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Reforming Modern Appraisal Litigation

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Reforming Modern Appraisal Litigation

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This Article demonstrates that appraisal claims in Delaware during the most recent period of activity continue to exhibit multiple proxies for legal merit, suggesting that modern appraisal litigation plays a salutary if small role in M&A practice. This Article also provides an account of how appraisal—in spite of its empirical virtues—has sparked a backlash among a group of defendants and deal advisors. They have pressed Delaware policymakers to consider an amendment that would, among other things, deprive beneficial owners of appraisal rights if they were not beneficial owners on a record date set by the target board. In practice, this would limit the utility of the appraisal remedy and the beneficial effects of trading in appraisal-eligible shares. Very little substantive argument has been offered publicly to justify the deal lawyers' amendment, but we attempt to engage with what we regard as the most plausible arguments in its favor: that appraisal as currently practiced threatens the vitality of the deal market and that it enriches dissenters at the expense of other stockholders. These arguments are without empirical support and as a matter of theory cannot withstand sustained scrutiny. In the final analysis, this effort to alter Delaware's appraisal statute stands, at best, as a misguided effort to promote bad policy or, at worst, as a deliberate attempt to scuttle the only serious merger-related remedy available to stockholders of Delaware firms.

We propose an alternative set of reforms that would enhance the effectiveness of the appraisal remedy. Delaware should require disclosure of more financial information in appraisal-eligible transactions; eliminate the irrational exemption for all-stock transactions; and adopt a *de minimis* requirement. The system of awarding interest to dissenters can be improved in ways we sketch out here but develop fully in a separate paper. Lastly, we offer a simple way to meet the demand of the deal advisors—that appraisal eligibility be tied to a record date set by the board—without forsaking the governance virtues of an active appraisal market: Delaware law should require that any applicable record date be set for not earlier than 20 days following the mailing of notice of appraisal rights. This would ensure that stockholders and other market participants are able to see crucial disclosures before the record date. It thus represents a sensible compromise by giving deal advisors what they've demanded without destroying the policy benefits of appraisal.

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INTRODUCTION

Over the past five years, the stockholder's appraisal remedy has been transformed from a forgettable attribute of stock ownership in Delaware to a potent option for dissidents.¹ Appraisal now stands as a formidable mechanism of deterrence to opportunistic mergers, although that deterrence is partial at best.² In spite of the increase in activity, appraisal petitions still account for only one out of every twenty merger-related lawsuits. Nevertheless, appraisal has struck a chord with defendants and defense lawyers, who are pushing Delaware to adopt amendments that would curb appraisal activity in important ways.³ The bizarre aspect about this lobbying effort is that it seems wholly unmoored from any evidence on what is actually happening in appraisal.

For an issue of such importance, it is crucial that any potential reform be grounded not in spooky stories but instead in the hard reality of what is happening on the ground. We have examined the incidence of appraisal before, but things are changing rapidly, and the focus of this Article is chiefly on the period from 2011 through 2014, when appraisal activity has been higher than any point in the past. Even in this era of heightened appraisal litigation, the empirical picture is an encouraging one. Stockholders dissent in a small number of transactions and focus on transactions where there is reason to suspect opportunism. Appraisal petitions are associated with deals that have abnormally low merger premia and are also associated with insider buyouts. The outcomes of appraisal petitions are also notable: a far larger percentage of claims go to trial than,

¹ See Charles Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, forthcoming WASH. U. L. REV. (2015) [hereinafter Korsmo & Myers, *Appraisal Arbitrage*]; Charles Korsmo & Minor Myers, *The Structure of Stockholder Litigation: When do the Merits Matter?*, 75 OHIO ST. L.J. 829 (2014) [hereinafter Korsmo & Myers, *Structure of Stockholder Litigation*].

² See James D. Cox & Randall S. Thomas, *Addressing Agency Costs Through Private Litigation in the U.S.: Tensions, Disappointments, and Substitutes*, SSRN draft dated Sept. 2, 2015, at 39-40 (describing limitations of appraisal remedy).

³ See Peter E. Kazanoff & Paul C. Gluckow, *Appraisal Arbitrageur's Standing Reaffirmed by Chancery Court*, Delaware Business Court Insider, Feb. 3, 2015 (noting that deal advisors are "waging an escalating war" and that "the fight is likely to continue to be played out before the Delaware Chancery and Supreme courts and in the General Assembly").

for example, merger class actions, suggesting that appraisal petitioners are unusually dogged in pressing their claims. Trial results from public company appraisal petitions have on average awarded a slight premium to the dissenting group. The median outcome is less than a 2% premium to the merger price, and the mean outcome is a premium of slightly more than 10%. Together these results suggest a system of private enforcement that is working well, if substantially short of its full potential.

The rise of modern appraisal has naturally prompted a re-evaluation of the appraisal remedy and consideration of possible reforms. In late 2014 and early 2015, Delaware’s blue-ribbon corporate reform committee—the Council of the Corporation Law Section of the Delaware State Bar Association—examined the appraisal statute and proposed only modest changes, intended to prevent interest rate arbitrage and the bringing of small claims for nuisance value.⁴ We regard the proposed changes as positive on balance, and at worst benign.⁵

Over the past few years year, however, a group of influential critics of appraisal have emerged, and they now have pressed for a far more radical overhaul of the appraisal statute. Most prominent among the critics are a group of deal lawyers led by the New York law firm Wachtell, Lipton, Rosen & Katz.⁶ The management of the Dole Food Company, which was the subject of a large appraisal action over a management-led going-private transaction, similarly pressed for radical change, though they appear to have largely fallen silent since an August 2015 court opinion found

⁴ See Proposed 2015 Amendments to the Delaware General Corporation Law, *available at* www.skadden.com/newsletters/Proposed_DGCL_Amendments_Related_Documents.pdf.

⁵ We discuss the interest rate proposal below. The de minimus requirement would allow respondents to automatically dismiss claims where fewer than 1% of shares seek appraisal or where the aggregate value of the shares seeking appraisal does not exceed \$1 million. This proposal strikes us as sensible, in that such small claims can have little deterrence value, consume judicial resources, and pose a heightened risk of nuisance litigation intended to capture avoided litigation costs. The data show, however, that such tactics are rare.

⁶ See Theodore N. Mirvis, Trevor S. Norwitz, Andrew J. Nussbaum, William Savitt, & Ryan A. McLeod, “Delaware Court Decisions on Appraisal Rights Highlight Need for Reform,” *Harvard Law School Forum on Corporate Governance and Financial Regulation*, January 21, 2015.

that Dole’s managers—the very same ones who agitated for undermining appraisal rights—had engaged in a scheme of pervasive fraud upon public stockholders.⁷ The deal lawyers have called for curtailing appraisal arbitrage by reducing the statutory interest rate and overturning a line of Delaware case law that stretches back half a century.⁸ The deal advisors press for an amendment to the appraisal statute that would strip beneficial holders of their appraisal rights if they were not beneficial owners on a record date set by the target board.⁹ As explained below, in practice this would require appraisal specialists to buy their shares before the record date for voting on the merger—not only long before the vote date but also, crucially, before the target company has mailed its proxy statement to stockholders. Dole management had gone further, lobbying the Delaware legislature and the Governor’s office to eliminate appraisal altogether for any stockholder who did not own its shares at the time a merger is announced.¹⁰

The arguments advanced in favor of these radical changes to the appraisal statute are often somewhat nebulous.¹¹ To the extent it is possible to discern the supposed policy justifications for the amendment, they boil down to claims like the following: The threat of appraisal liability will

⁷ In re Dole Food Co., Inc. Stockholder Litig., No. CV 8703-VCL, 2015 WL 5052214 (Del. Ch. Aug. 27, 2015).

⁸ See *Merion Capital LP v. BMC Software, Inc.*, No. CV 8900-VCG, 2015 WL 67586, at *6 (Del. Ch. Jan. 5, 2015) (holding that “Section 262 permits the existence of appraisal arbitrage by allowing investors to petition for appraisal of stock purchased after a merger is announced” and that “the unambiguous language of the statute does not give rise to any such share-tracing requirement”); *In re Appraisal of Transkaryotic Therapies, Inc.*, No. CIV.A. 1554-CC, 2007 WL 1378345, at *4 (Del. Ch. May 2, 2007) (“[F]ollowing the clear teachings of *Olivetti Underwood Corp.*, I conclude . . . that only Cede’s actions, as the record holder, are relevant . . . [and] . . . the actions of the beneficial holders are irrelevant in appraisal matters”); *Olivetti Underwood Corp. v. Jacques Coe & Co.*, 42 Del. Ch. 588, 593, 217 A.2d 683, 686 (1966) (“[T]here is no recognizable stockowner under the merger-appraisal provisions of our Corporation Law except a registered stockholder.”).

⁹ See Trevor S. Norwitz, “Delaware Poised to Embrace Appraisal Arbitrage,” *Harvard Law School Forum on Corporate Governance and Financial Regulation*, March 9, 2015.

¹⁰ See notes XX *infra*.

¹¹ See, e.g., White & Case Client Alert, *Increasing Hostility Towards Appraisal Arbitrage*, April 2015, at 1 (“While statutory appraisal remedies are intended to protect minority stockholders by enabling those who dissent to request a judicial determination of the fair value of their shares in a takeover context, this public policy rationale is absent from the current trend of increasing appraisal claims brought by institutional investors that engage in ‘appraisal arbitrage’ as they invest in target companies upon a takeover announcement with the intention of exercising appraisal rights.”).

frustrate many beneficial deals, keeping stockholders from getting the benefit of some set of merger proposals that will now go unmade. Merger agreements might cabin appraisal liability by including a closing condition allowing the acquirer to walk away if more than some specified percentage of stockholders demands appraisal, but that solution is unattractive to sellers (because it reduces the certainty of the deal) and also to buyers (because it allows dissenting stockholders to veto the transaction). The result of this uncertainty, in the transactional advisors view, is that acquirers facing potential appraisal liability will lower their bid to account for the expectation of an appraisal suit, and non-dissenting stockholders will be penalized by this holdback.

These arguments cannot withstand scrutiny. Merger parties control the appraisal liability they face, as deal advisors themselves acknowledge. One law firm memo put it this way: “[T]he transactions that attract appraisal petitions generally involve some basis for a belief that the deal price significantly undervalues the company—that is, transactions involving controlling stockholders, management buyouts, or other transactions for which there did not appear to be a meaningful market check or significant minority shareholder protections as part of the sales process.”¹² At the other end of the spectrum, the surest way to avoid appraisal liability is to see that the target got the best price available. Appraisal specialists focus on strong claims, and if the claim is not strong, it will not attract their attention.¹³ It is precisely the threat of appraisal liability, in other words, that should prevent acquirers from holding back value in merger negotiations. And given the litigation patterns we document here—where appraisal petitions focus on abnormally low

¹² Fried, Frank, Harris, Shriver & Jacobson LLP M&A Briefing, *New Activist Weapon: The Rise of Delaware Appraisal Arbitrage: A Survey of Cases and Some Practical Implications*, June 18, 2014, at 4.

¹³ See Section I.A, *infra* Korsmo & Myers, *Structure of Stockholder Litigation*.

merger premia and on insider deals—it may be safe to assume that any transaction deterred by appraisal liability is evidence of the system working well.¹⁴

The Delaware legislature never acted on the appraisal-related proposals from the Council in 2015, and many have suggested that the Council should revisit the issue in the winter of 2015-16.¹⁵ Given the influence of the deal advisors in Delaware, the Council will surely reexamine the proposals for radical change. The Council should reject them. Instead, it should consider a number of amendments to expand and improve the appraisal remedy: eliminating the exception for all-stock transactions, introducing a de minimis exception, and requiring more disclosure from companies so that stockholders are in a position to make an informed decision about exercising their appraisal rights.

Even if the Council were to propose an amendment that would strip beneficial owners of their appraisal rights unless they were beneficial owners on the record date, the Council should at the same time limit the discretion of the board to select a record date that deprives stockholders of information when they need it most. In particular, target boards should not be permitted to set a record date that is less than 20 days after the mailing of notice of appraisal rights to target stockholders. This would meet the stated goals of the critics while at the same time preserving the valuable governance role of modern appraisal.

Part I provides an empirical picture of both the incidence and outcome of stockholder appraisal litigation, focusing on the period from 2011 to 2014. The focus of Part II is a narrative description of the rise of appraisal activity and the backlash it has provoked among defense lawyers

¹⁴ See Korsmo & Myers, *Structure of Stockholder Litigation*.

¹⁵ See Peter E. Kazanoff & Paul C. Gluckow, *Appraisal Arbitrageur's Standing Reaffirmed by Chancery Court*, Delaware Business Court Insider, Feb. 3, 2015 (noting that deal advisors are “waging an escalating war” and that “the fight is likely to continue to be played out before the Delaware Chancery and Supreme courts and in the General Assembly”).

and defendants. Part III considers the various critiques that defense lawyers have offered of modern appraisal and the reforms they have advocated; the critiques generally fall flat and the reforms are inadvisable. A more sensible set of reforms are offered in Part IV, which details ways in which the appraisal remedy in Delaware can be made more effective.

I. AN EMPIRICAL PICTURE OF MODERN APPRAISAL LITIGATION

Given the seriousness of the reforms pressed by the defense bar, it is imperative to ensure that the debate be grounded in a realistic picture of modern appraisal practice. This Part presents that empirical picture of both the incidence of appraisal petitions and, to the extent publicly observable, their outcome.

The world of active appraisal litigation is still new, and thus the focus of our attention here is the period from 2011 through 2014, when appraisal activity has been more substantial than in prior years. Our analysis here reveals that appraisal litigation resources are focused on a small subset of transactions. In addition, the targeted transactions continue to stand out as having unusually low premia and an especially high likelihood of insider participation. In terms of outcomes, approximately 15% of filed appraisal petitions go to trial, an unusually high rate for merger litigation. The cases that go to trial, of course, are a non-random selection of cases; we would not expect them necessarily to have an exceptionally high or low trial award. Consistent with this prediction, judicial opinions following trial award on average a modest premium; the median award is less than 2% and the mean is about 10.5%.

As a baseline comparison, we present comparable figures for merger class action litigation during the same period. They are filed against nearly every transaction, with the volume of merger class actions approximately 20 times that of appraisal litigation. These filings targeted deals with no

statistically significant regard for the merger price and instead are associated with transaction size. In terms of outcomes, they are nearly always settled when not dismissed. In the world of merger litigation, appraisal appears to be working unusually well.

A. *The Incidence of Appraisal*

The first policy-relevant empirical question is what deals are targeted by appraisal petitions. The conventional view of appraisal has long been as a remedy that is used infrequently by stockholders. And, indeed, this view was consistent with actual litigation patterns through 2010. Beginning in around 2011, however, there has been a substantial increase in appraisal activity, as measured by multiple metrics. As we have shown elsewhere,¹⁶ this increase in appraisal activity did not, in its early years, proceed in an indiscriminate, blunderbuss fashion. Instead, it constituted a focused attack on the adequacy of the merger price in a relatively small number of transactions.¹⁷ Moreover, the transactions targeted for appraisal challenges were associated with insider buyouts and lower-than-expected merger premia—precisely the deals where minority shareholders were more likely to have been mistreated.¹⁸ The picture, in other words, was a regime of legal rights that worked well in terms of channeling challenges into the right transactions. To the extent there was an apparent problem, it was a problem of under-enforcement. The backlash that has emerged in recent years, however, may indicate that something has changed in the pattern of litigation. Perhaps

¹⁶ See Korsmo & Myers, *Structure of Stockholder Litigation*; Korsmo & Myers, *Appraisal Arbitrage*.

¹⁷ See Korsmo & Myers, *Appraisal Arbitrage* at XX (showing that the incidence of appraisal petitions has never exceeded 17% of appraisal-eligible transactions).

¹⁸ See *id.*, at 51-62.

there has been an increase in small-value nuisance suits or an increasingly indiscriminate pattern of litigation activity.¹⁹

To provide the debate with a firm factual footing, we collect and analyze data on appraisal activity involving public company transactions consummated through the end of 2014. We examine three metrics of appraisal activity: the transactions challenged in appraisal proceedings, the number of appraisal petitions filed, and the percentage of equity value held by dissenting stockholders. Across various metrics, we find that the intensity of activity fell slightly in 2014 from 2013 levels, but that the general trend has been consistent since 2011.

We present these and other summary statistics on appraisal activity in Delaware below. To provide some context, we also report—where possible—comparable data on merger class actions. Our underlying data involves all public-company merger transactions that triggered stockholders’ appraisal rights in Delaware. Stockholders have two potential methods for legally challenging such transactions—a merger class action and an appraisal petition—and we are able to compare which transactions attracted what type of legal challenge. Not all mergers are appraisal-eligible in Delaware, because Delaware law denies appraisal rights to stockholders in all-stock transactions.²⁰ Only when stockholders are required to accept cash (or various other non-stock forms of consideration) does the merger trigger the stockholders’ appraisal rights. As we explain below,²¹ this

¹⁹ One recent Chancery Court opinion expressed concerns along these lines. See *Merion Capital LP v. BMC Software, Inc.*, No. CV 8900-VCG, 2015 WL 67586, at *7 (Del. Ch. Jan. 5, 2015) (“It may be true that the plain language of Section 262 does not adequately serve all the purposes of that statute. It is possible that appraisal arbitrage itself leads to unwholesome litigation.⁵⁴ However, in evaluating my role in alleviating these concerns through the adjudication of this case, I find former Chancellor Chandler’s words in *Transkaryotic*—wherein over seven years ago he considered whether his decision would “pervert the goals of the appraisal statute by allowing it to be used as an investment tool for arbitrageurs”—to be particularly apposite: ‘To the extent that [these] concern[s] ha[ve] validity, relief more properly lies with the Legislature. Section 262, as currently drafted, dictates the conclusion reached here.... The Legislature, not this Court, possesses the power to modify § 262 to avoid the evil[s], if [they are] evil[s], that purportedly concern[] [the Respondent].’”).

²⁰ See DEL. CODE ANN. TIT. 8 § 262(b).

²¹ See *infra* at Part IV.A.

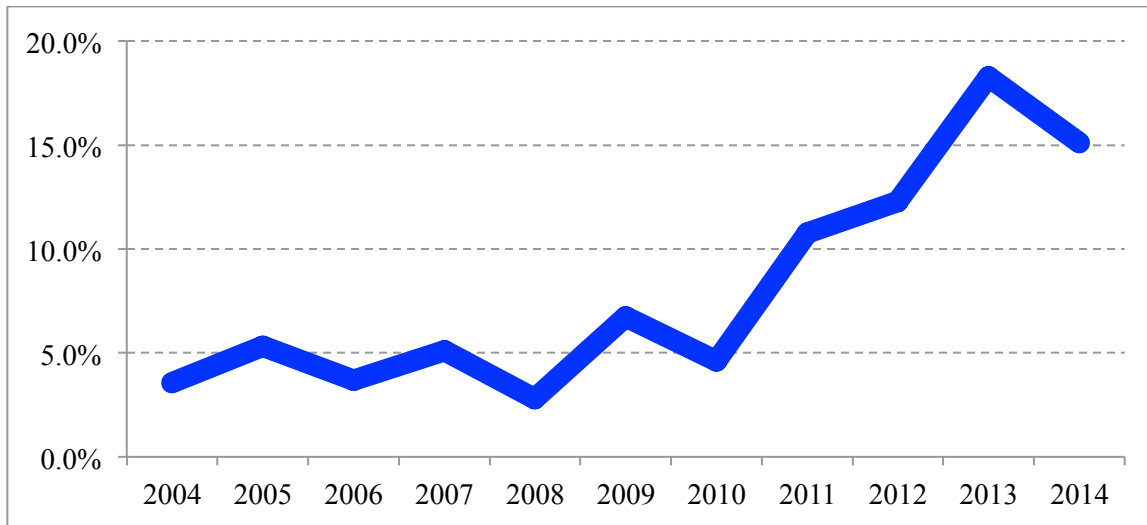
limitation makes no sense as a policy matter. But to ensure that we are comparing apples to apples, we restrict the purview of our analysis to appraisal-eligible transactions.

