

NOTE

DEFINING APPRAISAL FAIR VALUE

*Ben Lucy**

Appraisal is a statutory mechanism that entitles dissenting stockholders of Delaware merger targets to receive a judicially determined valuation of their shares. During a decade when Delaware courts significantly constrained other legal avenues of merger dissent, appraisal petitions increased dramatically, with individual cases potentially implicating billions of dollars of stockholder value. Recent appraisal case law has sparked considerable controversy over the role of market prices in courts' appraisal valuations. Courts and commentators have struggled to articulate exactly when market prices are the best evidence of fair value, as well as what types of market prices are most relevant to appraisal fair value. This Note presents a revised conception of appraisal fair value that is informed by economic theory and rooted in Delaware corporate law's longstanding goals of facilitating capital formation and maximizing stockholder value.

This Note proposes two changes to existing conceptions of merger deal prices in appraisal cases. First, the appraisal statute should be understood to exclude the value of reduced agency costs from appraisal awards. Second, when material non-public information is disclosed to the buyer but withheld from the market, both the appraisal statute and basic notions of market efficiency demand that courts take cognizance of it. The best way to operationalize these conceptual modifications is to presume that the target's unaffected stock price equals fair value unless the petitioner establishes that material information was withheld from the market.

* J.D. & M.B.A., University of Virginia, 2020. I am very grateful to Professor Quinn Curtis, who introduced me to corporate law and advised me on this Note. For helpful comments and suggestions, I thank Wade Houston, Will Walsh, George Geis, Joe Fore, Nick Carey, Rebecca Lamb, F.D. Carroll, Matt Hoffer-Hawlik, and Matt Levine. I thank Charlotte K. Newell for educating me about the history of Delaware's appraisal statute, and the staff of the *Virginia Law Review* for their input and editorial work on this Note—especially Matt West.

This approach adds needed clarity to the Delaware Supreme Court’s salutary recent embrace of the efficient capital markets hypothesis in the appraisal context. Adopting it would increase stockholder value, encourage efficient change-of-control transactions, and simplify appraisal proceedings. It preserves appraisal’s foundational role as a safeguard against the exploitation of minority stockholders by compensating them when the deal price omits suppressed material information.

| | |
|--|------|
| I. INTRODUCTION | 1184 |
| II. ORIGINS AND PURPOSES OF APPRAISAL LAW..... | 1189 |
| A. Policing the Market for Corporate Control..... | 1190 |
| B. Delaware Fair Value | 1194 |
| C. Dell and DFC | 1196 |
| D. Aruba and Beyond: The Economics of Fair Value | 1199 |
| III. A NEW FRAMEWORK FOR APPRAISAL FAIR VALUE..... | 1203 |
| A. Guiding Principles..... | 1204 |
| B. The Four Components of Merger Price..... | 1206 |
| C. Courts Should Exclude Agency Cost Reductions from Appraisal Awards Because They Represent Value Arising from the Merger | 1207 |
| D. Appraisal Awards Should Include the Impact of MNPI on the Merger Price | 1211 |
| E. Toward a New Judicial Framework for Appraisal..... | 1213 |
| IV. APPLYING THE FRAMEWORK..... | 1214 |
| A. Application to Recent Appraisal Cases | 1214 |
| B. Likely Consequences for Appraisal Litigation | 1216 |
| C. Likely Consequences for Capital Formation and the M&A Market..... | 1218 |
| D. The Continuing Importance of Appraisal..... | 1220 |
| V. CONCLUSION..... | 1221 |

I. INTRODUCTION

Section 262 of the Delaware General Corporation Law (“DGCL”) provides that a dissenting target stockholder in a merger or consolidation transaction may petition the Court of Chancery for an award of the fair

value of her shares.¹ Appraisal is a critical safety net for minority stockholders, and appraisal petitions increased dramatically during the past decade as Delaware courts have constrained other methods for challenging change-of-control transactions.² Disagreement persists about whether and when the market price, the deal price, or some other metric is the best indicator of fair value. Each of these approaches is rooted in an incomplete conception of the determinants of merger prices. This Note presents a revised model of merger deal prices that resolves many of the theoretical and practical impediments to articulating a properly functional appraisal remedy. It then suggests a method for operationalizing the revised model.

In two 2017 decisions, the Delaware Supreme Court (“Supreme Court”) relied on the Efficient Capital Markets Hypothesis (“ECMH”) to reverse the Court of Chancery and endorse the deal price as the best evidence of fair value. The decisions and the Supreme Court’s treatment of the ECMH sparked widespread debate about the proper role of the ECMH in appraisal law and the broader purposes of the appraisal statute. Unresolved questions about the proper role of the ECMH and its broader purposes remain pending before the Supreme Court as of the time of this writing. Although Delaware’s recent emphasis on the ECMH is a welcome development, its failure to account for the role of reduced agency costs and the value of non-public information threatens to undermine the benefits of adopting the ECMH. A more complete theory of appraisal law must acknowledge two critical facts. First, agency cost reductions—the value created by replacing existing managers with more effective ones—are a key motivation for pursuing mergers, and they should belong to the acquirer. To incentivize efficient change-of-control transactions, courts should exclude the value of reduced agency costs from appraisal awards. Second, the value of non-public information about the target company is often a key element of merger prices. By relying on the ECMH without explicitly incorporating the value of non-public information into appraisal fair value, courts subvert the theory’s ability to provide reliable estimates of fair value. The best formulation of the appraisal remedy—and the one most consistent with the ECMH, the appraisal statute, and the purposes of Delaware corporate law—presumes

¹ Del. Code Ann. tit. 8, § 262 (2020). The appraisal remedy is limited to two types of transactions: “squeeze-outs” effected under §§ 253 and 267, and other mergers or consolidation transactions involving some cash consideration. See *id.*

² See *infra* notes 20–22 and accompanying text.

market prices are fair in the absence of evidence that material non-public information was withheld from the market.

To define the “fair value” of an appraisal petitioner’s shares, it is first necessary to re-examine the composition of merger deal prices. If the target company’s stock trades in an efficient market, then its stock price “reflects all publicly available information as a consensus, per-share valuation.”³ The existing stock price sets the presumptive baseline for merger fair value because no rational stockholder would tender her shares to an acquirer at a lower price than she would receive on the open market.⁴ The second component of merger prices is the value of merger “synergies,” the value created by combining formerly separate business units. Agency cost reductions are a third source of value, created when an acquirer replaces existing management with superior business administrators. Finally, material non-public information (MNPI) is an often-overlooked fourth component of merger value. Prospective buyers receive MNPI during the diligence phase of merger transactions.⁵ MNPI is *by definition* relevant to company value; it is information which “would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information available” about the company.⁶

³ *Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd. (Dell)*, 177 A.3d 1, 16 (Del. 2017).

⁴ It is assumed that the Supreme Court has endorsed the ECMH inclusive of that theory’s conventional assumption that market participants are rational. See Steven M. Sheffrin, *Rational Expectations* 99 (2d ed. 1996). This assumption is uncontroversial in the present context—i.e., it is beyond doubt that no reasonable shareholder would tender her shares at a lower price than she could readily receive elsewhere—but it has been contested in others. See, e.g., Franco Modigliani & Richard A. Cohn, *Inflation, Rational Valuation and the Market*, 35 *Fin. Analysts J.* 24, 24 (1979) (arguing that persistent inflation distorts market prices of securities, a finding inconsistent with some forms of the ECMH); Lawrence H. Summers, *Does the Stock Market Rationally Reflect Fundamental Values?*, 41 *J. Fin.* 591 (1986) (arguing that empirical evidence does not conclusively confirm the ECMH and that market prices do not always rationally reflect the fundamental values of securities). This Note does not aspire to contribute to scholarly commentary on the ECMH; like the Supreme Court, it adopts the hypothesis as a tool for deciding appraisal cases. See *Dell*, 177 A.3d at 24; see also *Are Markets Efficient?*, *Chi. Booth Rev.* (June 30, 2016), <https://review.chicagobooth.edu/economics/2016/video/are-markets-efficient> [<https://perma.cc/7HBU-C4ZL>] (interview with Eugene Fama and Richard Thaler) (“The point is not that markets are efficient. . . . It’s just a model.”).

⁵ See *infra* Section III.B.

⁶ *Klang v. Smith’s Food & Drug Ctrs., Inc.*, 702 A.2d 150, 156 (Del. 1997) (quoting *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del. 1985)). Note, too, that MNPI may be value-positive or value-negative. See *infra* Section III.D.

The appraisal statute excludes from appraisal awards “any element of value arising from the accomplishment or expectation of the merger,”⁷ and synergies are consequently not included in appraisal awards. This Note will argue that the statute should also bar appraisal petitioners from recovering the value of agency cost reductions because they, too, are created by the transaction itself. This observation has important policy implications for capital formation; most importantly, excluding reduced agency costs is essential to incentivizing efficient change-of-control transactions.

Courts and academics analyzing appraisal have neglected to account for the value of non-public information as a determinant of merger prices. MNPI is definitionally value-laden, but in a world governed by the ECMH, it is not incorporated into market prices.⁸ When MNPI disseminated to the buyer is withheld from the market (e.g., if the board fails to disclose a conflict when it recommends stockholders vote in favor of a merger), the risk of minority stockholder exploitation is high. Appraisal analysis should therefore explicitly acknowledge that suppressed MNPI is relevant to company value. However, MNPI will often be prohibitively difficult for courts to value. For example, suppose that an appraisal petitioner establishes at trial that the merger buyer induced the target’s CEO to support an unfairly low deal price by secretly offering her employment at the merged firm. It will likely be very difficult to determine with precision how this undisclosed conflict affected the ultimate sale price; the petitioner certainly should have received a better price for her shares, but it is not clear how much. This presents a dilemma for implementing the proposed merger deal price model in appraisal cases.

The solution is to define market prices as the baseline for appraisal fair value, presuming that the target’s unaffected stock price is the best evidence of the company’s value. This automatically excises synergies and agency cost reductions from appraisal awards. The presumption can be surmounted by evidence of MNPI suppression. Where this threshold is met, the court should exercise its discretion to determine the appraisal award, as it currently does, bearing in mind that buyers are entitled to the

⁷ Del. Code Ann. tit. 8, § 262(h) (2020).

⁸ This Note adopts the “semi-strong” form of the ECMH embraced by the Supreme Court, which holds that market prices incorporate all publicly available information about asset prices. See *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc. (Aruba III)*, 210 A.3d 128, 137–38, 138 n.53 (Del. 2019).

value they create through synergies and reduced agency costs. This approach will meaningfully simplify appraisal proceedings and refocus the remedy on the policy goals it serves—facilitating capital formation and encouraging efficient, non-exploitative mergers.

Part II situates the appraisal remedy within its doctrinal context. It introduces appraisal as an important safeguard against minority stockholder exploitation in change-of-control transactions, one that operates outside of the traditional breach of fiduciary duty merger litigation arena. It details several cases that collectively embody the recent controversy over the ECMH's role in appraisal proceedings and concludes with an economic analysis of appraisal's role in the broader corporate contract. Part III presents the revised merger deal price framework. Starting with the assumption that Delaware corporate law exists to facilitate investment and maximize long-term stockholder value, it argues that courts should exclude agency cost reductions and include the value of MNPI. It then develops the foregoing analysis into a method for adjudicating appraisal petitions that relies on a rebuttable presumption that market prices are fair.

