

AN APPRAISAL OF THE MODEL BUSINESS CORPORATION ACT'S APPRAISAL RIGHTS PROVISIONS

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I

INTRODUCTION

The Delaware General Corporation Law¹ and the Model Business Corporation Act (MBCA)² have long been regarded as the two templates of corporate law.³ In approaching the optimal way to regulate various corporate issues, these two statutes have often reached similar conclusions.⁴ In the area of shareholder appraisal rights,⁵ however, the two statutes are diametrically opposed on many key elements. Most notably, MBCA chapter 13 on appraisal rights differs from Delaware's statutory appraisal provisions in four fundamental respects: (1) events that will trigger a shareholder's right to demand appraisal, (2) timing of the corporation's payment to shareholders demanding appraisal rights, (3) allocation of court costs and shareholder expenses, and (4) whether the market-out exception to appraisal rights is

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1. DEL. CODE ANN. tit 8, §§ 101-398 (2001).

2. MODEL BUS. CORP. ACT (2008).

3. See William J. Carney & George B. Shepard, *The Mystery of Delaware Law's Continuing Success*, 2009 U. ILL. L. REV. 1, 48-49 (2009) (stating that a number of state corporate law committees monitor changes made to both the MBCA and the Delaware General Corporation Law in determining what revisions to make to their own statutes).

4. For example, the MBCA and Delaware both allow director exculpation for breaches of the fiduciary duty of care. MODEL BUS. CORP. ACT § 2.02(b)(4) (2008); DEL. CODE ANN. tit. 8, § 102(b)(7) (2001). Additionally, plurality voting for the election of directors is the default rule in both the MBCA and Delaware. MODEL BUS. CORP. ACT § 10.22 (2008); DEL. CODE ANN. tit. 8, § 216(3) (2001).

5. Appraisal rights allow shareholders to object to the consideration to be received in certain corporate transactions and, instead, require corporations to pay shareholders the fair value of their stock as determined in an appraisal proceeding. See Hideki Kanda & Saul Levmore, *The Appraisal Remedy and the Goals of Corporate Law*, 32 UCLA L. REV. 429, 429 (1985) ("The appraisal remedy in corporate law confers upon shareholders a statutory right to dissent from specified fundamental or structural changes in the life of their corporation. The remedy requires the corporation to facilitate the shareholders' withdrawal by buying back their shares for fair value, or its equivalent, as determined through appraisal proceedings.").

limited only to appraisal-triggering transactions that are not conflict-of-interest transactions. These competing models provide state legislatures options for achieving differing policy aims when enacting appraisal-rights legislation.

Parts II–V of this article will address each of these four fundamental differences between the two appraisal statutes. After delineating the statutory differences, each part will explain the practical effects that flow from the competing statutory mandates and the resulting policy issues that motivated the choices that are ultimately reflected in these statutes. Finally, each part will show how state legislatures, faced with these two opposing models, have reacted to these four provisions. This article demonstrates that the vast majority of jurisdictions⁶ have chosen to reject Delaware’s approach and, instead, follow the MBCA on the first three issues. On the fourth issue, however, the majority of jurisdictions that have adopted a market-out exception in their appraisal statutes have followed the Delaware model. One wildcard in this last result is that, unlike the other three provisions, which have a long history in the MBCA, limiting the market-out exception to non-conflict transactions is fairly new: in 1999, the Committee on Corporate Laws (Committee), which writes the MBCA, adopted the country’s first conflict exception to the market-out. As a result, lawmakers have had substantially less experience with this conflict exception and less time to evaluate its merits compared to the other three issues.

II

APPRAISAL-TRIGGERING TRANSACTIONS

A. The Statutory Language

MBCA section 13.02(a) lists five mandatory appraisal triggers, each of which specifically defines events that require the corporation to offer its shareholders appraisal rights: (1) mergers, (2) share exchanges, (3) dispositions of assets, (4) amendments to the articles, and (5) conversion or domestication.⁷ Delaware, in contrast, mandates appraisal rights only for some mergers.⁸ Both

6. This article will use the term “jurisdictions” to refer to the fifty states and the District of Columbia.

7. See MODEL BUS. CORP. ACT §§ 13.02(a)(1)–(4), (6)–(8) (2008) for a list of mandatory appraisal triggers. Although the MBCA divides conversion and domestication triggers into three subsections, these triggers are similar in nature, and are often grouped together in state statutes; therefore, this article will treat them as a single trigger.

8. Although Delaware affords appraisal rights to shareholders in many mergers, *see* DEL. CODE. ANN. tit. 8, §§ 251, 252, 253, 254, 257, 258, 263, 264 (2001), it denies appraisal rights in certain specified merger situations. For example, when a surviving company issues twenty percent or less of its stock, and its charter and outstanding shares are not changed, or in certain holding-company mergers, Delaware does not grant appraisal rights to shareholders of the surviving or holding company. *Id.* §§ 251(g), 262(b). Similarly, in short-form mergers, Delaware does not grant appraisal rights to the parent’s shareholders. *Id.* §§ 253(d), 262(b)(3). References to “mergers” in this article include “consolidations,” which is a merger-like transaction in which the surviving entity is newly formed.

Delaware and the MBCA permit a corporation to offer appraisal rights for other events not mandated by their respective statutes.⁹

B. Practical Effects and Policy Issues

Clearly, the effect of five appraisal triggers under the MBCA, compared to only one in Delaware, is that the MBCA offers more opportunity for shareholders to demand their appraisal rights. Whether increased opportunity to exercise these rights is good corporate policy depends on one's view of appraisal rights and their function.¹⁰ On the one hand, the numerous appraisal triggers in the MBCA allow shareholders dissatisfied with the consideration in major transactions, such as mergers, share exchanges, and significant dispositions of assets, to seek alternative valuation through their appraisal rights. Moreover, because each of the five triggers would significantly alter the nature of the shareholders' investment, the MBCA's broader range of triggers treats similarly situated shareholders more consistently than does Delaware's single trigger. On the other hand, opponents of multiple triggers contend that these triggers offer multiple opportunities for the minority of shares who demand appraisal rights to thwart the will of the majority of shares who support the appraisal-triggering transaction.¹¹ Furthermore, opponents of the MBCA's numerous appraisal triggers might note that, whereas some appraisal triggers, like mergers,¹² cause the absorbing corporation to bear the costs and expenses of

9. *See id.* § 262(c) (“Any corporation may provide in its certificate of incorporation that appraisal rights under this section shall be available for the shares of any class or series of its stock as a result of an amendment to its certificate of incorporation, any merger or consolidation in which the corporation is a constituent corporation or the sale of all or substantially all of the assets of the corporation.”); MODEL BUS. CORP. ACT § 13.02(a)(5) (2008) (“A shareholder is entitled to appraisal rights . . . in the event of . . . any other amendment to the articles of incorporation, merger, share exchange or disposition of assets to the extent provided by the articles of incorporation, bylaws or a resolution of the board of directors.”).

10. Commentators cite various purposes for appraisal rights, including compensation for loss of shareholder veto power (after unanimous shareholder voting requirements eroded), protection of the majority from minority-initiated injunction suits, provision of a cash exit option at fair value, and creation of a monitor for conflict-of-interest transactions. *See* Mary Siegel, *Back to the Future: Appraisal Rights in the Twenty-First Century*, 32 HARV. J. ON LEGIS. 79, 93–97, 105, 110 (1995) (finding cash exit at fair value and conflict-of-interest monitoring the most cogent of these proposed purposes); Barry M. Wertheimer, *The Purpose of the Shareholder's Appraisal Remedy*, 65 TENN. L. REV. 661, 678–79 (1998) (surveying proposed purposes for appraisal rights and finding that most of these purposes are “animated by a goal of minority shareholder protection”).

11. The majority may find its appraisal-triggering transaction thwarted if the agreement contains a commonly used “appraisal out” covenant, which allows a corporation to back out of the deal when a specified percentage of shares demand appraisal. *See, e.g., In re MONY Grp. Inc. S'holder Litig.*, 853 A.2d 661, 670 (Del. Ch. 2004) (discussing, in the context of a merger, the details and modification of an “appraisal out” term). Moreover, parties to a potential transaction may not be willing to enter into a transaction if there is a risk that they will have to finance stockholders who cash out through the appraisal mechanism.

