analytical. Find the value.” *Twilight Zone*, *supra* note 469, at 8. It is not surprising that the corporation’s attorney would hold this point of view, but in a proceeding serving a purpose of minority shareholder protection, credibility of witnesses, good guys, and bad guys should be important. See *supra* Part II.F.

474. See Wertheimer, *supra* note 6, at 28-32.

475. See *supra* notes 9-14 and accompanying text.

solidation.⁴⁷⁶ Thus, a controlling shareholder can structure an acquisition as a sale of assets, for example, and deprive minority shareholders of an appraisal remedy.⁴⁷⁷

The Model Business Corporation Act is drafted more inclusively. It provides an appraisal remedy in the event of a merger, share exchange, or sale of assets, or upon certain amendments to the articles of incorporation.⁴⁷⁸ It is not, however, drafted broadly enough to cover all possible forms of transactions having virtually the same effect, including the typical de facto merger transaction.⁴⁷⁹

The American Law Institute's Principles of Corporate Governance (ALI Principles) provide a more comprehensive statutory model that is designed to grant an appraisal remedy regardless of the form in which a fundamental transaction is cast.⁴⁸⁰ The ALI Principles provide dissenters' rights in the event of a "business combination," any other transaction that has the effect of eliminating a shareholder's equity interest in the corporation, a sale of assets transaction, and certain fundamental changes to the articles of incorporation.⁴⁸¹ "Business combination" is defined broadly to include

476. See DEL. CODE ANN. tit. 8, § 262(b) (Supp. 1996).

477. See, e.g., *Hariton v. Arco Elecs., Inc.*, 182 A.2d 22, 27 (Del. Ch. 1962) (declining to find a de facto merger where the transaction conformed with the requirements for a sale of assets under Delaware law), *aff'd*, 188 A.2d 123 (Del. 1963); cf. Angie Woo, *Appraisal Rights in Mergers of Publicly-Held Delaware Corporations: Something Old, Something New, Something Borrowed, and Something B.L.U.E.*, 68 S. CAL. L. REV. 719, 731 (1995) (arguing that Delaware should expand the events that trigger the appraisal remedy).

478. See MODEL BUS. CORP. ACT § 13.02(a) (1991).

479. The classic de facto merger transaction involves a corporation that, in form, purchases the assets of another entity in exchange for a large quantity of its stock, such that, in substance, the corporation purchasing the assets actually is the acquired party. See, e.g., *Farris v. Glen Alden Corp.*, 143 A.2d 25, 31 (Pa. 1958) (recharacterizing a purchase of assets transaction as a de facto merger). Interestingly, the official comment to the MBCA states that the problems concerning de facto mergers "should not occur under the Model Act since the procedural requirements for authorization and consequences of various types of transactions are largely standardized." MODEL BUS. CORP. ACT § 11.01 cmt. 2. The comment goes on to note, for example, that the MBCA treats merger transactions like sale of assets transactions. See *id.* But, because the MBCA does not provide appraisal rights to shareholders of corporations that purchase assets, see *id.* § 13.02(a), it provides no appraisal remedy to shareholders of the corporation that has been, in substance, acquired in a de facto merger. Thus, a de facto merger identical to the one in *Glen Alden* could be accomplished under the MBCA, and would raise precisely the same de facto merger problem raised in that case.

480. The ALI Principles borrow in part from the California approach. See 2 ALI, PRINCIPLES, *supra* note 5, § 7.21 cmt. a & reporter's note 2.

481. See *id.* § 7.21.

traditional triggering events such as mergers and consolidations, but also covers nontraditional events such as de facto mergers.⁴⁸²

The ALI Principles provide the most neutral set of triggering events in the sense that the form of transaction does not affect the availability of appraisal rights. Another drafting technique that could be employed to achieve this goal, using the Model Business Corporation Act as a starting point, would be to include the usual Model Act list of triggering events,⁴⁸³ and then provide a catch-all provision that makes available appraisal rights for any other event that has substantive effects similar to the enumerated events.⁴⁸⁴

2. *Statutory Exceptions to the Appraisal Remedy.* The second area where current appraisal statutes fail to comport with the purposes of the remedy is with respect to statutory exceptions to the appraisal remedy. The continued existence in many states of a market exception to the appraisal remedy is the most glaring problem. The market exception arose in conjunction with the liquidity rationale for the appraisal remedy.⁴⁸⁵ There is no longer any justification for this exclusion, given the minority shareholder protection rationale for the remedy.⁴⁸⁶ Minority shareholders of

