Using the Deal Price for Determining "Fair Value" in Appraisal Proceedings

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February 6, 2017 Draft

Forthcoming in *The Corporate Contract in Changing Times: Is the Law Keeping Up?* (U. Chicago Press)

This Essay presents new data on appraisal litigation and appraisal outs. I find that appraisal claims have not meaningfully declined in 2016, and that perceived appraisal risk, as measured by the incidence of appraisal outs, has increased since the Dell appraisal in May 2016. After reviewing current Delaware appraisal doctrine, this Essay proposes a synthesizing principle: if the deal process involves an adequate market canvass, meaningful price discovery, and an arms-length negotiation, then there should be a strong presumption that the deal price represents fair value in an appraisal proceeding; but if the deal process does not have these features, deal price should receive no weight. This approach would represent a middle-ground between the competing approaches advanced by twenty-nine law, economics, and finance professors in the DFC Global appraisal, currently on appeal to the Delaware Supreme Court.

JEL Classifications: G30, G34, K22

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I. Introduction

It is well known in corporate law circles that there is a revolution underway with respect to appraisal rights. What used to be a sleepy backwater has become one of the hottest areas of transactional practice and Delaware doctrine. On offense, Chancellor Bill Chandler's 2007 opinion in *In re Appraisal of Transkaryotic Therapies, Inc.* opened the way for appraisal arbitrage, but the tactic did not materialize in a meaningful way until more recently. Sixty-two appraisal actions were filed in 2016, representing $1.9 billion in face-value claims, compared to sixteen actions, representing $129 million in face value, in 2012. (Hoffman 2017)

There are strong signs that this trend will continue: Merion Capital, Verition, and Magnetar Financial, among others, have made massive appraisal arbitrage plays in recent years, taking very large stakes in Delaware companies after the deal is announced but before the record date, with the intention of seeking appraisal of their shares. PetSmart ($889 million in face-value claims) and Starz (anticipated to be $400 million in claims) are just two prominent appraisal actions that are currently pending in the Delaware Chancery Court.

On defense, transactional planners are trying to protect their buy-side clients from appraisal risk by installing appraisal conditions to the deal. These conditions give the buyer the right to walk away in the event that a certain percentage of shares (typically, 10-15%) seek appraisal. What is not known (and cannot be known) are the deals that are entirely deterred due to appraisal risk, because the seller is not willing to accept the uncertainty of an additional acquirer walk-away right.

Until recently, goes the argument, Delaware courts were willing to rely on the deal price in an arms-length deal as the best evidence of "fair value."[1] This

[1] *See, e.g.*, Merion Capital LP v. Lender Processing Services, Inc., C.A. No. 9320-VCL (Del. Ch. 2016) at *73 (deferring to deal price because "[t]he Company ran a sale process that generated reliable evidence of fair value."); Merion Capital LP v. BMC Software, Inc., 2015 WL 6164771, at *18 (Del. Ch. 2015); LongPath Capital, LLC v. Ramtron Int'l Corp., 2015 WL 4540443, at *20 (Del. Ch. 2015); Merlin Partners LP v. AutoInfo, Inc., 2015 WL 2069417, at *17-*18 (Del. Ch. 2015); In re Appraisal of Ancestry.com, 2015 WL 399726, at *23 (Del. Ch. 2015); Huff

approach minimized appraisal risk as long as the deal process was good. However, two recent Delaware decisions arguably disrupted this conventional wisdom. In *In re Appraisal of Dell, Inc.* (Del. Ch. May 2016), Vice Chancellor Laster awarded dissenting shareholders $17.62 per share, which amounted to a 28% premium over the $13.75 per share deal price. Despite an ostensibly robust go-shop process, the Court concluded that "[t]he sale process functioned imperfectly as a price discovery tool" and therefore afforded no weight to the $13.75 deal price. And in *In re Appraisal of DFC Global Corp.* (Del. Ch. July 2016), just two months after *Dell*, Chancellor Bouchard awarded dissenting shareholders $10.21 per share, which was 7% more than the $9.50 per share deal price. In contrast to Vice Chancellor Laster's assessment of the process in *Dell*, Chancellor Bouchard concluded that DFC was sold in an "arm's-length sale," in a "robust" process that "lasted approximately two years and involved . . . reaching out to dozens of

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Fund Investment Partnesrhip v. CKx, Inc. 2013 WL 5878807, at *13 (Del. Ch. 2013), aff'd, 2015 WL 631586 (Del. 2015). *See also* M.P.M. Enterprises Inc. v. Gilbert, 731 A.2d 790, 796 (Del. 1999) ("A merger price resulting from arms-length negotiations where there are no claims of collusion is a very strong indication of fair value."); In re Rural Metro Corp. S'holders Litig., 88 A.3d 54, 102 (Del. Ch. 2014) ("Ordinarily this court places heavy reliance on the terms of a transaction that was negotiated at arm's length, particularly if the transaction resulted from an effective pre- or post-agreement market canvas[s]."); In re Creole Petroleum Corp., 1978 WL 2487, at *2 (Del. Ch. Jan. 11, 1978) (noting that market value "is normally of great weight."). These cases from 2014-16 mark a shift from earlier Delaware Supreme Court guidance, which deferred less to market prices. *See, e.g.,* Golden Telecom v. Global GT (Del. 2010) ("Requiring the Court of Chancery to defer – conclusively or presumptively – to the merger price, even in the face of a pristine, unchallenged transactional process, would contravene the unambiguous language of the statute and the reasoned holding of our precedent.").