1. Transaction-level Appraisal Challenges

The number of appraisal-eligible transactions in 2014 reached an all-time low during the 11-year period for which we have data. Only 86 transactions were eligible for appraisal, and thirteen of those attracted filed appraisal petitions. This 2014 rate of filing—15.1%—is consistent with the larger trend of increased appraisal activity that began in 2011. Figure 1 below shows the percentage of appraisal-eligible deals each year that faced an appraisal petition.

Figure 1

Percentage of Deals Challenged by Appraisal Challenge, 2004-14



Between 2011 and 2014, an average of 13.8% of transactions have triggered the filing of at least one appraisal petition. From 2004 through 2010, by contrast, 4.5% of transactions faced an appraisal filing. As we explain below, this rate somewhat overstates the actual intensity of appraisal

activity because a significant number of these challenges involve trivially small amounts of stock. At the same time, this rate necessarily excludes appraisal disputes that settle prior to any petition being filed.

For comparison, the rate at which the same universe of mergers was challenged by a class action lawsuit—the other available form of potential legal relief—was 88% between 2011 and 2014. In other words, approximately seven out of eight appraisal-eligible mergers are challenged by class actions, whereas only slightly more than one out of eight is challenged in appraisal. The ubiquity of merger class actions is widely regarded as evidence of a litigation epidemic that cries out for a policy solution.²² By contrast, the raw appraisal rate is not self-evidently high, in our view.

Which deals are challenged in appraisal proceedings? Whatever the effects of appraisal litigation, the appraisal remedy can only hope to be an effective tool of corporate governance if it targets deals that ought to be targeted—those with the greatest risk of mistreatment of minority stockholders. We thus compare the attributes of transactions that attracted at least one appraisal petition against those that did not. We again focus here on the four-year period from 2011 through 2014, when appraisal litigation has been most active.

The transactions can be broken down in multiple different ways. In particular, we examined various measures of the firm's size, whether the merger was involved a strategic or financial buyer, and whether an insider was part of the buyout group. We also use a calculated variable we call the premium residual, which is the difference between the actual merger premium and the merger premium we would expect given the size and industry of the target and the year of

²² See, e.g., Matthew D. Cain and Steven Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465 (2015).

the acquisition.²³ When a premium residual is negative, it indicates that the actual premium is lower than the expected premium; a positive premium residual means that the actual premium exceeds the expected premium. We would expect transactions involving financial and insider buyers and negative premium residuals to pose a greater risk of expropriation from minority stockholders, with the firm's size largely irrelevant. Table 1 below presents summary statistics on which deals attract appraisal litigation.

Table 1
Descriptive Statistics of Transactions Challenged in Appraisal

	Non-appraisal transactions	Appraisal transactions
Firm size		
Enterprise value (mean)	\$1.9 billion	\$1.8 billion
Equity value (mean)	\$1.6 billion	\$1.7 billion
Premium residual		
1-day (mean)	1.9%	-14.5%
1-week (mean)	2.9%	-15.4%
4-week (mean)	3.8%	-19.5%
Strategic merger	47%	42%
Insider participation	7.8%	18.6%
Financial buyer	24%	33%

The transactions targeted by appraisal are nearly indistinguishable from non-appraisal transactions in terms of size. By contrast, a substantial difference is evident across all measures of premium residual. The average premium residual is substantially lower for the appraisal deals than for non-appraisal deals. The proportion of strategic transactions challenged in appraisal is slightly lower

²³ For additional explanation of the premium residual, see Korsmo & Myers, *Structure of Stockholder Litigation*, at 872.

than in other deals. Insider participation is more than twice as common among deals facing an appraisal challenge than those that do not.

We analyze the incidence of appraisal petitions in logit regressions, focusing again only on the period from 2011 through 2014. Our dependent variable is whether the transaction faces an appraisal petition, and our independent variables are measures of size, measures of premium residual, and dummy variables for synergistic merger, a financial buyer, and insider participation. We present the results in Table A in the Appendix. The only variables with a statistically significant effect are the merger premium residual and the presence of insider participation. The lower the premium residual, the higher the likelihood of an appraisal petition. And the presence of an insider in the buyer group increases the chance of an appraisal petition. Both of these are consistent with the conclusion that appraisal petitioners focus their resources on meritorious claims.

One persistent talking point from critics of appraisal is to suggest that, by focusing on filed petitions, our data understate the actual amount of appraisal litigation. The implication apparently meant to be drawn is that a fuller view of appraisal activity would reveal a dramatically different landscape, rife with meritless nuisance claims. It is, of course, true that the public can only observe petitions that are filed with the court, which means any appraisal claims that settle before a filing will remain unseen. There are, no doubt, more appraisal demands than there are appraisal petitions. This is neither surprising nor scandalous. Just as an employer may settle with a wrongfully terminated employee without a court case, or an insurance company may settle quickly with an injured motorist where liability is clear, a firm may also settle with a dissenting stockholder so quickly that the stockholder never needs to file a petition. Practitioners have reported to us that as many as one in four appraisal demands settles without a public filing. Even if such cases were

dramatically different from cases involving filed petitions, they would likely not alter the overall picture significantly.

More importantly for our purposes, it is highly unlikely that the appraisal demands that settle early are different from the filed petitions in the way appraisal critics imply. To reach the conclusion drawn by the critics, one would have to believe that defense lawyers and their clients are systematically choosing to settle unusually weak claims quickly, while refusing to settle especially strong claims.²⁴ We suspect that such an illogical practice is precisely the opposite of reality, and that it is far more likely that it is the unusually strong cases that respondents choose to settle quickly rather than fight. As a result, though we cannot observe the appraisal claims settled without a public filing, we regard it as highly likely that the inclusion of such claims would make our results—that appraisal petitioners as a whole focus on cases that exhibit proxies for legal merit—stronger, not weaker.

2. *Number of complaints filed*

Another measure of appraisal activity is the raw number of petitions filed. Though widely cited in the popular press,²⁵ this number has somewhat less practical significance than the number of deals challenged. For a defendant, facing multiple petitions is generally no different than facing a

²⁴ Another reason defense lawyers might seek to settle in advance of trial is if the dissenter's stake is small in relation to the costs of defense. Such settlements are surely part of the pre-filing picture, but this phenomenon is hardly unique to appraisal. Any time the costs of defense are non-zero, there is some residual risk of nuisance litigation. As we explain below, the structural features of appraisal render this strategy far less attractive for appraisal petitioners than in other contexts. Given the real costs of pursuing an appraisal claim, nuisance suits become largely self-detering in the absence of a credible threat to go to trial. That is not to say small suits never happen, but a handful of settlements with claimants trying to exploit the costs of defense is not the pressing public policy problem that defense lawyers suggest appraisal now constitutes. Moreover, the prophylactic measure proposed by the Council of instituting a *de minimis* requirement for appraisal is targeted at this potential problem. In view of the failure of appraisal critics to embrace the *de minimis* requirement, it is safe to assume that small claimants in appraisal is more of a rhetorical move than a genuine concern.

²⁵ See, e.g., Liz Hoffman, Hedge Funds Wield Risky Legal Ploy to Milk Buyouts, WALL ST. J., April 13, 2014; Liz Hoffman, Judge Rules in Favor of Hedge Fund 'Appraisal Arbitrage' Strategy, WALL ST. J., Jan. 7, 2015.

single petition, as the petitions will inevitably be consolidated into one judicial proceeding. Moreover, dissenters need not file a petition themselves to share in the outcome from an appraisal proceeding filed by another dissenter. As a result, multiple filings are usually of secondary interest, largely signifying a desire among numerous dissenting stockholders to participate in control the case or to publicize their involvement.

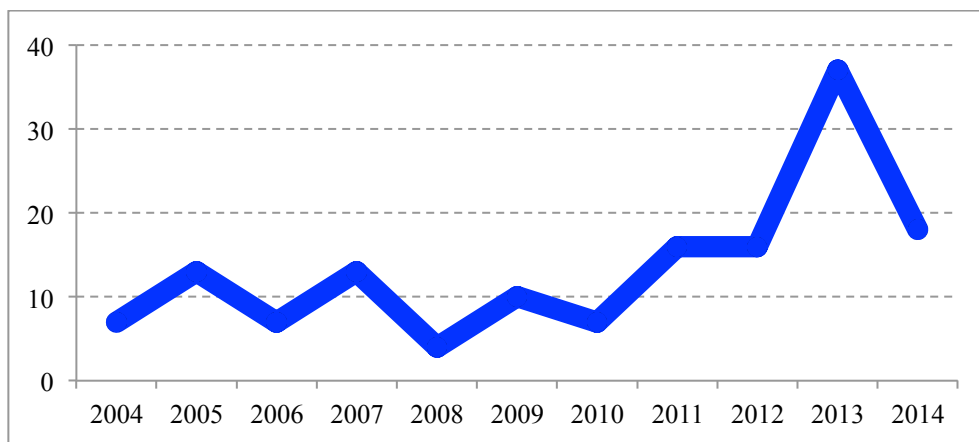
In classifying the filing of petitions, we focus—as before—on the effective date of the challenged transaction, rather than the date on which the actual petition was filed. Dissenting stockholders have 120 days following the closing of the transaction in which to file their petition.²⁶ Thus, the lag between the investment date and the petition date can be as much as four months. To preserve their appraisal rights, however, stockholders must decide to dissent much earlier, prior to the closing date.²⁷ Thus, for getting a sense of when dissenting stockholders are deciding to exercise their appraisal rights, the filing date for the petition is less informative than the closing date of the challenged transaction. We date each filed petition by the effective date of the challenged transaction. The filings are shown in Figure 2 below.

Figure 2

Appraisal petition filings by transaction year, 2004 to 2014

²⁶ See DEL. CODE ANN. TIT. 8 § 262(e).

²⁷ Among other things, would-be dissenters must give notice of intent to pursue appraisal, generally prior to any shareholder vote. See DEL. CODE ANN. TIT. 8 § 262(d).



There was a spike in the number of appraisal petitions filed challenging 2013 transactions, but in 2014 the filing level dropped back to the 2011-12 level. The average number of filings during the recent burst of appraisal activity from 2011 through 2014 was approximately 22 per year, and the average number from 2004 through 2010 was approximately 9 per year. This increase in filings beginning in 2011 is consistent with the more general increase in appraisal activity around that time.

The volume of appraisal petitions is trivial in comparison to the volume of merger class action filings. From 2011 through 2014, the number of merger class actions challenging the same universe of appraisal-eligible transactions averaged 426 lawsuit filings per year, or nearly twenty times the volume of appraisal petitions during the same period. In other words, appraisal petitions represented less than 5% of all merger-related lawsuits during the period, even for deals where appraisal was available as a remedy.

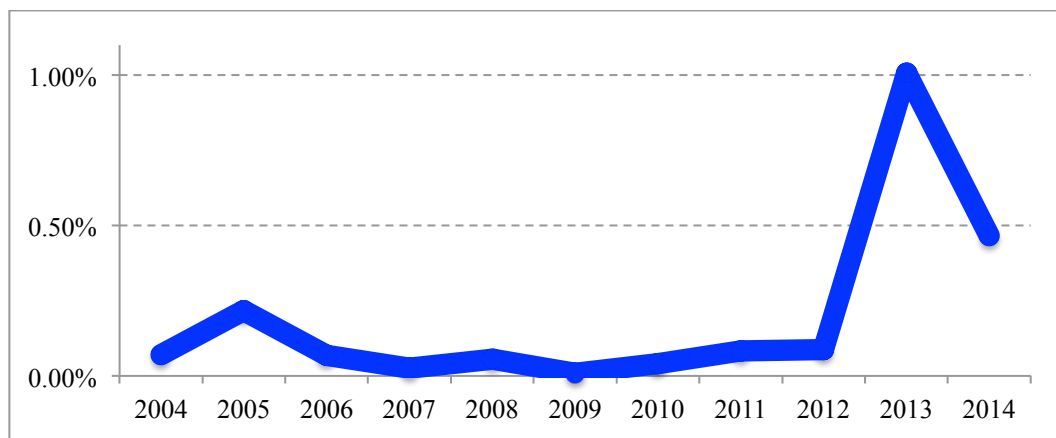
3. *Equity Value of Dissenting Shares*

Not all appraisal filings are alike in economic significance, of course. The dissenting group might be only one disgruntled retail stockholder holding a handful of shares, or it could be a group

of sophisticated institutions owning a substantial percentage of the target firm’s equity. To get a sense of the economic importance of appraisal, we define the value of dissenters’ position as the value of the merger consideration foregone in pursuing appraisal.²⁸ In 2014, the amount of aggregate equity value that dissented was 0.47% of the equity value of all appraisal-eligible public company transactions, which represented a decline from 2013, when approximately 1% of equity value dissented. Between 2011 and 2014, the aggregate equity value dissenting from all transactions was 0.36%. The comparable number for the period from 2004 through 2010 was 0.07%. Figure 3 below shows the percentage of equity value dissenting in each year.

Figure 3

Percentage of Equity Value in Appraisal, by year, 2004-2014



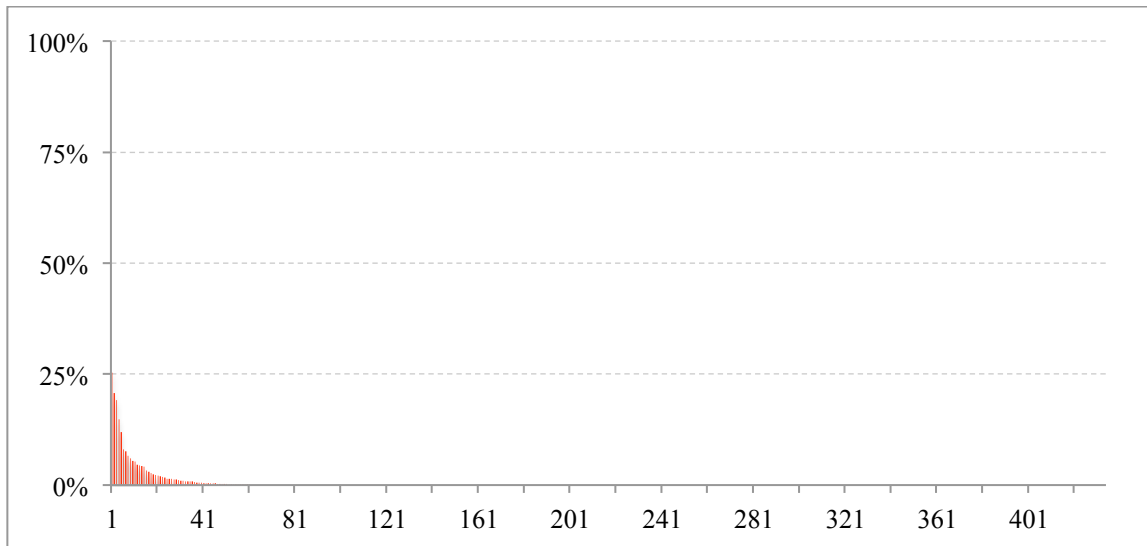
Appraisal activity is highly concentrated on a handful of transactions. In the four-year period from 2011 to 2014, there were 434 appraisal eligible transactions, of which 39—or

²⁸ Dissenting stockholders must forego receiving the merger consideration in order to pursue appraisal. See Korsmo & Myers, *Structure of Stockholder Litigation*, at 859.

approximately 9%—had more than 0.5% of equity value demand appraisal. The largest dissenting group in this period was 25.4%. Figure 4 below shows visually how much equity value sought appraisal for each eligible deal between 2011 and 2014. Each of the 434 transactions is represented by a single narrow vertical bar, and the portion of the bar in red represents the portion of equity demanding appraisal. The portion in white represents the portion of equity not demanding appraisal. The red area in the lower left-hand corner of the figure visually represents the amount of dissenting stock. The remaining area of the figure in white visually represents the amount of stock that did not dissent.

Figure 4

Amount of Equity Value in Appraisal, by transaction, 2011-2014



As these figures demonstrate, even though appraisal activity has never been higher than during this four-year period, the absolute amount of appraisal activity is still quite small. The overwhelming majority of transactions have no appraisal activity whatsoever. Only a comparatively small fraction

of transactions experience more than a trivial amount of appraisal activity: Fewer than 2% of transactions faced an appraisal group larger than 3.5% of the equity value.

The rate of appraisal challenge seems especially small in relation to the comparable figures from merger class actions. Not only did 88% of appraisal-eligible transactions face a fiduciary duty class action, these suits challenged approximately 97% of the equity value of all transactions during the period from 2011 to 2014. As discussed more fully below, the relevant figures suggest that appraisal petitions are far from posing an existential threat even to those suspect transactions that are targeted, much less to the far larger universe of transactions that never face an appraisal petition in the first place.

B. The Outcome of Appraisal Petitions

Even if appraisal petitioners are narrowly targeting the most problematic transactions, the incidence of appraisal petitions is only one half of the picture. The course the petitions take after filing is equally important. Pre-trial motion practice is relatively uncommon in appraisal cases. There are no conventional bases for moving to dismiss an appraisal petition or moving for summary judgment, aside from narrow technical questions about the eligibility of particular petitioners to seek appraisal.²⁹ Thus, very few appraisal petitioners ever face a standard motion to dismiss or motion for summary judgment.

Among merger litigation, appraisal cases are unusually likely to go to trial. Vice Chancellor Glasscock recently described an appraisal trial as a “common scenario in this Court.”³⁰ Of the 100 public company transactions challenged by a counseled common stockholder between 2004 and

²⁹ See, e.g., *In re Appraisal of Dell Inc.*, 2015 WL 4313206 (VCL) (granting summary judgment against several petitioners for failure to satisfy 262(a)’s continuous ownership requirement).

³⁰ *Merion Capital v. BMC Software, C.A. No. 8900-VCG*, Memorandum Opinion, dated October 21, 2015, at 1.

2013,³¹ there were 16 trials, representing 16% of all transactions challenged. The relatively high incidence of trial may be one reason for the high public visibility of appraisal, in spite of the small number of actual cases. Nonetheless, as in other types of stockholder litigation settlements are still the most common outcome; 81 cases—or 81%—settled, though some of these settlements happened after trial. The remaining cases were withdrawn or are still pending.