482. "Business combination" includes an exchange by a corporation of its stock for substantial assets of another corporation, unless the persons who were shareholders of the exchanging corporation immediately before the transaction own 60% or more of the voting power of the surviving entity immediately after the transaction, in approximately the same proportions. See *id.* § 7.21(a). In other words, dissenters' rights attach if a corporation buys assets from a corporation, and issues stock in return, and its existing shareholders wind up with less than 60% of the voting power of the post-transaction entity. Unlike the MBCA, this provision would cover the *Glen Alden* situation.

The ALI provision on triggering events is an improvement over existing appraisal statutes, although it is not perfect. For example, it refers only to acquiring the assets of another corporation in exchange for stock, see *id.*, although it is not clear why the provision should apply only if the seller of the assets happens to be a corporation, as opposed to another kind of entity. This is probably a drafting oversight rather than an intentional limitation. It also is unclear why voting power alone is determinative. If the existing shareholders retain 60% of the voting power, but only 40% of the other incidents of share ownership, such as dividend and liquidation rights, should appraisal rights be withdrawn? In addition, whenever an arbitrary number is chosen, such as 60% in this provision, it is always possible to argue that it should be higher or lower.

483. See MODEL BUS. CORP. ACT § 13.02(a).

484. This approach might be criticized as creating too much uncertainty, but it is the kind of uncertainty that provides an *ex ante* incentive not to attempt to circumvent the appraisal provisions in an abusive manner.

485. See *supra* notes 101-04 and accompanying text.

486. See *supra* notes 105-09 and accompanying text. Similarly, there is no reason for industry-specific exceptions to the availability of the appraisal remedy. See, e.g., Virginia Bank-

public corporations need protection from unfair cash-out mergers as much as their counterparts in nonpublic corporations.⁴⁸⁷

The Delaware experience is instructive. Because Delaware's market exception is inapplicable to cash-out mergers,⁴⁸⁸ much of the Delaware appraisal case law involves shareholders cashed out of publicly traded corporations.⁴⁸⁹ Courts have determined in many of these cases that the fair value of the shares substantially exceeded the cash-out merger price.⁴⁹⁰ In other words, the cash-out merger was proposed at a price well below fair value, and the minority shareholders needed the protection of the appraisal remedy.

Additionally, numerous cases of egregious behavior by majority shareholders of public corporations have arisen in the context of fiduciary duty claims, rather than appraisal claims.⁴⁹¹ These cases illustrate that minority shareholders of public companies need protection, both *ex post* and *ex ante*, from overreaching transactions proposed by majority shareholders; the mere existence of a market is not adequate protection.⁴⁹²

shares, Inc. v. Sandberg, 501 U.S. 1083, 1108 n.14 (1991) (noting that no appraisal remedy is available under Virginia law in the event of bank mergers).

487. Ironically, the presence of a market exception may work against the interests of the acquiring corporation. The appraisal remedy is, at least in some instances, the exclusive remedy available to shareholders in the event of an acquisition. See, e.g., MODEL BUS. CORP. ACT § 13.02(b). If the appraisal remedy is unavailable due to a market exception, a court might be more inclined to grant a shareholder alternative relief, perhaps including injunctive relief.

488. See DEL. CODE ANN. tit. 8, § 262(b)(2) (Supp. 1996).

489. See Thompson, *supra* note 6, at 4, 25-28.

490. See, e.g., Harris v. Rapid-American Corp., No. CIV.A.6462, 1992 WL 69614, at *1, *3 (Del. Ch. Apr. 6, 1992) (finding that the fair value was \$73.29 per share while the cash-out merger price was \$28); *In re* Appraisal of Shell Oil Co., No. CIV.A.8080, 1990 Del. Ch. LEXIS 199, at *1, *2 (Dec. 11, 1990) (finding that the fair value was \$71.20 per share while the cash-out merger price was \$58), *aff'd*, 607 A.2d 1213 (Del. 1992).