[potential buyers]" and "did not involve . . . conflicts of interest." Nevertheless, the Court only afforded the deal price one-third weight in its fair-value assessment.

Brouhaha ensued. On *Dell*, Wachtell, Lipton, Rosen & Katz wrote to its clients that "[t]he result reflects the remarkable view that 'fair value' in Delaware represents a price far higher than any buyer would have been willing to pay and that the merger price derived from an admirable sales process should be accorded no weight." (Lipton, Mirvis, Savitt & McLeod 2016) And Matt Levine stated in *Bloomberg View* (mostly tongue-in-cheek) that "[t]he proof that $17.62 was the fair price is that *no one was willing to pay it.*" (emphasis in original)

DFC Global added fuel to the fire for critics of this allegedly new Delaware approach, because the deal price was only afforded one-third weight despite a robust market canvass and the absence of conflicts of interest. In view of *DFC Global*, transactional attorneys wondered out loud how they could provide any assurances (or even guidance) for their clients regarding appraisal risk. Compounding the confusion in *DFC Global*, the company pointed out a clerical error to the Court after the opinion was issued. Correcting this error would have reduced the discounted cash flow (DCF) valuation from $13.07 per share to $7.70 per share, or 19% *below* the $9.50 per share deal price. Instead, the Court corrected the error but simultaneously increased the perpetuity growth rate from

3.1% to 4.0% – which was beyond what even the petitioners' valuation expert had proposed – in order to return to the Court's original valuation of $10.21. (DFC Global Opening Brief at 2; Frankel 2016)

All of this has contributed to a practitioner conventional wisdom that appraisal law and valuation approaches are in a state of disarray in Delaware. Both *Dell* and *DFC Global* are on appeal to the Delaware Supreme Court. Law360 declared both cases to be among the "top ten" to watch for 2017. (Chiappardi 2017)

Part II of this Essay presents new data on appraisal litigation (the "offense") and appraisal conditions (the "defense") in Delaware M&A deals. Part III offers a synthesis of the allegedly new developments in Delaware appraisal law, to demonstrate why current doctrine is not in a state of disarray but can be conceptualized as a coherent whole. Part IV recommends refinements to Delaware appraisal doctrine that would reduce the perceived appraisal risk by providing transactional planners a safe harbor if (but only if) the deal process is pristine. Part V concludes by comparing my proposed approach to approaches currently being offered by other corporate law academics in the *DFC Global* appeal.

II. New Evidence on Appraisal Litigation and Appraisal Outs

I begin with an examination of a hand-collected database of all appraisal claims filed in the Delaware Chancery Court between 2009 and 2016, provided to me by Liz Hoffman of the *Wall Street Journal*. **Figure 1** below summarizes this data for the public-company deals in the database. The face value of claims is calculated as the number of shares seeking appraisal multiplied by the deal price.

Figure 1: Face Value of Appaisal Claims in Delaware Chancery Court (2009-2016)