Part IV analyzes the proposed framework's likely consequences. It applies the framework to three noteworthy recent appraisal cases, reaching divergent results from the Delaware courts in each. It then argues that, if adopted, the adjudicatory model would bring much-needed clarity and rigor to the Supreme Court's embrace of the ECMH, enabling courts to more fully utilize the ECMH's analytical advantages. It would reduce some of the complexity associated with judicial determinations of company value, decrease the volume of appraisal petitions, and discourage speculative appraisal petitions—an outcome consistent with recent trends in Delaware deal jurisprudence. Next, it considers the likely effects on capital formation and the broader merger and acquisition (“M&A”) market. Excluding agency cost reductions would allow M&A buyers to retain the value they create when they replace inefficient management, increasing their incentives to pursue efficient corporate control transactions. It would also further the goal of maximizing stockholder value by eliminating appraisal premia. And, by incorporating MNPI into the fair value calculation, the suggested framework would discourage collusion between targets and buyers during the deal process, thereby preserving appraisal's traditional function as a check on process adequacy. Part IV closes by describing appraisal's continuing importance under the revised framework. Many firms' shares do not trade in efficient

markets, and this Note makes no attempt to supplant appraisal's established role in such cases. Furthermore, appraisal will remain an effective judicial tool for policing process adequacy, particularly in conflict transactions. A brief conclusion follows in Part V.

II. ORIGINS AND PURPOSES OF APPRAISAL LAW

Delaware is the preferred destination for American companies; over one million business entities and roughly two-thirds of the Fortune 500 call Delaware their legal home.⁹ This is largely due to the state's sophisticated corporate law regime. Its attractions include the Court of Chancery, a "specialised court made up of skilled jurists renowned for their expertise in complex corporate matters";¹⁰ the Supreme Court, which exercises appellate review over the Court of Chancery's decisions; and the DGCL, which is periodically amended by the Delaware General Assembly pursuant to recommendations by the Council of the Corporation Law Section of the Delaware State Bar Association ("Council"), an organization made up of practitioners, jurists, and academics.¹¹

Delaware corporate law is facilitative law. It "is designed as a menu that protects certain rights while allowing flexibility, allocated so as to enhance value and encourage investment."¹² By purchasing a company's shares, investors become parties to a broader "corporate contract"¹³ whose terms are defined by the company's bylaws, certificate of incorporation, and the DGCL.¹⁴ Corporate boards of directors are granted

⁹ Del. Div. Corps., About the Division of Corporations, <https://corp.delaware.gov/aboutagency/> [<https://perma.cc/7RKR-REPA>] (last visited July 31, 2020).

¹⁰ Adam O. Emmerich & Trevor S. Norwitz, For Corporate Litigation, Delaware Is Still the First State, in *The International Comparative Legal Guide to: Mergers & Acquisitions 2018*, at 7 (12th ed. 2018), <https://ssrn.com/abstract=3400258> [<https://perma.cc/7LZQ-4X5g>]; see also Charles Korsmo & Minor Myers, *The Flawed Corporate Finance of Dell and DFC Global*, 68 *Emory L.J.* 221, 276 (2018) [hereinafter Korsmo & Myers, *Flawed Corporate Finance*] ("As has long been recognized, the experience and wisdom of the Court of Chancery is one of the singular attractions in Delaware. It is this very sort of protection that reduces the cost of capital formation in the first place.").

¹¹ Del. State Bar Ass'n, About the Section of Corporation Law, <https://www.dsba.org/sections-committees/sections-of-the-bar/corporation-law/> [<https://perma.cc/2Q4E-G9AU>] (last visited July 31, 2020).

¹² Sam Glasscock III, *Ruminations on Appraisal*, 35 *Del. Law.* 8, 9 (Summer 2017).

¹³ See Brett A. Margolin & Samuel J. Kursh, *The Economics of Delaware Fair Value*, 30 *Del. J. Corp. L.* 413, 429–30 (2005).

¹⁴ *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 940 (Del. Ch. 2013).

considerable decisional leeway in managing stockholders' investments, but their managerial efforts are supervised by equitable common law doctrines, primarily through fiduciary principles.¹⁵ Directors owe stockholders "fiduciary duties of care and loyalty";¹⁶ they must "strive prudently and in good faith to maximize the value of the corporation for the benefit of its residual claimants."¹⁷ This body of law has consistently emphasized the creation and maximization of long-term stockholder value as the fundamental goal of the fiduciary relationship.¹⁸

A. Policing the Market for Corporate Control

A principal function of Delaware corporate law is to police the market for corporate control. It provides dissenting stockholders with two primary methods to combat unfair change-of-control transactions: breach of fiduciary duty ("BFD") litigation and appraisal. Fiduciary duty claims redress harm resulting from directors' violations of their duties of care and loyalty when they approve change-of-control transactions.¹⁹ BFD merger challenges have decreased markedly in Delaware since 2013,²⁰ due in large part to two decisions that constricted the availability of

¹⁵ *Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022, 1078 (Del. Ch. 2004).

¹⁶ *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 179 (Del. 1986).

¹⁷ *In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 20 (Del. Ch. 2013).

¹⁸ See, e.g., *Gantler v. Stephens*, 965 A.2d 695, 706 (Del. 2009) (characterizing directors' duty of loyalty as a "good faith pursuit" of long-term shareholder value maximization); *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1150 (Del. 1989) ("[D]irectors . . . are obliged to chart a course for a corporation which is in its best interests without regard to a fixed investment horizon."); *Frederick Hsu Living Tr. v. ODN Holding Corp.*, C.A. No. 12108, 2017 WL 1437308, at *18 (Del. Ch. Apr. 14, 2017) ("[T]he fiduciary relationship requires that the directors act prudently, loyally, and in good faith to maximize the value of the corporation over the long-term for the benefit of the providers of presumptively permanent equity capital . . ."); S. Samuel Arsht, *A History of Delaware Corporation Law*, 1 *Del. J. Corp. L.* 1, 20 (1976) (emphasizing the Delaware Corporation Law Revision Committee's consideration of stockholders' long-term interests in rejecting proposed amendments to the DGCL); Leo E. Strine, Jr., *Our Continuing Struggle with the Idea That For-Profit Corporations Seek Profit*, 47 *Wake Forest L. Rev.* 135, 147 n.34 (2012) (explaining that corporations may forego short-term profits where "such activities are rationalized as producing greater profits over the long-term").

¹⁹ See *Revlon*, 506 A.2d at 179.

²⁰ See Cornerstone Research, *Shareholder Litigation Involving Acquisitions of Public Companies: Review of 2017 M&A Litigation* 2, 4 (2018), <https://www.cornerstone.com/Publications/Reports/Shareholder-Litigation-Involving-Acquisitions-of-Public-Companies-Review-of-2017-M-and-A-Litigation> [<https://perma.cc/9LDT-5TRW>].

disclosure-only settlements²¹ and the likelihood of recovery in post-closing damages actions.²²

Appraisal, on the other hand, seeks to ensure that stockholders receive “fair value” for their shares in corporate control transactions, independent of any finding of director liability for BFD.²³ Stockholders of Delaware target companies who perfect their appraisal rights are entitled to a judicial calculation of fair value.²⁴ Each litigant bears an equal burden of proving the company’s value by a preponderance of the evidence.²⁵ After the court fixes the fair value price, the respondent pays the court’s fair value determination to the petitioner and all other stockholders seeking appraisal, plus statutory interest.²⁶

Scholars have written approvingly about appraisal’s role in protecting minority stockholders. Numerous studies have found that appraisal petitions are correlated with low deal premia;²⁷ others have indicated that legal changes which expand appraisal’s availability produce higher deal premia in appraisal-eligible transactions.²⁸ One exhaustive review found

²¹ See *In re Trulia, Inc. S’holder Litig.*, 129 A.3d 884, 898–99 (Del. Ch. 2016) (explaining that, for a disclosure-only settlement to gain approval by the court, the additional disclosures obtained by the plaintiff must be “plainly material”).

²² See *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 305–06 (Del. 2015). In post-closing BFD litigation where the entire fairness standard of review does not apply, the merger will be subject to the court’s most relaxed standard of review, the business judgment rule, if it “has been approved by a fully informed, uncoerced majority of the disinterested stockholders.” *Id.*

²³ See Del. Code Ann. tit. 8, § 262(a) (2020).

²⁴ Appraisal is only available in transactions involving some cash consideration. See *id.* § 262(b)(2). To perfect their appraisal rights, petitioning stockholders must refrain from voting in favor of the transaction, hold their shares continuously throughout the appraisal petition, and comply with other technical requirements. See *id.* § 262(a), (d). The appraisal statute contains a de minimis exception for most transactions. See *id.* § 262(g). Appraisal rights are not available in § 251(g) holding company reorganizations. *Id.* § 262(b).

²⁵ *M.G. Bancorporation, Inc. v. Le Beau*, 737 A.2d 513, 520 (Del. 1999).

²⁶ Tit. 8, § 262(h), (i). Interest accrues “at 5% over the Federal Reserve discount rate” and is “compounded quarterly.” *Id.* § 262(h). A recent revision to the appraisal statute provides that respondent corporations may limit the accrual of interest by paying appraisal petitioners a sum of money, after which interest will only accrue if the appraisal award exceeds the amount paid. See *id.*

²⁷ See, e.g., Audra Boone, Brian Broughman & Antonio J. Macias, *Merger Negotiations in the Shadow of Judicial Appraisal*, 62 *J.L. & Econ.* 281, 282 (2019); Jonathan Kalodimos & Clark Lundberg, *Shareholder Rights in Mergers and Acquisitions: Are Appraisal Rights Being Abused?*, 22 *Fin. Res. Letters* 53, 57 (2017) (“Deals petitioned for appraisal tend to have substantially lower premia than a matched sample.”).

²⁸ Scott Callahan, Darius Palia & Eric Talley, *Appraisal Arbitrage and Shareholder Value*, 3 *J.L. Fin. & Acct.* 147, 151 (2018)

that stockholders of merger targets receive higher premia following events that bolster the appraisal remedy, with no corresponding deterrent effect on the probability of individual firms becoming merger targets.²⁹ Professors Charles Korsmo and Minor Myers write that “[j]ust as the market for corporate control can serve as a check on agency costs from managerial shirking, appraisal rights can serve as a back-end check on abuses by corporate managers, controlling shareholders, or other insiders in merger transactions.”³⁰ Professors Albert H. Choi and Eric Talley developed an auction model for assessing the impact of appraisal on merger negotiations, concluding that “appraisal is an important mechanism not only in protecting the dissenting shareholders’ rights after the fact, but also in affecting their interests *ex ante*, by imposing a *de facto* price floor (reserve price) on bidding.”³¹ Where the appraisal remedy is available, the risk of an award in excess of the deal price should reduce merger buyers’ ability to underpay for merger targets.

Academics and the Council have also suggested appraisal is particularly valuable in light of the limitations on BFD litigation recently imposed by the Delaware courts.³² Given the leniency of the business judgment rule in BFD cases, the appraisal remedy may increasingly serve as a vital sub-BFD safeguard against the exploitation of minority stockholders by conflicted or incompetent management, controlling stockholders, and the like.³³ However, appraisal’s deterrence value is

²⁹ Boone et al., *supra* note 27, at 314.

³⁰ Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 Wash. U. L. Rev. 1551, 1598 (2015) [hereinafter Korsmo & Myers, *Appraisal Arbitrage*] (footnote omitted).

³¹ Albert H. Choi & Eric Talley, *Appraising the “Merger Price” Appraisal Rule*, 34 J.L. Econ. & Org. 543, 570 (2018).

³² See, e.g., Guhan Subramanian, *Appraisal After Dell*, in *The Corporate Contract in Changing Times: Is the Law Keeping Up?* 222, 235 (Steven Davidoff Solomon & Randall Stuart Thomas eds., 2019) (“Appraisal is the only remaining check against a deficient deal process.”); Korsmo & Myers, *Flawed Corporate Finance*, *supra* note 10, at 224 (“Following *Corwin*, appraisal is the last judicial sentry still on watch.”).