491. See, e.g., Ryan v. Tad's Enters., Inc., Nos. CIV.A. 10229, 11977, 1996 WL 936160, at *14 (Del. Ch. Apr. 24, 1996) (holding that a sale of assets and merger was unfair when, *inter alia*, the controlling shareholder had separate consulting and noncompetition agreements with the buyer), *aff'd*, 693 A.2d 1082 (Del. 1997); Coggins v. New England Patriots Football Club, Inc., 492 N.E.2d 1112, 1121-22 (Mass. 1986) (holding that a freeze-out merger designed solely for the benefit of the controlling shareholder was a violation of the controlling shareholder's fiduciary duty to minority shareholders); Berkowitz v. Power/Mate Corp., 342 A.2d 566, 573 (N.J. Super. Ct. Ch. Div. 1975) (enjoining a merger where the minority stockholders alleged that the controlling shareholders attempted to freeze-out minority stockholders, reduce the company's earnings prior to the merger by giving themselves large bonuses, and effect the merger when the market price was unreasonably low).

492. See 2 ALL, PRINCIPLES, *supra* note 5, ch. 4 introductory note (stating that "availability of a market exit falls short of being a satisfactory remedy in many instances").

There is a reasonable consensus among commentators that the market exception as it currently exists is contrary to the purposes of the appraisal remedy.⁴⁹³ Some have proposed retaining the market exception, but only for non-conflict of interest transactions.⁴⁹⁴ In other words, the market exception would apply to bona fide third-party transactions, but would be inapplicable to transactions where an insider had a conflict of interest, including the typical cash-out merger initiated by a majority shareholder. Although this would be an improvement over the blanket market exception that currently exists in a number of jurisdictions, it would be preferable to eliminate the market exception entirely and deal with true third-party transactions as proposed earlier.⁴⁹⁵

In order to apply the market exception only to non-conflict transactions, it would be necessary to craft a statutory definition of conflict of interest transaction that is broad enough to cover the multitude of potential conflicts. This is a hazardous undertaking, because it creates a risk that a conflict of interest transaction could slip through the cracks of the statutory definition.⁴⁹⁶ Some conflict of interest transactions are easily identified; for example, a going private cash-out merger initiated by a controlling shareholder. Others are harder to locate. A merger may appear to be an arm's-length transaction between unrelated parties, but the directors or managers of one corporation may receive a payment on the side, or other consideration, in return for their agreement to support the transaction.⁴⁹⁷ This more subtle side payment scenario is a real concern because it negates true arm's-length bargaining.⁴⁹⁸

493. See *supra* note 101.

494. See, e.g., Siegel, *supra* note 4, at 113, 124-29; Seligman, *supra* note 6, at 836, 840-41.

495. See *supra* notes 319-26 and accompanying text.

496. Professor Siegel, who advocates this approach, has designated general categories of relationships that would create conflicts of interest, but has not attempted to draft a statutory definition. See Siegel, *supra* note 4, at 124. The categories she proposed have some obvious gaps. For example, she included within the conflict of interest category transactions with officers of the corporation, but did not mention transactions with directors of the corporation. See *id.* Similarly, she included transactions in which directors receive financial benefits not available to shareholders, but did not include officers that receive such financial benefits. See *id.*

497. See Carney, *supra* note 24, at 101 & n.137; see also Kanda & Levmore, *supra* note 6, at 467-68 (noting that the self interest of managers may render them ineffective bargaining agents).

498. Those commentators calling for a continued market exception for non-conflict transactions generally have recognized that side payments to insiders create a conflict that should render the market exception inapplicable. See Siegel, *supra* note 4, at 124; Seligman, *supra* note 6,

From an *ex ante* perspective, it is preferable to provide an appraisal remedy to public shareholders in all contexts, rather than only in non-conflict situations. Subtle conflict of interest transactions present difficult problems of proof and interpretation. For example, if the acquiring corporation promises long-term employment contracts at enhanced compensation to the officers of the target corporation, does it do so to serve its business interests by securing a management team for the future, or does it do so to buy the cooperation of the officers of the target corporation in support of the transaction? This shade of gray problem justifies *ex ante* deterrence against overreaching transactions by insiders. Providing an appraisal remedy to all public shareholders best serves that purpose.⁴⁹⁹

Another statutory exception to the availability of appraisal rights that does not make sense is found in the Model Business Corporation Act with respect to sale of asset transactions. Under the MBCA, the sale of all or substantially all of the property of a corporation outside the usual and regular course of business ordinarily triggers the right to dissent.⁵⁰⁰ Appraisal is unavailable, however, if the sale of the corporation's property is for cash and is pursuant to a plan that calls for the proceeds from the sale to be distributed to the shareholders within one year.⁵⁰¹