Merger class actions can again serve as a useful baseline for comparison. Despite the fact that virtually every significant transaction is challenged, trials in merger class actions are extraordinarily rare, so rare that an analysis of trial outcomes in fiduciary class actions is essentially meaningless because there are so few. Even in fiduciary class actions that are tried to judgment, it may be the presence of appraisal petitioners that leads to trial, rather than the traditional “disclosure only” settlement.³² For example, one of the more prominent merger class actions trials involved Dole,³³ and appraisal may here have played a role in pushing that case to trial. The lead plaintiff’s counsel in Delaware was also counsel for appraisal petitioners with substantial holdings, and it presumably would have been difficult for the class action to be settled on mediocre terms because doing so might have prejudiced the appraisal claimants.

At trial, the sole merits issue is the fair value of the petitioners’ shares.³⁴ For both the petitioner and the respondent in an appraisal trial, the key witness is usually the financial expert who opines on the valuation of the firm. We collected information on the valuations offered by these experts. For the respondents’ experts, the median valuation was 16% below the merger price, and the mean was 22% below. For petitioners’ experts, the median valuation was 78% above the

³¹ We stop our analysis here in 2013 because cases filed after that are unlikely to have gone to trial as of the time of this writing.

³² See Cain & Davidoff Solomon, *A Great Game* (finding that as many as 80% of merger class actions end in a settlement providing additional disclosure as the only remedy).

³³ In re Dole Food Co., Inc., Stockholder Litig., 2015 WL 5052214 (Aug. 27, 2015) (VCL).

³⁴ See Korsmo & Myers, *Structure of Stockholder Litigation*, at 866.

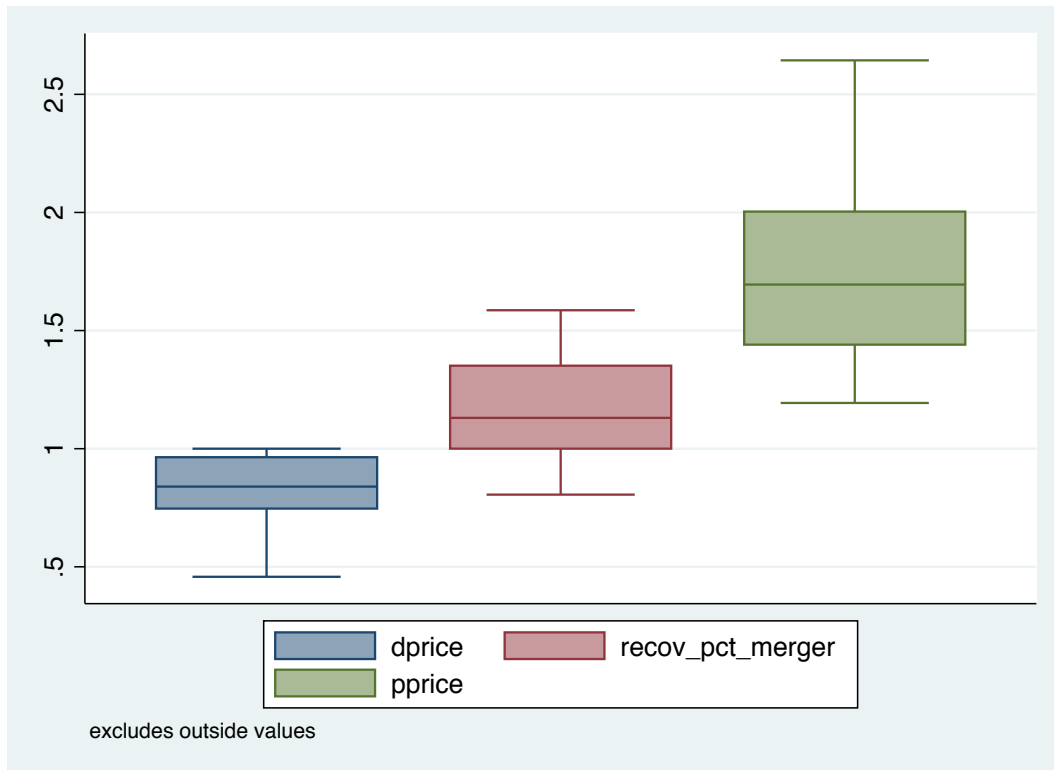
merger price, and the mean was 186% above. A common lament from the members of the Court of Chancery is that the divergent valuations produced by the dueling experts often put them in an awkward situation in attempting to arrive at a sensible valuation in a situation where both parties formally share the ultimate burden of proof.³⁵ The problem, though, may be unavoidable. The very fact that the parties failed to settle their claims is itself evidence that the parties' genuine beliefs on valuation are far apart,³⁶ so it should be no surprise that the evidence put on at trial is consistent with that. Following trial, judicial opinions award values that—unsurprisingly—tend to fall between the values proffered by the petitioners' and the respondents' experts. Figure 5 shows a box plot of the spread of valuations from respondents, judges, and petitioners.

Figure 5

Box Plots of Trial Valuations

³⁵ See *Huff Fund Inv. P'Ship v. CKx, Inc.*, 2013 WL 5878807 (Nov. 1, 2013) (VCG) (“Both parties bear the burden of establishing fair value by a preponderance of the evidence.”); *In re Appraisal of Ancestry.com, Inc.* 2015 WL 399726 (Jan. 30, 2015) (VCG) (“Section 262 is unusual in that it purports explicitly to allocate the burden of proof to the petitioner *and* the respondent....”).

³⁶ See George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1 (1984).



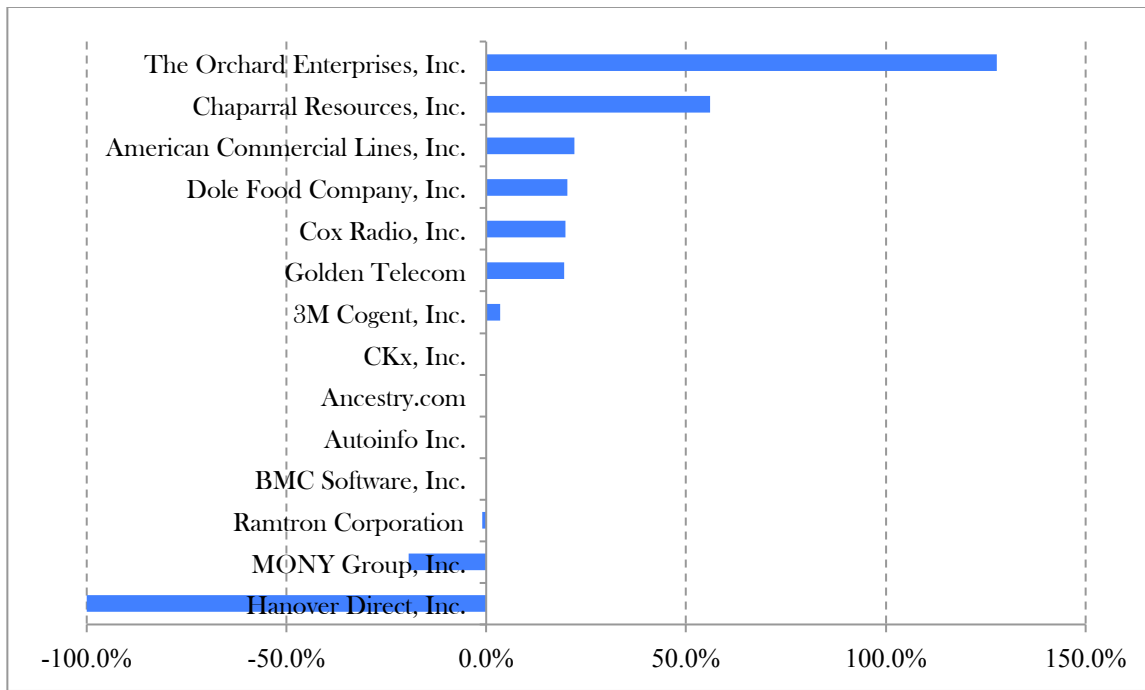
On the left, in blue, is a plot of the “fair values” proffered by the respondent, given as a multiple of the merger price; on the right, in green, are values argued by the petitioner; and in the middle, in red, are the “fair values” as ultimately determined by the court.

The 14 trial outcomes since 2004 for public company appraisal cases of common stock exhibit a wide spread. Three opinions awarded less than the merger price, and one of those—involving common stockholders of a firm subject to large arrearages to preferred stockholders—the petitioners suffered a complete wipeout, with the court holding that the common stock was worthless. At the other end of the spectrum, the highest recovery was a 138% premium over the merger price in *Orchard Enterprises*. As the box plot in Figure 5 indicates, the measures of central tendencies, however, are clustered only slightly above the merger price. The median recovery was

1.5% above the merger price, and the mean recovery was 10.6%. Figure 6 shows the trials and their outcomes.

Figure 6

Appraisal Trial Outcomes for Public Company Common Stock, 2004-2014



Two of these cases—Orchard Enterprises and Hanover Direct, the highest and lowest recoveries—involved disputes about the value owed to preferred stock, which may be unlike other types of appraisal disputes, but they essentially offset such that excluding them makes little difference to the mean or median trial outcome.

These trial results, of course, are not a random selection of appraisal-eligible cases. Cases selected for litigation by petitioners and the cases where petitioners are further willing to push to trial should be a group of relatively strong cases. Not exclusively the strongest cases, though,

because in those circumstances it would be natural for defendants to have a similar view of the likely trial outcome and attempt to settle in advance of trial.³⁷ Intriguingly, the most successful appraisal trial for the petitioners—Orchard Enterprises—arguably undercompensated the appraisal petitioners. Following the appraisal judgment, enterprising plaintiffs’ attorneys reanimated the Orchard fiduciary case and recovered an amount even beyond what the appraisal trial concluded to be the fair value.³⁸

One striking feature of the trial results is that four of the most recent opinions—*CKX*, *Ancestry.com*, *Autoinfo*, and *BMC Software*³⁹—all awarded the petitioners the negotiated deal price. In a fifth recent case, *Ramtron*,⁴⁰ fair value was calculated at a small discount to the merger price. Assuming these outcomes reflect a genuine trend, there are at least two potential explanations for this recent lack of success by appraisal petitioners, though they are not mutually exclusive. The first possible explanation is that the cases themselves were not as strong as earlier cases and that they reflect a change in petitioner behavior. All five cases were brought during the 2011-13 period when appraisal activity was increasing rapidly. Additionally, all five were brought by repeat petitioners who appear to specialize in appraisal, at least to some degree. It is entirely possible that all of these transactions delivered fair value to stockholders and that the decision to dissent from them and press to trial was foolhardy, reflecting a boomtown mentality. Some specialist petitioners, in other words, may have become intoxicated by their own marketing materials and failed to see the very large warts on these cases, or they may have proceeded to trial despite the warts in an effort to build or preserve reputational capital for future cases.

³⁷ *Id.*

³⁸ See *In re Orchard Enterprises Stockholder Litig.*, No. 7840-VCL, Memorandum Opinion, Aug. 28, 2014.

³⁹ *In re Appraisal of Ancestry.com, Inc.*, 2015 WL 399726 (Jan. 30, 2015) (VCG); *Merlin Partners LP v. AutoInfo, Inc.*, 2015 WL 2069417 (April 30, 2015) (VCN); *Merion Capital LP v. BMC Software, Inc.*, 2015 WL 6164771 (Oct. 21, 2015) (VCG).

⁴⁰ *LongPath Capital, LLC v. Ramtron Inter. Corp.*, 2015 WL 4540443 (June 30, 2015) (VCP).

A second possible explanation is that these cases may represent a changing approach by the Delaware Court of Chancery and a message both to would-be appraisal petitioners and to the extremely vocal critics of appraisal. The decisions have all arrived at a time when invective against appraisal from defense lawyers is at a fever pitch, in the form of denunciations of appraisal specialists at corporate law panels and in blog postings.⁴¹ No doubt, these protestations over nearly every element of the appraisal remedy might be, in part, intended to influence the Chancery Court, much as a football coach's sideline tantrum may be designed to influence the referees. Thus, one potential explanation—though perhaps too cynical—is that the recent spate of defeats the Delaware Court of Chancery has handed to appraisal petitioners was in part a shot across the bow of appraisal specialists, designed to staunch a perceived gold rush, and in part designed to let the appraisal alarmists—and the legislature—know that the court has appraisal well in hand, without the need for radical legislative reforms.

To summarize the factual picture that emerges, appraisal litigation activity in Delaware exhibits a number of distinctive features. Claims are small in number, representing only 5% of litigation activity related to mergers. Appraisal touches slightly more than one in eight appraisal-eligible merger transactions, and even in this era of heightened sensitivity to appraisal the amount of equity value demanding appraisal is small, representing less than one-half of one percent of equity value. Petitioners concentrate their resources on a group of transactions that have abnormally low merger premia and are especially likely to involve insider participation, both of which suggest a focus on the merits of the underlying claims. Appraisal petitioners are also far more likely to fight in court all the way to trial than other types of merger litigants.

⁴¹ See, e.g., Theodore Mirvis, *Delaware Court Decisions on Appraisal Rights Highlight Need for Reform*, Harvard Corporate Governance Blog, Jan. 21, 2015; Trevor S. Norwitz, *Delaware Legislature Should Act to Curb Appraisal Arbitrage Abuses*, Columbia Law School Blue Sky Blog, Feb. 10, 2015; Maurice Lefkort, *Hedge Funds Can Still Manipulate Corporate Law*, Wharton Blog Network, Feb. 12, 2015.

II. THE APPRAISAL BACKLASH

In spite of the evidence suggesting that appraisal plays a beneficial role in corporate M&A, an effort is afoot to pressure Delaware into adopting radical changes to its appraisal statute.⁴² The first signals of unrest from mergers and acquisitions advisors came following the takeover of Transkaryotic Therapies, Inc. and the subsequent appraisal proceeding—by far the largest ever to that time.⁴³ On April 21, 2005, Transkaryotic announced that it had agreed to merge with Shire Pharmaceuticals for \$37 per share. The board approved the merger by only a 5-2 vote, and the decision to merge prompted the Transkaryotic CEO to resign in protest. On June 20, Transkaryotic announced extremely positive results of a Phase III clinical trial for a drug in its pipeline. At a July 27 meeting, 52.7% of stockholders voted to approve the merger, and the transaction closed that day. Stockholder dissent had been growing since the announcement of the positive clinical trial results, and various hedge funds began amassing large amounts of stock with the intention of demanding appraisal. By the close of the transaction, about one-third of Transkaryotic’s stockholders had dissented and demanded appraisal.⁴⁴

Shire attempted to kick some of the shares out of the appraisal proceeding on the ground that they had been acquired too late. The record date for voting in the Transkaryotic stockholder meeting was June 10, 2005, and Delaware law conditions appraisal eligibility on the record owner not having voted for the merger.⁴⁵ For most publicly traded stock, the record owner is a depository

⁴² See Peter E. Kazanoff & Paul C. Gluckow, *Appraisal Arbitrageur’s Standing Reaffirmed by Chancery Court*, Delaware Business Court Insider, Feb. 3, 2015 (noting that deal advisors are “waging an escalating war” and that “the fight is likely to continue to be played out before the Delaware Chancery and Supreme courts and in the General Assembly”).

⁴³ 2007 WL 1378345 (Del. Ch. May 2, 2007).

⁴⁴ *Id.*

⁴⁵ See DEL. CODE ANN. TIT. 8 § 262(a).

trust such as Cede & Co.,⁴⁶ with purchases and sales on public exchanges merely altering the beneficial ownership of the relevant shares. Shire argued that the stock that the petitioners beneficially acquired after the record date was not eligible for appraisal unless they could demonstrate that such stock had not been voted in favor of the merger—an impossible requirement, given the way stock most is held by depository trusts in fungible bulk.⁴⁷ Prior Delaware precedent already made clear that stock over which beneficial ownership was acquired after the record date is eligible for appraisal,⁴⁸ and that this reality was well-understood by market participants.⁴⁹ Chancellor Chandler confirmed this understanding in a letter opinion denying Shire’s motion.⁵⁰

Although the Chancellor’s opinion only confirmed precedent that was half a century old,⁵¹ the *Transkaryotic* ruling soon loomed large in the minds of defense counsel. According to one prominent defense-side law firm, the decision held the “potential to revolutionize the use of

⁴⁶ For a detailed background on Cede & Co., see Vice Chancellor Laster’s scholarly opinion in *In re Appraisal of Dell Inc.*, 2015 WL 4313206 (Del. Ch. July 13, 2015).

⁴⁷ *Id.*

⁴⁸ *Olivetti Underwood Corp. v. Jacques Coe & Co.*, 217 A.2d 683, 686-87 (1966).

⁴⁹ See Elena Berton, *Hedge Funds Vex A Shire Takeover Of Transkaryotic*, WALL ST. J., August 17, 2005, at B8 (“Delaware corporate law allows all shareholders – even those who bought shares just before the vote on a takeover – to seek an independent valuation in court if they reckon the price being offered for their stock is inadequate, even if a majority approve the takeover.”). By contrast, defense lawyers often paint the *Transkaryotic* ruling as a surprise. Trevor S. Norwitz, *Delaware Legislature Should Act to Curb Appraisal Arbitrage Abuses*, Columbia Law School Blue Sky Blog, Feb. 10, 2015 (“Before *Transkaryotic*, it was generally understood that only shareholders who owned shares on the record date for the vote on the transaction could dissent and seek judicial appraisal of their shares.”).

⁵⁰ See *In re Appraisal of Transkaryotic Therapies, C.A. No. 1554-CC*, May 2, 2007, at 6 (“The question presented in this case can be stated thusly: Must a beneficial shareholder, who purchased shares after the record date but before the merger vote, prove, by documentation, that each newly acquired share (i.e., after the record date) is a share not voted in favor of the merger by the previous beneficial shareholder? The answer seems simple. No. Under the literal terms of the statutory text and under longstanding Delaware Supreme Court precedent, only a record holder, as defined in the DGCL, may claim and perfect appraisal rights. Thus, it necessarily follows that the record holder’s actions determine perfection of the right to seek appraisal.”).

⁵¹ *Olivetti Underwood Corp. v. Jacques Coe & Co.*, 42 Del. Ch. 588, 593, 217 A.2d 683, 686 (1966) (“[T]here is no recognizable stockowner under the merger-appraisal provisions of our Corporation Law except a registered stockholder.”)

appraisal rights” and “heralds a major new chapter in the appraisal rights remedy.”⁵² Despite the precedent affirming the point before and since *Transkaryotic*, defense lawyers claimed to be surprised by it.⁵³ In the wake of the *Transkaryotic* decision, legal scholars took note of the ruling and associated hedge fund use of appraisal, exploring its implications.⁵⁴ George Geis, for example, suggested that in the wake of *Transkaryotic* “it is possible that a robust market for appraisal rights will develop, analogous to the market for corporate control that allegedly disciplines otherwise entrenched managers with the threat of an external takeover.”⁵⁵ In the early years following the decision, however, very little changed in appraisal activity. The defense-side dystopia that some envisioned in the wake of the *Transkaryotic* ruling did not come to pass, and little attention was paid to the strategy. As the Figures in the preceding section reveal, there was no discernable increase in the incidence of appraisal through 2007 and 2008.

Meanwhile, the *Transkaryotic* litigation itself chugged along. At the commencement of the litigation, hedge fund analysts had floated \$45-50 valuations for *Transkaryotic* after factoring in the positive clinical trial results.⁵⁶ Stock analysts at Lehman Brothers covering Shire, however, estimated that the liability in the appraisal proceeding would be somewhere between \$1.00 and

⁵² Latham & Watkins LLP M&A Deal Commentary, *Appraisal Arbitrage: Will It Become A New Hedge Fund Strategy?*, May 2007, at 1 & 2.