12. *See* Siegel, *supra* note 10, at 122 n.201 (noting that, in mergers, the acquiring corporation “most often pays the appraisal bill”).

appraisal rights, other appraisal triggers, like charter amendments,¹³ cause a direct transfer of wealth among the corporation's existing shareholders from those not demanding appraisal to those demanding appraisal. State legislatures balance these countervailing concerns when adopting appraisal triggers. Their choices, explored in the section below, reflect their resolution of these competing issues.

C. Reaction from the State Legislatures

All jurisdictions offer appraisal rights for mergers, as does the MBCA.¹⁴ Moreover, thirty-five jurisdictions allow for private ordering that authorizes corporations to add other appraisal triggers,¹⁵ as do both Delaware and the MBCA. Only two jurisdictions, however, follow the Delaware statute in providing mergers as the sole statutorily-required appraisal trigger.¹⁶ The vast majority of jurisdictions have overwhelmingly supported offering appraisal rights for a variety of additional triggers, as does the MBCA. Specifically, all forty-four jurisdictions that authorize a compulsory share exchange¹⁷ recognize appraisal rights for this transaction.¹⁸ Moreover, forty-seven jurisdictions offer appraisal rights for significant dispositions of assets,¹⁹ thirty-nine jurisdictions grant appraisal rights for certain amendments to the articles of incorporation,²⁰

13. As charter amendments involve only a single corporate actor, appraisal proceeds are paid by the corporation at the expense of the remaining shareholders. *See also* MODEL BUS. CORP. ACT §§ 13.02(a)(4), (6)–(8) (2008) (granting appraisal rights for domestications and conversions, which also involve only a single corporate actor).

14. MODEL BUS. CORP. ACT ANN. § 13.02 statutory comparison (1)(A) (2008) (confirming that all jurisdictions grant appraisal rights for at least some mergers).

15. In addition to Delaware, jurisdictions providing for private ordering are: Alabama, Arizona, Arkansas, Colorado, Connecticut, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kentucky, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Carolina, North Dakota, Oregon, South Carolina, South Dakota, Tennessee, Utah, Virginia, Washington, West Virginia, and Wyoming. *See* MODEL BUS. CORP. ACT § 13.02(a)(5) (2008). In addition, although neither the MBCA nor Delaware authorizes appraisal rights for control-share acquisitions, six states have added this appraisal trigger: Indiana, Maine, Mississippi, Oklahoma, South Dakota, and Virginia.

16. The District of Columbia and Kansas grant appraisal rights only in the event of merger. *See* D.C. CODE § 29-101.73 (2010); KAN. STAT. ANN. § 17-6712 (2009).

17. Note that Delaware does not recognize the compulsory share exchange transaction. *See* MODEL BUS. CORP. ACT ANN. § 11.03 statutory comparison (2008).

18. *See* MODEL BUS. CORP. ACT ANN. § 11.03 statutory comparison (2008) for a list of jurisdictions recognizing compulsory share transactions and granting appraisal rights for these transactions.

19. Jurisdictions granting appraisal rights for a significant disposition of assets are: Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming.

20. Jurisdictions granting appraisal rights upon certain amendments to the corporation's articles of incorporation are: Alabama, Arizona, Arkansas, Connecticut, Florida, Georgia, Hawaii, Idaho, Illinois,

and nineteen jurisdictions provide appraisal rights for certain conversions and domestications.²¹ Thus, the vast majority of jurisdictions, ninety-six percent, support the MBCA's approach of recognizing a variety of appraisal-triggering events.

III

PAYMENT OF THE STOCK'S UNDISPUTED FAIR VALUE

A. The Statutory Language

With one exception,²² section 13.24 of the MBCA requires the corporation to pay shareholders "the amount the corporation estimates to be the fair value of their shares, plus interest"²³ early on in the appraisal proceeding.²⁴ The comment to section 13.24 explains this requirement:

Since . . . all rights as a shareholder are terminated with the deposit of that shareholder's shares, the former shareholder should have immediate use of such money. A difference of opinion over the total amount to be paid should not delay payment of the amount that is undisputed. Thus, the corporation must pay its estimate of fair value, plus interest from the effective date of the corporate action, without waiting for the conclusion of the appraisal proceeding.²⁵

The concept of prepaying the fair value of the stock has a long history in the MBCA. Both the 1978 and 1984 revisions of chapter 13 required prepayment; the Committee's 1999 revision simply reaffirmed this requirement and fine-tuned the language.²⁶

Iowa, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming.

21. Jurisdictions granting appraisal rights upon corporate conversion or domestication, or both, are: Arkansas, California, Colorado, Florida, Hawaii, Iowa, Kentucky, Maine, Massachusetts, Michigan, Minnesota, New Hampshire, North Dakota, Oregon, Pennsylvania, South Carolina, South Dakota, Texas, and Wyoming.

22. See MODEL BUS. CORP. ACT § 13.24(a) (2008) (providing an exception for shares described in section 13.25(a), which are shares a shareholder failed to certify that were owned as of the record date set for the transaction).

23. *Id.* § 13.24(a). The MBCA specifies that the corporation must pay interest at the "rate of interest on judgments" used in the jurisdiction on the effective date of the transaction. *Id.* § 13.01(5).

24. Specifically, MBCA section 13.24(a) requires the corporation to pay shareholders the undisputed fair value "within [thirty] days after the form required by section 13.22(b)(2)(ii) is due . . ." MBCA section 13.22(b) requires the corporation to send shareholders notice of their right to demand appraisal rights within ten days after the corporate action triggering appraisal rights is completed. In turn, MBCA section 13.22(b)(2)(ii) requires the corporation to set the due date for appraisal notice forms and specifies that the due date must be between forty and sixty days after the corporation sends shareholders notice of their appraisal rights.

25. MODEL BUS. CORP. ACT ANN. § 13.24 official cmt. (1999).

26. The 1978, 1984, and 1999 versions each required prepayment. MODEL BUS. CORP. ACT § 81(f)(3) (1978); MODEL BUS. CORP. ACT § 13.24(a) (1984); MODEL BUS. CORP. ACT § 13.24(a) (1999). The 1999 revisions, however, fine-tuned the prepayment language. Compare MODEL BUS. CORP. ACT § 81(f)(3) (1978) (requiring the corporation to pay dissenters the corporation's estimate of fair value "[i]mmediately upon effectuation of the proposed corporate action"), with MODEL BUS. CORP. ACT §

In contrast, section 262(h) of the Delaware statute requires the court to determine the fair value in an appraisal proceeding,²⁷ and section 262(i) requires the court to direct the corporation to pay such fair value, plus interest, to those shareholders entitled to such payment at the conclusion of the proceeding.²⁸ Therefore, absent a settlement, shareholders in an appraisal proceeding will not receive any money for their shares until the entire appraisal proceeding concludes. This is so even though Delaware law holds that shareholders demanding appraisal forfeit their shareholder status upon the effective date of the appraisal-triggering transaction.²⁹

B. Practical Effects and Policy Issues

The MBCA's requirement that the corporation pay the shareholder the undisputed fair value of the stock early on in the appraisal process has three practical effects. First, this requirement arms shareholders with some money—the undisputed fair value—which shareholders may use to continue their fight with the corporation. Second, it reduces the amount that is in dispute: if the shareholder and the corporation believe that the fair value is \$100 and \$70 per share, respectively, the two sides are now clearly fighting over only \$30 per share. Third, if the corporation's estimate of fair value³⁰ is greater than the amount ultimately determined by the court, the corporation will have paid this greater amount to the shareholder without any statutory right to require the shareholder to return the difference between the court's determination of fair value and the corporation's estimate of fair value. As a result, knowing that its payment of fair value will be a sunk cost will cause a corporation to be judicious about the amount it declares to be the fair value of the stock.

In contrast, Delaware's appraisal process requires the corporation to pay fair value, plus interest, as determined by the court at the termination of the appraisal proceeding. Thus, in Delaware, shareholders will not be able to finance appraisal litigation simply by surrendering their shares;³¹ as in all other

13.24(a) (1999) (specifying that the corporation must pay shareholders the undisputed fair value, in cash, within thirty days after shareholders submit the required form).