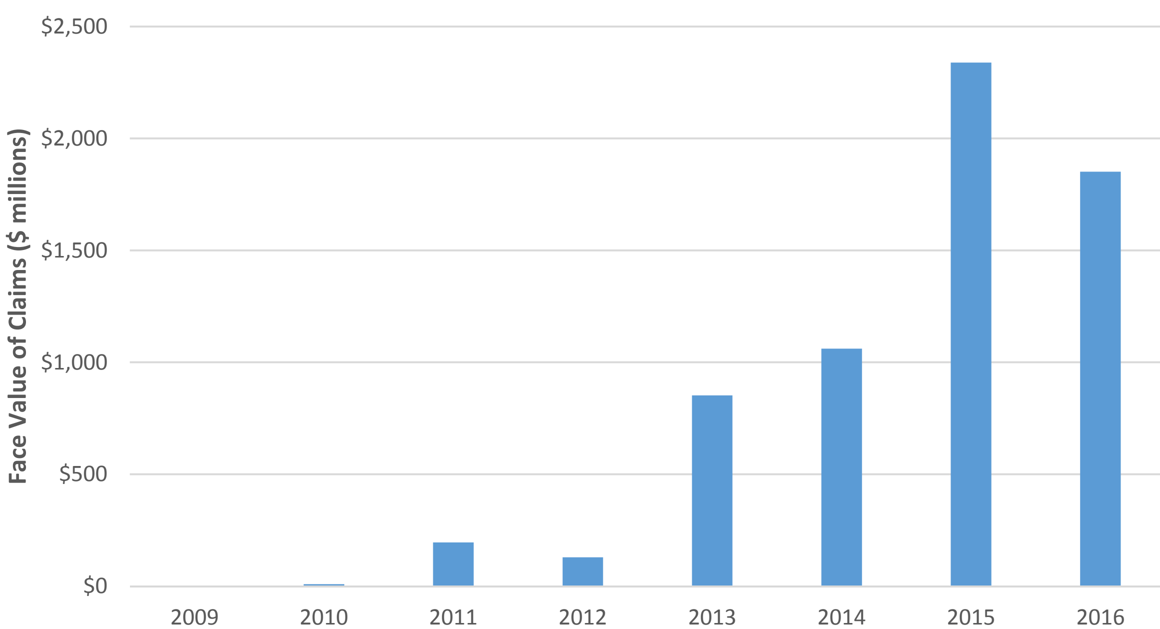


Figure 1 shows that appraisal has gone from a trickle in 2009 to approximately $2.0 billion in face value of claims in each of 2015 and 2016 – yielding a 70% cumulative annual growth rate over the past five years. **Table 1** lists the top 20 claims in the sample:

Table 1: Top 20 Appraisal Claims by Face Value

Company	Face Value of Claims ($MM)	% of Disinterested Shares	Year
Petsmart	$889	11%	2015
Safeway	$618	7%	2015
Dell	$505	2%	2013
BMC Software	$353	5%	2013
Starz	$299	9%	2016
AOL	$267	7%	2015
Dole	$230	31%	2013
Diamond Resorts	$207	10%	2016
Columbia Pipeline	$203	22%	2016
Examworks	$198	14%	2016
Lender Processing	$195	6%	2014
Zale	$184	27%	2014
Towers Watson	$163	2%	2016
Solera	$139	4%	2016
Clearwire	$125	3%	2013
Rouse Properties	$100	14%	2016
DirecTV	$91	<1%	2015
Fresh Market	$81	6%	2016
Ckx	$76	15%	2011
Rockwood Holdings	$75	1%	2015

Source: Hoffman database; MergerMetrics

The two largest claims in the sample (Petsmart and Safeway) made 2015 a record-breaking year. Even without such blockbuster claims in 2016, that year recorded the second-highest volume of claims. This result is notwithstanding the reforms to the appraisal statute in August 2016 (notably, the reduction in the statutory interest rate), which were intended to make appraisal less economically attractive. Although it is too to tell, the data provides suggestive evidence that the 2016 statutory reforms have not been effective in meaningfully slowing down appraisal arbitrage and highlights the need for safe harbors in appraisal doctrine, which I turn to in Part IV of this Essay.

Interestingly, none of these top 20 deals included appraisal outs (discussed in more detail below). This non-finding cuts against a certain conventional wisdom among practitioners that including an appraisal out put a “bullseye” on the deal for appraisal arbitrageurs. Instead, appraisal seems to be driven by deal fundamentals: for example, by far the largest deal in the sample in percentage terms (at 31% of disinterested shares seeking appraisal) occurred in the Dole MBO, which included egregious process flaws including material misrepresentations from the CEO/CFO to the board.

Table 2 shows the top ten shareholders that filed appraisal claims during the timeframe of analysis:

Table 2: Top 10 Shareholders Filing Appraisal Claims

Shareholder	Face Value of Claims ($MM)
Merion[2]	$1,809
Verition	$545
T. Rowe Price[3]	$434
Fortress	$403
Third Point	$332
Magnetar	$212
Farallon	$198
Muirfield	$176
Fir Tree	$149
Hudson Bay	$145

Source: Hoffman database

Table 2 shows significant concentration in the appraisal arbitrage industry, with Merion accounting for $1.8 billion in face value of claims – more than three times the second-larger filer, and representing a full 36% of the face value of all appraisal claims during the timeframe of analysis. Merion's remarkable market share might be explained by the fact that it has a dedicated appraisal arbitrage fund, and has been engaged in appraisal arbitrage longer than most of its competitor firms.

Putting it all together, the data shows what most corporate attorneys already know: appraisal has exploded in recent years, with highly sophisticated

[2] Includes claims filed by Merion Magnetar.
[3] Includes 27 million shares (or $371 million in face value of claims) brought in the Dell appraisal, which were ultimately knocked out due to procedural defects.

shareholders engaging in massive appraisal arbitrage and a multi-round, high-stakes game with M&A practitioners and the Delaware courts.