³³ See Council of the Corp. Law Section of the Del. State Bar Ass’n, *Section 262 Appraisal Amendments 1–2* (2015), <https://www.law.upenn.edu/live/files/6895-section-262-appraisal-amendments.pdf> [<https://perma.cc/8TBJ-M8SA>] [hereinafter *Appraisal Amendments*] (describing the importance of appraisal for conflict transactions where “fiduciary duties and litigation may not be sufficient to ensure that the merger price reflects the fair value of the acquired shares”); see also William J. Carney & Keith Sharfman, *The Death of Appraisal Arbitrage: Ending Windfalls for Deal Dissenters*, 43 Del. J. Corp. L. 61, 63 (2018) [hereinafter Carney & Sharfman, *Death of Appraisal Arbitrage*].

limited by the fact that the cost of appraisal is ultimately borne by the acquiring firm.³⁴

The volume of Delaware appraisal petitions surged over 400% between 2009 and 2016.³⁵ This increase coincided with the decrease in traditional BFD merger litigation noted above³⁶ and the rise of “appraisal arbitrage,” where sophisticated financial investors purchase shares after the merger announcement to exercise appraisal.³⁷ The Delaware General Assembly recently enacted modest reforms to the appraisal statute,³⁸ but it has pointedly declined to “eliminate or limit appraisal arbitrage,” with the Council citing research indicating that appraisal cases are generally “[non-]frivolous” and “self-selecting, attacking primarily conflict transactions or transactions involving questionable pricing.”³⁹

Appraisal arbitrage is inherently in tension with the spirit of the appraisal statute.⁴⁰ Appraisal arbitrageurs purchase shares after the target company’s legal dissolution is all but certain, for the express purpose of extracting value from the acquiring firm. Unlike ordinary stockholders, the only risks they bear are that the deal does not close or that the appraisal award (plus statutory interest) is less than their cost of capital. In contrast to conventional merger arbitrage investment strategies, which rely on direct class action suits and “plausibly redound[] to the benefit of all stockholders,”⁴¹ appraisal rights are only available to stockholders who do not vote in favor of the merger and who assume the additional risk of holding their shares until the conclusion of the appraisal petition.⁴² In other words, in a consummated transaction, ordinary stockholders who tender their shares in the merger never receive the appraisal payout, even if appraisal arbitrageurs ultimately receive one at a substantial premium to the deal price. But the practice is not obviously inefficient. To the extent that bidders fear appraisal, they are likely to increase their bid

³⁴ See Subramanian, *supra* note 32, at 237.

³⁵ Cornerstone Research, *Appraisal Litigation in Delaware: Trends in Petitions and Opinions 4* (2019), <https://www.cornerstone.com/publications/reports/appraisal-litigation-delaware-2006-2018> [<https://perma.cc/YL72-T5XK>].

³⁶ See Carney & Sharfman, *Death of Appraisal Arbitrage*, *supra* note 33, at 63.

³⁷ See, e.g., Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 30, at 1553; *Appraisal Amendments*, *supra* note 33, at 1.

³⁸ H.B. 371, 148th Gen. Assemb., Reg. Sess. (Del. 2016).

³⁹ *Appraisal Amendments*, *supra* note 33, at 1–2.

⁴⁰ See Glasscock, *supra* note 12, at 29.

⁴¹ Jay B. Kesten, *The Uncertain Case for Appraisal Arbitrage*, 52 *Wake Forest L. Rev.* 89, 136 (2017).

⁴² Del. Code Ann. tit. 8, § 262(a) (2020).

price.⁴³ Moreover, where a target company is subject to appraisal, price competition by appraisal arbitrageurs causes its share price to converge to the merger price much more quickly than would ordinarily be expected, expediting the availability of a liquidity event at or near the merger price for non-dissenting stockholders.⁴⁴

B. Delaware Fair Value

The appraisal statute provokes the question, “What is fair value?” The statute provides only that the Court of Chancery must make its fair value determination “exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation . . . tak[ing] into account all relevant factors.”⁴⁵ This vague dictate contrasts with other legal formulations of the concept of fair value,⁴⁶ deliberately inviting wide-ranging inquiries into the circumstances of merger deals. The statute is universally understood to exclude merger synergies from appraisal awards.⁴⁷ Beyond that, the relationship between appraisal fair value, standalone firm value, and merger deal prices is contested.

Conceptually, Delaware courts have consistently described appraisal as a distributive judicial intervention that returns “that which has been taken from [a dissenting target stockholder], viz., his proportionate interest in a going concern.”⁴⁸ Appraisal fair value is “the *pro rata* value of the entire firm as a going enterprise.”⁴⁹ The Supreme Court’s 1983 decision in *Weinberger v. UOP, Inc.* was the first case to expressly approve the use of modern financial techniques in appraisal cases,⁵⁰ but subsequent appraisal case law has been generally consonant with the

⁴³ See Boone et al., *supra* note 27, at 284.

⁴⁴ See *id.* at 283.

⁴⁵ Tit. 8, § 262(h).

⁴⁶ See, e.g., 26 C.F.R. § 1.170A-1(c)(2) (2017) (“[F]air market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.”).

⁴⁷ See *infra* notes 130–31 and accompanying text.

⁴⁸ *Tri-Cont’l Corp. v. Battye*, 74 A.2d 71, 72 (Del. 1950); see also *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 298 (Del. 1996) (explaining that appraisal returns that which “has been taken from the shareholder” in a merger or acquisition).

⁴⁹ *Kahn v. Tremont Corp.*, No. 12339, 1996 WL 145452, at *9 (Del. Ch. Mar. 21, 1996), *rev’d* on other grounds, 694 A.2d 422 (Del. 1997).

⁵⁰ 457 A.2d 701, 713 (Del. 1983).

theory of prior appraisal cases.⁵¹ Much of the debate has centered on whether “pro rata” means the value of the company in the hands of a controlling stockholder, divided by the appraisal petitioner’s fractional ownership stake, or something else.⁵²

As a practical matter, appraisal proceedings involve fact-intensive inquiries into the target company, the deal process, and the parties’ valuation models. They are characterized by often drastically divergent valuations presented by well-credentialed dueling experts.⁵³ Ultimately, the Court of Chancery must adopt a valuation method whether or not either side carries its burden of proving fair value.⁵⁴ The Supreme Court has acknowledged that there may be “no perfect methodology for arriving at fair value for a given set of facts,”⁵⁵ and the Court of Chancery has “discretion to select one of the parties’ valuation models as its general framework or to fashion its own.”⁵⁶ The court has employed a wide range of traditional valuation methods such as discounted cash flow⁵⁷ and comparable company analyses.⁵⁸ The court has also adopted a blended valuation approach that combines more than one method.⁵⁹ Despite the range of valuation methods available to it, in the first part of this decade, the Court of Chancery often deferred to the deal price in arm’s-length transactions.⁶⁰ In all cases, the Court of Chancery must explain its

⁵¹ See Lawrence A. Hamermesh & Michael L. Wachter, *The Short and Puzzling Life of the “Implicit Minority Discount” in Delaware Appraisal Law*, 156 U. Pa. L. Rev. 1, 3–4 (2007).

⁵² See *Kahn*, 1996 WL 145452, at *9 (“[T]he shares, even if not entitled to participate in the majority shareholders’ control premium, must carry at a minimum the *pro rata* value of the entire firm as a going enterprise.” (footnote omitted)); Lawrence A. Hamermesh & Michael L. Wachter, *The Fair Value of Cornfields in Delaware Appraisal Law*, 31 J. Corp. L. 119, 132–39 (2005); Margolin & Kursh, *supra* note 13, at 419–24.

⁵³ *Dell*, 177 A.3d 1, 22 (Del. 2017).

⁵⁴ See *Montgomery Cellular Holding Co. v. Dobler*, 880 A.2d 206, 222 (Del. 2005).

⁵⁵ See *Dell*, 177 A.3d at 22–23.

⁵⁶ *M.G. Bancorporation, Inc. v. Le Beau*, 737 A.2d 513, 525–26 (Del. 1999).

⁵⁷ *In re Appraisal of Dell Inc. (Dell Trial)*, C.A. No. 9322, 2016 WL 3186538, at *51 (Del. Ch. May 31, 2016).

⁵⁸ See *Borruso v. Commc’ns Telesystems Int’l*, 753 A.2d 451, 455 (Del. Ch. 1999).

⁵⁹ See, e.g., *In re Hanover Direct, Inc. S’holders Litig.*, Nos. 1969-CC, 3047-CC, 3291-CC, 2010 WL 3959399, at *1–3 (Del. Ch. Sept. 24, 2010) (adopting respondent’s expert’s blended approach and criticizing petitioner’s expert for using only one valuation method); *Andaloro v. PFPC Worldwide, Inc.*, Civ. A. Nos. 20336 & 20289, 2005 WL 2045640, at *20 (Del. Ch. Aug. 19, 2005) (according 75% weight to discounted cash flow analysis and 25% weight to comparable company analysis).

⁶⁰ See, e.g., *Subramanian*, *supra* note 32, at 222–23 (describing the trend and listing cases).

valuation methodology “in a manner that is grounded in the record before it.”⁶¹

C. Dell and DFC

In 2016, the Court of Chancery issued two momentous appraisal rulings in which it awarded petitioners a substantial premium over the deal price. The first case, *In re Appraisal of Dell Inc.*, involved the 2013 take-private transaction of Dell Inc.⁶² Michael Dell, the founder, CEO, and a large stockholder of Dell, executed a management buyout alongside a private equity buyer.⁶³ The court found that a “valuation gap” existed between the company’s market price and its intrinsic value, a sentiment apparently shared by Michael Dell himself.⁶⁴ And, because “incumbent management has the best insight into the Company’s value, or at least is perceived to have an informational advantage,” the court found that the transaction’s lengthy post-signing “go-shop” period, during which Dell was permitted to solicit competing bids from other companies, did not provide a meaningful market check.⁶⁵ The court deployed its own discounted cash flow analysis, awarding petitioners a 28% premium over the deal price.⁶⁶

The Supreme Court reversed, holding that the Court of Chancery abused its discretion by (1) finding a “valuation gap,” an outcome that it held conflicts with the ECMH; (2) finding that the lack of strategic bidders depressed the sale price; and (3) holding that certain features of management buyouts made the post-signing go-shop an unreliable market check.⁶⁷ The decision echoed the Council’s language when it declined to recommend modifications to the appraisal statute to limit or eliminate appraisal arbitrage: “Recent case law has suggested that a market test of a transaction will serve as a proxy for fair value in appraisal suits, so that arm’s-length deals with adequate market checks do not create appraisal risks for buyers.”⁶⁸ The high court repeatedly emphasized the role of the ECMH in appraisal petitions, stating that “the price produced by an

⁶¹ DFC Glob. Corp. v. Muirfield Value Partners, L.P. (*DFC*), 172 A.3d 346, 388 (Del. 2017).

⁶² *Dell Trial*, 2016 WL 3186538.

⁶³ *Id.* at *12.

⁶⁴ *Id.* at *2, *34.

⁶⁵ *Id.* at *42.

⁶⁶ See *id.* at *18, *51.

⁶⁷ *Dell*, 177 A.3d 1, 23–24 (Del. 2017).