The official comment to the MBCA explains this exception by stating that "[t]hese transactions are unlikely to be unfair to minority shareholders since majority and minority are being treated in precisely the same way and all shareholders will ultimately receive cash for their shares."⁵⁰² This is true, however, only if the property of the corporation is sold to an unrelated third party in a transaction without a conflict of interest.⁵⁰³ If the majority shareholder, or an entity

at 838-39; *cf.* 2 ALI, PRINCIPLES, *supra* note 5, § 7.22 cmt. c, illus. 2-3 (illustrating that side payment problems can negate existence of arm's-length transaction).

499. There is no reason to treat public and private corporations differently in this regard. In both types of corporations, a transaction triggering the appraisal remedy can involve a conflict of interest, or may be a true third-party sale. Private corporation shareholders receive appraisal remedies in both cases, although the presence of a true third-party sale should influence the way the court handles the appraisal proceeding. *See supra* notes 319-26 and accompanying text. Public corporation shareholders should be treated the same way.

500. *See* MODEL BUS. CORP. ACT § 13.02(a)(3) (1991).

501. *See id.*; *see also* LA. REV. STAT. ANN. § 12:131(B) (West Supp. 1997) (providing an exemption to applicability of appraisal remedy when triggering transaction involves a cash sale and a plan to distribute the proceeds within one year).

502. MODEL BUS. CORP. ACT § 13.02 cmt. 1(3).

503. The ALI Principles have recognized this point and, in many instances, provide an appraisal remedy if assets are sold to insiders. *See* 2 ALI, PRINCIPLES, *supra* note 5, § 7.21(c)(1).

controlled by the majority shareholder, is the purchaser of the corporation's property, the transaction presents exactly the same risk as a cash-out merger proposed by a majority shareholder, and an appraisal remedy should be available.⁵⁰⁴

For the same reasons, the existing Delaware market exception for non-cash-out mergers⁵⁰⁵ should be abolished. Overreaching transactions can be accomplished with non-cash consideration as well as with cash consideration, and the appraisal remedy should stand as both *ex ante* and *ex post* protection against such transactions.

3. *Procedural Requirements.* A third area where appraisal statutes could be improved is with respect to the procedures incident to the remedy. In many statutes, the procedural requirements imposed on a dissenting shareholder remain excessively onerous.⁵⁰⁶ The current MBCA has reduced, but not eliminated, the procedural burdens placed on the dissenting shareholder.⁵⁰⁷ Existing statutes should be scrutinized to insure that procedural burdens are minimized.⁵⁰⁸

These statutory procedures serve two primary purposes. First, they insure that the corporation is informed, at an early stage, about those shareholders who will seek appraisal. For planning purposes, those proposing a transaction have a legitimate interest in learning, prior to the time the transaction is consummated, whether a large number of shareholders will seek appraisal.⁵⁰⁹ Second, the procedures provide a timetable to keep the appraisal process moving along and

504. Sale of asset transactions should be treated no differently than mergers for appraisal purposes. A sale of asset transaction can involve a conflict of interest or a true third-party sale. From an *ex ante* perspective, appraisal rights should attach to all transactions involving the sale of all or substantially all of the assets of a corporation. If the sale of assets is a true third-party sale, the appraisal court should respond accordingly. See *supra* notes 319-26 and accompanying text.

505. See DEL. CODE ANN. tit. 8, § 262(b) (Supp. 1996).

506. For example, under Delaware law, the dissenting shareholder receives no payment until fair value finally is determined. See DEL. CODE ANN. tit. 8, § 262(h) (1991); Thompson, *supra* note 6, at 41. But see MODEL BUS. CORP. ACT § 13.25 (requiring the corporation to pay the dissenting shareholder the amount the corporation estimates to be the fair value of his shares "as soon as the proposed corporate action is taken, or upon receipt of a payment demand").

507. See *supra* notes 43-64 and accompanying text.

508. The ALI Principles are useful in this regard. See 2 ALI, PRINCIPLES, *supra* note 5, § 7.23.

509. If a large number of shareholders elect appraisal, the corporation might abandon or restructure the transaction. See EISENBERG, *supra* note 6, at 83.

prevent undue delay.⁵¹⁰ These purposes, however, can be served without penalizing shareholders who deviate insignificantly from the statutory procedures.