Against this offensive surge, I now turn to the defensive side of the equation. Using the MergerMetrics database, I construct a sample of all public-company acquisitions during the same time period as the Hoffman database (2009 to 2016), in which cash was at least some of the consideration and appraisal rights therefore likely applied. (n=1,474) As a starting point I find that the incidence of appraisal outs declines significantly with deal size: from 30% incidence in deals smaller than $250 million in value to 3% incidence in deals larger than $2.5 billion. This finding might reflect the fact that buyers are less confident about an adequate deal process in smaller deals than in larger deals, notwithstanding the fact that the dollar value of appraisal risk is greater in larger deals. I also find that appraisal outs are more common in non-Delaware deals (25% incidence) versus Delaware deals (10%), though this difference is driven almost entirely by the different average size of Delaware versus non-Delaware deals. The modal threshold that triggers an appraisal out is 10-14.9%, with Delaware deals skewing to slightly higher thresholds (i.e., less potency to the appraisal out) than non-Delaware deals.

To my knowledge, and indirectly confirmed by the MergerMetrics data,[4] no appraisal out has actually been triggered during this ten year period. This non-finding can be readily explained by the fact that appraisal arbitrage only works if the deal closes – so triggering an appraisal out would actually be a mistake among the dissenting shareholders. The concentration in the industry and the sophistication of the players makes it highly unlikely that such a mistake would happen in practice.

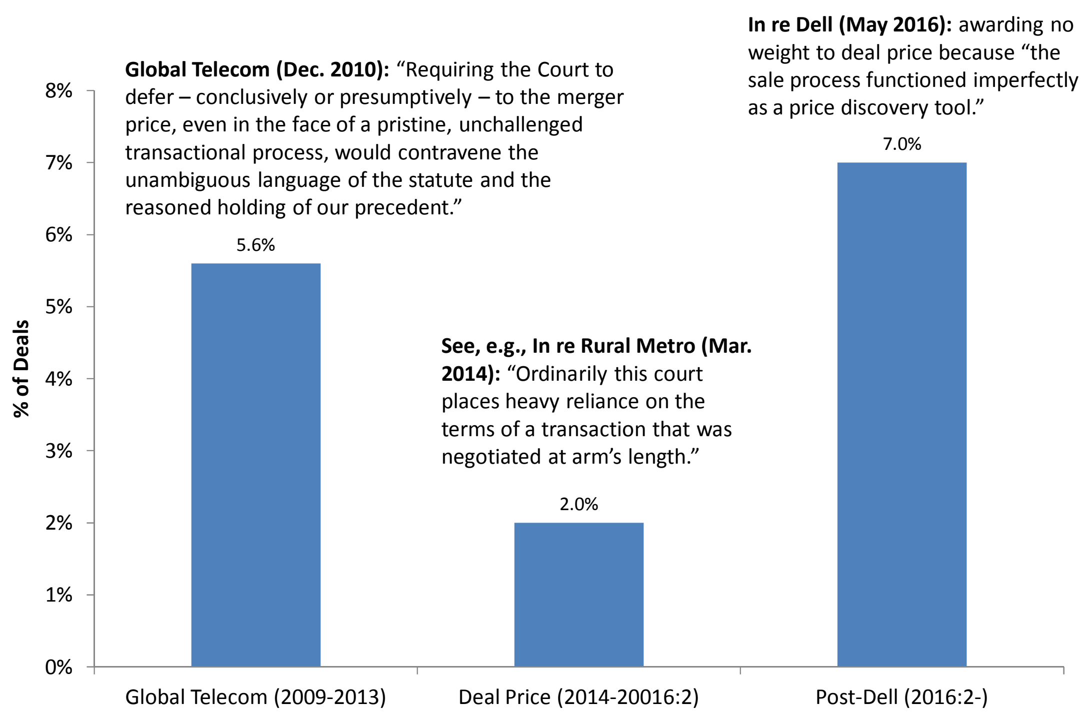
Focusing on the sub-sample of M&A deals involving Delaware targets larger than $250 million in deal value (n=629), I divide the deals into three time periods: the "Global Telecom" era (2009-2013), during which the Delaware Supreme Court held that deferring to the deal price "would contravene the unambiguous language of the statute and the reasoned holding of our precedent;" the "Deal Price" era (2014-May 2016), during which a series of Delaware Chancery Court decisions relied on the deal price as best evidence of fair value as long as the deal process was good; and the post-*Dell* era (June to December 2016). While I argue in Part III that the post-*Dell* era does not represent a meaningful change from Delaware's overall appraisal approach, practitioners certainly claimed that it did. The *Wall Street Journal*, for example, reported that "[t]he [*Dell*] decision is sending

[4] MergerMetrics reports no instance where a deal was terminated due to an appraisal out.

shudders all over Wall Street and the boardrooms of corporate America, because the court, in effect, overruled 'the market.'" (Hoffman 2016)

Figure 2 presents the incidence of appraisal outs in this sample during each of these three periods:

Figure 2: Appraisal Out Incidence (2009-2016)



Source: MergerMetrics. Includes all deals involving Delaware targets larger than $250 million in value

Figure 2 provides at least two interesting findings. First, consistent with intuition, the incidence of appraisal outs declined significantly in the period between 2014 and the first half of 2016 (pre-*Dell*), as the Delaware Chancery

Court gave practitioners guidance that appraised value would be the deal price as long as the deal process was good. <u>Second</u>, Figure 2 shows that practitioners' concerns regarding appraisal risk in the post-*Dell* era have materialized in the form of greater incidence of appraisal outs – in fact, an even higher incidence than during the *Global Telecom* era.