27. DEL. CODE ANN. tit. 8, § 262(h) (2008).

28. *Id.* § 262(i). Although the court has discretion to vary the interest rate, the statutory default rate is five percent above the Federal Reserve discount rate. *Id.* § 262(h).

29. *See Lewis v. Anderson*, 477 A.2d 1040, 1045 (Del. 1984) (noting that, upon the effective date of a merger, shareholders no longer have standing to maintain a derivative suit against the corporation); R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, *DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS* § 9.44(J) (3d ed. 1998) (“The change in stockholder status takes place upon the effective date of the merger, with certain exceptions.”). As noted above, in Delaware, appraisal rights are only triggered by certain mergers. DEL. CODE ANN. tit. 8, § 262(b) (2001); *see supra* note 8 and accompanying text.

30. MODEL BUS. CORP. ACT § 13.24(b)(2) (2008) requires that the corporation's estimate of fair value be at least equivalent to the fair value number that the corporation listed on its section 13.22 form.

31. *See supra* text accompanying notes 27–29 (explaining that shareholders in Delaware who exercise their appraisal rights do not receive payment until the conclusion of the appraisal proceedings).

litigation, shareholders (or their attorneys) must have the funds to sustain litigation. Furthermore, paying shareholders at the conclusion of the appraisal proceeding neither isolates the amount in dispute, as in an MBCA proceeding, nor generates any possibility that the corporation might overpay its former shareholders. Of course, the pressure to settle without a full appraisal proceeding is significant not only for the shareholder demanding appraisal, but also for the corporation, which will face its own legal expenses, extensive discovery requests, a complicated trial on valuation, and a statutorily designated interest rate from the date of the merger to the date it pays the judgment.

The policy issues resulting from these two different approaches are significant. As noted above, the MBCA's requirement that corporations pay shareholders the undisputed value of their stock arms them with funds that the shareholders can use to litigate against the corporation. The comment to MBCA section 13.24 acknowledges that this prepayment "changes the relative balance between the corporation and shareholders. . . ."³² Accordingly it is worth considering whether chapter 13 encourages shareholder litigation and, if so, whether such encouragement is good public policy. Supporters argue that this prepayment feature identifies the amount that is actually in dispute, and such identification encourages settlement: both sides can tangibly recognize that the amount in dispute is, perhaps, fairly small.

Related to whether the MBCA's prepayment provision encourages litigation is the issue of why the MBCA treats appraisal litigation differently from all other shareholder litigation. As noted above, the comment to the MBCA responds to this question by reasoning that, because the shareholder's status as a shareholder ends when the shareholder deposits her shares in conjunction with her election of appraisal rights, she should be compensated immediately for giving up her stock, at least to the extent the fair value of the stock is not in dispute. Delaware implicitly rejects this argument because shareholders in Delaware corporations do not receive any payment prior to the termination of the appraisal proceeding even though their status as shareholders ends earlier in the appraisal process than do their counterparts under the MBCA.³³

32. MODEL BUS. CORP. ACT ANN. § 13.24 official cmt. (1999).

33. The reason a shareholder's status as a shareholder ends sooner in Delaware than under the MBCA is that a shareholder in Delaware must submit notice of her intent to demand appraisal *prior* to the effective date of the appraisal-triggering transaction and, in most transactions, the rights of the shareholder terminate as soon as the appraisal-triggering transaction is consummated. *See* DEL. CODE ANN. tit. 8, § 262(k) (2008) ("From and after the effective date of the merger or consolidation, no stockholder who has demanded appraisal rights . . . shall be entitled to vote such stock for any purpose or to receive payment of dividends or other distributions on the stock . . ."). In contrast, the MBCA does not require shareholders to submit notice of their intent to elect appraisal rights until *after* the conclusion of the appraisal-triggering transaction; thus, these shareholders will first begin their appraisal election when the transaction is completed. *See supra* note 24 and accompanying text. One exception to Delaware's prior notice requirement applies in the context of short-form mergers and mergers approved by stockholders' written consents. In these transactions, the deadline to demand appraisal rights is twenty days after the corporation mails shareholders notice of appraisal rights. If the

C. Reaction from the State Legislatures

Like the MBCA, thirty-four jurisdictions require the corporation to pay the undisputed fair value of the stock prior to the conclusion of the appraisal proceedings.³⁴ Because more than two-thirds of the jurisdictions have chosen to follow the MBCA, their choices demonstrate a strong endorsement of the policies that underlie the MBCA's prepayment requirement. Seven other jurisdictions require the corporation to *offer* to pay its estimate of fair value of the stock prior to the conclusion of the appraisal proceedings.³⁵ These jurisdictions, however, differ materially from the MBCA's prepayment requirement because these jurisdictions do not require prepayment; instead, if a shareholder rejects the corporation's offer to pay as inadequate, that shareholder will not receive any payment until the conclusion of the appraisal proceedings. Finally, nine jurisdictions follow the Delaware statutory provision that does not require the corporation to make any payment or offer of payment until the conclusion of the appraisal proceeding.³⁶ Although these nine jurisdictions are a distinct numerical minority, it is notable that many are large corporate states, such as California, Maryland, and New York. Taken together, the ten jurisdictions that do not require the corporation to prepay its shareholders, plus the seven that require only an offer of payment, amount to only thirty-three percent of jurisdictions that reject a prepayment requirement, whereas sixty-seven percent of jurisdictions embrace it.

corporation sends shareholders notice of appraisal rights less than twenty days prior to the effective date of the transaction, the shareholders' appraisal demand will not be due until after the effective date of the transaction. *See* DEL. CODE ANN. tit. 8, § 262(d)(2) (2001) (requiring the corporation to provide notice of the short-form merger within ten days of the effective date of the transaction and requiring a shareholder response within twenty days of the mailing of the notice).

34. Of these jurisdictions, ten jurisdictions follow the 1999 revision to the MBCA, which requires the corporation to pay shareholders the fair value of their shares, in cash, within thirty days of the shareholder's perfection of appraisal rights. MODEL BUS. CORP. ACT § 13.24(a) (1999). The states adopting the 1999 language verbatim are: Connecticut, Idaho, Iowa, Maine, Massachusetts, Mississippi, Nevada, South Dakota, Virginia, and West Virginia. The remaining twenty-four jurisdictions that follow the MBCA have not adopted the exact language from the 1999 revisions, but in substance, each of the following jurisdictions requires the corporation to pay shareholders the fair value of their shares shortly after the commencement of the corporate action giving rise to appraisal rights and the shareholders' perfection of appraisal rights: Alaska, Arizona, Arkansas, Colorado, Hawaii, Illinois, Indiana, Kentucky, Michigan, Minnesota, Missouri, Montana, Nebraska, New Hampshire, North Carolina, North Dakota, Oregon, South Carolina, Tennessee, Utah, Vermont, Washington, Wisconsin, and Wyoming.

35. These jurisdictions are: Alabama, District of Columbia, Georgia, Florida, Louisiana, Rhode Island, and Texas.

36. The jurisdictions following the Delaware statute are: California, Kansas, Maryland, New Jersey, New Mexico, New York, Ohio, Oklahoma, and Pennsylvania.

IV

ALLOCATION OF COURT COSTS AND EXPENSES OF THE APPRAISAL
PROCEEDING

A. The Statutory Language

As was the case with the prepayment of the fair value of stock, the 1999 revision of chapter 13 fine-tuned the language of the 1978 and 1984 versions of chapter 13 relating to allocation of costs and expenses, but it continued to support the substantive decisions that the prior versions had embodied in the statute.³⁷ Currently, MBCA section 13.31(a) requires the court to determine the court costs of the proceeding, including the compensation and expenses of court-appointed appraisers. Section 13.31(a) then requires the court to assess these costs “against the corporation.”³⁸ Although the statute permits the court to make an exception to such assessment when all or some of the shareholders demanding appraisal “acted arbitrarily, vexatiously, or not in good faith,”³⁹ the statutory presumption is that the corporation must absorb the court costs of the appraisal proceeding. Whereas section 13.31(a) creates a statutory presumption that the corporation will pay the court costs, section 13.31(b), in contrast, does not create any presumption regarding the parties’ expenses.⁴⁰ Therefore, the parties are presumed to bear their own expenses unless their conduct trips section 13.31(b), which allows the court to assess the expenses of the respective parties⁴¹ upon the occurrence of certain triggering events. The statute

37. MODEL BUS. CORP. ACT § 81(i)(1) (1978); MODEL BUS. CORP. ACT § 13.31 (1984); MODEL BUS. CORP. ACT § 13.31 (1999). The 1999 version also added section (d), which allows shareholders who are owed required payments under sections 13.24, 13.25, and 13.26, to sue the corporation directly and entitles shareholders who receive a court award under section (d) to all of that suit’s costs and expenses.