At times, strict adherence to the statutory procedures has prevented shareholders from exercising appraisal rights, even where there has been no prejudice to the corporation.⁵¹¹ One way to solve this problem would be to adopt a statutory harmless error rule, or substantial compliance defense. Under such a rule, minor defects in compliance with the procedural requirements of the statute would not be fatal to the shareholder's appraisal remedy as long as the corporation received notice of the shareholder's intent to dissent before the transaction was consummated,⁵¹² and no substantial prejudice inured to the corporation.

Statutory procedures with respect to fee shifting and interest payments could also be improved. Appraisal statutes should grant courts flexibility to shift fees and costs to deter meritless litigation and unreasonable litigation tactics. The Delaware statute, in particular, is inadequate in this regard.⁵¹³

Because the dissenting shareholder is entitled to payment as of the transaction date, and often does not receive full payment until much later, appraisal litigation often involves a skirmish over the amount of interest the corporation must pay the shareholder as a result of this delayed payment.⁵¹⁴ In many cases, the litigants and courts have expended considerable energy resolving the interest rate that should be applied in this context.⁵¹⁵ A statutorily defined rate of in-

510. The MBCA procedures also require each party, early on, to take a position as to the fair value of the corporation. See MODEL BUS. CORP. ACT §§ 13.25(a), 13.28(a)(1). This joins the issue at the outset, perhaps encouraging a private agreement as to fair value without resort to judicial appraisal. See *id.* ch. 13 introductory cmt.

511. See *Pritchard v. Mead*, 455 N.W.2d 263, 266-67 (Wis. Ct. App. 1990).

512. The corporation's interest in receiving notice of dissent prior to the consummation of the transaction should depend, however, on receipt by the shareholder of adequate disclosure in order to decide whether to exercise dissenter's rights. If the disclosure is inadequate or misleading, a court should have the equitable power to waive the requirement of advance notice of intent to seek appraisal.

513. See *supra* note 322 and accompanying text.

514. Statutes generally call for a payment of interest to accompany the payment of fair value, see MODEL BUS. CORP. ACT § 13.30(e), or permit the court to award interest, see DEL. CODE ANN. tit. 8, § 262(h) (1991).

515. See, e.g., *In re Appraisal of Shell Oil Co.*, No. CIV.A.8080, 1990 Del. Ch. LEXIS 199, at *96-103 (Dec. 11, 1990), *aff'd*, 607 A.2d 1213 (Del. 1992); *Cede & Co. v. Technicolor, Inc.*, No. CIV.A.7129, 1990 Del. Ch. LEXIS 259, at *107-12 (Oct. 19, 1990), *rev'd on other grounds*,

terest would simplify matters and eliminate this counterproductive expenditure of resources.⁵¹⁶ The rate chosen must be fair, and able to respond to market conditions, rather than fixed at a level that becomes outdated. An interest rate tied to the prime rate would be a workable solution.⁵¹⁷

B. Appraisal Case Law

Courts have been slow to recognize the shift in the purpose served by the appraisal remedy, and have not uniformly applied the remedy consistent with its current purpose. The changes brought about by *Weinberger*⁵¹⁸ have brought the appraisal remedy closer to fulfilling its current purpose, but greater judicial sensitivity to that purpose when making determinations of fair value would be desirable.

In particular, courts determining fair value should be willing to look at all relevant appraisal evidence. They should not rely excessively on market prices, and should not permit minority or lack of

684 A.2d 289 (Del. 1996); *Pinson v. Campbell-Taggart, Inc.*, No. CIV.A.7499, 1989 Del. Ch. LEXIS 50, at *57-63 (Nov. 8, 1989).

516. It might be argued that a single statutory interest rate is unfair because different corporations have different costs of capital. Although this argument has some merit, it is questionable whether it justifies the resources devoted to skirmishing over the appropriate interest rate in individual cases, particularly when the skirmish amounts to another "dueling expert" scenario.