⁶⁸ Appraisal Amendments, *supra* note 33, at 2.

efficient market is generally a more reliable assessment of fair value than the view of a single analyst, especially an expert witness who caters her valuation to the litigation imperatives of a well-heeled client.”⁶⁹ The Supreme Court’s decision strongly suggested that the Vice Chancellor should award the deal price on remand,⁷⁰ and the parties eventually reached a settlement at the deal price.⁷¹

In the second case, *DFC Global Corp. v. Muirfield Value Partners, L.P.*, the Court of Chancery awarded petitioners a 7.5% premium over the deal price.⁷² The court identified three primary factors that supported the premium. The company, a payday lender, faced regulatory uncertainty due to the appointment of new regulatory authorities over payday lenders in key markets.⁷³ Relatedly, the court found that DFC’s stock price “appeared to be in a trough,” and that this fact was a key component of the acquirer’s investment thesis.⁷⁴ And the fact that DFC’s acquirer was a financial sponsor meant that its bid price was constrained by its internal rate of return requirements and did not necessarily reflect DFC’s “true” value.⁷⁵ The court found that these factors weakened the reliability of the parties’ experts’ valuation metrics, but ultimately chose to apply one-third weight each to the court’s own discounted cash flow analysis, a comparable companies valuation, and the deal price.⁷⁶

The Supreme Court again reversed, finding that there was a liquid market for the target’s shares and that efficient markets can price regulatory risk.⁷⁷ It rejected the Court of Chancery’s finding that financial sponsors undervalue merger targets; the absence of strategic buyers likely meant the company was worth *less*, not more.⁷⁸ It observed that the deal process was thorough and protracted.⁷⁹ Comparing the Court of

⁶⁹ *Dell*, 177 A.3d at 24.

⁷⁰ See *id.* at 44.

⁷¹ See Settling Dissenters’ Motion for Approval of Settlement and an Award of Attorneys’ Fees and Expenses at 2–3, 3 n.5, *Dell Trial*, 2016 WL 3186538 (C.A. No. 9322).

⁷² *In re Appraisal of DFC Glob. Corp. (DFC Trial)*, C.A. No. 10107, 2016 WL 3753123, at *23 (Del. Ch. July 8, 2016).

⁷³ *Id.* at *2.

⁷⁴ *Id.* at *22.

⁷⁵ *Id.*

⁷⁶ *Id.* at *23.

⁷⁷ *DFC*, 172 A.3d 346, 372–73 (2017). The Court of Chancery decided *Dell Trial* prior to *DFC Trial*, and the cases are presented in that order here, but the Supreme Court decided those cases’ respective appeals in the reverse order.

⁷⁸ See *id.* at 375–76, 375 n.154.

⁷⁹ *Id.* at 349.

Chancery’s equal weighting of three valuation metrics to a regression back to the “old Delaware Block Method,” the high court instructed the lower court on remand to avoid the “appeal of a mathematical formula” and to take care to ground its weighting decision in “reference to the economic facts before it and corporate finance principles.”⁸⁰ Given the Supreme Court’s strong emphasis on the ECMH and the deal price, its parting suggestion that “a single valuation metric [may be] the most reliable evidence of fair value” seemed to indicate that the lower court should simply award the deal price.⁸¹

The Court of Chancery’s *Dell* and *DFC* decisions generated considerable notoriety in the business community and among practitioners and academics.⁸² Its *Dell* decision was especially alarming, potentially implicating almost \$7 billion in appraisal value.⁸³ And, during the pendency of *DFC*’s Supreme Court appeal, dozens of law, finance, and economics professors lined up as opposing amici curiae. Arguing for reversal, one side urged the court to create a presumption that the deal price equals fair value unless it “bears indications of misinformation or bias.”⁸⁴ On the other side, the academics argued that the fair value award was defensible and that its determination, on *DFC*’s facts, should be left to the Court of Chancery.⁸⁵ Professor Guhan Subramanian argued for a “middle ground” approach: “If the deal process involves a meaningful market canvass and an arms-length negotiation, there should be a strong presumption that the deal price represents fair value in an appraisal proceeding; but if the deal process does not include these features, then deal price should receive no weight.”⁸⁶ The high court declined to create any presumption because the appraisal statute charges the Court of Chancery with accounting for “all relevant factors.”⁸⁷

⁸⁰ *Id.* at 388.

⁸¹ *Id.*

⁸² See Subramanian, *supra* note 32, at 223 (describing the “[b]rouhaha” following *Dell*).

⁸³ See Victor Lewkow, Meredith E. Kotler & Mark E. McDonald, Analysis of Delaware Supreme Court’s *Dell* Appraisal Decision, Harv. L. Sch. F. on Corp. Governance 1 (Dec. 19, 2017), <https://corpgov.law.harvard.edu/2017/12/19/analysis-of-delaware-supreme-courts-dell-appraisal-decision/> [<https://perma.cc/VW8E-9M58>].

⁸⁴ See Brief of Law and Corporate Finance Professors as Amici Curiae in Support of Reversal at 16, *DFC*, 172 A.3d 346 (No. 10107).

⁸⁵ See Brief of Law, Economics and Corporate Finance Professors as Amici Curiae in Support of Petitioners-Appellees and Affirmance, *DFC*, 172 A.3d 346 (No. 10107).

⁸⁶ See Subramanian, *supra* note 32, at 226.

⁸⁷ *DFC*, 172 A.3d at 348 (quoting Del. Code Ann. tit. 8, § 262(h) (2020)).

D. Aruba and Beyond: The Economics of Fair Value

The Court of Chancery followed the drama of *Dell* and *DFC* with an even more extreme appraisal ruling. In *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, the court shocked both the M&A bar and the litigants themselves by finding the target's *unaffected market price*—i.e., its thirty-day average trading price prior to the merger announcement—was the best evidence of its fair value.⁸⁸ The case immediately caused a stir in the financial press,⁸⁹ and it soon generated discussion in the academy.⁹⁰ Commentators generally agreed that the case posed an existential threat to the appraisal remedy.⁹¹

After meticulously documenting a sales process that included, as one commentator wrote, “rampant conflicts of interest, negotiating negligence[,] and selective disclosure” by the target’s board and management,⁹² the court observed that the transaction “looks like a run-of-the-mill, third-party deal. Nothing about it appears exploitive.”⁹³ The court concluded that the deal price likely exceeded fair value, and it narrowed the universe of possible solutions to the unaffected market price and the deal price less synergies.⁹⁴ It found that the deal-price-less-synergies number was unreliable for the same reason it rejected the

⁸⁸ *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc. (Aruba I)*, C.A. No. 11448, 2018 WL 922139, at *1, *4 (Del. Ch. Feb. 15, 2018); see also *Aruba III*, 210 A.3d 128, 131 (Del. 2019) (“Neither party claimed that Aruba’s preannouncement stock price was the best measure of fair value at the time of the merger.”).

⁸⁹ See, e.g., Matt Levine, *Appraisal Arbitrage Is in Trouble*, Bloomberg (Feb. 22, 2018), <https://www.bloomberg.com/opinion/articles/2018-02-22/appraisal-arbitrage-is-in-trouble> [<https://perma.cc/3PNJ-NW7E>] (“Who would ever bring an appraisal action again?”).

⁹⁰ See, e.g., Carney & Sharfman, *Death of Appraisal Arbitrage*, supra note 33 (welcoming the decision); Michael Kass, *Sometimes Silence Is Golden: “Dell Compliance” Following Aruba III* (May 30, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3394316 [<https://perma.cc/LH27-BBL6>] (criticizing the decision on some grounds and praising it on others).

⁹¹ See, e.g., William J. Carney & Keith Sharfman, *Will Aruba Finish Off Appraisal Arbitrage and End Windfalls for Deal Dissenters? We Hope So*, Harv. L. Sch. F. on Corp. Governance (Mar. 25, 2019), <https://corpgov.law.harvard.edu/2019/03/25/will-aruba-finish-off-appraisal-arbitrage-and-end-windfalls-for-deal-dissenters-we-hope-so/> [<https://perma.cc/6YMP-W8NJ>] (“[H]appily, [appraisal arbitration] now appears finally to have reached its end.”); Leslie A. Pappas, *Delaware Ruling Raises Doubts About Appraisal Arbitrage in Courts*, Bloomberg L. News (Apr. 17, 2019), <https://news.bloomberglaw.com/corporate-governance/delaware-court-in-aruba-dead-end-for-appraisal-arbitrage> [<https://perma.cc/VC2T-LHL2>] (suggesting appraisal arbitration after *Aruba* may be a “dead end”).

⁹² Kass, supra note 90, at 3.

⁹³ *Aruba I*, 2018 WL 922139, at *38.

⁹⁴ *Id.* at *38, *54.

parties' discounted cash flow analyses: it was "likely tainted by human error."⁹⁵ Company valuation is virtually always subject to human error, so this was a surprising justification for rejecting a particular valuation method. The court then identified an even more novel reason for rejecting the deal-price-less-synergies figure: even after subtracting synergies, the resulting number still included the value of agency cost reductions which, the court reasoned, are excluded because they "aris[e] from the accomplishment or expectation of the merger."⁹⁶

In a reversal, the Supreme Court again found an abuse of discretion by the Court of Chancery.⁹⁷ The high court rejected "the trial judge's sense that [*Dell* and *DFC*] somehow compelled him to make the decision he did," finding that such a conclusion "was not supported by any reasonable reading of those decisions or grounded in any direct citation to them."⁹⁸ It also discarded the Court of Chancery's "inapt theory that it needed to make an additional deduction from the deal price for unspecified 'reduced agency costs.'"⁹⁹ The high court gave little guidance on the future role of the ECMH in appraisal, but it clarified that *Dell* and *DFC* "reaffirm[] the traditional Delaware view, which is accepted in corporate finance, that the price a stock trades at in an efficient market is an important indicator of its economic value that should be given weight."¹⁰⁰ This quotation is in tension with the high court's finding that the Court of Chancery abused its discretion by according market prices *too much* weight by relying on the unaffected trading price. The Supreme Court directed the lower court to award the deal price less synergies.¹⁰¹

These cases present a picture of Delaware courts constricting the appraisal remedy. In *Dell* and *DFC*, the Supreme Court reversed the Court of Chancery's fair value awards where they exceeded the deal price, finding that the deal price was best evidence of fair value. Had the Supreme Court affirmed *Aruba*, many predicted it would have effectively quashed the appraisal remedy altogether.¹⁰² Although *Aruba III* rejected

⁹⁵ Id. at *2.

⁹⁶ Id. at *3 (quoting Del. Code Ann. tit. 8, § 262(h) (2020)).

⁹⁷ *Aruba III*, 210 A.3d 128, 130 (Del. 2019).

⁹⁸ Id. at 135.

⁹⁹ Id. at 133.

¹⁰⁰ Id. at 138 (footnote omitted).

¹⁰¹ Id. at 141–42.

¹⁰² See, e.g., Carney & Sharfman, *Death of Appraisal Arbitrage*, *supra* note 33, at 61.

the Court of Chancery's use of the target's unaffected trading price, it still directed the lower court to award a price below the merger price.¹⁰³

Dell and *DFC* were widely noted for their forceful reliance on the ECMH.¹⁰⁴ This emphasis was a significant departure from appraisal as a historical concept. For instance, in 1934, in the very first reported Delaware appraisal case, the Court of Chancery rejected the use of market price, stating that “[t]here are too many accidental circumstances entering into the making of market prices to admit them as sure and exclusive reflectors of fair value.”¹⁰⁵ Financial markets have become dramatically more efficient since the 1930s,¹⁰⁶ and pointing to the ECMH is sensible in light of *Weinberger*'s instruction that judicial valuation should be informed by “techniques or methods which are generally considered acceptable in the financial community.”¹⁰⁷ Nonetheless, the adoption of the hypothesis as a normative guidepost in appraisal cases was new. In a ruling denying petitioners' motion for re-argument in *Aruba*, the Vice Chancellor detailed his attempt and ultimate failure to locate “a single Delaware Supreme Court decision before *Dell* and *DFC* that mentioned the efficient capital markets hypothesis by name, much less cited it with approval.”¹⁰⁸

Dell and *DFC* generated similar perplexity in the academy. In a powerful critique, Professors Korsmo and Myers argued that the Supreme Court committed a fatal error by apparently conflating the market for fractional interests in firms with the market for entire companies: “The market for corporate control, dealing with a limited universe of buyers for companies that generally lack exact substitutes, is unavoidably less efficient than the market for individual shares.”¹⁰⁹ That is, the fact that the market for *Dell*'s *stock* was efficient does not suggest that the market for

¹⁰³ *Aruba III*, 210 A.3d at 141–42.