III. A Synthesis of Existing Doctrine

The prior Part presented evidence suggesting that perceived appraisal risk has increased in the aftermath of *Dell*. Some of my earlier work has presented empirical evidence indicating that practitioners can over-react to developments in Delaware doctrine (*see, e.g.*, Coates & Subramanian 2000). In this Part, I explain why the increase in appraisal outs in the aftermath of *Dell* represents the same phenomenon: that is, much ado about not very much.

I begin with a synthesis of where the Delaware doctrine of appraisal rights currently stands. In a nutshell, I reject claims that the Dell appraisal represents a departure from the prior Delaware approach, which emphasized reliance on the deal price in arms-length deals. Instead, *Dell* is just another chapter in the eternal dance between the Delaware Chancery Court and transactional practice with respect to deal process design. Transactional planners innovate, the Delaware courts signal qualified acceptance, and then transactional planners push to see how far Delaware will allow the new deal technology to go. (*cf.* Coates & Subramanian 2000; Restrepo & Subramanian 2017)

In this chapter of the (no doubt) never-ending saga, the Delaware courts signaled ten years ago that a post-signing go-shop process could provide a meaningful market canvass. Such a market check satisfies the target board's *Revlon* duties and would also provide presumptive evidence that the deal price represents fair value in appraisal proceedings. In *Dell*, transactional planners tested the limits of this deal technology. As it turns out, the test went beyond the breaking point.

In *Dell*, the Special Committee engaged in very limited pre-signing competition – reaching out only to private equity (PE) firms Kohlberg Kravis Roberts and Texas Pacific Group (in addition to Silver Lake, which teamed with Michael Dell to make its offer). The Special Committee did not reach out to other PE firms – notably, Blackstone, which had just hired former Dell's former M&A head Dave Johnson; or Southeastern, which had originally proposed the management buyout idea to Michael Dell. Nor did the Special Committee reach out to Hewlett-Packard, even though Evercore (one of the Special Committee's bankers) estimated $3-4 billion of synergies between Dell and HP. During this pre-signing phase, Evercore assured the Special Committee that there was no need to reach out to Blackstone and HP pre-signing because they (Evercore) would reach out during the go-shop period; but Evercore was conflicted in this advice because they received a large contingent payment for any overbid they found during the go-shop period, and no such payment for a pre-signing overbid.[5]

Vice Chancellor Laster correctly chastised the Special Committee for not engaging in more pre-signing competition:

> The Committee did not engage with Blackstone before signing, even though Blackstone approached the Company in January about a possible transaction. . . .
>
> [In addition,] [d]uring the pre-signing phase, the Committee did not contact any strategic buyers. . . . HP was the obvious choice.
>
> Without a meaningful source of competition, the Committee lacked the most powerful tool that a seller can use to extract a portion of the bidder's anticipated surplus. The Committee had the ability to say no, and it could demand a higher price, but it could not invoke the threat of an alternative deal. . . .

One takeaway from *Dell* is that pre-signing and post-signing competition are not created equal: that is, a post-signing go-shop is not a substitute for robust pre-signing competition. If the Special Committee is going to give up pre-signing

[5] *See also* Dell Appraisal at 23: "The petitioners observe correctly that Evercore would earn a contingency fee only from offers produced during the go-shop period, so it had an incentive to prefer that any additional bidder emerge during that phase."

competition in favor of a post-signing go-shop, it better get something in exchange, ideally a price bump. (Subramanian 2016)

Another takeaway from *Dell* is that sell-side advisors should approach both strategic buyers and financial buyers during the pre-signing phase.   An auction solely among financial buyers will get the highest price generated from a leveraged buyout model, which (the Dell court found) may not be the same as "fair value."

In addition to limited pre-signing competition and the absence of pre-signing strategic buyers, the Special Committee granted Michael Dell and Silver Lake a one-time match right. While a one-time match right is better than an unlimited match right, it eliminated the possibility of an offer with a "short fuse," which might have been the only way a third-party bidder could find a meaningful pathway to success against Michael Dell. For the first time (to my knowledge), the Delaware Chancery Court acknowledged what game theorists have known for a long time, that an unlimited match right represents a "powerful deterrent" to a potential third-party bid.

To summarize: the Dell deal process checked all the boxes to satisfy the indicia of a market canvass, but Vice Chancellor Laster looked beneath the surface to investigate whether this market canvass was meaningful. The limited pre-signing competition, the one-time match right, Evercore's conflicted advice, and the tight

(45-day) go-shop window did not adequately mitigate the inherent advantage of Michael Dell/Silver Lake; as such, the market canvass correctly received no weight.