⁵³ Fried, Frank, Harris, Shriver & Jacobson LLP M&A Briefing, *New Activist Weapon: The Rise of Delaware Appraisal Arbitrage: A Survey of Cases and Some Practical Implications*, June 18, 2014, at 2 (describing opinion as “against expectations”); Latham & Watkins LLP M&A Deal Commentary, *Appraisal Arbitrage: Will It Become A New Hedge Fund Strategy?*, May 2007, at 2 (suggesting a “common assumption that only beneficial owners on the record date who issued appropriate no vote instructions to the record holder would be able to establish eligibility for appraisal”).

⁵⁴ George S. Geis, *An Appraisal Puzzle*, 105 *Nw. L. Rev.* 1635 (2011); See Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 *U. Pa. L. Rev.* 1021, 1038-39 (2007) (suggesting that “[w]hen hedge funds are dissatisfied with the terms of an acquisition and unable to obtain better terms, they also resort to litigation” and giving examples, including appraisal as a last resort).

⁵⁵ Geis, *Appraisal Puzzle*, at 1638.

⁵⁶ Elena Berton, *Hedge Funds Vex A Shire Takeover Of Transkaryotic*, *WALL ST. J.*, August 17, 2005, at B8 (“The takeover of *Transkaryotic* was announced before the final test results for I2S were released. The results turned out to be very positive and suggested I2S was capable of fetching annual sales of \$200 million, according to analysts. This led some *Transkaryotic* shareholders to question Shire's offer, arguing that their shares could be valued at as much as \$45 to \$50 each.”).

\$5.00 per share.⁵⁷ On November 5, 2008, Shire announced that it had settled the appraisal claims. Shire disclosed that it agreed to pay “the same price of \$37 per share originally offered to all [Transkaryotic] shareholders at the time of the July 2005 merger, plus interest.”⁵⁸ There were 11.3 million shares that had demanded appraisal, and they received “total payment of \$567.5 million, representing consideration at \$37 per share of \$419.9 million and an interest cost of \$147.6 million.” This account of the settlement—that Shire settled for the original \$37 merger price—has been repeated in practitioner and academic commentary alike.⁵⁹

On closer scrutiny, however, a different picture emerges. As noted, when it announced the settlement in November 2008, Shire claimed it was paying over \$147.6 million in interest. In the immediately prior quarter, however, the company had projected a potential liability for interest in the appraisal litigation that was less than half that amount.⁶⁰ The increased amount of “interest” makes sense, however, when broken down by the number of dissenting shares; the \$147.6 million works out to precisely \$13 per share. The petitioners, in other words, settled for \$50 per share, although Shire worked hard to make the settlement appear as though there was no premium to the merger price.⁶¹ This result—known to the many sophisticated entities that pursued appraisal rights

⁵⁷ Elena Berton, *Hedge Funds Vex A Shire Takeover Of Transkaryotic*, WALL ST. J., August 17, 2005, at B8.

⁵⁸ Shire 10-Q, filed Nov. 10, 2008, at 28.

⁵⁹ Geis, *Appraisal Puzzle*, at 1639-40 (“[D]espite the favorable summary judgment ruling, petitioners in Transkaryotic eventually settled their claim for the initial \$37 merger consideration (plus interest), thereby throwing their claims of purported price inadequacy into question.”);

⁶⁰ Shire 10-Q, filed August 4, 2008, at 24 (“At June 30, 2008 the Company recorded a liability of \$419.9 million based on the merger consideration of \$37 per share for the 11.3 million shares outstanding at that time plus a provision for interest of \$70.6 million that may be awarded by the Court.”).

⁶¹ Shire 10-K, filed Feb. 27, at F-52 (“Upon reaching agreement in principle with all the dissenting shareholders, the Company determined that settlement had become the probable manner through which the appraisal rights litigation would be resolved. Under current law, (although not applicable in this case because the merger was entered into before the relevant amendment to the law became effective) the court presumptively awards interest in appraisal rights cases at a statutory rate that is 5 percentage points above the Federal Reserve discount rate (as it varies over the duration of the case). In connection with the settlement, the Company agreed to an interest rate that approximates to this statutory rate. Based on the settlement, the Company amended the method of determining its interest provision to reflect this revised manner of resolution, and recorded additional interest expense of \$73.0

in Transkaryotic—was no doubt a key reason the case generated interest in pursuing appraisal as an investment strategy.

In 2010, new and more sophisticated petitioners began to crop up, although general appraisal patterns did not yet change in any externally obvious way. In April, an entity called Merion Capital filed its first petition, challenging the takeover of Airvana, Inc.⁶² Another entity that dissented from the Airvana transaction was Magnetar Capital.⁶³ Both Merion and Magnetar would come to be among the most active appraisal petitioners in terms of dollars at stake.⁶⁴ Merlin Partners, an affiliate of the Cleveland-based investment firm Ancora Advisors that had participated in its first appraisal case in mid-2006, also began filing appraisal petitions in its own name in 2010.⁶⁵ Merion is reputed to have raised capital devoted solely to the strategy of pursuing appraisal rights, and Merion's investments in some targets were so large that it crossed the 5% threshold, triggering SEC filing requirements.⁶⁶ Merion appears to invest in target companies exclusively *after* the announcement of a deal, with all Merion purchases of target stock disclosed on the relevant Form 13Gs occurring after the announcement of the merger transaction. Another large repeat petitioner is Verition Capital, a multi-strategy fund based in Greenwich, Connecticut. Verition, Magnetar and Merlin all appear committed to appraisal as an investment strategy, making and dissenting on numerous large positions in target companies.

In spite of the increasing sophistication of appraisal petitioners—and the slight increase in the percentage of transactions facing an appraisal petition—the strategy did not attract much media

million in its consolidated financial statements for the year to December 31, 2008 on reaching settlement with the dissenting shareholders.”).

⁶² See Steven Davidoff Solomon, *Fine Legal Point Poses Challenge to Appraisal Rights*, N.Y. TIMES, May 30, 2014.

⁶³ CITE

⁶⁴ See Korsmo & Myers, *Appraisal Arbitrage*.

⁶⁵ *Id.*

⁶⁶ CITE

attention until, in early 2013, two large going-private transactions put appraisal back on the map. Michael Dell's effort to acquire Dell Inc. sparked a number of protests from stockholders, with perhaps the most influential of them coming from Carl Icahn. Icahn was displeased with the deal and publicly threatened that he was going to exercise his appraisal rights in the absence of a price increase.⁶⁷ This was not Icahn's first foray into appraisal: he was a large part of the dissenting group in Transkaryotic. In response, Dell Inc. formed a special committee, and their counsel has since explained that Icahn's threat to dissent from the transaction prompted the merger parties to increase the merger consideration by \$400 million. In addition to getting the board's attention, Icahn's saber-rattling attracted attention in the *New York Times*, the *Wall Street Journal*, and other publications.⁶⁸

The late-2013 privatization of Dole Food also gave discontented stockholders an opportunity to demand appraisal, and many did. The offer to acquire Dole came from the company's controlling stockholder, who simultaneously indicated he would not sell his stake to anyone else. Despite investor unrest over the price, the ultimately successful bid was not subject to any competitive pressure, and approximately 19% of Dole stockholders ended up dissenting from the transaction. The first appraisal petition was filed in mid-November of 2013.

It was, in fact, the Dole litigation that appears to have led to the initial effort to alter Delaware's appraisal statute. The push by Dole management to change Delaware's appraisal statute began in late 2013, only a few weeks after the first appraisal petition was filed in the Dole case. The company's assistant corporate secretary contacted staff in the Delaware Governor's office, and the governor's office emailed the CEO of Dole the list of the membership on

⁶⁷ See Michael J. De La Merced, *Icahn's Latest Gamble at Dell: Appraisal Rights*, N.Y. TIMES, July 10, 2013.

⁶⁸ See, e.g., *id.*; Ronald Barusch, *Dealpolitik: Is Dell Headed for Record-Breaking Delaware Appraisal Case?*, WALL ST. JOURNAL, Feb. 11, 2013.

Delaware’s influential Corporation Law Council—the body of the Delaware bar that proposes amendments to the DGCL—and indicating a willingness to discuss “next steps.”⁶⁹ In early 2014, Dole and representatives of the governor’s office scheduled a conference call to discuss two seemingly unrelated topics: Dole’s operations in the Port of Wilmington and the variable interest rate payable to appraisal petitioners.⁷⁰ In addition to being a defendant in one of the largest appraisal cases in Delaware, Dole—an importer of fruits and vegetables—was also the biggest tenant in the Port of Wilmington. According to news reports, Dole was attempting to use its leverage as a large employer in Delaware to force changes in the state’s appraisal statute.⁷¹

By early summer, the appraisal issue had somehow seeped into the unrelated debate over fee-shifting bylaws in the wake of the *ATP Tour v. Deutscher Tennis Bund* decision.⁷² Delaware’s Council had recommended a legislative change that would prohibit such bylaws. C. Michael Carter, Dole’s CEO, sent a letter to Delaware legislators attempting to tie fee-shifting bylaws to appraisal: “In Dole’s view, the proposed legislation is anti-business and will only serve to encourage the appraisal arbitration lawsuits that have become so commonplace against companies in Delaware.”⁷³ The puzzling joining of otherwise-unrelated issues makes sense only in light of the potential liabilities facing Dole. The fee-shifting legislative amendment stalled that spring, and the legislature passed a joint resolution calling on the Council to examine the fee-shifting issue in the coming year. But the resolution also included something else: a sentence requesting that the Council also examine “the operation and administration of the statutes and court rules governing

⁶⁹ Email on file with authors, obtained through FOIA request. The Council is the entity that generates proposed amendments to Delaware’s corporate statute. See Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749 (2006).

⁷⁰ Email on file with authors, obtained through FOIA request.

⁷¹ Wilmington News-Journal article.

⁷² 91 A.3d 554 (Del. 2014).

⁷³ Letter from C. Michael Carter to Sen. Bryan Townsend, June 9, 2014, on file with authors.

the exercise of appraisal rights; and the rate of interest on any fair value determination in an appraisal.”⁷⁴ By fall, Dole’s demands on the governor’s office had become explicit, and it was directly threatening to reincorporate elsewhere and encourage others to follow.⁷⁵ Dole representatives spoke directly with the Delaware Secretary of State, in addition to the governor’s staff, and the message was that C. Michael Carter and David Murdock “remain very focused on the need for change in Delaware’s appraisal rights law.”⁷⁶

Meanwhile, the defense bar assisted Dole’s efforts by issuing public commentary sounding ominous notes about appraisal.⁷⁷ A prominent New York-based corporate litigator, for example, described a “troubling expansion of stockholder appraisal rights.”⁷⁸ One law firm memo worried about the “risky business of valuation in Delaware courts,” suggesting that the “wide latitude” that courts had in valuing the cashed-out stock can rely on “unrealistic” financial projections.⁷⁹ A blog post by a Wachtell, Lipton, Rosen, and Katz transactional advisor claimed there was an “urgent need for legislative reform in Delaware to ameliorate the risk that appraisal arbitrage—now a multibillion dollar industry—poses to transactional vitality and shareholder value.”⁸⁰ The general

⁷⁴ Delaware Senate Joint Resolution No. 12, June 18, 2014.

⁷⁵ Email from Genevieve Kelly to Michael Barlow, Sept. 22, 2014 (on file with authors) (“Dole believes change in Delaware’s appraisal statute is urgently needed, both in the interest provision and in the provision describing when a stockholder has appraisal rights (we believe a stockholder who buys stock after the announcement of a transaction is just buying a lawsuit and should not have appraisal rights. . .) [A panel on appraisal investing that included a prominent plaintiffs’ attorney] show companies why there is a need to re-incorporated in more business friendly states”).

⁷⁶ Email from Genevieve Kelly to Michael Barlow, Sept. 25, 2014 (on file with authors).

⁷⁷ See Maurice Lefkort, Hedge Funds Can Still Manipulate Corporate Law, Wharton Blog Network, Feb. 12, 2015 (claiming that the appraisal rights “are being manipulated by sophisticated market players to reap above-market, low-risk returns in a practice known as ‘Appraisal Arbitrage’” and that “[a]llowing this practice to continue will come at the expense of the stockholders who are not manipulating these rules, and at the efficiency of the mergers and acquisitions marketplace”); WSGR Alert: The Growth of Appraisal Litigation in Delaware, Nov. 18, 2013, at 1, (“Less noticed [than the rise in merger class actions], but perhaps more significant, has been the growing tendency of institutional and other large investors to exercise their appraisal rights under Delaware law”).

⁷⁸ Theodore Mirvis, Delaware Court Decisions on Appraisal Rights Highlight Need for Reform, Harvard Corporate Governance Blog, Jan. 21, 2015.

⁷⁹ WSGR Alert: The Growth of Appraisal Litigation in Delaware, Nov. 18, 2013, at 2.

⁸⁰ Trevor S. Norwitz, Delaware Legislature Should Act to Curb Appraisal Arbitrage Abuses, Columbia Law School Blue Sky Blog, Feb. 10, 2015.

tenor of these commentaries was one of a mortal threat to the merger market.⁸¹ At least one intended audience must have been Delaware's blue-ribbon Council on Corporation Law, which was examining potential reforms to the appraisal statute at that time.⁸² The talking points that emerged, kaleidoscopically, from these various defense-side commentaries involved a threat to merger activity, a potential price reaction by acquirers, and the re-emergence of appraisal closing conditions in merger agreements. The mechanisms through which appraisal would generate this parade of horrors was assumed without ever really being explained.

In the early spring of 2015, the Delaware Council issued its long-awaited set of reforms. There were two reforms that addressed appraisal. One would introduce an option for the respondent company to pay over some amount to the petitioner after the deal closing to stop the running of interest; the second would deny appraisal rights in a transaction unless the dissenting group exceeded a *de minimis* requirement: either more than 1% of the company or more than \$1 million in value at the merger price. These two reforms were designed to fix specific shortcomings in the appraisal process. The interest payment proposal would at least ensure that respondent companies were not forced to unwillingly borrow money from the petitioners at more than they were willing to pay. And the *de minimis* requirement foreclosed the unwelcome possibility that a small stockholder could try to force a settlement for the nuisance value of the claims.

In addition to these incremental reforms, the Council also considered the more radical proposals offered by Dole and the defense-side New York firms. In light of the evidence indicating

⁸¹ Trevor S. Norwitz, *Delaware Legislature Should Act to Curb Appraisal Arbitrage Abuses*, Columbia Law School Blue Sky Blog, Feb. 10, 2015 (“Commentators have been warning for years of the dangers of appraisal arbitrage, including increasing complexity of and risk to transactions, and diversion of value from the general body of shareholders to small groups of appraisal ‘raiders.’”).

⁸² In some ways, this represents the system working well. The Council is the body that collects potential reforms to the DGCL and evaluates their desirability, and one way they get suggestions is from counsel outside Delaware. Hamermesh, *Policy Foundations of Delaware Corporate Law*, 106 Colum. L. Rev. at 1756 (“Council members not uncommonly receive suggestions for change from clients or co-counsel outside of Delaware. . . .”)

that appraisal claims were uncommon, and were focused on claims with strong evidence of merit, the Council very sensibly declined to recommend them.⁸³ Indeed, one prominent law firm issued a memorandum that somewhat sheepishly explained how the Council’s reforms would have precisely the right incentive effects on appraisal claims: encouraging strong cases and discouraging weak ones.⁸⁴ The Council’s proposed reforms are generally adopted by the legislature as a matter of course,⁸⁵ but among defense-side firms the measured amendments proposed by the Council were regarded as inadequate. The Council had delivered nothing from the law firms’ and Dole’s wish list,⁸⁶ and the law firms ratcheted up the doomsday rhetoric in response. One firm issued a client note painting a bleak picture of the future: “Failure to adequately address the rising trend of appraisal arbitrage risks creating incentives for buyers to lower their price in anticipation of having to pay appraisal arbitragers post-closing and therefore shifting value away from long-term

⁸³ See Explanatory Paper for Section 262 Appraisal Amendments, March 6, 2015, at 1-2 (noting that “[t]he subcommittee initially considered whether to modify Section 262 to eliminate or limit appraisal arbitrage” but concluded that it should not and listing reasons).

⁸⁴ See Fried Frank M&A Briefing: Proposed Appraisal Statute Amendments Would Permit Companies to Reduce Their Interest Cost—Likely to Discourage ‘Weaker’ Appraisal Claims and Make Settlement of ‘Stronger’ Claims Harder, March 23, 2015.

⁸⁵ Marcel Kahan & Edward Rock, Symbiotic Federalism and the Structure of Corporate Law, 58 Vand. L. Rev. 1573, 1600 (2005) (“Delaware’s legislature then typically adopts the proposed amendments. Neither a legislative committee nor the legislature as a body changes the proposal or debates its merits, and the vote on the proposed amendment tends to be unanimous.”)

⁸⁶ White & Case Client Alert, *Increasing Hostility Towards Appraisal Arbitrage*, April 2015, at 2 (“[The 2015 Council legislative reforms] have been criticized as insufficient to effectively address the problems of appraisal arbitrage.”); Fried, Frank, Harris, Shriver & Jacobson LLP M&A Briefing, *Proposed Appraisal Statute Amendments Would Permit Companies to Reduce Their Interest Cost—Likely To Discourage “Weaker” Appraisal Claims and Make Settlement of “Stronger” Claims Harder*, March 23, 2015, at 5-6 (“The Amendments do not include any of the more far-reaching changes that have been advocated by companies and others seeking to limit the volume of appraisal claims and the prevalence of appraisal arbitrage, or to ameliorate the burden on the court of determining “fair value”, such as: a limitation on the types of transactions to which appraisal rights would be applicable; restrictions on the timing for filing an appraisal petition; a change in the definition of fair value; limiting appraisal rights to stockholders who owned their shares before announcement of the merger; further requirements with respect to establishing that shares have not been voted in favor of the merger; or establishing a burden of proof on the parties (rather than the Chancery Court) to determine fair value.”).

stockholders towards short-term arbitragers without advancing the underlying public policy rationale for appraisal rights.”⁸⁷

A group of seven law firms took the unusual step of writing a letter directly to the Council to protest that it had failed to propose more radical reforms to the appraisal statute.⁸⁸ The seven firms stated goal was more aggressive amendments that would ensure that “appraisal arbitrage will be eliminated.”⁸⁹ The law firms offered what has become the standard proposal from defense lawyers: “amend the statute to make express that appraisal rights are not available to shareholders with no right to vote on—and therefore dissent from—the transaction.”⁹⁰ The letter gestured toward a grab-bag of possible arguments in favor of such an amendment,⁹¹ without actually bothering to actually make these arguments. The law firms themselves, of course, are enormously influential in Delaware; it is these New York firms that often select Delaware counsel, and staying in the good graces of these firms is understandably crucial to the livelihoods of many Delaware lawyers.

At the same time, Dole continued to engage in a lobbying effort to introduce an alternative slate of legislative amendments. The Dole amendments went farther than those suggested by the law firms, and would have, among other things, deprived stockholders of appraisal rights where their shares were “purchased after public announcement of the terms of the merger or

⁸⁷ White & Case Client Alert, *Increasing Hostility Towards Appraisal Arbitrage*, April 2015.