¹⁰⁴ See, e.g., *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc. (Aruba II)*, C.A. No. 11448, 2018 WL 2315943, at *13 (Del. Ch. May 21, 2018) (“In my view, *Dell* and *DFC* changed things. I regarded the Delaware Supreme Court's endorsement of the efficient capital markets hypothesis and its emphasis on market indicators over the subjective views of knowledgeable insiders as altering the decisional landscape and authorizing greater reliance on market value.”); Korsmo & Myers, *Flawed Corporate Finance*, supra note 10, at 259.

¹⁰⁵ *Chi. Corp. v. Munds*, 172 A. 452, 455 (Del. Ch. 1934).

¹⁰⁶ See, e.g., Charles M. Jones, *A Century of Stock Market Liquidity and Trading Costs* (2002), <https://ssrn.com/abstract=313681> [<https://perma.cc/LKM8-HLJ3>] (documenting the decline in bid-ask spreads and changes in other liquidity measures between 1900 and 2000).

¹⁰⁷ *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983).

¹⁰⁸ *Aruba II*, 2018 WL 2315943, at *8 n.64.

¹⁰⁹ Korsmo & Myers, *Flawed Corporate Finance*, supra note 10, at 226–27.

Dell *the company* was efficient. That the deal price was fair does not follow axiomatically from the observation that Dell's stock traded in an efficient market. The same academics also pointed out that the Supreme Court appeared to conflate "well-supported notions of semi-strong market efficiency, often known as informational efficiency, with an unfounded and widely discredited notion of value efficiency."¹¹⁰ In other words, the semi-strong form of the ECMH does not purport to be an indicator of true value.

Aruba I was perceived by many, including the litigants in the case, as a "reductio ad absurdum" of the Supreme Court's imprecise treatment of the ECMH.¹¹¹ In addition to rejecting the company's unaffected stock price as the best evidence of Aruba's fair value, the Supreme Court appeared to push back against Korsmo and Myers's commentary, denying that its *Dell* and *DFC* holdings implied "that the market price of a stock was necessarily the best estimate of the stock's so-called fundamental value at any particular time. Rather, they did recognize that when a market was informationally efficient . . . the market price is likely to be more informative of fundamental value."¹¹² This confusing rehashing of *Dell* and *DFC* provokes the question, *which* market price is more informative of appraisal fair value—the company's stock, or the company itself? If the answer is the market for companies, then the decision reaffirms the Supreme Court's conflation of the market for companies with the market for shares of stock. And if the answer is the market for the company's stock, then why did the high court reject the unaffected trading price as the best evidence of fair value?

In total, these three cases represent both a full-throated endorsement of the ECMH by the Supreme Court and a lack of clarity about how to implement it. In July 2019, the Court of Chancery, after a careful factual inquiry and lengthy discussion of the recent case law, again awarded the petitioner the target's unaffected trading price in *In re Appraisal of Jarden Corp.*¹¹³ The petitioner in *Jarden* has appealed to the Supreme Court.¹¹⁴ The role of the ECMH remains a live issue in Delaware appraisal law.

¹¹⁰ Id. at 261.

¹¹¹ Kass, *supra* note 90, at 3; see also *Aruba II*, 2018 WL 2315943, at *16 ("The petitioners initially argue that [the court] issued the Post-Trial Ruling as an act of political theater designed to show the Delaware Supreme Court the error of its ways.").

¹¹² *Aruba III*, 210 A.3d 128, 137 (Del. 2019).

¹¹³ C.A. No. 12456, 2019 WL 3244085, at *1–4 (Del. Ch. July 19, 2019).

¹¹⁴ Notice of Appeal, *Fir Tree Value Master Fund, LP v. Jarden Corp.*, No. 454-2019 (Del. filed Nov. 1, 2019).

Controversies over the meaning of appraisal fair value rage on. The statute is vague, and it was originally drafted in the late nineteenth century.¹¹⁵ It is thus tempting to dismiss appraisal as an unworkable anachronism that is ill-suited to the complexities of modern financial markets.¹¹⁶ However, the statute was more likely drafted in intentionally vague terms as an acknowledgment of the complexity and variety of merger transactions and the consequent need for judicial flexibility.¹¹⁷ Delaware courts are uniquely capable of wrestling with financial complexity, and the great number of American businesses that rely on the state's corporate legal regime depend on the courts' willingness to bring a nuanced perspective to proceedings like appraisal petitions.

But a clearer construction of the meaning of fair value is clearly desirable. And, given the considerable uncertainty caused by recent developments in appraisal law, establishing a more generalizable framework for determining fair value would be beneficial from an efficiency standpoint. The ECMH provides a helpful starting point for this project. Before *Dell* and *DFC*, the doctrine was largely absent from appraisal law. Following those decisions, the ECMH should be viewed as a valuable tool for understanding company value. At the very least, the hypothesis should be on the menu of valuation options from which the Court of Chancery may select within its discretion in appraisal cases. The following Parts III and IV develop a simple framing of the ECMH into a workable appraisal doctrine.

III. A NEW FRAMEWORK FOR APPRAISAL FAIR VALUE

This Part proposes a new model of appraisal fair value: if the target company's stock trades in an efficient market, courts should presume that its unaffected trading price is the best evidence of fair value. This approach automatically excludes the value of merger synergies and agency cost reductions from appraisal awards. Excluding synergies is uncontroversial; excising reduced agency costs is not, but both the plain language of the statute and the core goals of Delaware corporate law

¹¹⁵ See 10 Del. Laws 462–63, § 56 (1899).

¹¹⁶ See Ernest L. Folk III, Review of the Delaware Corporation Law 196 (1968) (“Muddled theory and inconsistent treatment has always been characteristic of the appraisal right in all jurisdictions . . .”).

¹¹⁷ See *Dell*, 177 A.3d 1, 22–23 & n.105 (Del. 2017); Robert S. Reder & Blake C. Woodward, Delaware Supreme Court Refuses To Establish a Presumption Favoring Deal Price in Statutory Appraisal Proceedings, 71 Vand. L. Rev. En Banc 59, 69 (2018).

require it. The presumption can be overcome by evidence that the existence of certain non-public information inhibited the market's ability to properly value the company. This fills a critical gap in the Supreme Court's characterization of the ECMH by recognizing that even efficient markets only process the information they actually possess. Most of the functions typically cited in favor of the appraisal remedy—protecting the minority against controllers, conflicted boards and managers, and ineffectual sales processes—address situations where parties' possession of asymmetric information is likely to distort market prices. Incorporating MNPI therefore preserves appraisal's function as a check on process adequacy by erecting an evidentiary threshold to traditional appraisal analysis that can be easily surmounted in cases where these kinds of deficiencies are likely to exist.

A. Guiding Principles

The suggested framework is rooted in the following three principles. First, Delaware corporate law's primary purpose is to facilitate capital formation and economic activity. It does so in large part by creating and enforcing the corporate contract. Gaps in the express terms of stockholder agreements are filled by the DGCL and common law doctrines.¹¹⁸ The law is guided here by the subsidiary goal of maximizing long-term stockholder value.¹¹⁹ Delaware's corporate legal regime seeks to protect all stockholders by limiting agency costs associated with the corporate form, but it is not overly concerned with the distributional aspects of stockholder value maximization.¹²⁰ Instead, its focus is on aggregate efficiency, although efficient capital formation does require some

¹¹⁸ See *supra* notes 11–13 and accompanying text.

¹¹⁹ See *supra* note 18.

¹²⁰ See, e.g., *Klaassen v. Allegro Dev. Corp.*, No. 8626, 2013 WL 5967028, at *11 (Del. Ch. Nov. 7, 2013) (“[C]orporate directors do not owe fiduciary duties to individual stockholders; they owe fiduciary duties to the entity and to the stockholders as a whole.”); *Gilbert v. El Paso Co.*, Civ. A. Nos. 7075, 7079 & 7078, 1988 WL 124325, at *9 (Del. Ch. Nov. 21, 1988) (“Directors’ fiduciary dut[ies] run[] to the corporation and to the entire body of shareholders generally, as opposed to specific shareholders or shareholder subgroups.”); see also *Frederick Hsu Living Tr. v. ODN Holding Corp.*, C.A. No. 12108, 2017 WL 1437308, at *22 (Del. Ch. Apr. 14, 2017) (“[T]he fiduciary-based standard of conduct requires that decision makers focus on promoting the value of the undifferentiated equity in the aggregate.”); R.H. Coase, *The Problem of Social Cost*, 3 *J.L. & Econ.* 1, 34 (1960) (“When an economist is comparing alternative social arrangements, the proper procedure is to compare the total social product yielded by these different arrangements.”).

protection for minority stockholders.¹²¹ Value-increasing corporate control transactions are desirable, and the law encourages them.¹²² In the appraisal context, a 2015 amendment to the appraisal statute reflects this balance by creating a minimum ownership threshold for appraisal petitioners.¹²³ So, although appraisal exists to protect minority stockholders, its purpose is not to protect a tiny (or idiosyncratic) minority.

Second, the purpose of appraisal is, as the Supreme Court has stated, to award dissenting stockholders the value of their “proportionate interest in [the company as] a going concern.”¹²⁴ This means the stockholder’s fractional interest in the company whose stock she actually paid for, i.e., the company with its existing ownership structure.

Finally, appraisal fair value should embrace the semi-strong form of the ECMH as formulated by the Supreme Court: if the market for a company’s stock is efficient, then its stock price “reflects all publicly available information as a consensus, per-share valuation.”¹²⁵ Financial economics provides numerous ways of gauging the efficiency of asset markets,¹²⁶ and courts have devised tests and suggested criteria for analyzing the efficiency of the market for companies’ stock.¹²⁷ Adopting

¹²¹ See Glasscock, *supra* note 12, at 9 (“The reason for appraisal must be sought, I think, in terms of efficient capital markets, not fairness. . . . A system that allowed controllers to squeeze value from a minority could be ‘fair’ if transparent, I suppose, but nonetheless inefficient: presumably, few people would invest in equity ownership subject to squeeze-out at an unfair price.”); see also *Credit Lyonnais Bank Nederland v. Pathe Commc’ns Corp.*, Civ. A. No. 12150, 1991 WL 277613, at *34 n.55 (Del. Ch. Dec. 30, 1991) (observing that in certain cases “both the efficient and the fair” course of action may diverge from the interests of target shareholders).

¹²² See, e.g., *DFC*, 172 A.3d 346, 368 (Del. 2017) (describing the “important” policy goal that the buyer “not end up losing its upside for purchase by having to pay out the expected gains from its own business plans for the company it bought to the petitioners”).

¹²³ See Appraisal Amendments, *supra* note 33, at 4.

¹²⁴ *Aruba III*, 210 A.3d 128, 132 (Del. 2019).

¹²⁵ *Dell*, 177 A.3d 1, 16 (Del. 2017).

¹²⁶ See, e.g., Steven L. Jones & Jeffrey M. Netter, *Efficient Capital Markets*, *Libr. of Econ. & Liberty*, <https://www.econlib.org/library/Enc/EfficientCapitalMarkets.html> [<https://perma.cc/J4YT-YMLL>].