517. An alternative to prime rate would be a rate tied to a specified maturity of United States treasury securities.

Another issue that arises with some frequency is whether the interest paid should be simple or compound. In Delaware, this decision is left to the discretion of the trial court. *See* DEL. CODE ANN. tit. 8, § 262(i) (1991); *Technicolor*, 684 A.2d at 301. In many instances, the courts have opted to award simple interest. *See, e.g., id.* at 301; *In re Appraisal of Shell Oil Co.*, 607 A.2d at 1221-22. *But see* *Le Beau v. M.G. Bancorporation, Inc.*, No. CIV.A.13414, 1998 WL 44993, at *12-13 (Del. Ch. Jan. 29, 1998) (holding that an award of compound interest is appropriate because "in today's financial markets a prudent investor expects to receive a compound rate of interest on his investment"). The award of simple interest penalizes dissenting shareholders and does not accord with economic realities. *See* Thompson, *supra* note 6, at 41-42; David S. Reid, Note, *Dissenters' Rights: An Analysis Exposing the Judicial Myth of Awarding Only Simple Interest*, 36 ARIZ. L. REV. 515, 515 (1994) (asserting that "fully compensat[ing] a shareholder for loss of use of money . . . necessarily involves awarding compound interest through application of future value concepts"). Rather than permitting ad hoc case-by-case determination, appraisal statutes should call for the payment of compound interest at a prescribed rate.

518. *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983); *see supra* notes 17-23 and accompanying text.

marketability discounts.⁵¹⁹ Courts should adjust upward market price based valuations to eliminate the inherent minority discount embodied in such valuations. Evidence of third-party sales value with respect to the corporation as a whole should be particularly relevant in the appraisal context.⁵²⁰

Courts should be aware of the context in which the appraisal proceeding arises and the equitable posture of the parties. When appraisal is employed as a remedy in the context of a conflict of interest transaction, courts must be particularly alert to the possibility that the transaction price may not be fair and equitable. On the other hand, when faced with a true third-party, arm's-length transaction not raising any conflict of interest problem, courts should not hesitate to dispose of the appraisal proceeding summarily.

IV. CONCLUSION

The appraisal remedy, long a fixture of corporate law, has seen new life since the *Weinberger* decision. At the same time, the purpose of the remedy has evolved so that its primary function is now to protect minority shareholders from unfair fundamental transactions

519. See Heglar, *supra* note 136, at 261; Siegel, *supra* note 4, at 137-39; Thompson, *supra* note 6, at 38-40.

520. An ongoing dispute in corporate finance involves why purchasers of corporations are consistently willing to pay substantial premiums above market prices. See, e.g., Black, *supra* note 33, at 598-99 (stating that while the debate over the existence of premiums centers on whether or not the premiums reflect real efficiency gains, some combination of efficiency gain and overpayment may explain the premiums); Reinier Kraakman, *Taking Discounts Seriously: The Implications of "Discounted" Share Prices as an Acquisition Motive*, 88 COLUM. L. REV. 891, 893-901 (1988) (reviewing three explanations for acquisition premiums: "(1) acquirers may be discovering more valuable uses for target assets; (2) share prices may 'underprice' these assets; or, finally, (3) acquirers may simply be paying too much"). One possibility is that the purchaser will be able to run the target company more efficiently, or will achieve synergy with its existing operations, such that there are gains to be achieved by the acquisition. See Kraakman, *supra*, at 894. If such gains are indeed achievable, the next issue is how they should be allocated between the purchaser and the selling shareholders.

Third-party sales value permits the market to make this determination. The purchaser must pay a price sufficiently above the prior market price to convince enough of the selling shareholders to part with their shares. This effectively allocates some of the anticipated gains to the selling shareholders. The purchaser will pay this premium price, however, only if it believes that it can still earn an attractive return by engaging in the acquisition, relative to other investment opportunities available to it. Thus, some of the expected gains inure to the purchaser, or it would not be willing to make the purchase. Properly viewed, this is not really a matter of allocating to the dissenting shareholder "synergy" or gains anticipated from the transaction, but merely a recognition that when the corporation is valued as a whole based on third-party sales value, the parties are, in effect, sharing the difference between the pre-transaction market price and the value believed achievable by the purchaser.

involving conflicts of interest. Existing appraisal law, both statutory and judicial, has not fully recognized the role that the appraisal remedy now plays in corporate law. Appraisal statutes should be amended to comport with the remedy's current purpose. In addition, for the appraisal remedy effectively to serve its function, both *ex ante* and *ex post*, it is crucial that courts determine fair value in a manner consistent with the purposes of the remedy.

1998]

SHAREHOLDERS' APPRAISAL REMEDY

713

1998]

SHAREHOLDERS' APPRAISAL REMEDY

715