The lesson from *Dell* is *not* that deal price no longer represents fair value in an arms-length deal; but rather that practitioners have to earn the right for their deal to be considered arms-length. Mere indicia of a market canvass are no longer sufficient. Put differently, arguments that *Dell* represents a departure from prior appraisal doctrine are based on the premise that it replicated an arms-length deal. Closer inspection reveals that it did not. Practitioners have to work harder than exhibited in the Dell transaction to cleanse the taint of conflict.

There is no evidence to date that transactional planners have operationalized these learnings. For example, in the MergerMetrics sample described in Part II, the incidence of go-shop clauses (hovering around 10%) and the incidence of match rights (around 98%) have not declined in the six months since *Dell*, compared to the six months before. In effect, practitioners have tried to cure the symptoms of *Dell* (with increased incidence of appraisal outs) but not the underlying disease (through improved deal process). Unless practitioners understand the correct learnings from *Dell* and earn the right to call their deal arms-length, Delaware courts will continue to ignore deal prices and appraisal arbitrage firms will continue to run the table in appraisal proceedings.

One obstacle to dissemination of deal process design best practices is the fact that appraisal is a buy-side cost, but the sell-side controls the deal process that determines whether the deal price represents fair value. In contrast, fiduciary duty claims are a sell-side risk, so the sell-side board has incentives to at least satisfy its fiduciary duties. The result is a deal price that is “good enough for fiduciary duty” (as one prominent Delaware practitioner recently put it to me), which is not necessarily the same as “fair value.”

And so buy-side advisors and their clients have an interesting tactical choice: they could encourage the sell-side board to have a good deal process (pre-signing auction, no matching rights, etc.) in order to reduce their post-closing appraisal risk, but that very same deal process might push up the price that the buyer has to pay to all shareholders. Better, in most cases, to allow a deficient process that gets the seller a “good enough for fiduciary duty” price, and then bear the consequences of appraisal. The result is that dissemination of deal process design best practices will be slow, at best.

IV. Refinements to Existing Doctrine

The Prior part demonstrated why *Dell* is not aberrational; rather, it reflects the Delaware courts' acknowledgement that not all market checks are created equal. But if an inadequate market canvass should receive no weight in an appraisal decision (see *Dell*), the question remains what weight should an adequate market canvass receive. My proposed answer to this question is straightforward: 100%. This approach would represent a departure from *DFC Global*, which awarded only a one-third weight to the deal price even though the Court concluded that the deal process was robust, involved a prolonged market canvass, and did not have conflicts of interest.

The Court in *DFC Global* declined to award 100% weight to the deal price because the company was in a period of significant regulatory uncertainty. Interestingly, Dell was in a similar state of equipoise at the time of the MBO: on one hand the metaphor of "falling knife" was used repeatedly in the discussion of Dell's prospects, while on the other hand, observers and participants in the deal (including Michael Dell) repeatedly referenced the large upside potential. But this kind of "barbell" scenario should not rule out the validity of deal prices as strong evidence of fair value.

By way of analogy, the correct price for a coin flip with payoffs of $1 or nothing is 50 cents, and a good deal process will find that price in the marketplace. In *Dell*, the coin flip seems to have paid off: In April 2014 (just 16 months after the deal closed) Dell management reported cost savings of $1.6 billion; and in December 2014 *Bloomberg* reported that Michael Dell and Silver Lake had made "a paper gain of at least 90 percent on their investment." But even if the coin flip pays off, the right price at the time of the deal is still 50 cents. The problem, as the Court identified, was that Michael Dell bought the coin flip for 40 cents.

Even in a steady-state company, where the cash flows can be predicted better than in *DFC Global* or *Dell*, auction theorists might quibble that an adequate market canvass does not necessarily yield fair value. For example, in an auction where the highest reservation price is $100 and the second-highest is $80, auction theory predicts that the seller will receive $81 – just more than the $80 second-highest reservation price, but not nearly the $100 full willingness-to-pay from the highest bidder. A brave court might ignore the deal price and conduct a DCF analysis to award fair value of $100, even though the auction only achieved $81.

However, as prior commentators have noted (*see, e.g.*, Subramanian 1998), valuation methods are notoriously imprecise in estimating "fair value." The error that comes from achieving only the second-highest reservation price is not as great as the error that is inherent in a discounted cash flow analysis. In my recent *Mergers & Acquisitions* executive education course at Harvard Business School, for example, experienced valuation practitioners deviated from each other by as much as 30-40% in valuing M&A targets. In an appraisal proceeding, Delaware Chancery Court judges are asked to engage in the artificially precise task of providing a point estimate of value. Even investment bankers, who are finance professionals, only provide a valuation range in their fairness opinions.

For all of these reasons, my proposed approach would put 100% weight on deal price if the deal process includes an adequate market canvass, meaningful price discovery, and an arms-length negotiation. Then Vice-Chancellor (now Delaware Supreme Court Chief Justice) Leo Strine put it well, more than a decade ago in *Union Illinois v. Union Financial* (Del. Ch. 2004): "[F]or me (as a law-trained judge) to second-guess the price that resulted from that process [a competitive auction] involves an exercise in hubris and, at best, reasoned guess-work."