¹²⁷ See, e.g., *Menaldi v. Och-Ziff Capital Mgmt. Grp. LLC*, 328 F.R.D. 86, 94–95 (S.D.N.Y. 2018) (listing the “*Cammer* and *Krogman* factors” for evaluating market efficiency). Similarly, the Supreme Court in *Dell* described some of the “hallmarks of an efficient market” that the market for Dell’s stock exhibited: it had “a deep public float, was covered by over thirty equity analysts in 2012, boasted 145 market makers, was actively traded with over 5% of shares changing hands each week, and lacked a controlling stockholder.” 177 A.3d at 25 (footnotes omitted).

the ECMH is thus a reliable (if imperfect) lodestar, one which helpfully focuses appraisal analysis on a widely accepted estimation of company value: prices produced by efficient markets.

B. The Four Components of Merger Price

In a world governed by the semi-strong form of the ECMH, there are four components of the price a buyer is willing to pay for a target. Any definition of appraisal fair value must either include or exclude each element. The starting point is the company's unaffected stock price. The second and third elements have been discussed at length in appraisal opinions and the academic literature: synergies and agency cost reductions. The fourth component is non-public information to which the buyer gains access during the diligence phase of a merger transaction.

Where the target company's stock trades in an efficient market, its market capitalization sets the baseline for determining its fair value. The Supreme Court in *DFC* wrote that

because DFC's shares were widely traded on a public market based upon a rich information base, the 'fair value of the stockholder's shares of stock' held by minority stockholders like the petitioners, would, to an economist, likely be best reflected by the prices at which their shares were trading as of the merger.¹²⁸

Efficient markets equilibrate forces of supply and demand for shares of a company's stock, producing a reliable estimation of its current value—and, unmistakably, the one most consistent with the ECMH. Also, as suggested above, the existence of a market price for a company's stock forms a practical price floor in change-of-control transactions because rational investors will not tender their shares at a price below it.¹²⁹

Synergies represent speculative value created by mergers, e.g., economies of scale, access to new customers or markets, cheaper financing costs, and other related advantages that the buyer enjoys after acquiring the target.¹³⁰ Synergies, where they exist, are thus wholly

¹²⁸ *DFC*, 172 A.3d 346, 367 (Del. 2017) (quoting Del. Code Ann. tit. 8, § 262 (2020)); see also *Aruba III*, 210 A.3d at 138 (“[T]he price a stock trades at in an efficient market is an important indicator of its economic value that should be given weight . . .”).

¹²⁹ See supra note 4 and accompanying text.

¹³⁰ See Richard A. Brealey, Stewart C. Myers & Franklin Allen, *Principles of Corporate Finance* 795–96, 800, 802 (10th ed. 2011).

created by the merger. Courts and commentators agree on this point: synergies are not included in appraisal awards.¹³¹

Agency cost reductions are a related source of merger value. They are obtained by replacing a company's management with managers who better serve the interests of stockholders.¹³² All else equal, a well-run company is more valuable to its stockholders than a poorly run one in precisely the amount of agency cost reductions. In *Aruba III*, the Supreme Court found that the Court of Chancery abused its discretion by deducting "unspecified" agency cost reductions from the appraisal award.¹³³ Conceptually, whether reduced agency costs should be included is disputable.

Non-public information is by definition excluded from a company's stock price. During the diligence phase of a merger transaction, prospective buyers obtain non-public information about the target. This information is an integral part of the transaction process and necessitates the execution of preliminary confidentiality agreements. It may reflect positively or negatively on the company's future outlook, whether as a going concern or in combination with the buyer's business. This Part will argue that courts should include the impact of non-public information that is relevant to value in appraisal cases.

C. Courts Should Exclude Agency Cost Reductions from Appraisal Awards Because They Represent Value Arising from the Merger

Brett A. Margolin and Samuel J. Kursh present an elegant model of the stockholder-management relationship and argue appraisal should include agency cost reductions. Starting with the manager-owned Coasean "classical firm," they posit that the corporate form emerges because diversified investors possess operational risk management technology superior to that of owner-managers: diversification.¹³⁴ Investing in numerous firms whose returns are negatively correlated insulates

¹³¹ See, e.g., *DFC*, 172 A.3d at 368 (courts must exclude any "synergistic gains" (citation omitted)); Lawrence A. Hamermesh & Michael L. Wachter, Finding the Right Balance in Appraisal Litigation: Deal Price, Deal Process, and Synergies, 73 Bus. Law. 961, 993 (2018) (removing synergies from appraisal awards is "[a]mong the clearest propositions in Delaware appraisal case law").

¹³² See Brealey et al., *supra* note 130, at 808.

¹³³ *Aruba III*, 210 A.3d at 133.

¹³⁴ Margolin & Kursh, *supra* note 13, at 425–26.

investors from firm-specific operational risk (“alpha” risk).¹³⁵ A diversified investment portfolio is only sensitive to its components’ correlation with the broader market (“beta” risk), which can be managed by adding or removing investments with higher or lower betas to achieve the desired balance.¹³⁶ Diversified, alpha-indifferent investors are thus more efficient bearers of operational risk than manager-owners because they have neutral risk preferences with respect to their individual portfolio companies. But stockholders recognize that selling shares dilutes the manager’s share of the residual, introducing the risk of managerial shirking and misappropriation.¹³⁷ Moreover, diversification makes stockholders inefficient bearers of agency cost-related risk due to the high costs of monitoring the many companies whose shares make up a diversified portfolio.¹³⁸

Stockholders demand compensation for bearing the risk of managerial agency costs. Stockholders accomplish this by discounting the company’s expected residual cash flows to account for managerial agency costs. A company’s equity thus “effectively constitutes the corporation’s policy limit; the amount of risk investors are willing to insure given their assessment of the corporation’s ability to pay competitive premiums.”¹³⁹ If the market learns that it has underestimated the probability or magnitude of managerial agency costs—say, through a report of a feud between top executives—then some stockholders will sell, depressing the company’s stock price.¹⁴⁰ This means that the cost of a pro rata claim to the same amount of residual has decreased or, conversely, that the company’s cost of capital has increased. The stockholders have raised the premiums they demand to insure the company’s risk.

Margolin and Kursh posit that the “core” promise of corporate fiduciary law is that management will minimize agency costs.¹⁴¹ Making the corporate promise credible increases investor confidence and reduces

¹³⁵ *Id.* at 426; see also Harry Markowitz, *Portfolio Selection*, 7 *J. Fin.* 77, 87–91 (1952) (stating the mathematical underpinnings of portfolio diversification).

¹³⁶ Margolin & Kursh, *supra* note 13, at 426.

¹³⁷ *Id.*

¹³⁸ *Id.* at 426 n.35.

¹³⁹ *Id.* at 427 n.35.

¹⁴⁰ See Robert F. Bruner, *Applied Mergers and Acquisitions* 79 (2004) (“Agency costs are inefficiencies arising from such things as self-interested risk management, perquisites, and lax attention. These costs accumulate because of the failure of directors to monitor and control the management of the firm in the best interests of its shareholders. Shareholders bear the costs of agency problems in the form of depressed share prices.”).

¹⁴¹ Margolin & Kursh, *supra* note 13, at 430.

the firm's cost of capital.¹⁴² Appraisal “enforces this promise when the shareholder-firm relationship terminates in a merger.”¹⁴³ Since failure to enforce the promise would encourage managers to create agency costs, they write, “[f]air [v]alue must be the value of a 100% interest in the firm.”¹⁴⁴ In other words, appraisal fair value should be defined as a pro rata share of the firm's value in the hands of a controlling stockholder.

Other courts and commentators have argued that agency cost reductions should not be included in appraisal awards. Like synergies, agency cost savings are—definitionally, they contend—value created by the merger itself. Professors Carney and Sharfman, following Henry G. Manne's 1965 article, *Mergers and the Market for Corporate Control*, argue that “[b]ecause the law has long treated appraisal as allowing an exit for an investor not willing to enter the newly created combination, it [is] logical to limit the investor's compensation to what his shares were worth without considering the merger's financial benefits or detriments.”¹⁴⁵ In a change-of-control transaction, the acquiring firm often anticipates creating value by installing more effective management, which results in a new, higher firm value.¹⁴⁶ Only stockholders of the acquiring firm are entitled to enjoy it. This Part adopts this latter view.

The plain language of the statute flatly forecloses Margolin and Kursh's contention that the value of reduced agency costs should be included in appraisal awards. Agency cost reductions, where they exist, are definitionally created by the transaction itself, and they are widely recognized as a motivation to pursue mergers.¹⁴⁷ Replacing existing managers with more effective ones is a classic example of creating value by moving an asset from a lower-value use to a higher-value one.¹⁴⁸ Reduced agency costs therefore constitute “value arising from the

¹⁴² Id. at 429–30 (quoting Frank H. Easterbrook & Daniel R. Fischel, *The Economic Structure of Corporate Law* 5 (1991)).

¹⁴³ Id. at 430.

¹⁴⁴ Id.

¹⁴⁵ Carney & Sharfman, *Death of Appraisal Arbitrage*, *supra* note 33, at 93–94.

¹⁴⁶ Id. at 94 (“[C]ompanies are valued as going concerns with their *current* management, and if that management was . . . replaced by a stronger management team, that change of control would generate greater profits and add value to the firm.” (emphasis added) (citing Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 *J. Pol. Econ.* 110, 112–13 (1965))).

¹⁴⁷ See Brealey et al., *supra* note 130, at 796.

¹⁴⁸ See, e.g., Luke M. Froeb, Brian T. McCann, Mikhael Shor & Michael R. Ward, *Managerial Economics: A Problem Solving Approach* 12 (3d ed. 2014).

accomplishment or expectation of the merger”¹⁴⁹ and must be excised from appraisal awards.

Margolin and Kursh’s argument is supported by fairness and efficiency concerns that should be addressed before proceeding. First, denying appraisal petitioners the value of reduced agency costs does not encourage companies to violate any broader “corporate promise.” In Delaware, stockholders transfer cash to managers who reward them by pursuing long-term value maximization.¹⁵⁰ Their investments are subject to both operational and agency cost-related risks, and investors know this *ex ante*. Managerial incompetence and malfeasance are part of the risk that investors carry. There is no logical connection between a stockholder’s residual claim to the standalone value of a firm with weaker management, on the one hand, and a claim to the value of a new firm with better management, on the other.

Moreover, if we trust efficient markets, we should expect stockholders to be capable of discounting for expected agency costs. Margolin and Kursh themselves acknowledge this: “Rational investors price securities by netting expected agency costs against the value of their interests’ proportionate claim on the firm’s potential residual.”¹⁵¹ Rational investors will *always* do this, except when they plan to acquire all of the shares, and that is rare. Investors seldom buy a company’s shares with the expectation that one day they will become the controller of the company and reduce managerial agency costs. Therefore, under Margolin and Kursh’s model, in a firm’s natural state, the “corporate promise” remains *indefinitely* unkept. The notion that the corporate promise remains unperformed in the absence of M&A activity is too paradoxical to require further refutation. Not only do minority stockholders buy in at a “minority rate,” they buy in to that specific firm with its existing management and ownership structure at that rate. On what basis can they demand a “majority” rate in a corporate control transaction?¹⁵² This Section thus concludes that, particularly if the ECMH is now a normative appraisal guidepost, agency costs should be excluded from the definition of appraisal fair value.

¹⁴⁹ Del. Code Ann. tit. 8, § 262(h) (2020).

¹⁵⁰ See *supra* note 18 and accompanying text.

¹⁵¹ Margolin & Kursh, *supra* note 13, at 429.

¹⁵² See Carney & Sharfman, *Death of Appraisal Arbitrage*, *supra* note 33, at 77 (“The idea that market value is an unfair measure misses the point that most investors . . . invested at a discount reflecting these agency costs, so getting out at a discount reflecting these same costs is both fair and exactly what they bargained for.”).