⁸⁸ Letter to the Council of the Corporate Law Section of the Delaware State Bar Association from Cravath, Swaine & Moore LLP, Davis Polk & Wardwell LLP, Latham & Watkins LLP, Skadden, Arps, Slate Meagher & Flom LLP, Simpson Thatcher & Bartlett LLP, Sullivan & Cromwell LLP, and Wachtell, Lipton, Rosen, and Katz, dated April 1, 2015, at 1 (hereinafter “Letter from Seven Firms”) (“In our view, the proposed legislation does not adequately respond to the current circumstance in which decisions of the Delaware courts have opened the door to what has come to be called ‘appraisal arbitrage’”).

⁸⁹ Letter from Seven Firms, at 2.

⁹⁰ Letter from Seven Firms, at 2.

⁹¹ Letter from Seven Firms, at 3 (arguing that the firms’ approach would “reduce the unseemly claims-buying that is rampant and serves no legitimate purpose, but threatens to undermine transactional certainty and reduce value to shareholders of Delaware corporations as acquirers, particularly in leveraged transactions, may be forced to factor the enhanced appraisal risk into their calculations”).

consolidation.”⁹² In an unusual turn, the amendments proposed by the Council were never introduced in the Delaware legislature. Neither were Dole’s amendments ever introduced. By the close of the legislative session in 2015, in fact, nothing had changed on appraisal despite the surrounding controversy. The expectation appears to be that the Council will return to the drawing board and Delaware will revisit the issue of how, if at all, to change its appraisal statute in 2016.⁹³ The deal lawyers seem primed to mount a lobbying effort through another legislative season.⁹⁴

In a striking coda to this spate of lobbying by Dole, Vice Chancellor Laster issued his ruling in the Dole class action in August 2015.⁹⁵ He found that David Murdock and C. Michael Carter had engaged in a pattern of fraud, attempting to mislead stockholders and other directors about the value of Dole. The opinion held Murdock and Carter liable for \$148 million in damages, or about \$2.47 per share, on top of the \$13.50 merger consideration. The irony of the outcome is that Laster declined to issue a ruling in the appraisal suit, suggesting instead that the classwide damages might render the appraisal proceedings moot.⁹⁶ As a result, it remains unclear whether Dole will continue their efforts to alter the appraisal remedy in Delaware. At the very least, given Murdock and Carter’s pattern of fraud described in the opinion, Delaware policymakers may now look more skeptically at the changes to the appraisal statute that Dole claimed were so urgently needed. Nevertheless, the Council may still revisit alterations to the appraisal statute and grapple with the demands of the New York deal lawyers.

⁹² Draft Legislation (on file with authors).

⁹³ Liz Hoffman, *Dole and Other Companies Sour on Delaware as Corporate Haven*, Wall Street Journal, Aug. 2, 2015 (“The bill [drafted by Dole] was never introduced, although lawmakers have promised to consider the measure next year.”).

⁹⁴ E.g., Peter E. Kazanoff & Paul C. Gluckow, *Appraisal Arbitrator’s Standing Reaffirmed by Chancery Court*, Delaware Court Business Insider, Feb. 3, 2015 (“This fight is likely to continue to be played out before the Delaware Chancery and Supreme courts and in the General Assembly.”).

⁹⁵ *In re Dole Food Co., Inc., Stockholder Litig.*, 2015 WL 5052214 (Aug. 27, 2015).

⁹⁶ *In re Dole Food Co. Stockholder Litigation*, at 4 (“In addition to the plenary litigation, holders of 17,287,784 shares sought appraisal. This decision likely renders the appraisal proceeding moot. The parties will confer on this issue and inform the court of their views.”).

III. EVALUATING THE NASCENT CRITIQUE OF APPRAISAL

The attack on appraisal maintained by its public critics has not, to this point, consisted of a sustained analysis of the remedy, though of course that may come in due time. The sole white paper that advances arguments on behalf of the deal lawyers' favored amendment misunderstands the deterrence role of appraisal and inadvertently highlights the folly of the deal lawyers' amendment.⁹⁷ Aside from that paper, to call the discussion of appraisal a debate would be to mischaracterize it. The policy arguments against appraisal have thus far been a hodgepodge of overstated and conclusory jabs, each generally heavy on rhetoric but light on empirical evidence and analysis.

In light of our empirical findings, the most appropriate reforms to the appraisal statute in Delaware would be ones that *increase* the availability of appraisal. As the evidence reported in the first Part shows, the appraisal remedy is invoked infrequently, appraisal petitions are associated with merits-related factors, and the outcome of appraisal petitions do not suggest a serious problem with the system or a threat to merger activity. In these respects, appraisal stands as the polar opposite of the system of fiduciary class actions. Commentators should be lauding appraisal and exploring ways to expand its reach and impact, instead of seeking to undermine the remedy, as detailed in the prior Part.

Given the seriousness of the reforms that the critics propose, however, it is vitally important to evaluate any potential arguments that might be made their favor. Though appraisal opponents have failed to do so, it is possible to construct, from a mosaic of sources, what the stronger arguments against appraisal might be. In this Part, we do our best to formulate and evaluate such

⁹⁷ Guarav Jetley & Xinyu Ji, *Appraisal Arbitrage—Is There a Delaware Advantage*, 71 BUS. LAW. __ (2016).

arguments. In sum, we find that none of the arguments advanced or suggested by critics of appraisal can withstand serious scrutiny. They are unsupported by the data, often self-contradicting or otherwise illogical, and frequently boil down to an inchoate sense that there is something gross about buying stock for the purpose of bringing a lawsuit. We begin, in Parts III.A. and III.B., by addressing two arguments that we regard as fundamentally unserious, but which are raised so frequently that they ought to be addressed, if only in the spirit of clearing away the underbrush.

A. *Investing in a Lawsuit is Icky*

As discussed above, many appraisal petitioners are specialists who generally have no holdings in the target company at the time of the announcement of a transaction, or even at the time the company issues its proxy statement or other disclosure documents to its stockholders. These specialists acquire the stock with the expectation of bringing an appraisal petition. The stock they acquire will have its appraisal rights triggered by the announced transaction. Such specialist petitioners—appraisal arbitrageurs, as they are sometimes called—now own the bulk of stock involved in appraisal proceedings.⁹⁸ One basic supposition that undergirds criticism of appraisal is that it there is something improper or unseemly about buying a lawsuit in this way.⁹⁹ A related argument is that stockholders should be estopped from demanding appraisal for any stock acquired after the announcement of the merger terms because the stock was purchased with full knowledge of the merger and its terms.¹⁰⁰

⁹⁸ See Korsmo & Myers, *Appraisal Arbitrage*.

⁹⁹ See Letter from Seven Firms, at 3 (decrying “unseemly claims-buying that is rampant and serves no legitimate purpose”).

¹⁰⁰ Dole advanced precisely this argument that stockholders who acquired stock after the announcement of a merger should be estopped from demanding appraisal because they “purchased all of their appraisal shares with full knowledge of the [m]erger—including the [m]erger price and other terms—from which they now seek ‘relief.’” In re Appraisal of Dole Food Company, C.A. No. 8703-VCL, Respondent’s Brief in Support of Motion for Certification of Interlocutory Appeal, Jan. 30, 2015. Vice Chancellor Laster concluded that this would “override the plain language of

This reaction to claim alienation certainly has deep common law roots,¹⁰¹ but it represents an attitude that is out of touch with reality and long out of date. In modern society, the buying and selling of legal claims is entirely commonplace, and it should not be regarded as alarming or undesirable in its own right. Examples of claim transfer and aggregation are legion.¹⁰² Contract claims are often freely assignable. Legal claims held by corporations are routinely acquired via merger, and often form an important part of the economic value in a transaction. Personal injury and other claims can effectively be transferred to an insurance company via subrogation or assignment. Legal claims are often purchased out of bankruptcy by specialist funds. The ability to recover on shareholder claims via derivative suit or corporate class action typically transfers with the shares. Claims appurtenant to property, such as real estate or patents, can often be transferred with the property. Most ubiquitously, at least a portion of almost all legal claims is effectively sold to attorneys as a contingency fee. Increasingly, portions of claims are being sold to specialized litigation finance firms, as well.¹⁰³ In many, if not most of these everyday scenarios, the driving economic logic is the same: the transfer of claims to parties who—via greater expertise, economies of scale, ability to diversify away risk, etc.—can vindicate the underlying legal rights more effectively and thus make the claims more valuable, benefiting the claim-seller and purchaser alike.¹⁰⁴

Appraisal is no different. If Stockholder A has a right to bring an appraisal petition by virtue her stock ownership, there is nothing unusual or repugnant about empowering her to

the statute.” In re Appraisal of Dole Food Company, C.A. No. 8703-VCL, Telephonic Rulings of the Court, Transcript, Feb. 13, 2015, at 34.

¹⁰¹ Champerty and maintenance have historically stood as bars to selling choses in action. See 4 William Blackstone, Commentaries, at 133-35.

¹⁰² See Charles R. Korsmo & Minor Myers, *Aggregation by Acquisition: Replacing Class Actions with a Market For Legal Claims*, forthcoming IOWA L. REV. 2016 [hereinafter Korsmo & Myers, *Aggregation by Acquisition*]; Michael Abramowicz, *On the Alienability of Legal Claims*, 114 YALE L.J. 697 (2005).

¹⁰³ See, e.g., Jonathan A. Molot, *Litigation Finance: A Market Solution to a Procedural Problem*, 99 GEO. L.J. 65 (2010); Maya Steinitz, *Whose Claim is This Anyway? Third Party Litigation Financing*, 95 MINN. L. REV. 1268, 1276 (2011).

¹⁰⁴ See Korsmo & Myers, *Aggregation by Acquisition*.

alienate the appraisal right along with the stock. There may of course be some other good reason to deprive Stockholder A of the ability to exercise the appraisal right in the first place, but the fact of sale simply has no bearing on what legal remedies to afford in a particular situation. Unless the appraisal right itself is substantively undesirable, the mere fact that it has been transferred to someone better able to vindicate the right does not constitute an argument against its vindication.

B. Modern Appraisal is an Adulteration of “Real Appraisal”

A related type of argument sometimes leveled against appraisal is that the modern form of appraisal litigation fails to serve some historic policy rationale of appraisal.¹⁰⁵ The practice, in other words, is at odds with the intent of the remedy. A claim from a deal lawyer at Wachtell is representative: “Appraisal rights . . . were designed to provide a safety valve for shareholders of an acquired company who are dissatisfied with the consideration they are to receive, by allowing them to seek a judicial determination of the ‘fair value’ of their shares. The remedy was not designed to create a new way for short-term speculators to game the system and profit at the expense of the broader shareholder body.”¹⁰⁶ In some ways, this line of argument simply collapses into the “claims-selling-is-icky” argument. If it is consistent with the “purpose” of the appraisal remedy that a stockholder can avail herself of the appraisal remedy, there is no reason why that same purpose should not be served by the transferee stockholder seeking appraisal in the same situation. Moreover, a principal goal—perhaps *the* principal goal—of any system of private stockholder

¹⁰⁵ See White & Case Client Alert, *Increasing Hostility Towards Appraisal Arbitrage*, April 2015, at 2. (“[T]he proposed reforms have been criticized for failing to address the disconnect between the public policy objective of appraisal rights as a dissenters’ remedy and the Chancery Court’s willingness to forego any requirement that the stockholders seeking an appraisal award actually oppose the takeover in a stockholders’ vote or have a longer-term investment horizon.”).

¹⁰⁶ Trevor S. Norwitz, *Delaware Legislature Should Act to Curb Appraisal Arbitrage Abuses*, Columbia Law School Blue Sky Blog, Feb. 10, 2015.

litigation is deterrence, and from that point of view the identity of the plaintiff does not matter at all, so long as the claim is brought in the right circumstances.¹⁰⁷

The argument that appraisal specialists are acting in ways inconsistent with the appraisal statute has things precisely backwards. As one prominent commentator recently noted, the available evidence on appraisal—that petitioners are selective in targeting mergers with low premia—shows that “[a]ppraisal rights . . . are being deployed in accordance with their purpose.”¹⁰⁸

C. Appraisal Only Benefits Dissenting Stockholders

One of the most common and superficially plausible criticisms of appraisal arbitrage—that the benefits of appraisal are captured entirely by specialist investors and not shared with stockholders as a group—is thoroughly misguided. It ignores the fact that arbitrageurs must acquire their shares in the first place in what will typically be an informationally-efficient market.¹⁰⁹ If appraisal claims were limited to stockholders on the announcement date of the relevant transaction, the vindication of appraisal rights would depend on the serendipitous presence of a large, sophisticated stockholder, and small holders would typically be unable to benefit from their appraisal rights at all, except perhaps via deterrence. Ironically, if the critics of appraisal arbitrage were successful in eliminating it, they would transform appraisal into the very thing they decry: a

¹⁰⁷ See, e.g., John C. Coffee, Jr., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter is Not Working*, 42 MD. L. REV. 215, 219 (1983) (“The conventional theory of the private attorney general stresses that the role of private litigation is not simply to secure compensation for victims, but is at least equally to generate deterrence, principally by multiplying the total resources committed to the detection and prosecution of the prohibited behavior.”).

¹⁰⁸ Bill Bratton, Appraisal Arbitrage, JOTWELL (November 25, 2015) (reviewing Minor Myers & Charles R. Korsmo, Appraisal Arbitrage and the Future of Public Company M&A, Wash. U. L. Rev. (forthcoming 2015), available at SSRN), <http://corp.jotwell.com/appraisal-arbitrage/>.

¹⁰⁹ As Judge Easterbrook has noted, “few propositions in economics are better established than the quick adjustment of securities prices to public information. *West v. Prudential Sec., Inc.*, 282 F.3d 935, 938 (7th Cir. 2002). In this context, the availability of appraisal rights is itself public information and, in a competitive market, the value of such rights will be reflected in trading prices.

system where only large, sophisticated investors benefit directly, while small investors are left out in the cold. It is precisely through the ability to sell their shares to an appraisal specialist that the typical investor can share directly in the benefits of appraisal.

Furthermore, like any other participant in a diversified economy of specialists, the original holders of legal claims share in the increased value created by aggregating specialists.¹¹⁰ As the appraisal market matures, we expect specialists to bid the post-announcement price of target shares up to the present expected value of the appraisal claim. And indeed, post-announcement trading above the merger price is evident in a number of transactions that ultimately faced appraisal petitions.

Perhaps more importantly, appraisal—like many other forms of private litigation—can benefit stockholders in at least two ways: through compensation or through deterrence. Even where non-dissenters do not share directly in compensation, they share in the benefits of deterrence. As noted above, the threat of appraisal can help deter opportunistic transactions. To name but a single obvious example, Carl Icahn’s threat to pursue his appraisal rights against Dell generated an additional \$400 million in value for minority stockholders.¹¹¹

D. Only Beneficial Holders on the Record Date Should be Eligible for Appraisal

Another misguided but common proposal is to limit appraisal to holders of stock on the record date for the shareholder vote on a transaction, reversing the holding of long line of

¹¹⁰ See, e.g., Abramowicz, *supra* note 94, at 736; Korsmo & Myers, *Aggregation by Acquisition* (explaining why “[i]n a competitive market, the seller [of a legal claim] will receive the bulk of the additional value that a claim provides to an aggregator.”).

¹¹¹ See Fried, Frank, Harris, Shriver & Jacobson LLP M&A Briefing, *New Activist Weapon: The Rise of Delaware Appraisal Arbitrage: A Survey of Cases and Some Practical Implications*, June 18, 2014, at 3 (“In the Dell going private transaction, for example, the threat by Carl Icahn and others to seek appraisal of the shares they had amassed after announcement of the deal effectively blocked the required shareholder vote (a majority of the minority shares outstanding) and led to a \$400 million increase in the merger price paid to shareholders (as recently discussed publicly by legal counsel to the Dell special committee).”).

Delaware case law. It is often claimed that doing so would eliminate an unfair advantage for appraisal specialists—a “free option” to wait and see if positive developments following the record date but before the closing date lead to an increased estimate of fair value.¹¹² If developments are negative, the stockholder can back out and take the merger consideration (or decline to buy stock in the first place), and if developments are positive, the stockholder can seek appraisal to capture the newly revealed fair value.

This criticism, however, is exactly backwards. Allowing stockholders to “wait and see” simply balances the post-vote playing field, which is otherwise almost always tilted in favor of the acquirer and against the target holders. Following a shareholder vote in favor of a transaction, shareholders are typically in a no-win situation akin to the writer of a put option. If new information reveals the target company to be more valuable than originally thought, the stockholders are still entitled only to the merger price and do not share in the upside. If new information reveals the company to be less valuable, the acquirer can often find a way to let the deal fall through, or back out for the cost of a termination fee of 2-3%.¹¹³

Indeed, one of the more common types of opportunistic transaction exploits this “heads I win, tails you lose” dynamic of a delay between the stockholder vote and the closing. In the recent acquisition of the grocery store chain Safeway by Albertson’s, for example, oil prices precipitously declined following approval of the merger but prior to the closing. Reduced oil prices caused the stock of similar grocery store companies (which are highly sensitive to transportation costs) to

¹¹² Guarav Jetley & Xinyu Ji, *Appraisal Arbitrage—Is There a Delaware Advantage*, 71 BUS. LAW. ___ (2016) ; Trevor S. Norwitz, *Delaware Legislature Should Act to Curb Appraisal Arbitrage Abuses*, Columbia Law School Blue Sky Blog, Feb. 10, 2015 (“[T]he relevant appraisal valuation date is the closing of a transaction, rather than the time of announcement of the deal or the shareholder vote. This gives the appraisal arbitrageur a free option on positive developments between signing and closing. Indeed in the Safeway case, appraisal seekers are expected to argue that they should be entitled to higher consideration because grocery stocks rose between the signing and closing of that deal, in part due to the decline in oil prices.”).

¹¹³ See Micah S. Officer, *Termination Fees in Mergers and Acquisitions*, 69 J. FIN. ECON. 431, 432-33 (2003).

nearly double, while the amount to be received by Safeway stockholders remained frozen at the merger price.¹¹⁴ There can be little doubt that if rising oil prices had cut the value of Safeway in half, Albertson's would have found a way to walk away or amend the transaction, but the minority stockholders had no such ability.

The risk of such opportunism is especially stark in light of the information asymmetries between management and acquirers (following due diligence) on the one hand and outside shareholders on the other.¹¹⁵ The Transkaryotic merger itself involved the announcement of “extraordinarily positive” clinical trial results for one of the company's drugs shortly after the record date—results that were almost certainly known by insiders beforehand.¹¹⁶ In both cases, large appraisal actions by after-acquirers allowed the target's stockholders the opportunity to share in upside surprises that would otherwise have been captured entirely by the acquirers and their collaborators in management (for whom the upside “surprise” may not always be so surprising).

More generally, it is far from clear why it would be desirable for appraisal specialists to bear additional risk—including closing risk—by forcing them to buy in early, before as much relevant information about fair value as possible has been revealed. Doing so can only result in under-enforcement of appraisal rights and under-compensation of existing stockholders.¹¹⁷ Of course, that may be precisely the goal of those pushing the reforms. But again, even stockholders who do not themselves pursue appraisal can benefit from specialists being able to delay the investment

¹¹⁴ See, e.g., Liz Hoffman, Hedge Funds Plan to Seek Higher Price for Safeway, WALL ST. J., Feb. 2, 2015 (“Since the deal was announced, grocery stock have soared, helped in part by a drop in oil prices....Shares of market leader Kroger Co., for example, are up roughly 90% over the past year.”).