38. MODEL BUS. CORP. ACT § 13.31(a) (2008).

39. *Id.*

40. Unlike section 13.31(a), section 13.31(b) contains no explicit presumption that the parties’ respective expenses will be allocated to the corporation. By not including an explicit presumption on shifting expenses, the MBCA incorporated the implicit assumption that parties will bear their own expenses, absent a showing that either party engaged in bad conduct. See Alfred F. Conard, *Amendments of Model Business Corporation Act Affecting Dissenters’ Rights (Sections 73, 74, 80 and 81)*, 33 BUS. LAW. 2587, 2604 (1978) (explaining that the 1978 MBCA revision, unlike the prior version, permitted the court to shift expenses based on either party’s behavior that was “vexatious, arbitrary, or not in good faith”).

41. In MBCA section 13.31, the phrase “expenses of the respective parties” generally refers to each party’s individual outlay for items such as attorney and expert fees. Although the 1984 and 1999 versions of section 13.31(b) specified that “expenses of counsel and experts” may be shifted upon triggering events, the 2006 amendments to section 13.31(b) provided a more expansive interpretation, allowing courts to shift all reasonable “expenses.” The MBCA Annotated comments clarify that the shortened reference to “expenses” was designed to reflect the adoption of “expenses” as a defined term in the 2006 amendments to section 1.40(9AA). See MODEL BUS. CORP. ACT ANN. § 1.40(9AA) (2006) (providing the newly-added definition of expenses: “reasonable expenses of any kind that are incurred in connection with a matter”); MODEL BUS. CORP. ACT ANN. § 13.31 hist. background (2008). Compare MODEL BUS. CORP. ACT § 13.31(b) (1984), and MODEL BUS. CORP. ACT § 13.31(b) (1999), with MODEL BUS. CORP. ACT § 13.31(b) (2006).

specifically states that expenses may be assessed against the corporation if the court finds that the corporation did not substantially comply with the key requirements of chapter 13,⁴² or against either side if the court finds such party “acted arbitrarily, vexatiously, or not in good faith” regarding the appraisal process.⁴³ Finally, although the 1999 version of section 13.31(c) permitted the court to spread the costs of counsel fees among all shareholders who benefited (if the court had not assessed these fees against the corporation), the 2006 version of the MBCA expanded this provision to cover all of the shareholders’ expenses, rather than just counsel fees.⁴⁴ In sum, absent some bad conduct by the shareholders, the corporation will not only pay the costs of the proceeding, but is also at risk to pay the shareholders’ expenses. In contrast, in the absence of their own bad conduct, the MBCA guarantees shareholders that they will not pay court costs, and may have their expenses either absorbed by the corporation or spread among all shareholders demanding appraisal rights.

The Delaware statute, in contrast, grants courts discretion on how to allocate costs of the proceeding. Specifically, Delaware section 262(j) states: “[t]he costs of the proceeding may be determined by the Court and taxed upon the parties as the Court deems equitable in the circumstances.”⁴⁵ Although section 262(j) authorizes a court to allocate court costs equitably, a pair of early Delaware Supreme Court decisions affirmed the Delaware custom of allocating court costs to the corporation absent bad faith by the shareholder demanding appraisal rights.⁴⁶ Delaware’s practice has been to follow these cases, which have a distinct preference for allocating court costs to the corporation.⁴⁷ In contrast to

42. MODEL BUS. CORP. ACT § 13.31(b)(1) (2008). Specifically, the corporation may be required to pick up the expenses of the shareholders if the corporation failed to substantially comply with the requirements imposed by sections 13.20, 13.22, 13.24, or 13.25.

43. *Id.* § 13.31(b)(2).

44. *Id.* § 13.31(c). *See supra* note 41 for a related discussion of the 2006 MBCA’s broader approach to expenses, as applied to section 13.31(b).

45. DEL. CODE ANN. tit. 8, § 262(j) (2001).

46. *Tri-Continental Corp. v. Battye*, 74 A.2d 71, 77 (Del. 1950) (“In the absence of a showing of bad faith on the part of the dissenting stockholders, or a showing that the statutory procedure was made use of for the purpose of being ‘bought off’, we think it reasonable to tax all costs against the surviving corporation.”); *Meade v. Pac. Gamble Robinson Co.*, 58 A.2d 415, 418 (Del. 1948) (finding “reasonable” the Court of Chancery’s construction of section 262’s predecessor as allowing the court to allocate court costs to the corporation absent a showing that the stockholder acted in bad faith, incurred unnecessary expenses, or used appraisal as leverage for an unwarranted payout).

47. *See Cooper v. Pabst Brewing Co.*, No. 7244, 1993 Del. Ch. LEXIS 91, at *31 (Del. Ch. June 8, 1993) (citing 262(j) to support a one-sentence assessment of court costs against the corporation when the appraisal value was lower than the first-tier tender offer price but exceeded the second-tier merger price); *In re Appraisal of Shell Oil Co.*, No. 8080, 1990 Del. Ch. LEXIS 199, at *103 (Del. Ch. Dec. 11, 1990) (citing 262(j) to support a one-sentence assessment of court costs against the corporation when the appraisal value exceeded the merger price); *Lebman v. Nat’l Union Electric Co.*, No. 4964, 1980 Del. Ch. LEXIS 490, at *3–4 (Del. Ch. Nov. 5, 1980) (holding petitioner’s unreasonable but earnest belief in the merits of his case showed a lack of bad faith, which was sufficient to shift the costs of the appraisal proceeding to the corporation). *Cf. Kleinwort Benson Ltd. v. Silgan Corp.*, No. 11107, 1995 Del. Ch. LEXIS 75, at *34 (Del. Ch. June 15, 1995) (noting section 262(j) allowed the court to allocate costs equitably and splitting the costs of a court-appointed neutral appraisal expert between the parties, while allocating the remainder of the court costs to the corporation).

the statute's express grant of judicial discretion regarding court costs, the Delaware statute makes no mention of judicial discretion to allocate one party's expert and attorney expenses to its opponent. Instead, the statute's only reference to expenses allows the court discretion to allocate a shareholder's expenses among all shares entitled to appraisal.⁴⁸ Although section 262(j) is silent regarding whether a court may assign expert and attorney expenses to an adverse party, Delaware case law recognizes a bad faith equitable exception to the rule that parties will bear their own expenses.⁴⁹ Delaware thereby allows a court to assign attorney and expert expenses upon evidence of a party's egregious conduct.⁵⁰

B. Practical Effects and Policy Issues

In appraisal proceedings under both MBCA section 13.31 and Delaware section 262(j), courts *could* end up dividing court costs and expenses of experts and attorneys in a similar manner. For instance, under both statutes, the corporation could end up bearing court costs and expenses of the shareholders' experts and attorneys.⁵¹ Such a result is far more likely under the MBCA, however, both because that statute creates a presumption that the corporation will bear the court costs, and because that statute has multiple specific triggers that allow the court to assign expenses to the corporation. In Delaware, where the statute grants the court discretion to allocate only the court costs, a court would likely be motivated to allocate the shareholders' expert and attorney expenses to the corporation only if the corporation engaged in truly egregious conduct.⁵² Similarly, shareholders demanding their appraisal rights *could* find

48. DEL. CODE ANN. tit. 8, § 262(j) (2001).

49. *See Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 301 (Del. 1996) ("In the absence of an equitable exception, the plaintiff in an appraisal proceeding should bear the burden of paying its own expert witnesses and attorneys.").