D. Appraisal Awards Should Include the Impact of MNPI on the Merger Price

Investors traditionally purchase a company's shares without possessing complete information about it. Information may be withheld for strategic, regulatory, or logistical reasons. Some of it is positive, some negative, and some is likely meaningless to investors. For instance, an investor might own shares in a company whose management is currently aware that it will underperform its earnings guidance in the following quarter, or one that furtively pursues a strategic acquisition without disclosing it to the public. The risk of not knowing this information is inherent in investing and is presumptively included in the company's cost of capital. Investors, in other words, have bought the risk of what they do not know—positive, negative, or neutral.

Non-public information may be relevant to fair value. *Material* non-public information is that which “would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information available” about the company.¹⁵³ But, as the Supreme Court has stated, “[u]nder the semi-strong form of the efficient capital markets hypothesis, the unaffected market price is not assumed to factor in nonpublic information.”¹⁵⁴ That is, the market for the company's stock could be efficient, but if MNPI is withheld, the market will efficiently arrive at the *wrong price*. When a prospective buyer receives MNPI about the target before the merger is signed, it should alter the buyer's willingness to pay.¹⁵⁵ Since the positive and negative risks of non-public information are borne by investors, any non-synergistic MNPI should be a component of appraisal fair value. When a company's board of directors seeks stockholder action (e.g., in recommending a merger), it must disclose “all material reasonably available facts” relating to the action it seeks.¹⁵⁶ Courts should deter boards from failing to disclose MNPI in recommending mergers by explicitly ruling that non-disclosure may

¹⁵³ *Klang v. Smith's Food & Drug Ctrs., Inc.*, 702 A.2d 150, 156 (Del. 1997) (quoting *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del. 1985)).

¹⁵⁴ *Aruba III*, 210 A.3d 128, 140 (Del. 2019).

¹⁵⁵ See generally Bruner, *supra* note 140, at 186 (“The significance of private information implies that the deal search should be structured to generate private information and transactions before they become widely known. The potential asymmetry of information in the market implies the existence of a first-mover advantage. Specialists (i.e., bankers) who focus their expertise will thrive in the context of information asymmetries because they can get paid to help buyers exploit a first-mover advantage.” (emphasis omitted)).

¹⁵⁶ *Klang*, 702 A.2d at 156.

result in an appraisal award above the merger price. Although appraisal is a “buy-side” risk,¹⁵⁷ including MNPI in the fair value equation should induce buyers’ boards to encourage target boards to avoid MNPI non-disclosure during the deal process.

The task of incorporating diligence-phase dissemination of MNPI into fair value will often be prohibitively difficult. To begin with, it is impossible to observe the counterfactual of what impact the MNPI would have had on the company’s stock price had it been disclosed to the public. And in the context of a sales process governed by confidentiality agreements, the mere fact that a prospective buyer possesses MNPI about a target is not a sufficient predictor of the MNPI’s impact on the prospective buyer’s bid. Making that leap would be an example of mistaking the market for shares of stock with the market for entire companies.¹⁵⁸ Put another way, there is no reason to believe that a prospective acquirer accurately values the MNPI it receives. Moreover, disclosed MNPI may have a differential impact on prospective buyers’ bids. It is thus unclear what effect MNPI will have on any given merger bid. MNPI may even reduce a prospective buyer’s willingness to pay. This happens frequently, and it is one reason that buyers may underbid or forego the opportunity to buy a company.¹⁵⁹ But negative MNPI might still exist in executed merger transactions, so long as the value of synergies and/or reduced agency costs more than compensates for it. Disaggregating these effects is likely to be a complicated, perhaps hopeless task.

Evidence of a competitive bidding process should mitigate some degree of judicial skepticism about deal price fairness. Although a market for companies will never be a semi-strong form efficient market, undisclosed MNPI is less likely to produce an unfair deal price when it is disseminated to multiple prospective bidders. This determination should be based on a fact-intensive inquiry into the number and seriousness of potential bidders and their individual characteristics. Courts should recognize, however, that a competitive bidding process cannot guarantee that value-positive MNPI will be incorporated into the deal price. For instance, if the board runs a competitive bidding process and ultimately recommends a merger where a board member or manager will

¹⁵⁷ See Subramanian, *supra* note 32, at 237.

¹⁵⁸ See *supra* Section II.D.

¹⁵⁹ See, e.g., *DFC*, 172 A.3d 346, 374 (Del. 2017) (stating that “potential buyers dropped out of the sales process after receiving confidential information about DFC”).

subsequently be employed by the target company, this information is material, but the deal price is highly unlikely to reflect the conflict. Situations like this necessitate more exacting review of the transaction.

The transaction at issue in the *Aruba* case illustrates MNPI suppression: both parties were aware that the company was undervalued; Aruba told the acquirer that its upcoming quarterly earnings would exceed analysts' expectations.¹⁶⁰ The parties colluded to suppress the impact of the earnings beat on the market price of Aruba's stock by announcing the merger and earnings simultaneously.¹⁶¹ Knowing that Aruba would exceed earnings expectations should have increased the buyer's willingness to pay for the company. In a competitive bidding process, this knowledge would likely have induced multiple higher bids and possibly the addition of new prospective bidders, just as it increased the market price of Aruba's stock once it was eventually disclosed.

Interestingly, news of the deal was leaked the day before Aruba announced its earnings, prompting a 21% rally in Aruba's stock price.¹⁶² After its earnings announcement, Aruba's stock momentarily traded *above* the deal price.¹⁶³ If the market for shares of Aruba, a then-public company, was efficient, then this reflected the market's calculation of some non-zero probability that the merger would be renegotiated following the earnings announcement. No such renegotiation occurred.¹⁶⁴

E. Toward a New Judicial Framework for Appraisal

MNPI suppression is very likely to distort merger prices. It is also likely to be hard to value. To properly account for MNPI's importance in a world governed by the ECMH without incurring the cost of valuing it, Delaware courts should recognize a rebuttable presumption that, if the target's stock trades in an efficient market, then its existing market capitalization before the merger announcement is the best evidence of its value. Because the target's stock price will converge toward the merger price in the post-signing period, the pre-announcement figure must be used. Otherwise, appraisal fair value would always be presumed to be the deal price, a suggestion that the Supreme Court has rejected repeatedly.¹⁶⁵

¹⁶⁰ See *Aruba I*, C.A. No. 11448, 2018 WL 922139, at *18 (Del. Ch. Feb. 15, 2018).

¹⁶¹ See *id.* at *33.

¹⁶² *Id.* at *20.

¹⁶³ *Id.* at *34.

¹⁶⁴ See *id.* at *20.

¹⁶⁵ See *DFC*, 172 A.3d 346, 348 (Del. 2017).

This approach will exclude both merger synergies and agency cost reductions from the fair value award. The presumption can be rebutted by evidence that MNPI was suppressed or otherwise unavailable to the market.

The proposed framework presents the court with a clean slate on which to begin its appraisal analysis. The court presumes that the target's market price is its fair value, which eliminates the necessity of inquiring into the value of agency cost reductions; the delta between trading price and deal price is some combination of synergies and agency cost reductions whose precise makeup the court need not determine. If the petitioner presents sufficient evidence of suppressed MNPI, the court can depart from the market price and award a higher or lower one using conventional evidence-based appraisal techniques. Uncompetitive sales processes, controlling stockholders, and managerial and board conflicts should be judicially cognizable as circumstantial evidence of MNPI suppression. Against the petitioner's allegations of MNPI suppression, the respondent can point to the adequacy of the sales process and the comprehensiveness of its disclosures relating to the transaction. If the court concludes that MNPI was suppressed, then it should exercise its discretion in adopting the valuation method it determines is warranted by the evidence before it.¹⁶⁶

IV. APPLYING THE FRAMEWORK

A. Application to Recent Appraisal Cases

The new framework would generate divergent results in *Dell* and *DFC*, at least on the basis of the facts determined by the Court of Chancery in those cases. In *Dell*, the court identified numerous process issues. For instance, the transaction's market check was conducted by a conflicted financial advisor on a questionably abbreviated time frame.¹⁶⁷ *Dell* was also a conflict transaction; Michael Dell was both the primary proponent

¹⁶⁶ It is not meant to be suggested that MNPI can never be valued. If a target company owns an asset—for instance, a research project—whose value becomes knowable for the first time between financial reporting periods, and its value is disclosed to prospective buyers but not to the market, the court might plausibly award appraisal petitioners pro rata shares of the company's pre-announcement value plus the value of the asset. In situations like this (which are obviously rare), the court need not undertake some other valuation methodology to arrive at appraisal fair value.

¹⁶⁷ See Subramanian, *supra* note 32, at 229–30 & 241–42 n.7.

of the transaction and the CEO of the target company. Moreover, the Dell board believed the company was undervalued.¹⁶⁸ The Court of Chancery identified a “valuation gap,” which it attributed to Dell’s stockholders’ and analysts’ “myopia.”¹⁶⁹ At first glance, the notion of a valuation gap appears inconsistent with the ECMH. However, the court pointed out that the gap was likely related to a potentially transformative (if risky) \$14 billion investment Dell had recently made.¹⁷⁰ It quoted then-Vice Chancellor Strine: “The dangers for the minority arguably are most present when the controller knows that the firm is on the verge of breakthrough growth”¹⁷¹ This strongly suggests that Michael Dell and his buyout partner may have possessed MNPI that the market (and Dell’s stockholders) did not. If the court found that the buyers likely exploited this informational advantage to the detriment of stockholders, this would defeat the presumption that market price equals fair value.

Dell would thus be a candidate for more exacting judicial review under the proposed appraisal framework. For example, the court could adopt a valuation model prepared by either party’s financial advisor in preparation for the buyout negotiations, or it could devise its own model. In *Dell Trial*, the court extensively reviewed the internal mechanics of several valuation models in evidence, ultimately deciding that two of them were superior.¹⁷² Finding “no reason to prefer one realistic case over the other,” the court defined Dell’s fair value as their average.¹⁷³ Under this Note’s suggested framework, such a finding by the Court of Chancery would be sustained on appeal.

In *DFC*, by contrast, the merger price resulted from a competitive process with a meaningful market check.¹⁷⁴ No aspect of the case suggests that MNPI was withheld from the market. The Supreme Court was correct to observe that markets can price regulatory risk; if *DFC*’s stock was in a “trough,” this means only that the risk had increased.¹⁷⁵ The buyer’s status

¹⁶⁸ See Matt Levine, Michael Dell Bought His Company Too Cheaply, Bloomberg (June 1, 2016, 11:38 AM), <https://www.bloomberg.com/opinion/articles/2016-06-01/michael-dell-bought-his-company-too-cheaply> [<https://perma.cc/BC36-5KMH>].

¹⁶⁹ *Dell Trial*, C.A. No. 9322, 2016 WL 3186538, at *32–34 (Del. Ch. May 31, 2016).

¹⁷⁰ *Id.* at *32.

¹⁷¹ *Id.* (quoting Del. Open MRI Radiology Assocs., P.A. v. Kessler, 898 A.2d 290, 315 (Del. Ch. 2006) (Strine, V.C.)).

¹⁷² See *Dell Trial*, 2016 WL 3186538, at *45–51.

¹⁷³ *Id.* at *51.

¹⁷⁴ *DFC*, 172 A.3d 346, 349 (Del. 2017).

¹⁷⁵ *Id.* at 360.

as a private equity buyer is not relevant to the value of the target. DFC's market price would have been an acceptable representation of fair value.