¹¹⁵ See, e.g. William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 688 (2010) (“Everybody agrees that managers know more than shareholders. Everybody also agrees that agency costs arise when managers use this informational advantage for their own gain.”); Robert Charles Clark, CORPORATE LAW § 12.2, at 507 (1986) (noting that abusive transactions are most likely when management “knows that the company is really worth more than its current market price”).

¹¹⁶ *In re Transkaryotic Therapies, Inc.*, 954 A.2d 346, 355 (Del. Ch. June 19, 2008).

¹¹⁷ See Abramowicz, *supra* note 94, at 736 (noting that claim-sellers will receive a lower price as the claim-purchaser bears additional risk).

decision, through the ability to sell their shares to specialists at a higher price. If acquirers are concerned about the possibility of intervening events prior to closing, they have many options, including abbreviating the pre-closing period, structuring the deal as a tender offer, or building flexibility into the pricing terms.

E. After-Acquiring Dissenters Should be Required to Prove How Their Shares Were Voted

Some critics have suggested a more modest idea: that appraisal petitioners should still be allowed to pursue appraisal for shares acquired after the record date, but only if they can demonstrate that the actual shares purchased were not voted in favor of the merger.¹¹⁸ Even if this requirement were desirable in theory, it would be highly problematic in practice. At present, most stock in public companies is held in so-called “fungible bulk” by the Depository Trust Company, making it impossible to trace individual shares from seller to buyer and prove how those shares were voted.¹¹⁹

While technology could undoubtedly solve this issue, doing so would create far more serious problems. Suddenly, shares voted *against* a merger would possess a potentially valuable right that shares voted *in favor* of the merger would lack. The fungibility of shares would thus be destroyed, requiring would-be purchasers to determine and evaluate the characteristics of the individual shares offered by individual sellers, dramatically increasing search costs and imperiling market efficiency.

¹¹⁸ See Trevor S. Norwitz, *Delaware Legislature Should Act to Curb Appraisal Arbitrage Abuses*, Columbia Law School Blue Sky Blog, Feb. 10, 2015 (suggesting that the “problem” of appraisal arbitrage “can be substantially ameliorated...by requiring those who would assert appraisal rights to demonstrate that their shares were not voted in favor of the deal”).

¹¹⁹ See *In re Appraisal of Dell Inc.*, 2015 WL 4313206 (Del. Ch. July 13, 2015); Geis, *An Appraisal Puzzle*.

Worse yet, this requirement would create incentives for potentially destructive strategic behavior by investors. Shares voted against a merger, and thereby possessing appraisal rights, would often be more valuable than shares voted in favor of the merger. Stockholders would thus have an incentive to abstain or vote against even a merger they favor, if they believed the merger would nonetheless be approved. In the absence of a clear statement of the compelling policy goals that would be furthered by a share-tracing requirement, this appears to be a can of worms best left unopened.

F. Appraisal Will Scare Away Good Transactions

These ill-considered criticisms of the form and procedure of appraisal arbitration likely reflect a more basic discomfort with the substance of appraisal rights. This phenomenon is not unique to appraisal. For example, it appears to us that much of the revulsion toward so-called “patent trolls” is really directed at the substance of patent law. The (arguably) excessive and overbroad nature of modern intellectual property rights were tolerable when those rights were not effectively enforced by patent holders. When patent trolls began enforcing those rights more effectively, the rights themselves suddenly become intolerable. Misplaced scorn that should be directed toward the substance of intellectual property law is heaped on the patent trolls instead.¹²⁰ A similar dynamic may be at work in the criticism of appraisal. Criticism is disproportionately directed toward the form, when what really rankles is the substance.

We will leave to others the defense of intellectual property law (if it can be defended), but our research leads us to believe that criticism of the substance of appraisal rights is nearly—though

¹²⁰ See, e.g., Doug Lichtman & Mark A Lemley, *Rethinking Patent Law’s Presumption of Validity*, 60 STAN. L. REV. 45 (2007) (calling for a weakening of the presumption of patent validity, in part as a means of thwarting patent trolls).

not quite—as misguided as criticism of the forms and procedures surrounding appraisal. The substantive criticism is simply the following: If the target’s directors (or controlling shareholders) have breached their fiduciary duties in entering into a merger agreement, the proper remedy is a fiduciary duty class action. A class action will bring all of the target’s shares before the court, ensuring both full deterrence and compensation of all shareholders instead of a small group of specialists. In the absence of a breach of fiduciary duties, it is folly to believe that a law-trained judge can produce a more accurate valuation than the deal market. Even where a court may properly find fair value to be higher than the transaction price, such a prospect will deter transactions or simply cause acquirers to hold back some portion of value that would otherwise be paid to the target shareholders, in the expectation that it will be paid as a “tax” to the squeaky wheels who seek appraisal.¹²¹

As an initial matter, any appeal to fiduciary duty class actions is a mirage. As we and others have documented elsewhere, whatever its theoretical merits, the merger class action is thoroughly broken in practice.¹²² Virtually every merger faces a fiduciary duty class action—regardless of the merits of the transaction—and the vast bulk of these actions result in disclosure-only settlements or, at best, a very small per share recovery. We postulate that the pathologies of merger class actions are driven by the agency problem between plaintiffs’ attorneys and the shareholders they ostensibly represent, but whatever the reasons, class actions hold out little hope as an effective tool of deterrence or compensation.

Moreover, while the transaction particulars undergirding appraisal are related to and can sometimes overlap with those relevant to the fiduciary duty class action, the emphasis is crucially

¹²¹ See, e.g., Paul Mahoney & Mark Weinstein, *The Appraisal Remedy and Merger Premiums*, 1 AM. L. & ECON. REV. 239, 273-74 (1999) (arguing that, “given the existence of legally enforceable fiduciary duties, appraisal does not benefit public company shareholders”)

¹²² See Korsmo & Myers, *Structure of Stockholder Litigation*.

different. In a fiduciary duty class action, the court is faced with the question of holding individual directors personally liable for having breached their duties to the stockholders. Courts are naturally and properly hesitant to take such a drastic step lest directors become risk-averse, making decisions with an eye toward minimizing the risk of personal liability rather than seeking to maximize expected value for stockholders.¹²³ An appraisal action asks a substantially more modest question: did stockholders get fair value for their shares in the merger? If not, the acquirer must make up the difference, but nobody is held personally liable.

To be sure, the questions in the two kinds of actions are frequently related. Often, when stockholders do not get fair value for their shares, it will be because the board has breached its fiduciary duties. We would thus expect the strongest appraisal claims to also present strong fiduciary duty claims, and vice versa. But forcing both types of claims into the same analytical box is a self-evident mistake. Many types of managerial sloth, incompetence, pressure, or collusion that courts have been understandably hesitant to characterize as breaches of fiduciary duty can nonetheless lead to minority stockholders receiving well below fair value for their shares. In such situations, appraisal constitutes a useful middle course between holding directors personal liable (and potentially granting injunctions) and allowing unfair transactions to escape any meaningful scrutiny. By providing a judicial backstop against transactions that deny minority stockholders the fair value of their shares, appraisal can reduce the discount applied to minority stakes and thereby reduce companies' cost of capital.

¹²³ See, e.g., Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83 (2004). As Chancellor Allen explained the problem, directors and managers “enjoy...only a very small proportion of any ‘upside’ gains earned by the corporation on risky investment projects. If, however, corporate directors were to be found liable for a corporate loss..., their liability would be joint and several for the whole loss....[T]his stupefying disjunction between risk and reward for corporate directors threatens undesirable effects.” *Gagliardi v. Trifoods Inter., Inc.*, 683 A.2d 1049, 1052 (Del. Ch. 1996).

Of course, the foregoing assumes that situations exist where the court can arrive at a more accurate valuation of the company than did the deal process. The incentive effects generated by appraisal flow backward from the expected outcome of the proceeding in court. In an appraisal proceeding, the stockholder is entitled to a judicial determination of the value of the stockholder's shares. The court must determine the "fair value" of the stock, and it may rely on any types of evidence that is otherwise admissible.¹²⁴ A random judicial outcome—or even one that is simply less accurate than the deal price—can serve no useful deterrence function (nor any useful compensation function). Thus, critics of appraisal have often decried its "casino-like" outcomes,¹²⁵ and the chancellors themselves have occasionally voiced their discomfort with the idea of a law-trained jurist being asked to second-guess the judgment of the market.¹²⁶ The natural conclusion reached via such criticisms is that the transaction price itself should generally be treated as the best evidence of fair value and ought to be deferred to. In a spate of recent appraisal cases, the Delaware chancellors have done just that.

As we have noted elsewhere, we are sympathetic to this argument.¹²⁷ And, indeed, we believe the set of situations where the appraisal given by a judge will be superior to that given by the deal market will be relatively small. But it is important not to overstate the case: the set is hardly empty. Most obviously, where the target company's board has breached its fiduciary duties, few would argue that the deal price is reliable. In such cases, the appraisal remedy can be a useful

¹²⁴ See *Weinberger v. UOP*. See also Steven Davidoff Solomon, *Delaware Courts Pause on the Deal Price Do-Over*, N.Y. TIMES, Feb. 19, 2015 ("The inputs for any valuation depend on future projections that can change depending on the forecaster. In addition, valuation involves techniques and inputs that are at the substantial discretion of whoever is doing the valuation.").

¹²⁵ James C. Morphy, *Doing Away With Appraisal in Public Deals*, 26 DEL. LAW. 30 (2008). See also Michael P. Dooley, *Rules, Standards, and the Model Business Corporation Act*, 74 LAW & CONTEMP. PROBS. 45, 53 (2011) (noting that appraisal awards are sometimes "two to three times the merger consideration, thereby turning appraisal into something of a lottery") (footnote omitted).

¹²⁶ See, e.g., *Huff Fund Inv. P'ship v. CKx Inc.*, C.A. No. 6844-VCG, memo. op. (Del. Ch. Nov. 1, 2013).

¹²⁷ See Korsmo & Myers, *Appraisal Arbitrage*, at 57-58.

“second best” tool of deterrence and compensation where serious agency problems between plaintiffs’ counsel and the class otherwise cripple the effectiveness a fiduciary duty class action.

This is especially true because there is no reason to believe the relationship is strong between deals where directors breach their duties and the cases where a plaintiffs’ attorney actually demonstrates it.

More broadly, critics miss the mark when they claim that appraisal flies in the face of Delaware’s traditional respect for market efficiency. Such claims conflate the stock market (which is generally highly efficient) with the deal market (which often is not). Among the other requirements for market efficiency are liquidity and fungibility. Public stock market prices are generally efficient because large numbers of identical shares of stock in a given company trade on a highly liquid market with millions of participants. The deal market, however—dealing as it does with entire companies, rather than individual shares—often lacks both qualities. No two companies are exactly alike, and the market for whole companies is unavoidably chunky, rather than liquid. As such, the deal market is unavoidably less efficient at valuing entire companies (including the value of control) than the stock market is at valuing minority shares.¹²⁸

Nonetheless, where there is a true auction for a company, it would likely be hubris for a court to second-guess the outcome. An auction, however, is far from uniform practice in the real world. At the extreme, unfaithful management, or an acquirer with a controlling stake or contractual veto rights can deliberately hamstring the sale process. Less dramatically, agreeing to a host of standard deal protections terms—ranging from no-shop provisions to matching rights to the ubiquitous termination fee—that courts have thus far found consistent with *Unocal* can serve to substantially impede an auction dynamic. The widespread use of matching rights, which grant an

¹²⁸ See generally Guhan Subramanian, *The Drivers of Market Efficiency in Revlon Transactions*, 28 J. CORP. L. 691 (2003).

acquirer the right to match a subsequent superior bid, appears to us especially problematic. It gives the acquirer the ability to bid far below its reservation price, secure in the knowledge that it can simply match any superior bid should one emerge. Even more problematically, it serves to ward off subsequent bids in the first place—any potential subsequent bidder would be hesitant to invest the time and resources to prepare a competing bid, knowing that the original bidder could simply match any bid that did not overvalue the company.¹²⁹ In sum, there are a number of reasons to doubt the efficiency of price formation even in an ideal deal market, let alone in the real one.

On the other side of the coin, worries about valuations being performed by “law-trained” judges—sometimes poignantly expressed by the chancellors themselves¹³⁰—are overblown. We are, after all, talking about the Delaware Court of Chancery, not the traffic court of Mandan, North Dakota. The five chancellors are world-leading specialists in corporate law, often with substantial practice experience prior to joining the court. Once on the court, they are tasked with valuation questions on a routine basis. The ability of the unbiased and expert chancellors to perform company valuations strikes us as often more credible than the contingently-compensated investment bankers and corporate officers they are often so anxious to defer to.

Taken together, the foregoing suggests that, in a substantial percentage of cases, appraisal by a disinterested chancellor will produce a more accurate estimate of fair value than the deal market. We cannot say with any confidence what this percentage is, but it is far from obvious that the roughly 1 in 8 deals targeted by appraisal petitions in the recent era of appraisal arbitrage is too high. If anything, the chancellors have been overly modest in recent cases, seemingly deferring to

¹²⁹ See Brian J.M. Quinn, *Re-Evaluating the Emerging Standard of Review for Matching Rights in Control Transactions*, 36 DEL. J. CORP. L. 1011 (2011).

¹³⁰ *Union Illinois 1995 Inv. Ltd. P'ship v. Union Fin. Grop*, 847 A.2d 340, 359 (Del. Ch. 2004) (“For me (as a law-trained judge) to second-guess the price that resulted from that process involves an exercise in hubris and, at best, reasoned guesswork.”).

the deal price if the deal process can plausibly be described as an arm's-length deal. Deference that may be justified in the context of a fiduciary duty class action—where the question is one of personal liability and incentives for risk-taking—is less appropriate in the context of appraisal, where the question is simply one of comparative accuracy.

Where the court is able to achieve a more accurate valuation than the deal market, concerns that appraisal arbitration will deter beneficial transactions evaporate. Of course appraisal will deter transactions—if it did not, it would have far less public utility. But it will only deter transactions that ought to be deterred—those that are not profitable after paying fair value. If a transaction is only profitable for the acquirer if they can pay the target stockholders less than the fair value of their company as a going concern—which is all an appraisal proceeding requires—then the transaction is value-destroying and should not take place. Given the strongly encouraging empirical picture of appraisal, there is no reason to think that appraisal should stand in the way of any well-priced transaction.

G. Acquirers Will Hold Back Value to Pay Dissenters, At the Expense of Other Stockholders

There is similarly little reason to fear that acquirers will simply “hold back” value that would otherwise be paid to all stockholders, in anticipation of paying an “appraisal tax.”¹³¹ This critique, inadvertently or otherwise, tends to assess the effects of appraisal by contrasting it to a world where fiduciary duty class actions or other mechanisms have achieved optimal deterrence. Unfortunately, that is not the world we live in. In reality, acquirers often face no meaningful

¹³¹ White & Case Client Alert, *Increasing Hostility Towards Appraisal Arbitrage*, April 2015, at 2. (“Failure to adequately address the rising tide of appraisal arbitration risks creating incentives for buyers to lower their price in anticipation of having to pay appraisal arbitrage post-closing and therefore shifting value away from long-term stockholders towards short-term arbitrage without advancing the underlying public policy rationale for appraisal rights.”).

deterrence other than an adverse shareholder vote or a topping bid, possibilities that—for reasons explained above—may in some circumstances be remote or altogether lacking. Acquirers already “hold back” as much value as they can get away with. In this light, the argument that appraisal works some inappropriate “value transfer” from the acquirer to appraisal petitioners is exactly backwards.¹³² The court-determined value transfer from acquirers in appraisal is the very engine of deterrence against opportunism in public-company mergers, but as we explain below that deterrence only partial given the legal limitations on the appraisal remedy.

Acquirers may respond to the appraisal threat by paying more or otherwise improving the deal process, in the hopes of convincing the court to defer to the deal price or of avoiding an appraisal petition altogether. This is what happened in the Dell transaction, with partial success.¹³³ Or they may end up paying value in an appraisal proceeding. In either case, minority shareholders benefit—either directly through improved merger consideration, or indirectly through appraisal specialists bidding up the price of their stock above the price set by passive merger arbitrageurs or even above the deal price.

As with most forms of regulation, appraisal exists in a world of “second bests.” We would prefer to rely on the integrity of a deal price that emerges in a competitive market, but in many cases we cannot. We would prefer to rely on a class mechanism to achieve optimal deterrence and compensation, but we cannot. Appraisal offers a second best alternative to both: (1) valuation by an impartial expert judge where there is reason to believe it will be more reliable than a flawed deal

¹³² See Guarav Jetley & Xinyu Ji, *Appraisal Arbitrage—Is There a Delaware Advantage*, 71 BUS. LAW. ___, 7 (2016).

¹³³ See Fried, Frank, Harris, Shriver & Jacobson LLP M&A Briefing, *New Activist Weapon: The Rise of Delaware Appraisal Arbitrage: A Survey of Cases and Some Practical Implications*, June 18, 2014, at 3 (“In the Dell going private transaction, for example, the threat by Carl Icahn and others to seek appraisal of the shares they had amassed after announcement of the deal effectively blocked the required shareholder vote (a majority of the minority shares outstanding) and led to a \$400 million increase in the merger price paid to shareholders (as recently discussed publicly by legal counsel to the Dell special committee).”). Even after the price bump, many stockholders still pursued their appraisal, though a great many backed away very early in the process.

market; and (2) a partial method of aggregation that is not plagued by the agency problems that hamper the class action.

H. The Threat of Appraisal Generates Too Much Uncertainty for Acquirers

The goal of any acquirer is to determine the extent of target's assets and liabilities; the due diligence process is so extensive because potential acquirers wish to determine precisely what assets and liabilities they will bid on. Critics suggest that appraisal presents a potential liability for the acquirer that is different in kind than many others it will inherit in the transaction because that liability cannot generally be determined at the time the buyer performs its diligence on the rest of the company. For this reason, defense lawyers describe appraisal liability as if it is some unknowable quantity akin to a meteor strike.¹³⁴ In reality, the extent of the appraisal liability will be governed by two straightforward variables: (1) the number of shares that seek appraisal and (2) the merits of the appraisal claim—that is, how much a court might be expected to award at trial. Both of these variables are quite clear to buyers by the time of the transaction's closing. And they can be discovered—and managed—as early in the process as the buyer wishes.

The number of dissenting shares in an appraisal case has a natural limit of around 50% of the outstanding stock, even under *Transkaryotic*.¹³⁵ As we discuss below, this puts an upper limit on the potential deterrence value of appraisal, but for purposes of transactional certainty it puts a cap on one aspect of potential appraisal liability. More importantly, an acquirer that is worried about

¹³⁴ Trevor S. Norwitz, *Delaware Legislature Should Act to Curb Appraisal Arbitrage Abuses*, Columbia Law School Blue Sky Blog, Feb. 10, 2015 (“Appraisal arbitrage creates significant risks for buyers, who could find themselves obligated to pay much more for a target company than they had expected to when negotiating the deal. While any buyer needs to know how much it will have to pay to acquire a target, this need is especially acute in leveraged acquisitions where an increase in acquisition costs could easily make the difference between a successful deal and a failure, or even a bankruptcy.”).