As discussed in the prior Part, the test is a stringent one: for example, an exclusive pre-signing negotiation followed by a go-shop process in which the buyer gets an unlimited match right would probably not qualify for deference to the deal price. Practitioners would need to earn the right to call their deal process arms-length, which would mean departing from some current "market" practices.

But if they earn the right, the deal price should get 100% weight in appraisal proceedings.

Putting it all together, the proposed rule is this: in a true arms-length deal with meaningful price discovery, there should be a strong presumption that the deal price represents fair value in an appraisal proceeding;[6] but if the deal process does not include a meaningful market canvass and an arms-length process, deal price should receive no weight. The first prong is inconsistent with *DFC Global* while the second prong is consistent with *Dell*.

Students of corporate law may recognize a similarity to the Delaware Supreme Court's recent refinements to freeze-out doctrine in *Kahn v. M&F Worldwide Corp* (Del. 2014). In that case, the Delaware Supreme Court held that approval by a special committee of independent directors and approval from a majority of the minority shares adequately cleansed the taint of conflict such that the business judgment rule should apply. In doing so the Delaware Supreme Court converted a substantive inquiry ("Was the deal price entirely fair to the minority shareholders?") into a procedural inquiry ("Did the minority shareholders have

[6] This strong presumption might be overcome, for example, by evidence that the fair value at closing (which is what the Delaware appraisal statute requires) was different from fair value at the time the deal was announced; or that the deal price included some measurable and significant share of the synergies from the deal (which should be excluded for purposes of appraisal). But either of these would just require adjustments from the deal price rather than giving the deal price less than 100% weight.

adequate procedural protections?”). Similarly, the approach proposed in this Essay converts a substantive question (“What is the fair value of the dissenting shares?”) into a procedural question (“Was the deal process good?”).

One might reasonably ask why the test proposed in this Essay needs to be binary: where the deal process is good but not perfect, why not acknowledge the shades of grey by awarding the deal price (say) one-third weight? This weighting system is a vestige of the pre-*Weinberger* “Delaware Block Method,” where courts were instructed to attach weights to each of stock market value, earnings value, and net asset value. While *Weinberger* explicitly rejected the Delaware Block Method in favor of “any techniques or methods which are generally considered acceptable in the financial community,” the idea of a weighting approach continues to have intuitive appeal as a way to triangulate on fair value.

However, deal process is better assessed as a binary question: was there an adequate market canvass, meaningful price discovery, and an arms-length negotiation? In this inquiry there can be no crossing the river halfway. To see why, consider a not-so-hypothetical deal process in which three financial buyers have reservation prices of $70, $80, and $90; and one strategic buyer has a reservation price of $100. The seller conducts a pre-signing auction solely among the financial buyers and reaches a deal with the high bidder among them, at $81.

The seller then runs a go-shop, and the strategic buyer declines to bid because the financial buyer has a match right. The deal closes at $81 and certain shareholders seek appraisal.

In that proceeding, the Court concludes that the Special Committee erred in not reaching out to the strategic buyer pre-signing, and further erred in providing the financial buyer a match right. Now what? The Court could nevertheless award some weight to the $81 deal price, on the grounds that the deal process was good but not perfect. But this stylized example illustrates why such a weighting approach would be a mistake, because it would be impossible to know what would have happened in the event of a meaningful market canvass. Put differently, the very nature of deal process design makes it impossible to determine what impact (if any) a flaw has on the deal price. In some endeavors (say, counting marbles) an after-the-fact reviewer can bracket the error term. This is not possible with deal process errors. The implication is that the weighting for deal price in appraisal proceedings should necessarily be an all-or-nothing affair.

V. Comparison to Alternative Approaches

In the *DFC Global* appeal currently pending before the Delaware Supreme Court, twenty-nine law and finance professors have lined up on both sides with amicus briefs. While I ultimately favor reversal in that case, I believe that my approach for doing so would represent a middle-ground between the competing approaches offered by my colleagues in academia.

On one end of the spectrum, nine law and corporate finance professors have submitted an amicus brief urging reversal.[7] These well-respected scholars propose that appraised value should depart from the deal price only "where the transaction price bears indications of misinformation or bias." Bainbridge et al. (2017) at 16. With regard to misinformation, the professors explain that "where material information is withheld from the market, discounted cash flow or other valuation analyses are necessary because the deal price will not reflect that inside information." *Id.* at 17. With regard to bias, the professors invoke fiduciary duty doctrine, requiring only that "directors must make an informed decision about value" and "their decision must be disinterested." *Id.* at 16.