In *Aruba*, the parties' collusive suppression of MNPI makes Aruba's stock price unreliable evidence of fair value. In addition, the timing of the merger and earnings announcements frustrates any attempts to analyze the "true" price impact of the earnings beat. If the parties had instead planned to announce the merger the day *after* earnings, and the stock surged above the deal price after the market incorporated the earnings release, then maybe Aruba would have renegotiated the deal. This is unknowable, but it seems unlikely.¹⁷⁶ Additionally, both the market and Aruba's board were unaware until very late in the deal process that HP intended for Aruba's CEO to run the company post-merger and that HP solicited the CEO in violation of its confidentiality agreement with Aruba.¹⁷⁷ This information was certainly material and arguably value-positive, but it was withheld from the market.

"Valuing" the MNPI Aruba's board suppressed would likely be impossible. Under this approach, the court need not attempt it. The Court of Chancery can (as it currently does) choose its valuation method based on its assessment of the evidence presented to it. The lack of a competitive bidding process makes the deal price unreliable, but the court heard abundant evidence about the parties' respective expert valuation models.¹⁷⁸ Selecting from among competing valuation models will often be tainted by human error, but the appraisal statute requires such exercises of judgment; after all, context-based, fact-intensive judicial determinations of company value are part and parcel of Delaware appraisal jurisprudence to date. To ensure that agency cost reductions are excluded, the court should base its decision on standalone valuation models, rather than on deal-price-less-synergies estimates.

B. Likely Consequences for Appraisal Litigation

This revised model of fair value redirects appraisal's process adequacy analysis through the prism of stockholder value. Having adopted the ECMH, courts should acknowledge that non-public information is the only type of merger value in excess of the target's pre-merger market capitalization to which appraisal petitioners are entitled. Courts can work

¹⁷⁶ See *Aruba I*, C.A. No. 11448, 2018 WL 922139, at *20 (Del. Ch. Feb. 15, 2018).

¹⁷⁷ See *id.* at *19.

¹⁷⁸ See generally *id.* at 45–54 (discussing the competing experts' valuations and analyses).

outward from the market price of the target's stock, responding to allegations of MNPI suppression as appropriate. Process adequacy and the existence of controlling stockholders will only be relevant where the petitioner can logically connect them to an actual, improper extraction of value from the minority. And, as noted above, a competitive bidding process should attenuate some degree of judicial suspicion about MNPI suppression.¹⁷⁹

The framework serves judicial economy by simplifying the appraisal process while retaining flexibility where it is needed. It sets a presumptive cap on appraisal fair value awards: the unaffected trading price. This would reduce the volume of appraisal petitions. It also means that, in a number of cases, the necessity of a judge-made company valuation would be eliminated. It seems fair to imagine that judges, boards of directors, and M&A practitioners might welcome this development. Relatedly, it avoids the technical dilemma of disaggregating synergies from merger deal prices, which can be a fraught task.¹⁸⁰ Valuing firms where MNPI has been withheld will still present familiar ambiguities and necessitate exercises of judgment, but this will only be necessary in cases where the petitioner meets its burden of proving MNPI suppression. Litigants will focus on that issue at the pleading stage, obviating the need for courts to independently ferret out suppressed MNPI.

This new adjudicatory model would substantially curtail speculative appraisal petitions, particularly for public companies whose shares trade in efficient markets. This comports with recent efforts by Delaware courts to rein in rent-seeking M&A litigation.¹⁸¹ It is also intuitively satisfying: the statute was not drafted to create investment opportunities for sophisticated financial entities. Moreover, *all* public company mergers take place at a premium to the target's stock price, and in many cases, it is not obvious that Delaware corporate law should care that a minority of stockholders would have preferred an even better deal. If this observation sounds callous under the existing appraisal regime, it can be guiltlessly embraced in a world where MNPI suppression is the court's primary concern—even if the petitioner is an appraisal arbitrageur. If a deal looks suspicious, Delaware law can still accommodate speculative appraisal petitions.

¹⁷⁹ See *supra* Section III.D.

¹⁸⁰ See *Aruba I*, 2018 WL 922139, at *2, *44.

¹⁸¹ See *supra* Section II.A.

In contrast to a legislative solution, this method relies only on the appraisal statute, Delaware decisions, and economic theory explicitly adopted by the Supreme Court to limit appraisal arbitrage to situations where it is most likely to be net-positive for all stockholders. If information is suppressed, the presumption drops away, and it is possible that the fair value award could actually exceed the deal price. Appraisal will retain its teeth.

C. Likely Consequences for Capital Formation and the M&A Market

By reducing the probability that a merger transaction will eventually result in a judge valuing the target company, the proposed model will reduce uncertainty and increase confidence from would-be participants in corporate control transactions. If the merging companies can demonstrate that they did not suppress MNPI by showing a careful, fair deal process, they need not worry about a judicially imposed merger price increase. If the parties are aware of this *ex ante*, i.e., if it is adopted as the law in Delaware, then they will be motivated to move prudently and dispassionately throughout the deal process.

The proposed framework will also create greater overall stockholder value by reducing transaction costs, most obviously through reducing the volume of appraisal litigation. More importantly, it will reduce appraisal premia. Professors Choi and Talley have argued cogently that appraisal increases target stockholder value by setting a “reserve price.”¹⁸² If that is the case, then curbing the remedy in the manner suggested could destroy stockholder value by reducing would-be buyers’ bids for target companies. The other side of the story is that the “reserve price” functions as a merger premium.¹⁸³ In a clean transaction where target stockholders are already protected by their right to an informed majority vote and the board’s duty to verify that the merger is value-efficient, a sufficiently high appraisal premium could cause an otherwise willing buyer to forego the deal.¹⁸⁴ Such an outcome would be undesirable from the standpoint of shareholder value maximization. Moreover, appraisal law is in flux, as the above discussions of recent case law demonstrate. Consequently, to the extent appraisal creates a reserve price or appraisal premium, the uncertainty associated with appraisal litigation will likely often generate

¹⁸² Choi & Talley, *supra* note 31, at 570.

¹⁸³ See Glasscock, *supra* note 12, at 11.

¹⁸⁴ See *id.*

inefficient merger premia, i.e., ones that do not accurately reflect the probability-weighted cost of appraisal to the buyer. This, too, is an undesirable outcome; crucially, it could actually reduce target stockholders' ex ante willingness to pay by throwing into doubt whether they can receive a fair cash-out price for their shares.

The proposed solution will incentivize efficient transactions by letting buyers keep the entire "upside" they create by replacing inefficient management—a policy objective the Supreme Court identified pointedly in its *DFC* decision.¹⁸⁵ In their paper, Professors Choi and Talley "presume[] an 'optimal' appraisal rule to be one that maximizes target shareholders' ex ante expected net payoff."¹⁸⁶ This analysis does not incorporate any such presumption. Instead, it is guided by the principle stated above: Delaware corporate law is not singularly centered on the distributional aspects of corporate control transactions, and value-enhancing mergers should be encouraged. From this point of view, the existing appraisal remedy should not be retained merely because it enhances *target* stockholder value.¹⁸⁷ On the contrary, privileging target stockholders over buyer stockholders could destroy value. Recall, too, that among the three sources of merger premia this Note recognizes, target stockholders are entitled only to that value which arises from MNPI. Any extraction of additional value in the form of an appraisal premium—one which, as described above, is likely to be inefficient—cannot be synergies or MNPI. Awarding agency costs to target stockholders risks disincentivizing efficient corporate control transactions by depriving the buyer of the value it creates by purchasing the target.

This discussion of the distributional consequences of appraisal doctrine also implicates Margolin and Kursh's argument. If, as they have argued, appraisal is the final enforcement mechanism for the broader corporate promise,¹⁸⁸ then the risk of appraisal is a "bonding cost," i.e., one incurred by an agent to increase the principal's confidence in the contractual relationship.¹⁸⁹ But the cost of appraisal is borne by the acquirer, not the

¹⁸⁵ *DFC*, 172 A.3d 346, 368 (Del. 2017).

¹⁸⁶ Choi & Talley, *supra* note 31, at 567.

¹⁸⁷ Professors Choi and Talley appear to basically agree with this observation. See *id.* ("Were we to incorporate both buyers' and sellers' expected welfare, it would be optimal to set the reserve price at [the mean valuation among all target shareholders], so that the company always ends up in the hands of the highest valuing player.").

¹⁸⁸ See *supra* notes 142–44, 144 and accompanying text.

¹⁸⁹ —See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 *J. Fin. Econ.* 305, 308 (1976).

target or its managers. Analytically, this casts doubt on how effectively appraisal can deter managerial shirking. By extension, it also weakens the argument that appraisal fair value must be defined as a pro rata share of a controlling stake in the target company to fulfill the policy goal of reducing firms' cost of capital.¹⁹⁰ Normatively, it suggests that managers are free-riding on the buyer's statutory obligation to pay appraisal fair value. Why should the buyer's stockholders incur the costs of enforcing the broader corporate contract between the target's owners and management?

If appraisal is understood in these terms, then the suggestion by Professors Korsmo and Myers that appraisal plays a complementary role to the market for corporate control in policing managerial agency costs is less unequivocally true than it first appears.¹⁹¹ The market for companies safeguards against ineffectual management because it allows buyers with better management to reap the rewards of replacing the target's management. To the extent that the appraisal remedy ignores the reduction in agency costs that efficient mergers accomplish, it reduces buyers' incentives to pursue such transactions in the first place. By contrast, explicitly carving agency cost reductions out of fair value awards will ensure that would-be buyers know they will capture the entire upside that they create by completing the transaction.

D. The Continuing Importance of Appraisal

Although the proposed framework would diminish the volume of appraisal petitions, appraisal still has an important role to play. First, even where the market for the target's stock is efficient, factors such as conflicted management, controlling stockholders, and uncompetitive deal processes may suggest that MNPI was withheld and the deal price was inadequate. And even in perfectly "clean" transactions, the existence of suppressed MNPI, if proven, can produce an appraisal award that exceeds the deal price. This creates an additional layer of deterrence against ineffective deal negotiation by target boards; to the extent that speculative appraisal petitions serve as a desirable secondary market check, they can play the same role under the new regime.

¹⁹⁰ Cf. Coase, *supra* note 120, at 32 (arguing that, where one firm is relieved of liability for incidental harm to an adjacent one, the second firm will reduce or cease investment due to the anticipated cost of the harm).

¹⁹¹ See *supra* note 30 and accompanying text.

Many firms do not trade in efficient markets, and the full range of appraisal methods should be available to the Court of Chancery when it evaluates petitions in such cases. This accords with Professor Ernest Folk's contention in his comprehensive Review of the Delaware Corporation Law (even as he recommended near-wholesale abolition of statutory appraisal) that appraisal rights are especially important for companies "whose shares truly have no market."¹⁹² For example, the acquisition of a Delaware private company target—say, a startup—will almost certainly require intensive judicial review. There is no *de minimis* exception to appraisal in cases involving private companies, which likely reflects the Delaware General Assembly's recognition that minority stockholders are particularly vulnerable in situations like this.¹⁹³ The proposed framework acknowledges the analytical sensitivity required in this and similar scenarios by preserving the customary range of judicial discretion.

V. CONCLUSION

The ECMH helpfully focuses complex appraisal inquiries around the true sources of value for stockholders. Where companies trade in efficient markets, the best evidence of their fair value is simply the market price of their shares. Efficient markets constantly digest available information and present a collective estimation of company value that is widely regarded as reliable. This step automatically accommodates the observation that agency cost reductions constitute value arising from the merger itself. But if material information is withheld from the market, informational efficiency fails to support the purpose of the appraisal remedy. MNPI suppression thus serves as a justification for further judicial inquiry into the transaction. This, in turn, preserves appraisal as a check on process adequacy, conflicts, and other information asymmetries that disadvantage minority stockholders.

¹⁹² Folk, *supra* note 116, at 196–97.

¹⁹³ See Appraisal Amendments, *supra* note 33, at 4.