¹³⁵ The limit in a stockholder vote is the number of outstanding shares minus the number of votes in favor of the transaction; the limit in a two-step transaction is the number of shares minus the number of shares tendered.

potential appraisal liability can quite easily address that liability directly by putting a closing condition in the merger agreement that allows the buyer to walk away in the even more than, say, 10% of the shares demand appraisal. Such a provision provides a hard ceiling of protection for the buyer. Naturally, however, many targets may resist such a condition because it does not provide enough certainty to the seller.¹³⁶ The buyer is thus in a superficially difficult position: either include an appraisal condition and impair the attractiveness of the bid, or leave out the appraisal condition and potentially face the prospect of higher liability in an appraisal proceeding. An additional complication with appraisal conditions is that it generates the possibility that one holder of a comparatively small portion of equity (5.1% or 10.1%) could hold out and frustrate the entire transaction. For this reason, transaction advisors have cautioned that “it is difficult to predict the effect of an appraisal rights condition on a transaction.”¹³⁷

In reality, the number of shares demanding appraisal does not arise from some unknowable process. The two relevant variables—the number of shares demanding appraisal and the strength of the appraisal claim—are jointly determined by the same set of facts, as our own work has shown. This is evidence that the system is working well. Thus yet another way to ensure that the number of shares demanding appraisal is low is to make the appraisal claim as unattractive as possible. The way to do that is to deliver the highest possible price to stockholders and to ensure that the process of selling the company is as open and transparent to potential alternative bidders as possible. One law firm has described the dynamic in this way: “If a transaction has been subject to an aggressive competitive process and the deal price is generally viewed as being high, the

¹³⁶ Fried, Frank, Harris, Shriver & Jacobson LLP M&A Briefing, *New Activist Weapon: The Rise of Delaware Appraisal Arbitrage: A Survey of Cases and Some Practical Implications*, June 18, 2014, at 5 (“Buyers in a competitive process will be wary to include this condition as it would be likely to significantly diminish the competitiveness of the bid as compared to bids not imposing the condition.”).

¹³⁷ Fried, Frank, Harris, Shriver & Jacobson LLP M&A Briefing, *New Activist Weapon: The Rise of Delaware Appraisal Arbitrage: A Survey of Cases and Some Practical Implications*, June 18, 2014, at 5.

pursuit of appraisal would then seem more unlikely. At the other extreme, a transaction with a company controller or a private equity deal with major management participation would be a probable suspect for the assertion of appraisal rights, particularly if the sales process appears to raise questions.”¹³⁸ This again should reinforce the conclusion that appraisal is generating beneficial deterrent effects in the merger market. This may of course be why many serial acquirers and defense-side lawyers may not like appraisal much; it is a substantive commitment to ensure that target stockholders get what they are entitled to, even if the presence of board negligence or malfeasance. But from the perspective of equity investors, it is precisely the sort of protection that adds ex ante value.

Transactional practice can adapt very easily to other elements of this new reality. A buyer, for example, might not know the strength of the appraisal claim until the target files its proxy statement or tender offer statement.¹³⁹ These documents will describe the character of the sales process, any conflicts on the target side that may have hobbled the negotiations, the advice that the financial advisors gave the board, and the board’s own internal estimates of the company’s future performance. For buyers worried about appraisal liability, however, it is a simple matter to have the target make representations about those very matters.¹⁴⁰

¹³⁸ Fried, Frank, Harris, Shriver & Jacobson LLP M&A Briefing, *New Activist Weapon: The Rise of Delaware Appraisal Arbitrage: A Survey of Cases and Some Practical Implications*, June 18, 2014, at 4.

¹³⁹ Fried, Frank, Harris, Shriver & Jacobson LLP M&A Briefing, *New Activist Weapon: The Rise of Delaware Appraisal Arbitrage: A Survey of Cases and Some Practical Implications*, June 18, 2014, at 5 (“Importantly, the company’s sale process, as well as the range of fairness established by the target company’s bankers, is unknown to the buy-side party until the company’s proxy statement is furnished to shareholders. A buyer—for example, a private equity firm in a management-led buyout (where the court can be expected to be skeptical of the transaction)—may want to try to avoid attracting appraisal petitions by offering a price at the high end of the fairness range and by acquiescing in (or even encouraging) a robust sale process by the seller. Critically, however, even in this case, the buyer has no certainty as to whether the seller may have improperly prepared the company projections, conducted the market check or dealt with any conflicts, or otherwise may have acted in ways that could render the process unreliable—and thus invite appraisal demands.”).

¹⁴⁰ Fried, Frank, Harris, Shriver & Jacobson LLP M&A Briefing, *New Activist Weapon: The Rise of Delaware Appraisal Arbitrage: A Survey of Cases and Some Practical Implications*, June 18, 2014, at 5 (“Buyers, particularly those in transactions that will be most at risk for attracting appraisal petitions, may begin to seek ways to obtain some

I. The Interest Rate is Too High

The rate of interest awarded in appraisal proceedings also attracts consistent fire from defense lawyers.¹⁴¹ Many critics contend that the current statutory interest rate—equal to the federal funds rate plus 5%—is too high, and that much of the recent boom in appraisal arbitrage simply reflects attempts to leverage this rate of interest. As we have explained elsewhere, we are dubious that the statutory rate has played a causative role in the recent rise in appraisal activity.¹⁴² More importantly, it is not clear that the statutory rate is too high in the first place.

The question of the proper interest rate on judgments is complex, and one we address in a separate forthcoming paper. The interest rate is a policy lever that at the margin has effects on the volume and pace of appraisal litigation. If appraisal is prone to under-enforcement, as prominent commentators suggest,¹⁴³ then one plausible approach to moving closer to optimal deterrence would be to increase the interest rate in hopes of stimulating more appraisal claims.¹⁴⁴ As a policy response to under-enforcement, however, this would be too blunt and likely ineffective.

A natural but mistaken impulse is to compare the statutory interest rate to some measure of pure credit risk like the interest rates on bonds issued by acquirers.¹⁴⁵ In the first place, the claims

protection in this area, such as, possibly, including representations as to the process in the merger agreement or requiring information about the process before signing the merger agreement.”)

¹⁴¹ White & Case Client Alert, *Increasing Hostility Towards Appraisal Arbitrage*, April 2015 (“the current interest rate environment unambiguously favors appraisal claims”); Fried, Frank, Harris, Shriver & Jacobson LLP M&A Briefing, *New Activist Weapon: The Rise of Delaware Appraisal Arbitrage: A Survey of Cases and Some Practical Implications*, June 18, 2014, at 2 (“the well above market statutory interest payable on appraisal awards”).

¹⁴² See Korsmo & Myers, *Appraisal Arbitrage*.

¹⁴³ See James D. Cox & Randall S. Thomas, *Addressing Agency Costs Through Private Litigation in the U.S.: Tensions, Disappointments, and Substitutes*, SSRN draft dated Sept. 2, 2015, at 39-40 (describing limitations of appraisal remedy).

¹⁴⁴ See, e.g., Elizabeth Chamblee Burch, *Securities Class Actions as Pragmatic Ex Post Regulation*, 43 Ga. L. Rev. 63, 89 (2008).

¹⁴⁵ Guarav Jetley & Xinyu Ji, *Appraisal Arbitrage—Is There A Delaware Advantage?*, SSRN Draft dated September 2, 2015, at 49 (“[I]n cases where the credit of the acquiring company (or the other entity responsible for

held by appraisal petitioners differ substantially from those held by bondholders, and encompass litigation and durational risks in addition to credit risks. More to the point, the appraisal petitioner is simply not a bondholder at all. The petitioner is a former stockholder, whose equity investment has been taken from her by board-initiated operation of law. It is perhaps more sensible to look to the surviving company's cost of equity instead of its cost of debt because that would compensate the petitioner for what has been taken.

More broadly, the interest rate on judgments is often expected to play a number of sometimes-conflicting roles. As noted, it should adequately compensate the petitioner for what has been taken, it should disgorge from the respondent company any unjust enrichment, but most importantly it should aim to make both parties time-indifferent. In addition, the interest rate should ideally not be a fact-intensive, individualized question, lest it consume undue judicial resources or increase litigation costs (and thereby increase the nuisance value of claims).

In light of these considerations, the recent proposal of the Delaware Bar Council represents a sensible compromise. The proposed amendment borrows from the MBCA in allowing appraisal respondents to pay some amount of cash that would stop further accrual of interest on that amount. If the respondent views the interest rate as excessive, it may avoid interest accrual by paying over cash at any time. The shortcoming of the proposal is that it would allow for too much strategic behavior by appraisal respondents. First, the company's option can be exercised anytime, opening the door to tactical payment decisions by the company. A better approach is to offer the company the option to pay cash only within a discrete window following the transaction's effective date. Second, the option creates the wrong incentives for distressed and leveraged companies. Where a surviving company's cost of debt is below the statutory interest rate, it will

paying the fair value award to the petitioner) is rated "BB" or higher, the statutory rate appears to overcompensate petitioners for a bond-like claim").

likely exercise its option; where the company's cost of debt exceeds the statutory interest rate—as will likely be the case in many leveraged transactions—the surviving company will take advantage of the cheap financing. If the option is to be unilateral, a significantly higher default interest rate may actually be desirable, in terms of creating the proper incentives for all parties. Faced with a higher default statutory interest rate, the party with the best information on fair value at the outset of the proceeding—the respondent—would have a strong incentive to pay over its best estimate of fair value at an early date. This would minimize the effect of the interest rate on the proceeding and at the same time minimize the social costs invested in dispute resolution.

IV. A REASONABLE SET OF REFORMS TO DELAWARE'S APPRAISAL STATUTE

The aggressive reforms proposed by the defense bar have no policy justification, but there are a variety of reforms to the appraisal statute that could have beneficial effects. The goals of our proposed reforms are to enhance the deterrent effect of appraisal and to minimize any risk of abuse. We offer a number of modest proposals here. A bolder set of proposals might be designed to address what may be the biggest problem with appraisal: In view of the empirical realities, the remedy is very likely under-used, resulting in under-deterrence of opportunistic transactions.¹⁴⁶

¹⁴⁶ A basic problem with appraisal as a mechanism of deterrence is that there is a natural limit to the number of shares that can dissent. In a long-form merger or a tender offer, realistically not more than 50% could conceivably demand appraisal, and in a short-form merger not more than 10% could dissent. This, if anything, illustrates why one might fear that a cunning acquirer would try to hold back value in merger negotiations. If the fair value of a stock is \$10 but the acquirer can get the votes for \$9, the acquirer is better off paying only half of the stockholders the extra \$1. This creates a straightforward under-enforcement problem. One possible avenue for reform that might help address this problem is to borrow from the federal antitrust regime and allow dissenting stockholders to claim multiple damages. Under federal law, plaintiffs who successfully make out an antitrust violation are entitled to treble damages. The policy rationale for this rule is that antitrust law will otherwise be under-enforced and that a damages multiple will push private enforcement closer to an optimal level. This reasoning could quite easily be imported into the appraisal context. In long-form and 251(h) mergers, dissenting stockholders should be entitled to perhaps double damages, and in short-form mergers, dissenters should be entitled to some higher multiple of damages. To avoid overdeterrence, the multiple should only apply to the amount by which the judgment exceeds the amount that cashed-out stockholders received in the merger. The consequences of any reform along these lines would be far-reaching and obviously would require a far more in-depth examination to consider how it might alter the status quo.

We explicitly reject as bad policy the defense lawyers’ proposal to alter the appraisal rules so as to strip beneficial owners of their rights if they were not beneficial owners on the record date. But in view of the mounting pressure from the defense bar to adopt some rule to that effect, it is imperative to consider ways to minimize the negative impact of such a change. We offer such a route here: by ensuring that record dates always follow the mailing of the notice of appraisal rights by 20 days.

A. Eliminate the Exception for All-Stock Deals

Delaware’s appraisal statute denies appraisal rights to stockholders of target companies who are forced in a merger to accept only public-traded stock.¹⁴⁷ There is no policy justification at all for this limitation. At one time, this might have been an important for accounting purposes: paying more than a specified percentage of merger consideration in cash—as appraisal forces acquirers to do—would in an earlier era have prevented the acquirer from using pooling-of-interests accounting. That is no longer the case, and more importantly from a corporate law perspective there is simply no basis for making a distinction between different forms of merger consideration.

Commentators sometimes suggest that this so-called “market out” exception makes sense because the market sets the price of the stock offered as consideration, and those dissatisfied with the merger consideration can just sell into the deep, liquid market.¹⁴⁸ But this misunderstands the relevant circumstances. A target stockholder might feel shortchanged not because she is getting stock in the acquiring company but because she is not getting enough of it. Just as easily as they

¹⁴⁷ 262(b)

¹⁴⁸ JEFFREY HAAS, CORPORATE FINANCE 90 (2014) (“The market-out exception recognizes that the market is superior to a judge when it comes to fairly valuing the shares of dissenting public stockholders. If those stockholders are to receive stock as merger consideration, the market-out exception encourages them to simply cash out before the merger is consummated by selling their shares in the open market. When dissenting public stockholders are forced to receive cash as merger consideration, by contrast, the market may not provide a fair valuation.”).

could be underpaid in cash, target stockholders could be underpaid in stock of Exxon Mobil or in postage stamps or in anything else, for that matter.¹⁴⁹ Nor does the type of merger consideration affect the Chancery Court’s ability to calculate fair value. The fact that target stockholders are getting 1.5 shares of Beta Corp. as consideration in a merger does not require the court to determine the value of Beta Corp. stock. The sole task before the court would remain valuing the target company, precisely the same question the court must answer in all other appraisal proceedings.

In the context of director duties in a change of control, Delaware’s jurisprudence has seized upon a similar distinction between stock and cash consideration.¹⁵⁰ That distinction has attracted persuasive criticism from Vice Chancellor Laster for fumbling the actual question of interest: whether stockholders have received enough.¹⁵¹ In answering the question, the form of consideration

¹⁴⁹ Vice Chancellor Laster has made the same point in the context of Revlon scrutiny. J. Travis Laster, *Revlon is a Standard of Review: Why It’s True and What It Means*, 19 *FORDHAM J. CORP. & FIN. L.* 5, 39-40 (2013) (“Negotiated acquisitions are bargaining situations. Value is not conferred charitably on sell-side stockholders; it must be extracted. If an acquirer expects a transaction to generate synergies, the acquirer should be willing to share a portion of the synergies with the target as the price of getting the deal done and achieving the remaining gains. In a cash deal, the gain-sharing takes the form of a higher dollar figure. In a stock deal, the gain-sharing takes the form of a larger share of the post-transaction entity. In either case, the gains are allocated through negotiation.”).

¹⁵⁰ A line of Delaware precedents holds that the application of Revlon and its doctrinal progeny turns on the percentage of stock and cash that target stockholders receive. See *Time*, *Paramount v. QVC*, *Smurfit-Stone*, etc.

¹⁵¹ *Steinhardt v. Howard-Anderson*, No. 5878-VCL (Del. Ch. Jan 24, 2011) (Transcript of Ruling of the Court on Plaintiffs’ Motion for a Preliminary Injunction. Vice Chancellor Laster suggested that engaging in a “dance on the head of a pin” debate about whether enough cash present to trigger Revlon is beside the point. The relevant inquiry for Revlon purposes is whether “target stockholders are in the end stage.” Cash consideration has always triggered a change in control under Revlon because “if you want more cash for your shares, this is the only time you have to get it.” Stock consideration has been treated differently, the idea being that securing a premium now may not be critical because stockholders can obtain some future control premium down the line on their stock consideration. But as Laster noted, “target stockholders today are bargaining for what their share of that control premium will be,” and in that sense this is similarly the final period because “this is the only opportunity where you can depend on your fiduciaries to maximize your share of that value.” Vice Chancellor Laster correctly treated the form of consideration as irrelevant and focused instead what should be the ultimate object of inquiry in Revlon: “extract[ing] the premium, both in the sense of maximizing cash now, and in the sense of maximizing [target stockholders’] relative share of the future entity’s control premium.” *Id.* at 7.

does not matter. Laster has argued that that enhanced *Revlon* review should apply to stock-for-stock transactions and that the *Paramount* doctrine should be discarded.¹⁵²

Exempting an entire class of transactions from the appraisal remedy ensures that they will remain beyond the beneficial governance effects of appraisal. Moreover, the breadth of the exception invites creative ways to avoid the merger statute. Not only are transactions exempt from appraisal if stockholders receive stock in the surviving company but also under section 262(b)(2)(B) if stockholders receive shares of “any other corporation” that is publicly traded. An inventive acquirer intent on underpaying target stockholders could avoid the appraisal statute altogether by offering as merger consideration not \$10 in cash but instead \$10 worth of stock in Halliburton, or Crocs, or any other publicly traded company. Inadequate consideration in any form is still inadequate consideration. The market out exception should be eliminated.

B. A Minimum Threshold for Appraisal

An appraisal petition is the start of a proceeding that has no motion to dismiss or other pre-trial opportunities to sort strong claims from the weak. Those who preserve their appraisal rights and file a petition are entitled to press all the way to trial, and the costs of defending such a proceeding can run into the millions of dollars. This presents the risk that a stockholder with a small number of shares could threaten to push a defendant all the way to trial and extract a settlement for less than the costs of litigation. As we have explained, we believe the procedural structure of appraisal—where plaintiffs can proceed only on behalf of their own holdings and must forego the merger consideration and bear their own costs—is an effective deterrent to this sort of

¹⁵² J. Travis Laster, *Revlon is a Standard of Review: Why It's True and What It Means*, 19 FORDHAM J. CORP. & FIN. L. 5, 33 (2013) (“[E]nhanced scrutiny should apply to all negotiated acquisitions. The Delaware Supreme Court therefore can and should retire the *Paramount* doctrine.”).

behavior. At some low values, the dissenter does not have a credible threat to go to trial at all and should not be able to force a settlement for much of anything. A more plausible threat is that a plaintiffs' attorney might file an appraisal petition in hopes of obtaining backdoor discovery into the character of the sales process, and that inquiry might provide the grounds for a post-closing fiduciary class action.

The empirical evidence presented in Figure 1 suggests that, to the extent that this behavior may exist at all, it is a limited problem. The Delaware Council nevertheless proposed the very reasonable prophylactic measure of requiring that the dissenting group meet some de minimis threshold in order to proceed with appraisal. They set that threshold at \$1 million in stock at the merger consideration or 1% of equity value, whichever is lower. This is a sensible approach to the potential problem of nuisance suits, which can have no beneficial deterrent effect.

The underlying intuition is that if the transaction does not bother holders of more than \$1 million in stock, there is no sense in forcing defendants to defend an appraisal proceeding. If anything, the dollar amount minimum is set too low in the proposal. A more reasonable level might be more like \$2.5 or \$3 million, which is large enough to ensure that it cannot be profitable to settle simply for the costs of litigation. There is no reason to limit this approach to appraisal: this de minimis threshold could usefully be imported to derivative litigation, securities litigation, and merger class actions, as well.