50. The equitable exception is narrow, but the Supreme Court of Delaware recently found it appropriate to allocate expert and attorney expenses against the corporation in *Montgomery Cellular Holding Co., Inc. v. Dobler*, based on the corporation's continuous bad conduct throughout the appraisal proceeding. 880 A.2d 206, 228–29 (Del. 2005) ("Given the overwhelming evidence that the respondents repeatedly acted in bad faith to obstruct if not prevent a fair valuation," the court was "constrained to conclude that the Court of Chancery abused its discretion by declining to award attorneys' and expert witness fees."). Note also that the Court of Chancery has split on whether a Delaware procedural rule permitting Delaware trial courts discretion to fix and assess experts' fees applies to appraisal proceedings. *See* DEL. CODE ANN. tit. 10, § 8906 (1998). *Compare In re Sunbelt Beverage Corp. S'holder Litig.*, No. 16089-CC, 2010 Del. Ch. LEXIS 1, at *57–61 (Del. Ch. Jan. 5, 2010) (shifting a shareholder's expert expenses to the corporation pursuant to section 8906, and failing to identify any bad conduct to justify the shift of those expert expenses), *with Taylor v. Am. Specialty Retailing Grp., Inc.*, No. 19239, 2003 Del. Ch. LEXIS 75, at *44 (Del. Ch. July 25, 2003) (holding that section 8906 was not available in appraisal proceedings, because section 8906 "is inconsistent with the more specific fee shifting provisions of [section] 262(j)").

51. *See supra* note 47 (illustrating that, although Delaware courts typically assign court costs against the corporation, section 262(j) does not mandate this result); *supra* note 50 (explaining Delaware's equitable exception, which permits shifting of expert and attorney fees in appraisal proceedings in certain limited circumstances).

52. *See infra* note 55.

themselves in the same financial position under both statutes if the court required the corporation to shoulder the court costs and allocated the shareholders' expenses among all shareholders demanding appraisal.

Although similar outcomes could eventuate, a few differences between the statutes remain. One is that the statutorily-driven MBCA gives more concrete assurances to shareholders regarding the assignment of costs and expenses than does the Delaware statute. This is particularly true regarding expert and attorney expenses, which Delaware case law, but not its appraisal statute, permits to be assigned in certain limited situations.⁵³ As a result, the appraisal remedy becomes a more predictable and viable option for shareholders demanding appraisal rights under statutes that follow this aspect of the MBCA than those that follow Delaware's appraisal provision. Not only does the MBCA's specific language allocating costs and expenses provide comfort to shareholders, but the MBCA's language identifying bad conduct by either of the parties is also helpful to shareholders as it provides parameters for the court's discretionary allocation of costs and expenses. As the comment to section 13.31 explains, that discretion is designed to encourage the parties to settle: "[T]he purpose of all these grants of discretion with respect to expenses is to increase the incentives of both sides to proceed in good faith under this chapter to attempt to resolve their disagreement without the need of a formal judicial appraisal of the value of shares."⁵⁴ While it is arguable that the Delaware statutory language authorizing the court to allocate costs of the proceeding (but not expert and attorney expenses) as the court deems "equitable" may similarly motivate all parties to proceed in good faith, the lack of specificity regarding what constitutes bad conduct,⁵⁵ and the narrow construction Delaware courts apply to this equitable exception, reduce the likelihood that either party will be forced to bear the other side's expenses. This, in turn, may provide less incentive for the parties to settle.⁵⁶

The primary policy effect of these competing models is straightforward: the MBCA makes pursuing the appraisal demand more economically feasible than

53. See *supra* note 50.

54. MODEL BUS. CORP. ACT ANN. § 13.31 official cmt. (2008).

55. For a number of years, Delaware courts have acknowledged an equitable exception to section 262(j)'s silence on expense shifting. See, e.g., *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 301 (Del. 1996). Yet only recently have they begun to articulate the kinds of behavior constituting the exception in the context of an appraisal proceeding. In *Montgomery Cellular*, the Supreme Court of Delaware explained that Delaware courts have not adopted a "single, comprehensive definition of 'bad faith'" that justifies expense shifting. 880 A.2d at 227. The court found, however, that the corporation's destruction of evidence, failure to respond to discovery requests, presentation of a "fatally flawed" expert evaluation, and chief executive officer's telling of lies under oath compelled a finding of bad faith. *Id.* at 227-29.

56. Compare MODEL BUS. CORP. ACT § 13.31(b) (2008) (defining a broad range of behavior that will trigger a court's power to allocate expenses, that is, if the corporation "did not substantially comply" with specified requirements or if the corporation or one or more shareholders acted "arbitrarily, vexatiously, or not in good faith with respect to the rights" granted by chapter 13), with *Montgomery Cellular*, 880 A.2d at 227 (explaining that the "bad faith exception is applied in 'extraordinary circumstances' as a tool to deter abusive litigation").

does Delaware's appraisal provision. Similar to the prepayment provisions, critics of the MBCA might question why the statute encourages shareholder litigation, particularly when appraisal rights have significant downsides for the corporation and for all other shareholders.⁵⁷ Moreover, critics might ask why this litigation, as opposed to other shareholder litigation, should be made "economically feasible." Supporters, on the other hand, might counter that, absent some substantial financial relief, appraisal rights are merely a theoretical right for those who own only a small number of shares.⁵⁸ Under the Delaware model, the shareholder and, perhaps, the shareholder's attorney, must be ready to absorb the high costs of an appraisal action if the parties do not settle. Furthermore, the MBCA arguably does a better job of encouraging the parties to settle: the MBCA's multiple specific triggers make it more likely that a court will require one party to shoulder its opponent's expert and attorney expenses than under Delaware's limited equitable exception. The threat of bearing both sides' expenses creates an incentive for both parties to settle, rather than to engage in a full-blown appraisal proceeding.

C. Reaction from the State Legislatures

Thirty-six jurisdictions, or seventy-one percent, have adopted MBCA section 13.31(a)'s approach, which creates a rebuttable presumption that the corporation will bear the court costs of the appraisal proceeding.⁵⁹ Furthermore, thirty-nine jurisdictions, or seventy-six percent, have adopted MBCA section 13.31(b)'s approach, which contains an unwritten assumption that parties will bear their own expert and attorney expenses,⁶⁰ but allows a court to allocate expenses equitably upon a finding that either party has engaged in certain specified bad conduct.⁶¹ In contrast, only seven jurisdictions have adopted

57. See Siegel, *supra* note 10, at 79, 97–98 (noting that a sufficient number of appraisal demands may trip covenants that permit a party to the appraisal-triggering transaction to back out of the deal, or the appraisal demand may disqualify the transaction from the desired tax treatment); see also *supra* note 11.

58. See Siegel, *supra* note 10, at 79–80 (noting that, without some financial assistance, the high cost of exercising appraisal rights makes the remedy feasible only to shareholders who own a large number of shares).

59. Altogether, thirty-six jurisdictions apply section 13.31(a)'s approach, including thirty-two that largely adopt the MBCA language, and four other jurisdictions reach the same result via different statutory language. See MODEL BUS. CORP. ACT ANN. § 13.31 statutory comparison (2008) for a list of the thirty-two jurisdictions. Arizona's statutory language generally mirrors the MBCA, presuming the corporation bears court costs, except it inverts the presumption (allocating court costs to the shareholder) when the appraisal value does not materially exceed the amount offered. See ARIZ. REV. STAT. ANN. § 10-1331 (West through 2010 2d Reg. Sess. and 9th Spec. Sess.). The Maryland, New Mexico, and Rhode Island statutes all reach roughly the same outcome as MBCA section 13.31(a) via alternate statutory language, presuming that the corporation will bear court costs, but granting courts discretion to allocate costs equitably in the face of bad conduct. See MD. CODE ANN., CORPS. & ASS'NS § 3-211(d) (West through 2010 Reg. Sess.); N.M. STAT. ANN. § 53-15-4(G) (West through 2010 2d Reg. Sess. and 2d Spec. Sess.); R.I. GEN. LAWS § 7-1.2-1202(g) (West through Jan. 2010 Sess.).