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[7] The nine are (affiliations as noted in the brief): Stephen M. Bainbridge, William D. Warren Distinguished Professor of Law at UCLA School of Law; William J. Carney, Charles Howard Chandler Professor of Law Emeritus at Emory University School of Law; Lawrence A. Cunningham, Henry St. George Tucker III Research Professor of Law at George Washington University Law School; Hideki Kanda, Emeritus Professor at the University of Tokyo and Professor at Gakushuin University Law School; Michael Knoll, Theodore K. Warner Professor of Law and Academic Director for Legal Education Programs, Law School, Professor of Real Estate, the Wharton School, and Co-Director, the Center for Tax Law and Policy, at University of Pennsylvania; Fred S. McChesney, de la Cruz-Metschikoff Endowed Chair in Law and Economics at University of Miami School of Law; Keith Sharfman, Professor of Law & Director of Bankruptcy Studies at St. John's University School of Law; George B. Shepherd, Professor of Law at Emory University School of Law; and Thomas Smith, Professor of Law at University of San Diego School of Law.

For reasons described in this Essay, the Bainbridge et al. approach would represent an overly broad reliance on the deal price. The approach would break from well-established Delaware doctrine by requiring a fiduciary duty breach in order to depart from the deal price in appraisal. Delaware courts have repeatedly acknowledged that the inquiry in a fiduciary duty proceeding is not the same as the inquiry in an appraisal proceeding, yet the Bainbridge et al. approach tethers these two things together. Similarly, requiring "misinformation" in order to depart from the deal price sets an unduly high bar. Take *Dell*: no one would claim that there was "misinformation" in that deal, but just because the Dell shareholders were not deceived does not mean that they received fair value.

At the other end of the spectrum, no fewer than twenty other professors of law, economics, and finance have submitted an amicus brief urging affirmance of *DFC Global*.[8] These equally well-respected professors argue that "Chancellor

[8] The twenty are (affiliations as noted in the brief): Jennifer Arlen, Norma Z. Paige Professor of Law at NYU Law School; Robert Bartlett, Professor of Law at UC Berkeley School of Law; Antonio Bernardo, Professor of Finance at the UCLA Anderson School of Management; Bernard S. Black, Nicholas D. Chabraja Professor at Northwestern University, Pritzker School of Law, Institute for Policy Research, and Kellogg School of Management (Finance Department); Patrick Bolton, Barbara and David Zalaznick Professor of Business and member of the Committee on Global Thought at Columbia University; Brian Broughman, Associate Dean for Research and Professor of Law at Indiana University, Maurer School of Law; Albert H. Choi Albert C. BeVier Research Professor of Law, University of Virginia School of Law; John C. Coffee Jr., Adolf A. Berle Professor of Law, Columbia Law School; Peter Cramton, Professor of Economics at the University of Maryland and European University Institute, and on the International Faculty at the University of Cologne; Jesse M. Fried, Dane Professor of Law at Harvard Law School; Jeff Gordon, Richard Paul Richman Professor of Law

Bouchard found that the tremendous regulatory uncertainty surrounding DFC Global reduced the reliability of the negotiated price," and that this finding "should be treated as any other finding of fact." (Arlen et al. 2017) Arlen et al. further argue that "exclusive reliance on the merger price is *functionally equivalent to eliminating the appraisal remedy altogether*." *Id.* at 11. (emphasis in original) Under their proposed approach, the weight afforded to the deal price by the Chancery Court should be disturbed only for abuse of discretion. *Id.* at 20.

For reasons described in this Essay, the cost of imprecise valuation methodologies is likely to be greater than the cost of imperfect price discovery due to regulatory uncertainty. Awarding anything less than 100% weight to the deal price when the deal process is good would create unnecessary appraisal risk and would unnecessarily chill value-creating deals.

To summarize, the Bainbridge et al. approach would require reversal of both *DFC Global* and *Dell*, because there was no "misinformation or bias" in either deal

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at Columbia Law School; Eric Maskin, Nobel Laureate and Adams University Professor, Harvard University; W. Bentley MacLeod, Sami Mnaymneh Professor of Economics, Professor of International and Public Affairs, Columbia; Justin McCrary, Professor of Law at UC Berkeley Law; Alan Schwartz, Sterling Professor at Yale University; Kathryn E. Spier, Domenico De Sole Professor of Law at the Harvard Law School; Eric L. Talley,Isidor and Seville Sulzbacher Professor of Law at Columbia Law School; Robert Thompson, Peter P. Weidenbruch Professor of Business Law at Georgetown Law; Mark Weinstein, Associate Professor of Finance and Business Economics at the University of Southern California Marshall School of Business; and Ivo Welch, Distinguished Professor of Finance and holds the J. Fred Weston Chair in Finance at UCLA Anderson.

process. As such, the deal price would govern in both deals. The Arlen et al. approach would require affirmance of both cases (unless there was abuse of discretion), through deference to the finder of fact on the appropriate weight for the deal price. In contrast, my proposed approach would suggest reversal of *DFC Global* and affirmance of *Dell*. This middle-ground approach would defer entirely to the deal price when the deal process is good (thus reversing *DFC Global*) but cast a "hard look" as to whether the deal process included an adequate market canvass, meaningful price discovery, and an arms-length negotiation (as in *Dell*).

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