Importantly, this does not close the courthouse door to small holders. The proposed thresholds look to the size of the dissenting group, not the individualized holdings of the members of the dissenting group. Thus, if many small holders were skeptical of a transaction and all demanded their appraisal rights, they could press the claim collectively because as a group they exceed the threshold even if none did individually, even without selling to an appraisal arbitrageur.

A related reform that has some initial appeal is to craft a safe-harbor from the appraisal statute where the character of the sales process is so exemplary that no one could doubt that the resulting price was equal to the fair value of the stock. We ourselves have argued in favor of such a reform in the past.¹⁵³ The trouble of course is crafting a workable standard. One natural but fundamentally flawed idea is to simply import the result of any *Revlon* inquiry. If the target directors met their *Revlon* obligations, then the appraisal price must be the negotiated merger price. This suffers from a multitude of problems. First, stockholders very rarely know whether the board has complied with its *Revlon* obligations; nearly every transaction is attacked by a merger class action, but those rarely end with anything other than a settlement in which the *Revlon* claims (among others) are released, and the only insight into the actual merit of the *Revlon* claim comes from a plaintiffs' attorney on the cusp of receiving a fee assuring the court that his inquiry revealed nothing. The availability of appraisal—a remedy that serves a useful governance purpose—cannot turn on a broken class action system that systematically fails to perform any reliable governance purpose.

More importantly, the *Revlon* inquiry asks the wrong question. A board could quite easily meet its fiduciary obligations in circumstances where there is no reason to suppose the outcome has any bearing on the fair value of the stock. Imagine a negotiation between a target company and a controlling stockholder who refuses to sell his stock. The board could do an exemplary job negotiating with the controller, such that they met and even exceed their fiduciary expectations. It would be absurd to hold those directors liable for anything. At the same time, if there were no competitive pressure whatsoever on the bidder, there would be no reason to believe that the negotiated price constitutes the fair value of the stock. Yet another problem is that even what looks

¹⁵³ See Korsmo & Myers, *Appraisal Arbitrage*.

like a clean process from the outside can be undermined from within by frauds large and small. It is difficult if not impossible to craft a safe harbor focused on procedure and form that cannot be gamed to the disadvantage of minority stockholders.

For these reasons, the reluctant conclusion is that, as a practical matter, drafting a safe harbor is a fool's errand. If Delaware were to adopt a de minimis rule like the one proposed by the Council or one with a higher threshold, the risk of a petitioner dissenting in hopes of reaching a costs-of litigation settlement would approach zero. The appraisal remedy itself provides the soundest protection against abuse. Our evidence shows that petitioners appear to be targeting a group of transactions where something appears amiss. Defense lawyers themselves have acknowledged as much.¹⁵⁴ The current system works well enough that too much would be lost by attempting to create safe harbor.

C. Improving Merger-related Disclosures

Delaware should enhance the disclosure requirements imposed on companies engaged in transactions triggering appraisal rights. When a corporate board presents stockholders with an investment decision like a tender offer or an appraisal election, “[t]he directors of a Delaware corporation are required to disclose fully and fairly all material information within the board's control.”¹⁵⁵ Delaware borrows from the federal standard of materiality, noting that a fact is material when “there is a substantial likelihood that a reasonable shareholder would consider it important in

¹⁵⁴ Fried, Frank, Harris, Shriver & Jacobson LLP M&A Briefing, *New Activist Weapon: The Rise of Delaware Appraisal Arbitrage: A Survey of Cases and Some Practical Implications*, June 18, 2014, at 4. (“[T]he transactions that attract appraisal petitions generally involve some basis for a belief that the deal price significantly undervalues the company—that is, transactions involving controlling stockholders, management buyouts, or other transactions for which there did not appear to be a meaningful market check or significant minority shareholder protections as part of the sales process.”).

¹⁵⁵ *Malone v. Brincat*, 722 A.2d 5, 12 (Del.1998).

deciding how to vote.”¹⁵⁶ The materiality standard in Delaware, as in federal law, does not require that the information would necessarily change the vote of a reasonable investor. The standard is a lower one: Information is material if there is “a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”¹⁵⁷

In spite of the facial liberality of the materiality standard, the interpretation has at times been too parsimonious. Consider *Skeen v. Jo-Ann Stores, Inc.*,¹⁵⁸ where stockholders alleged that a company’s merger-related disclosures failed to provide stockholders with the information necessary to make an informed decision about appraisal. According to the stockholders, the financial disclosures released by the company were deficient because they failed to include: a summary of the methodologies and fairness ranges generated by the company’s financial advisor; the projections of future performance prepared by company management; and prices at which the company had discussed sale in the year prior to the merger.¹⁵⁹ This information is obviously material under the traditional tests. In forming a meaningful opinion on the fair value of the company, the stockholder would plainly need access to that information. The Delaware Supreme Court, however, held that disclosure of that information was not required under Delaware’s materiality standard. The Court held that “[o]mitted facts are not material simply because they might be helpful” and that the undisclosed information would not have “significantly altered the total mix of information already provided.” It was not enough, in the Court’s view, for the

¹⁵⁶ *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del.1985) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976)).

¹⁵⁷ *Id.* (quoting *TSC Indus.*, 426 U.S. at 449, 96 S.Ct. 2126).

¹⁵⁸ *Skeen v. Jo-Ann Stores, Inc.*, 750 A.2d 1170 (Del. 2000).

¹⁵⁹ *Skeen v. Jo-Ann*, 750 A.2d at 1173.

stockholders to “merely allege that the added information would be helpful in valuing the company.”¹⁶⁰

Not long after *Skeen*, then-Vice Chancellor Strine implicitly criticized the decision, noting that stockholders are often at a severe informational disadvantage when forced to make decisions about tendering or demanding appraisal.¹⁶¹ In the context of disclosures related to a fairness opinion, Strine pushed beyond the inadequate strictures of *Skeen* and held that stockholders were entitled to “a fair summary of the substantive work performed by the investment bankers upon whose advice the recommendations of their board as to how to vote on a merger or tender rely.”¹⁶² Subsequent decisions have adopted a similarly context-specific approach to materiality in the disclosure of financial data and other valuation-related issues.¹⁶³ The Supreme Court has supplied a useful remedy for disclosure violations: quasi-appraisal, an equitable remedy that mirrors the statutory appraisal by allowing a stockholder to proceed on appraisal claims an opt-out basis for all cashed-out stockholders.¹⁶⁴ Nevertheless, the underlying disclosure standard is still that “a disclosure that does not include all financial data to make an independent determination of fair value is not . . . per se misleading or omitting a material fact.”¹⁶⁵ This standard is inadequate.

The standard that Delaware should embrace is precisely the one rejected in *Skeen*: “Stockholders should be given all the financial data they would need if they were making an

¹⁶⁰ *Skeen* at 1174. The Court affirmed the central holding of *Skeen* in *McMullin v. Beren*, though at the same time it held that a disclosure claim based on an extraordinary set of omissions could withstand a motion to dismiss. 765 A.2d 910, at 925 (noting that the disclosures alleged omitted “indications of interest from other potential acquirers; the handling of these potential offers; the restrictions and constraints imposed by [the parent] on the potential sale of [the target]; the information provided to [the financial advisor] and the valuation methodologies used by [the financial advisor]”).

¹⁶¹ *In re Pure Resources, Inc. Shareholders Litigation*, 808 A.2d 421, 450 (2002).

¹⁶² *Pure Resources* at 449.

¹⁶³ See e.g., *In re Orchard Enterprises Inc. Stockholders Litig.*, 88 A.3d 1, 16-23 (2014); *In re PNB Holding Co. Shareholders Litig.*, No. CIV.A. 28-N, 2006 WL 2403999, at *16 (Del. Ch. Aug. 18, 2006)

¹⁶⁴ *Berger v. Pubco*, 976 A.2d 132 (2009).

¹⁶⁵ See *Nguyen v. Barrett*, C.A. 11511-VCG, letter ruling, Oct. 8, 2015, at 11-12 (quoting *In re CheckFree Corp. Stockholder Litig.*, 2007 WL 3262188 (Del. Ch. Oct. 17, 2007)).

independent determination of the fair value.”¹⁶⁶ For a stockholder confronting a choice about appraisal, the essential task is to form an independent estimate of the fair value of the company. To do that, the stockholder is entirely reliant on the disclosure choices made by the board of directors, who naturally wish to avoid releasing any information that would paint their negotiated transaction in an unflattering light. The object of corporate law in this area should thus be to ensure that the company discloses sufficient information to put stockholders on an equal informational footing in determining the company’s fair value. The costs of additional disclosure are low—both in terms of the direct costs associated with collecting and disclosure and the indirect costs of informing competitors or others who could access the disclosures. By contrast, the potential benefits are high in terms of enhancing a private enforcement system that the evidence indicates is working well.

In terms of disclosure of financial material, Delaware law should require that the company disclose all information that reasonably bears on the value of the company. The disclosures should be rigorous enough to permit stockholders to determine the fair value the company and to perform a critical evaluation of the recommendations by the board. This would require that companies disclose forecasts and projections prepared by the company, and in particular a description of any reports and presentations bearing on value that were either presented to the board or prepared by the board in connection with the merger. Additional disclosure requirements are not a complete prophylactic against crucial omissions, as recent cases have made clear.¹⁶⁷ But they would constitute at least a step in the direction of ameliorating the grave informational asymmetry between managers and stockholders.

¹⁶⁶ *Id.* at 1174.

¹⁶⁷ See *Dole* (finding that management deliberately undermined projections); *Rural/Metro* (finding projections inadequate because bankers derailed process).

D. A Better Version of the Deal Advisors' Proposal

The one commonality among all defense lawyers' commentary has been a single-minded focus on depriving beneficial owners of their appraisal rights if they did not own the stock on the record date for voting on the merger. Given the attention heaped upon that idea, the Council must be the object of substantial pressure to propose an amendment along those lines. We here offer a variation on that proposal—not because it is a desirable reform in and of itself, but as a way to achieve the critics' stated goals while limiting any attendant policy damage done.

The historic relationship between stockholder voting and appraisal is one many commentators believe to be important and wish to preserve.¹⁶⁸ But there is no obvious policy justification to do so. Stockholders are dissenting from the merger transaction, not from the vote. There may be good reasons why the acquirer should be on notice of the number of dissenting stockholders before it chooses to close the transaction, but the connection between the appraisal right and the vote on the merger is one of pure inertia. It would be entirely sensible to eliminate the language about voting in Section 262.

In framing this issue, defense lawyers have set up a false choice, perhaps deliberately. Defense lawyers wish to deny appraisal rights to everyone except those who happened to hold the stock on the record date, not because of some historic connection between the two concepts but because it forces stockholders to operate at a severe information deficit. Stockholders are informed of the record date sometimes well after it has passed, when they learn of it in the company's definitive proxy statement.

¹⁶⁸ Theodore Mirvis, *Delaware Court Decisions on Appraisal Rights Highlight Need for Reform*, Harvard Corporate Governance Blog, Jan. 21, 2015 (“Billions of dollars are now committed to buy appraisal claims for investors who can scarcely be said to have ‘dissented,’ as they did not even own the stock they ever had the right to vote on.”).

It is easy to forget how little stockholders know in the wake of a merger announcement.¹⁶⁹ They know only the principal terms of the deal and the contents of the merger agreement, which are filed publicly and promptly. But stockholders are otherwise stranded on an informational desert. They know nothing about key information that will help them evaluate the merger: about the company's standalone projections, about the conduct of management in the negotiations, about the diligence and breadth of the company's sales process, about potential conflicts of interest that the company's advisors may have, and so forth. They learn this information only when they see the company's proxy statement, which also serves as formal notice of appraisal rights under Delaware law. This is also generally when they learn of the record date—and that record date is almost always publicly disclosed after it has passed. In the Transkaryotic transaction, for example, the company issued a press release on June 13, 2005 disclosing that the board had set June 10 as the record date,¹⁷⁰ and the final proxy was not available to stockholders for still another two weeks.¹⁷¹ The consequence of this confluence of factors is that the only stockholders who have enough information to object (or sell to someone who can object) are those that have seen the proxy statement, but any stockholder who has seen the proxy statement would, under the defense lawyer's proposal, be barred from alienating the appraisal right along with the stock. Some defense lawyers have even noted this fact as a bug in the current system instead of the virtue that it is.¹⁷² It is

¹⁶⁹ Jetley and Ji overlook this crucial point. See Guarav Jetley & Xinyu Ji, *Appraisal Arbitrage—Is There a Delaware Advantage*, 71 BUS. LAW. ___, 26 (2016) (suggesting that the 54 days, on average, between the announcement date and the record date is “a meaningfully long period to observe the evolution of the merger arbitrage spread and the deal process”).

¹⁷⁰ See press release attached to Transkaryotic Therapies, Inc. DEFA14A filing, available at <http://www.sec.gov/Archives/edgar/data/885259/000095013505003271/b55446tdefa14a.htm>.

¹⁷¹ See Transkaryotic Therapies, Inc. Definitive Proxy Statement, filed with SEC on June 27, 2005, available at <http://www.sec.gov/Archives/edgar/data/885259/000095013505003515/0000950135-05-003515-index.htm>.

¹⁷² Fried, Frank, Harris, Shriver & Jacobson LLP M&A Briefing, *New Activist Weapon: The Rise of Delaware Appraisal Arbitrage: A Survey of Cases and Some Practical Implications*, June 18, 2014, at 2 (“With this timing advantage, investors can review information in the company's proxy statement relating to its sale process and fairness of price, can assess any pre-closing shareholder litigation that has been commenced, and can evaluate market, industry

little different than a restaurant asking a patron to order her meal before she has a chance to look at the menu.

An additional difficulty with the law firms' proposal to vest the record date with some magical importance for purposes of appraisal is that the record date is controlled by the very board that may have sold the company for too little. The same fatal flaw is true of other related proposals offered by defense lawyers, like one to replace the effective date of the merger as the relevant valuation date in an appraisal with some earlier date like the stockholder vote date.¹⁷³ The timing and structure of these fundamental transactions are entirely within the control of the board, the very body that may have failed to secure fair value. Moreover, stockholder votes are sometimes held far in advance of the closing of a transaction.

There is a simple way of meeting the defense lawyers' goals while at the same time preserving the robust and beneficial market for appraisal-eligible shares: limiting the discretion of the board in setting the record date to ensure that cannot keep stockholders in an information vacuum. If the Council were to recommend stripping appraisal rights from beneficial holders who did not own the stock on the record date, it should also propose a related change to Section 213(a) of the DGCL, which addresses the setting of the record date. Section 213(a) outlines the procedure for the fixing of a record date by the board. It contemplates two record dates: one fixing the date to determine stockholders entitled to notice of the meeting, and another fixing the date for determining the stockholders entitled to vote at the meeting. The straightforward way to fix the defense lawyers' proposal is to add the following language to Section 213(a): "Notwithstanding

and target company conditions at a time much closer to the merger closing date (as of which time the court will determine fair value in an appraisal proceeding) as compared to the time when the deal price was negotiated and then voted on.").

¹⁷³ Trevor S. Norwitz, Delaware Legislature Should Act to Curb Appraisal Arbitrage Abuses, CLS Blue Sky Blog, Feb. 10, 2015.

anything else in this subsection, for any meeting of stockholders where stockholders will vote upon a transaction that triggers rights under § 262 of this title, the record date for determining the stockholders entitled to vote at such meeting shall not be less than 20 dates after the mailing of any applicable notice under § 262(d)(1) of this title.” This would ensure that target stockholders have the ability to sell into a thick and informed market while their shares still have the full complement of stockholder rights that the DGCL contemplates.

One possibility is that defense lawyers’ commitment to tying voting to appraisal rights is fleeting, representing little more than a seemingly simple way to kill the only serious remedy available to stockholders in the event of an opportunistic merger. Some have been comfortable saying as much: “The sensible solution is to amend the statute to make express that appraisal rights are not available for shares purchased after public announcement of the terms of the merger. . . .”¹⁷⁴ But this approach to reform—vesting the record date with more significance while ensuring that stockholders have enough information and time to make good decisions—preserves the virtues of the current system and meets the stated objections of the defense bar.

CONCLUSION

The appraisal remedy has emerged in recent years as one of the most useful avenues for relief from an opportunistic merger. As we have shown, appraisal constitutes a very small percentage of all merger-related litigation involves appraisal; merger class actions are nearly 20 times as prevalent. And those transactions that are targeted by an appraisal petition are more likely to have a lower expected deal price and more likely to involve an insider cash-out transaction. The

¹⁷⁴ Theodore Mirvis, Delaware Court Decisions on Appraisal Rights Highlight Need for Reform, Harvard Corporate Governance Blog, Jan. 21, 2015.

specialists in appraisal, in other words, appear to target their resources on transaction that call for additional scrutiny. This ought to represent private enforcement at its best.

The rise of appraisal has not brought acclaim but instead it has provoked a concerted effort to undermine its effectiveness. Each possible argument trotted out against appraisal—it will deter beneficial mergers or it will cause buyers to hold back value or it will allow appraisal specialists to prey on other stockholders—cannot stand up to serious analysis. The Delaware council should again decline to pursue any of the amendments proposed by Dole or the defense bar. Instead, the Council should propose amendments that eliminate the exception to appraisal rights for all-stock transactions, improve merger-related disclosures, and adopt a *de minimis* requirement for appraisal. To the extent that the Council proposes an amendment that would eliminate the appraisal rights of beneficial owners who acquire after the record date, the Council should constrain the discretion of companies in setting the record date. The record date should be no earlier than 20 days after the mailing of the notice of appraisal rights. This would at least preserve a substantial portion of the benefits of an active market in appraisal rights, thereby aiding minority stockholders and decreasing the cost of equity capital for Delaware corporations.

APPENDIX

Table A

Logit Regressions Where Independent Variable is Whether Transaction Faced Counsellor Appraisal Petition

VARIABLES	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Counsellor appraisal petition	Counsellor appraisal petition	Counsellor appraisal petition	Counsellor appraisal petition	Counsellor appraisal petition	Counsellor appraisal petition	Counsellor appraisal petition	Counsellor appraisal petition
Enterprise value (log)	0.03	0.0378	0.0375	0.0654				
	-0.0883	-0.0893	-0.0895	-0.0899				
Equity value (log)					0.0913	0.104	0.102	0.135
					-0.094	-0.094	-0.0937	-0.0949
One-day residual	-1.051**	-1.078**			-1.136**	-1.175**		
	-0.455	-0.465			-0.481	-0.493		
One-week residual			-1.048**				-1.139**	
			-0.469				-0.492	
Four-week residual				-1.290***				-1.402***
				-0.475				-0.501
Synergistic merger		-0.14	-0.15	-0.116		-0.179	-0.19	-0.155
		-0.367	-0.366	-0.368		-0.366	-0.366	-0.367
Insider participation		0.962**	0.956**	0.975**		0.962**	0.962**	0.982**
		-0.426	-0.426	-0.429		-0.427	-0.426	-0.431
Financial buyer		0.185	0.172	0.124		0.193	0.181	0.134
		-0.39	-0.39	-0.393		-0.39	-0.39	-0.393
Constant	-2.051***	-2.224***	-2.219***	-2.462***	-2.452***	-2.639***	-2.629***	-2.902***
	-0.601	-0.642	-0.645	-0.655	-0.639	-0.677	-0.678	-0.698
Observations	395	392	391	394	397	394	393	396