60. See *supra* note 40 and accompanying text.

61. Thirty-nine jurisdictions apply section 13.31(b)'s approach, including thirty-five that adopt the MBCA language, and four other jurisdictions that reach the same result via different statutory

Delaware's approach, which allows courts to allocate the court costs "equitably,"⁶² and only five jurisdictions mimic Delaware's absence of statutory guidance regarding assessing expert and attorney expenses against an adverse party.⁶³ The minority of jurisdictions that do not adopt the approach of either the MBCA or Delaware have three different views on how to allocate costs,⁶⁴

language. The same thirty-two states that are mentioned *supra*, in note 59, as adopting section 13.31(a)'s language, are joined by Illinois, Indiana, and North Carolina in adopting section 13.31(b)'s language. *See* 805 ILL. COMP. STAT. 5/11.70(i)(1)–(2) (West through 2010 Reg. Sess.); IND. CODE ANN. § 23-1-44-20(b) (West through 2010 2d Reg. Sess.); N.C. GEN. STAT. ANN. § 55-13-31(b) (West through 2010 Reg. Sess.). Arizona's statutory language generally mirrors the MBCA section 13.31(b) on expenses, but adds a section allowing courts to allocate expenses to the shareholder if the appraisal price does not materially exceed the price offered by the corporation. *See* ARIZ. REV. STAT. ANN. § 10-1331(B) (West through 2010 2d Reg. Sess. and 9th Spec. Sess.). In addition, New Jersey, Maryland, and New Mexico each clarify that expert and attorney expenses are not included in the court's costs allocation, thereby implying a presumption that parties will bear their own expenses. *See* N.J. STAT. ANN. § 14A:11-10 (West 2010); MD. CODE ANN., CORPS. & ASS'NS § 3-211(d)(2) (West through 2010 Reg. Sess.); N.M. STAT. ANN. § 53-15-4(G) (West through 2010 2d Reg. Sess. and 2d Spec. Sess.). But these jurisdictions allow courts discretion to allocate attorney and expert expenses equitably if the corporation did not make an offer, or if the offer was not in good faith (New Jersey) or was materially exceeded by the court appraisal price (Maryland, New Mexico). *Cf.* Rhode Island's approach, *infra* note 65.

62. Two states, Kansas and Oklahoma, adopted Delaware section 262(j)'s language. Five more states, Indiana, North Carolina, New Jersey, Ohio, and Texas, granted courts the power to apportion court costs "equitably" between the parties, but do so in statutory language that does not track Delaware section 262(j). Courts in all seven states have split costs variously or allocated all costs to one party based on the equitable grant contained in the state's appraisal statute. *Compare* *Vernon v. Commerce Fin. Corp.*, 85 P.3d 211, 216 (Kan. Ct. App. 2004) (finding the district court did not abuse its discretion in splitting costs evenly between both parties because the statute allowed for equitable allocation of costs), *and* *N.J. Sports & Exposition Auth. v. Del Tufo*, 554 A.2d 878, 881–82 (N.J. Super. Ct. App. Div. 1989) (approving of the trial court's decision to split the court-appointed appraiser's fee, but finding insufficient support in the record for the amount of the fee), *with* *Moore v. New Ammest, Inc.*, 630 P.2d 167, 171 (Kan. Ct. App. 1981) (noting the trial court allocated costs to the corporation) *overruled on other grounds by* *Arnaud v. Stockgrowers State Bank*, 992 P.2d 216, 220 (Kan. 1999), *and* *Gannon v. Baker*, 830 S.W.2d 706, 709 (Tex. App. 1992) (leaving undisturbed the trial court's allocation of costs against the corporation).

63. As noted *supra* note 62, Kansas and Oklahoma adopt Delaware section 262(j)'s language. Three more states, Louisiana, Ohio, and Texas, reflect a similar approach by failing to provide for expert and attorney expense allocation using statutory language different from Delaware's. Scant case law exists illuminating the manner in which courts in these five states actually allocate expert and attorney expenses, although at least one court refused a shareholder's request to shift expenses. *See, e.g.,* *Woolf v. Universal Fid. Life Ins. Co.*, 849 P.2d 1093, 1097 (Okla. Civ. App. 1992) (refusing to shift expenses based on the lack of authorization in Oklahoma's appraisal statute); *cf.* Rhode Island's statutory approach, *infra* note 65.

64. States not following the MBCA or Delaware's approach to court costs either (1) presume that parties will bear their own costs, such as Alaska and New York, which create a statutory presumption that parties will bear their own court costs, but allow a court to assign all or part of the costs if the court finds a party engaged in certain specified bad conduct; (2) remove any presumption that either party will bear the costs incurred by the other side, such as Illinois and Louisiana, which use statutory language that instructs courts to apportion costs based on whether the appraisal price exceeds the corporation's offer or the shareholder's estimation of share value; or (3) adopt a hybrid approach, such as California's statute, which requires the court to allocate court costs equitably between the parties, unless the appraisal price exceeds the corporation's offer, in which case the statute directs the court to allocate the court costs against the corporation. *See* ALASKA STAT. § 10.06.580(e) (West 2010); N.Y. BUS. CORP. LAW § 623(h)(7), (e) (West 2010); 805 ILL. COMP. STAT. 5/11.70(i) (West through 2010

and two different approaches to allocating expenses.⁶⁵ Finally, two jurisdictions have no statutory provision governing the allocation of appraisal costs and expenses.⁶⁶ More than two-thirds of jurisdictions have adopted the MBCA's statutory treatment of costs and expenses, thereby showing the legislatures' clear preference for the MBCA's long-standing codification of these issues over Delaware's countervailing provisions.

V

THE MARKET-OUT EXCEPTION

A. The Statutory Language

As noted above, MBCA section 13.02(a) lists the transactions that trigger a shareholder's appraisal rights. Section 13.02(b)(1), however, creates an exception to appraisal rights for shares that can be sold in a liquid market;⁶⁷ this exception is commonly known as the "market-out exception." The rationale underlying this exception is that at the announcement of an appraisal-triggering transaction, the market for that corporation's stock is operating with maximum efficiency and serves as a reliable determination of the fair value of the corporation's shares.⁶⁸ Section 13.02(b)(4) creates an exception to the market-out exception if the corporate transaction is an "interested transaction."⁶⁹ As a result, under the MBCA, the market-out exception to appraisal rights applies only if the market is sufficiently liquid and the transaction does not fall within the definition of an "interested transaction." The comment to section 13.02 explains these two requirements:

Reg. Sess.); LA. REV. STAT. ANN. § 12:131(G) (West through 2009 Reg. Sess.); CAL. CORP. CODE § 1305(e) (West through 2009 Reg. Sess.).

65. States not following the MBCA or Delaware's approach to expenses either (1) presume that parties will bear their own expenses, such as Alaska and New York, which presume that parties will bear their own expert and attorney expenses, but allow a court to assign all or part of the expenses if the court finds a party engaged in certain specified bad conduct; or (2) adopt one of two hybrid approaches, such as California's statute, which provides no presumption of expense allocation, unless the appraisal price exceeds the corporation's offer by 125%, in which case the statute allows the court to equitably allocate expenses against the corporation; and Rhode Island's statute, which allows a court discretion to allocate a party's expert expenses equitably if the corporation did not make an offer, or if the offer was materially exceeded by the court appraisal price, but does not provide for the allocation of attorney's fees. *See* ALASKA STAT. § 10.06.580(e) (West 2010); N.Y. BUS. CORP. LAW § 623(h)(7), (e) (West 2010); CAL. CORP. CODE § 1305(e) (West through 2009 Reg. Sess.); R.I. GEN. LAWS § 7-1.2-1202(g) (West through Jan. 2010 Sess.).

66. The District of Columbia and Missouri have no statutory provisions for court costs or expenses of experts or attorneys.

67. MODEL BUS. CORP. ACT § 13.02(b)(1) (2008).

68. *See* MODEL BUS. CORP. ACT ANN. § 13.02 cmt. at 2 (2008) (explaining that the announcement of an appraisal-triggering transaction encourages market professionals and other interested parties to evaluate the transaction and submit competing proposals if the corporation's proposed transaction is inadequate).

69. MODEL BUS. CORP. ACT § 13.02(b)(4) (2008). The definition of an "interested transaction" is set forth in section 13.01(5.1).

The premise of the market out is that the market must be liquid and the valuation assigned to the relevant shares must be 'reliable.' Section 13.02(b)(1) is designed to assure liquidity. . . . [S]ection 13.02(b)(4) is designed to assure reliability by recognizing that the market price of, or consideration for, shares of a corporation . . . may be subject to influences where a corporation's management, controlling shareholders or directors have conflicting interests that could . . . adversely affect the consideration that otherwise could have been expected. Section 13.02(b)(4) thus provides that the market out will not apply in those instances where the transaction constitutes an interested transaction.⁷⁰

Like the MBCA, Delaware's appraisal statute contains a market-out exception,⁷¹ unlike the MBCA,⁷² however, Delaware's market-out exception is not limited only to disinterested transactions.⁷³

B. Practical Effects and Policy Issues

Prior to the MBCA revisions in 1999, no jurisdiction had adopted a market-out exception that was limited to non-conflict transactions.⁷⁴ Additionally, as of 1999, state appraisal statutes were fairly evenly divided between those that contained a market-out exception⁷⁵ and those that did not:⁷⁶ twenty-six states had a market-out exception, whereas twenty-four states, the District of Columbia, and the MBCA did not. Because the premise of appraisal rights is to afford shareholders whose corporations engage in certain transactions the fair value of their stock in cash, supporters of the market-out exception argued that a sufficiently liquid market offers shareholders the fair value of their stock in cash without either the shareholder or the corporation incurring the large costs attendant to an appraisal process.⁷⁷ Opponents of the market-out exception,

70. MODEL BUS. CORP. ACT ANN. § 13.02 cmt. at 3 (2008).

71. DEL. CODE. ANN. tit. 8, § 262(b)(1) (2001).

72. MODEL BUS. CORP. ACT § 13.02(b)(1) (2008).

73. Delaware's appraisal statute does have other exceptions to the market-out exception. For example, Delaware's market-out exception does not apply to cash-out mergers. As such, depending on the merger consideration, appraisal rights may be available for more Delaware mergers than for mergers effected pursuant to the MBCA. *See* DEL. CODE. ANN. tit. 8, § 262(b)(2) (2001) (reinstating appraisal rights despite the existence of a liquid market based on the nature of the consideration the shareholder receives in the appraisal-triggering transaction); *see also id.* § 262(b)(3) (reinstating appraisal rights for short-form mergers under section 253).

74. Siegel, *supra* note 10, at 79, 124.

75. The twenty-six jurisdictions that had a market-out exception in 1999 were: Alaska, Arizona, California, Colorado, Delaware, Florida, Georgia, Indiana, Kansas, Louisiana, Maine, Maryland, Michigan, North Carolina, Nevada, New Jersey, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, Utah, Virginia, and Wisconsin.

76. In addition to the MBCA, twenty-five jurisdictions did not have a market-out exception in 1999. The states without a market-out exception in 1999 were: Alabama, Arkansas, Connecticut, District of Columbia, Hawaii, Idaho, Illinois, Idaho, Kentucky, Massachusetts, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New Mexico, New York, North Dakota, Ohio, South Dakota, Vermont, Washington, West Virginia, and Wyoming.

77. *See* MODEL BUS. CORP. ACT ANN. § 13.02 cmt. at 2 (1999) ("Moreover, the market exception reflects an evaluation that the uncertainty, costs and time commitment involved in any appraisal proceeding are not warranted where shareholders can sell their shares in an efficient, fair and liquid market.").

however, directly challenged the premise that the stock market always offers fair value.⁷⁸

Opponents of the market-out exception contended that market value and fair value are not necessarily synonymous under all circumstances. They proffered concerns that the market may be “demoralized,”⁷⁹ be reflective only of publicly available information,⁸⁰ or only a mirror of the transaction price,⁸¹ rather than of the stock’s fair value. The Committees that drafted the 1978 and 1984 versions of MBCA chapter 13 agreed with these concerns: the 1978 Committee repealed the market-out exception that had been enacted in the 1969 version of the MBCA,⁸² and the 1984 Committee affirmed that decision.⁸³

In 1999, the Committee recognized the concerns articulated in prior drafts of chapter 13 that confining shareholders to the market price could, in some circumstances, deny shareholders the fair value of their stock.⁸⁴ The 1999 Committee, however, also believed that the market-out exception had great value even if it was not reliable in all circumstances. Specifically, the strengths of the market-out are that it eliminates the uncertainty, large costs, and time commitment involved in any appraisal proceeding. Furthermore, although the market may not always achieve a perfect price, the variables involved in an appraisal proceeding surely do not produce an ideal price either,⁸⁵ and are indisputably attendant by large financial and time costs. Thus, deciding against a market-out simply because some, but not all, transactions may make the market price potentially unfair seemed too crude of a choice.⁸⁶ Rather than a wholesale acceptance or rejection of the market-out critiques, the 1999

78. See generally Ronald J. Gilson & Reiner H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984) (discussing the efficient market hypothesis and whether the market price represents fair value of the company’s stock).

79. See Conard, *supra* note 40, at 2595–96 (citing the prevalence of demoralized markets in the 1970s as a reason for removing the market-out exception from the MBCA).

80. See Siegel, *supra* note 10, at 126 (recognizing the possibility that if the market only reflects publicly available information, only management will be in a position to know if stock is undervalued).

81. See Conrad, *supra* note 40, at 2595–96 (stating it is impossible for the market price to reflect the value of shares “excluding any appreciation or depreciation in anticipation of the corporate change” that gave rise to appraisal rights).

82. MODEL BUS. CORP. ACT § 73(c) (1969); MODEL BUS. CORP. ACT § 73(c) (1978).

83. See MODEL BUS. CORP. ACT § 13.02 (1984) (not including a market-out exception).

84. See MODEL BUS. CORP. ACT ANN. § 13.02 cmt. at 3 (2008) (noting that, although the premise of the market-out is that the value offered by the market is deemed reliable, the market might not be a reliable indicator of the fair value of stock in certain appraisal-triggering transactions).

85. Determinations of fair value are inextricably tied to the methodology used to calculate fair value. Different methodologies ascribe different weights to each variable and incorporate different assumptions within the valuation model. In *Weinberger v. UOP, Inc.*, the Delaware Supreme Court overruled the “Delaware block” method for determining fair value, holding that such a determination “requires consideration of all relevant factors involving the value of the company.” 457 A.2d 701, 713 (Del. 1983).

86. Conflict transactions may confine shareholders to a demoralized market, but absent a conflict, decisions by directors that are consistent with directors’ fiduciary duties should provide shareholders with the approximate fair value of their transaction. MODEL BUS. CORP. ACT ANN. § 13.02 cmt. at 3 (2008); see also Siegel, *supra* note 10, at 127.

Committee identified those circumstances that might generate a demoralized market, an uninformed market, or a market that merely mirrored the transaction price, and concluded that such concerns were significant only if the appraisal-triggering transaction was a conflict-of-interest transaction. As a result, the Committee adopted a market-out exception to appraisal rights, but, through its additional exception for conflict-of-interest transactions, the Committee reinstated appraisal rights for those transactions when the market is, arguably, unreliable. Delaware's adoption of a market-out without any exception for conflict transactions recognizes the valuable aspects of the market-out exception, but presumably accepts that the market is sufficiently reliable so as to not require an exception for conflict transactions.

C. Reaction from the State Legislatures

Given that jurisdictions in 1999 were fairly evenly divided between those that did and did not adopt a market-out exception,⁸⁷ it is interesting to consider not only whether jurisdictions have limited their market-out exceptions to non-conflict transactions, but also whether the market-out has increasingly attracted opponents or supporters. Since 1999, ten jurisdictions added a market-out exception.⁸⁸ Thus, in the ten years from 1999 to 2009, the number of market-out provisions increased from twenty-six to thirty-six jurisdictions, an impressive 38.5% growth. This large increase may reflect either legislative comfort with the market and its numerous benefits,⁸⁹ an understanding of the downsides of appraisal rights,⁹⁰ or both. Indeed, although there may be possible failings in a market price, the appraised value, as discussed above, is certainly not a perfect number. Therefore, when faced with two arguably imperfect determinations of share value, it would be reasonable to select the most cost-efficient valuation. Thirty-six legislatures, or 70.5%, have done so by embracing a market-out exception.

Of these thirty-six market-out exceptions, eleven,⁹¹ or approximately 30.5%, have embraced the MBCA concept that the market-out exception should be inapplicable if the appraisal-triggering transaction is a conflict transaction.⁹² The

87. *See supra* notes 75–76 (listing jurisdictions with and without a market-out exception in 1999 and noting that numerically, they were fairly evenly divided).

88. The states that added a market-out exception after 1999 are: Connecticut, Idaho, Iowa, Massachusetts, Mississippi, New York, North Dakota, South Dakota, West Virginia, and Wyoming.

89. *See supra* notes 68, 77 and accompanying text.

90. *See supra* notes 11, 58 and accompanying text; Siegel *supra* note 10, at 109 (explaining that allowing appraisal rights in non-conflict transactions runs counter to the normal presumption of the business judgment rule).

91. The states that limit the market-out to non-conflict transactions are: Connecticut, Florida, Idaho, Iowa, Maine, Maryland, Massachusetts, Mississippi, South Dakota, Virginia, and West Virginia.

92. Each of these statutes either (1) reinstates appraisal rights if the transaction is an “interested transaction” when the definition of interested is provided in the definitional section of the statute (Connecticut, Mississippi, Virginia); or (2) lists specific instances of conflict, modeled after the definition of an interested transaction in MBCA section 13.01(5.1), which render appraisal rights available (Florida, Idaho, Iowa, Maine, Maryland, South Dakota, West Virginia). *See infra* note 99.

eleven jurisdictions that limit their market-out exceptions to non-conflict transactions consist of four of the twenty-six jurisdictions that had a market-out in 1999 and later amended their statutes to include a conflict exception,⁹³ and seven jurisdictions from the ten that added a market-out exception since 1999.⁹⁴ Thus, because a significant number of jurisdictions (seventy percent) that added a market-out exception since 1999 embraced the further exception for conflict-of-interest transactions, there was a greater inclination toward the conflict exception among those legislatures that added a market-out rather than among those who already had a market-out. Such a result is not surprising; those legislatures that already had adopted a market-out exception before 1999 had obviously achieved some level of comfort with this exception, and were therefore less receptive to the Committee's argument that an unqualified market-out is flawed.

On the other hand, Delaware and twenty-four other jurisdictions have a market-out exception that does not contain an exception for conflict transactions. The relatively recent addition of the conflict exception raises the initial question whether these twenty-five legislatures have rejected the MBCA's conflict exception or whether these legislatures have simply not yet considered the issue. The statistics, however, strongly suggest that most of these twenty-five jurisdictions have considered and rejected the conflict-of-interest limitation. First, one might presume that the ten states that added a market-out exception since 1999 also considered whether to limit that exception by adding a conflict transaction; as noted above, three of these states chose not to add the conflict limitation.⁹⁵ Second, because seventeen of the twenty-six jurisdictions that had market-out exceptions in 1999 have since amended aspects of their appraisal provisions without adding a conflict exception,⁹⁶ one might again suspect that this group also considered and rejected a conflict exception. As a result, one might presumptively conclude that twenty of these jurisdictions rejected adding a conflict exception to their market-out exceptions. This leaves only two other groups of jurisdictions with market-out exceptions for which the inferences are less apparent: three jurisdictions amended aspects of their corporate statutes without amending any aspects of their appraisal provisions,⁹⁷

Finally, the Massachusetts statute lists specific instances of conflict that reinstate appraisal rights, but the enumerated instances of conflict differ from those listed in the MBCA. *See infra* note 102 and accompanying text.

93. These jurisdictions are Florida, Maine, Maryland, and Virginia.

94. The jurisdictions that added a market-out limited to non-conflict transactions are Connecticut, Idaho, Iowa, Massachusetts, Mississippi, South Dakota, and West Virginia.

95. *See supra* note 88 and accompanying text. The three jurisdictions that added a market-out exception, but did not limit the market-out to non-conflict transactions are: New York, North Dakota, and Wyoming.

96. These jurisdictions are: California, Colorado, Delaware, Georgia, Indiana, Kansas, Michigan, North Carolina, Nevada, New Jersey, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Texas, and Wisconsin.

97. These jurisdictions are: Alaska, Arizona, and Utah.

and two jurisdictions' legislatures have not yet amended any aspect of their respective corporate statutes, including their appraisal provisions.⁹⁸

One can only speculate as to the reasons why a majority of jurisdictions have chosen to embrace the market-out exception without limiting that market-out to non-conflict transactions. Some legislatures might not be convinced that the market-out needs this further exception, and thus, have chosen to follow Delaware's approach. Others might embrace the soundness of the Committee's argument, but might want more time to analyze the experiences other jurisdictions have with this exception before adopting this novel approach. Still others might agree with the Committee's position, but be concerned that the definition of "interested transaction" in the MBCA is not easy to master: the definition takes up over one and a half pages; has definitions of "interested person," "beneficial owner," and "excluded shares"; and is tripped by ownership of stock, power, and position in the corporation.⁹⁹ Such a complex definition might generate concerns about whether lawyers could determine, with the certainty required for disclosure in the proxy materials,¹⁰⁰ whether appraisal rights are, in fact, available due to the conflict exception. If such a determination is difficult, and lawyers err in their judgment, the consequences to the corporation could be significant.¹⁰¹ Perhaps the complexity of the MBCA's definition is what caused Massachusetts to embrace the logic of a conflict exception but to devise a simplified definition of conflict.¹⁰² Regardless of the reason, the decision of twenty-five legislatures to follow Delaware's market-out exception has the concomitant effect of decreasing the availability of appraisal rights, as shareholders will be relegated to the market for both conflict and non-conflict transactions.

98. These jurisdictions are: Tennessee and Louisiana.

99. See MODEL BUS. CORP. ACT § 13.01(5.1) (2008).

100. Corporations must disclose a variety of information in their proxy materials. Schedule 14A, Item 3 of the Securities Exchange Act of 1934 ('34 Act), 15 U.S.C.A. § 78 (West 2010), specifically requires corporations to disclose whether appraisal rights are available and the procedure for perfecting appraisal rights. A failure to disclose accurately whether appraisal rights are available is a violation of § 14(a) of the '34 Act.

101. Such incorrect disclosure might lead to a violation of § 14(a) of the '34 Act and § 10(b) of the '34 Act, as well as have serious other consequences under state law. See *Berger v. Pubco Corp.*, 976 A.2d 132, 144 (Del. 2009) (granting shareholders quasi-appraisal rights when a corporation's initial disclosure accompanying notice of appraisal rights was inadequate).

102. The Massachusetts statute provides that appraisal rights are not available so long as shareholders receive cash or marketable securities and "no director, officer or controlling shareholder has a direct or indirect material financial interest in the merger other than in his capacity as (i) a shareholder of the corporation, (ii) a director, officer, employee or consultant of either the merging or surviving corporation or of any affiliate of the surviving corporation if his financial interest is pursuant to bona fide arrangements with either corporation or any such affiliate, or (iii) in any other capacity so long as the shareholder owns not more than five percent of the voting shares of all classes and series of the corporation in the aggregate." MASS. GEN. LAWS ANN. ch. 156D, § 13.02 (West through 2010 2d Annual Sess.). Note that this definition, although simpler than its counterpart in the MBCA, creates its own problems by, for example, failing to define "material."

VI CONCLUSION

Appraisal rights are, indisputably, controversial. The controversy is broad, ranging from disputes over the function of appraisal rights to arguments assessing their desirability. It is therefore not surprising that the appraisal provisions in the MBCA and the Delaware statute highlight this controversy through specific differences in their appraisal provisions that expand or contract the availability of appraisal rights, or make these rights more or less feasible for shareholders. Delaware's market-out exception and single appraisal trigger clearly decrease the frequency of appraisal rights. Moreover, in those instances where shareholders have appraisal rights, Delaware treats that appraisal litigation like all other litigation; because no litigation is shareholder-friendly, only shareholders with large amounts of stock normally demand appraisal rights in Delaware.¹⁰³ The MBCA's appraisal provisions, in contrast, are more shareholder-friendly: there are numerous appraisal triggers, the market-out exception is available only in non-conflict transactions, and shareholders benefit from the statute's provisions on prepayment and allocation of costs. The vast majority of jurisdictions have supported most of the MBCA's key appraisal provisions, thereby making the remedy both available and viable for shareholders.

103. See Siegel, *supra* note 10, at 80 n.3 (citing *Green v. Santa Fe Indus., Inc.*, 533 F.2d 1283, 1297-98, 1301 (2d Cir. 1976) (Mansfield, J., concurring) *rev'd on other grounds*, 430 U.S. 462 (1977) (illustrating that, in Delaware, only shareholders owning a large number of shares will find appraisal financially beneficial)).